## The March 2017 Senior Credit Officer Opinion Survey on Dealer Financing Terms

The March 2017 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 use of exchange-traded funds (ETFs) that invest in fixed-income and equity markets by the respondents' various client types. 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 February 14, 2017, and February 27, 2017. The core questions asked about changes between December 2016 and February 2017.

## **Core Questions**

 $(Questions 1-79)^2$ 

Survey respondents generally reported little change in conditions over the past three months in pricing and across markets and instruments covered in the core questions of the survey. The responses, however, offered a few insights regarding the past three months in dealer-intermediated markets:

• Nearly all dealers reported that resources and attention devoted to the management of concentrated credit exposure to dealers and other financial intermediaries have remained basically unchanged, while a small fraction noted an increase with regard to central counterparties and other financial utilities (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). About one-fifth of dealers noted that changes to practices of central counterparties, such as margin requirements, have influenced the terms

<sup>&</sup>lt;sup>1</sup> 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").

<sup>&</sup>lt;sup>2</sup> Question 80, not discussed here, was optional and allowed respondents to provide additional comments.

- they applied to uncleared derivative transactions with clients at least to some extent.
- Respondents indicated that price and nonprice terms on securities financing transactions and OTC derivatives were little changed across all classes of counterparties (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit").
- Similarly, the use of financial leverage by all classes of counterparties was also reported to have remained unchanged by almost all respondents (see the exhibit "Use of Financial Leverage").
- With respect to securities financing transactions, dealers generally reported that
  financing rates (collateral spreads over the relevant benchmark) over the past
  three months had remained basically unchanged across various collateral types.
  About one-third and one-fifth of respondents noted an increase in funding demand
  for equities and high-yield corporate bonds, respectively, in part reflecting
  substantial increases in the prices of these assets (see the exhibit "Measures of
  Demand for Funding and Market Functioning").
- Regarding liquidity and market functioning, more than one-third of dealers that
  participate in the consumer asset-backed securities market indicated that liquidity
  and functioning had improved, while about one-fourth noted such improvement in
  the non-agency residential mortgage-backed securities market. Smaller net
  fractions of dealers suggested that liquidity and functioning in high-grade
  corporate bonds and commercial mortgage-backed securities have improved.

## **Special Questions on the Use of ETFs**

(*Questions* 81–90)

In the December 2013 survey, respondents were queried about their clients' use of ETFs that invest in fixed-income assets. The special questions in the March survey revisit this topic and also solicit similar information on the use of equity ETFs by different types of clients. In addition, the special questions ask about the reasons behind the changes in clients' use of fixed-income and equity ETFs since 2013 and inquire about dealers' expectations for changes in the use of these instruments, through the end of this year, as a result of the Department of Labor's Fiduciary Rule and the Securities and Exchange Commission's liquidity risk-management rules.

With regard to **clients' use of fixed-income ETFs**, dealers reported the following:

• About one-half and three-fifths of respondents indicated that separately managed accounts and hedge funds, respectively, use fixed-income ETFs at least to some

- extent. Smaller but significant fractions of dealers reported that mutual funds, pension plans, endowments, and insurance companies use fixed-income ETFs.<sup>3</sup>
- Similar to responses in the December 2013 survey, for each type of client, more than one-half of dealers indicated that fixed-income ETFs are used by their clients for both longer-term strategic and shorter-term tactical positioning, as opposed to predominantly one of the two purposes. Slightly more than two-fifths of respondents reported that their hedge fund clients use fixed-income ETFs predominantly or almost exclusively for shorter-term tactical positions.
- Net fractions of around three-fifths of respondents noted that the use of fixedincome ETFs has increased since December 2013 by each of their client types
  (that is, hedge funds, mutual funds, pension plans, endowments, insurance
  companies, and separately managed accounts). Of the respondents who noted a
  change in ETF use, almost all cited client-specific factors (such as changes to
  risk-management practices or business model) and other financial market
  developments as at least somewhat important drivers of the change. In addition, a
  bit more than one-half of the respondents pointed to the expected implementations
  of the liquidity risk-management and fiduciary rules as at least somewhat
  important reasons for the change. Some dealers also cited other factors such as
  lower fees, liquidity considerations, and the ease of use of these instruments as
  reasons for the change.
- One-fifth to one-half of dealers indicated that they anticipate various types of clients will increase their use of fixed-income ETFs as a result of the new fiduciary and liquidity risk-management rules through the end of this year.

With respect to **clients' use of equity ETFs**, respondents indicated the following:

- Nearly three-fifths to more than three-fifths of respondents indicated that equity ETFs are used at least to some extent across client types. Of note, almost all respondents indicated that hedge fund clients use equity ETFs in managing their portfolios to at least some extent.
- Similar to the responses to the questions about clients' use of fixed-income ETFs, net fractions of one-half or more of respondents reported that these instruments are used for both longer-term strategic and shorter-term tactical positioning by all client types. A net fraction of about two-fifths of dealers indicated that hedge funds use equity ETFs predominantly or almost exclusively for shorter-term tactical positions.

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<sup>&</sup>lt;sup>3</sup> In the December 2013 survey, about one-third to two-fifths of dealers reported some use of ETFs by their clients. Note that, at that time, no dealers pointed to a significant use of these instruments; however, in the current survey a small fraction of respondents cited significant use of fixed-income ETFs by their clients.

- Net fractions of two-fifths or more of respondents noted that the use of equity ETFs had increased somewhat or substantially since December 2013 by each of their client types. As is the case for fixed-income ETFs, of the respondents who noted a change in their clients' use of equity ETFs over the past three years, almost all cited client-specific factors such as changes to risk-management practices or business model as at least somewhat important drivers of the change. Dealers also pointed to the expected implementation of the fiduciary rule (cited by approximately one-half of dealers) and the liquidity risk-management rule (cited by approximately one-third of dealers) as at least somewhat important in driving the change.
- In contrast with responses on fixed-income ETFs, only small fractions of dealers indicated that they expect their clients' use of equity ETFs to increase through the end of the year as a result of the new fiduciary and liquidity risk-management rules.

This document was prepared by Ayelen Banegas, 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.