The September 2021 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The September 2021 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 between mid-May 2021 and mid-August 2021. In addition to the core questions, the survey included a set of special questions about risk-management practices in equity derivatives markets. The 23 institutions participating in the survey account for almost all dealer financing of dollar-denominated securities to non-dealers and are the most active intermediaries in OTC derivatives markets. The survey was conducted between August 17, 2021, and September 1, 2021. The core questions asked about changes between mid-May 2021 and mid-August 2021.[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:

- Price and nonprice terms on securities financing transactions and OTC derivatives were generally unchanged across most classes of counterparties. For hedge funds, about one-fifth of dealers, on net, reported tightening of nonprice terms such as haircuts, maximum maturity, or covenants. A small net fraction of dealers reported easing nonprice terms for trading real estate investment trusts (REITs) (see the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit”). A small net fraction of dealers indicated an increase in hedge funds’ and trading REITs’ efforts to negotiate more-favorable price and nonprice terms.

- Almost all respondents indicated that resources and attention devoted to managing concentrated credit exposure to dealers and central counterparties remained unchanged and that changes in central counterparty practices have not affected, or have minimally affected, the credit terms they offer to clients on bilateral transactions that are not cleared.

- The volume and duration of mark and collateral disputes remained basically unchanged over the past three months for most counterparty types, although small net fractions of

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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.

dealers indicated a reduction in the volume of such disputes with hedge funds, traded REITs, mutual funds and exchange-traded funds, and separately managed accounts.

With respect to clients' **use of financial leverage**, dealers indicated little change, on net, over the past three months for most types of counterparties. However, about one-fifth of dealers, on net, reported a decrease in the use of leverage by hedge funds (see the exhibit "Use of Financial Leverage").

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

- Nonprice terms in master agreements for OTC derivatives remained largely unchanged.

- The volume and duration of mark and collateral disputes remained largely unchanged over the past three months for most types of contracts. A small net fraction of respondents indicated a decrease in the volume of mark and collateral disputes for commodity derivatives, while a similar fraction indicated an increase in the volume of disputes for contracts referencing interest rates. Furthermore, a small net fraction of respondents reported an increase in dispute durations for derivatives referencing equities and securitized products.

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

- For non-agency residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and consumer asset-backed securities, about one-third of respondents indicated easing of funding terms, such as haircuts and collateral spreads, for both average and most-favored clients. For other asset classes, terms under which various types of securities are funded remained largely unchanged.

- On net, about one-fourth of dealers reported increased demand to fund high-yield corporate bonds. About one-fifth of dealers, on net, reported decreased demand to fund agency RMBS. In addition, between one-fifth and one-fourth of respondents, on net, reported increased demand for term funding for high-yield corporate bonds, CMBS, and non-agency RMBS. Demand for funding for other asset classes was largely unchanged (see the exhibit "Measures of Demand for Funding and Market Functioning").

- Approximately one-fifth of respondents, on net, indicated an improvement in liquidity and market functioning for CMBS and non-agency RMBS markets.

- The volume and duration of mark and collateral disputes remained unchanged, on net, across all collateral types.

Special Questions on Risk-Management Practices in Equity Derivatives Markets

The special questions asked about the importance of various risk-management practices for clients engaged in trading options and other derivative products referencing individual stocks and the changes in their application since the beginning of the year. The questions were asked separately in relation to clients who engage in trading exchange-listed options on individual stocks and to clients who use OTC derivative products referencing individual stocks.

With respect to **risk-management practices for clients trading exchange-listed options**, dealers reported the following:

- Nearly all dealers reported having institutional clients who engage in trading exchange-listed equity options, and approximately two-fifths of dealers reported that such clients constitute a moderate or large fraction of their institutional clientele.

- Three-fourths of dealers with institutional clients trading exchange-listed equity options on individual stocks ranked *collection of initial and variation margin* as their first or second most prevalent risk-management tool for managing counterparty risk. Next was *limits on potential future exposure* (PFE), which was ranked as the first or second most prevalent risk-management tool by one-half of respondents.[3] While ranked less prominently overall than these top two tools, a frequently mentioned option is the *monitoring of overall client leverage and exposure,* selected by two-thirds of respondents as either the third or fourth most prevalent risk-management tool.

- Approximately one-third of respondents, on net, reported tightening of the terms for initial and variation margin and for the monitoring of overall client leverage and exposure since the beginning of 2021. Close to one-fifth of respondents, on net, reported tightening of the limits on PFE over the same period.

With respect to **risk-management practices for clients trading OTC derivatives and structured products linked to individual stocks**, dealers reported the following:

- Nearly all dealers reported having institutional clients who use OTC derivative and structured products with exposure to individual stocks, and approximately one-half of dealers reported that such clients constitute a moderate or large fraction of their institutional clientele.

- With respect to OTC derivatives linked to individual stocks, two-thirds of respondents indicated that total return swaps are the most heavily used, two-thirds ranked OTC equity options as the second most heavily used, and one-third ranked auto-callable structured notes as the third most heavily used product.

- The rankings of counterparty risk-management tools for OTC derivatives closely matched those for exchange-listed equity options. Three-fourths of dealers ranked *collection of initial and variation margin* as the first or second most prevalent risk-management tool. Next was *limits on PFE,* which was ranked as the first or second most prevalent risk-management tool by two-thirds of respondents. In addition, *monitoring of*

[3] PFE is a measure of counterparty risk defined as the maximum exposure estimated to occur at a future date at a high statistical significance level.

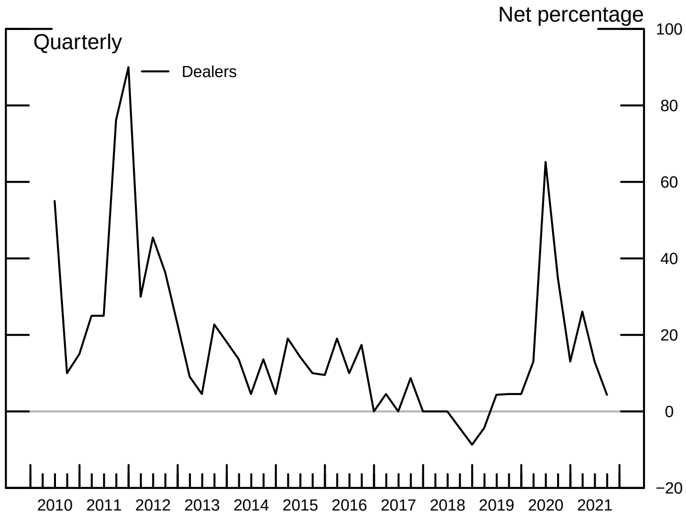
overall client leverage and exposure was selected by one-half of respondents as either the third or fourth most prevalent risk-management tool.

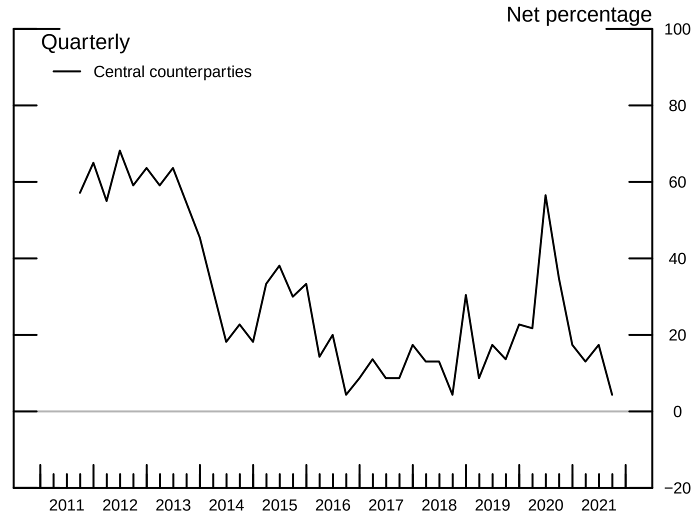
- The tightening of risk-management terms in 2021 was more pronounced for OTC derivatives than for exchange-listed options. Approximately three-fifths of respondents, on net, reported tightening of terms for initial and variation margin for clients using OTC derivative and structured products with exposure to individual stocks. Furthermore, approximately two-fifths of respondents, on net, reported tightening of limits on PFE. Approximately one-third of respondents, on net, indicated tightening in their monitoring of overall client leverage and exposure.

This document was prepared by Valery Polkovnichenko, Division of Reseach & 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.

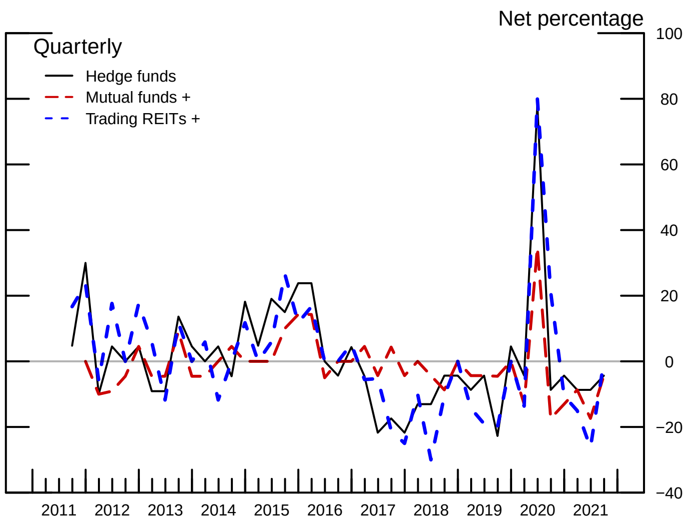
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

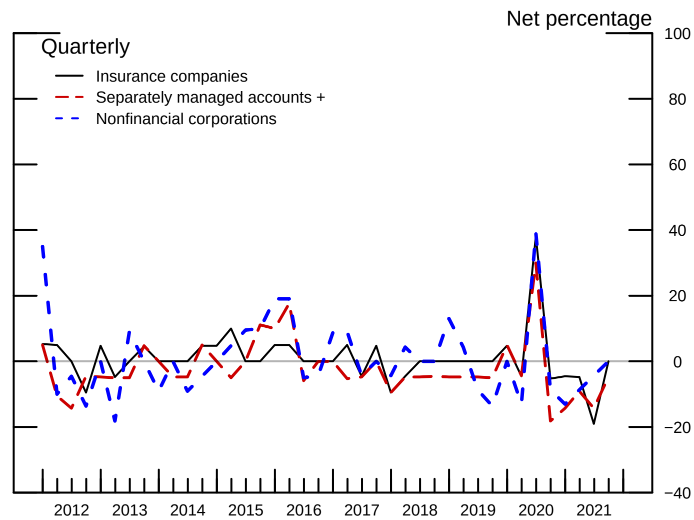
Respondents increasing resources and attention to management of concentrated exposures to the following:



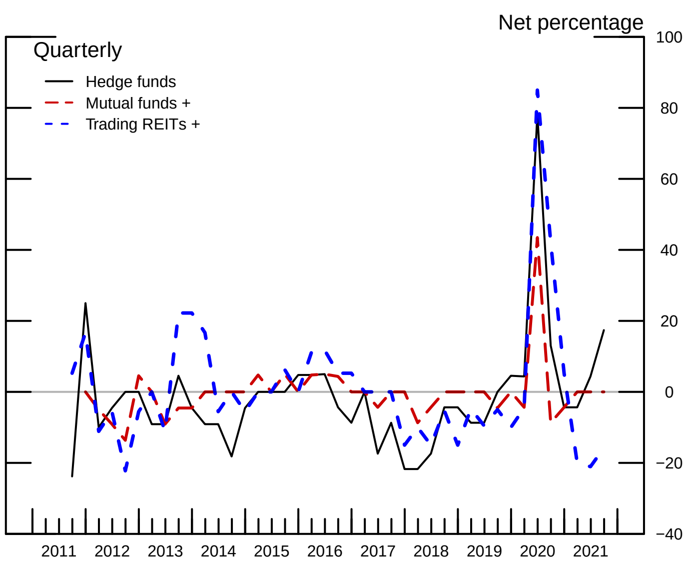


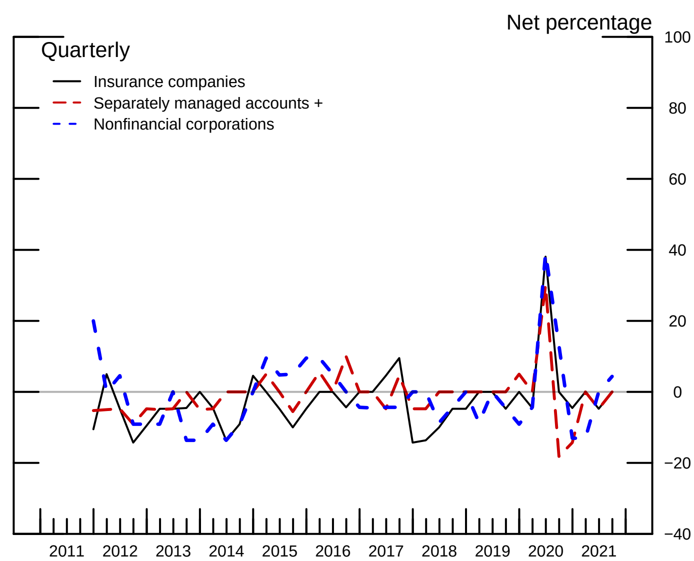
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

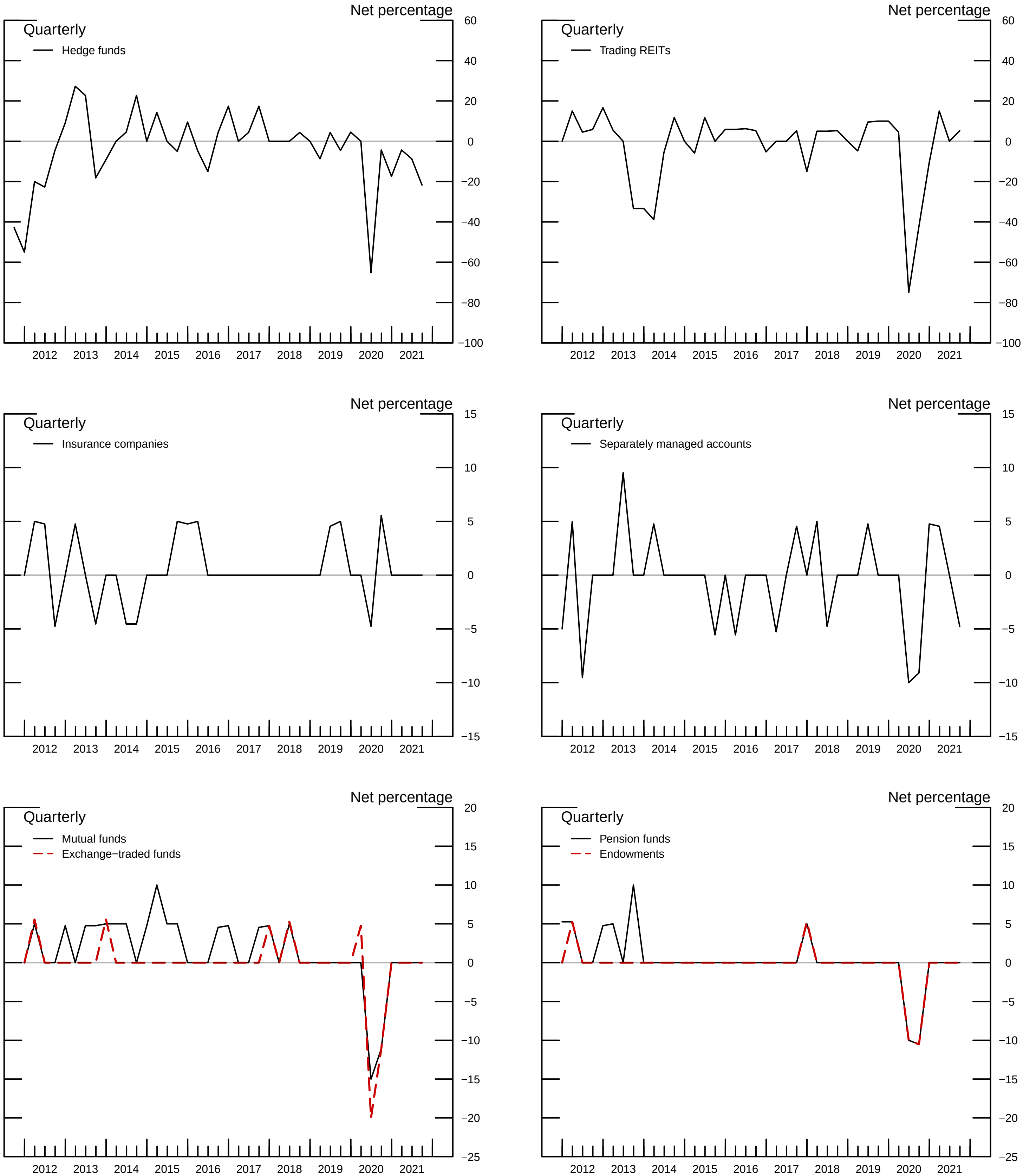




Note: REIT is real estate investment trust.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

Use of Financial Leverage

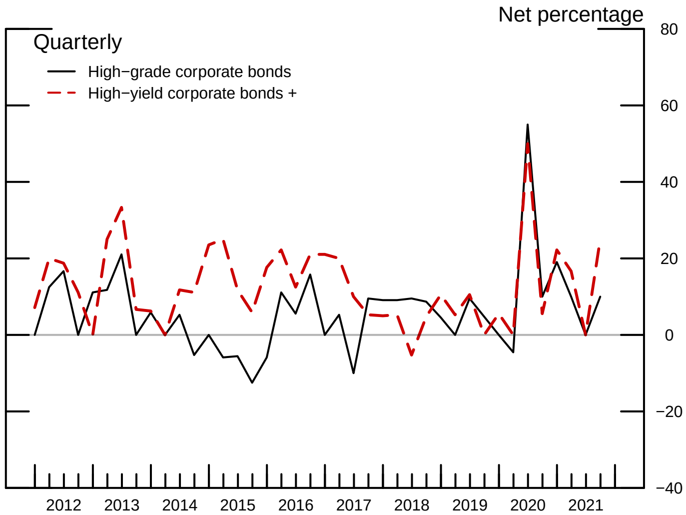
Respondents reporting increased use of leverage by the following:

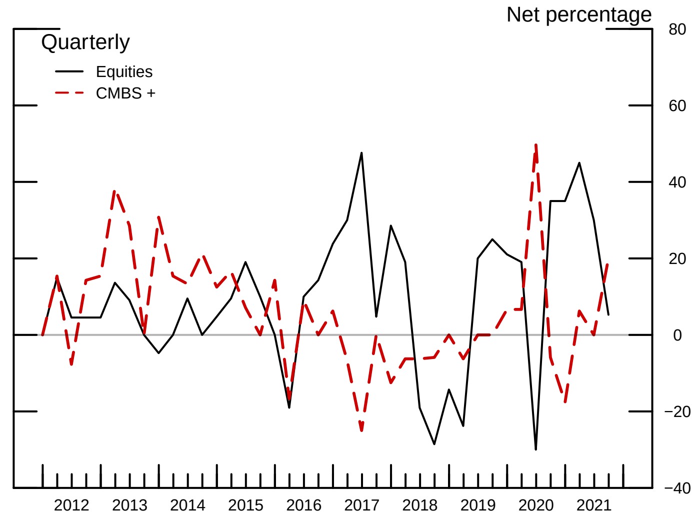


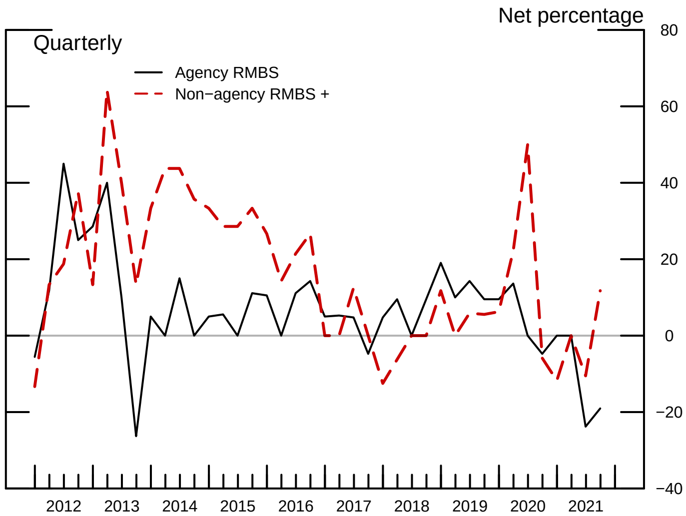
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

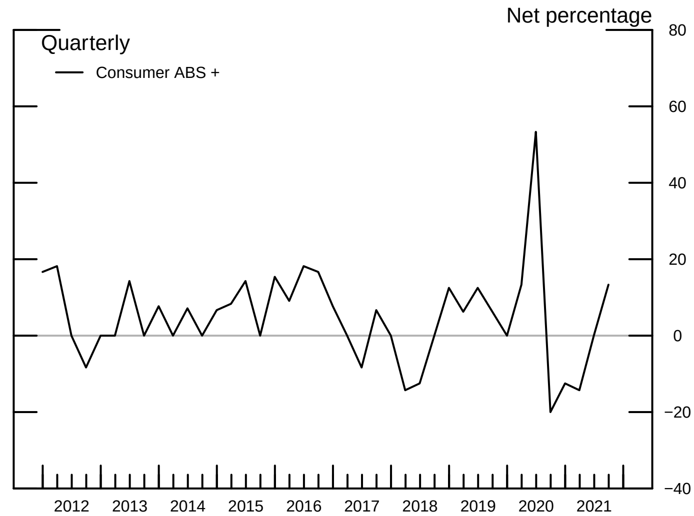
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

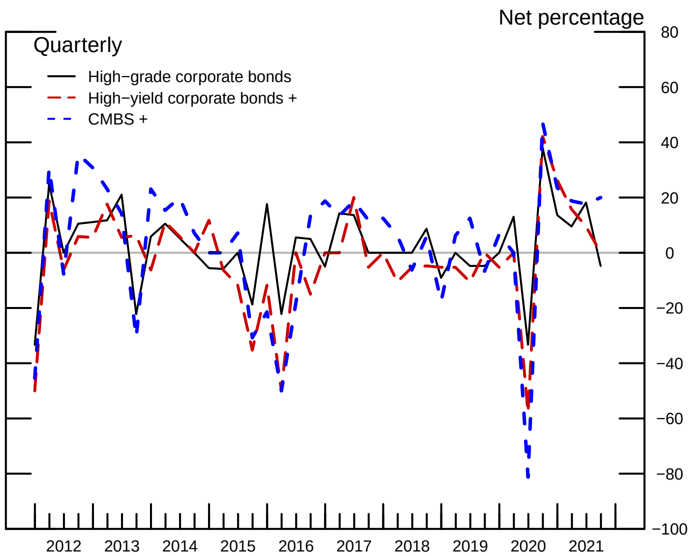


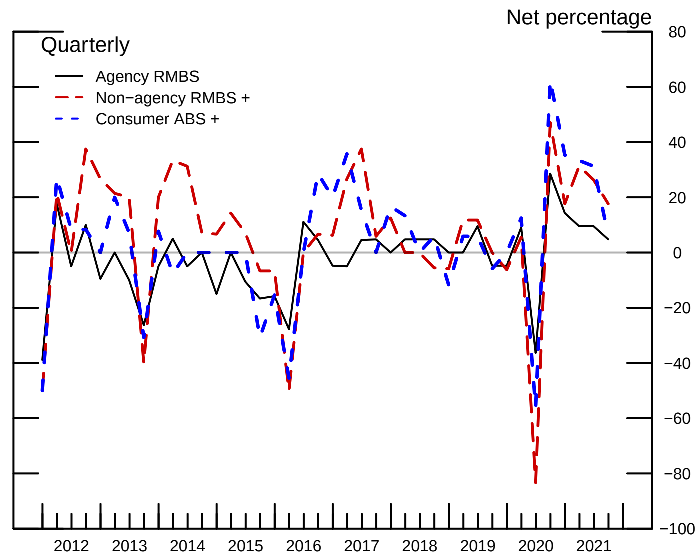






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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