The December 2020 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The December 2020 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 regarding dealers' current and expected capacity to intermediate Treasury securities. The survey was conducted during the period between November 10, 2020, and November 26, 2020. The core questions asked about changes between September 2020 and November 2020.[1]

Core Questions
(Questions 1–79)[2]

Responses to the core questions in the December survey offered a few insights into recent changes 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 revealed the following:

- Price and nonprice terms on securities financing transactions and OTC derivatives were generally unchanged across most classes of counterparties, although a small net fraction of dealers reported easing of price terms, nonprice terms, or both offered to mutual funds, exchange-traded funds (ETFs), separately managed accounts, and nonfinancial corporates (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). Approximately one-fourth of dealers indicated an increase in hedge funds' efforts to negotiate more-favorable price and nonprice terms.
- A small fraction of respondents indicated an increase in resources and attention devoted to managing concentrated credit exposure to dealers and central counterparties, and roughly one-fifth of respondents reported that changes in central counterparty practices have influenced the credit terms they offer to clients on bilateral transactions that are not cleared.
- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types, although a small net fraction of dealers indicated a reduction in the duration of such disputes with mutual funds and ETFs.

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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**, on net, dealers indicated little change over the past three months for most counterparties, although one-fifth of dealers indicated a decrease in hedge funds' use of leverage (see the exhibit "Use of Financial Leverage").

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

- Nonprice terms in master agreements for OTC derivatives remained largely unchanged, although a small fraction of dealers reported that initial margin requirements on OTC derivatives for equities increased for both average and most-favored clients.
- A small fraction of dealers reported a decrease in the posting of nonstandard collateral permitted under relevant arrangements.
- The volume and duration of mark and collateral disputes remained largely unchanged over the past three months.

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

- On net, one-third of dealers reported increased demand to fund equities, one-fifth reported increased demand to fund high-grade and high-yield corporate bonds, and one-fifth reported decreased demand to fund commercial mortgage-backed securities (CMBS) (see the exhibit "Measures of Demand for Funding and Market Functioning"). Demand for funding remained largely unchanged across all other asset classes.
- Small net fractions of dealers reported easing of funding terms for various types of securities. Most notably, over one-half of dealers reported easing of haircuts for non-agency residential mortgage-backed securities and CMBS. On net, dealers reported that haircuts for agency mortgage-backed securities remained unchanged.
- A small fraction of dealers reported a decrease in the duration of mark and collateral disputes across all collateral types.
- Approximately one-third of respondents indicated an improvement in liquidity and market functioning for the high-yield bond and consumer asset-backed securities market. A smaller net fraction of respondents also indicated an improvement for other markets.

Special Questions on Dealers' Capacity to Intermediate U.S. Treasury Securities
(Questions 81–90)

The turmoil in U.S. Treasury markets in March of this year highlighted dealers' unique role in intermediating Treasury cash and securities financing transactions. In the special questions, dealers were asked about recent developments in their capacity to intermediate Treasury securities—broadly defined as their ability to provide Treasury intermediation services to counterparties and clients, including providing immediacy of execution in Treasury cash markets, clearing and settlement, repurchase agreements (repos) and reverse repos, and securities lending and borrowing. Specifically, dealers were asked about their current capacity to intermediate Treasury securities, the factors influencing their capacity to intermediate Treasury securities in March 2020, and their expectations regarding counterparties' and clients' demand for Treasury intermediation services over the next year.

With respect to dealers' current capacity to intermediate Treasury securities, dealers reported the following:

- On net, approximately one-third of respondents indicated that their capacity to intermediate Treasury securities increased since January 2020.
    - Dealers most frequently cited Federal Reserve asset purchases and expected changes in Treasury issuance as the most important reasons behind their increased capacity to intermediate Treasury securities.
    - A small fraction of respondents also cited changes in their risk assessment of the Treasury market and regulatory changes as contributing factors.
- With regard to the **amount of capital and available funds committed to Treasury intermediation**, dealers were asked what fraction is dedicated to different services. Respondents indicated the following:
    - Approximately one-half of dealers reported that less than 20 percent of their committed capital and available funds is dedicated to provide immediacy in the execution of buying and selling securities. Roughly two-fifths indicated that between 20 and 60 percent is dedicated to providing immediacy.
    - There was a fair amount of heterogeneity in dealers' reported fractions of capital and available funds dedicated to provide securities financing transactions. However, roughly one-third of all dealers reported that over 80 percent of their committed capital is dedicated to this service.
    - Nearly all respondents indicated that less than 20 percent of their committed capital and available funds is dedicated to provide clearing and settlement services.

With respect to factors influencing dealers' capacity to intermediate Treasury securities in March 2020, dealers reported the following:

- Three-fifths of dealers indicated that their most constrained service was the provision of immediacy of execution in buying and selling securities.
- Approximately one-half of dealers indicated that they reevaluated the amount of capital and available funds committed to Treasury intermediation on an intraday or daily basis during that episode, while roughly one-fifth of dealers reported that they did not reevaluate the amount of capital or liquid funds committed to Treasury intermediation.

With respect to dealers' expectations of demand by their counterparties and clients for Treasury intermediation services over the next year, dealers reported the following:

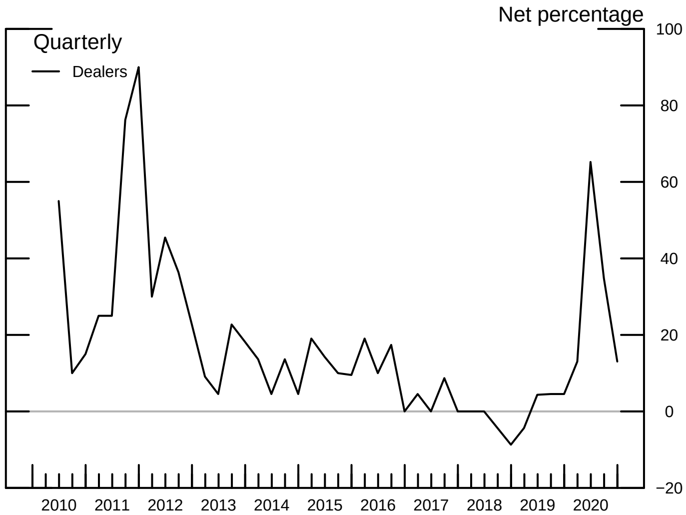
- On net, approximately two-fifths of dealers expected an increase in their counterparties' and clients' demand for Treasury intermediation services.
    - Dealers most frequently cited the expected change in Treasury issuance as the most important factor driving the anticipated increase in their counterparties' and clients' demand. Federal Reserve asset purchases and changes in counterparties' and clients' risk assessments of the Treasury market were cited as the second and third most important factors, respectively.

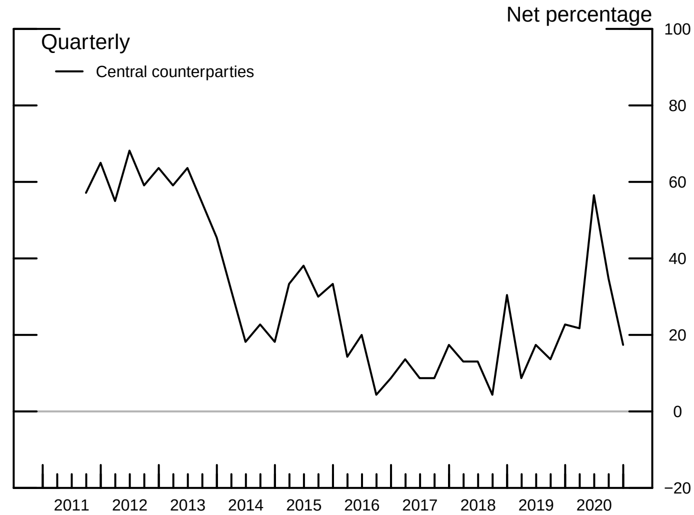
- One-third of all dealers reported that they expect to increase the amount of capital or funds committed to Treasury intermediation.

This document was prepared by Sebastian Infante, 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.

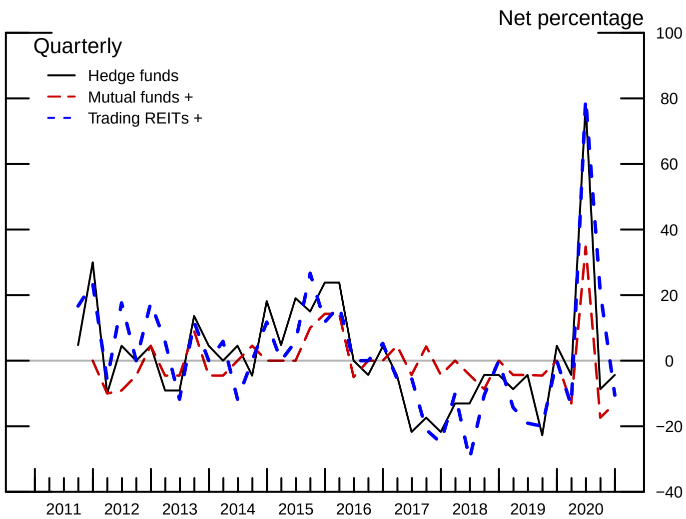
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

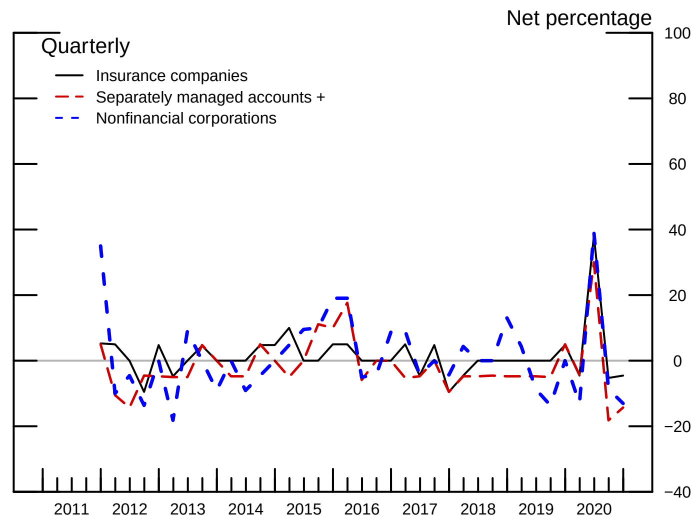
Respondents increasing resources and attention to management of concentrated exposures to the following:



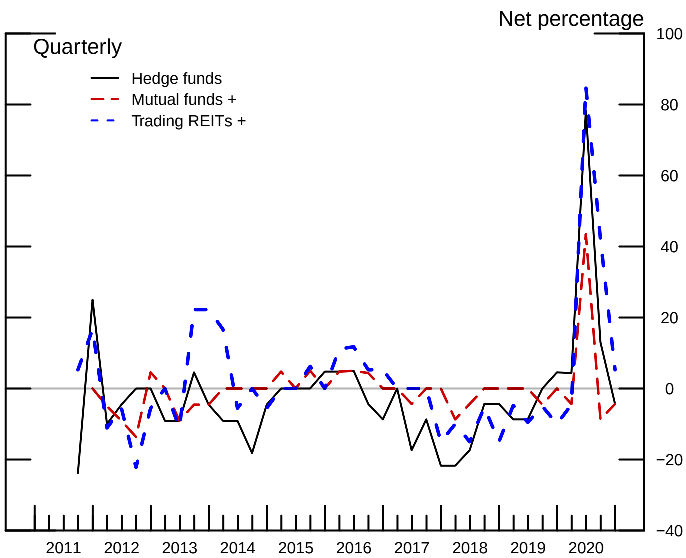


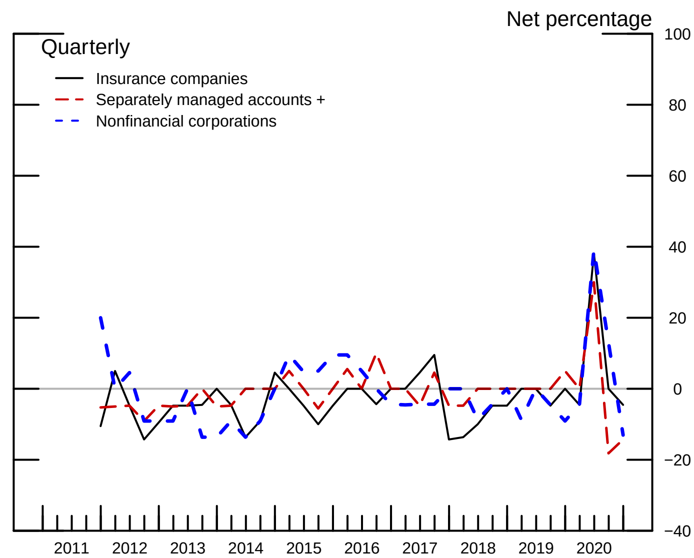
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

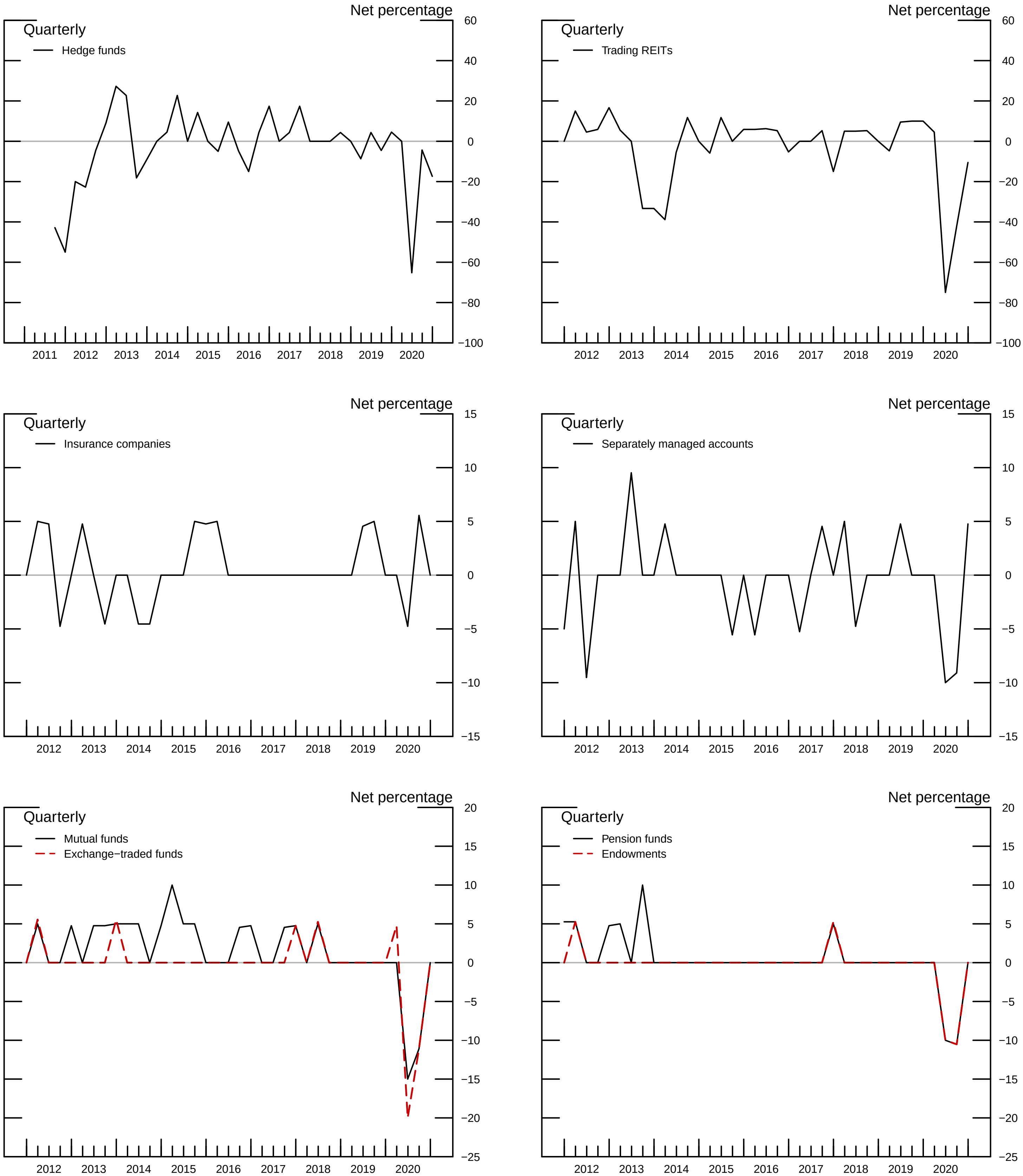




+ The question was added to the survey in September 2011.
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

Use of Financial Leverage

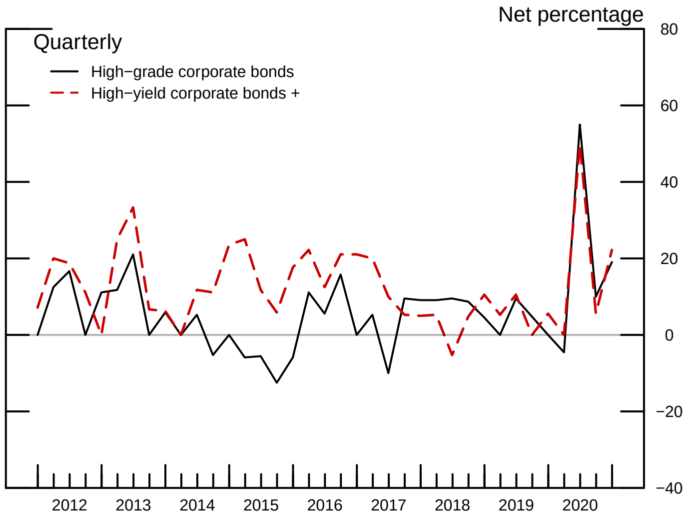
Respondents reporting increased use of leverage by the following:

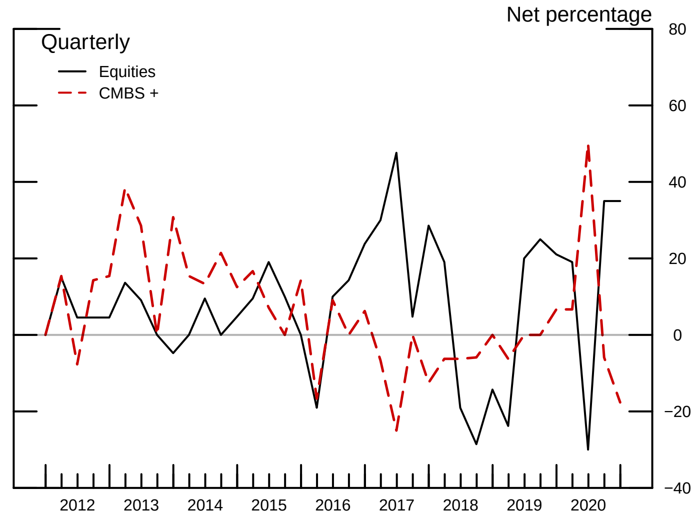


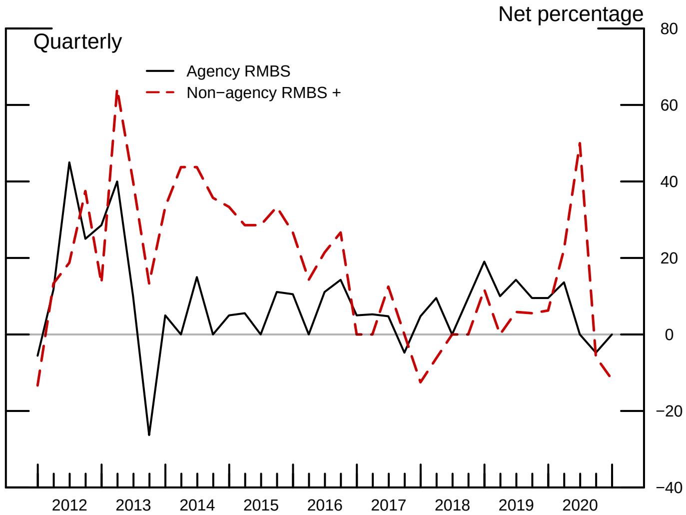
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

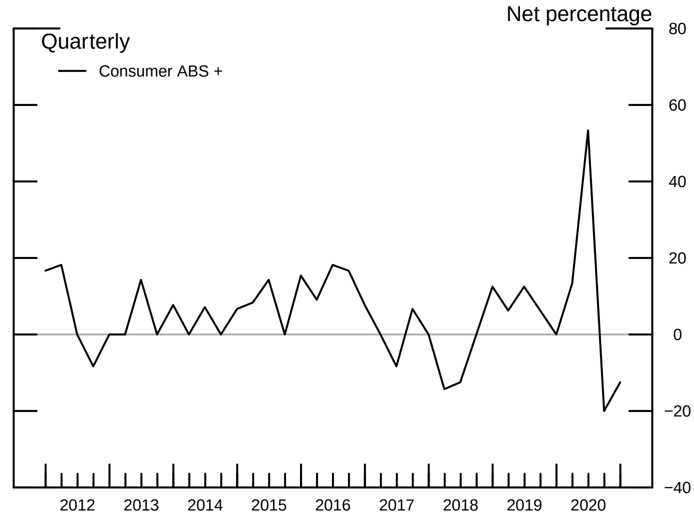
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

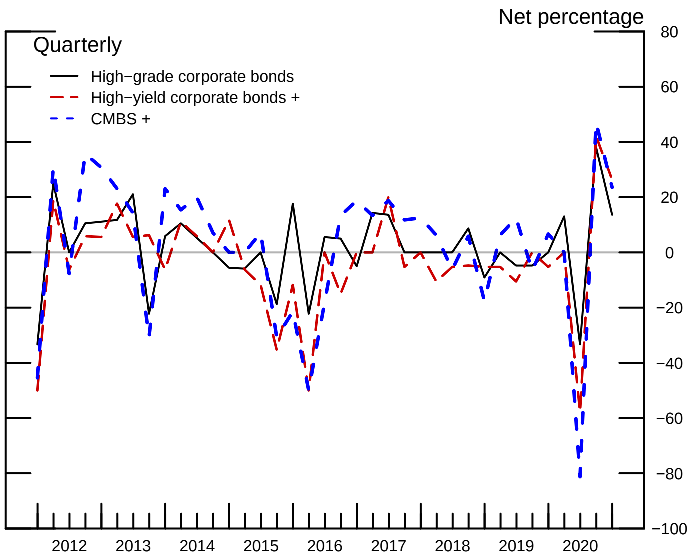


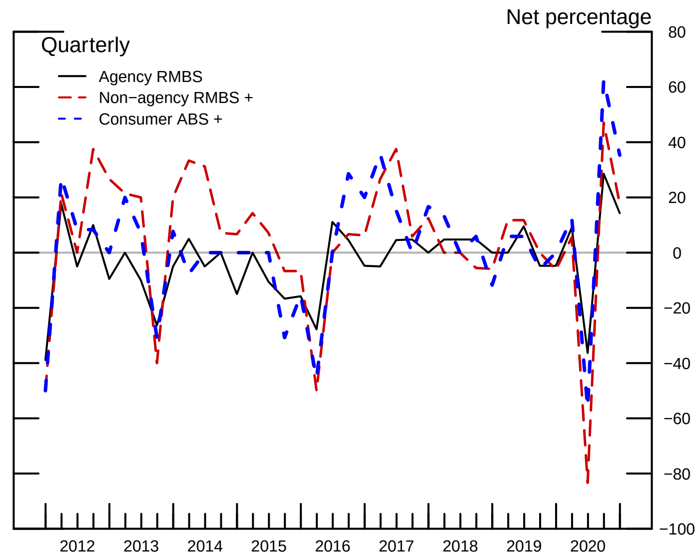






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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