The September 2016 Senior Credit Officer Opinion Survey on Dealer Financing Terms

The September 2016 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 the effects on dealer firms of the money market fund (MMF) reforms required by the U.S. Securities and Exchange Commission (SEC), which must be implemented by mid-October 2016. The 23 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. (Note that 2 of the 23 participants were added to the September round of the survey.) The survey was conducted between August 23, 2016, and September 6, 2016. The core questions asked about changes between June 2016 and August 2016.[1]

Core Questions
(Questions 1–79)[2]

Responses to the core questions in the September survey offered a few insights regarding the developments in dealer-intermediated markets over the past three months:

- Price and nonprice terms on securities financing transactions and OTC derivatives were basically unchanged across all classes of counterparties. The use of financial leverage by all classes of counterparties was also reported to have changed little.
- Initial margin requirements on OTC derivatives were said to be basically unchanged for average and most-favored clients. In addition, the majority of respondents noted that the volume, duration, and persistence of mark and collateral disputes with all counterparty types were basically unchanged.
- With respect to securities financing transactions, about one-fourth of dealers reported an increase in collateral spreads over the relevant benchmark (financing rates) for high-yield (HY) bonds for both average and preferred clients. Smaller fractions of respondents reported similar increases for high-grade bonds, non-agency residential-mortgage-backed securities (RMBS), and commercial mortgage-backed securities. Other terms under which various types of securities are funded remained largely unchanged since the previous survey.

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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.

- More than one-fourth of dealers reported increased demand to fund non-agency RMBS, while about one-fifth noted greater demand to fund both high-grade and HY bonds as well as consumer asset-backed securities (ABS). Smaller fractions of dealers reported increased demand to fund agency RMBS and equities.
- A net fraction of more than one-fourth of respondents noted an improvement in liquidity and functioning in the underlying market for consumer ABS. Of note, despite robust issuance in the primary market, a net share of close to one-fifth of respondents reported a deterioration in liquidity and market functioning in the HY bond market over the past three months. For all other products, market functioning and liquidity were little changed.

Special Questions on Money Market Fund Reforms
(Questions 81–86)

The SEC's 2014 MMF reforms have led to changes in the MMF industry, and more changes may occur before the October 2016 deadline for implementing key provisions of the reforms. These developments may have already affected dealers' use of short-term funding to finance their activities and may have additional effects in coming months. The September 2016 survey included a set of special questions intended to help us understand the effects of the MMF reforms on institutions' use of short-term funding instruments.

With respect to how their use of short-term funding instruments and counterparties has changed *over the past year*, dealers reported the following:

- The use of various short-term funding instruments has changed noticeably over the past year. Two-fifths of dealers indicated that they had reduced the use of commercial paper (CP) as a source of funding, while one-fourth noted a decline in the use of certificates of deposit (CDs). By contrast, small net fractions of dealers reported an increase in the use of Treasury and agency repos as well as other types of repos.
    - Of the respondents who reported decreased use of CP and CDs, almost all pointed to MMF reforms as at least a "somewhat important" reason for the decline. In addition, one-half of such respondents pointed to other post-crisis regulatory reforms and institution-specific internal factors as "important" reasons.
    - Of the respondents who reported increased use of Treasury and agency repos, one-half indicated that MMF reforms were a "very important" reason for the increase.[3]
    - Among the dealers who reported increased use of other types of repos, one-half noted that other post-crisis reforms and institution-specific internal factors were "very important" reasons for the change.[4]

[3] One-third of respondents also pointed to institution-specific internal factors and other post-crisis regulatory reforms as being "very important" in driving the change.
[4] The SEC's MMF reforms have resulted in substantial increases in the assets under management in government MMFs and marked reductions in the assets of prime MMFs. These changes have boosted MMF holdings of Treasury and agency repos (which are disproportionately held by government MMFs) and reduced the funds' holdings of other types of repos, CP, and CDs (which are almost exclusively held by prime MMFs).

- In terms of counterparties, net fractions of roughly two-fifths and one-third of respondents reported a decrease in funding obtained from money funds via CDs and CP, respectively. By contrast, small net fractions of dealers indicated that Treasury and agency repo funding from money funds had increased.
- With respect to counterparties other than money funds, a net fraction of about one-fourth of respondents noted that funding from corporations via CDs had increased. Small net fractions of respondents also pointed to increases in funding from corporations and other investment funds via repos other than those backed by Treasury and agency securities. By contrast, dealers indicated that they were receiving less funding via Treasury and agency repos from securities lenders.

With respect to how dealers anticipate their use of short-term funding instruments and counterparties to change *for the remainder of the year as a result of changes related to MMF reform*, respondents indicated the following:

- About one-fifth of dealers expect their use of Treasury and agency repos to increase, while the vast majority of dealers anticipate the use of other types of repos to remain basically unchanged.
- More than two-fifths of dealers that use CDs as a funding source expect a decline, and a net fraction of about one-third of dealers that use CP as a funding source anticipate a decline.
- Several respondents expect to increase their use of other short-term funding instruments like corporate deposits and equity-linked notes.
- With respect to counterparties, one-fifth of respondents expect Treasury and agency repos provided by MMFs to increase. Conversely, at least one-fourth of dealers anticipate money funds to decrease funding via each of the other types of instruments listed in the survey.
- A net fraction of one-fourth of respondents expect pension funds to reduce their lending to dealers via CP; a smaller net fraction expect pension funds to reduce their lending via CDs.

Dealers were also asked to estimate how they expect price and nonprice terms they will face for the rest of the year to change in response to MMF reforms. Respondents reported the following:

- One-fourth of respondents anticipate financing rates for Treasury and agency repos to ease somewhat during the remainder of the year. By contrast, more than half of dealers expect rates on CDs and CP to increase.
- With respect to nonprice terms, one-fifth of dealers foresee an easing of nonprice terms (for example, maximum maturity) for CP, and a smaller net fraction of dealers anticipate easing for CDs.

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 Statistics Function and the Markets Group at the Federal Reserve Bank of New York.