The March 2023 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The March 2023 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 client trading of volatility products in the interest rate, foreign exchange, and credit markets. The 20 institutions participating in the survey account for most of the dealer financing of dollar-denominated securities to non-dealers and are the most active intermediaries in OTC derivatives markets. The survey was conducted between February 14, 2023, and February 27, 2023. The core questions asked about changes between November 2022 and February 2023.[1]

Core Questions

(Questions 1–79)[2]

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:

- For trading real estate investment trust (REIT) clients, around one-fifth of dealers, on net, reported that price terms on securities financing transactions and OTC derivatives tightened over the past three months (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). A smaller fraction of dealers reported that nonprice terms, such as haircuts, maximum maturity, or covenants, tightened somewhat. Dealers cited deterioration in current or expected financial strength of counterparties as the main reason for the tightening.

- For nonfinancial corporations, one-fifth of dealers reported that nonprice terms tightened somewhat since the previous survey. A smaller net fraction of dealers reported a tightening of price terms. Deterioration in current or expected financial strength of counterparties was cited as the main reason for the tightening.

- Respondents indicated that resources and attention devoted to managing concentrated credit exposure to dealers and central counterparties remained mostly unchanged over the past three months. More than one-half of respondents indicated that changes in central

[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.

counterparty practices have affected to at least a small degree the credit terms they offer to clients on bilateral transactions that are not cleared.

- Around one-fifth of dealers indicated a decrease in the volume of mark and collateral disputes over the past three months with nonfinancial corporate clients and separately managed accounts established with investment advisers. Around one-fifth of dealers indicated that the duration and persistence of mark and collateral disputes with separately managed accounts decreased over the past three months.

With respect to clients' **use of financial leverage**, dealers, on net, indicated that the use of leverage remained basically unchanged for all client types (see the exhibit "Use of Financial Leverage").

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

- Initial margin requirements were reported to be mostly unchanged, on net, for all types of OTC derivatives.
- The volume, duration, and persistence of mark and collateral disputes remained mostly unchanged, on net, for all types of OTC derivatives.
- Nonprice terms in master agreements for OTC derivatives remained mostly unchanged.

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

- Funding terms remained mostly unchanged, on net, for all collateral classes.
- For all collateral classes, the demand for funding was mostly unchanged on net (see the exhibit "Measures of Demand for Funding and Market Functioning").
- One-fifth and around one-third of dealers indicated that liquidity and market functioning for non-agency residential mortgage-backed securities and consumer asset-backed securities, respectively, improved over the past three months.[3]
- The volume, duration, and persistence of mark and collateral disputes remained mostly unchanged, on net, across all collateral classes over the past three months.

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[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 Trading of Volatility Products
(Questions 81–95)

Special questions asked about volatility products referencing interest rates (IR), foreign exchange (FX) rates, and credit spreads.[4] Dealers were asked about clients' positioning in volatility products and about changes in market conditions for these products and client interest in trading them. *Net long (net short)* positioning means that the value of the position increases (decreases) with increased volatility.

Almost two-thirds of dealers responded that they have a material number of clients who trade IR volatility products. With respect to **IR volatility products**, respondents indicated the following:

- The liquidity and functioning of the market for IR volatility products remained basically unchanged, on net, relative to January 2021.

- More than one-half of respondents, on net, reported that their clients' interest in trading IR volatility products increased relative to January 2021. Increased desire to hedge volatility and increased willingness of clients to take on volatility risk were cited as the main reasons for this increase in client trading interest.

- Dealers were asked about the current net positioning of their clients with respect to IR volatility. For insurance companies, nonfinancial corporations, commercial banks, and the combined category of pension plans, endowments, and sovereign wealth funds, net fractions of around three-fourths, two-thirds, two-fifths, and one-fourth of respondents, respectively, indicated either that most clients are net long or that more clients are net long than net short. For hedge funds, one-fourth of respondents, on net, indicated either that most clients are net short or that more clients are net short than net long.

Almost two-thirds of dealers responded that they have a material number of clients who trade FX volatility products. With respect to **FX volatility products**, respondents indicated the following:

- Almost one-half of respondents reported that the liquidity and functioning of the market for FX volatility products improved relative to January 2021.

- Over one-half of respondents, on net, reported that their clients' interest in trading FX volatility products increased relative to January 2021. Increased desire to hedge volatility, increased willingness of clients to take on volatility risk, and improvement in liquidity conditions for trading these products were cited as the main reasons for this increase in client trading interest.

- For hedge funds, asset managers, and insurance companies, net fractions of one-half, around two-fifths, and around one-third of respondents, respectively, indicated either that most clients are net long or that more clients are net long than net short. For nonfinancial

[4] Volatility products include, for example, options on cash bonds and IR futures, IR swaptions, and IR caps and floors for IR volatility, FX options and swaptions as well as cross-currency options and swaptions for FX rate volatility, and credit default swaptions and index tranches for credit spread volatility.

corporations, around one-third of respondents, on net, indicated either that most clients are net short or that more clients are net short than net long.

Nearly one-third of dealers responded that they have a material number of clients who trade credit spread volatility products. With respect to **credit spread volatility products**, respondents indicated the following:

- One-half of respondents reported that the liquidity and functioning of the market for credit spread volatility products improved relative to January 2021.

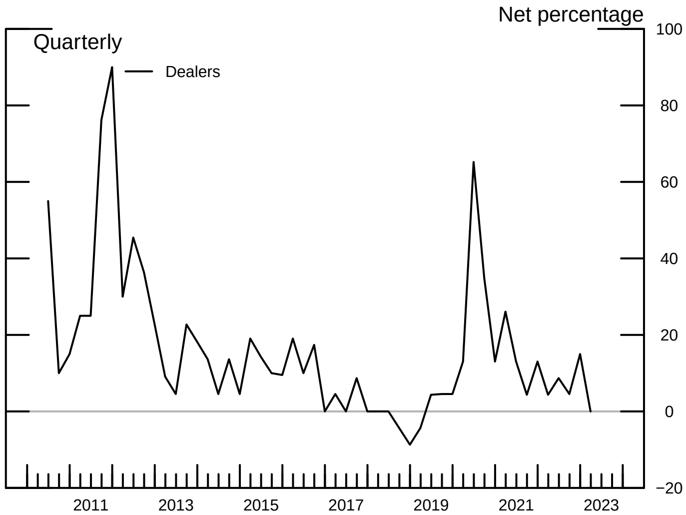
- Nearly all respondents reported that their clients' interest in trading credit spread volatility products increased relative to January 2021. Increased desire to hedge volatility was cited as the main reason for this increase in client trading interest, followed by improvement in liquidity conditions for trading these products and increased willingness of clients to take on volatility risk.

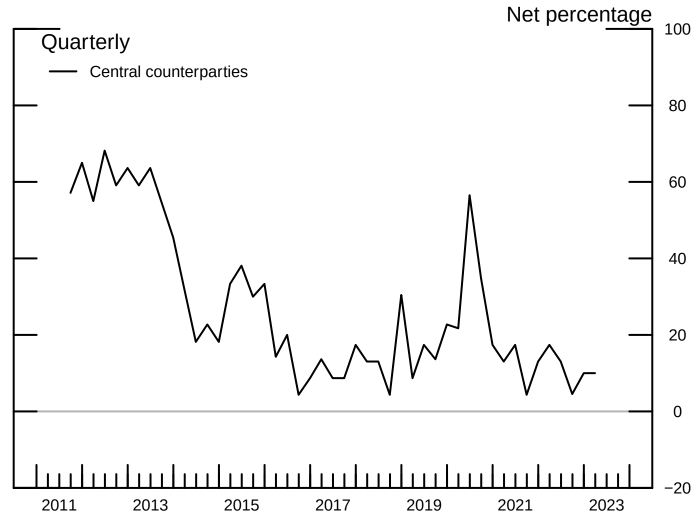
- For nonfinancial corporations, two-thirds of respondents indicated that more clients are net short than net long. The other types of clients are mostly net neutral.

This document was prepared by Xin Huang, 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.

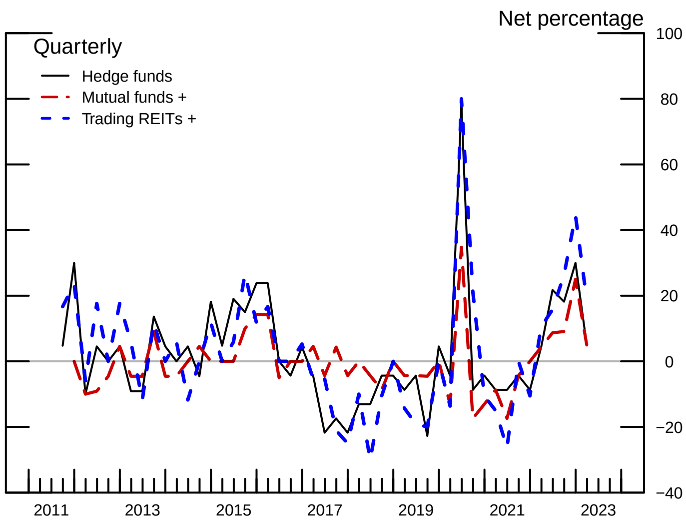
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

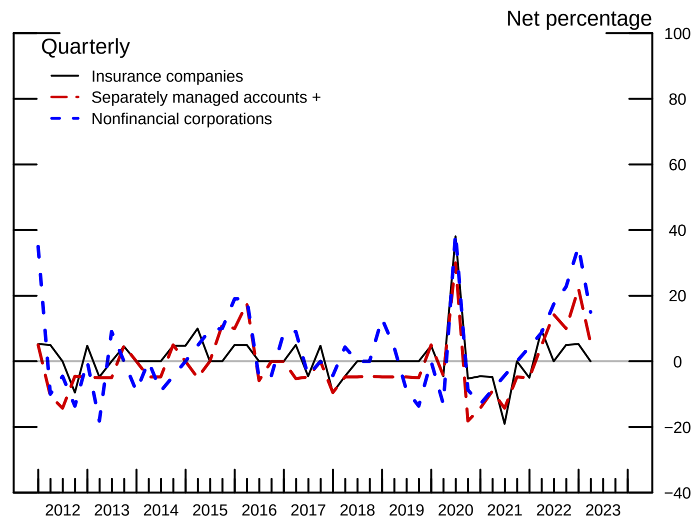
Respondents increasing resources and attention to management of concentrated exposures to the following:



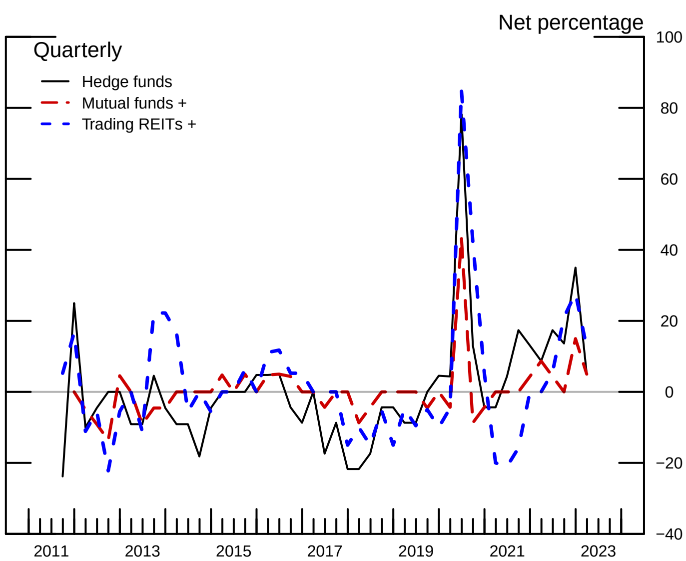


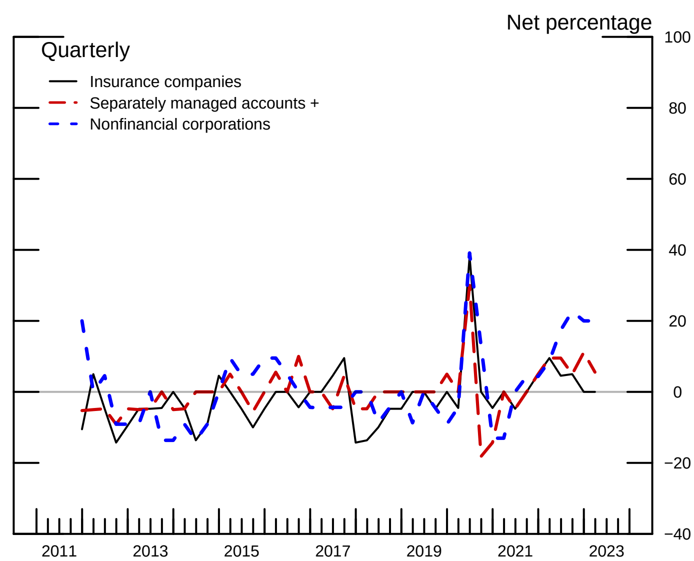
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

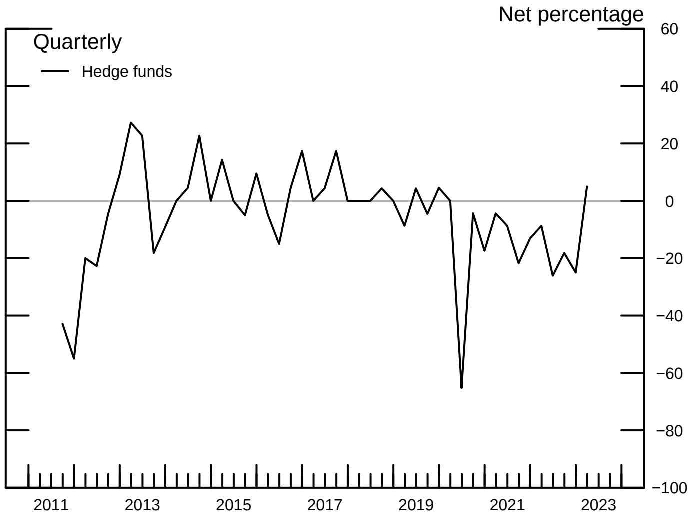


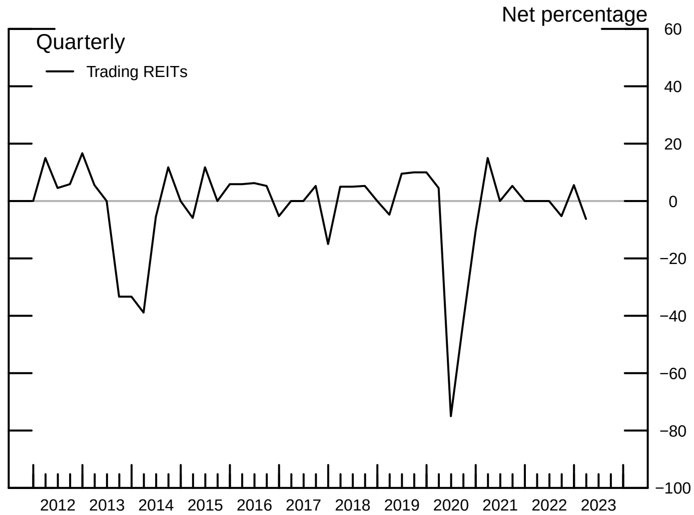


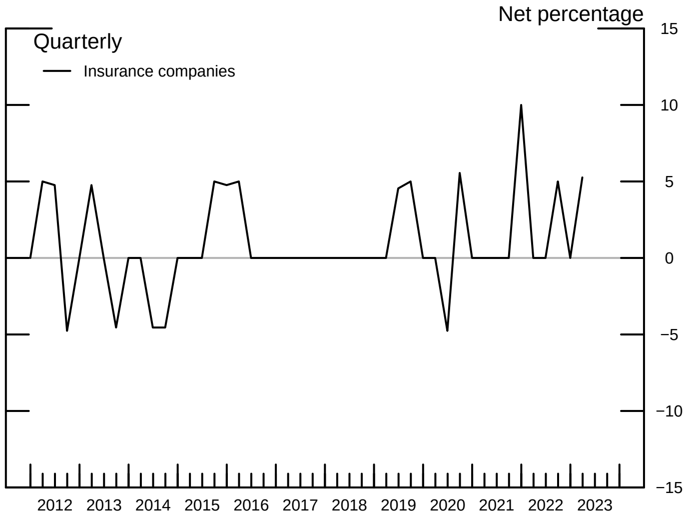
Note: REIT is real estate investment trust.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

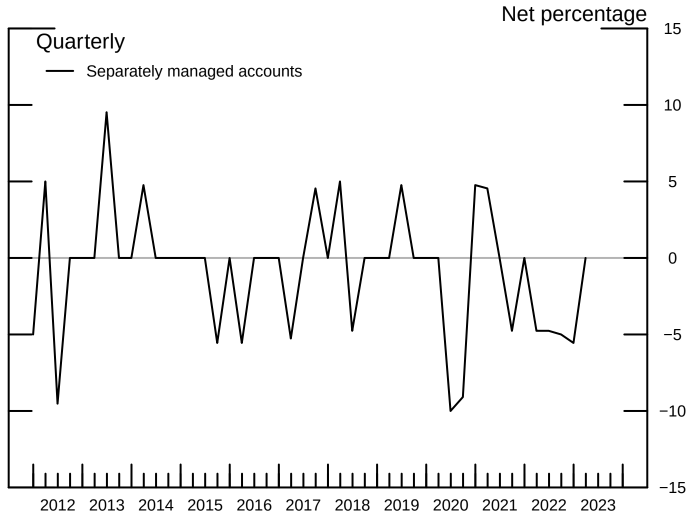
Use of Financial Leverage

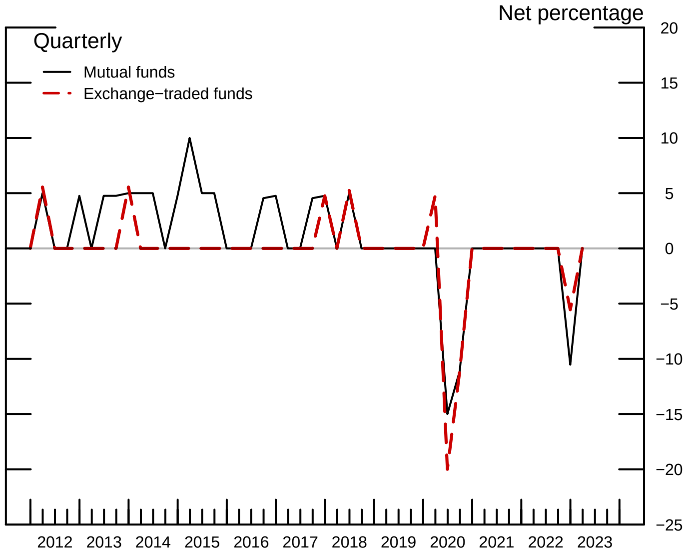
Respondents reporting increased use of leverage by the following:

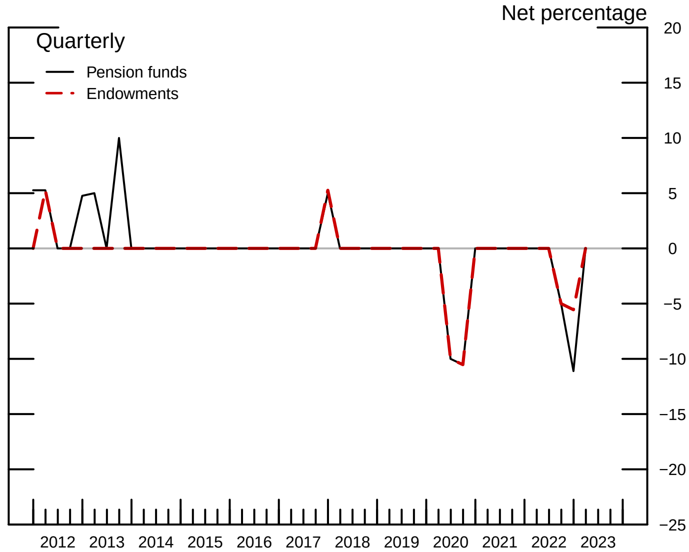








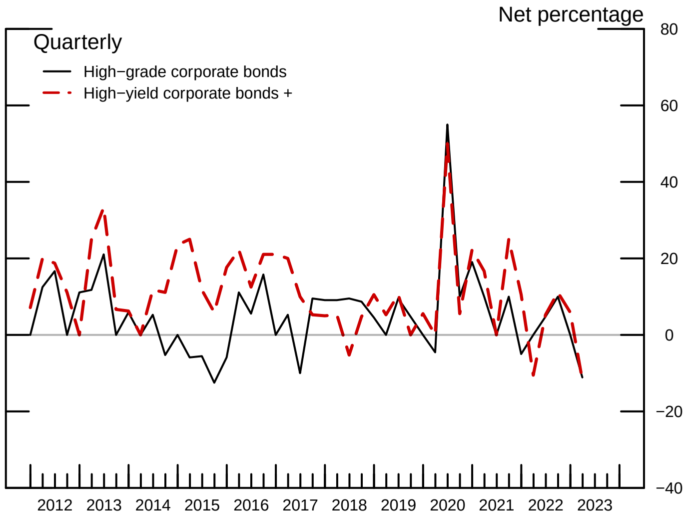


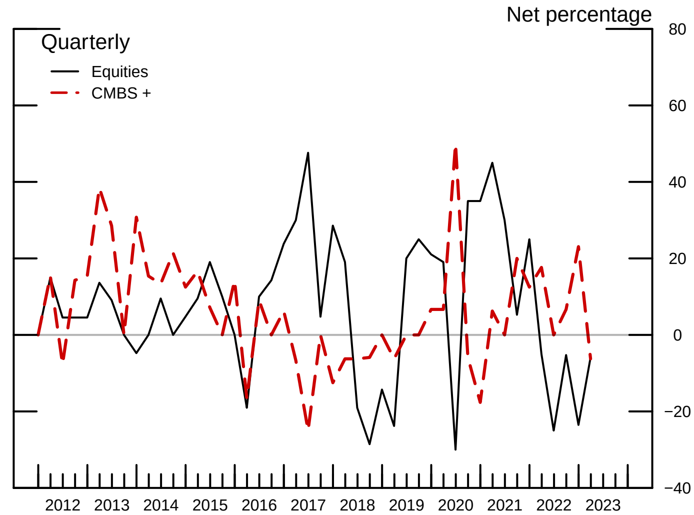


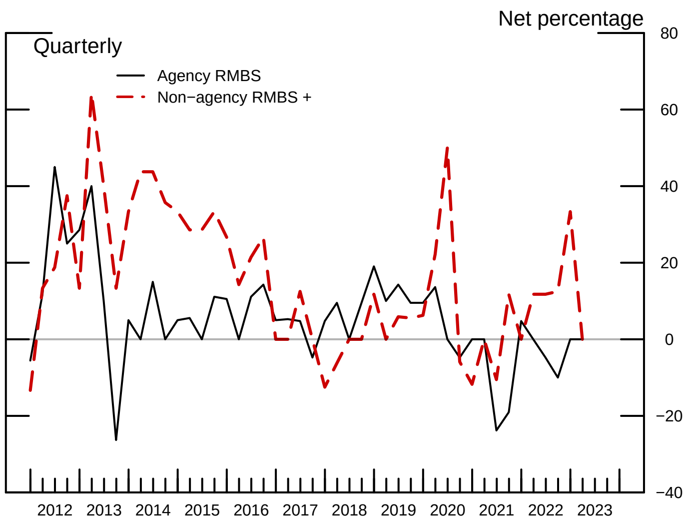
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

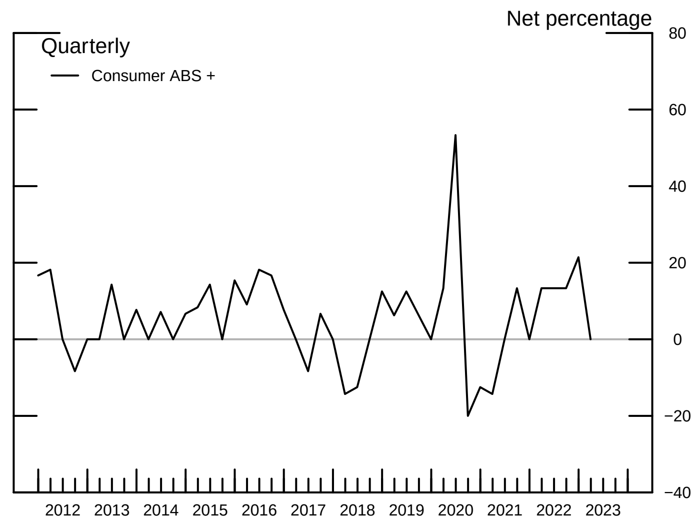
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

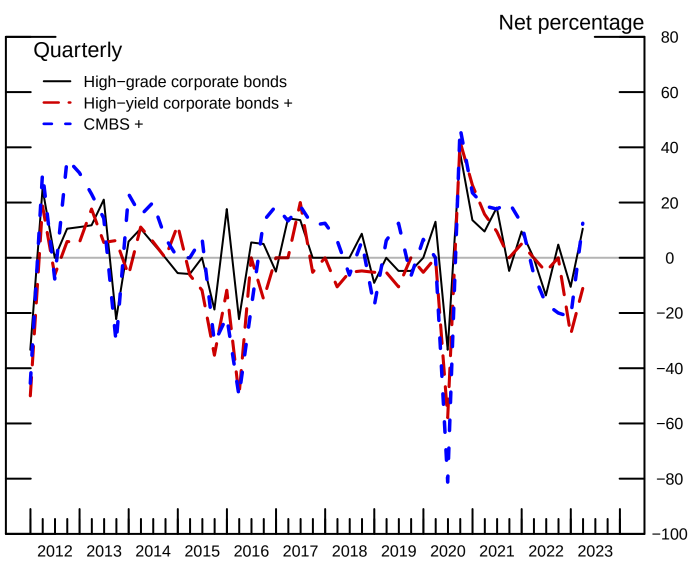


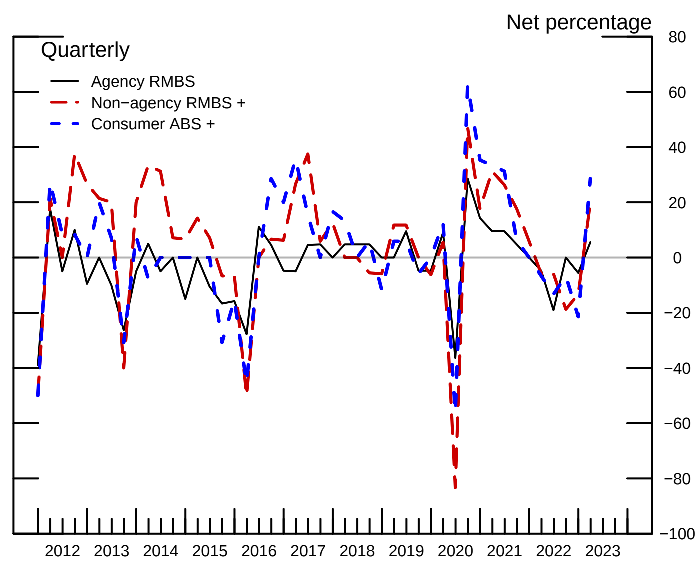






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





Note: CMBS is commercial mortgage−backed securities; RMBS is residential mortgage−backed securities; 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.