The September 2018 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The September 2018 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 potential effects of hypothetical future changes in the interest rate environment on the price and nonprice terms for financing provided to clients and on the positioning of different classes of clients for such changes. The 23 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 21, 2018, and August 31, 2018. The core questions asked about changes between June 2018 and August 2018.[1]

Core Questions

(Questions 1–79)[2]

Responses to the core questions in the September survey offered a few insights on recent developments in dealer-intermediated markets. 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 for financing were basically unchanged for all classes of counterparties (see the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit”).
- In providing credit to their trading real estate investment trust (REIT) clients, a small fraction of respondents reported that efforts by clients to negotiate more-

[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.

favorable price and nonprice terms had increased somewhat over the past three months.

- Small net fractions of respondents indicated that the volume as well as duration and persistence of mark and collateral disputes with other dealers had declined somewhat. Declines in the duration of disputes with insurance companies and nonfinancial corporations were also noted by a small fraction of respondents.

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.

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

- Initial margin requirements on OTC derivatives were basically unchanged, on net, for average and most-favored clients.

- A small fraction of respondents indicated that the duration and persistence of mark and collateral disputes on equity contracts had decreased.

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

- Nearly one-third of respondents indicated a decrease in funding demand for equities (see the exhibit "Measures of Demand for Funding and Market Functioning") over the past three months. A smaller fraction of respondents indicated decreased demand for term funding (that is, funding with a maturity greater than 30 days) of non-agency residential mortgage-backed securities.

- On net, one-fifth of dealers reported a decrease in financing rates for equities. Smaller net fractions of respondents indicated a decrease in financing rates for high-grade corporate bonds and (for preferred clients) for high-yield corporate bonds.

- Across asset classes, survey responses indicated that liquidity and functioning, as well as the volume and duration of mark and collateral disputes, have changed little in the past three months.[3]

[3] 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.

Special Questions on Hypothetical Scenarios of the Yield Curve
(Questions 81–88)

Since the beginning of the year, the U.S. Treasury yield curve has shifted upward in level while flattening in slope. In the special questions for the survey this quarter, dealers were queried about the potential effects of hypothetical future changes in the interest rate environment on the price and nonprice terms for financing provided to clients and on the positioning of different classes of clients for such changes.

The first scenario specified a **moderate inversion** of the yield curve by the end of 2018. Under this scenario, the 10-year yield falls below the 3-month yield while the level of the 2-year yield remains roughly unchanged relative to the present. Responses revealed the following:

- Small net fractions of respondents indicated that price and nonprice terms would tighten somewhat under the scenario. The most cited reasons were that the scenario entails higher internal treasury charges for funding, that the scenario is associated with worsening in general market liquidity and functioning, and that the scenario signals future macroeconomic conditions that would be associated with deterioration in the financial strength of counterparties.

- On net, over two-fifths of respondents reported that insurance company clients and pension plans and endowments were more typically net long with respect to this scenario than net short.[4] Net fractions of roughly one-third and one-fifth of respondents indicated that nonfinancial corporations and trading REIT clients, respectively, were more typically net long as well.

- With respect to fixed-income and global macro hedge fund clients, responses to the question on client positioning were quite diverse. On balance, it appears that roughly equal proportions of hedge fund clients are net long and net short.

The second scenario specified a **moderate parallel shift upward** in the yield curve by the end of 2018. Under this scenario, the slope of the yield curve remains approximately unchanged relative to the present. Responses revealed the following:

- On net, respondents indicated that price and nonprice terms for financing would remain basically unchanged under the scenario.

- Nearly one-half of respondents reported that nonfinancial corporate clients were more typically net long with respect to this scenario than net short. For other client types, responses to the question on client positioning were more diverse.

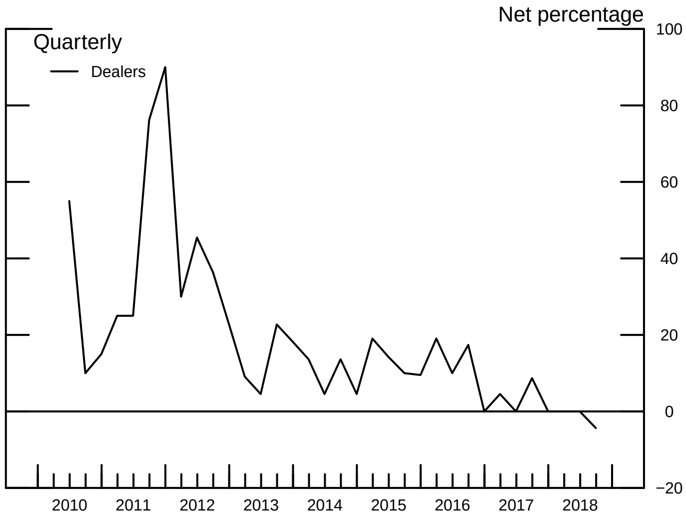
[4] In the survey special questions, “net long” was defined to mean that the clients’ positions would be expected to increase in value, on net, under the given scenario, and “net short” was defined to mean that the clients’ positions would be expected to decrease in value on net.

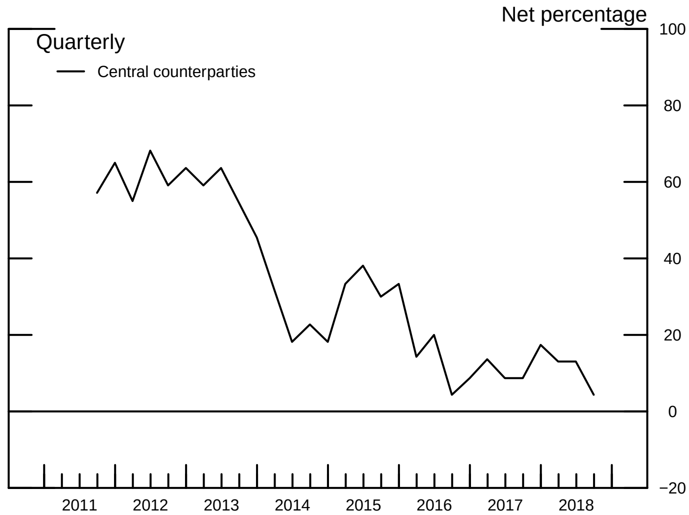
On net, one-fourth of dealers indicated that fixed-income hedge fund clients were more typically net long than net short. A smaller net fraction of respondents indicated that global macro hedge fund clients were more typically net long than net short.

This document was prepared by Michael Gordy, 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.

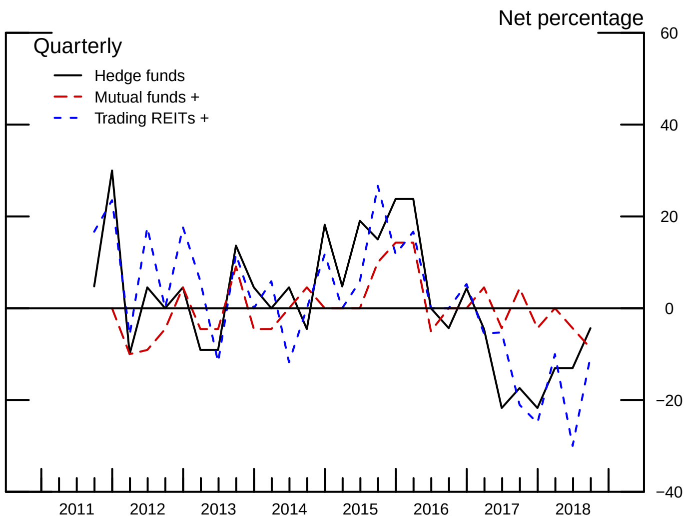
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

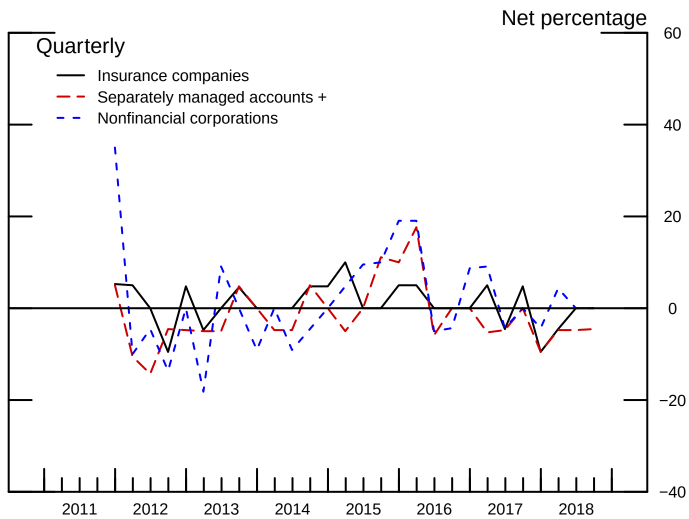
Respondents increasing resources and attention to management of concentrated exposures to the following:



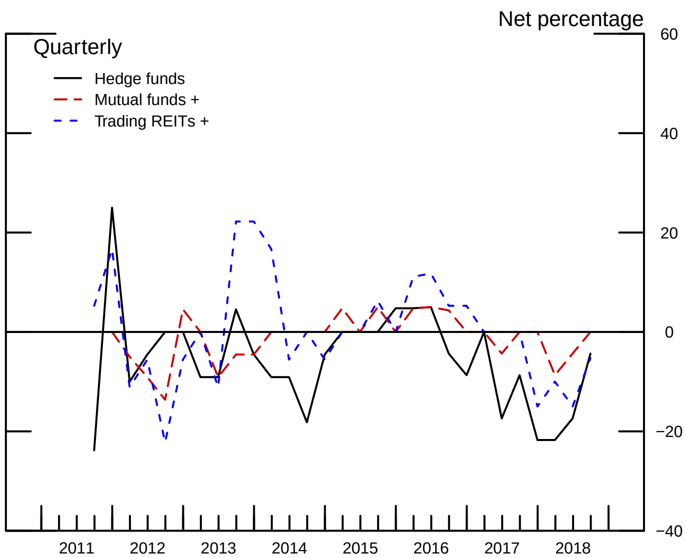


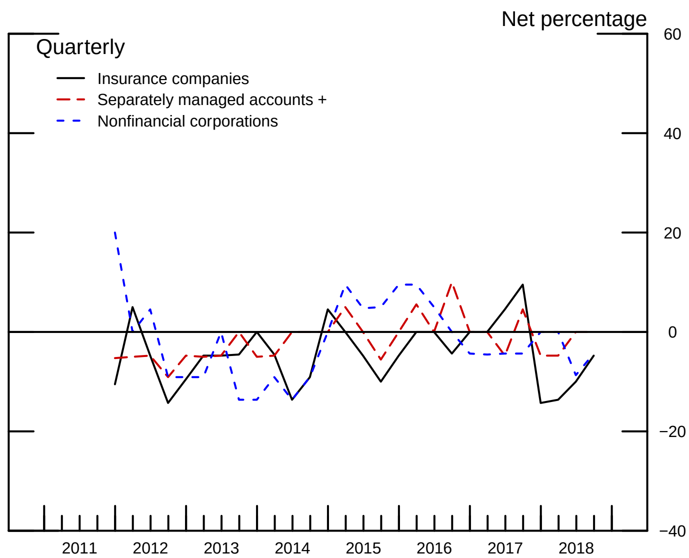
Respondents tightening price terms to the following:





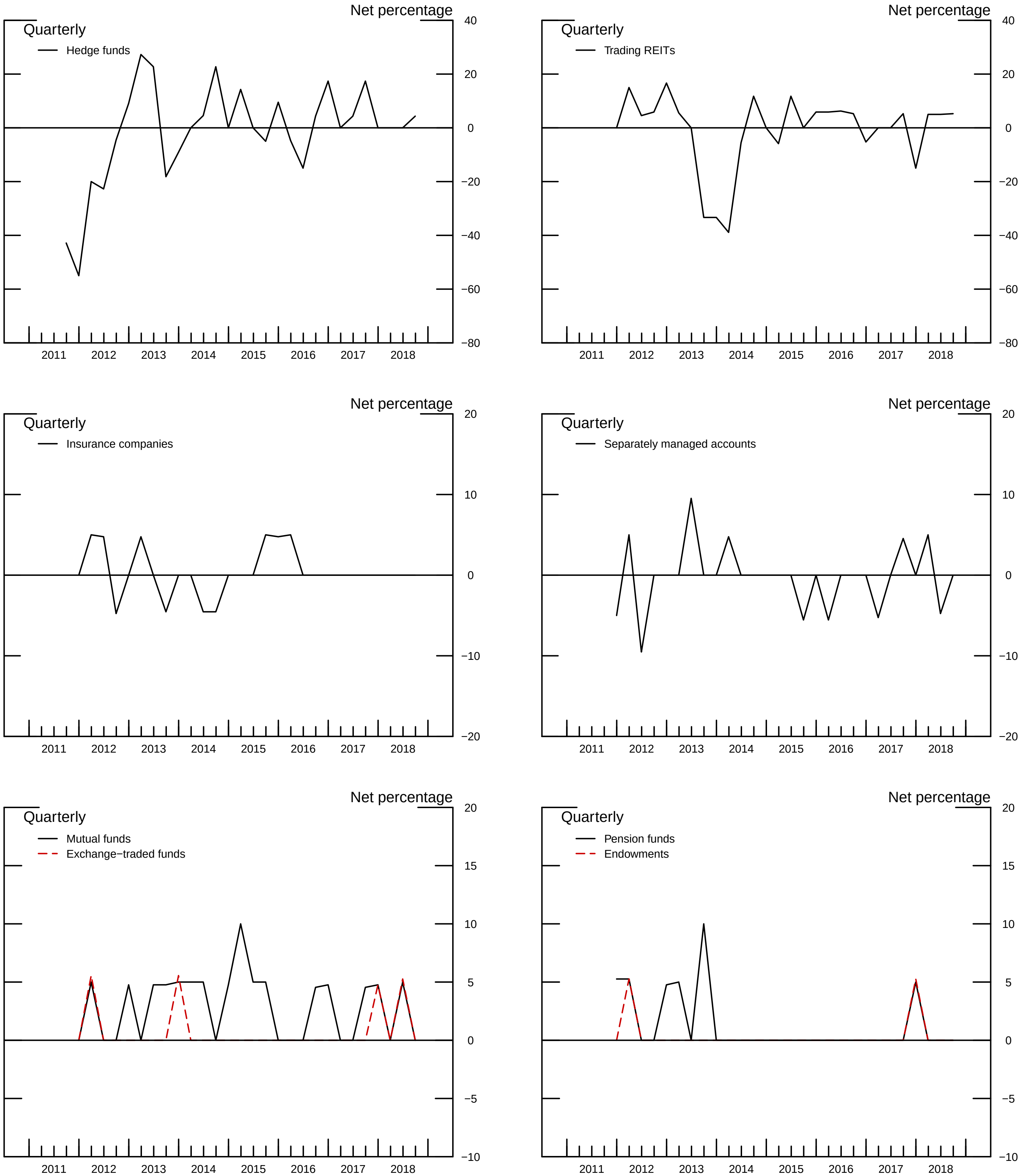
Respondents tightening nonprice terms to the following:





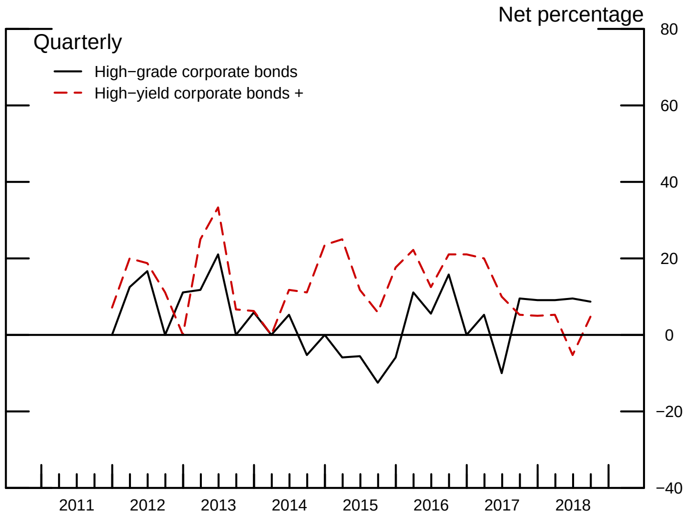
Use of Financial Leverage

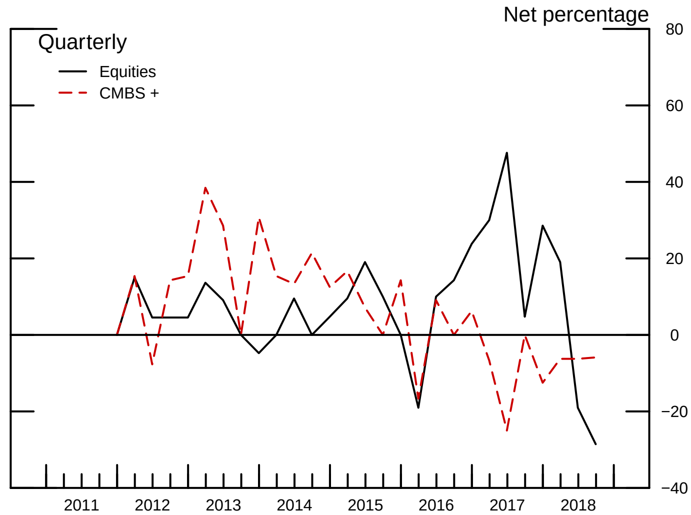
Respondents reporting increased use of leverage by the following:

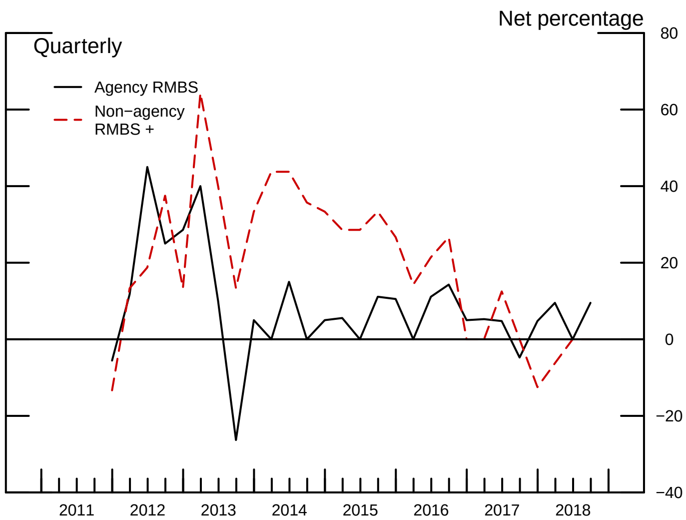


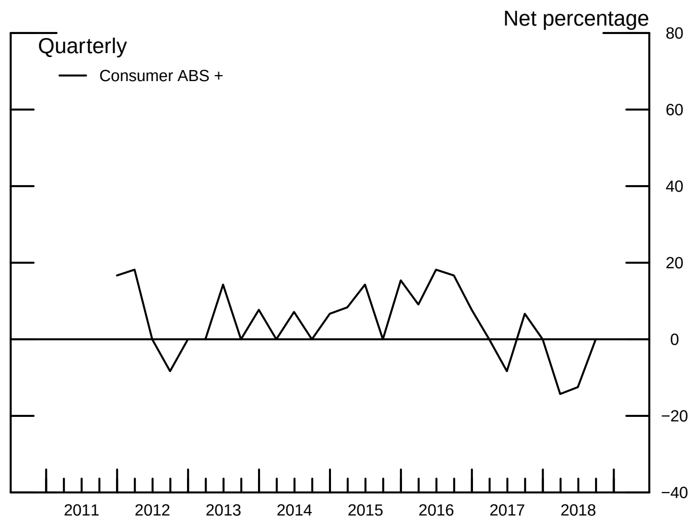
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:









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