

# The June 2021 Senior Credit Officer Opinion Survey on Dealer Financing Terms

## Summary

The June 2021 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 the use of synthetic prime brokerage (PB) arrangements as well as risk management associated with the provision of such services by prime brokers to a broad range of clients. The 23 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 May 11, 2021, and May 24, 2021. The core questions asked about changes between mid-February 2021 and mid-May 2021.<sup>1</sup>

## Core Questions

(Questions 1–79)<sup>2</sup>

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. However, for trading real estate investment trusts (REITs), about one-fourth of dealers, on net, reported an easing of price terms and about one-fifth, on net, reported an easing of nonprice terms. A small net fraction of dealers also reported easing of price terms offered to mutual funds, exchange-traded funds, separately managed accounts, and insurance companies (see the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit”). Approximately one-fourth of dealers indicated an increase in trading REITs’ efforts to negotiate more-favorable price and nonprice terms, and a small fraction reported the same for insurance companies.
- Small net fractions of respondents indicated that resources and attention devoted to managing concentrated credit exposure to dealers and central counterparties increased and that changes in central counterparty practices have influenced, to at least some extent, the credit terms they offer to clients on bilateral transactions that are not cleared.

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

- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types, although small net fractions of dealers indicated a reduction in the volume of such disputes with hedge funds, insurance companies, and nonfinancial corporations.

With respect to clients' **use of financial leverage**, on net, dealers indicated little change over the past three months for all types of counterparties (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. Small net fractions of dealers reported that initial margin requirements on OTC derivatives for equities and total return swaps for nonsecurities increased for average clients.<sup>3</sup>
- A small net 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 for most types of contracts. A small net fraction of respondents indicated an increase in the volume of mark and collateral disputes for equities, while a similar fraction indicated a decrease in the volume of disputes for commodities.

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

- Terms under which various types of securities are funded have eased for most asset classes since the previous survey. Most notably, for non-agency residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and consumer asset-backed securities (ABS), about one-half of respondents indicated easing of funding terms with respect to haircuts and collateral spreads for both average and most-favored clients.
- On net, about one-third of dealers reported increased demand to fund equities. For agency RMBS, about one-fourth of respondents, on net, reported decreased demand for funding, although a small net fraction reported increased demand for term funding. Demand for funding for other asset classes was largely unchanged (see the exhibit "Measures of Demand for Funding and Market Functioning").
- Approximately one-third of respondents indicated an improvement in liquidity and market functioning for the consumer ABS market. Smaller net fractions of respondents also indicated an improvement for the high-grade bond, non-agency RMBS, and CMBS markets.
- The volume and duration of mark and collateral disputes remained unchanged, on net, across all collateral types.

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<sup>3</sup> Nonsecurities are investments that cannot be traded on public exchanges, such as bank loans—including, for example, commercial and industrial loans and mortgage whole loans.

## Special Questions on Synthetic Prime Brokerage (Questions 81–90)

In the special questions, dealers were asked about the use of synthetic PB arrangements and risk management associated with the provision of such services to a broad range of clients. Under such arrangements, levered exposure is created through total return swaps and other OTC derivatives rather than through traditional secured financing such as margin lending or repurchase agreements. The questions were similar to those posed to dealers in the special questions of the June 2016 survey.

With respect to the **use of synthetic PB by clients**, dealers reported the following:

- About one-half of respondents reported that synthetic PB was widely used by equity long-short hedge fund clients.<sup>4</sup> For other client types, including other hedge funds, separately managed accounts and family offices, other asset managers, and proprietary trading firms and broker-dealers, over one-half of respondents indicated that synthetic PB was used by at least some clients or in some situations.
- On net, dealers indicated that the use of synthetic PB has increased since June 2016 across all client types. In particular, over one-half of respondents indicated that it had increased for equity long-short hedge funds, other hedge funds, and proprietary trading firms and broker-dealers.
- Access to foreign markets was identified as the most important reason motivating clients' use of synthetic PB, with nearly one-half of dealers citing it as very important.<sup>5</sup> A majority of dealers indicated that each of the other reasons listed, including tax considerations, availability of greater leverage, ease in establishing and adjusting positions, and preserving confidentiality of proprietary trading strategies, was at least somewhat important.

With respect to **hedging of client swaps under synthetic PB**, dealers reported the following:

- Roughly one-half of dealers reported that offsetting trades between client portfolios, offsetting trades between clients and external swap dealers, and offsetting client trades with holdings of cash securities were used to hedge client swaps under synthetic PB to some extent or to a considerable extent. Smaller fractions of dealers reported using offsetting trades between clients and other lines of business within their firm and offsetting client trades with exchange-traded futures and derivatives to at least some extent.
- Respondents reported that their reliance on all sources of offsetting trades increased since June 2016, with one-half or more reporting that they rely more on offsetting trades

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<sup>4</sup> In the June 2016 survey, which asked about the use of synthetic PB for more specific types of hedge funds, equity long-short hedge funds that are fundamentally oriented were most often cited as widely using synthetic PB.

<sup>5</sup> Synthetic PB allows clients to gain exposure to assets in foreign jurisdictions without facing the costs and legal barriers associated with transacting directly in foreign markets. Access to foreign markets was also cited as the most important reason motivating clients' use of synthetic PB in the June 2016 survey.

between client portfolios, between clients and other lines of business within their firm, and between clients and external swap dealers.

With respect to **risk-management practices associated with synthetic PB**, dealers reported the following:

- As in the June 2016 survey, collection of initial and variation margin was widely cited as the most important method for managing counterparty exposure to swap clients. Monitoring of clients' overall leverage and risk exposure and limits on long-short gross notional exposure were cited as the next most important methods.
- On net, about one-third of dealers reported that initial margins on cross-margined swaps are somewhat smaller than those on otherwise similar swaps that are not cross-margined.<sup>6</sup> A small net fraction of dealers indicated that typical initial margins posted by clients on non-cross-margined swaps had increased since June 2016, while those on cross-margined swaps were reported to be unchanged.
- Over four-fifths of respondents indicated that liquidity and concentration risk of the underlying position were very important factors in determining initial margins for swap clients. Roughly two-thirds said the client's overall leverage and risk profile was very important, while roughly one-half said the ease of hedging the underlying position was very important.
- Nearly all respondents indicated that the procedures for determining initial margin requirements were mostly or entirely uniform across synthetic PB clients. Less than one-tenth of dealers said the requirements were mostly customized, and none said they were entirely customized.

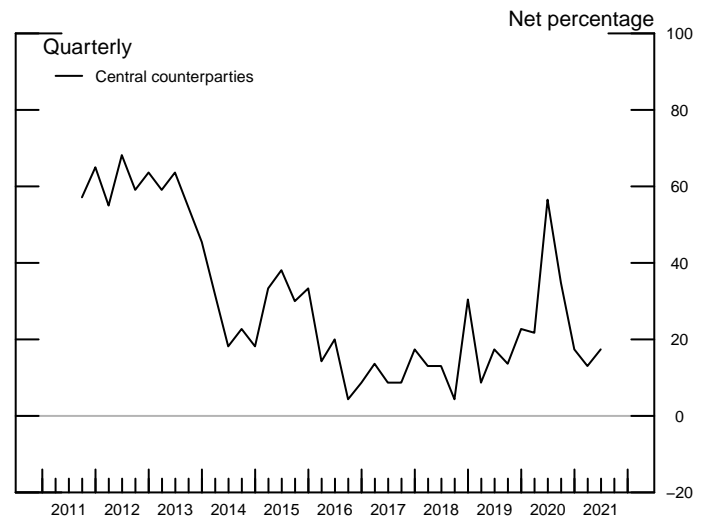
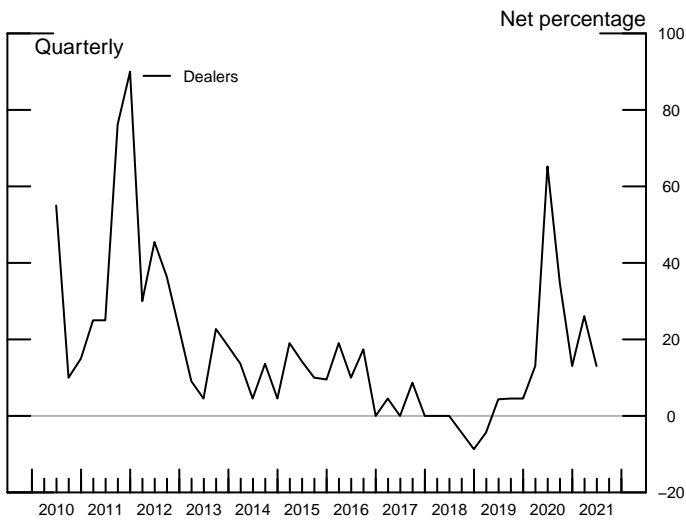
*This document was prepared by Zack Saravay, Division of Monetary Affairs, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Capital Markets Function, the Statistics Function, and the Markets Group at the Federal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

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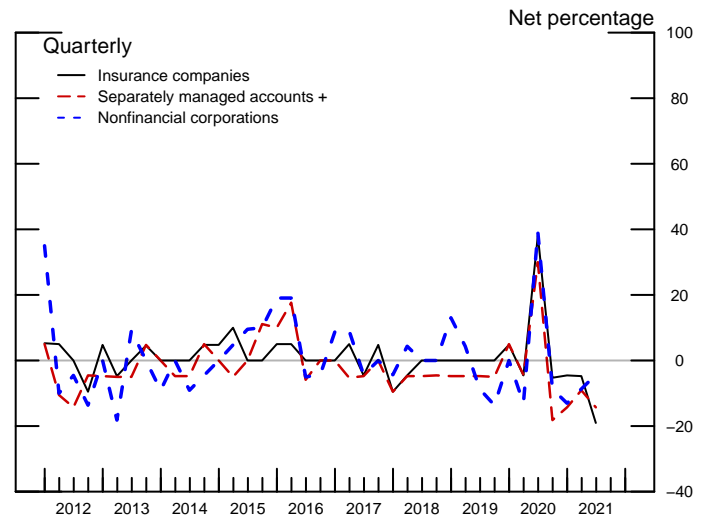
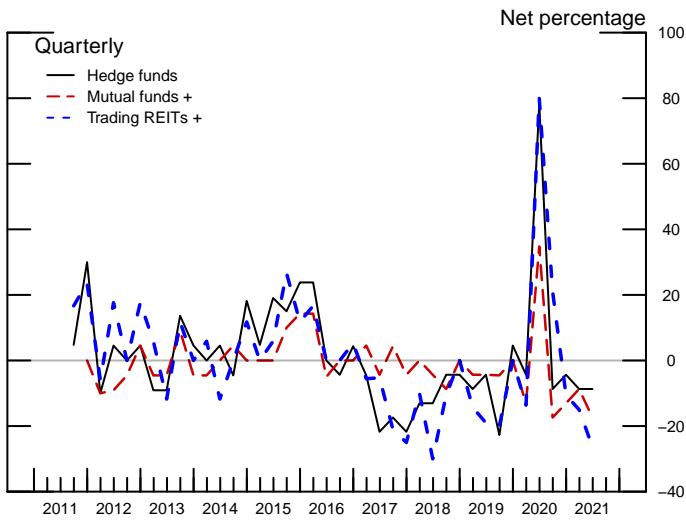
<sup>6</sup> Swaps that are not cross-margined have a margin requirement, which is set on a swap-by-swap basis. Cross-margined swaps are margined jointly with other positions in a PB account.

# Management of Concentrated Credit Exposures and Indicators of Supply of Credit

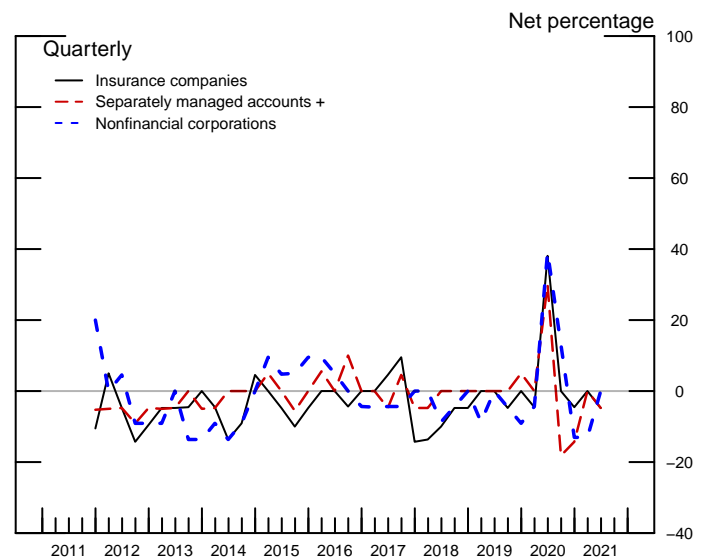
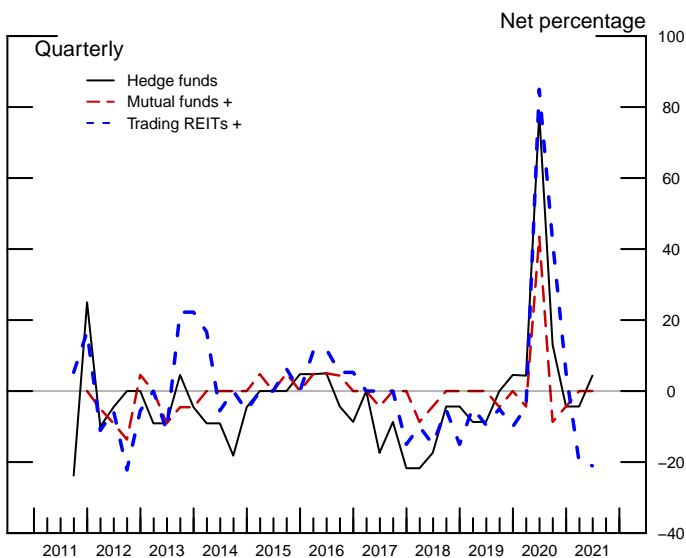
Respondents increasing resources and attention to management of concentrated exposures to the following:



Respondents tightening price terms to the following:



Respondents tightening nonprice terms to the following:



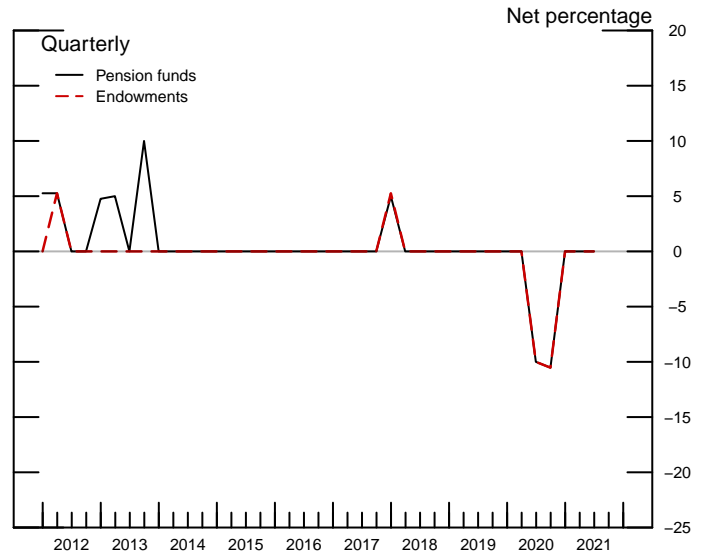
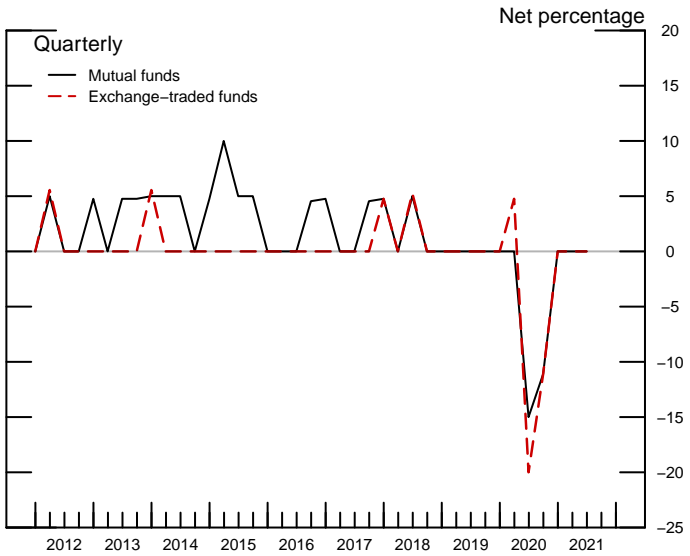
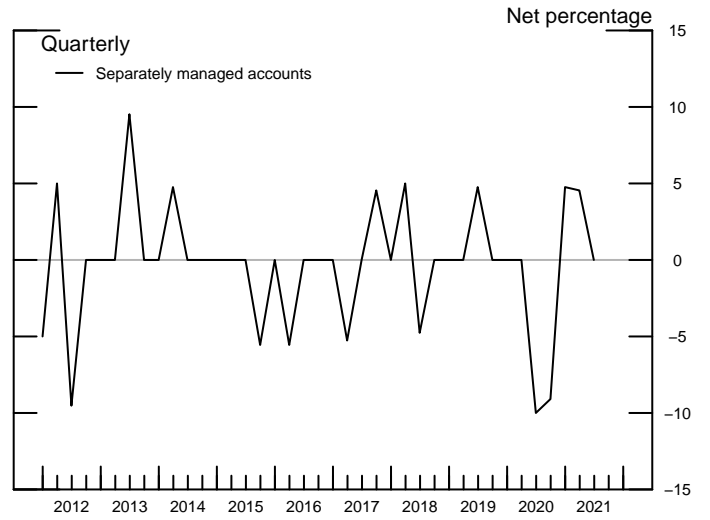
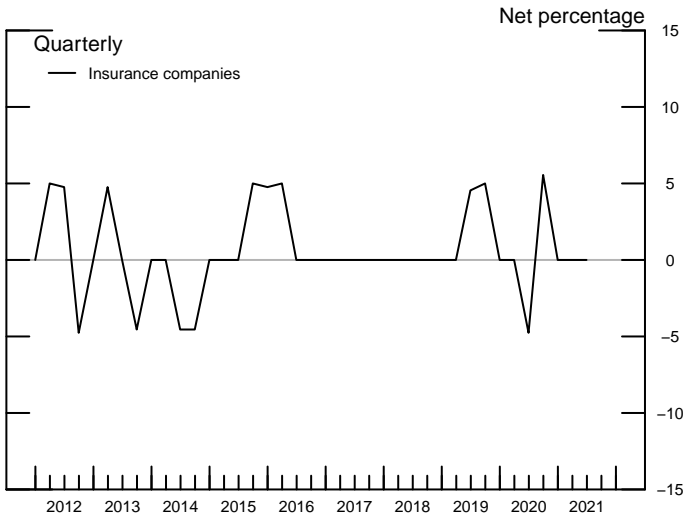
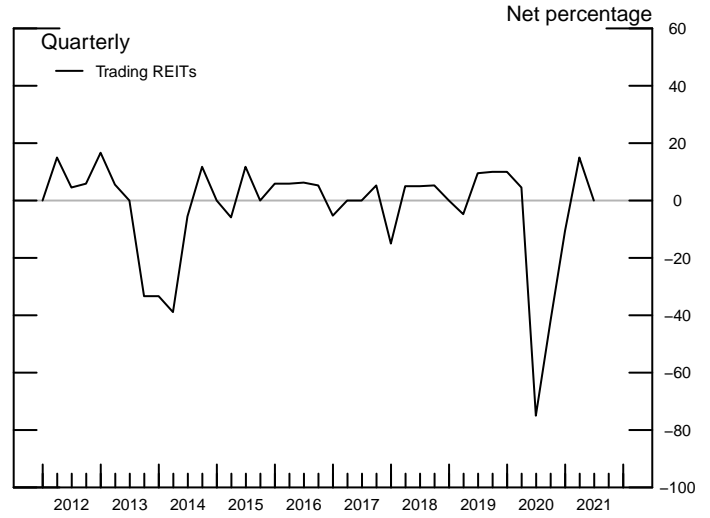
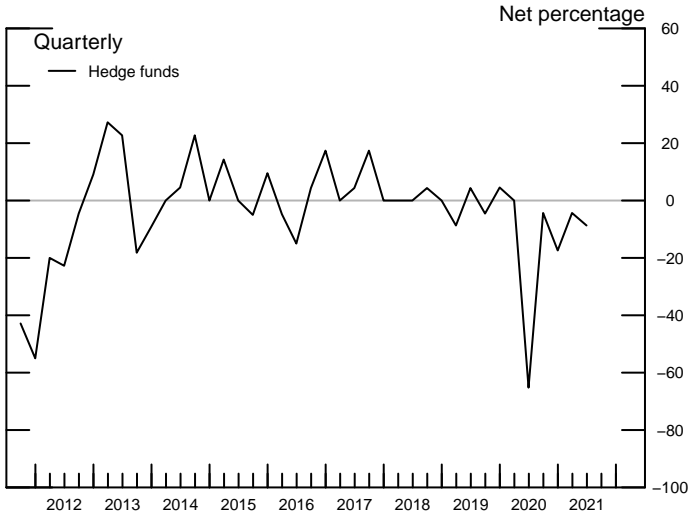
Note: REIT is real estate investment trust.

+ 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:

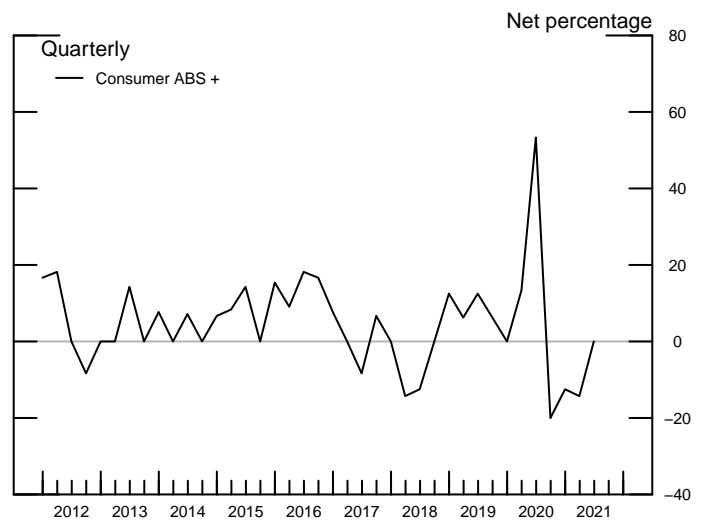
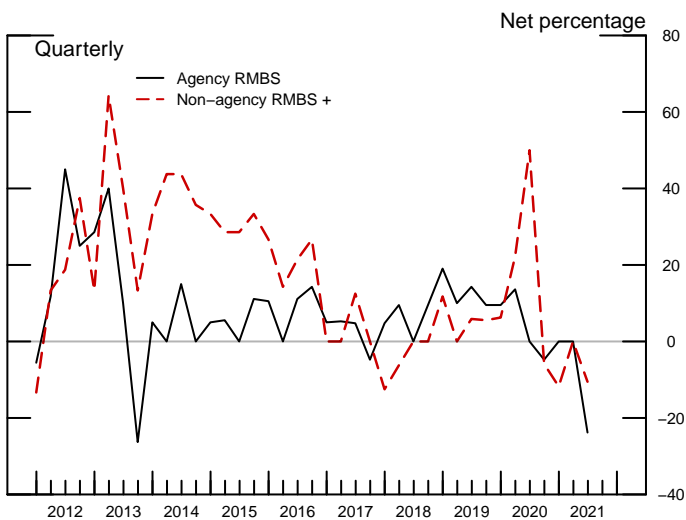
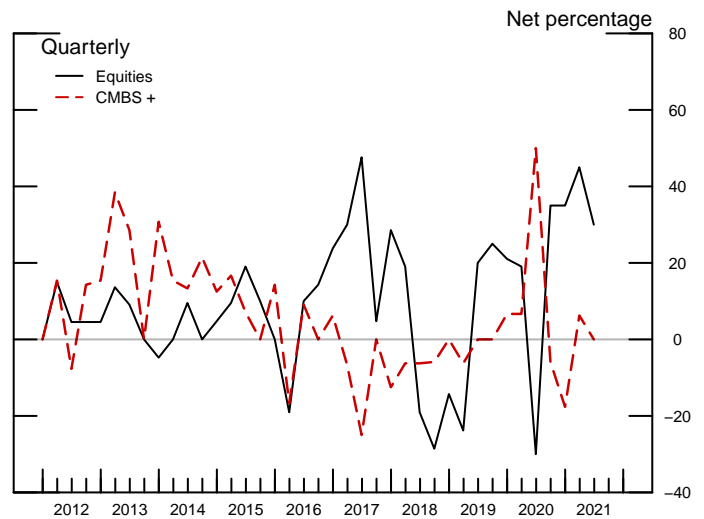
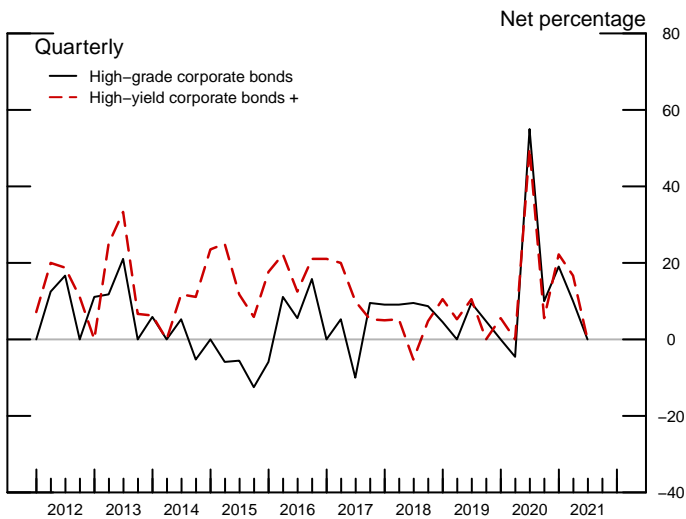


Note: REIT is real estate investment trust.

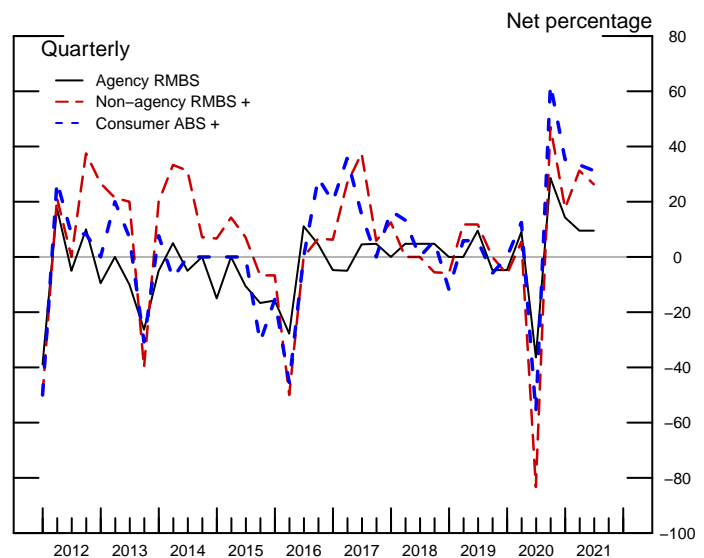
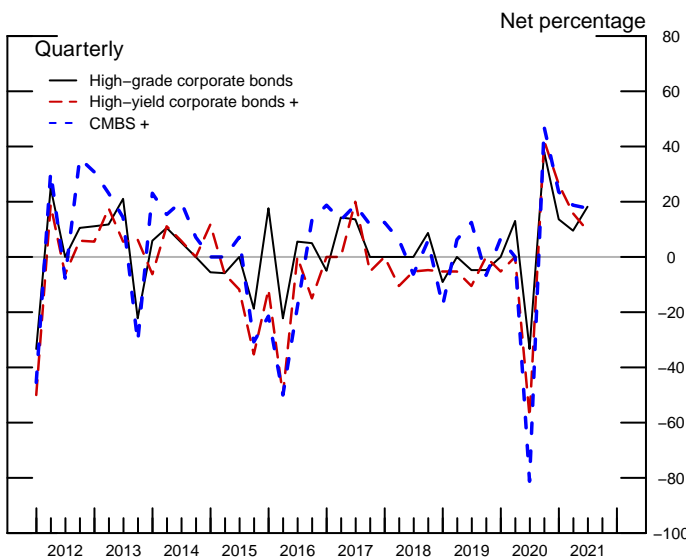
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

# 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.