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Senior Credit Officer Opinion Survey on Dealer Financing Terms

March 2016

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

Summary

The March 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 changes in dealers' credit and counterparty exposures as a result of the recent decline in oil prices. The 21 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 February 17, 2016, and March 2, 2016. The core questions asked about changes between December 2015 and February 2016.[1]

Core Questions

(Questions 1–79)[2]

Responses to the core questions in March generally suggested little change over the past three months in the credit terms applicable to most classes of counterparties covered by the survey. The responses, however, offered a few insights regarding recent developments in dealer-intermediated markets:

- One-fifth of respondents reported an increase in resources and attention devoted to the management of concentrated credit exposure to dealers and other financial intermediaries over the past three months. A smaller fraction of respondents noted an increase in resources and attention devoted to the management of concentrated credit exposures to central counterparties and other financial utilities over the same period.
- Dealers indicated that they had generally tightened price terms on securities financing transactions and OTC derivatives across most classes of counterparties over the past three months, while nonprice terms were said to have changed little.

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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.

    - In particular, a net fraction of about one-fifth of respondents reported that price terms offered to hedge funds, nonfinancial corporations, real estate investment trusts, and separately managed accounts had been tightened somewhat.
    - The most-cited reason for the tightening in credit terms was a worsening in general market liquidity and functioning. Some respondents also cited their diminished availability of balance sheet or capital as well as higher internal treasury charges for funding as reasons for tightening terms.
- Dealers indicated that the use of financial leverage by all classes of counterparties was little changed over the past three months. 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, one-third of dealers reported an increase in haircuts on high-yield corporate bonds over the past three months and noted an increase in financing rates (collateral spreads over the relevant benchmark). In addition, one-fifth of respondents pointed to higher financing rates for commercial mortgage-backed securities (CMBS) over the same period, and a smaller fraction reported higher haircuts.
- As in the December survey, one-fifth of dealers pointed to an increase in demand for funding for high-yield corporate bonds over the past three months. By contrast, about one-fifth of respondents reported a decrease in demand for funding for equities and a smaller fraction reported a decrease in funding demand for CMBS.
- Dealers noted a deterioration in liquidity and market functioning across all asset classes, with more than two-fifths of respondents singling out high-yield corporate bond markets and one-third of respondents reporting a deterioration in liquidity and market functioning in CMBS and non-agency residential mortgage backed securities markets.

Special Questions on Exposure to Declines in Oil Prices
(Questions 81–85)

The recent decline in commodity prices, notably of oil, has reportedly created concerns on the part of market participants about the credit exposures of dealers to producers, processors, and other financial institutions. A set of special questions in the March survey sought information about dealers' oil-related credit and counterparty exposures arising from various transaction and product types as well as against various client types.

With respect to the materiality of exposures to recent declines in oil prices both at the overall institution level and through various transaction and product types, responses to the special questions revealed the following:

- About two-thirds of dealers characterized the materiality of current credit and counterparty exposures at the overall firm level as at least "somewhat significant."

The remaining respondents reported having either no significant exposures or no exposures at all.

- Based on responses from dealers that reported at least "somewhat significant" exposures at the overall firm level, the following insights about exposures through various transaction and product types are noteworthy:[3]
    - Almost all respondents noted having at least "somewhat significant" exposure to revolving lines of credit and other liquidity arrangements, including those provided to investment fund clients with energy-related positions.
    - About two-fifths of dealers reported having at least "somewhat significant" exposure to term loans, included those secured by proven oil reserves, while almost two-fifths of respondents pointed to trade financings (for example, letters of credit).
    - Smaller fractions of dealers noted having exposures to cleared and noncleared derivatives contracts with both financial and nonfinancial counterparties.
    - Only one respondent pointed to "very significant" exposures to structured transactions (for example, total return swaps, long-term oil purchase agreements, financing against estimated possible reserves, and transportation and storage agreements).

With regard to the client types driving the exposures for each of the transaction and product types covered in the survey, responses to the special questions revealed the following[4]:

- Dealers pointed to commodity mining and producing companies, commodity trade companies, and other nonfinancial corporations as important drivers of exposures through term loans, revolving lines of credit, and trade financings.
- A wider mix of client types were said to be at least somewhat important in accounting for exposures that arise from cleared and noncleared derivatives contracts with both financial and nonfinancial counterparties.

Responses to the special questions offered the following insights with respect to changes in exposures since mid-2014, when oil prices began to decline, at the overall institution level and through various transaction and product types:

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[3] The fractions in this section are calculated as a share of those dealers that report at least "somewhat significant" in their response to question 81.A. The tables provided with the public report are calculated as a share of all dealers who responded to the questions.

[4] The fractions in this section also are calculated as a share of those dealers that report at least "somewhat significant" in their response to question 81.A. The tables provided with the public report are calculated as a share of all dealers who responded to the questions.

- About two-fifths of all respondents indicated that their overall exposures had remained basically unchanged, while a similar fraction of respondents reported that exposures had declined somewhat.
    - About one-fourth of dealers pointed to a decrease in exposures to term loans and revolving lines of credit, while about one-third reported a decrease in exposures to derivative transactions with nonfinancial counterparties.
- To the extent that exposures have declined since mid-2014, almost all dealers noted that such a reduction had been implemented by lowering risk limits to the oil sector, to related counterparties, or to both, and by allowing positions to mature without reinvestment.

This document was prepared by Ashish Kumbhat, 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.