BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
DIVISION OF MONETARY AFFAIRS
DIVISION OF RESEARCH AND STATISTICS

For release at 2:00 p.m. EDT
July 1, 2015

Senior Credit Officer Opinion Survey on Dealer Financing Terms

June 2015

The June 2015 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The June 2015 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 set of questions, the survey included a set of special questions about liquidity conditions in selected fixed-income markets. The 21 institutions that participated in the June 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 May 19, 2015, and June 1, 2015. The core questions asked about changes between March 2015 and May 2015.[1]

As in most recent surveys, responses to the core questions in June generally suggested little change over the past three months in the credit terms applicable to most classes of counterparties covered by the survey. The responses, however, offered a few insights regarding recent developments in dealer-intermediated markets:

- Nearly two-fifths of respondents reported an increase in the amount of resources and attention devoted to the management of concentrated exposures to central counterparties and other financial utilities over the past three months. Nearly one-third of dealers noted that the practices of central counterparties (including margin requirements and haircuts) influenced to some extent the credit terms applied to clients on bilateral uncleared transactions.

- Dealers indicated that the use of financial leverage by all classes of counterparties had remained basically unchanged over the past three months.

[1] For questions that ask about credit terms, reported 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, reported 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").

- About one-fifth of dealers pointed to an increase in initial margin requirements applicable to OTC foreign exchange (FX) derivatives for both average and most-favored clients. The net fraction of respondents reporting an increase was somewhat smaller than that observed in the March survey.

- One-fifth of dealers reported an increase in demand for funding of equities and almost one-third noted an increase in demand for funding of non-agency residential mortgage-backed securities (RMBS).

In response to the set of special questions on liquidity conditions in selected fixed-income markets, over four-fifths of respondents indicated that current liquidity and market functioning in secondary markets for nominal Treasury securities had deteriorated relative to the second quarter of 2010. A net fraction of one-half reported that conditions had deteriorated in secondary markets for agency RMBS, while two-fifths of dealers pointed to a deterioration in secondary markets for corporate bonds. Respondents reporting a deterioration primarily pointed to decreased willingness on the part of securities dealers to provide balance sheet resources for market-making purposes as a result of regulatory changes as well as changes in internal risk-management practices.

Counterparty Types

(Questions 1–40)

Dealers and Other Financial Intermediaries. As in the past several surveys, over four-fifths of respondents to the June survey reported that the amount of resources and attention devoted to the management of concentrated credit exposure to dealers and other financial intermediaries remained basically unchanged over the past three months, while the remainder pointed to an increase. (See the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit.”)

Central Counterparties and Other Financial Utilities. In the June survey, nearly two-fifths of respondents indicated that they had increased the amount of resources and attention devoted to the management of concentrated credit exposures to central counterparties and other financial utilities over the past three months. Nearly one-third of dealers noted that changes in the practices of central counterparties, including changes in margin requirements and haircuts, had influenced, to some extent, the credit terms applied to clients on bilateral transactions that are not cleared.

Hedge Funds. Four-fifths of respondents to the June survey indicated that price terms (such as financing rates) offered to hedge funds for securities financing and OTC derivatives transactions were little changed over the past three months. The remainder indicated that price terms had tightened somewhat; these respondents pointed to diminished availability of balance sheet or capital as the primary reason for such tightening. All dealers reported that nonprice terms (including haircuts, maximum maturity, covenants, cure periods, cross-default provisions, or other documentation features) had remained unchanged. The provision of differential terms to the most-favored hedge funds remained essentially unchanged as well. However, one-fifth of respondents reported an increase in the intensity of efforts by hedge fund clients to negotiate more-favorable terms. The use of leverage and the availability of additional (and not utilized) financial leverage under agreements currently in place with hedge funds were reported to be generally unchanged. (See the exhibit "Use of Financial Leverage.")

Trading Real Estate Investment Trusts. As in the past few surveys, respondents in June indicated that both price and nonprice terms offered to trading real estate investment trusts had remained largely unchanged over the past three months. On net, respondents indicated that the use of financial leverage was unchanged. Provision of differential terms to most-favored clients and the intensity of efforts by clients to negotiate more-favorable terms were reported to be little changed.

Mutual Funds, Exchange-Traded Funds, Pension Plans, and Endowments. Almost all respondents to the June survey indicated that both price and nonprice terms offered to mutual funds, exchange-traded funds, pension plans, and endowments had remained basically unchanged over the past three months. Provision of differential terms to most-favored clients and the intensity of efforts by clients to negotiate more-favorable terms were reported to be little changed overall. Almost all respondents indicated that the use of financial leverage remained unchanged over the past three months.

Insurance Companies. As in previous surveys, respondents in June indicated that both price and nonprice terms offered to insurance companies had changed little over the past three months, as had the use of financial leverage. Provision of differential terms to most-favored clients and the intensity of efforts by clients to negotiate more-favorable terms were also reported to be little changed.

Separately Managed Accounts Established with Investment Advisers. All of the dealers indicated in the June survey that price and nonprice terms negotiated by investment advisers on behalf of separately managed accounts were basically unchanged over the past three months. Provision of differential terms to most-favored clients and the use of financial leverage by investment advisers were also reported to be unchanged, as was the intensity of efforts by investment advisers to negotiate more-favorable terms.

Nonfinancial Corporations. Respondents indicated that both price and nonprice terms offered to nonfinancial corporations had remained largely unchanged over the past three months. As in the past two surveys, a small number of dealers, on net, reported an increase in the intensity of efforts by nonfinancial corporations to negotiate more-favorable price and nonprice terms.

Mark and Collateral Disputes. As in the March survey, respondents in June indicated that the volume, persistence, and duration of mark and collateral disputes with all counterparty types included in the survey were little changed over the past three months.

Over-the-Counter Derivatives

(Questions 41–51)

As in previous surveys, the nonprice terms (such as acceptable collateral, covenants, and the recognition of portfolio or diversification benefits) incorporated in new or renegotiated OTC derivatives master agreements were reported to be generally unchanged, on net, over the past three months.[2] About one-fifth of dealers in the June survey indicated an increase in initial margin requirements applicable to OTC FX derivatives for both average and most-favored clients. The reported increase in initial margins on OTC FX transactions was somewhat smaller than that observed in the March survey. For all other contract types, such as interest rate derivatives or equity derivatives, nearly all respondents indicated that initial margins had remained basically unchanged over the past three months for both average and most-favored clients.

Dealers reported little change in the frequency with which nonstandard collateral—that is, collateral other than cash and U.S. Treasury securities—was posted to fulfill margin requirements. Respondents generally reported that the volume, persistence, and duration of mark and collateral disputes had remained unchanged for all contract types, but one-fifth of dealers noted an increase in the volume of disputes for interest rate contracts.

Securities Financing

(Questions 52–79)

As in previous surveys, dealers reported that the credit terms under which most types of securities included in the survey are financed were little changed, on balance, over the past three months. For high-yield corporate bonds, one-fifth of dealers noted that effective financing rates (collateral spreads over the relevant benchmark) had tightened for both average and most-favored clients.

One-fifth of dealers reported in the June survey an increase in demand for funding of equities over the past three months, and almost one-third reported an increase in demand for funding of non-agency RMBS. Over one-third of respondents noted an increase in demand for term funding—that is, funding with a maturity greater than 30 days—of non-agency RMBS. For other collateral types reported in the survey, respondents indicated that the demand for funding and term funding has remained basically unchanged. (See the exhibit “Measures of Demand for Funding and Market Functioning.”)

[2] The survey asks specifically about requirements, timelines, and thresholds for posting additional margin, acceptable collateral, recognition of portfolio or diversification benefits, triggers and covenants, and other documentation features, including cure periods and cross-default provisions.

For all collateral types, respondents indicated that the liquidity and functioning of the underlying markets remained basically unchanged over the past three months.[3] Finally, similar to previous surveys, all of the respondents indicated that the volume, duration, and persistence of mark and collateral disputes were basically unchanged for all of the collateral types.

Special Questions on Liquidity Conditions in Selected Fixed-Income Markets
(Questions 81–89)

A number of market commentaries have pointed to a deterioration in liquidity conditions in secondary markets for fixed-income securities over the past several years. A set of special questions in the June survey asked in greater detail about changes in liquidity and market functioning in the secondary markets for nominal Treasury securities, agency RMBS, and corporate bonds relative to the second quarter of 2010.

Over four-fifths of respondents characterized current liquidity and market functioning in secondary markets for nominal Treasury securities as having deteriorated over the past five years. Of note, almost one-third of dealers reported that conditions had deteriorated considerably. With respect to the most important reasons for the change, respondents reporting a deterioration in liquidity conditions primarily cited decreased willingness on the part of dealers to employ balance sheet resources for market-making purposes as a result of regulatory changes.[4] The next most cited reason attributed the deterioration to decreased willingness on the part of the dealers to employ balance sheet resources for market-making purposes as a result of changes in internal risk-management practices or higher internal treasury charges. Other less frequently cited reasons were the increasingly automated nature of trading, increased presence of nondealer firms as liquidity providers, and changes in demand for intermediation by clients.

Over one-half of dealers, on net, reported that liquidity and market functioning in secondary markets for agency RMBS had deteriorated over the past five years. The reasons primarily cited for the deterioration were similar to those reported for nominal

[3] Note that survey respondents are 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 market itself. This question is not asked with respect to equity markets in the core questions.

[4] Survey respondents were offered a list of five possible reasons for improvement or deterioration in liquidity conditions, as well as a sixth option of “Other,” which invited text-based commentary. The five listed reasons for deterioration were (1) increasingly automated nature of trading, (2) changes in demand for intermediation by clients, (3) increased presence of nondealer firms as liquidity providers, (4) decreased willingness on the part of the dealers to provide balance sheet for market-making purposes as a result of changes in internal risk-management practices or higher internal treasury charges, and (5) decreased willingness on the part of the dealers to provide balance sheet for market-making purposes as a result of regulatory changes. Participants were asked to select up to three of the reasons and to indicate the order of importance among the selected reasons.

Treasury securities—that is, decreased willingness on the part of dealers to employ balance sheet resources for market-making purposes as a result of regulatory changes or as a result of changes in internal risk-management practices or higher internal treasury charges. Among the remaining choices, changes in demand for intermediation by clients was cited by several respondents as the third most important reason.

Two-fifths of dealers, on net, reported that liquidity and market functioning in the secondary markets for corporate bonds had deteriorated over the past five years. A few respondents pointed to an improvement, however. Among those reporting a deterioration, the distribution of reasons cited was very similar to what was reported for agency RMBS.

The June survey solicited open-ended commentary on metrics that best support the dealer's view of market liquidity evolution over the past five years. Because of the essentially qualitative nature of the responses, a brief summary of the responses is provided below in place of quantitative aggregation.

Among the metrics mentioned as best capturing the deterioration in secondary markets for nominal Treasury securities, reduced trading volume and turnover (defined as trading volume divided by debt outstanding) were the most frequently cited by survey respondents. Also featured in responses were wider bid-asked spread as well as reductions in measures of depth in the central limit order book or greater price impact of trades. A few dealers pointed to increased volatility at month-end and around market events as indicative of deteriorating liquidity.

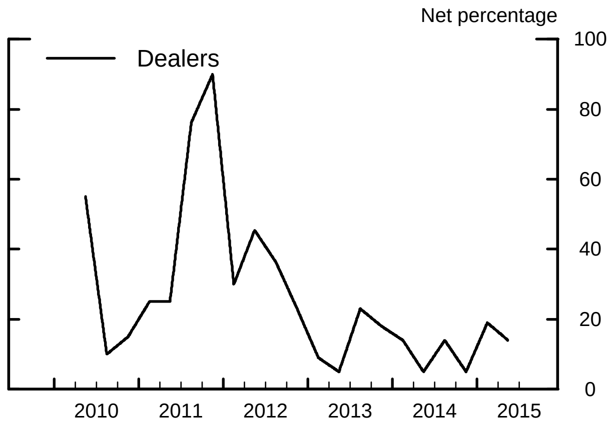
With respect to the secondary market for agency RMBS, reduced trading volume was again the most frequently suggested metric for deterioration. Also cited were reduced market depth or greater price impact of trades, followed by higher bid-asked spread and increased volatility.

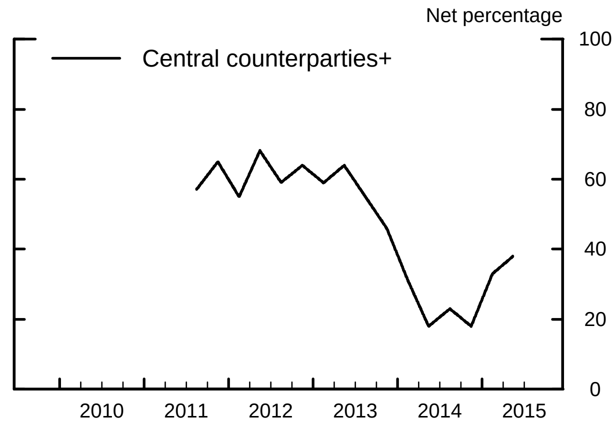
Finally, with regard to secondary markets for corporate bonds, respondents again most frequently pointed to reduced trading volume (or turnover) as an illustrative metric of the deterioration in liquidity and market functioning. Some survey respondents pointed to wider bid-asked spread, greater price impact of trades, increased volatility, reduced breadth (that is, a smaller number of issues being traded), and reduced average trade size as indicators that best summarize such deterioration.

This document was prepared by Michael Gordy, Division of Research & Statistics, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Statistics Function and the Markets Group at the Federal Reserve Bank of New York.

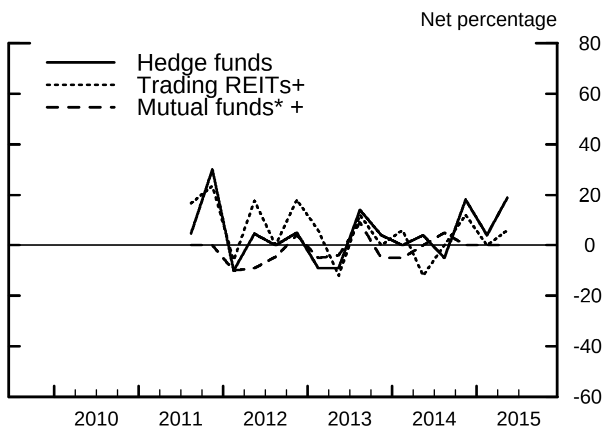
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

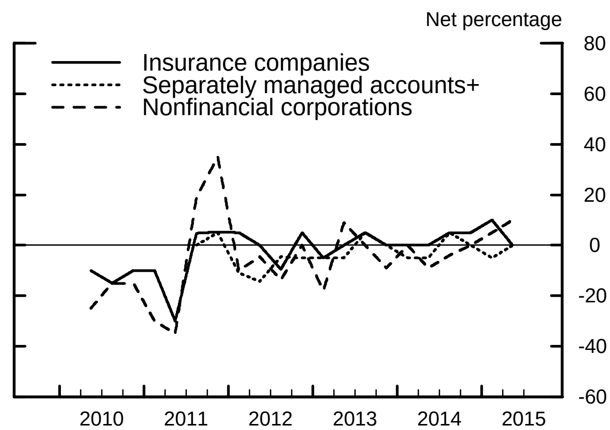
Respondents increasing resources and attention to management of concentrated exposures to:



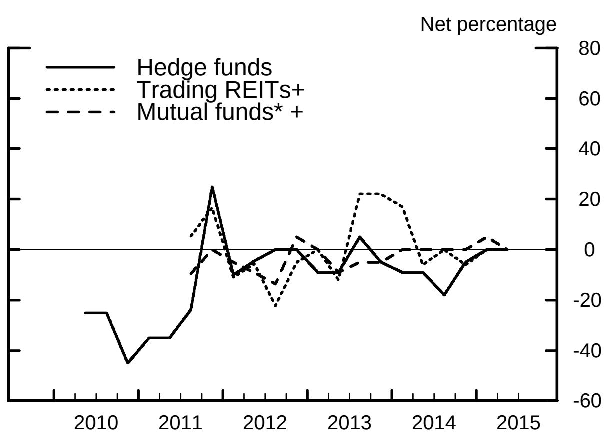


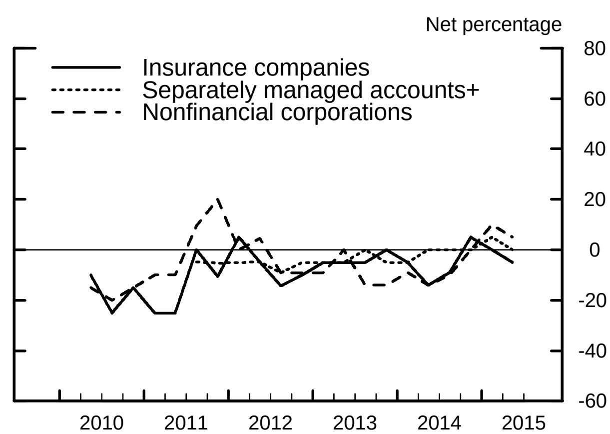
Respondents tightening price terms to:





Respondents tightening nonprice terms to:

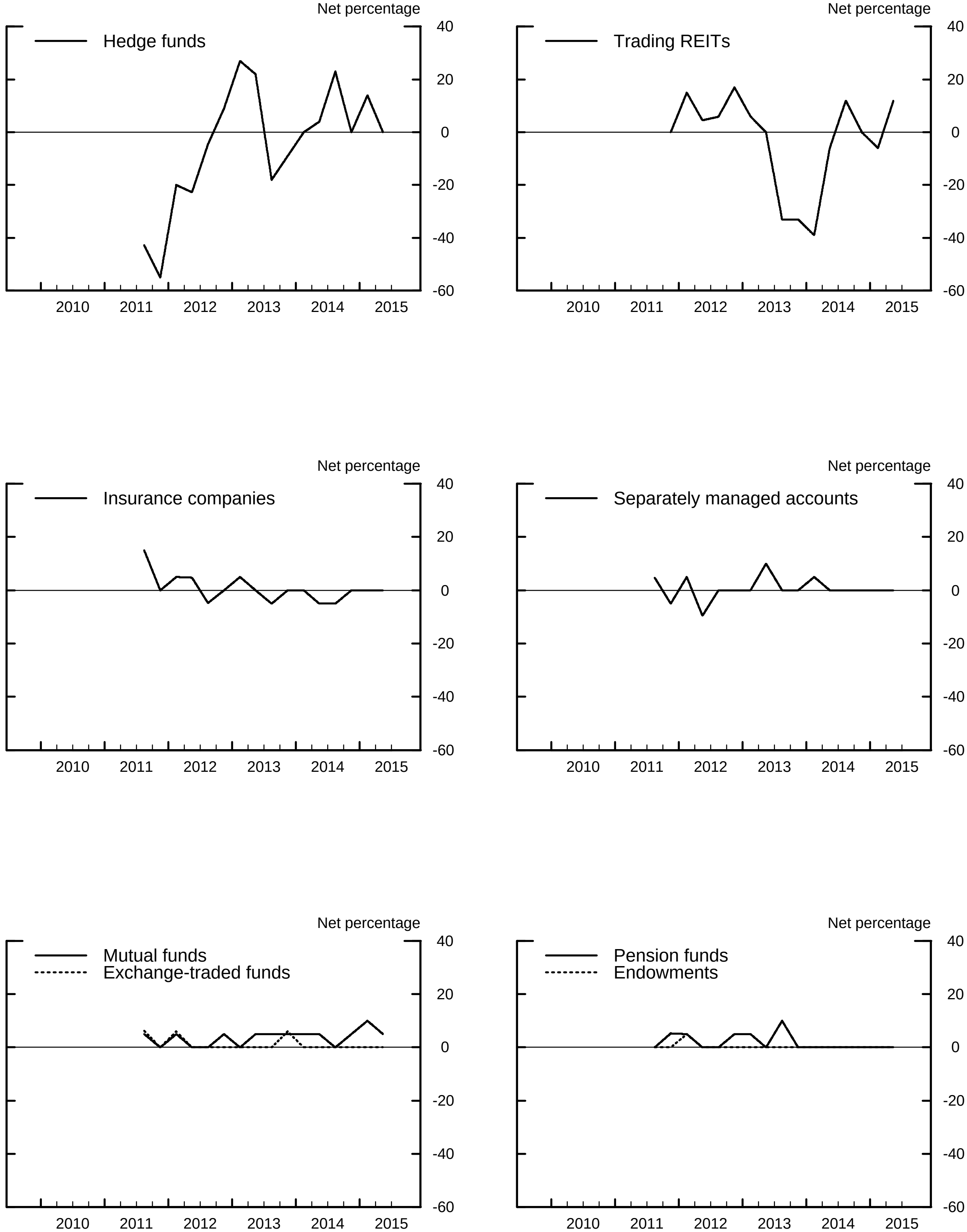




+ This question was added in the September 2011 survey.
* Includes mutual funds, exchange-traded funds, pension plans, and endowments.

Use of Financial Leverage

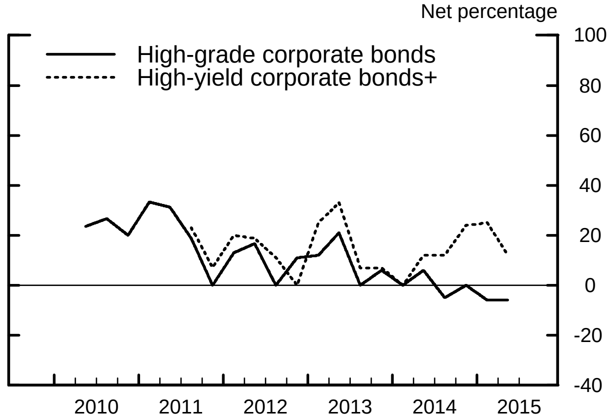
Respondents reporting increased use of leverage by:

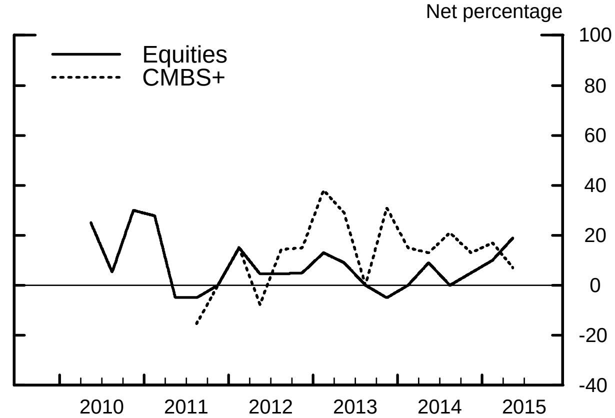


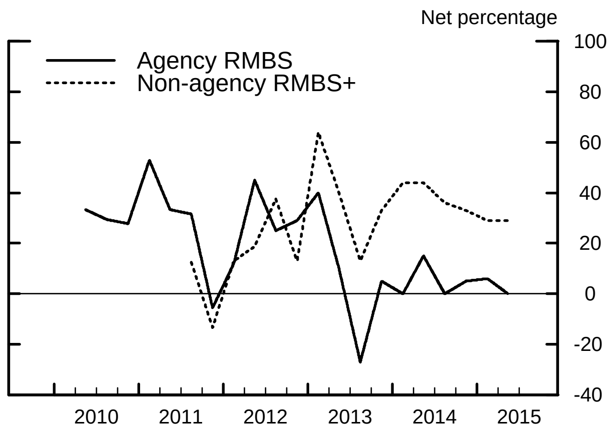
Note: This question was added in the September 2011 survey.

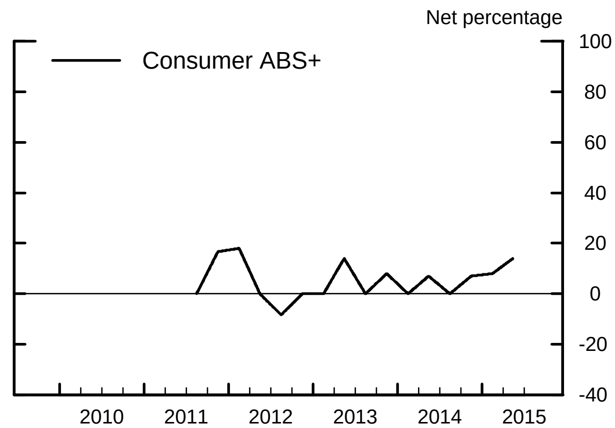
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of:

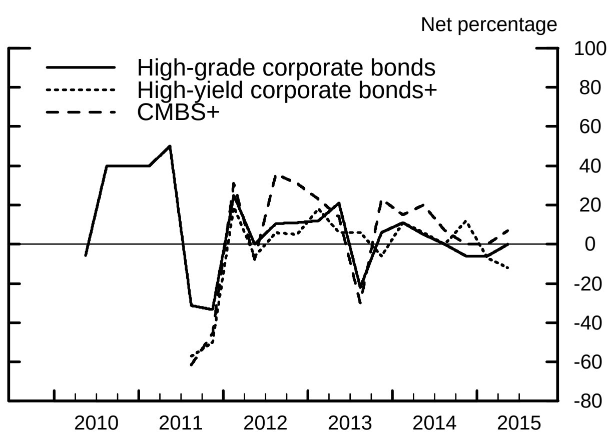


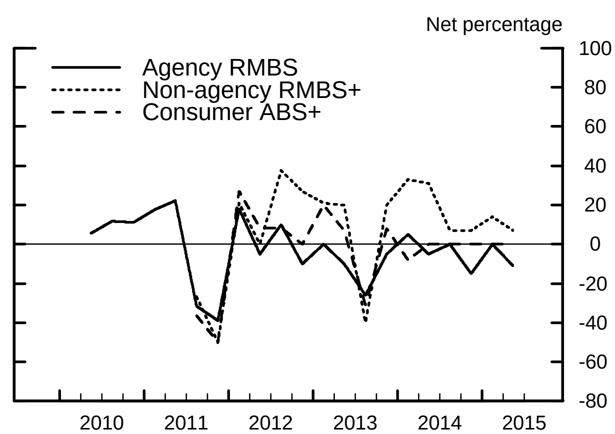






Respondents reporting an improvement in liquidity and functioning in the underlying markets for:





+ This question was added in the September 2011 survey.