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

Summary

The September 2019 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 the overall level of liquidity in the E-mini S&P 500 futures market and about the potential for liquidity to decline in this market when price volatility increases. 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 August 13, 2019, and August 28, 2019. The core questions asked about changes between June 2019 and August 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:

- About one-fourth of dealers, on net, reported an easing in price terms to hedge fund clients, and about one-fifth reported an easing in price terms to their trading real estate investment trust clients. Most of the respondents indicating an easing in price terms pointed to more aggressive competition from other institutions as a reason for easing. Price terms were basically unchanged for other counterparty types (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). Nonprice terms were reportedly unchanged for all classes of counterparties.
- One-fifth of respondents indicated that efforts to negotiate more-favorable price and nonprice terms have increased for hedge funds over the past three months.
- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types.

[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.

Regarding **securities financing transactions**, respondents indicated the following:

- Similar to the previous quarter, one-fourth 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 an easing in effective financing rates for non-agency residential mortgage-backed securities for their most-favored clients, and one-fourth reported an easing for their average clients. One-fourth of dealers also reported a decrease in the effective financing rates for consumer asset-backed securities for their average and most-favored clients over the past three months. Funding terms were little changed across other asset classes queried in the survey.
- Dealers 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 on OTC derivatives were basically unchanged for average and most-favored clients.
- Most dealers reported that the volume and duration of mark and collateral disputes have not changed across all OTC derivatives. A small net fraction of dealers reported a decrease in the duration and persistence of mark and collateral disputes for OTC equity derivatives.

Special Questions
(Questions 81–86)

In recent months, press reports have pointed to reduced liquidity in the E-mini S&P 500 futures market. In the September survey, dealers were asked about changes in equity futures market liquidity and changes in the fragility of liquidity—defined as the tendency of liquidity to significantly decline when price volatility increases. Specifically, the survey's special questions asked about changes between January 2018, the month immediately preceding the spike in equity volatility in February 2018, and the most recent quarter-end in June 2019. The questions focused on the most important reasons for the changes and the most important effects of the changes.

[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.

With respect to **the current level of liquidity in the equity futures market**, respondents reported the following:

- About one-half of respondents, on net, reported a deterioration in the current level of liquidity in the equity futures market compared with the January 2018 level.
- About one-half of the dealers that reported a deterioration in liquidity cited higher levels of realized equity return volatility as the most important reason for the deterioration. The next two most important reasons for the deterioration are the decreased willingness of principal trading firms (PTFs) to provide liquidity and an increase in the concentration of firms that provide liquidity, cited by one-half and one-third of dealers, respectively.[3]
- One-third of the dealers that reported a deterioration in liquidity cited increased volatility in the equity market as a possible consequence of the deterioration, one-fourth cited the decrease in the willingness of their clients to take on risk, and one-fourth did not identify any significant consequences of the deterioration in liquidity.[4]

With respect to **the current fragility of liquidity in the equity futures market**, respondents reported the following:

- About one-fourth of respondents, on net, reported that the current fragility of liquidity in the equity futures market increased compared with the January 2018 level.
- About one-half of the dealers that reported an increase in the fragility of liquidity cited the decreased willingness of PTFs to provide liquidity during times of high price volatility as the most important reason for the increase. The next two most important reasons for the increase in the fragility of liquidity are the decreased willingness of non-PTFs to provide liquidity during times of high price volatility and higher levels of realized equity return volatility, each cited by one-third of dealers.
- One-half of the dealers that reported an increase in the fragility of liquidity cited the decrease in the willingness of their clients to take on risk as a possible consequence of the deterioration, one-fourth cited the decrease in their own willingness to take on risk, and about one-third did not identify any significant consequences of the increase in the fragility of liquidity.

---

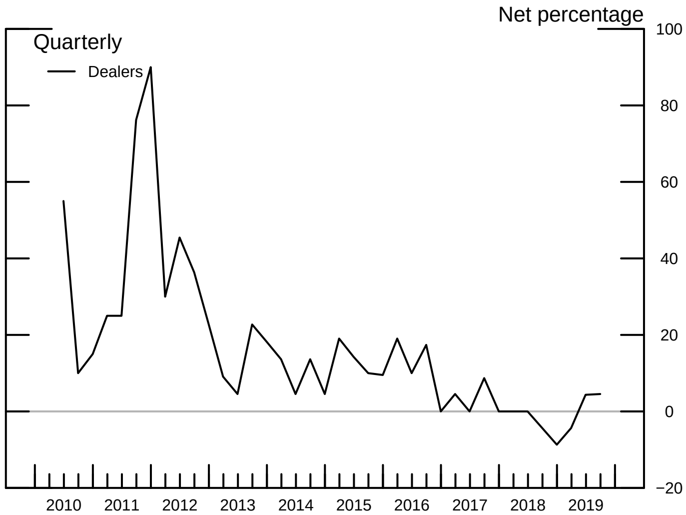
[3] A PTF is defined as a principal investor who deploys proprietary low-latency automated trading strategies and who may be registered as broker-dealer but does not have clients as in a typical broker-dealer business model; see U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Reserve Bank of New York, U.S. Securities and Exchange Commission, and U.S. Commodity Futures Trading Commission (2015), *Joint Staff Report: The U.S. Treasury Market on October 15, 2014* (Washington: Department of the Treasury, Board of Governors, FRBNY, SEC, and CFTC, July), https://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf.

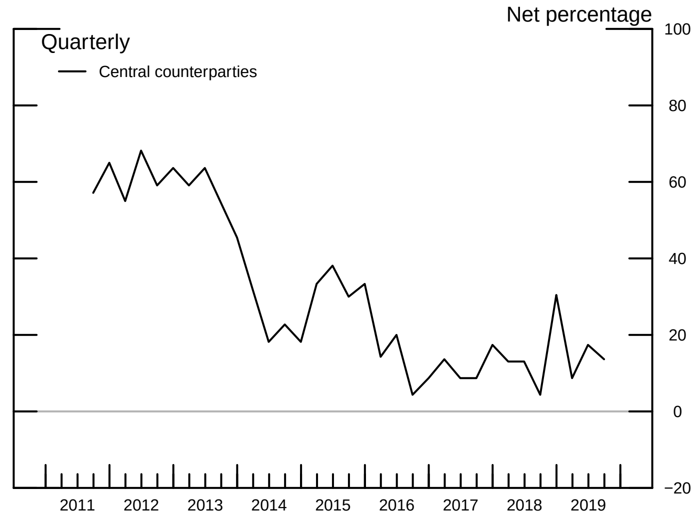
[4] The dealers that cited increased volatility as a consequence of the deterioration in liquidity selected "other" in the survey question and wrote in a free-form text response.

This document was prepared by Pawel Szerszen, 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.

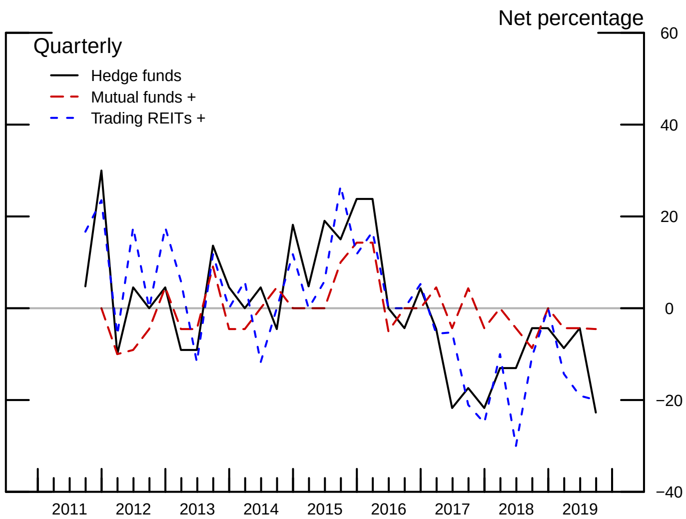
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

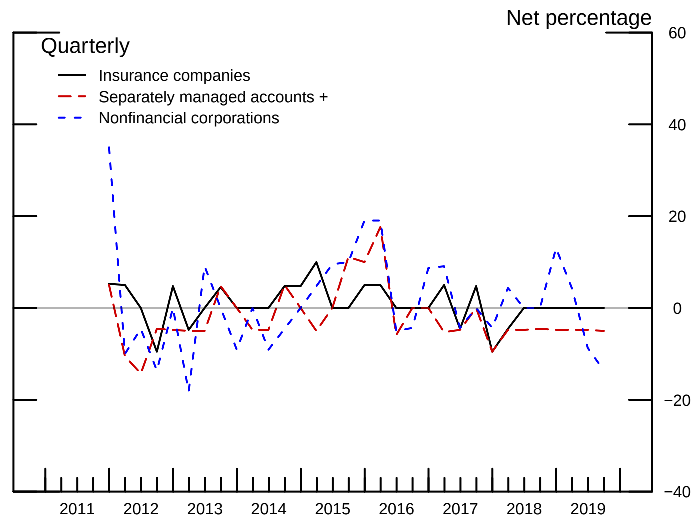
Respondents increasing resources and attention to management of concentrated exposures to the following:



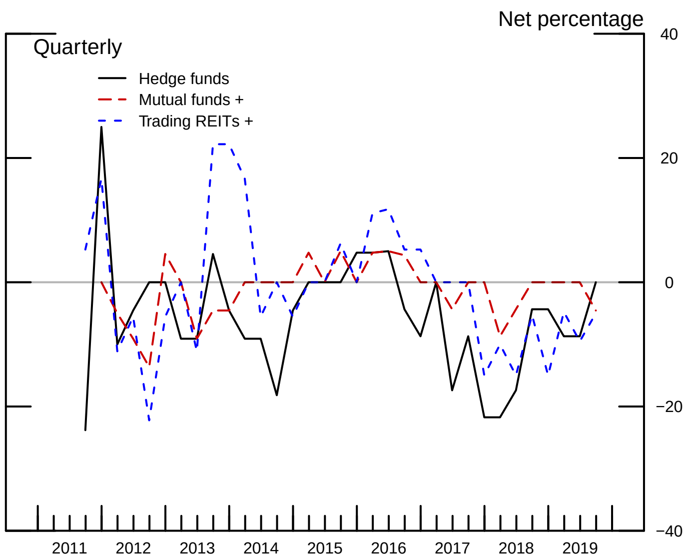


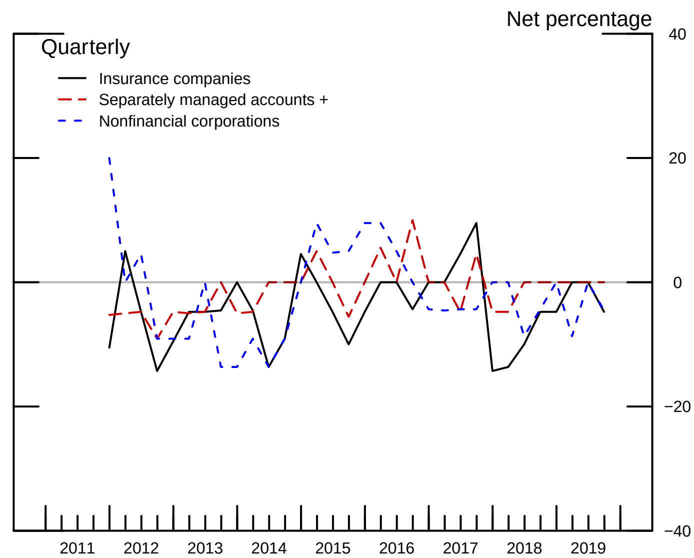
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

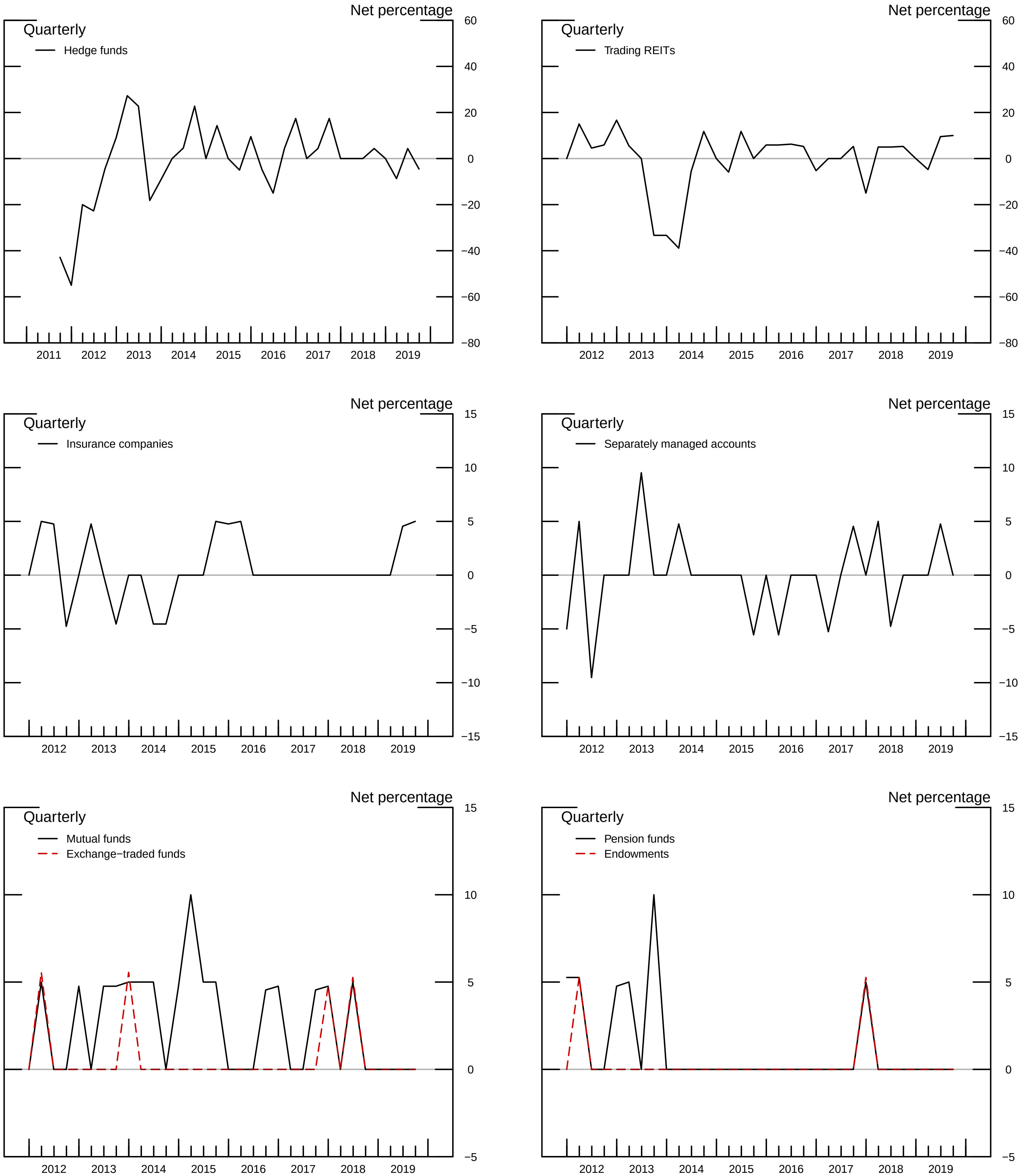




"+" indicates the question was added to the survey in September 2011.

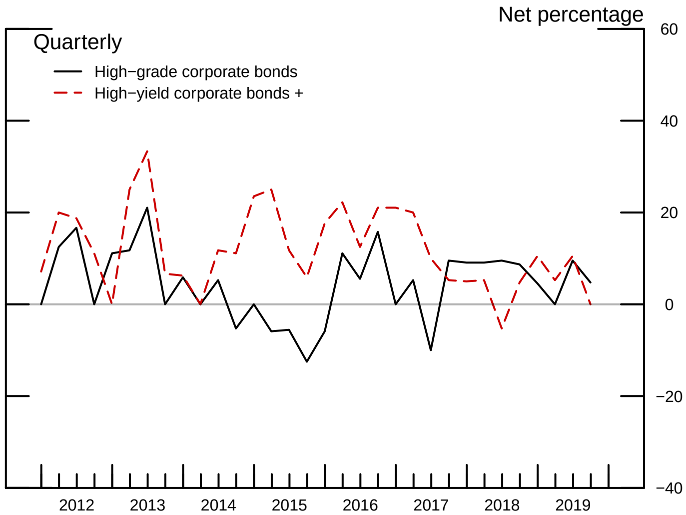
Use of Financial Leverage

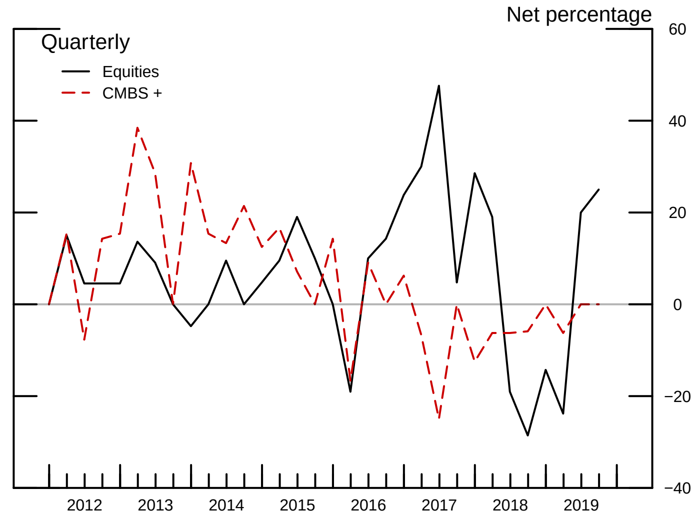
Respondents reporting increased use of leverage by the following:

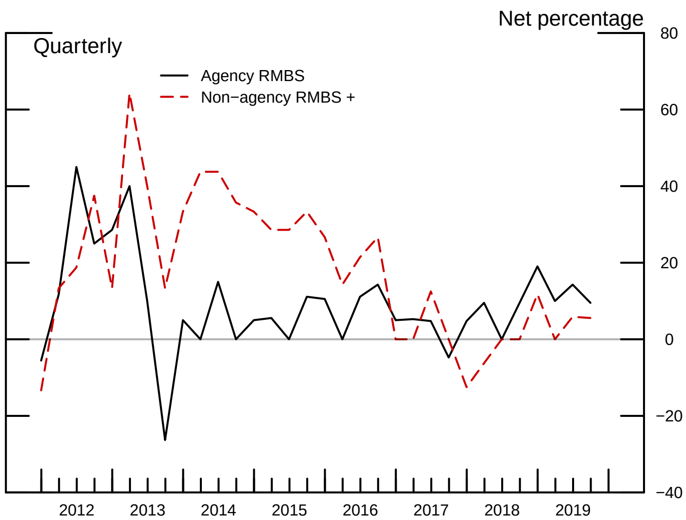


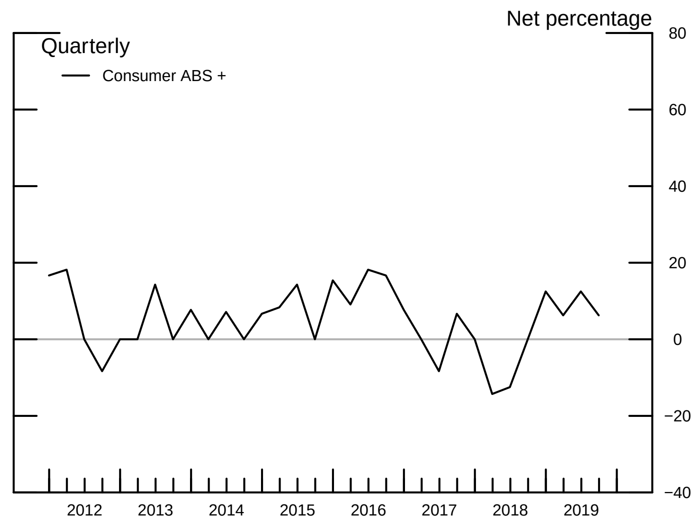
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

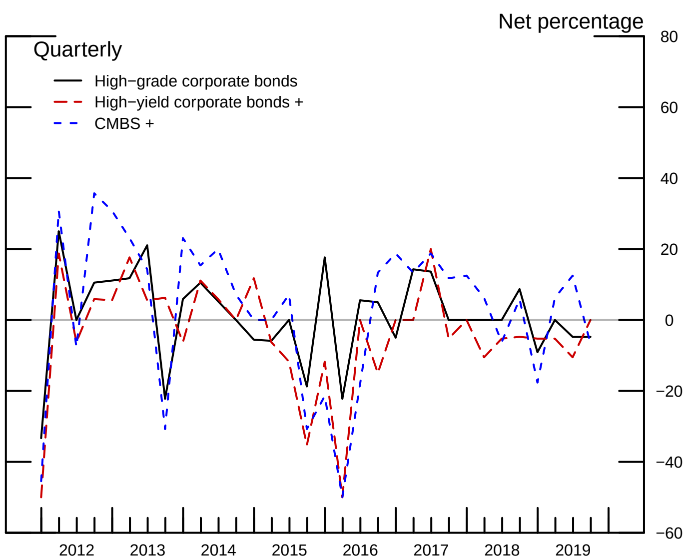


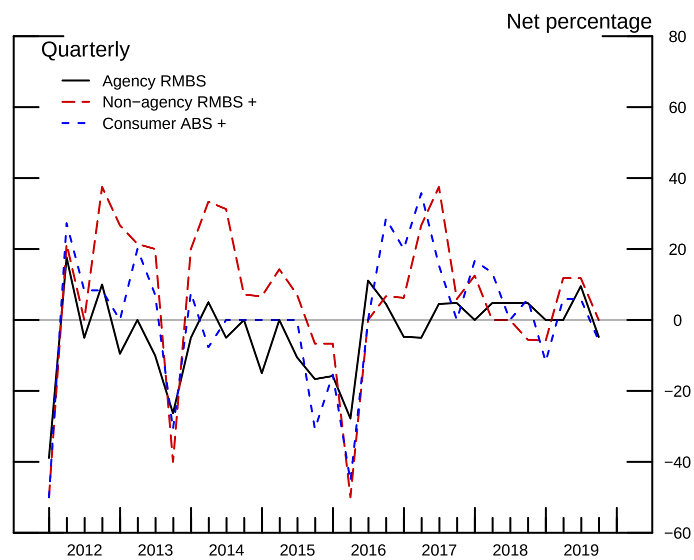






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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