I Don't Recall: Information and the Governance Tradeoffs in Securities Lending

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Motivation

Institutional investors lend shares to earn extra revenue, but lose voting power.

- Common framing: lending and voting are *substitutes*.
- But lending also generates **information about how to vote**.

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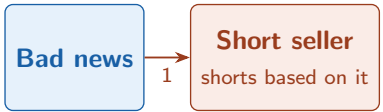
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Bad news

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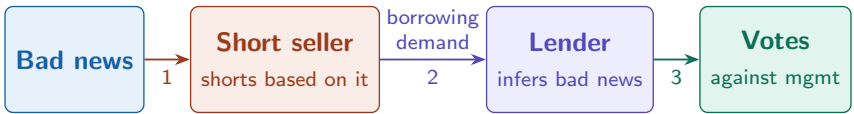
Evidence:

2. Borrowing demand conveys information to lenders (Honkanen (2025); Greppmair et al. (2024); Chague et al. (2025)).

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Evidence:

2. Borrowing demand conveys information to lenders (Honkanen (2025); Greppmair et al. (2024); Chague et al. (2025)).
3. High recall activity around record dates predicts subsequent votes against management (Aggarwal et al. (2015); Li and Zhu (2023)).

Research Question and Main Result

Research Questions

Are lending and governance substitutes? Can firm value *improve* when an informed shareholder *does not* recall shares to vote?

My model: it can. The key tradeoff for firm value is

$$\underbrace{\text{a larger number of } \textit{less} \text{ informed votes}}_{\text{Recall shares to vote}} \quad \text{vs.} \quad \underbrace{\text{a smaller number of } \textit{more} \text{ informed votes}}_{\text{Do not recall shares}}.$$

Intuition: informed short sellers **won't borrow if they expect to be recalled**. Recalling destroys the lending market as a source of information.

$\Rightarrow$ Lending and voting can be **complements**.

Model Overview

Firm Payoffs

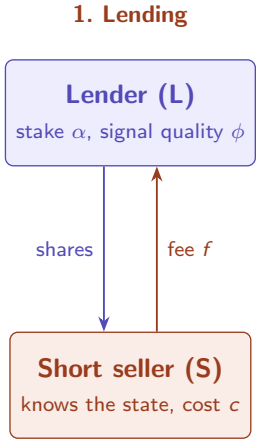
One firm. Payoff $\Pi(\theta, V)$ depends on the state $\theta \in \{l, h\}$ and the vote outcome $V \in \{0, 1\}$.

	$V = 0$ **(status quo)**	$V = 1$ **(change)**
$\theta = h$	π	$\pi - \delta$
$\theta = l$	0	δ

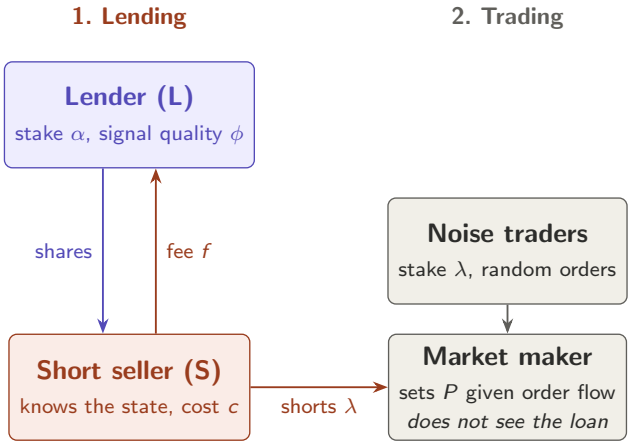
with $\pi > 0$ and $\delta \in (0, \frac{\pi}{2})$.

- The value-maximizing vote is **change in the low state**, **status quo in the high state**.
- δ is the *the value at stake in the vote*.

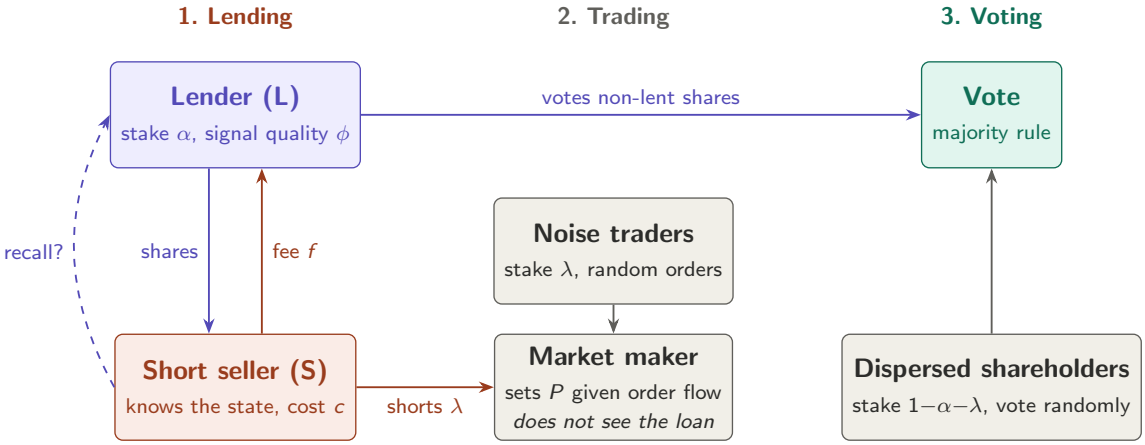
Model Timeline



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Solution

Lender's Recall Decision

Short seller borrows only in the low state $\implies$ after lending, L votes for change.

Lender's Recall Decision

Threshold rule for recall: L recalls iff $f < \underline{f}$, where

$$\underline{f} \equiv \underbrace{\alpha}_{\text{Stake}} \cdot \underbrace{\delta}_{\text{Value Improvement}} \cdot \underbrace{\frac{1}{2(1-\alpha-\lambda)}}_{\uparrow \text{ in prob. vote goes L's way}}$$

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- Short seller observes f *before* borrowing. Recall is costly, so she won't borrow if $f < \underline{f}$.
- Any $f < \underline{f}$ is equivalent to a prohibitively high fee. If the optimal $f^* \geq \underline{f}$ attracts borrowing, L strictly prefers it.

$$W(f^*) > W(f \to \infty) = W(f < \underline{f}) \implies \textbf{L never recalls in equilibrium.}$$

Characterization of Optimal Fee

What $f^* \geq \underline{f}$ will the lender choose? Max. expected lending revenue *plus* portfolio value:

$$\max_{f \geq \underline{f}} \underbrace{R(f)}_{\text{Lending Rev.}} + \underbrace{\Gamma(f)}_{\text{Value of Shares}} .$$

- **Value of lender's shares decreasing in f: $\Gamma'(f) \leq 0$**

Solution: $f^* = \max(\hat{f}, \underline{f})$ where $\hat{f}$ is unconstrained optimum.

- $\hat{f}$ = Max. revenue fee - Information discount

Recall and Firm Value

Compare equilibrium firm value (no recall) to a counterfactual policy that *forces* recall.

Key Tradeoff

- Recall: Lender has all his votes, but loses lending signal
- No recall: Lender does not cast all his votes, but has extra signal for remaining votes

Main Result

Firm value increases when the lender does **not** recall shares whenever his private signal is sufficiently weak

- Uninformative private signal: Extra votes from recall are just noise. Firm value improves when L gets extra signal.
- Perfectly informative private signal: Lending signal has no impact on informativeness of L's vote. Better to recall and vote all shares—though L is still privately unwilling to recall (revenue compensates).

Feedback and Short-Selling Profits

Expected per-share short-selling profits equal

$$\underbrace{E[P \mid \text{short}]}_{\text{Selling price}} - \underbrace{Pr(\text{V=change}|\text{short})\delta}_{\text{Expected close-out price}} - \underbrace{f}_{\text{Fee}}$$

Feedback effect

- Higher $\delta \Rightarrow$ higher close-out price following "correct vote" $\Rightarrow$ shorting less profitable
- An endogenous short-sale constraint (Edmans et al. (2015))
- Less information conveyed via lending market—**holding fees constant**.

But L sets the fee, and **L values S's information**

- May cut fees to compensate short seller and preserve info flow

Proposition

When $f^* > \underline{f}$, short-selling profits can be *increasing* in δ. When $f^* = \underline{f}$, they decrease.

Implications and Conclusion

Policy implications

- **Index funds.** Thought to have weak incentives to acquire firm-specific voting information. But they are *major securities lenders*, so they passively receive a steady flow of such info.
- **Pass-through voting.** Carries an unintended cost: weaker lender incentives to subsidize short sellers, reducing the lending market's information content.

Conclusion

- I model how a securities lender trades off lending revenue, voting power, and information when lending shares.
- Lenders commit not to recall by setting fees above the gain from an extra recalled vote.
- Not recalling shares can **raise** firm value since lender's remaining votes will be more informed.
- **Key takeaway**: Lending and voting are not necessarily substitutes — information spillovers can make them complements.