

# **Share lending vis-à-vis voting**

**A report commissioned by the International Corporate Governance Network**

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**LINSTOCK**

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## Introduction and key findings

In January 2004, the International Corporate Governance Network circulated amongst its members a survey of securities holders' lending practices. The questions contained in the survey focused on the impact of share lending on voting and other indicia of shareholder ownership and participation. The recipients of the survey were pension funds, mutual funds, investment trusts, insurance companies and other asset managers. In total, 39 member institutions responded to the survey, 31 of which currently lend (or have lent shares) in their portfolio. The list of survey respondents can be found in the Appendix to this report.

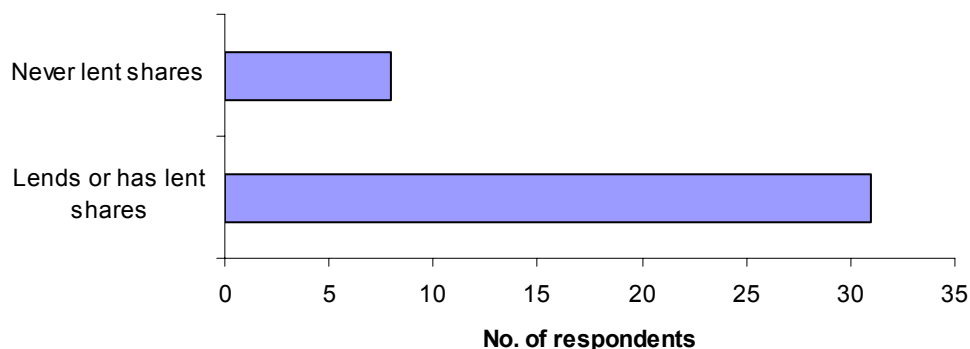
Key findings from the survey include the following:

- The scale of stock lending by the respondent institutions is considerable: two thirds of respondents lend, on average, more than 10% of their portfolio during a calendar year.
- Most stock lending is done by third parties (e.g. custodians) and only a few respondents undertake the actual lending themselves.
- In 50% of cases, the custodian or other agent is allowed to lend shares without the respondent's knowledge.
- Less than a third of respondents lend shares in order to recapture part of a dividend or the effect of a scrip issue.
- The vast majority of respondents will normally vote shares for which stock lending is an option (when the shares have not yet been lent).
- In the majority of cases, portfolio managers are not normally apprised of when shares have actually been lent.
- 70% of respondents rarely, if ever, recall shares for the sole purpose of voting them.
- All but 3 respondents had 'never' or 'rarely' been frustrated in their attempts to recall shares in order to vote them.
- Only a handful of respondents suggested that share blocking requirements affect their willingness to lend or recall shares.
- Just over half the respondents have a set of written guidelines to facilitate decisions on whether to recall shares.
- 50% of respondents had no idea whether more frequent recall of shares would have a significant impact upon market liquidity or price levels. 38% of respondents thought it would and 12% thought it would not.
- Only 3 respondents could cite specific examples of where market liquidity or price levels were actually affected by the recall of lent shares.

## Participation in stock lending

As shown in Figure 1, all but 8 respondents currently lend or have lent shares in their portfolio.

**Fig 1: Do you lend or have you ever lent shares in your portfolio?**



As indicated in the matrix below, of the 8 institutions who have never lent shares, only 3 cited the risk of losing votes as a reason for their policy of not lending shares.

	Inst 1	Inst 2	Inst 3	Inst 4	Inst 5	Inst 6	Inst 7	Inst 8
No authority from beneficiaries		X	X	X				X
Fear of incurring financial loss <sup>1</sup>	X		X					
Do not want to risk losing vote				X	X		X	
Unwilling to encourage short selling or other results of lending to markets	X				X			
The issue just hasn't come up <sup>2</sup>						X		

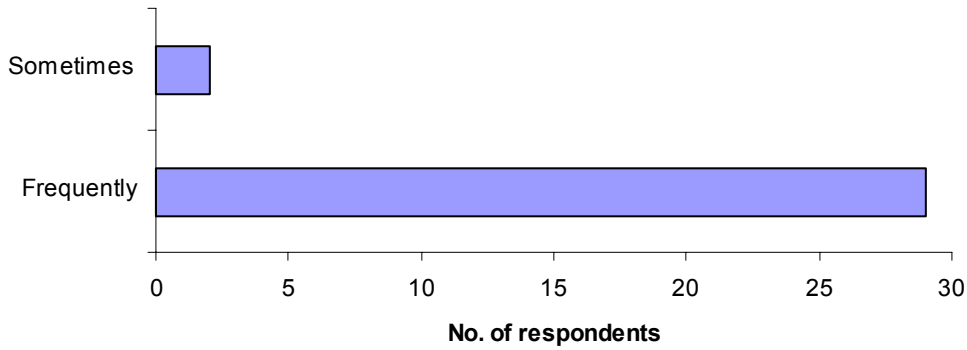
## Frequency of stock lending

As shown in Figure 2, 29 respondents indicated that they 'frequently' lend shares and 2 indicated that they 'sometimes' lend shares. None suggested that they only 'rarely' lend shares.

<sup>1</sup> The first institution in this matrix added a note explaining that: "the low liquidity level of the [domestic] Capital Market increased the possibility of having our share values depreciated by doing share lending". The fourth institution in this matrix also cited another reason, viz. "regulatory issues re. client assets".

<sup>2</sup> The verbatim response of the institution giving this answer was as follows: "We do not engage in share lending [because] the issue just hasn't come up, and we therefore really haven't formulated any policy or even reaction to the issue."

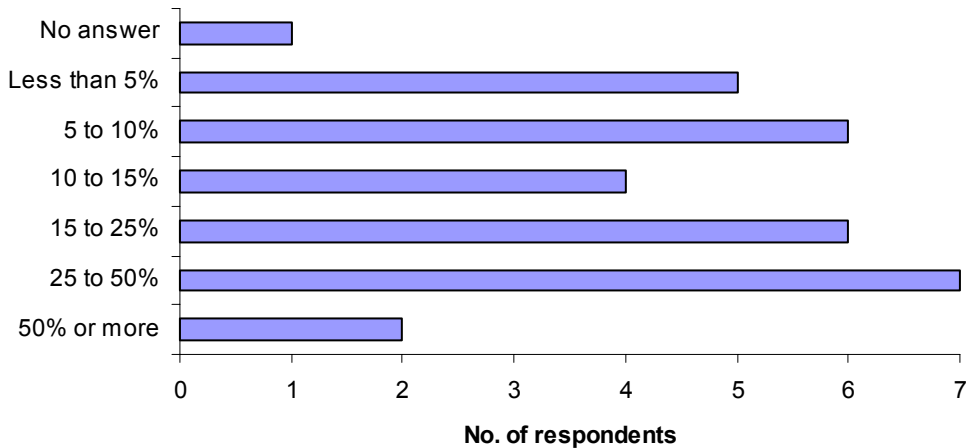
**Fig 2: How frequently do you lend shares?**



**Average (and maximum) scale of stock lending**

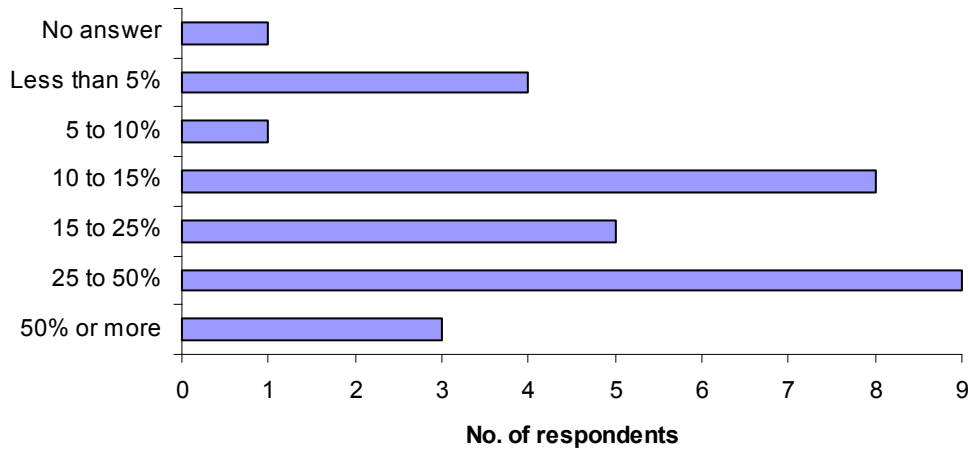
As indicated in Figure 3, there is a marked variation in the scale of stock lending. Of the ‘heavy’ lenders, 7 respondents estimated that 25 to 50% of their portfolio was lent on average during a calendar year and a further 2 estimated the figure at more than 50%<sup>3</sup>. As for the maximum amount lent at the peak of a year’s activity, only 3 institutions estimated this figure at above 50% (see Figure 4).

**Fig 3: How much of your portfolio would you estimate is lent on average during a calendar year?**



<sup>3</sup> N.B. One of these 2 respondents runs “two different programmes”. The first programme lends on average more than 50% of its portfolio whilst the second lends on average between 5 and 10%. Only the first of these programmes is included in the source data for Figures 3 & 4.

**Fig 4: What is the estimated maximum of your portfolio that is lent at the peak of a year’s activity?**

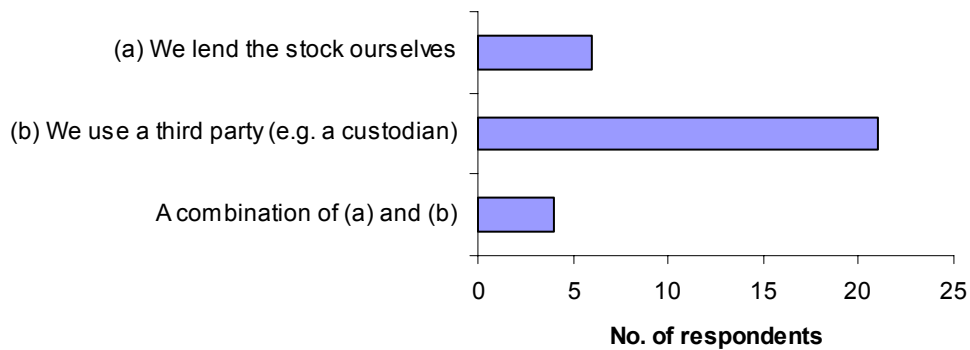


### Responsibility for stock lending

As shown in Figure 5, only a minority of respondents indicated that they lend stock themselves whilst 21 indicated that the practice was handled entirely by a third party.

Of the 25 respondents who use third parties (irrespective of whether they lend stock themselves), 24 indicated that they had “a separate lending contract” with the third party and only 1 respondent indicated that the question of whether it used a separate contract was “not applicable”. And of the 24 respondents who have a separate lending contract with the third party, 19 “negotiate a contract with special provisions from the lending party” and only 5 use a standard form agreement.

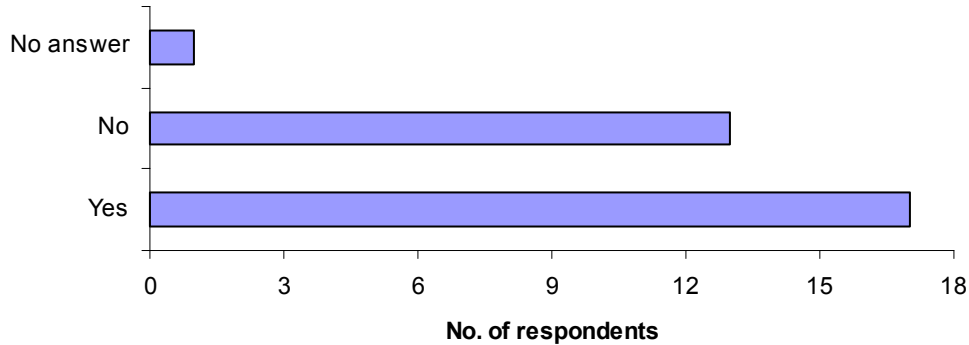
**Fig 5: Who does the actual lending?**



## Discretion over Stock Lending

As shown in Figure 6, there was an equal split between respondents who grant their custodian or other lending agent discretion to lend shares without their express knowledge and those who don't.

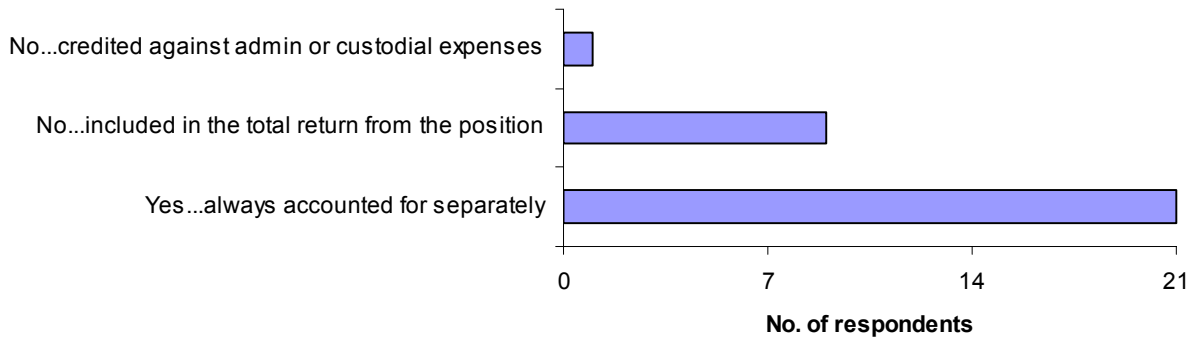
**Fig 6: Does your custodian or any other agent have discretion to lend your shares without your knowledge?**



## Lending income

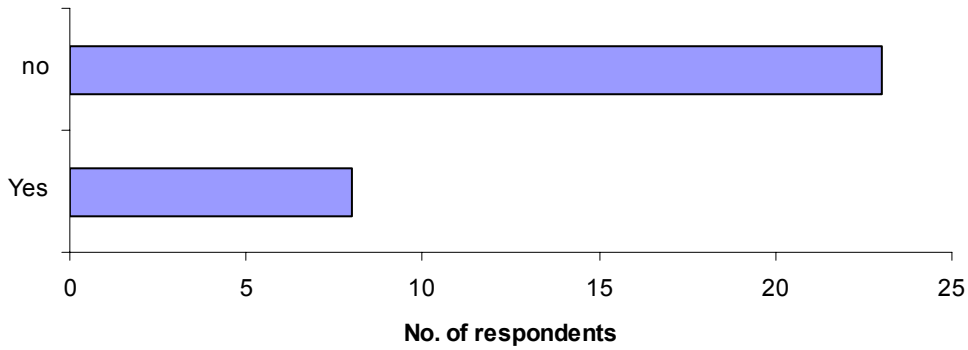
As shown in Figure 7, the majority of respondents stated that lending income is always accounted for separately from other portfolio returns but 9 respondents indicated that lending income is included in the total return and 1 respondent said that it was credited against administrative or custodial expenses.

**Fig 7: Do you segregate lending income from other portfolio returns?**



As for the motivation for engaging in stock lending, only 8 respondents stated that they lend shares in order to recapture part of a dividend or the effect of a scrip issue (see Figure 8).

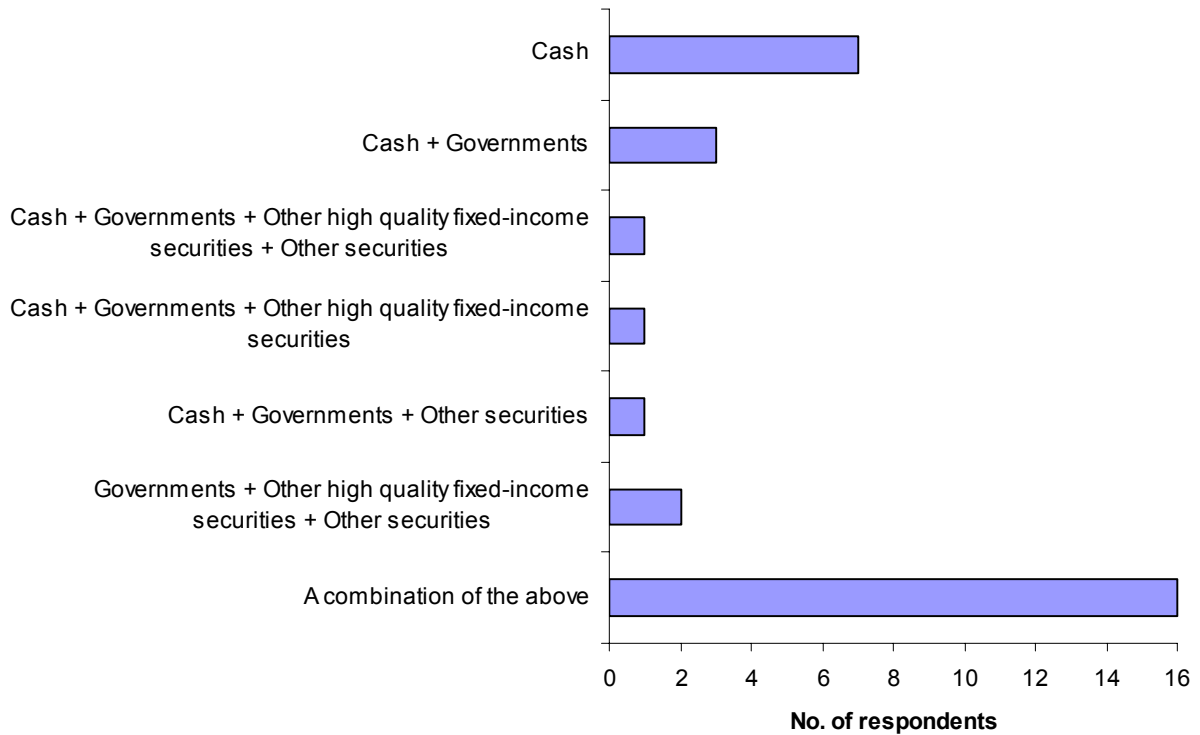
**Fig 8: Do you lend shares in order to recapture part of a dividend or the effect of a scrip issue?**



### Lending collateral

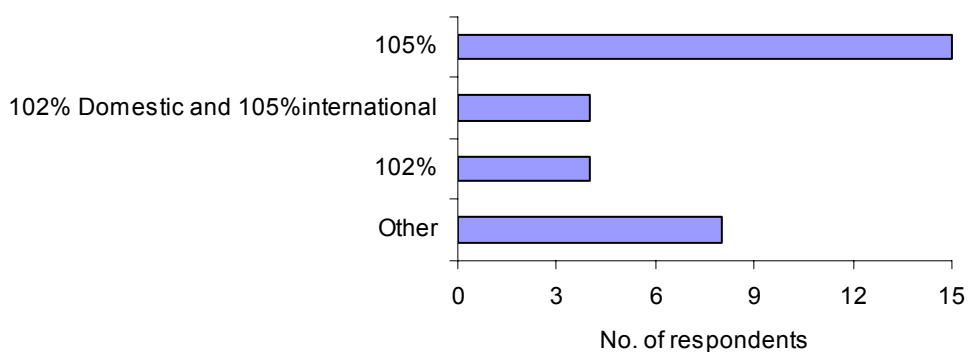
As shown in Figure 9, only 7 respondents indicated that they rely exclusively on cash as collateral for a share loan. Most used a combination of cash and other securities. As shown in Table 1 and Figure 10, the normal collateral requirement for most respondents was 105%.

**Fig 9: What do you normally require as collateral for a share loan?**



**Table 1: What is your normal collateral requirement**

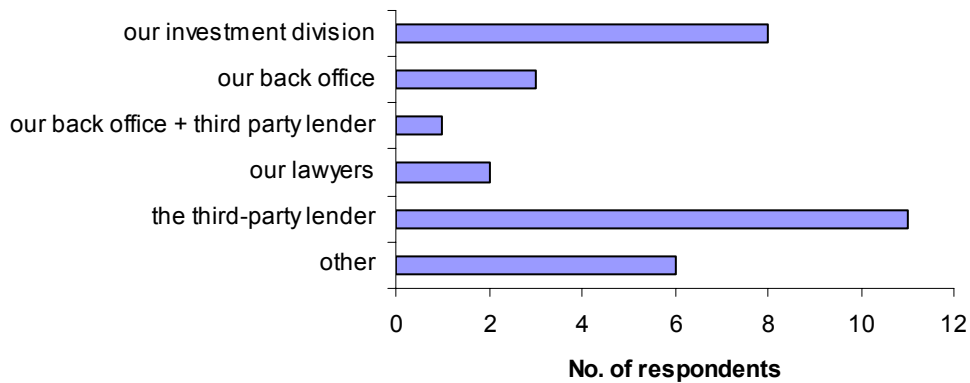
105%	15
102% Domestic and 105% international	4
102%	4
102% for fixed income, 105% for equities	1
102.5 % for gilts, 105% for equities	1
102% US Treasuries	1
102% North American Gov Bonds / 105% non NA Gov Bonds or other (e.g.IPVs)	1
102% if US equity is lent, 105% if other equities are lent	1
102% domestic equity and fixed income / 105% international equity	1
102% / 105%	1
varies depending on currency of borrowed securities and collateral	1

**Fig 10: What is your normal collateral requirement?**

## Determinations as to the adequacy of collateral security

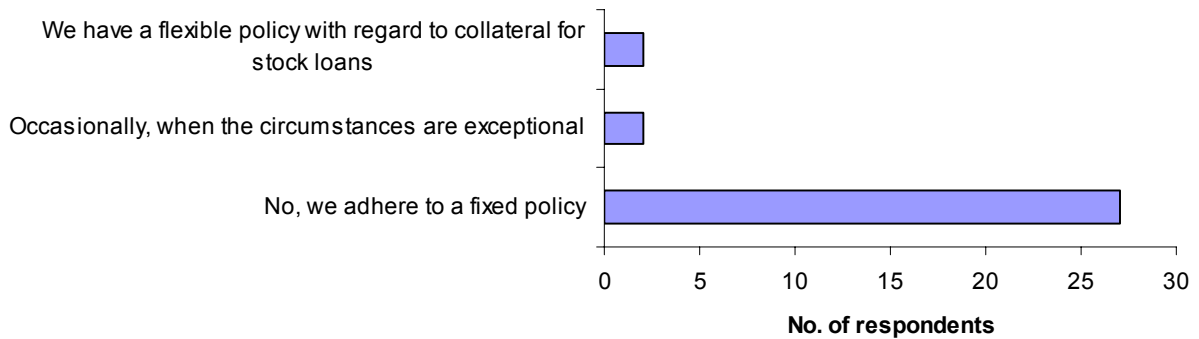
As shown in Figure 11, 13 respondents indicated that they retained responsibility (in their investment division, in their back office, or in their lawyers' office) for determining the adequacy of collateral security. 1 respondent said these determinations were shared between their back office and their third party lender. 11 respondents indicated that this was the responsibility of their third-party lender and 6 indicated that some 'other' party bore the responsibility.

**Figure 11: Who determines what is adequate collateral security for the loan**

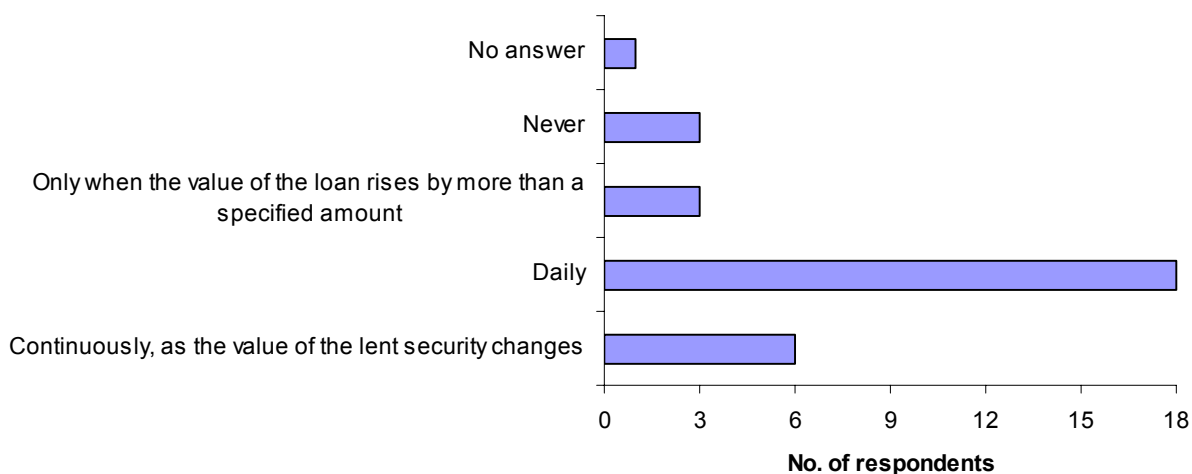


As shown in Figure 12, most respondents have a fixed policy with regard to collateral for stock loans with only 4 respondents indicating that they have a flexible policy or are willing to make occasional exceptions. With regard to the frequency with which collateral requirements are adjusted, most respondents indicated that such adjustments are made on a daily or continuous basis (see Figure 13). Most respondents also indicated that determinations as to the appropriate rate for a stock loan are made by reference to market lending rates, with only 3 respondents suggesting that they lend ‘whenever they can do so at a profit’.

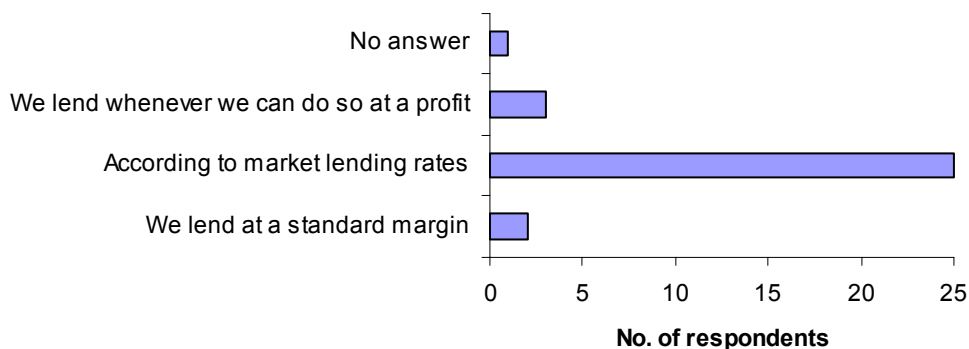
**Fig 12: Do you ever accept other than your normal collateral for a loan?**



**Fig 13: Do you regularly adjust the collateral requirements for your loans?**



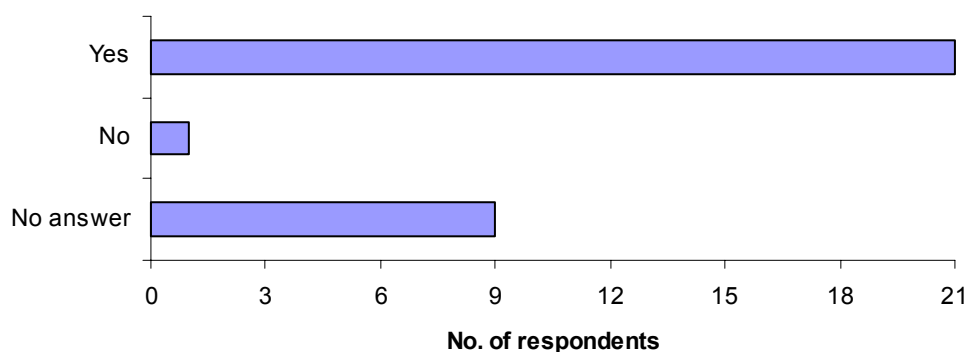
**Fig 14: How do you determine the appropriate rate for a stock loan?**



### Voting shares for which stock lending is an option

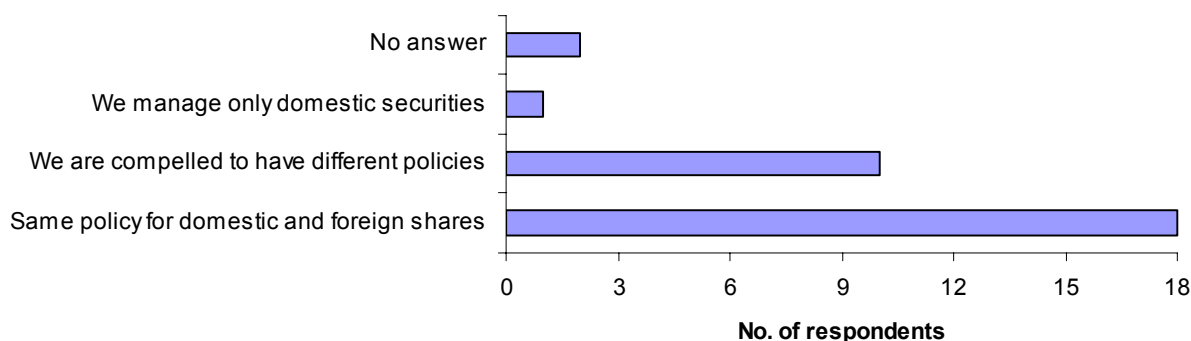
As shown in Figure 15, the majority of respondents stated that they would vote shares for which stock lending is an option and only 1 respondent suggested that they would not vote shares they considered available for lending<sup>4</sup>.

<sup>4</sup> 8 respondents stated that they 'do not lend shares they intend to vote' without directly answering the question of whether they vote shares for which stock lending is an option.

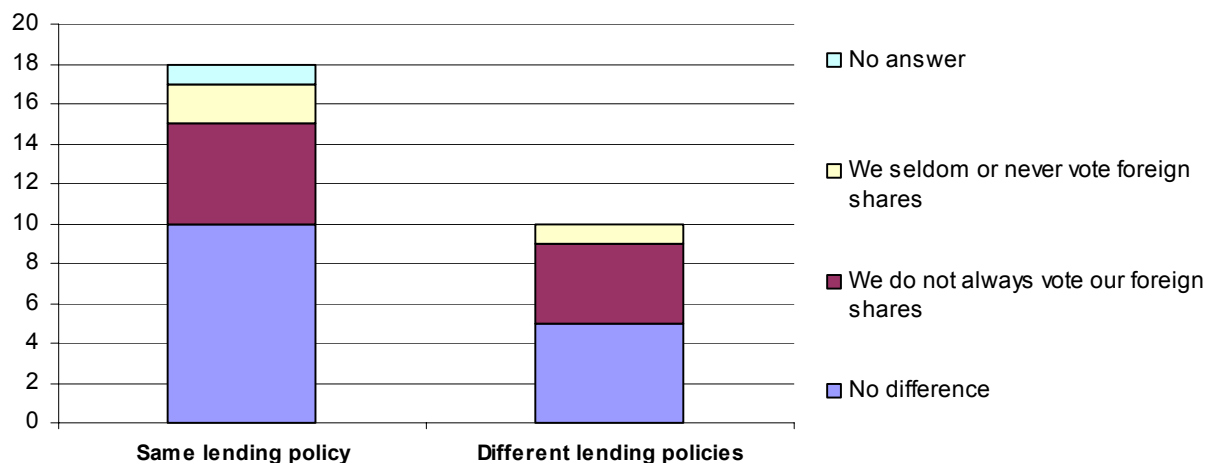
**Fig 15: Do you normally vote those shares for which stock lending is an option (if they are not lent)?**

### Voting foreign shares

As shown in Figure 16, the majority of respondents state that for the purposes of lending they don't make a distinction between domestic (i.e. home market) and foreign shares. Nevertheless, 10 respondents made clear that they were 'compelled to have different policies and arrangements' for their shares 'depending upon the country of origin'.

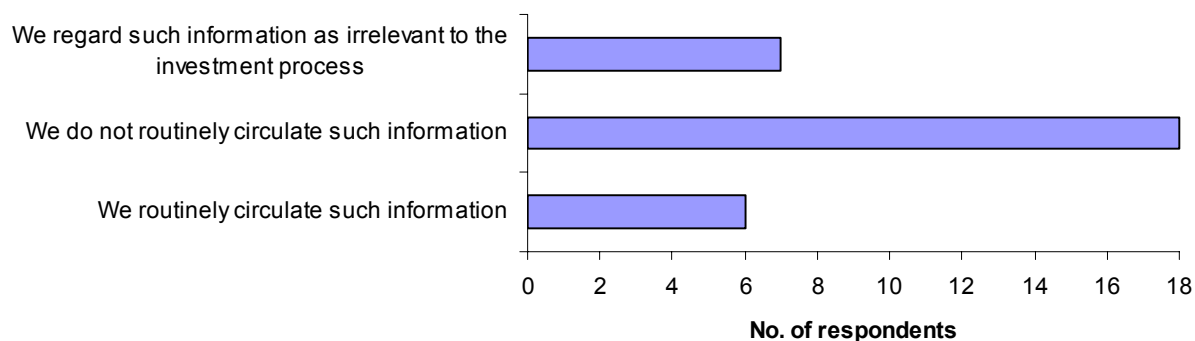
**Fig 16: For the purposes of *lending*, do you make a distinction between domestic and foreign shares?**

With regard to the voting of foreign shares, the majority of respondents (18 in total) indicated that their policy on voting foreign shares was no different to their policy on voting domestic shares. However, 9 made clear that they did not always vote their foreign shares and 3 indicated that they 'seldom or never voted foreign shares'. As shown in Figure 17, there was little correlation between 'maintaining the same policy with respect to the lending of foreign and domestic shares' and voting foreign shares.

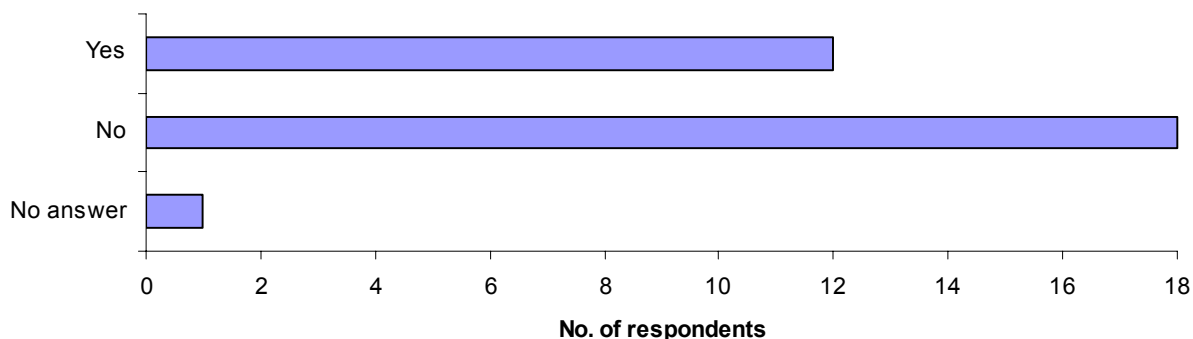
**Fig 17: Do you have different policies with regard to voting domestic and foreign shares?**

## Knowing whether shares have been lent

As shown in Figure 18, only 6 respondents indicated that information is routinely circulated to their investment staff detailing instances in which there has been interest expressed in borrowing a particular share<sup>5</sup>. 18 indicated that they do not routinely circulate such information and a further 7 considered this information to be 'irrelevant to the investment process'. More particularly, the majority of respondents indicated that their portfolio managers were not normally apprised of when shares have actually been lent (see Figure 19). The majority of respondents also indicated that when their investment staff/portfolio managers look at a list of holdings, they do not routinely see what portion of a position has been lent (see Figure 20).

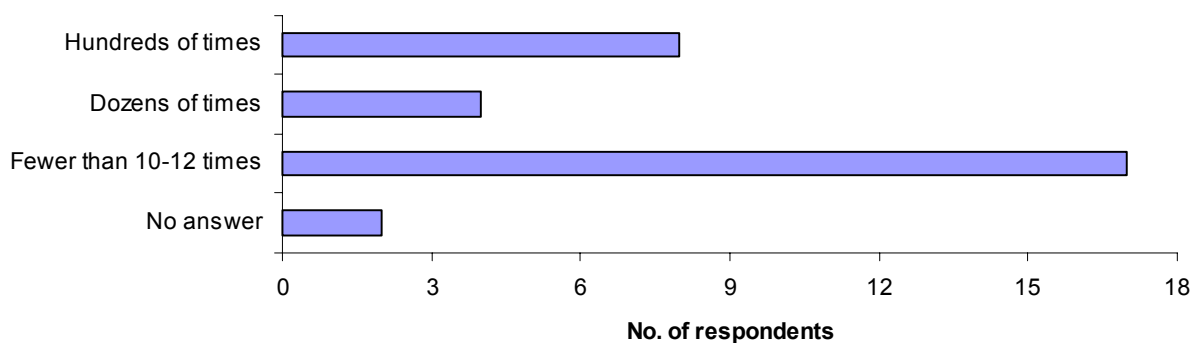
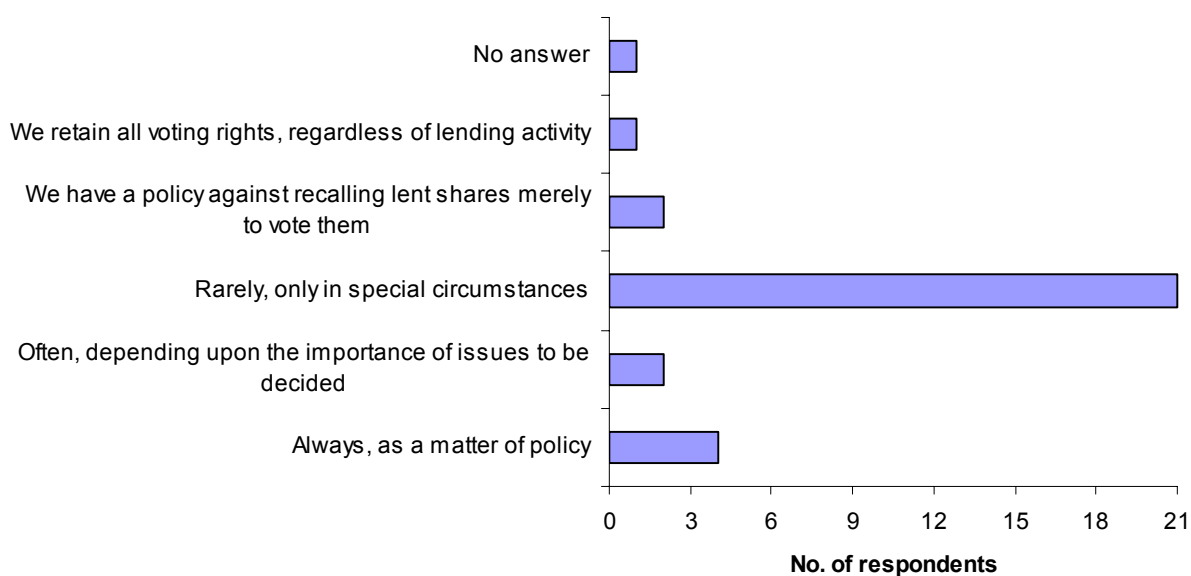
**Fig 18: Does your investment staff normally know when there has been interest expressed in borrowing a particular share?**

<sup>5</sup> And one of these 6 respondents stressed that his institution only routinely circulates such information 'when it reflects an actual short position'.

**Fig 19: Are your portfolio managers normally apprised of when shares have actually been lent?****Fig 20: When your investment staff/portfolio managers look at a list of holdings, do they immediately see what portion of a position has been lent?**

## Recalling lent shares in order to vote them

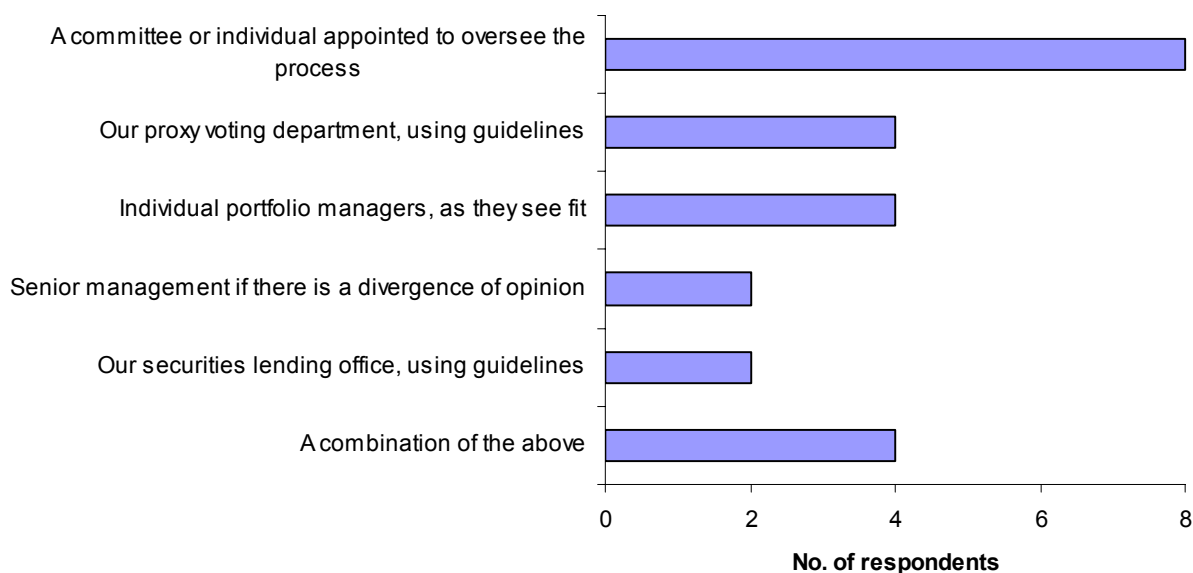
As shown in Figures 21-22, there was a marked variation in the frequency with which the respondents recall shares *for whatever reason* but few respondents rarely recall lent shares *in order to vote them*. Nevertheless, 4 respondents did indicate that they 'always' recall lent shares for voting purposes 'as a matter of policy' and 2 suggested that they 'often' did so, 'depending upon the importance of the issues to be decided'.

**Fig 21: How often in a year would you normally recall lent shares (for whatever reason)?****Fig 22: Do you, or have you ever, recall(ed) lent shares in order to vote them?**

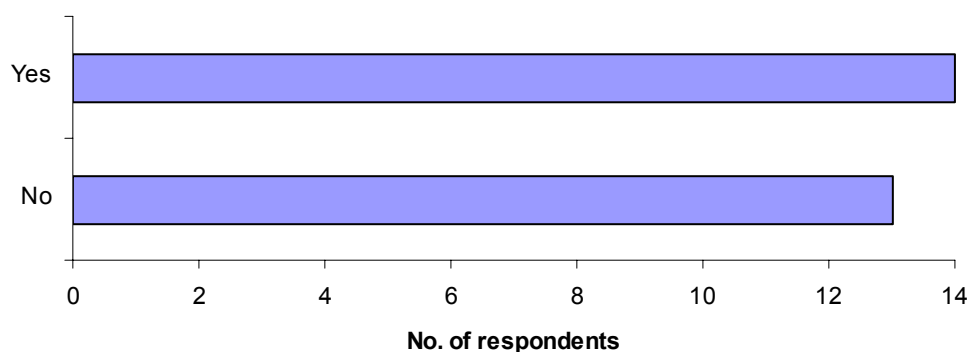
On the responsibility for determining when shares should be recalled (in order to be voted), most respondents indicated that such responsibility rests with a committee or individual appointed to oversee the process or with their proxy voting department, 'using guidelines set down by senior management or by individual customers'. Only 4 respondents indicated that the decision to recall lent shares (for the purposes of voting), would be made by 'individual portfolio managers, as they see fit'. And only 2 respondents indicated that such decisions were made by their securities lending office 'using guidelines set down by senior management or by individual customers' (see Figure 23).

Half the respondents also made clear that they maintain a set of written guidelines to facilitate recall decisions made by whomever is responsible (see Figure 24).

**Fig 23: Who determines when shares should be recalled?**

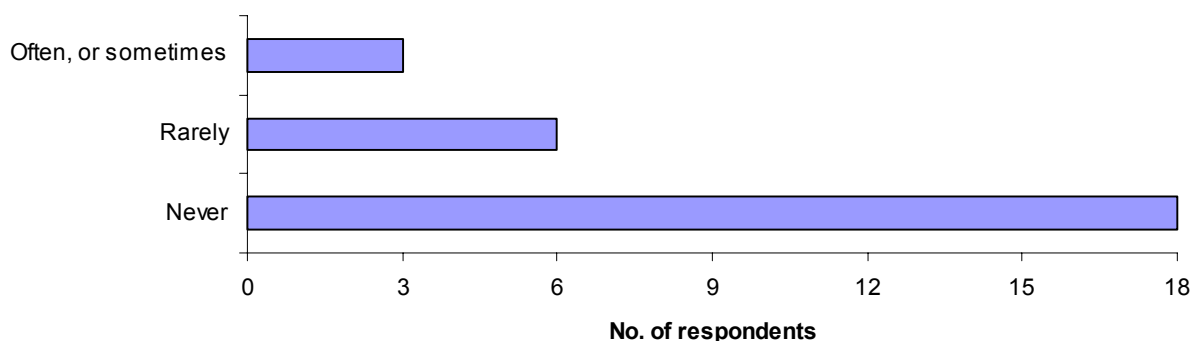
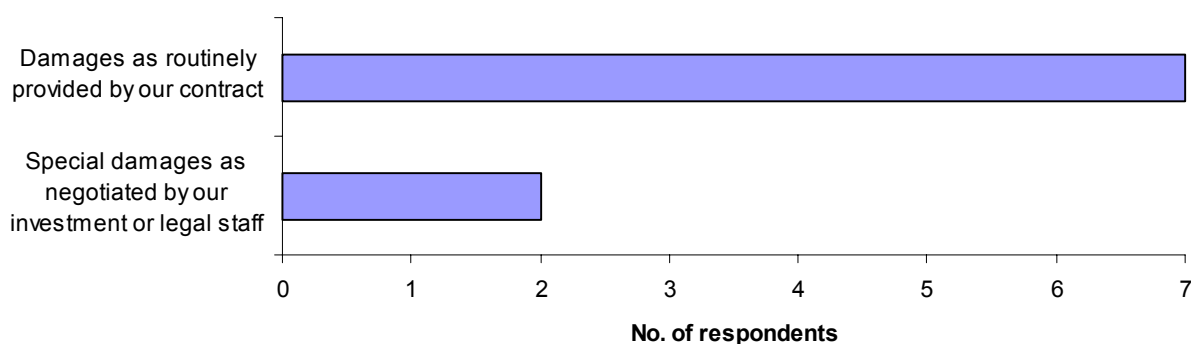


**Fig 24: In deciding whether shares are to be recalled, do you have a set of written guidelines to facilitate decisions made by whomever is responsible?**



### **Frustrated attempts to recall lent shares in order to vote them**

Given that most respondents rarely, if ever, recall lent shares in order to vote them, it is not surprising to find that only 9 respondents had been frustrated in their attempts to recall shares for this purpose (see Figure 24). 7 of these respondents indicated that restitution for failure to deliver recalled shares was made through ‘damages as routinely provided’ by their contract. In 2 cases it was made through special damages as negotiated by their investment or legal staff (see figure 25).

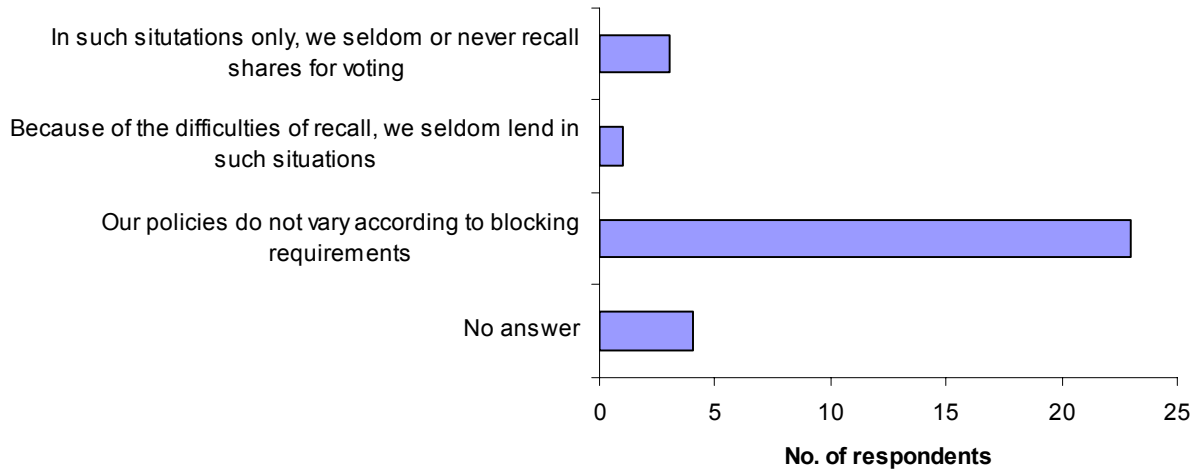
**Fig 25: Have you ever been frustrated in your attempt to recall lent shares in order to vote them?****Fig 26: What process was used to determine restitution for failure to deliver recalled shares?**

### Factors affecting respondents' willingness to lend recall lent shares

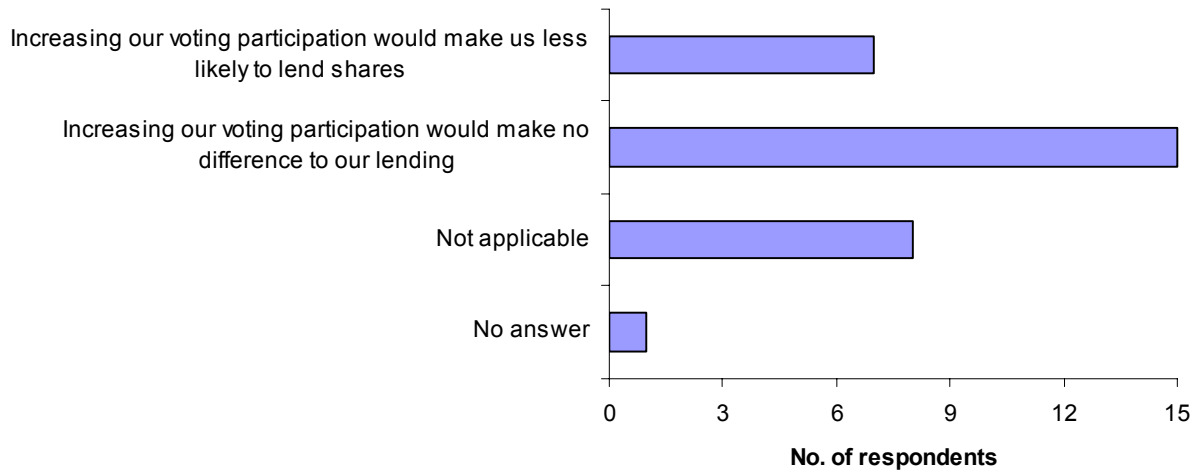
As shown in Figure 27, only a handful of respondents suggested that share blocking requirements affect their willingness to lend or recall shares (which is hardly surprising given that most are reluctant to recall shares solely for the purposes of voting<sup>6</sup>). Likewise, a majority of respondents also indicated that an increase in their voting participation rates would make no difference to their willingness to lend shares (see Figure 28). What was rather more surprising, however, was that only 5 respondents indicated that the potential loss of a significant portion of lending revenue would make them less likely to recall any lent shares (see Figure 29). As for the likely impact on lending activity of separating the voting record from the dates of shareholder meetings (and/or dividend record dates), 8 respondents thought it would have a positive impact but the majority felt it would make no difference (see Figure 30).

<sup>6</sup> N.B. Of the 6 respondents who indicated that they 'always' or 'often' recall shares in order to vote them, 5 made clear that their policies in this respect 'do not vary due to blocking requirements' and 1 did not answer the question.

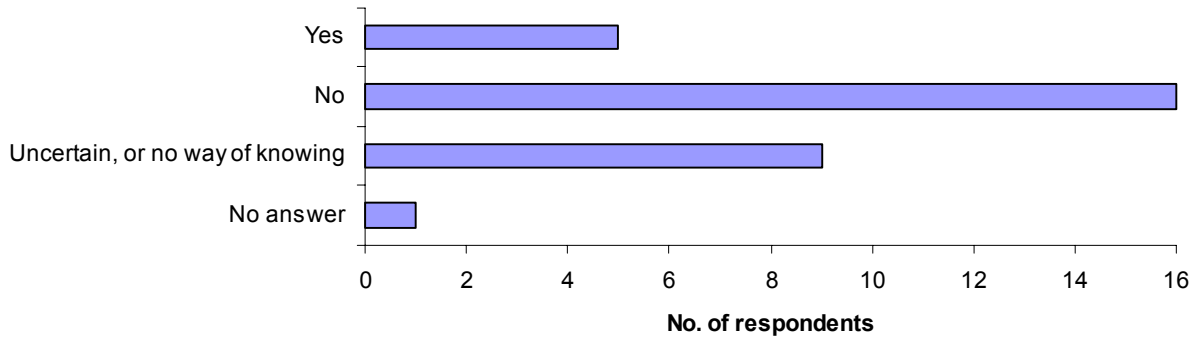
**Fig 27: Do your lending and/or recalling policies vary according to whether voting the share requires that it be blocked for some period of time?**



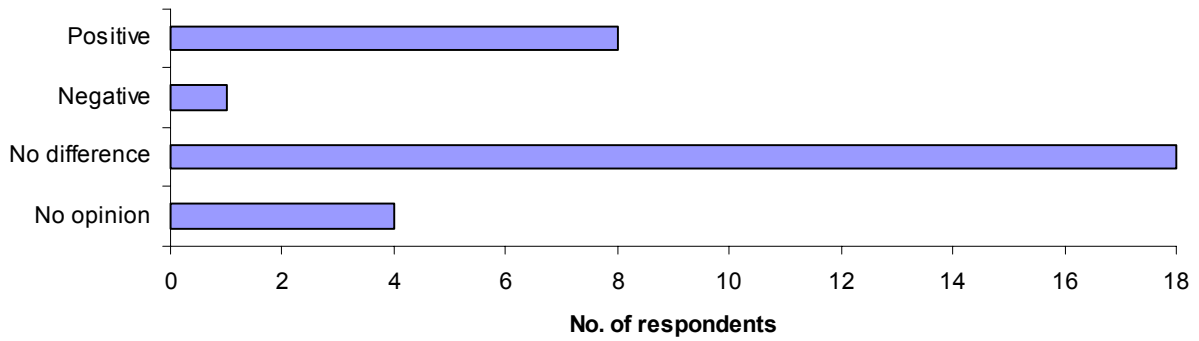
**Fig 28: Would a change in your voting policy make a difference to your willingness to lend shares?**



**Fig 29: Would the potential loss of a significant portion of lending revenue make you less likely to recall any lent shares?**



**Fig 30: Would separating the voting record date from the dates of shareholder meetings and/or dividend record dates have a positive or negative impact upon your lending activity?**

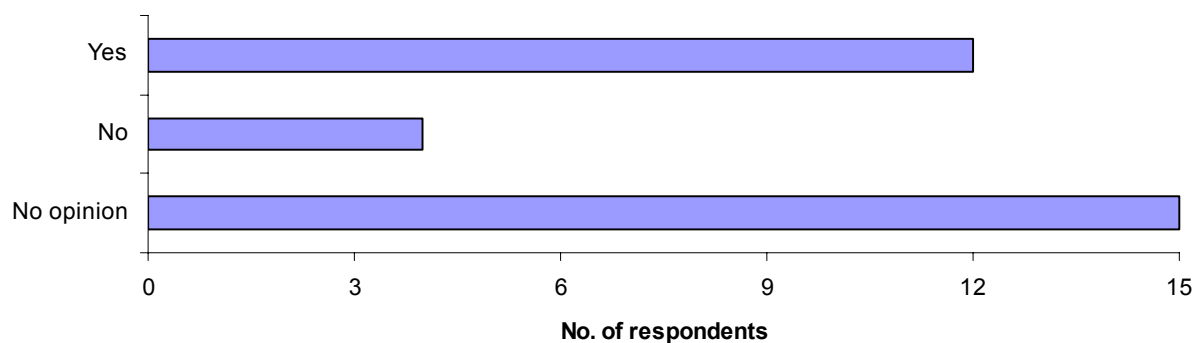


## The impact on market liquidity of more frequent recall of lent shares

As shown in Figure 31, half the respondents had no idea whether more frequent recall of shares would have a significant impact upon market liquidity or price levels. But, of those who did venture an opinion, 12 felt it would have a significant impact<sup>7</sup> and only 4 felt it would not. However, only 3 respondents could cite specific examples of where market liquidity or price levels were actually affected by the recall of lent shares. The examples cited were those of:

- “P&O Princess.”
- “BSkyB - Most institutions recalled stock in advance of the Nov AGM causing a spike in the share price. Ironically the company claimed this as evidence of market support for their succession plans.”
- “Illiquid stocks which we never lend such as Air France.”

**Fig 31: Do you believe more frequent recall of lent shares would have a significant effect upon market liquidity or price levels?**

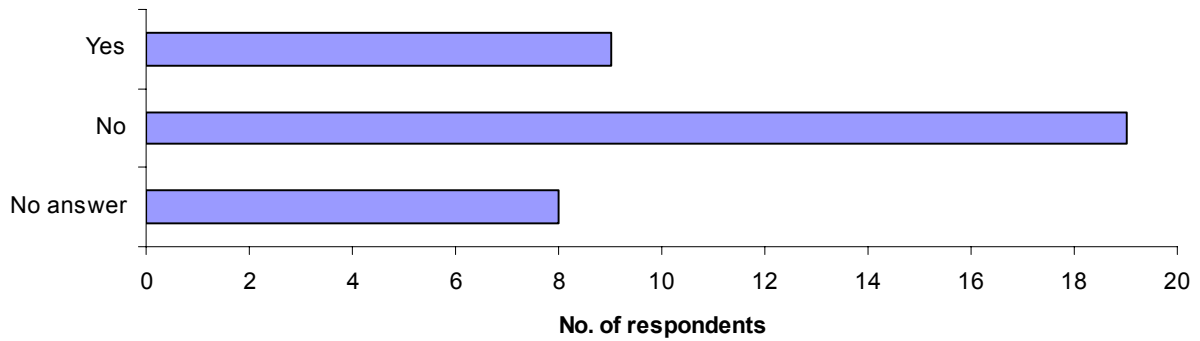


<sup>7</sup> N.B. One of these 12 respondents made it clear that, although more frequent recall of lent shares might have a significant effect upon stock lending revenues and liquidity, it was unlikely to have a significant impact on market price levels.

## Issuing policy statements on share lending vis-à-vis voting

As shown in Figure 32, the majority of respondents do not provide their clients with a policy statement on share lending vis-à-vis voting.

**Fig 32: Have you published or do you issue to your clients upon demand a policy statement on share lending vis-à-vis voting?**



## Appendix – List of survey respondents

- ABP
- AMP Capital Investors
- Arlington Capital Investors Limited
- Bank Degroof
- Barclays Global Investors
- bclMC
- Brandes Investment Partners
- Computer Associates
- CalPers
- Calvert
- Canada Pension Plan Investment Board
- Coal Pension Trustee Services
- Credit Agricole
- Dexia Asset Management
- Hermes Investment Management
- HESTA
- Insight Investment
- JP Morgan Fleming Asset Management, London
- Morley Fund Management
- New Covenant Funds
- Nissay Asset Management
- Newton Investment Management
- Ohio Public Employees Retirement System
- Ohio Teachers Retirement System
- Ontario Teachers Pension Plan
- OPSEU Pension Trust
- PGGM
- PREVI
- PSS and CSS Boards
- Railways Pension Trustee Company Ltd
- Relational Investors LLC
- SAS Trustee Corporation
- School Employers Retirement System of Ohio
- State of NJ Division of Investments
- Standard Life Investments
- TIAA-CREF
- Varma Mutual Pension Insurance Company
- Walden Asset Management / Boston Trust & Investment Management Company
- Wellington Management Company