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

The March 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 leverage through margin accounts in the U.S. equity markets. 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 February 13, 2018, and February 26, 2018. The core questions asked about changes between December 2017 and February 2018.[1]

Core Questions

(Questions 1–79)[2]

Responses to the core questions in the March 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:

- In providing credit to their hedge fund clients, about one-fifth of respondents reported an easing in nonprice terms, and smaller fractions reported an easing in price terms and an increase in negotiation intensity (see the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit”). Among the dealers that indicated an easing of terms, more aggressive competition from other institutions was cited as the most important reason.
- Price and nonprice terms were basically unchanged for all other classes of counterparties.

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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 all classes of counterparties (see the exhibit "Use of Financial Leverage").

With regard to **OTC derivatives markets**, responses indicated that initial margin requirements were basically unchanged, on net, for average and most-favored clients.

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

- Approximately one-fifth of dealers indicated an increase in funding demand for equities (see the exhibit "Measures of Demand for Funding and Market Functioning"). Demand for funding has remained basically unchanged across other asset classes.
- Survey responses indicate that liquidity and functioning across asset classes have changed little in the past three months.[3]
- One-fifth of dealers, on net, reported a decrease in financing rates of high-grade corporate bonds for most-favored clients. Smaller net fractions indicated a decrease in financing rates of high-grade and high-yield corporate bonds for average clients.
- One-fourth of respondents noted a decrease in haircuts and financing rates for non-agency residential mortgage-backed securities (RMBS), commercial mortgage-backed securities, and consumer asset-backed securities, and smaller fractions indicated an increase in maximum funding and maximum maturity for these asset classes. A small fraction of dealers, on net, reported an easing across all terms for agency RMBS.
- On net, dealers indicated no change in terms for securities financing transactions in equities.

Special Questions on Equity Market Leverage

(Questions 81–86)

Leverage in U.S. equity markets, measured by the amount of credit extended through margin accounts relative to market capitalization, has increased since 2010. In the special questions for the survey this quarter, dealers were queried about their clients' use of leverage in U.S. equity markets, primarily focusing on leverage through margin accounts.

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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.

With respect to the **amount of credit extended to clients through margin accounts as a fraction of gross positions (defined as the sum of long and short exposures)**:

- A net fraction of one-half of respondents reported an increase in this amount since the beginning of 2016 for their hedge fund clients, and one-fifth, on net, reported such an increase for mutual funds, ETFs, pension plans, and endowments. The most cited reason for the increase was greater willingness on clients' parts to take risk due to either lower expected future volatility or higher risk appetite. The next most cited reason was higher expected future returns.
- Dealers were asked to rank the current level of leverage extended to their clients' investments in 10 U.S. equity market sectors through margin accounts.[4] One-half of dealers reported that they extend either the highest or the second-highest amount of margin credit to client investments in the technology sector. One-half reported the same for the financial sector, and one-third did so for the energy sector; smaller fractions were reported for the industrial and consumer staples sectors.

Broadly speaking, there are two types of margining practices in U.S. equity markets. Strategy-based margins, such as those governed by the Federal Reserve Board's Regulation T, set the amount of margins based on individual positions or strategies. Alternatively, portfolio margins determine the amount of margins based on the projected loss of a portfolio and generally result in lower margin requirements, especially for hedged or diversified positions.[5] Portfolio margining was first introduced as a pilot program in April 2007 and was made permanent in August 2008. On **clients' use of various margining practices**, responses revealed the following:[6]

- Two-thirds of dealers indicated that their hedge fund clients mostly use portfolio margins but also use strategy-based margins to some extent. One-fourth responded that their hedge fund clients almost exclusively use portfolio margins.
- One-half responded that separately managed accounts established with investment advisors and mutual funds, ETFs, pension plans, and endowments mostly use portfolio margins but also use strategy-based margins to some extent. One-fifth indicated that these clients almost exclusively use portfolio margins.

Lastly, **on various methods that clients could use to take on leverage in U.S. equity markets**, the responses revealed the following:

- Three-fourths of dealers indicated that their clients predominantly use margin accounts to obtain leverage. Synthetic leverage through derivatives exposure was

[4] The 10 S&P 500 sectors—energy, basic materials, industrial, consumer discretionary, consumer staples, health, financial, technology, telecom, and utilities—were the choices given in the survey, and respondents were asked to rank the top three.

[5] Portfolio margins are specified in FINRA rule 4210 (g).

[6] Total numbers of responses were insufficient to draw conclusions for trading REITs, insurance companies, and nonfinancial corporations.

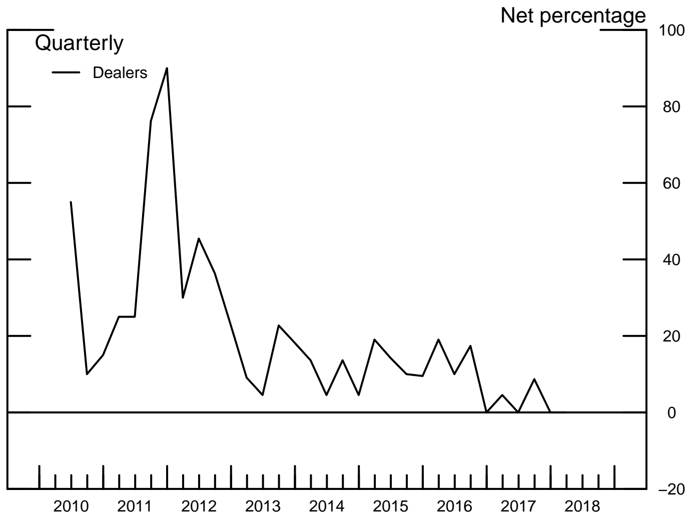
the second most frequently cited, followed by leverage through securities loans and repurchase agreements.

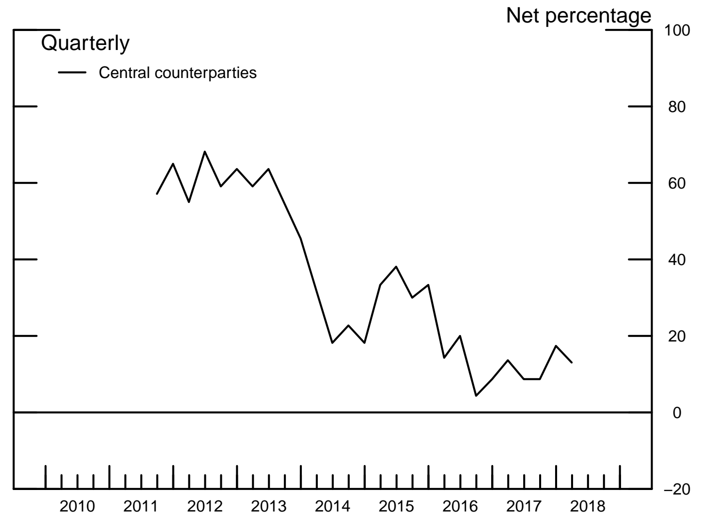
- Of those respondents that reported that their clients use methods other than margin accounts to take on leverage, three-fourths indicated that the amount of leverage that clients take using those alternative methods has not changed since the beginning of 2016. One-fourth reported an increase.

This document was prepared by Yesol Huh, 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 Statistics Function and the Markets Group at the Federal Reserve Bank of New York.

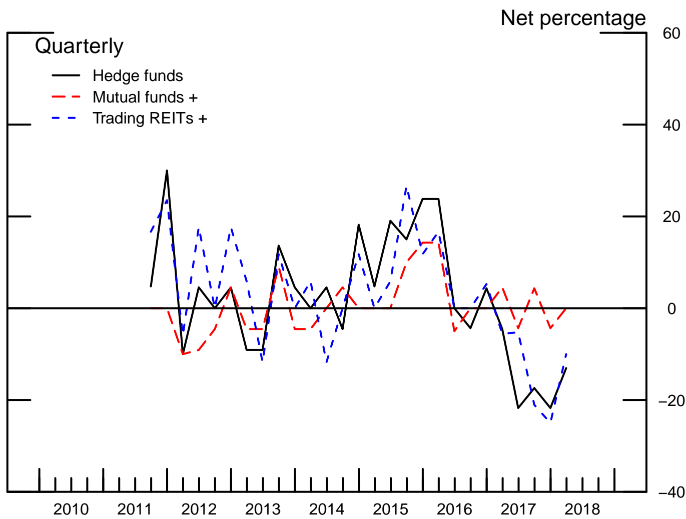
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

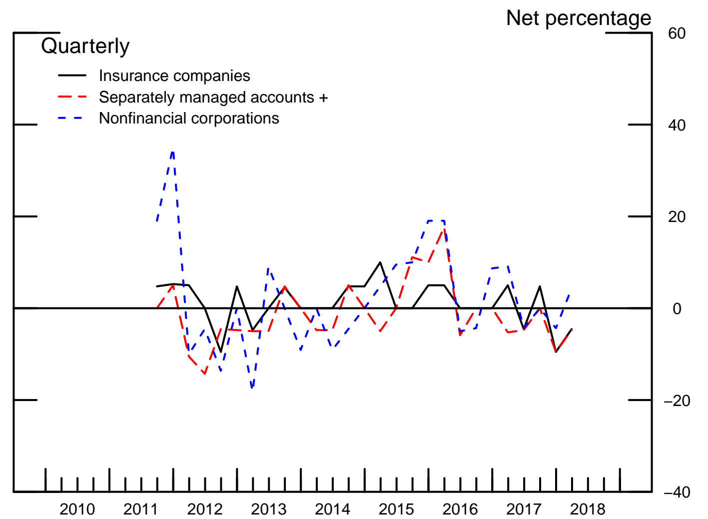
Respondents increasing resources and attention to management of concentrated exposures to the following:



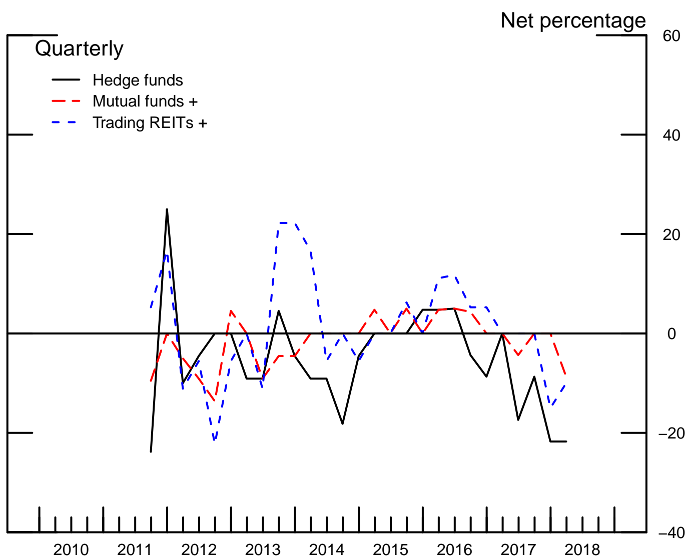


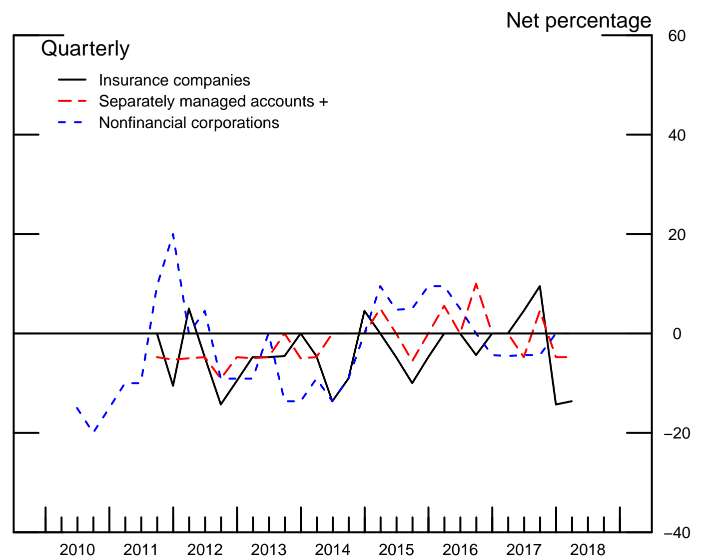
Respondents tightening price terms to the following:





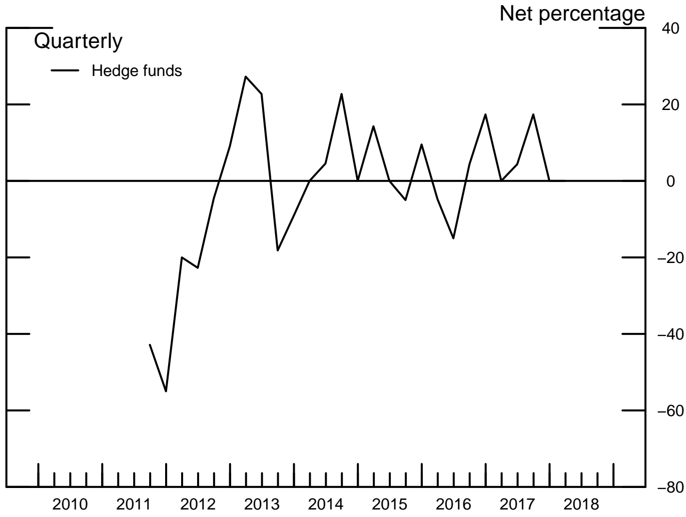
Respondents tightening non−price terms to the following:

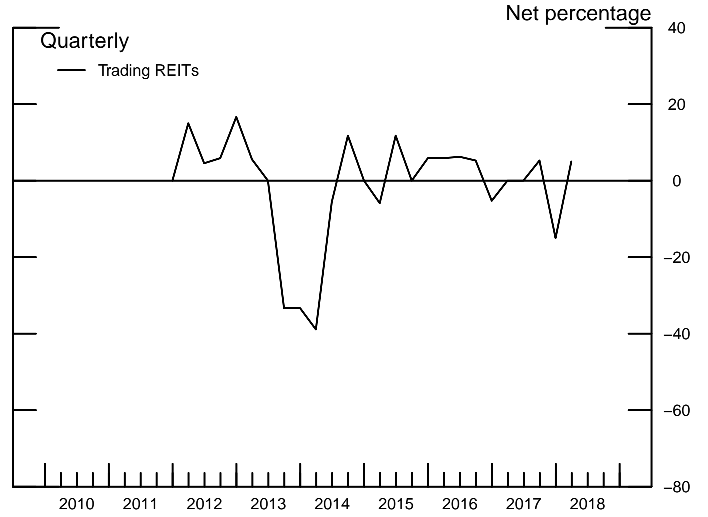


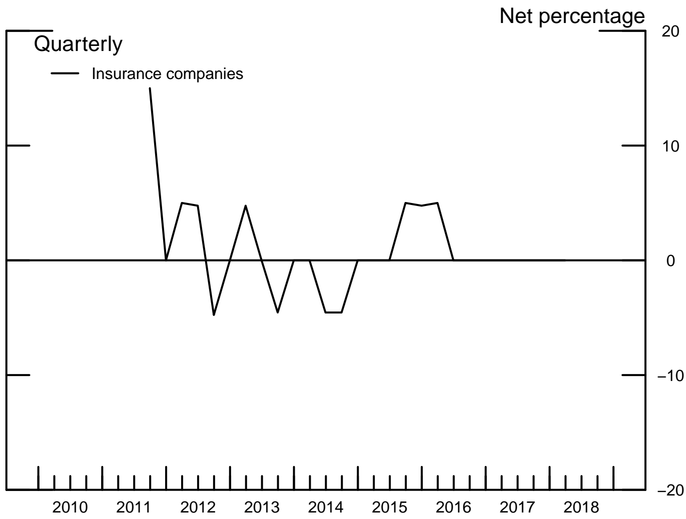


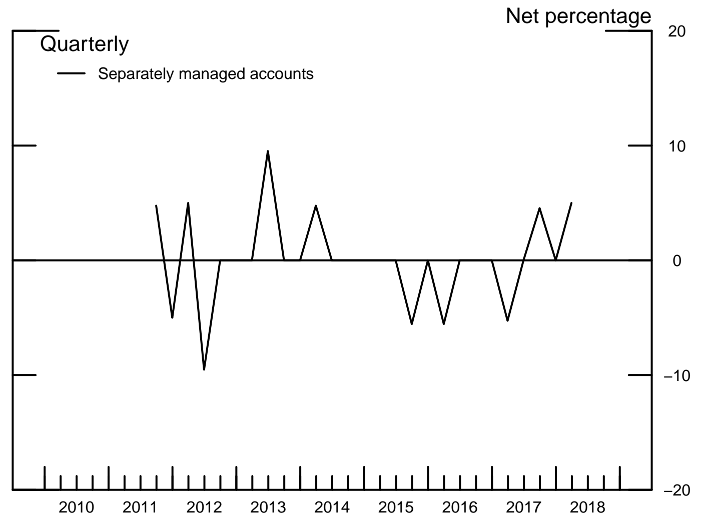
Use of Financial Leverage

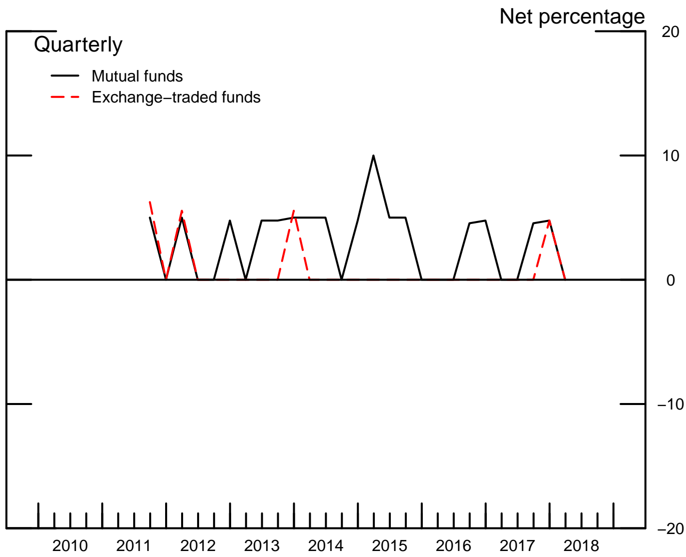
Respondents reporting increased use of leverage by the following:

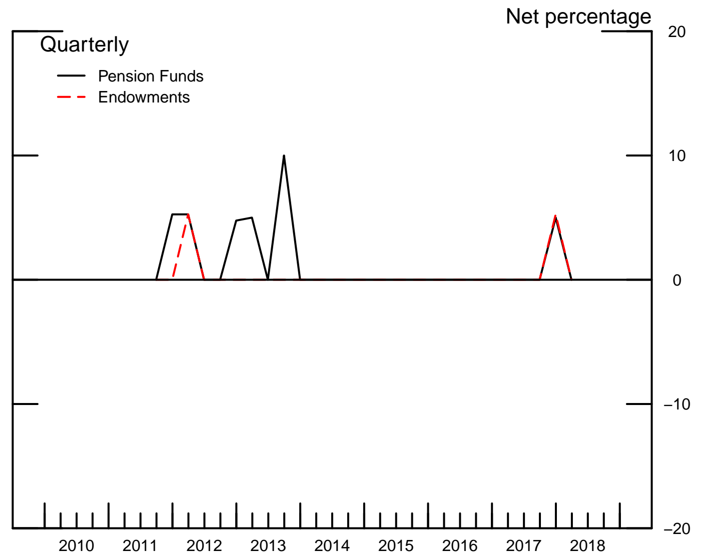






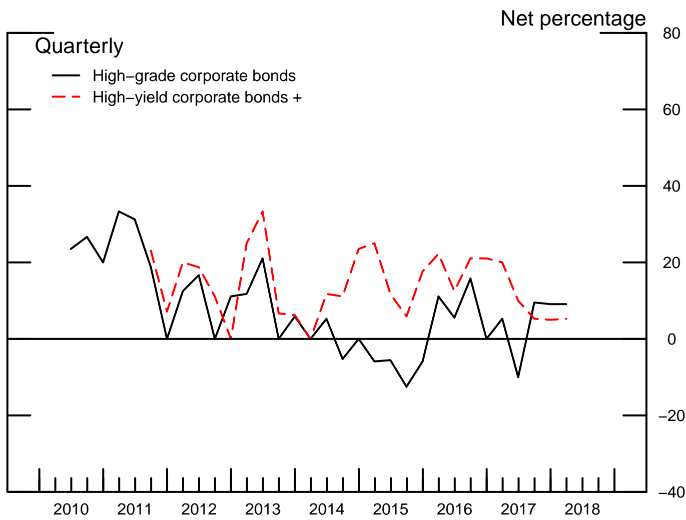


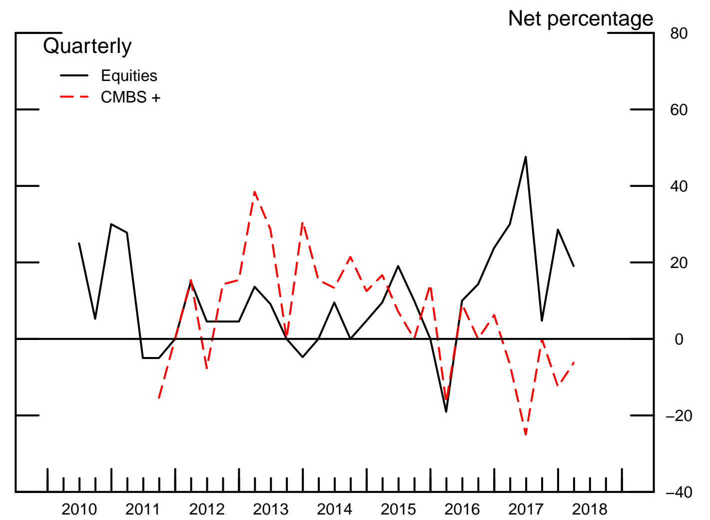


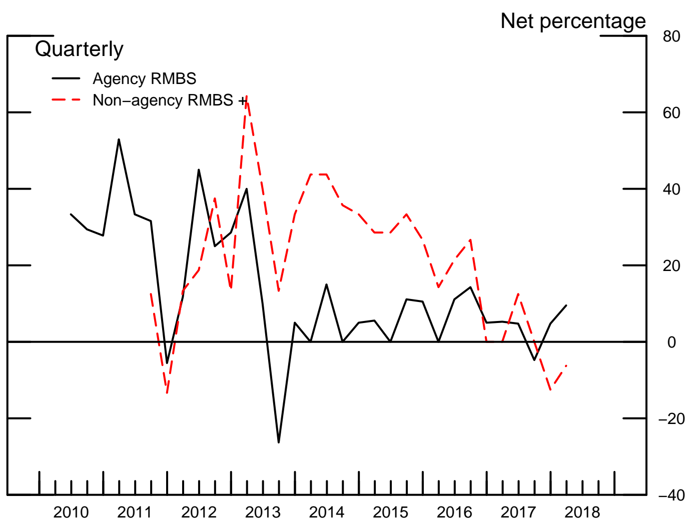


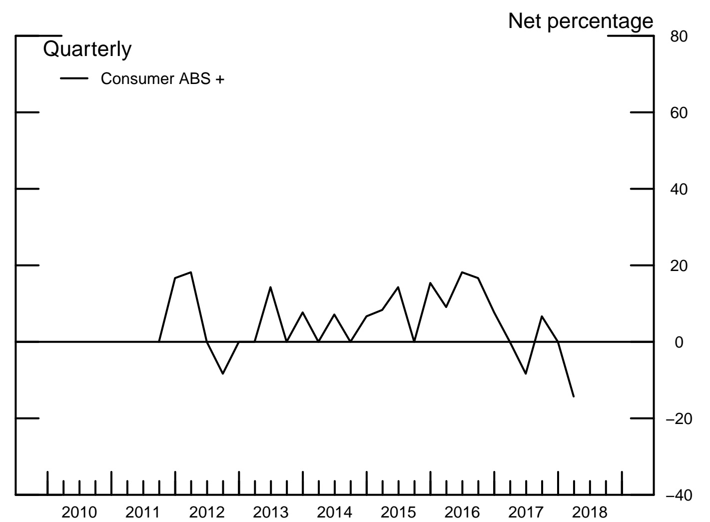
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:









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