The December 2017 Senior Credit Officer Opinion Survey on Dealer Financing Terms

The December 2017 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 developments in the collateralized loan obligation (CLO) market over the past three years. 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 November 6, 2017, and November 17, 2017. The core questions asked about changes between September 2017 and November 2017.[1]

Core Questions

(Questions 1–79)[2]

Responses to the core questions in the December survey offered several insights regarding 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:

- About one-fifth of respondents reported an easing in price terms for their hedge fund and trading real estate investment trust (REIT) clients. Among the dealers that indicated an easing of terms, more aggressive competition from other institutions was cited most frequently as an important reason. About one-fifth of dealers reported an easing in nonprice terms for hedge fund clients, and a smaller fraction reported such an easing for trading REIT clients. Price and nonprice terms were basically unchanged for all other classes of counterparties.
- About one-fourth of dealers noted an increase in the intensity of efforts by hedge fund clients to negotiate more favorable terms, and a smaller net fraction reported such an increase by trading REIT clients.

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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.

- A net fraction of one-sixth of dealers indicated an increase in the amount of resources and attention devoted to the management of concentrated credit exposure to central counterparties and other financial utilities. The same fraction of dealers noted that changes in the practices of central counterparties, such as margin requirements and haircuts, had influenced the credit terms applied to their clients on uncleared bilateral transactions to some extent.

With respect to the **use of financial leverage**, a small fraction of dealers reported a decrease in the use of financial leverage by trading REIT clients, while the use of financial leverage by other classes of counterparties was basically unchanged. A slightly smaller fraction of dealers reported an increase in the availability of additional (and currently unutilized) financial leverage under agreements currently in place with hedge funds.

With regard to **OTC derivatives markets**, dealers reported the following:

- Initial margin requirements on OTC derivatives were basically unchanged, on net, for both average and most-favored clients, across all types of derivatives.
- Small fractions of dealers reported that the volume of mark and collateral disputes had decreased on OTC derivatives contracts referencing equities, foreign exchange, and corporates.

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

- One-fifth of dealers noted a decrease over the past three months in haircuts for average clients in non-agency residential mortgage-backed securities (RMBS) and for both average and preferred clients in commercial mortgage-back securities. The same fraction of respondents reported an increase in the maximum amount of funding for preferred clients in non-agency RMBS. Across all asset classes, dealers reported that financing rates (collateral spreads over the relevant benchmarks) and maximum maturity were basically unchanged.
- Over one-fourth of respondents indicated an increase in demand for funding for equities, and a small net fraction reported an increase in demand for term funding with a maturity greater than 30 days for agency RMBS.
- A small fraction of dealers noted an improvement in the liquidity and market functioning for asset-backed securities. The liquidity and market functioning for other asset classes was reported to have been generally unchanged.

Special Questions on Collateralized Loan Obligations

(Questions 81–98)

Over the past three years, CLO assets under management have expanded at a solid pace, and a number of new CLO securities have been brought to the market. In the special questions for the survey this quarter, dealers were asked about the various ways in which they were involved in the CLO market. Dealers were also asked to assess changes in

credit terms and conditions in the CLO market since November 1, 2014, and to provide reasons behind the changes, if any.

With respect to dealers' **current provision of warehouse financing facilities (for funding of leveraged loans on an interim basis to allow the accumulation of assets for eventual securitization into CLOs) and changes to this provision over the past three years**, dealers reported the following:

- About three-fifths of dealers reported that they provided warehouse financing facilities.
- Of the dealers that provided warehouse financing, a net fraction of almost two-thirds noted an increase, over the past three years, in their willingness to provide such financing.
- A net fraction of one-third of the dealers that provided warehouse financing noted an easing in price or nonprice terms. More aggressive competition from other institutions was, on balance, cited as the most important reason for the easing, followed by an improvement in the credit quality of their clients and their institutions' increased willingness to take on risk.
- The vast majority of dealers that provided warehouse financing indicated an increase in their clients' demand for these financing facilities. The important reasons for the increase cited by dealers included their clients' increased willingness to take on risk and higher expected returns on CLO securities associated with realized or anticipated interest rate increases.

With respect to dealers' **current provision of funds to facilitate their clients' purchase of CLO securities and changes to this provision over the past three years**, dealers indicated the following:

- About three-fifths of respondents reported that they provided financing to facilitate their clients' purchase of CLO securities. Among these dealers, a net fraction of about two-thirds reported some easing, over the past three years, in price and nonprice terms under which CLO purchases were funded. Dealers pointed to an improvement in general market liquidity and functioning as the most important reason for an easing, followed by more aggressive competition from other institutions and their own increased willingness to take on risk.[3]
- About three-fifths of the respondents that provided financing to facilitate their clients' purchase of CLO securities, on net, reported that their clients' demand for such funding had increased over the past three years. Important reasons for the increased demand cited by dealers included their clients' increased willingness to take on risk and higher expected returns on CLO securities associated with realized or anticipated interest rate increases.

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[3] Most of the dealers that provided financing to facilitate the purchase of CLO securities for their clients reported that the liquidity and functioning in the CLO market had improved over the past three years.

- More than one-third of the respondents that provided such financing reported that the securities currently financed for their clients were mostly mezzanine tranches. The same fraction reported that the securities were mostly a mix of triple-A-rated and mezzanine tranches or a mix of mezzanine and equity tranches. Over one-fifth reported that the securities covered a range of tranches across the capital structure, all in meaningful proportions.

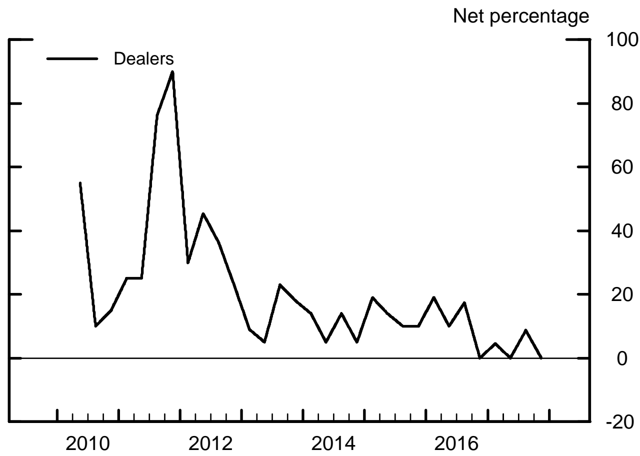
With respect to dealers' **current ownership of CLO securities and changes over the past three years**, they reported the following:

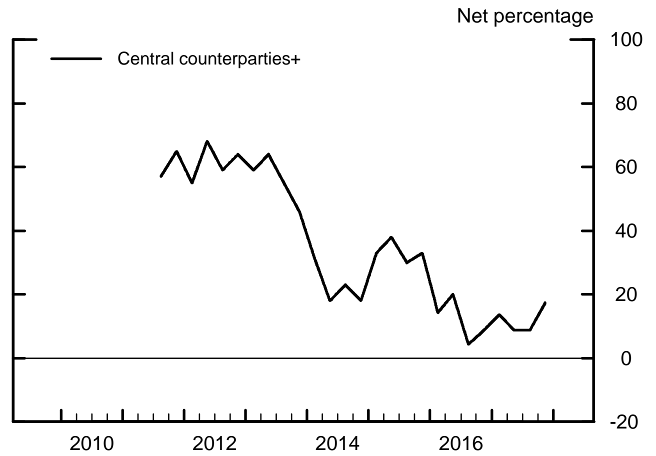
- About two-thirds of the respondents reported that they directly held CLO securities. Of those respondents, two-fifths reported an increase, over the past three years, in their demand for CLO securities. Dealers cited an improvement in general market liquidity and functioning as the primary reason for the increase, followed by increased availability of balance sheet or capital and their increased willingness to take on risk.
- Three-fifths of the respondents holding CLO securities reported holding mostly triple-A-rated tranches in the CLO capital structure. Over one-fourth reported holding mostly mezzanine tranches, a mix of triple-A-rated and mezzanine tranches, or a mix of mezzanine and equity tranches. The remainder reported holding a range of tranches across the capital structure, all in meaningful proportions.

This document was prepared by Youngsuk Yook, 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.

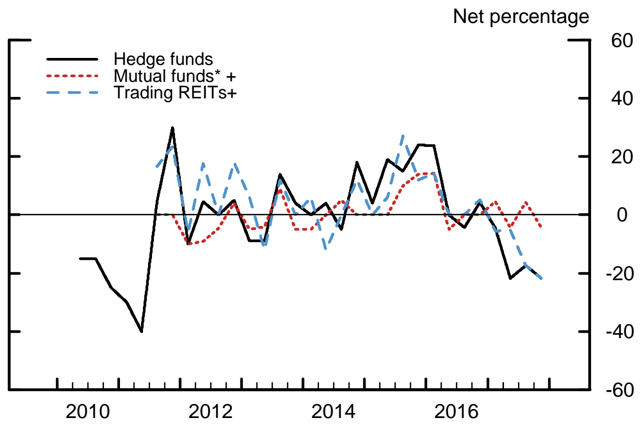
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

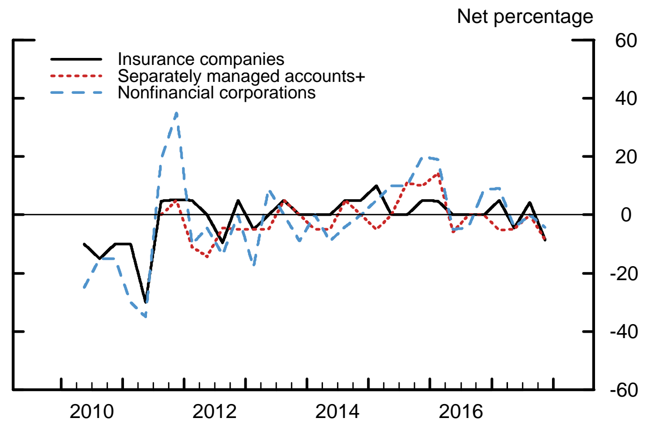
Respondents increasing resources and attention to management of concentrated exposures to the following:



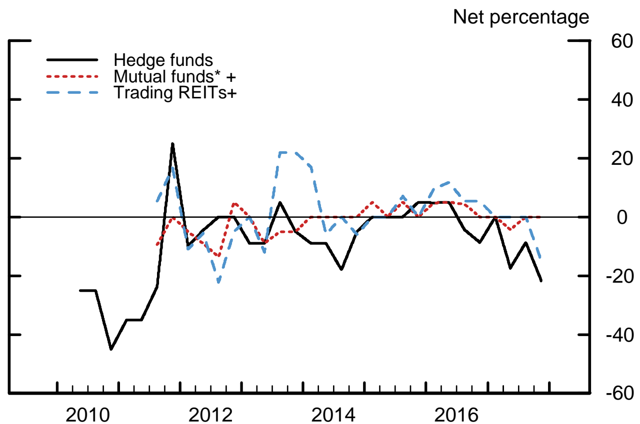


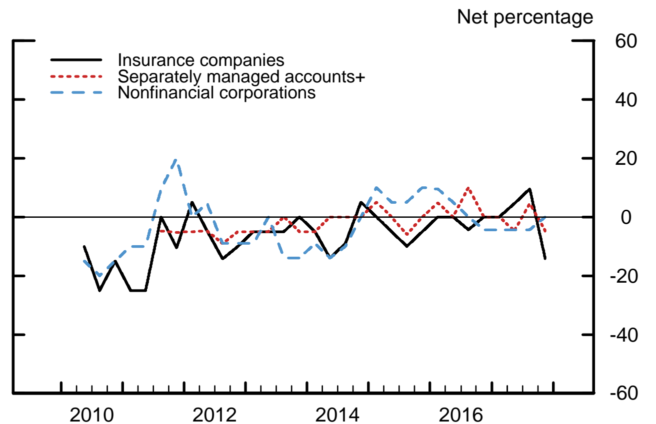
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

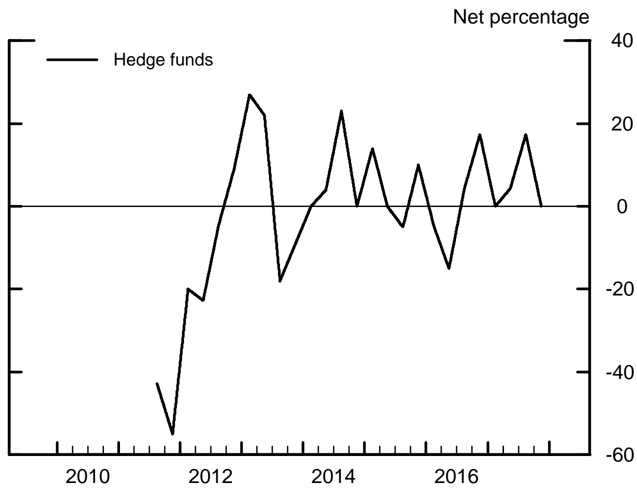


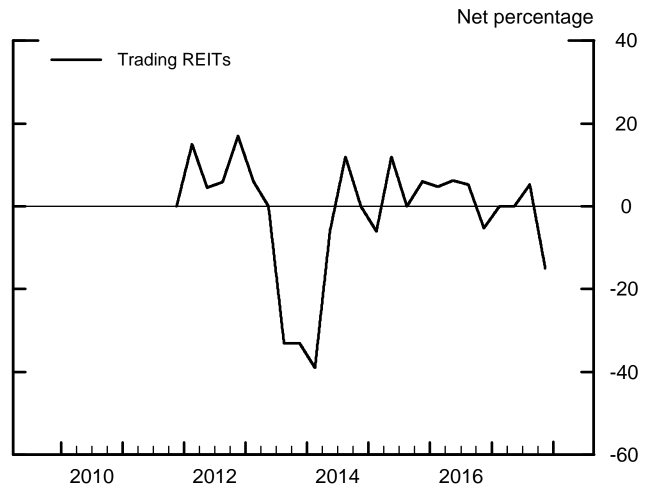


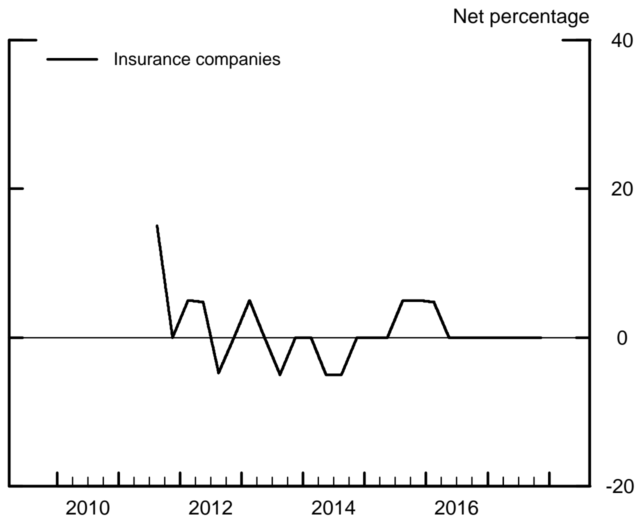
+ This question was added in the September 2011 survey.
* Includes mutual funds, exchange-traded funds, pension plans, and endowments.

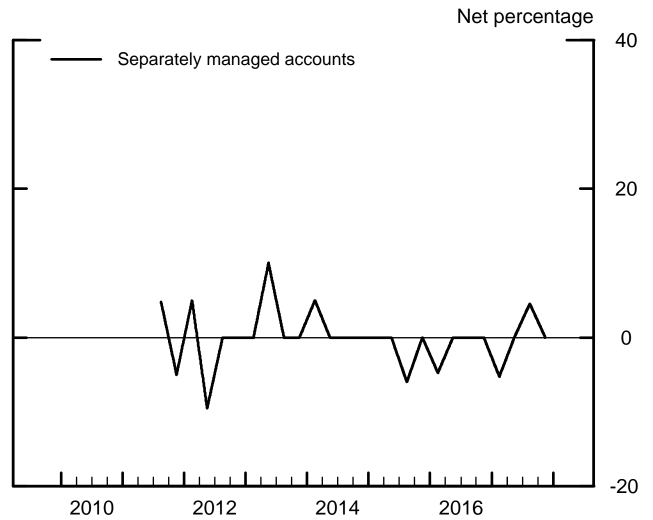
Use of Financial Leverage

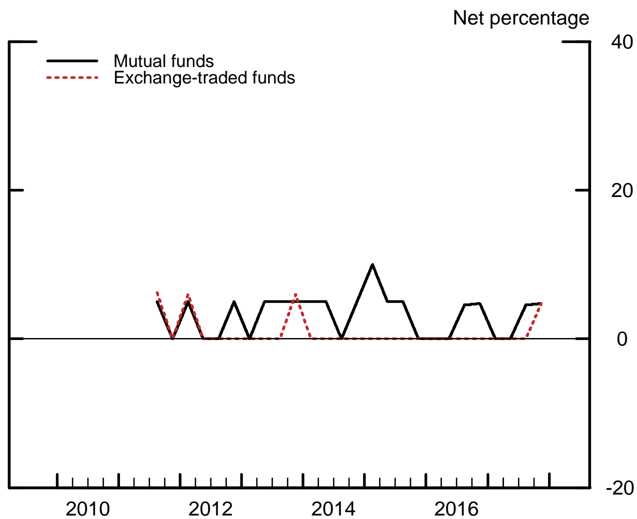
Respondents reporting increased use of leverage by the following:

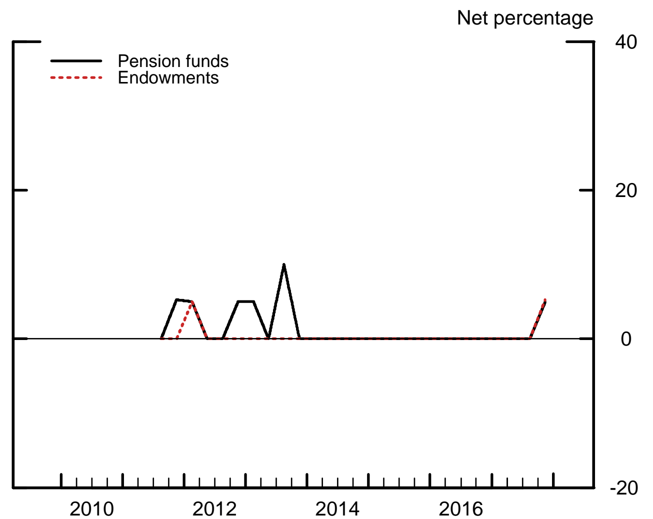








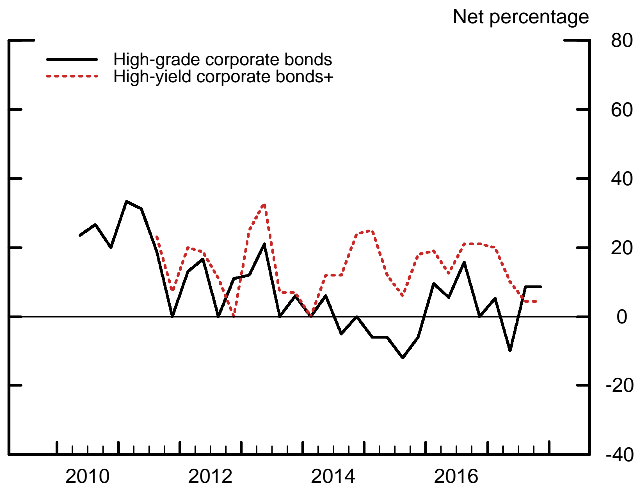


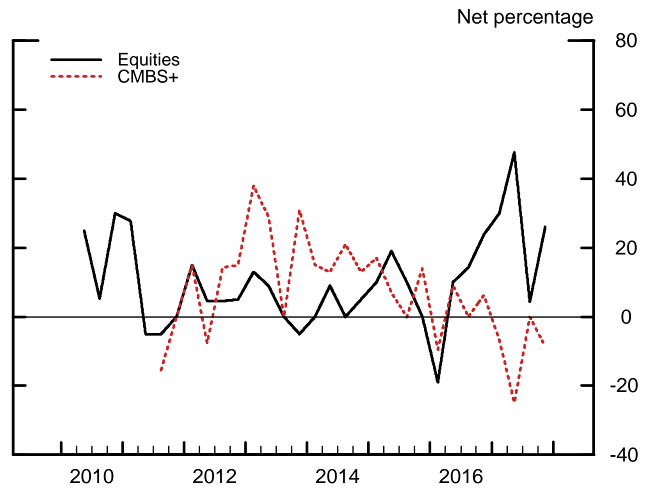


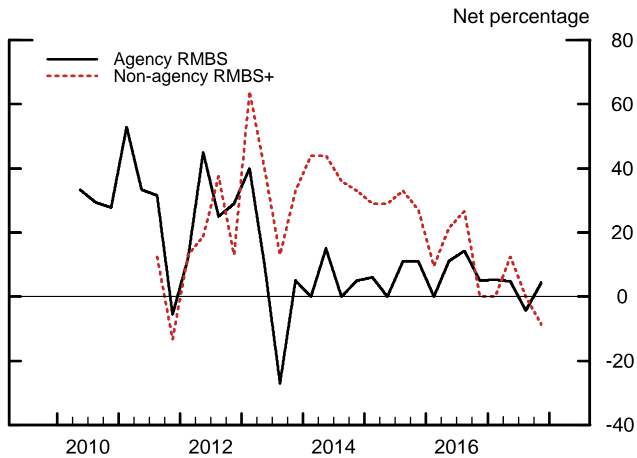
Note: All questions regarding counterparties' use of financial leverage were added in the September 2011 survey.

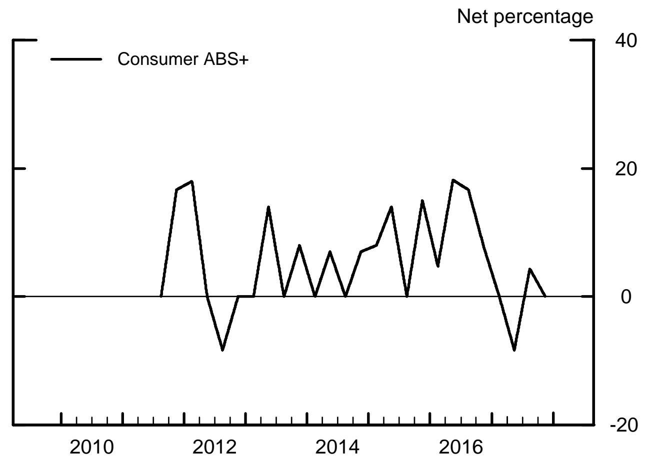
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

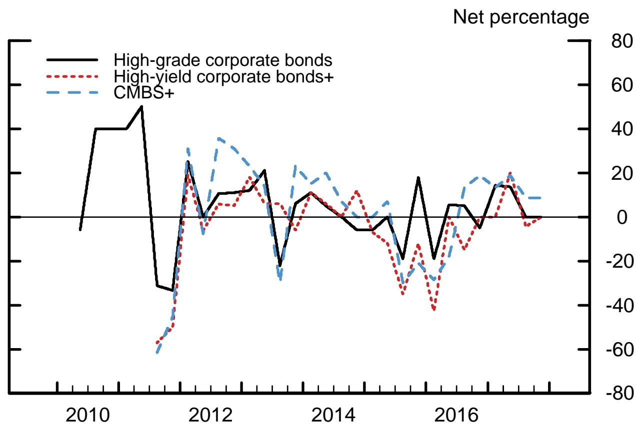


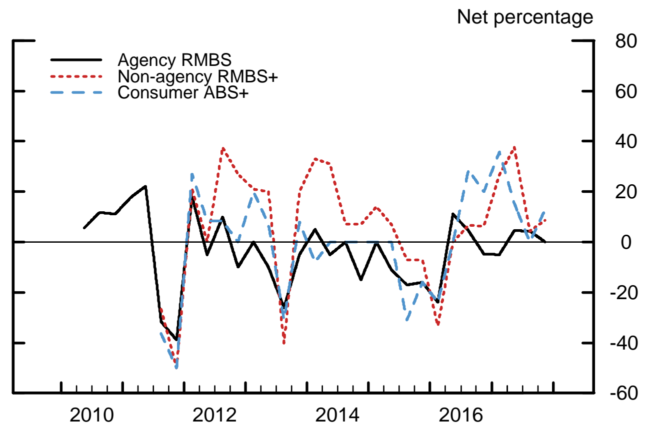






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





+ This question was added in the September 2011 survey.