The March 2020 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The March 2020 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 related to bifurcation of spreads in corporate bond and collateralized loan obligations markets during the second half of 2019. The 22 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 11, 2020, and February 25, 2020, and closed before the recent period of high market volatility related to COVID-19. The core questions asked about changes between December 2019 and February 2020.[1]

Core Questions
(Questions 1–79)[2]

Responses to the core questions in the December survey offered a few insights into recent changes in the terms under which dealers facilitate their clients' securities and derivatives transactions. 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 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 over the past three months (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit").
- Price and nonprice terms on securities financing transactions and OTC derivatives were generally unchanged across all classes of counterparties, although a small net fraction of dealers indicated easing of price terms for mutual funds, real estate investment trusts (REITs), and nonfinancial corporations (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit").

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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.

- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types, although a small net fraction of dealers indicated a reduction in the volume and duration of such disputes with hedge funds, REITs, mutual funds, and exchange-traded funds.

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.
- The volume and duration of mark and collateral disputes remained largely unchanged over the past three months, with a small net fraction of respondents indicating a decrease in the duration and volume of such disputes across most OTC derivatives.

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

- A net fraction of approximately one-fifth of dealers reported increased demand to fund equities, and a similar net fraction of dealers reported increased demand for term funding of non-agency residential mortgage-backed securities (RMBS). A somewhat smaller net fraction of respondents also indicated an increase in demand for funding for agency RMBS and asset-backed securities (ABS). Demand for funding remained largely unchanged for investment-grade and high-yield bonds (see the exhibit "Measures of Demand for Funding and Market Functioning").
- Terms under which various types of securities are funded remained largely unchanged since the previous survey. A small net fraction of dealers reported tightening of financing for equities for their preferred clients.
- A small fraction of dealers, on net, reported an improvement in the liquidity and functioning of the market in high-grade corporate bonds, agency and non-agency RMBS, and consumer ABS in the past three months (see the exhibit "Measures of Demand for Funding and Market Functioning").[3]

Special Questions on the Bifurcation of Spreads in Corporate Bond and CLO Markets

Spreads on speculative-grade corporate bonds and CLO tranches exhibited a notable bifurcation in the second half of 2019, with spreads of triple-C corporate bonds and below-investment-grade CLO tranches over comparable-maturity Treasury securities having widened substantially and spreads of corporate bonds rated B or double-B and investment-grade CLO tranches having narrowed. In the special questions of the survey this quarter, dealers were asked about changes

[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.

in demand for funding for these securities over the second half of 2019 and the main reasons for these changes.

With respect to spread bifurcation in the **corporate bond** market, dealers reported the following:

- Most respondents indicated that demand for funding of corporate bonds rated triple-C and below remained unchanged.
- Meanwhile, a net fraction of about one-fourth of respondents indicated increased demand for corporate bonds rated B or double-B.
- The most frequently cited top reason for increased demand for funding of corporate bonds rated B or double-B was increased willingness of clients to take on risk, with some dealers also citing eased terms of financing or clients' improved assessment of credit risk of these bonds.

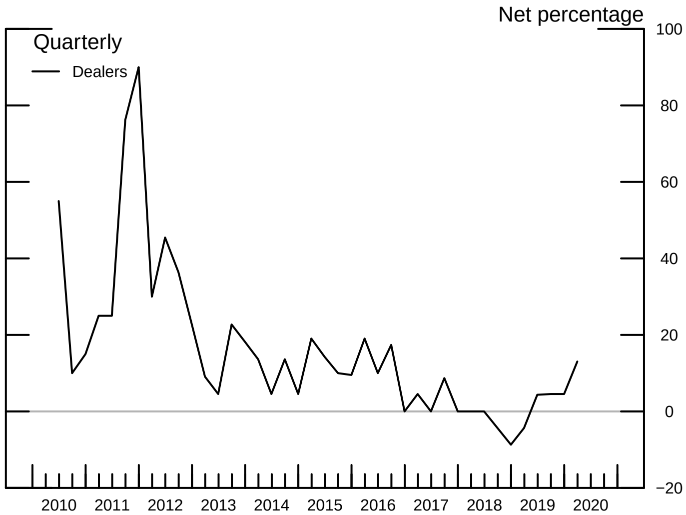
With respect to spread bifurcation in the **CLO** market, dealers reported the following:

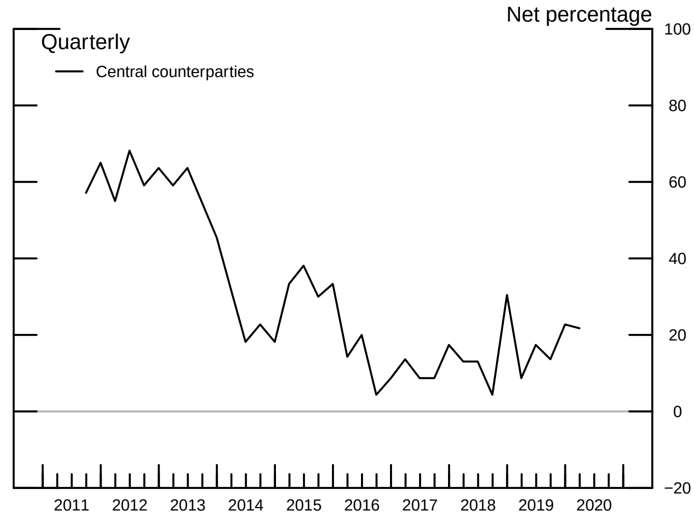
- Most respondents indicated that demand for funding of CLO tranches below investment grade remained unchanged.
- A net fraction of about one-fifth of respondents indicated increased demand for investment-grade CLO tranches.
- The most frequently cited top reason for increased demand for funding of investment-grade CLO tranches was clients' improved assessment of credit risk of these securities, with some dealers also citing increased willingness of clients to take on risk.

This document was prepared by Valery Polkovnichenko, 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.

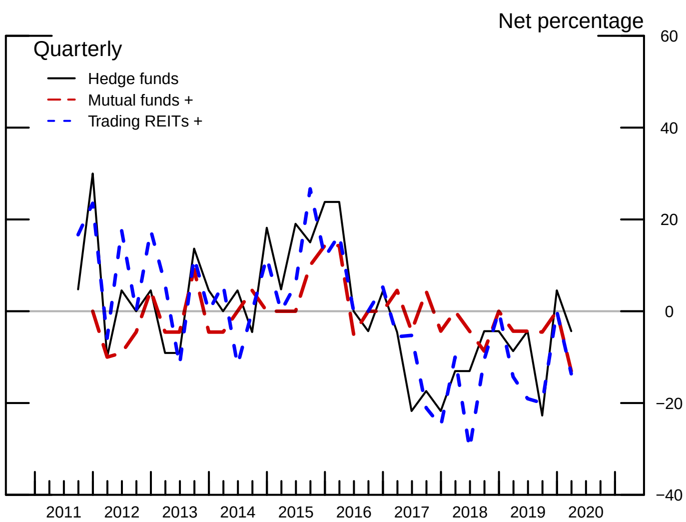
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

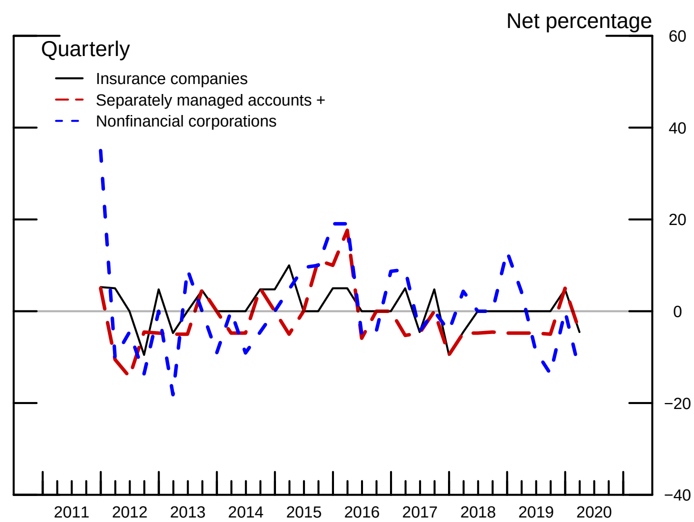
Respondents increasing resources and attention to management of concentrated exposures to the following:



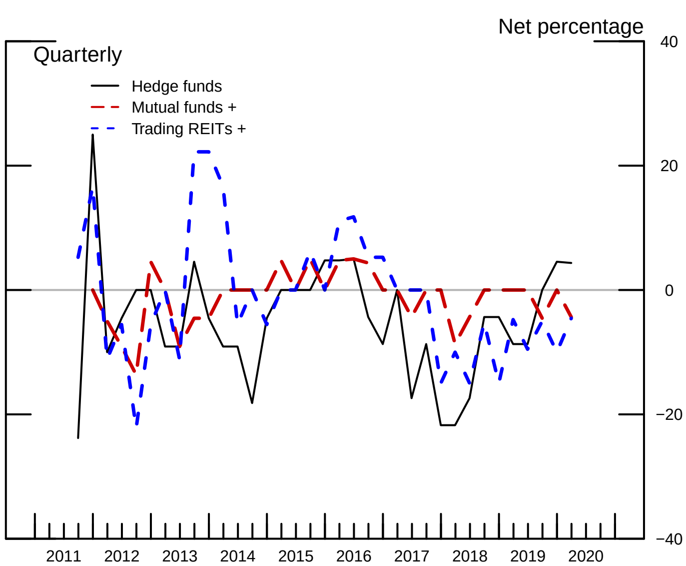


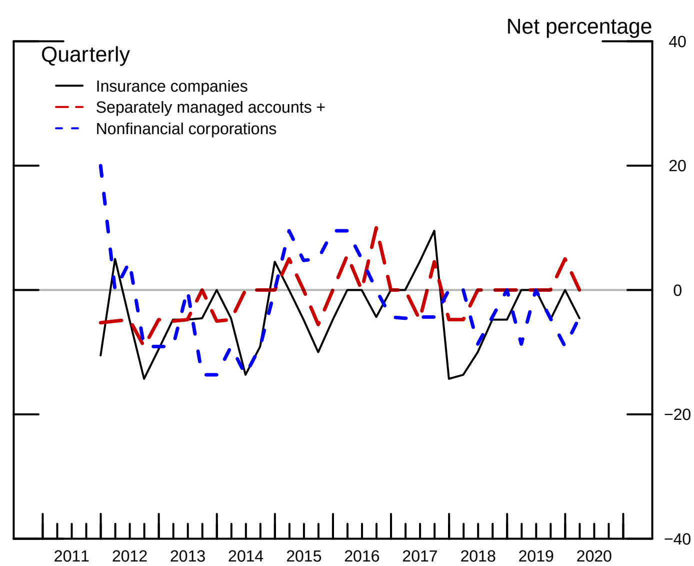
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

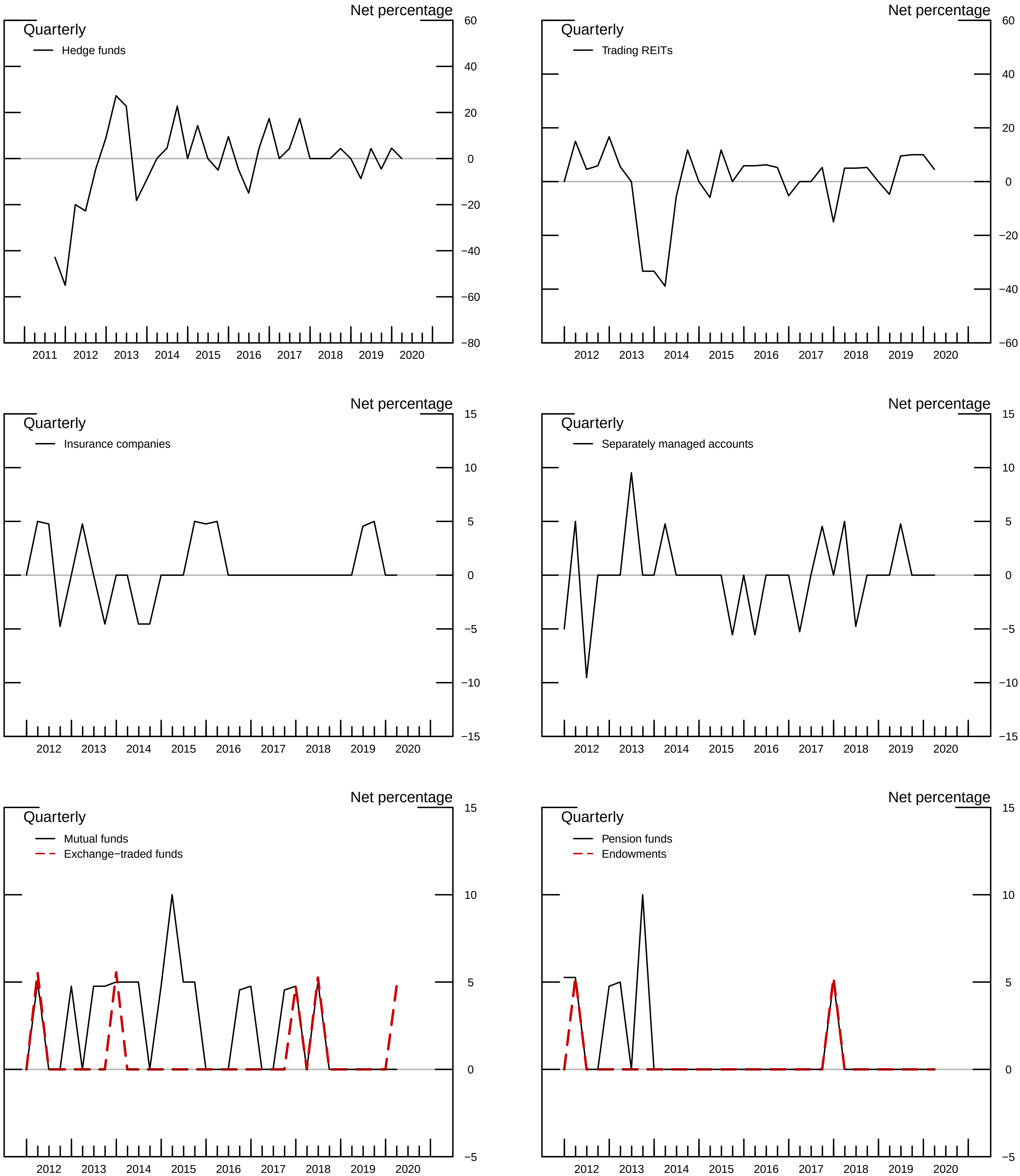




+ The question was added to the survey in September 2011.
Note: REIT is real estate investment trust.

Use of Financial Leverage

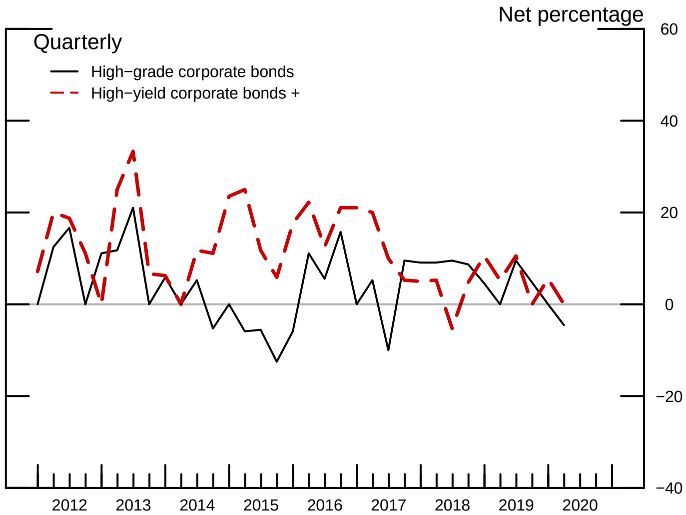
Respondents reporting increased use of leverage by the following:

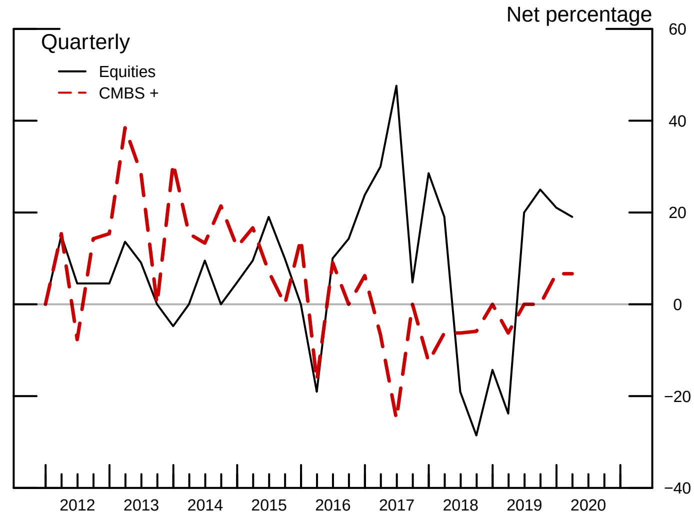


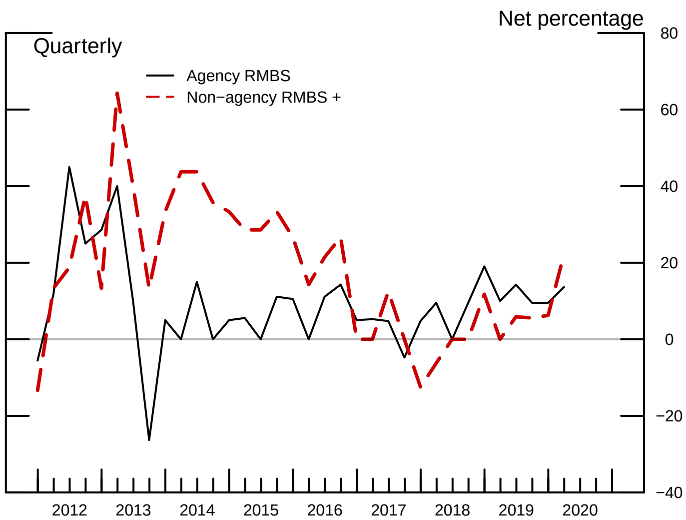
Note: REIT is real estate investment trust.

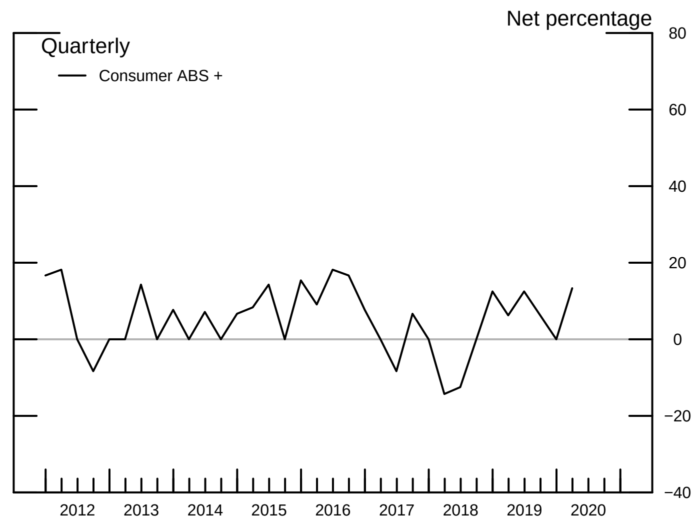
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

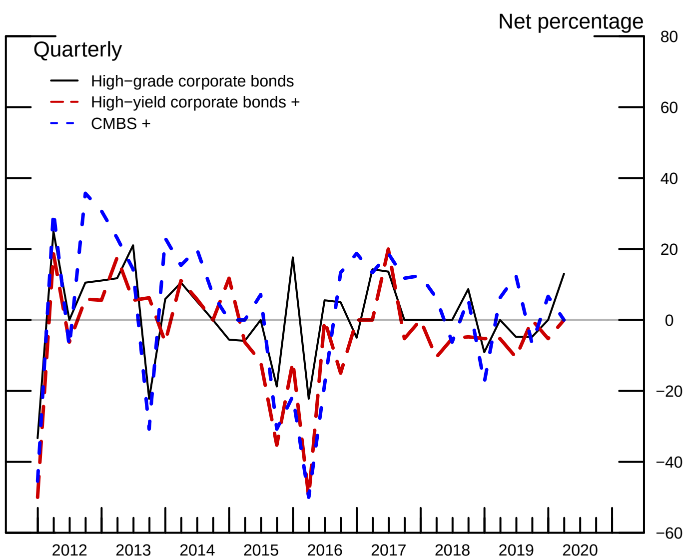


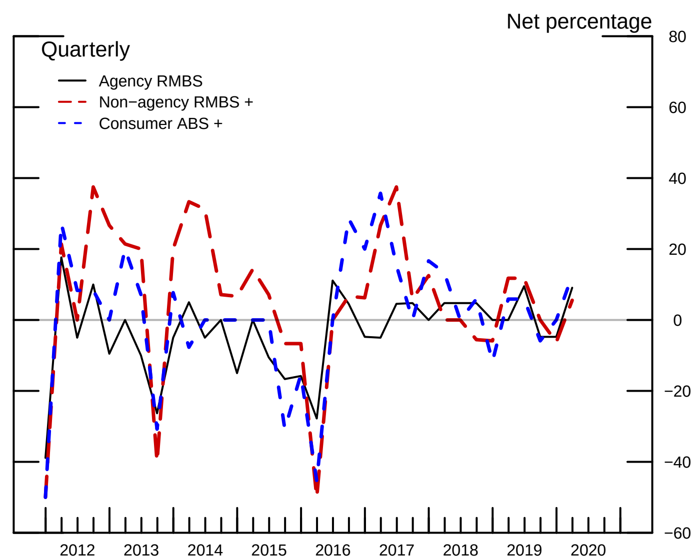






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





+ The question was added to the survey in September 2011.
Note: CMBS is commercial mortgage−backed securities, RMBS is residential mortgage−backed securities, and ABS is asset−backed securities.