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

Summary

The June 2019 Senior Credit Officer Opinion Survey on Dealer Financing Terms (SCOOS) 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 seeking a longer-term perspective on the current use of financial leverage by hedge funds. 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. The survey was conducted during the period between May 14, 2019, and May 31, 2019. The core questions asked about changes between March 2019 and May 2019.

Core Questions
(Questions 1–79)[1]

Responses to the core questions indicated a few changes over the past three months 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 showed the following:

- One-fifth of dealers, on net, reported an easing in price terms to their trading real estate investment trust (REIT) clients. Price and nonprice terms were reportedly unchanged for other counterparty types (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit").
- Similar to the previous quarter, one-fifth of respondents indicated that nonfinancial corporations have increased their efforts to negotiate more favorable price and nonprice terms over the past three months.
- The volume and duration of mark and collateral disputes remained unchanged over the past three months for most counterparty types. One-fifth of respondents indicated a decrease in the duration of such disputes with mutual funds, exchange-traded funds, pension plans, and endowments.

[1] 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.

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

- In contrast to the trend over the previous four quarters, one-fifth of dealers, on net, indicated an increase in funding demand for equities (see the exhibit "Measures of Demand for Funding and Market Functioning"). Demand for funding remained largely unchanged across all other asset classes.
- One-third of dealers, on net, reported a decrease in effective financing rates for equity collateral for their average clients over the past three months, while one-fourth of dealers reported the same for their preferred clients.
- Net fractions of one-fifth to one-fourth of dealers reported a decrease in effective financing rates for non-agency residential mortgage-backed securities, commercial mortgage-backed securities, and consumer asset-backed securities. Funding terms were little changed across other asset classes queried in the survey.
- Dealers, on net, reported no material change in the liquidity and functioning of the market across collateral classes in the past three months.[2]

With regard to **OTC derivatives markets**, responses showed the following:

- Initial margin requirements were basically unchanged, on net, for most types of OTC derivatives transactions. A small net fraction of dealers reported a decrease in initial margin requirements with respect to OTC equity derivatives for most-favored clients.
- Most dealers reported that the volume and duration of mark and collateral disputes have not changed across most OTC derivatives, although a small net fraction of dealers reported a decrease in dispute durations for OTC interest rate derivatives.

Special Questions
(Questions 81–85)

Available indicators of the use of leverage by hedge funds have generally shown an upward trend in recent years but do not cover earlier periods. In the June 2019 SCOOS, dealers were asked to provide a longer-term perspective on the use of financial leverage by hedge funds, comparing current levels of hedge fund leverage to the pre-crisis peak around June 2007 and the post-crisis trough around March 2009 on a seven-point scale.

[2] 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.

Dealers were also asked about the changes since June 2007 in the terms under which they fund different types of hedge fund positions and changes in the initial margin requirements applicable to different types of OTC derivatives contracts with hedge fund clients.

With respect to **the current levels of gross leverage employed by different types of hedge fund clients**, respondents reported the following:

- Across the majority of hedge fund strategies, respondents most frequently reported that hedge fund leverage was roughly in the middle between the pre-crisis peak around June 2007 and the post-crisis trough around March 2009. However, there was variation across hedge fund strategies in the distributions of responses around the midpoints.

With respect to the **terms associated with the funding of different types of hedge fund positons**, respondents indicated the following:

- Between one-fourth and one-third of respondents, on net, reported that spreads over relevant benchmarks for funding long–short equity portfolios and high-yield corporate bonds are above June 2007 levels. One-fourth of dealers, on net, also reported increased haircuts for high-yield corporate bond collateral.
- Funding terms for investment-grade corporate bonds, including the maximum amount of funding, maximum maturities, haircuts, and spreads over relevant benchmarks, were reported to be about unchanged, on net, since June 2007.

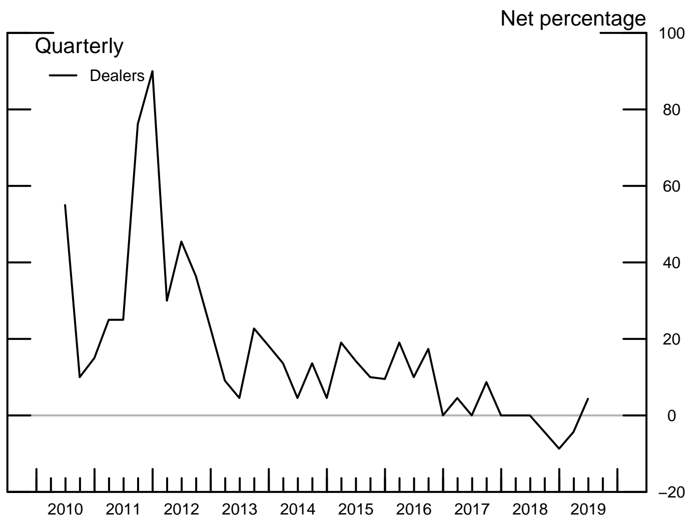
With respect to the **initial margin requirements for OTC derivatives transactions with hedge fund clients**, respondents showed the following:

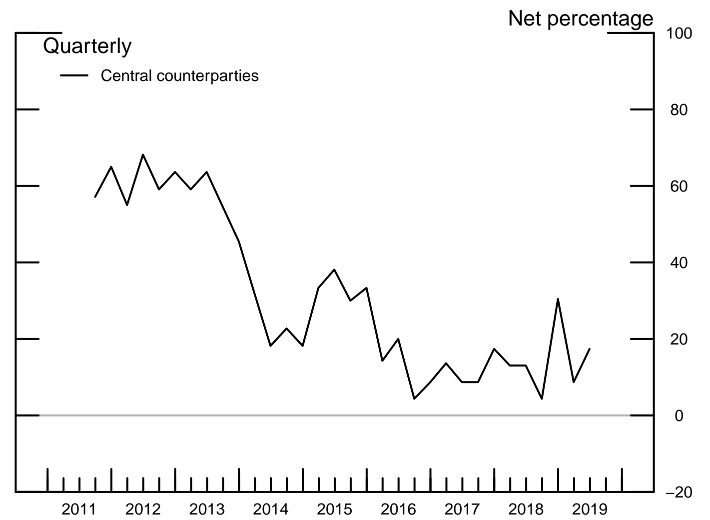
- Dealers reported, on net, no notable changes since June 2007 in initial margin requirements on OTC equity, interest rate, or credit derivatives transactions with their hedge fund clients.

This document was prepared by Lubomir Petrasek, 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.

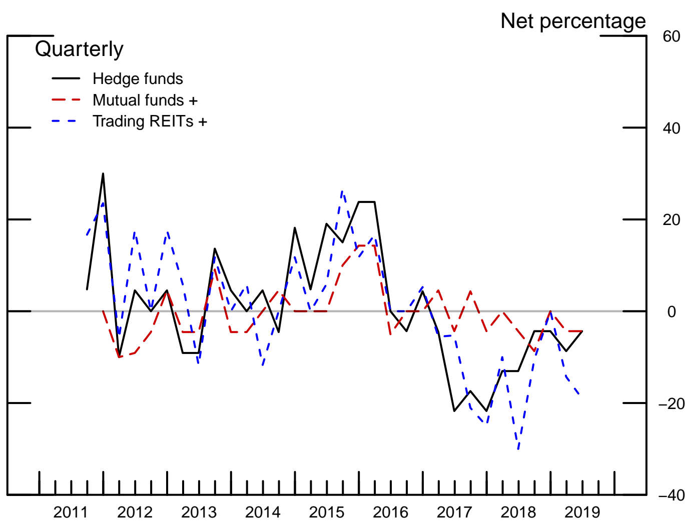
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

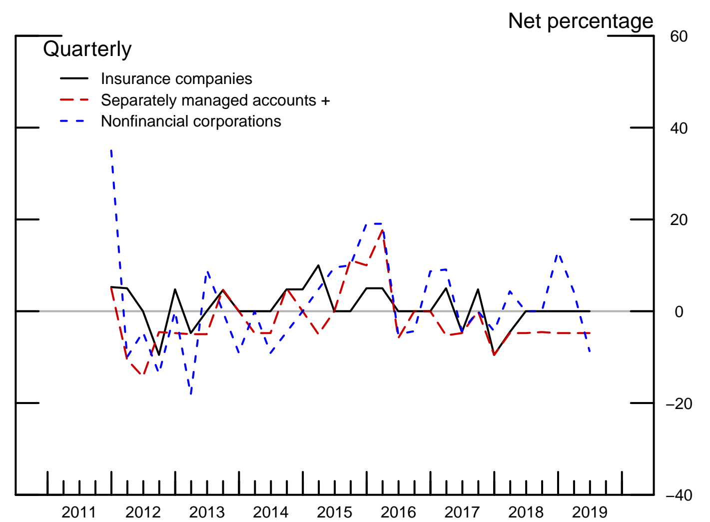
Respondents increasing resources and attention to management of concentrated exposures to the following:



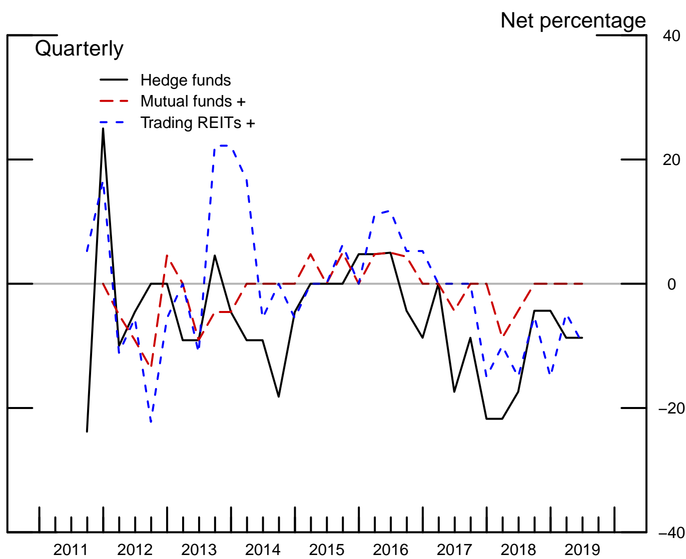


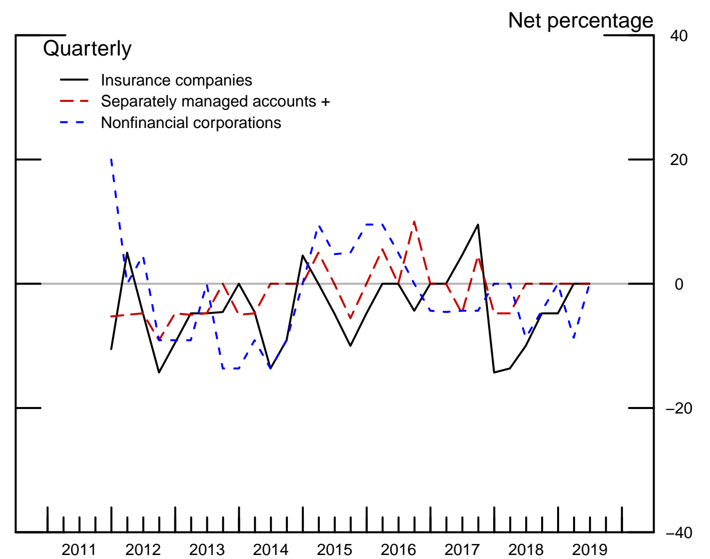
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

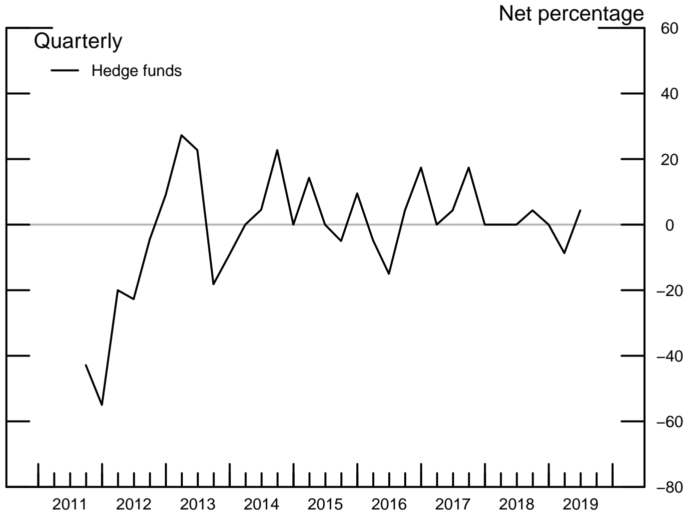


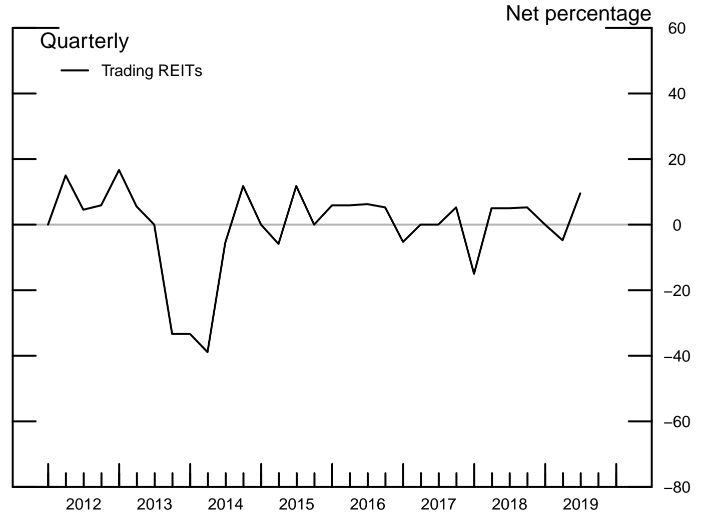


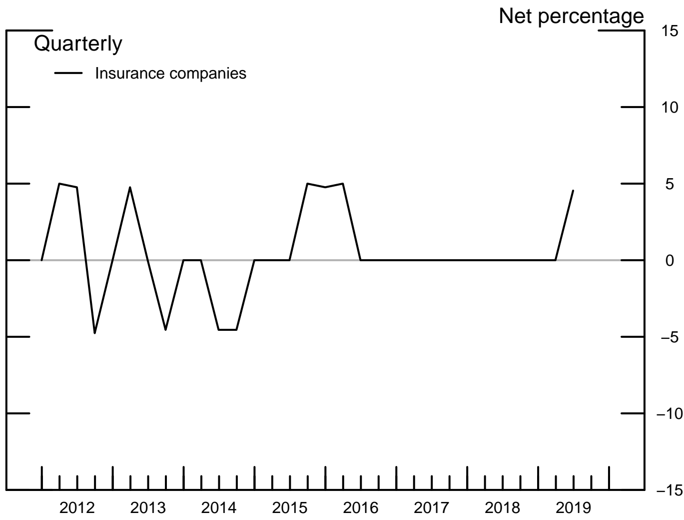
"+" indicates the question was added to the survey in September 2011.

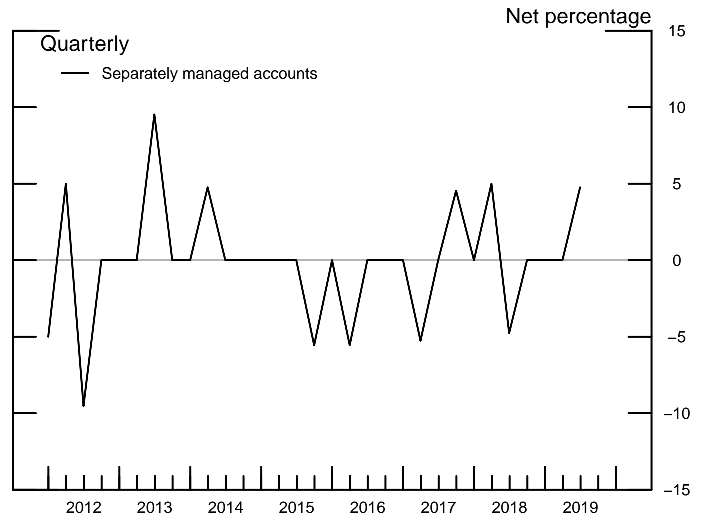
Use of Financial Leverage

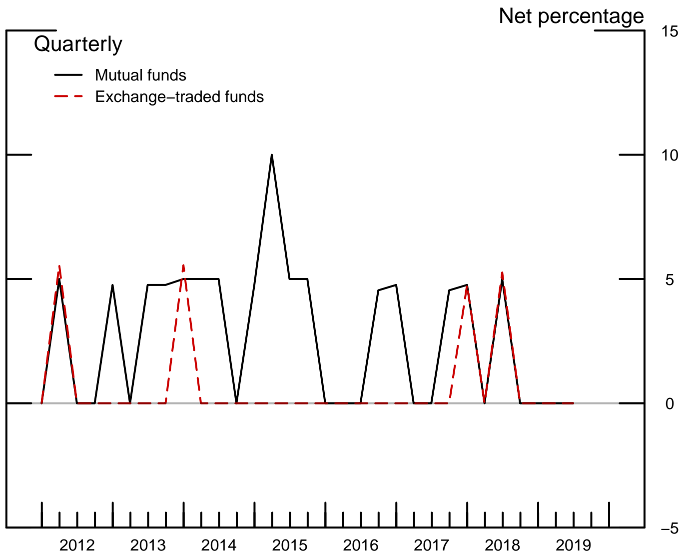
Respondents reporting increased use of leverage by the following:

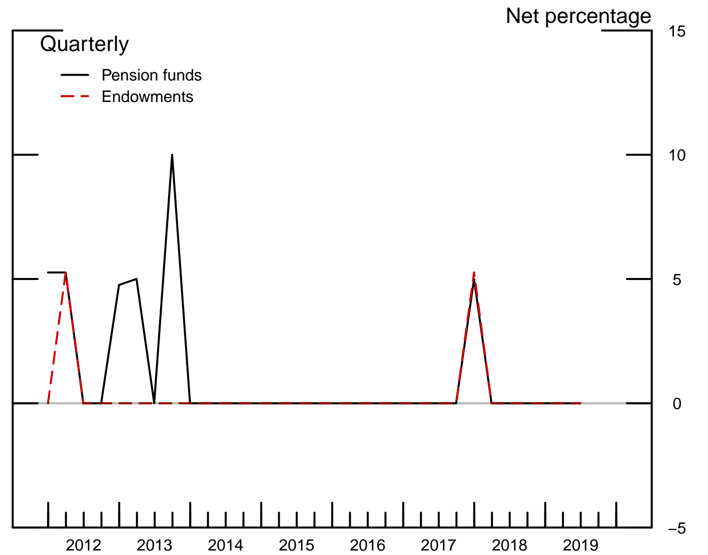






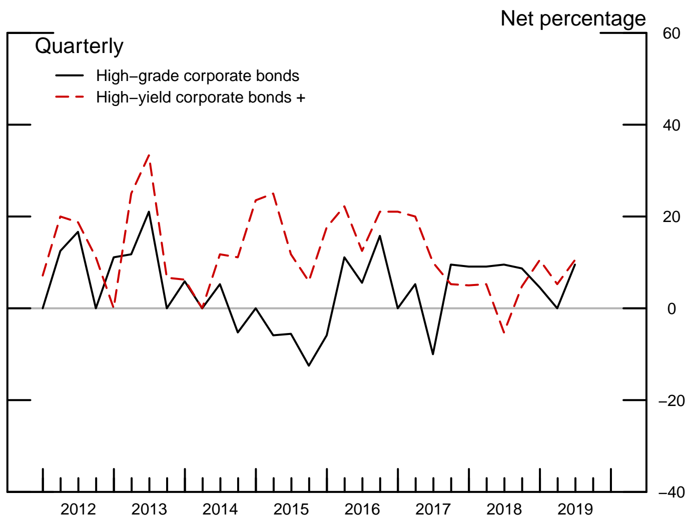


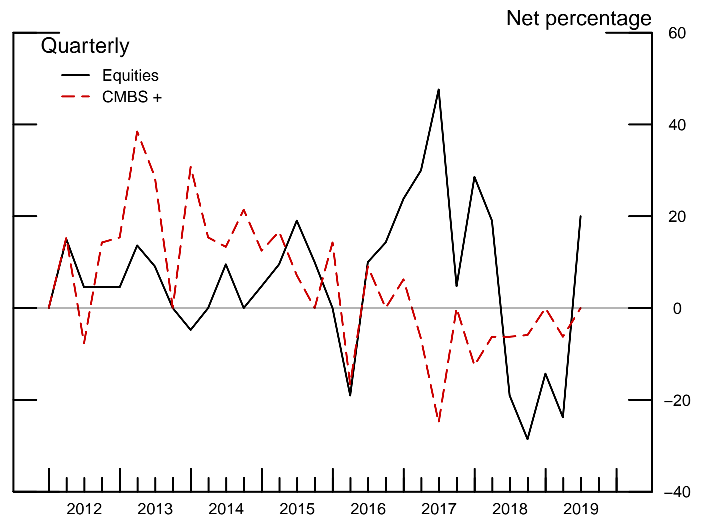


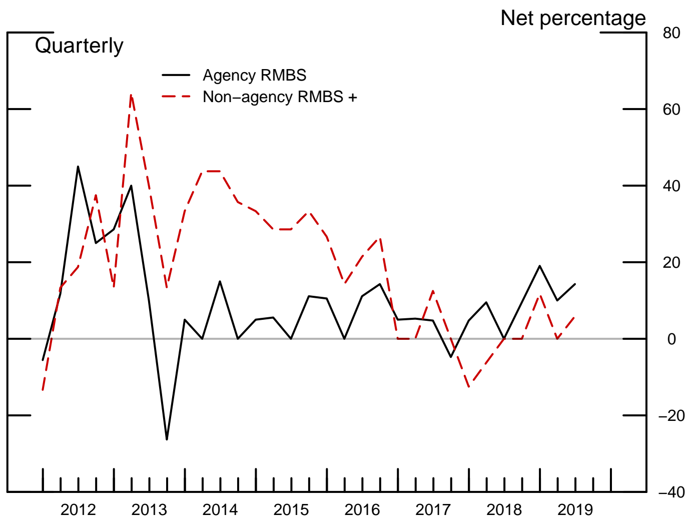


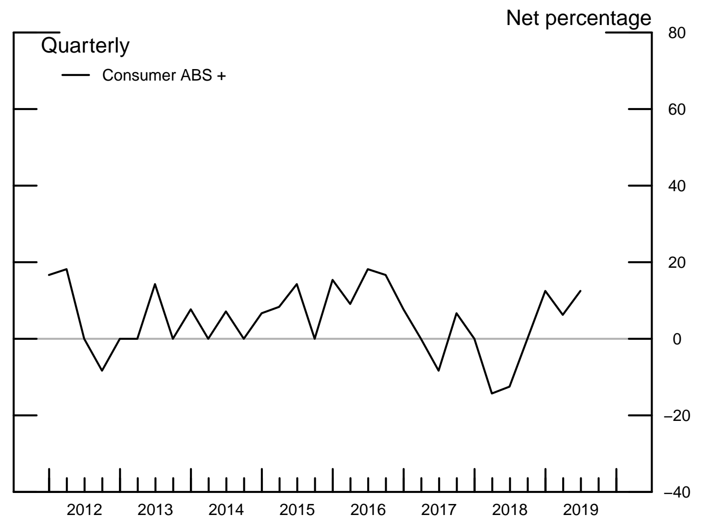
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

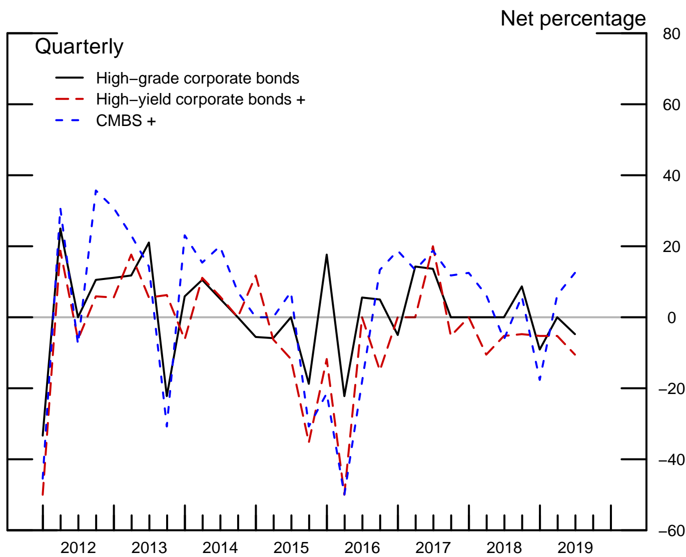


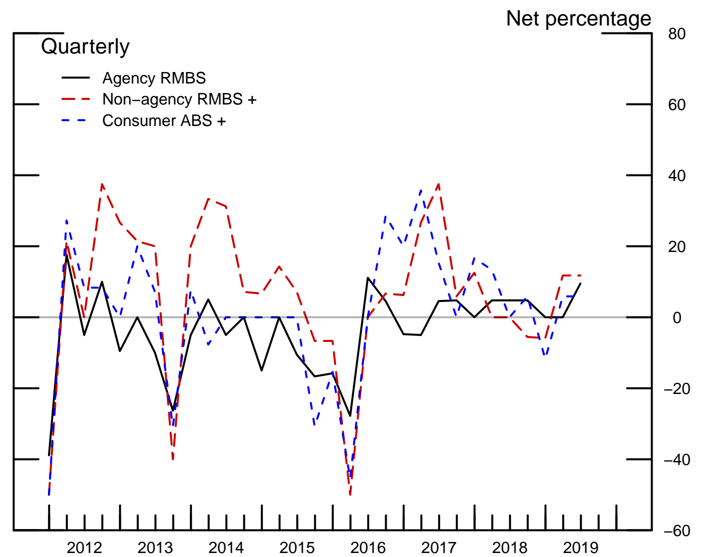






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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