Canada and the world of securities finance

Chris Benedict, vice president of DataLend, highlights the state of the equity securities finance industry in Canada and how it compares to other jurisdictions

With $88 billion of equities on loan at year-end 2013, Canada held 10 percent of the global market share—which made it the second-largest securities lending market in the world by equity on-loan value behind only the US, which had $498 billion (59 percent market share). That placed Canada ahead of other major securities finance markets such as Germany, France, the UK and Japan.

Canada's equity securities finance story is largely one of stability, not unlike its equities markets overall of late. On-loan values have been on a gradual rise for some time, rising alongside the S&P/TSX Composite Index, but also partly due to new entrants in the securities lending market and beneficial owners returning to securities lending following the financial crisis. Canada's economic stability is a key factor in that.

Despite its considerable volumes, fees to borrow Canadian equities, on average, tend to trail other markets. When compared to the US, Europe, and the Far East and Australia Pacific from the start of 2013 through Q1 2014, Canadian equities have traded at the lowest fees of the four locales at an overall average of 43 basis points. That compares to an average of 65 bps in the US, 90 bps in Europe and 114 bps in the specials-heavy markets of the Far East and Australia Pacific (see Figure 1). Canada's low fees to borrow relative to other regions is another reflection of its economic stability.

Like the US, Canada is primarily a general collateral market. On a typical day, upwards of four-fifths of Canadian securities lending transactions will be traded at general collateral levels (see Figure 2). The US mirrors that paradigm, while Europe and the Far East and Australia Pacific have considerably more warm and hot trades. In Europe, about two-thirds of trades are typically general collateral, while in the Far East and Australia Pacific, the number is much smaller at approximately one-third, according to a DataLend analysis of trades last year.

There are exceptions, of course. Last year a handful of equities heated up in the financial news headlines and in securities lending activity too, leading to an increase in the share of stocks trading in the 500-plus bps fee bucket in the spring and summer of 2013, as illustrated in Figure 1.

Perhaps most notably, BlackBerry's travails and steady stock price decline led to a spike in short interest last year, lifting fees to borrow for hedge funds looking to short the beleaguered stock. Lately, as the stock price has rebounded some since the latter part of 2013, fees to borrow have dropped substantially to a lukewarm 30 bps today. From a short perspective, it seems the street now believes the bottom is in. Indeed, some analysts have recently posited that BlackBerry may actually turn a profit by the end of 2015.

Telus, another Canadian company in the IT sector, also heated up last year. As opposed to short selling as was the case with BlackBerry, the securities lending activity in this stock accelerated amid a corporate action situation whereby the company exchanged non-voting shares for common shares in early 2013. What followed was diminished supply as lenders pulled back inventory prior to the corporate action and also recalled stock subsequent to it, both resulting in soaring utilisation and fees to borrow. The stock now trades at general collateral levels.

Loblaw was another actively traded name in the Canadian securities lending market, one driven by M&A arbitrage activity as the food retailer moved to acquire Shoppers Drug Mart in July of 2013. Fees to borrow that stock gradually dropped to lukewarm territory as the acquisition neared its close date in March of this year.

All in all, the Canadian market appears to be steady-as-she-goes once more with the proportion of hot trades thinning out again while general collateral trades still dominate. In that regard, apart from sheer volumes, the world's second largest securities lending market looks quite like the first.

Chris Benedict will give the annual Canadian Market Update at the Canadian Securities Lending Association (CASLA) Conference on Securities Lending on May 8 in Toronto.

Figure 1: fee bands as a percentage of total on loan—Canadian equities (in bps)

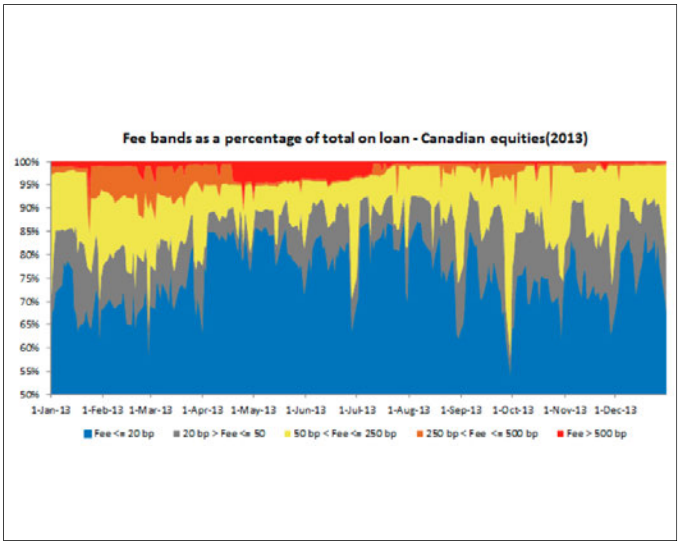

Figure 2: global equities, volume-weighted average fees (bps)