The December 2019 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The December 2019 Senior Credit Officer Opinion Survey on Dealer Financing Terms collected qualitative information on changes over the previous three months in credit terms and conditions in securities financing and over-the-counter (OTC) derivatives markets. In addition to the core questions, the survey included a set of special questions about stress in overnight funding markets that occurred in mid-September 2019. The 22 institutions participating in the survey account for almost all dealer financing of dollar-denominated securities to nondealers and are the most active intermediaries in OTC derivatives markets. The survey was conducted during the period between November 5, 2019, and November 21, 2019. The core questions asked about changes between September 2019 and November 2019.[1]

Core Questions
(Questions 1–79)[2]

Responses to the core questions in the December survey offered a few insights into recent changes in the terms under which dealers facilitate their clients' securities and derivatives transactions. With regard to the **credit terms applicable to, and mark and collateral disputes with, different counterparty types across the entire range of securities financing and OTC derivatives transactions**, responses to the core questions revealed the following:

- About one-fourth of dealers indicated an increase in the amount of resources and attention devoted to the management of concentrated credit exposure to central counterparties and other financial utilities over the past three months (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit").
- Price and nonprice terms on securities financing transactions and OTC derivatives were generally unchanged across all classes of counterparties.
- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types, although a small net fraction of dealers indicated an increase in the volume of such disputes with mutual funds, exchange-traded funds, pension plans, and endowments.

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[1] For questions that ask about credit terms, net percentages equal the percentage of institutions that reported tightening terms ("tightened considerably" or "tightened somewhat") minus the percentage of institutions that reported easing terms ("eased considerably" or "eased somewhat"). For questions that ask about demand, net fractions equal the percentage of institutions that reported increased demand ("increased considerably" or "increased somewhat") minus the percentage of institutions that reported decreased demand ("decreased considerably" or "decreased somewhat").
[2] Question 80, not discussed here, was optional and allowed respondents to provide additional comments.

With respect to clients' **use of financial leverage**, on net, dealers indicated little change over the past three months (see the exhibit "Use of Financial Leverage") for all classes of counterparties. However, a small net fraction of dealers indicated an increase in the leverage available to hedge funds.

With regard to **OTC derivatives markets**, responses to the core questions revealed the following:

- Initial margin requirements on OTC derivatives were basically unchanged, on net, for average and most-favored clients.
- The volume of mark and collateral disputes remained unchanged over the past three months across most OTC derivatives. A net fraction of about one-fifth of respondents indicated a decrease in the duration of such disputes for OTC interest rate derivatives.

With respect to **securities financing transactions**, respondents indicated the following:

- A net fraction of one-fifth of dealers reported increased demand to fund equities, while a smaller net fraction of dealers reported increased demand for term funding to fund agency residential mortgage-backed securities (RMBS) over the past three months (see the exhibit "Measures of Demand for Funding and Market Functioning"). Demand for funding remained largely unchanged across all other asset classes.
- Roughly one-fifth of dealers, on net, reported an easing in the effective financing rates for equities for their average and most-favored clients. One-fifth of respondents, on net, also reported an easing in effective financing rates for agency RMBS for their average clients. Other terms under which various types of securities are funded remained largely unchanged since the previous survey.
- Dealers, on net, reported no material change in the liquidity and functioning of the market across collateral classes in the past three months.[3]

Special Questions on Stress in Overnight Funding Markets

During the week beginning September 16, 2019, signs of stress emerged in overnight funding markets when both secured and unsecured overnight borrowing rates temporarily increased sharply. In the special questions for the survey this quarter, dealers were queried about how and why the volume of their overnight secured borrowing and lending changed, if any, between September 16, 2019, and September 18, 2019, compared with that in the first week of September 2019.

With respect to secured **borrowing**, dealers reported the following:

[3] Note that survey respondents were instructed to report changes in liquidity and functioning in the market for the underlying collateral to be funded through repurchase agreements and similar secured financing transactions, not changes in the funding markets themselves. This question was not asked with respect to equity markets in the core questions.

- Most respondents indicated that their overnight secured borrowing remained basically unchanged. Seven dealers reported a change in borrowing, about evenly split between increased and decreased borrowing.
- The most commonly cited counterparty type from which dealers reported decreased borrowing was depository institutions.

With respect to secured **lending**, dealers reported the following:

- Most respondents reported that the volume of overnight secured lending remained basically unchanged. More specifically, roughly three-fourths of respondents reported basically no change in secured lending, while about one-fifth reported a decrease and about one-tenth reported an increase. The decrease was not concentrated in any one counterparty type.
- Dealers were asked to rank the most important reasons for changing their volume of lending. Their responses revealed the following:
  - Among respondents who reported decreasing their volume of lending, the most important factors cited were less demand from counterparties and funding constraints—either a higher cost of funding relative to the lending rate or insufficient aggregate reserves. Other commonly cited reasons were reduced risk appetite and a higher degree of uncertainty.
  - Dealers reported a variety of reasons for keeping their level of lending basically unchanged despite a higher lending rate, including unchanged demand from counterparties, insufficient room to expand balance sheet for regulatory reasons such as the Supplementary Leverage Ratio and Liquidity Coverage Ratio, and reduced risk appetite.
  - The dealers who reported an increase in lending noted higher demand from counterparties as an important factor for the increase.[4] They also listed balance sheet availability or abundant reserves as important reasons for increasing their lending.

In response to questions about changes in the price terms that dealers offered to their clients on one-week or shorter securities lending over this period, respondents reported the following:

- On net, about three-fifths of dealers reported tighter price terms to nonprimary dealers for these transactions, while about two-fifths of dealers reported tighter price terms to primary dealers, hedge funds, and other levered investors.
- A small net fraction of dealers reported providing more preferable terms to most-favored clients.

Lastly, dealers were asked how they viewed the funding pressure episode when overnight Treasury repurchase agreement (repo) rates spiked on September 16, 2019. The responses revealed the following:

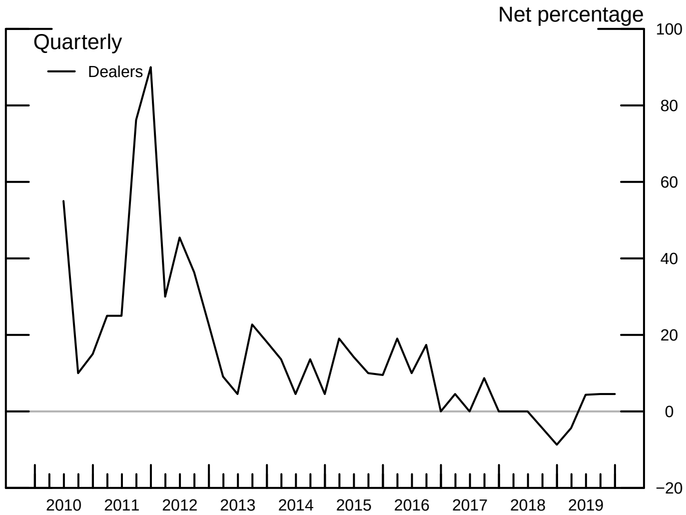
[4] Those dealers reported to have increased lending to their hedge fund clients.

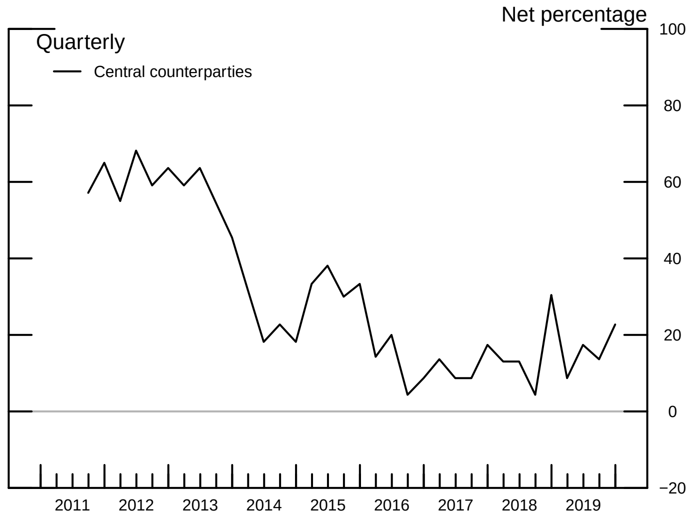
- About three-fifths of respondents were at least somewhat certain that the spike in overnight Treasury repo rates was driven by technical factors and thus would only be temporary.
- All dealers reported that significantly elevated overnight Treasury repo rates would need to persist for more than one day before their firm would substantially increase secured lending through overnight reverse repo. Three-fourths of dealers indicated that such an event would need to last longer than a week for them to increase lending through overnight reverse repo.

This document was prepared by Charles Press, Division of Monetary Affairs, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Capital Markets Function, the Statistics Function, and the Markets Group at the Federal Reserve Bank of New York.

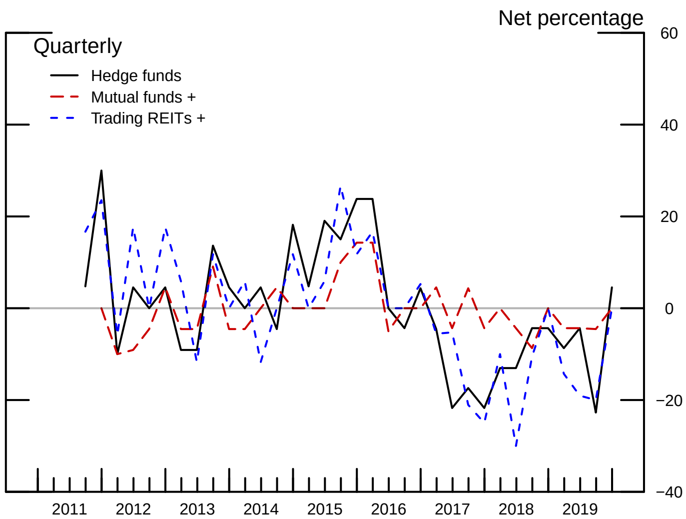
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

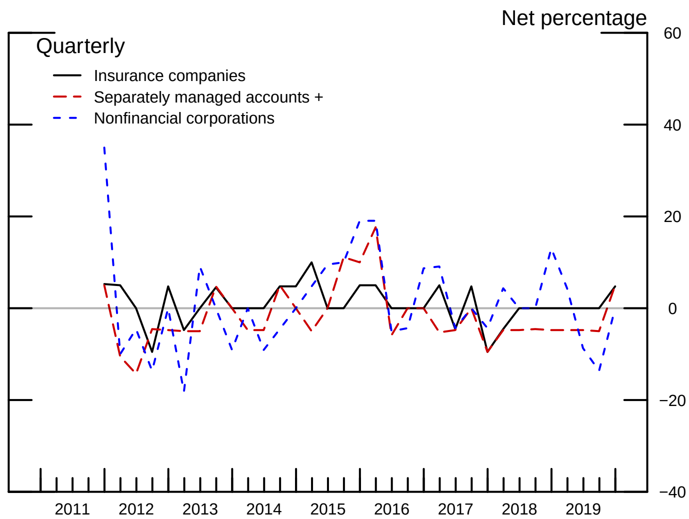
Respondents increasing resources and attention to management of concentrated exposures to the following:



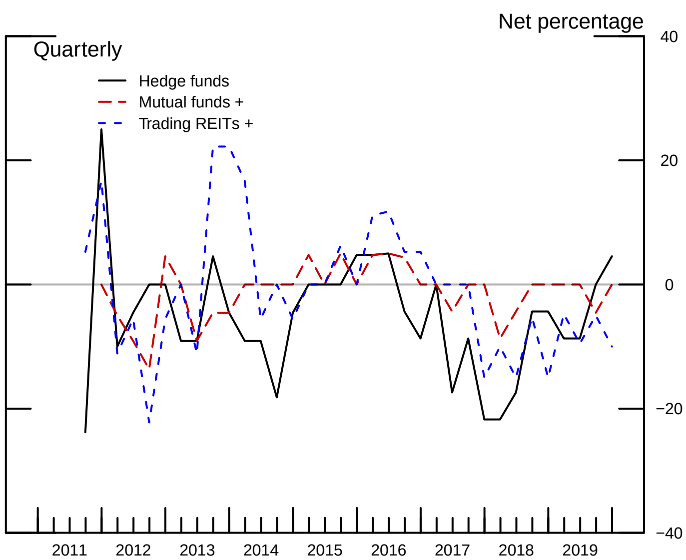


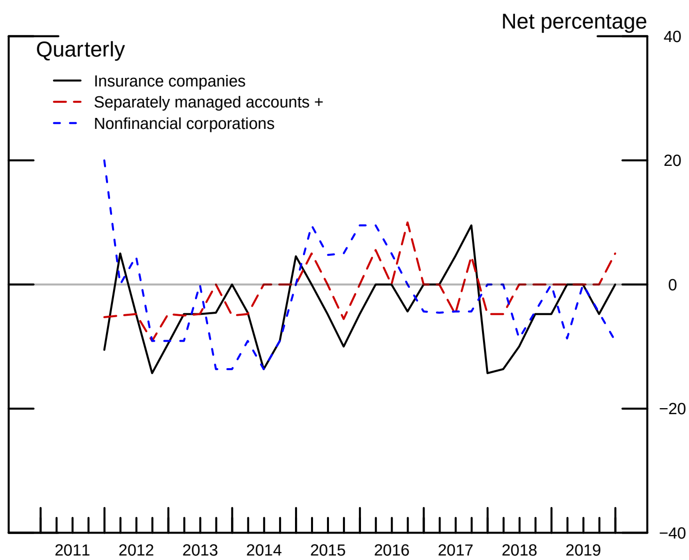
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

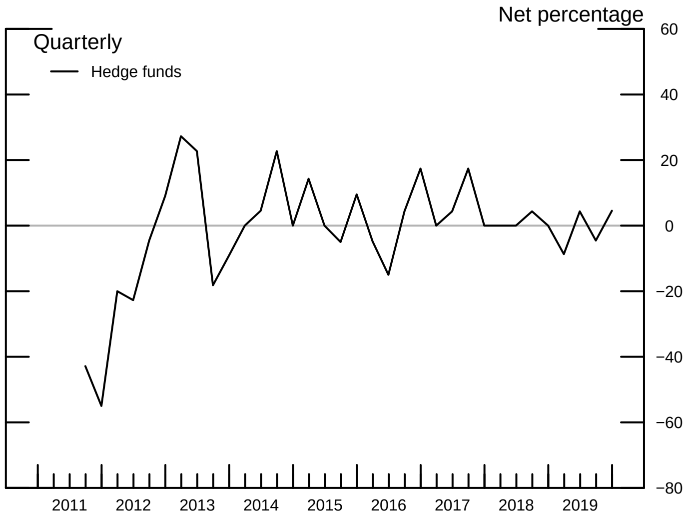


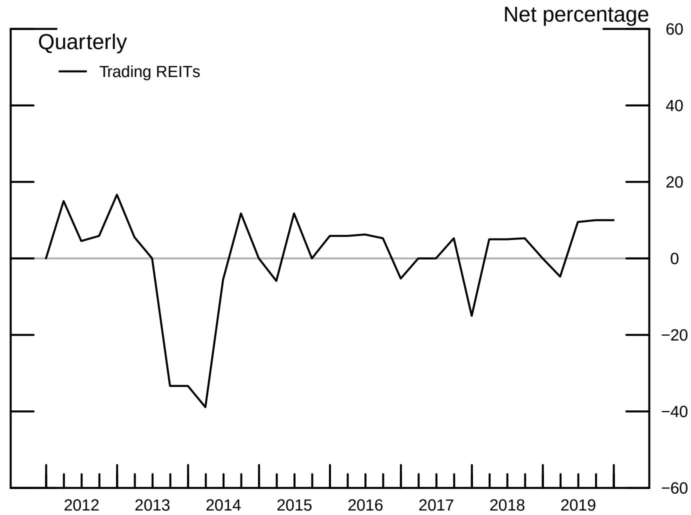


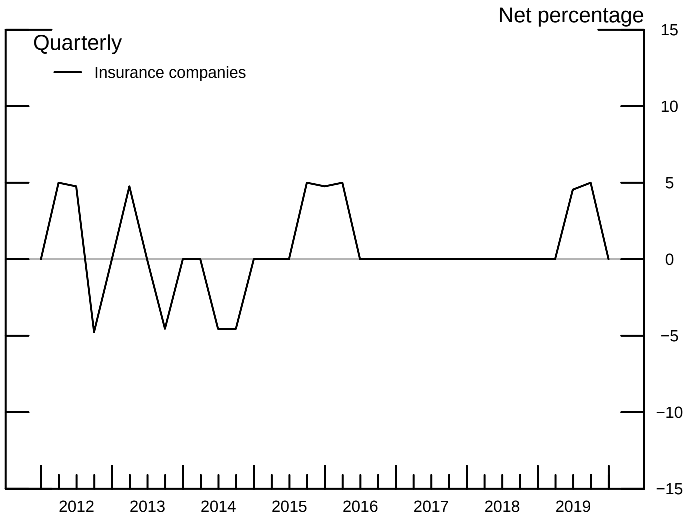
+ The question was added to the survey in September 2011.
REIT: Real Estate Investment Trust

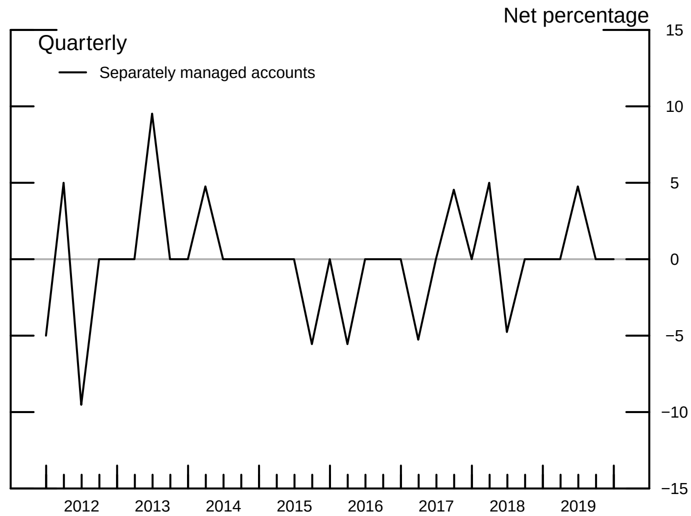
Use of Financial Leverage

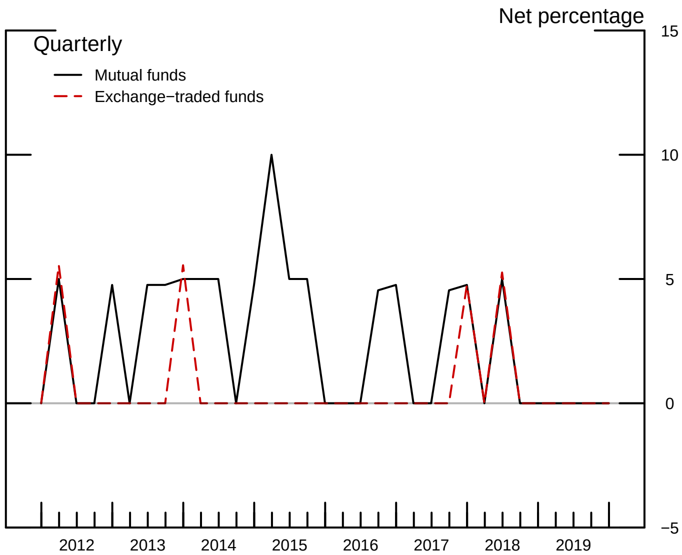
Respondents reporting increased use of leverage by the following:

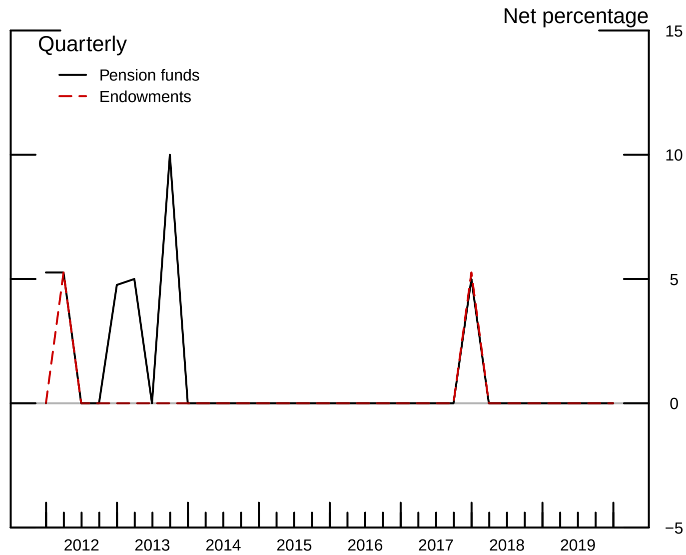








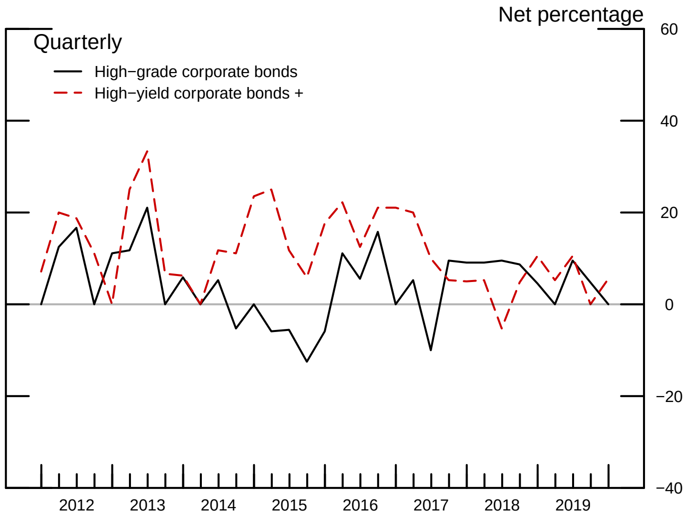


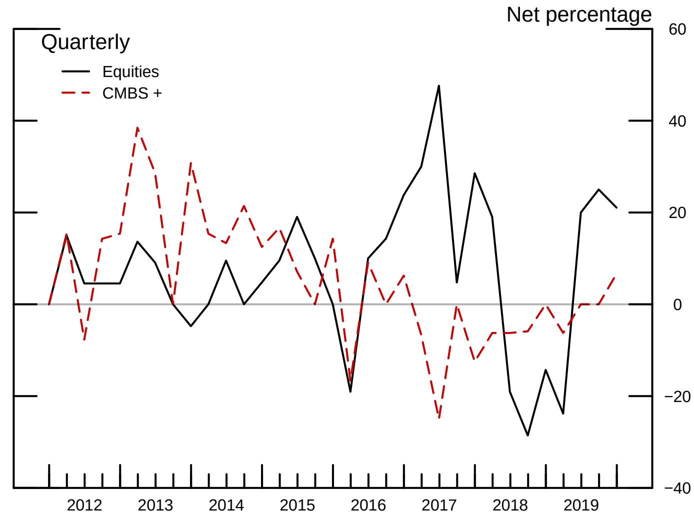


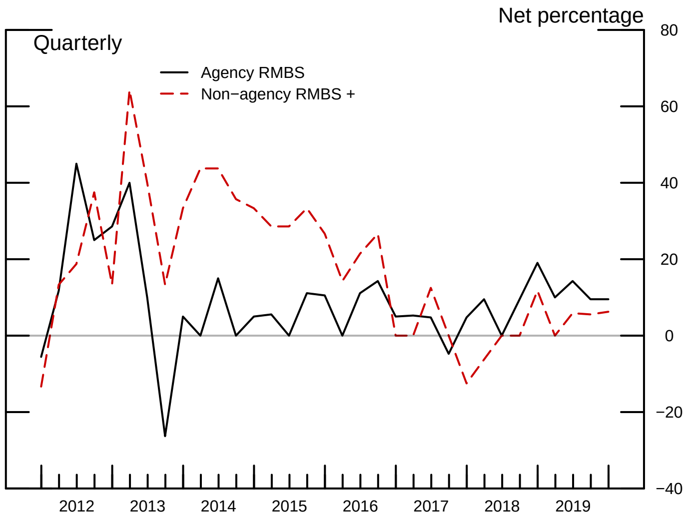
REIT: Real Estate Investment Trust

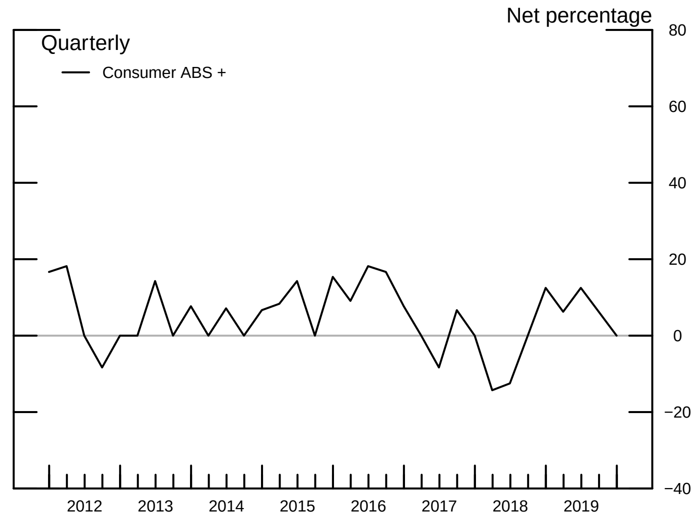
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

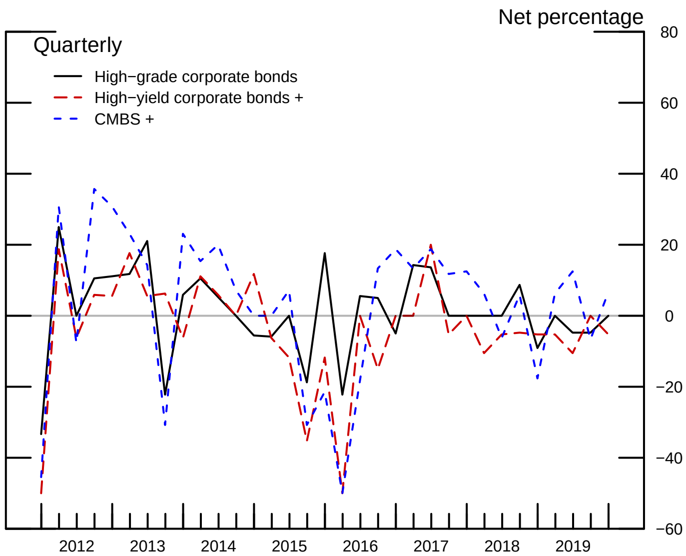


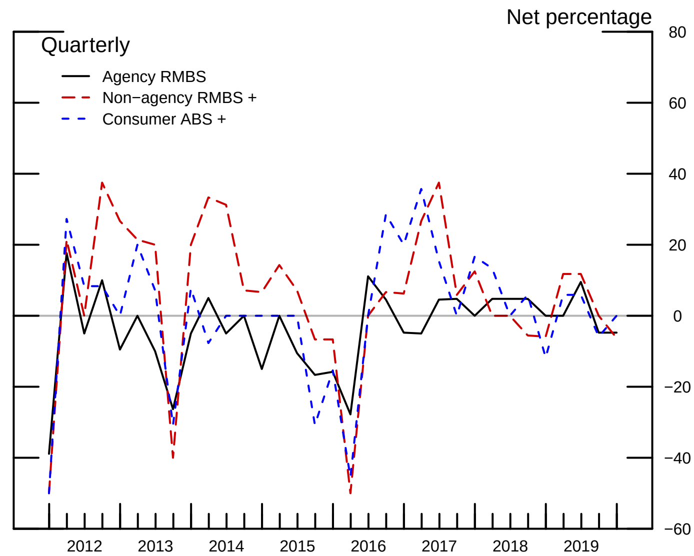






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





+ The question was added to the survey in September 2011.
CMBS: Commercial Mortgage−Backed Securities, RMBS: Residential Mortgage−Backed Securities, ABS: Asset−Backed Securities