The September 2022 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The September 2022 Senior Credit Officer Opinion Survey on Dealer Financing Terms collected qualitative information on changes 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 client trading activity and terms offered to clients engaged in commodity derivatives trading. The 22 institutions participating in the survey account for almost all dealer financing of dollar-denominated securities to non-dealers and are the most active intermediaries in OTC derivatives markets. The survey was conducted between August 16, 2022, and August 29, 2022. The core questions asked about changes between May 2022 and August 2022.[1]

Core Questions

(Questions 1–79)[2]

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:

- One-fourth of dealers reported that price terms on securities financing transactions and OTC derivatives offered to trading real estate investment trusts (REITs) and nonfinancial corporations have tightened somewhat over the past three months (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). Dealers cited deterioration in current or expected financial strength of counterparties as the most important reason for tightening. One-fifth of dealers reported having tightened price terms for hedge funds. Worsening in general market liquidity and functioning as well as reduced willingness of their institution to take on risk were cited as the main reasons for the tightening. None of the dealers reported an easing of price terms for any counterparty types.

- Over one-fifth of dealers, on net, reported that nonprice terms, such as haircuts, maximum maturity, or covenants, tightened somewhat for trading REITs and nonfinancial corporations since the previous survey. A smaller net fraction of dealers reported a tightening for hedge funds.

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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**, a net fraction of one-fifth of dealers indicated decreased use of leverage by hedge funds, continuing a trend of decreasing hedge fund leverage observed in several recent surveys (see the exhibit "Use of Financial Leverage"). Meanwhile, respondents noted that the use of leverage by other client types was basically unchanged.

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

- One-fifth of dealers reported that initial margin requirements for average clients increased somewhat over the past three months for commodity derivatives and total return swaps referencing nonsecurities, and a smaller fraction of dealers reported such increases for foreign exchange derivatives. Initial margin requirements were reported to be mostly unchanged for other types of OTC derivatives.

- One-fifth of dealers reported an increase in the duration and persistence of mark and collateral disputes relating to OTC equity derivatives. The volume, duration, and persistence of mark and collateral disputes relating to other types of OTC derivatives remained unchanged on net.

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

- Net fractions of two-fifths, one-third, and one-fifth of dealers reported a tightening of funding terms with respect to collateral spreads, haircuts, and maximum maturity, respectively, for average clients in non-agency residential mortgage-backed securities (RMBS). One-third of dealers, on net, reported a tightening with respect to haircuts and collateral spreads for consumer asset-backed securities.

- Small net fractions of dealers reported a tightening of funding terms across all dimensions for agency RMBS and commercial mortgage-backed securities (CMBS). One-fifth of respondents, on net, reported a tightening of collateral spreads for CMBS. One-fourth of respondents indicated that collateral spreads for financing high-yield bonds have tightened.

- Demand for funding was largely unchanged for all asset classes (see the exhibit "Measures of Demand for Funding and Market Functioning").

- A net fraction of one-fifth of dealers indicated that liquidity and market functioning for non-agency RMBS and CMBS deteriorated over the past three months.[3]

[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.

Special Questions on Commodity Derivatives
(Questions 81–94)

Special questions asked dealers about client trading activity and terms offered to clients engaged in commodity derivatives trading.

Almost two-thirds of dealers responded that they have financial clients for whom commodity derivatives account for a substantial share of their trading activity. With regard to **commodity derivatives trading by these financial clients and the terms offered them**, these respondents indicated the following changes relative to the beginning of 2022:

- Net fractions of one-fourth and two-fifths of respondents indicated a tightening of price and nonprice terms, respectively, for financial clients.

- For centrally cleared derivatives positions, dealers may require clients to post additional initial margin beyond that required by central counterparties. Almost two-thirds of respondents reported that they increased the amount of additional initial margin they require from financial clients.

- On net, one-half of respondents reported that the total use of commodity derivatives by financial clients had increased.

- Two-fifths of respondents reported that the uncleared share of commodity derivatives transactions by financial clients had increased, and none reported a decrease. An increase in initial margin for cleared commodity derivatives relative to uncleared commodity derivatives was the most cited reason for this development. Some dealers cited an increase in expected variation margin flows for cleared commodity derivatives relative to uncleared commodity derivatives and a higher demand for customization as important reasons.

Three-fifths of dealers indicated that they have nonfinancial clients—for example, commodity traders, producers, and consumers—for whom commodity derivatives account for a substantial share of their trading activity. With regard to **commodity derivatives trading by these nonfinancial firms and the terms offered to them**, these respondents indicated the following changes relative to the beginning of 2022:

- One-half and one-third of respondents noted a tightening of price and nonprice terms, respectively, for nonfinancial clients.

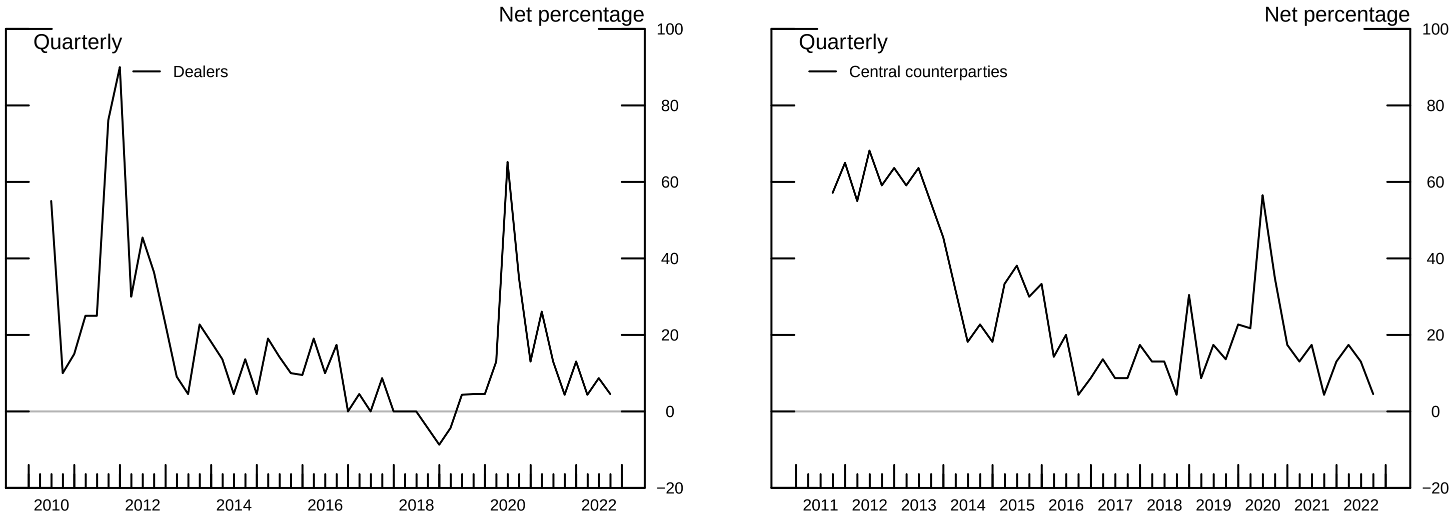
- One-fourth of respondents reported that they increased the amount of additional initial margin that they require from nonfinancial clients for centrally cleared derivatives positions. The remaining respondents indicated that the amount of additional margin had not changed.

- Respondents, on net, indicated that the total use of commodity derivatives by nonfinancial clients remained unchanged. Only a small net fraction of respondents reported an increase in the uncleared share of commodity derivatives transactions by nonfinancial clients.

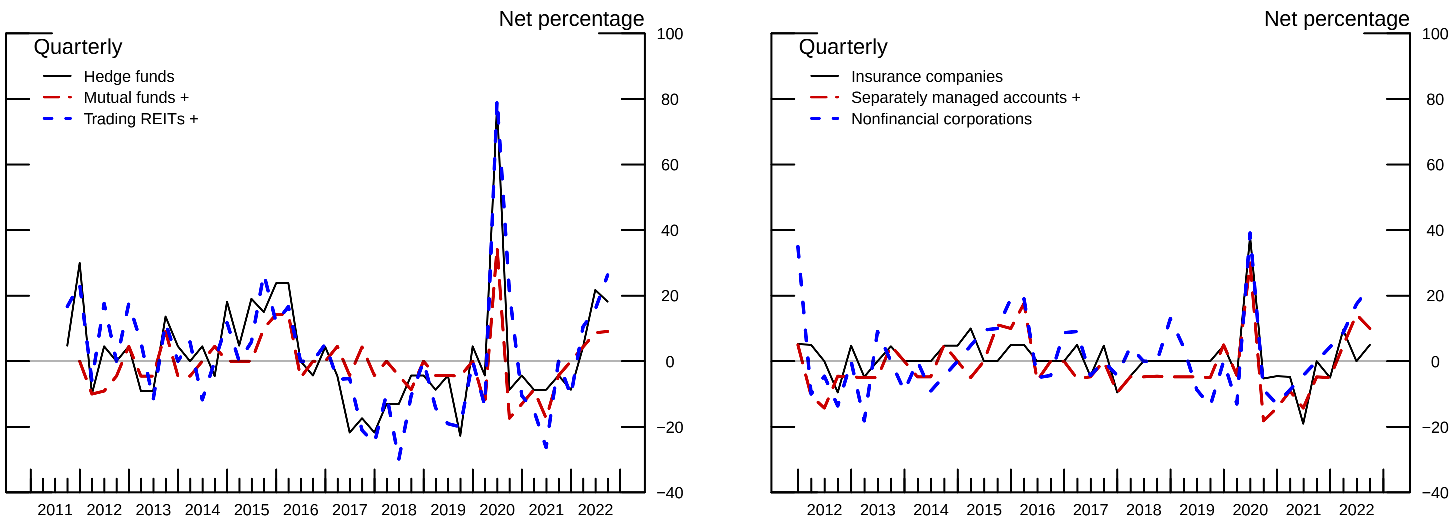
This document was prepared by Yesol Huh, Division of Research and Statistics, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Capital Markets Function, the Statistics Function, and the Markets Group at the Federal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

Management of Concentrated Credit Exposures and Indicators of Supply of Credit

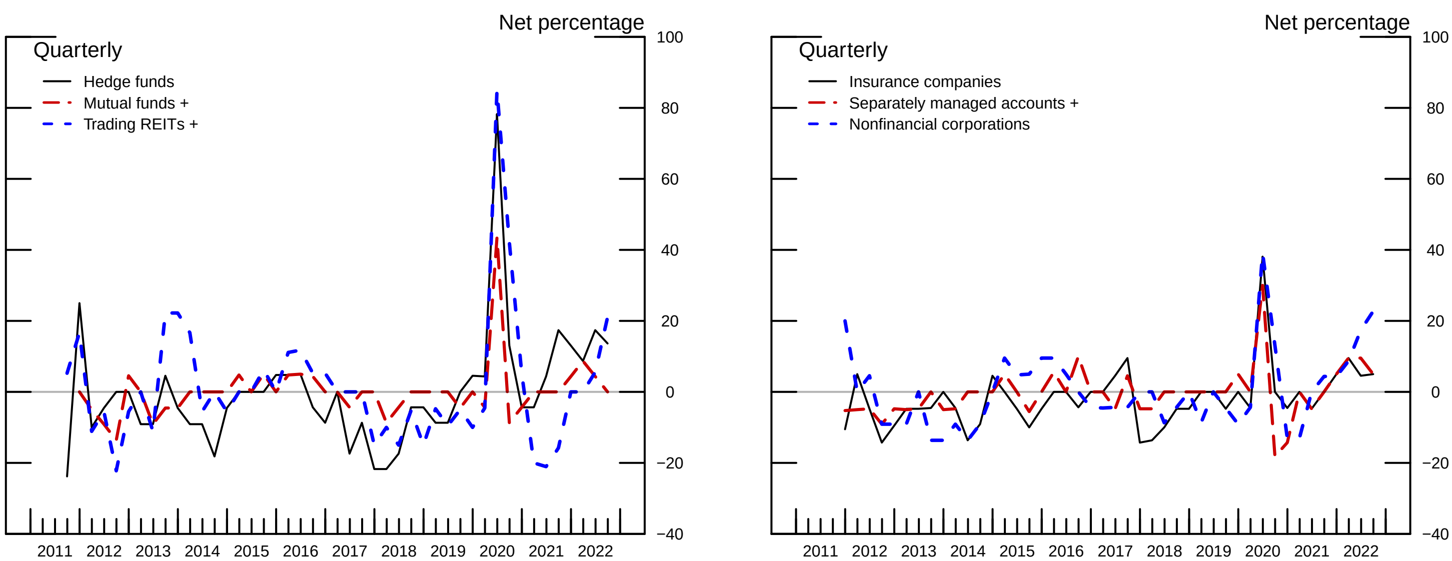
Respondents increasing resources and attention to management of concentrated exposures to the following:



Respondents tightening price terms to the following:



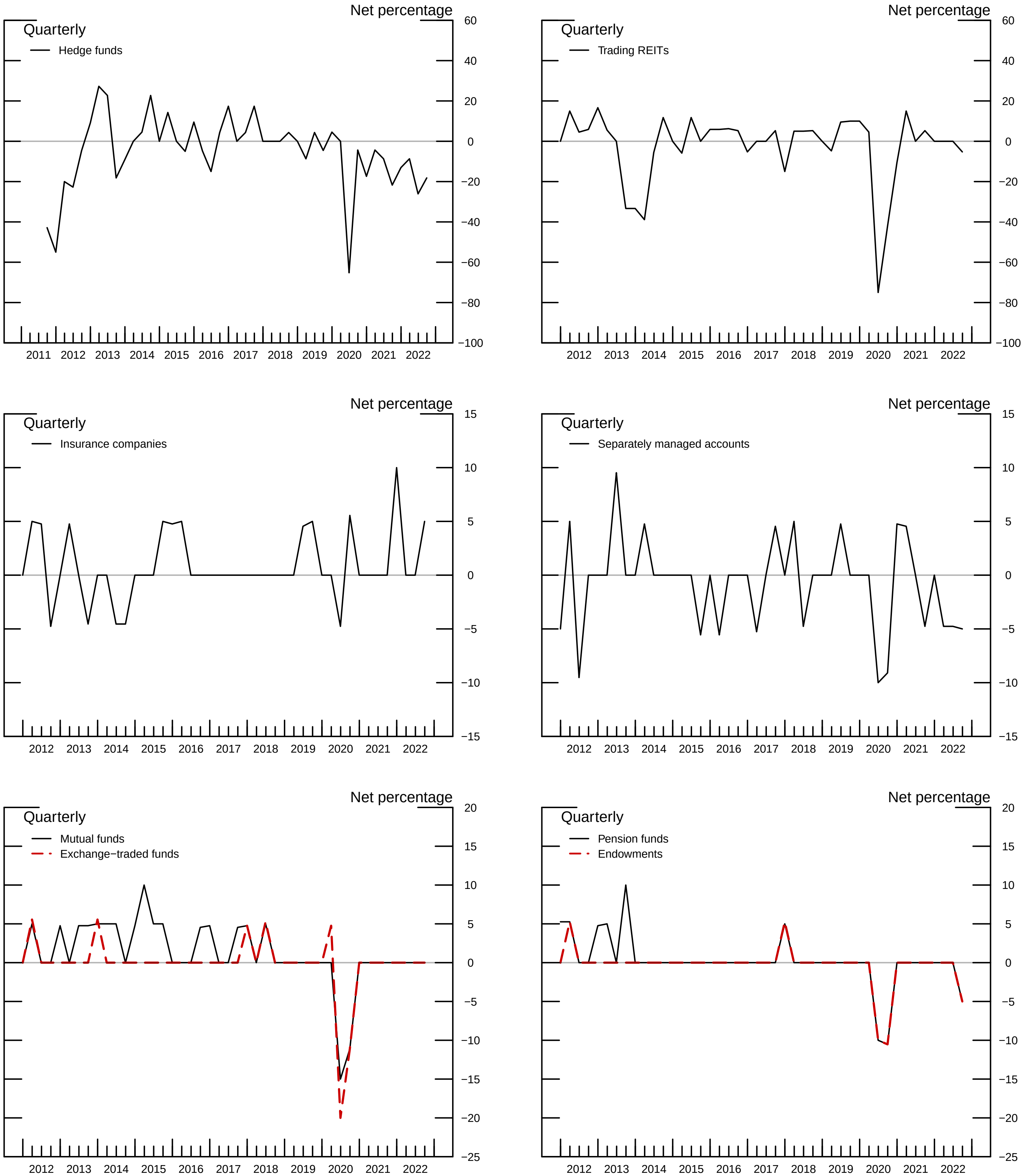
Respondents tightening nonprice terms to the following:



Note: REIT is real estate investment trust.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

Use of Financial Leverage

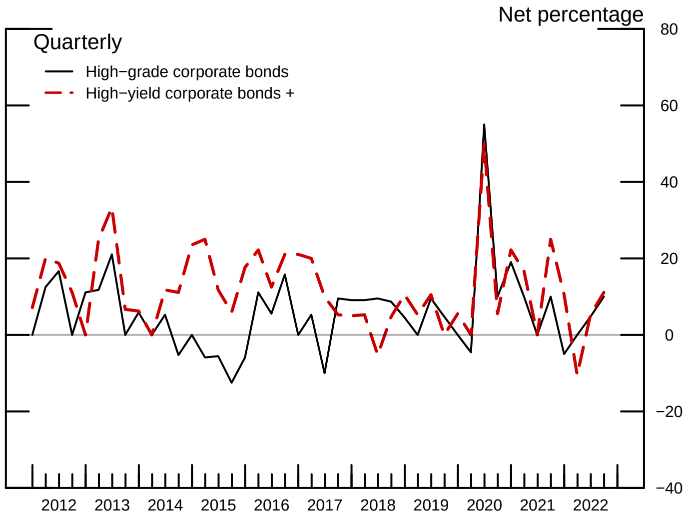
Respondents reporting increased use of leverage by the following:

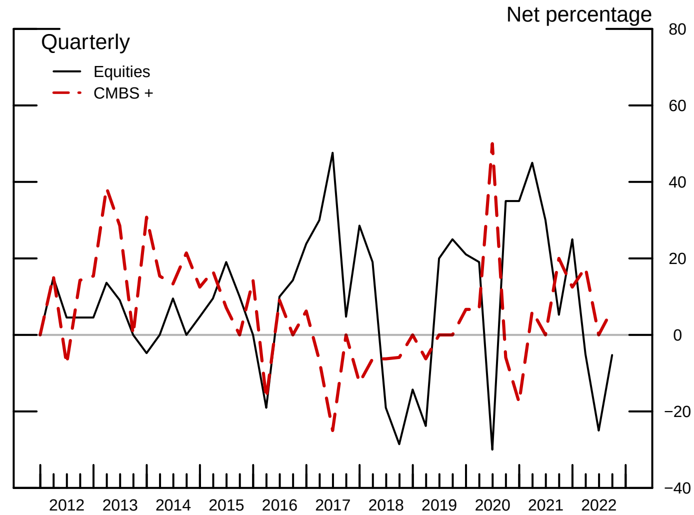


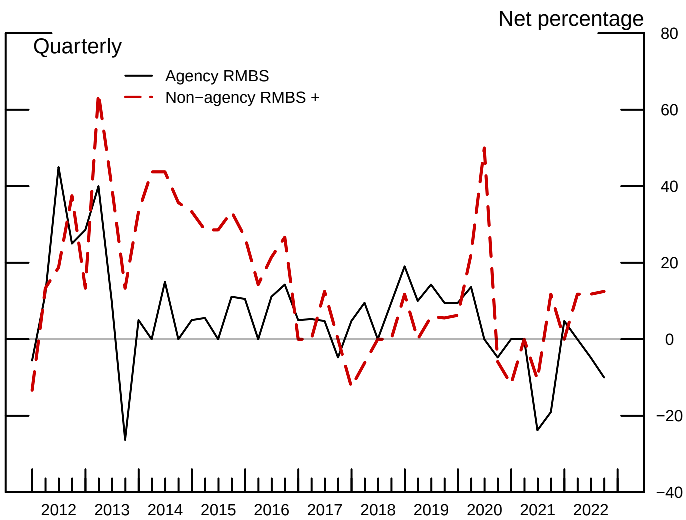
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

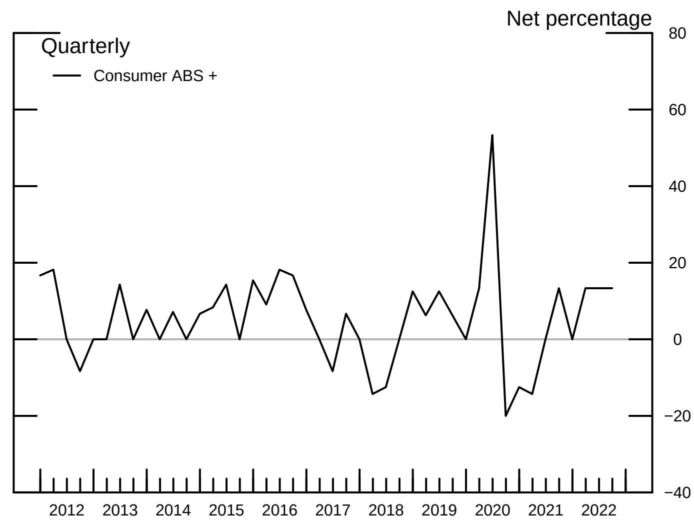
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

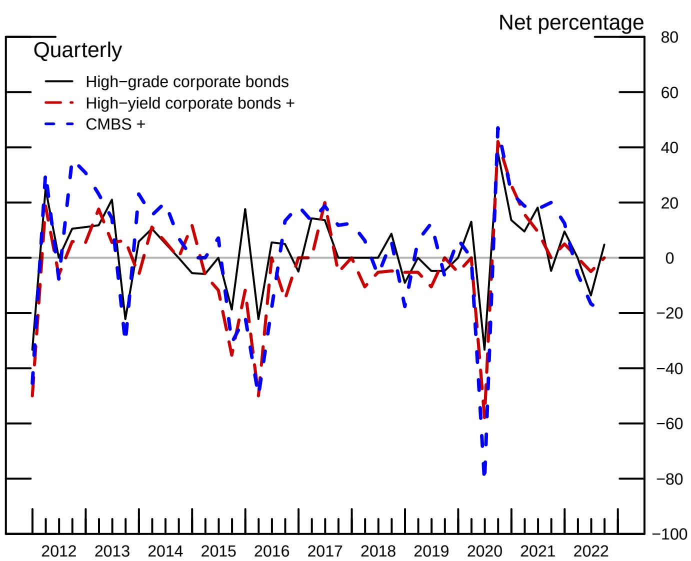


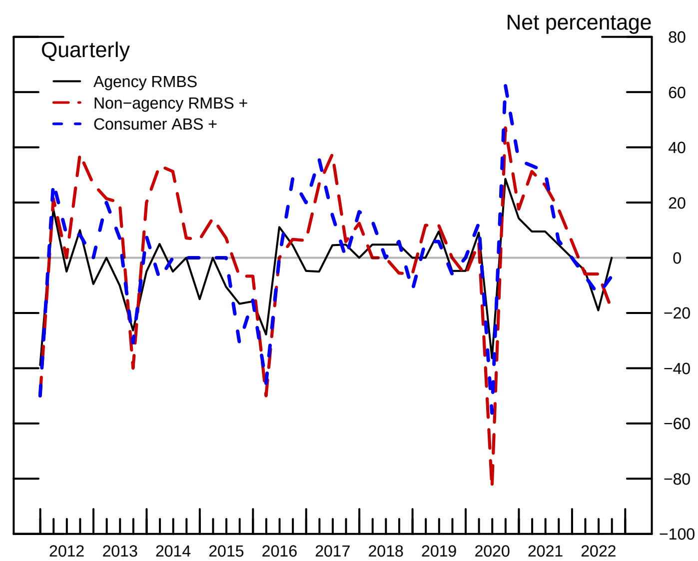






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





Note: CMBS is commercial mortgage−backed securities, RMBS is residential mortgage−backed securities, and ABS is asset−backed securities.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.