

# The June 2018 Senior Credit Officer Opinion Survey on Dealer Financing Terms

## Summary

The June 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 special questions about the effect on dealers and their clients of the increase in U.S. equity market volatility in early February and the widening in LIBOR-OIS spreads that occurred earlier this year. 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 May 7, 2018, and May 23, 2018. The core questions asked about changes between March 2018 and May 2018.

## Core Questions

(Questions 1-79)<sup>1</sup>

Responses to the core questions in the June 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**, survey responses revealed the following:

- In providing credit to their hedge fund clients, about one-eighth and one-fifth of respondents reported an easing in price and nonprice terms, respectively (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.
- In providing credit to their trading real estate investment trust (REIT) clients, on net, nearly one-third of respondents reported an easing in price terms, while just under one-fifth of respondents reported an easing in nonprice terms. As was true for hedge fund clients, the dealers that indicated an easing of terms cited more aggressive competition from other institutions as the most important reason for the easing in terms.
- Price and nonprice terms were basically unchanged for all other classes of counterparties.

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<sup>1</sup> Question 80, not discussed here, was optional and allowed respondents to provide additional comments.

- About one-fifth and one-fourth of the dealers reported an increase in negotiation intensity by hedge fund and trading REIT clients, respectively, for more favorable price and nonprice terms.
- With regard to mark and collateral dispute with different counterparty types, a small number of dealers reported considerable increases in the volume of disputes with various counterparties.

Dealers indicated little change over the past three months with respect to the **use of financial leverage** by different counterparty types on net (see the exhibit “Use of Financial Leverage”).

With regard to **OTC derivatives markets**, responses to the core questions revealed that initial margin requirements were basically unchanged, on net, across all counterparty types.

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

- On net, roughly one-fourth of all dealers indicated a decline in demand for funding on equities (see the exhibit “Measures of Demand for Funding and Market Functioning”).
- One-fourth of all dealers reported a decrease in the demand for term funding on non-agency residential mortgage-backed securities. One-fifth of all respondents also noted a decrease in the demand for term funding on consumer asset-backed securities. Demand for funding on other asset classes was reportedly little changed.
- Approximately one-fifth of dealers reported a decrease in financing rates for high-grade and high-yield corporate bonds and commercial mortgage-backed securities; a similar fraction reported that financing rates had eased for equities for their most-favored clients. Financing rates for other asset classes were reportedly little changed.
- Survey responses indicate that liquidity and functioning across asset classes have changed little in the past three months.<sup>2</sup>

## Special Questions

### *Equity Market Volatility*<sup>3</sup>

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<sup>2</sup> 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.

<sup>3</sup> The description of the LIBOR-OIS spread in the introduction paragraph below covers the period from the close of the prior survey to the close of the current survey.

(Questions 81-85)

Volatility in U.S. equity markets increased sharply in early February 2018 and the LIBOR–OIS spread also rose notably in recent months.<sup>4</sup> In special questions for the survey this quarter, dealers were queried about the effects of these financial market developments on their risk management practices and on how they fund their clients.

With respect to the **effect of the February increase in U.S. equity market volatility**, respondents indicated the following:

- Roughly one-half of dealers responded that they made some changes to their counterparty risk management in response to the market volatility. About one-fifth of dealers made changes to margin requirements or haircuts or both; a smaller fraction reported changes to models used to assess counterparty risk or to actual counterparty risk limits.<sup>5</sup> Just under one-third of dealers specified other actions they took in response to the rise in market volatility, which included an increase in stress tests on the VIX and other volatility-related securities and derivatives, as well as more proactive monitoring of intraday margin calls.
  - For those dealers that reported making changes, responses were mixed as to whether those changes were long-lasting or temporary.<sup>6</sup> Dealers that made changes to models used to assess counterparty risk noted that the changes were long lasting. Responses regarding changes in margin requirements, haircuts and counterparty risk limits were roughly split between the long-lasting and temporary buckets.
- Dealers indicated that increases in margin requirements or haircuts or both by central counterparties over the past three months had either minimal or no influence on the terms on bilateral transactions offered to their clients.
- Four-fifths of dealers reported no change in the demand for leverage via margin loans or equity derivatives since the increase in equity market volatility.

### ***Widening in LIBOR–OIS Spread***<sup>7</sup>

(Questions 86-88)

With respect to the **effect of the widening in the LIBOR–OIS spread**, respondents indicated the following:

- All dealers reported that the amount of funding they made available to clients remained basically unchanged in response to the increase in the spread. With

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<sup>4</sup> Notwithstanding the declines seen in the LIBOR–OIS spread since April, at the time the survey was conducted the measure was still higher relative to its level its level in February, when the survey for the March SCOOS report was under way.

<sup>5</sup> Responses to the question on which actions dealers took were not required to be mutually exclusive, and therefore the responses do not sum to 100 percent.

<sup>6</sup> Changes were deemed “long lasting” if they remained in place after the spike in implied volatility in early February and “temporary” if they were reversed after the spike in implied volatility had subsided.

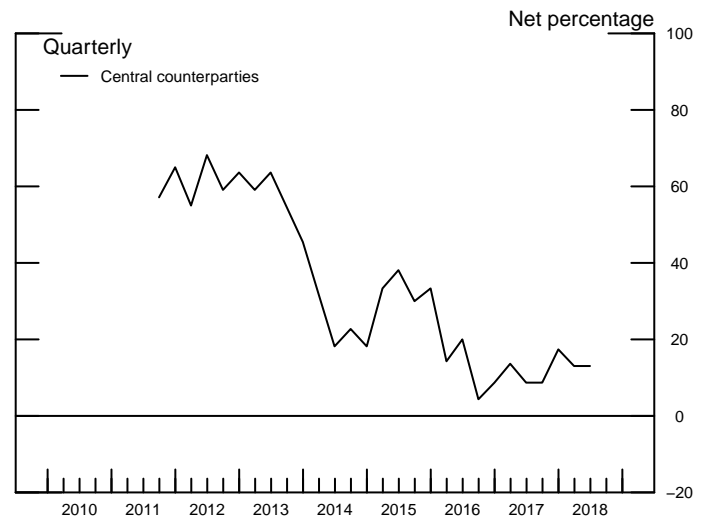
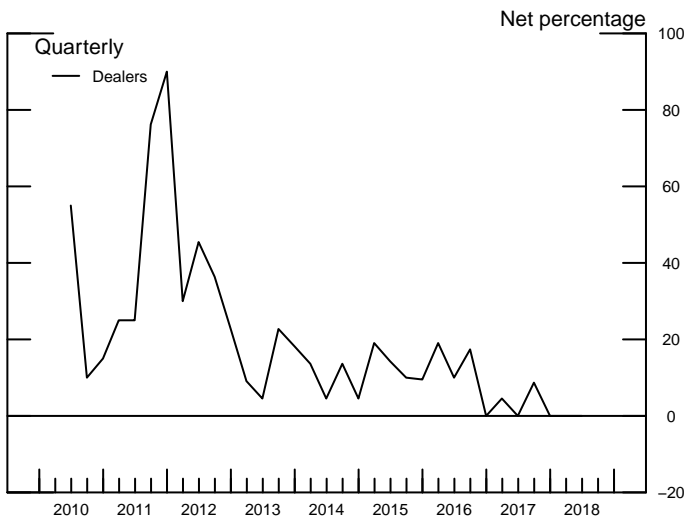
<sup>7</sup> The description of the LIBOR-OIS spread in the introduction paragraph below covers the period from the close of the prior survey to the close of the current survey.

regard to terms, a small fraction of dealers indicated tightening in price terms to hedge funds and trading REITs in response to the rise in the spread, while price terms to other types of clients were unaffected. Nonprice terms for all clients were said to be unchanged in reaction to the widening in the spread.

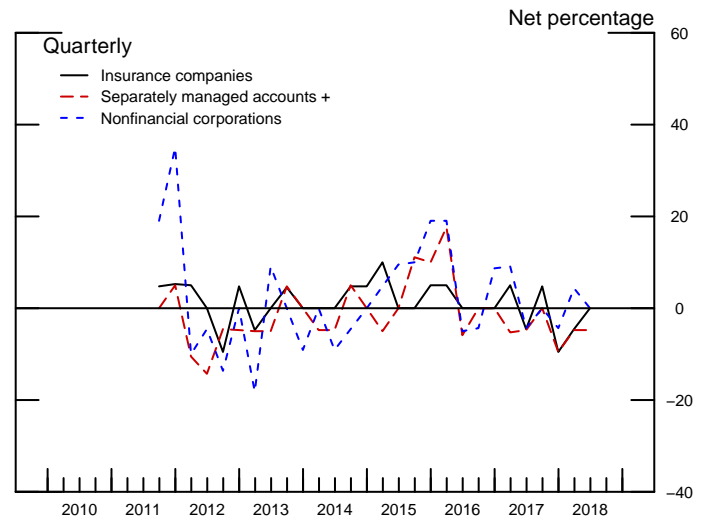
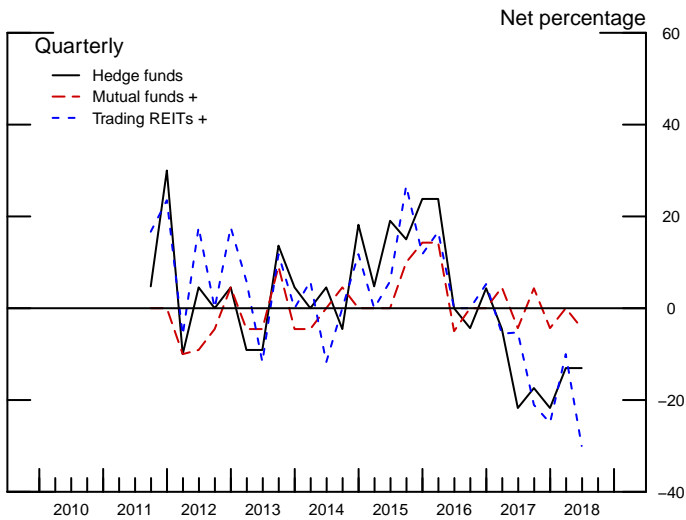
*This document was prepared by Sean Savage, Division of Monetary Affairs, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Statistics Function and the Markets Group at the Federal Reserve Bank of New York.*

# Management of Concentrated Credit Exposures and Indicators of Supply of Credit

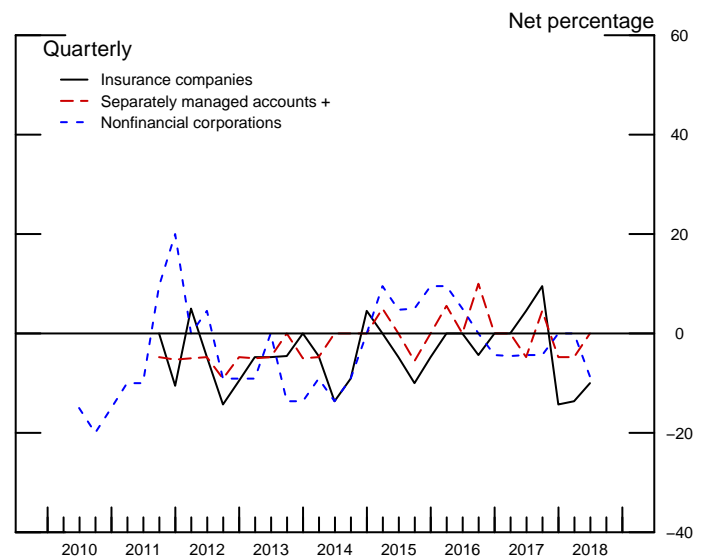
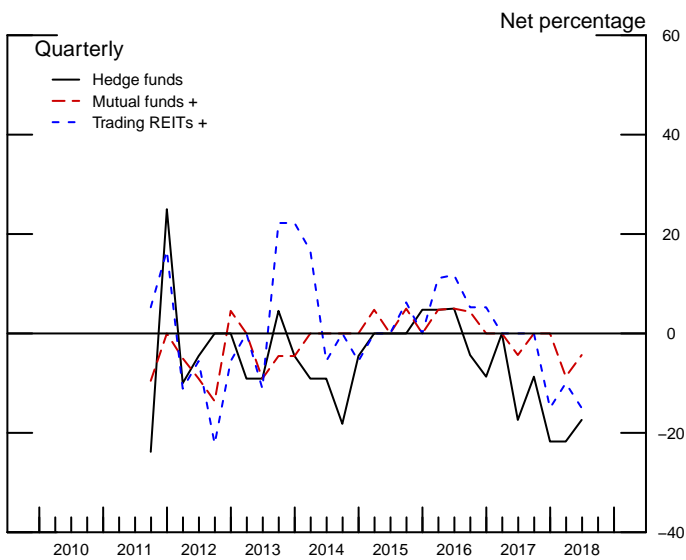
Respondents increasing resources and attention to management of concentrated exposures to the following:



Respondents tightening price terms to the following:

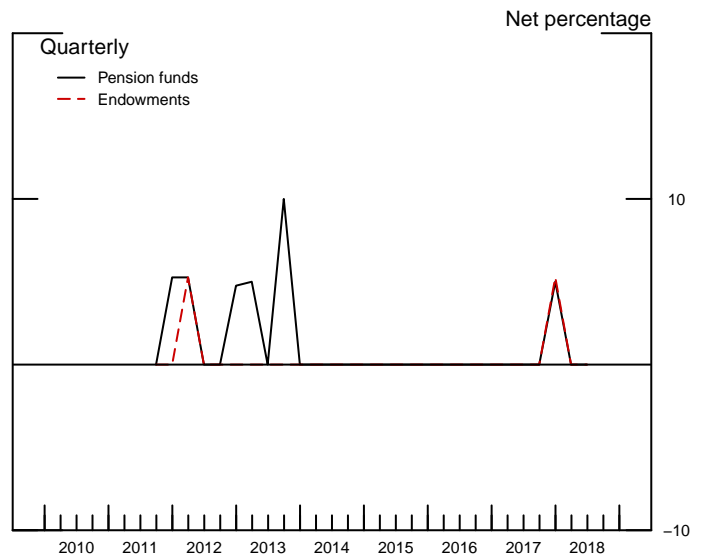
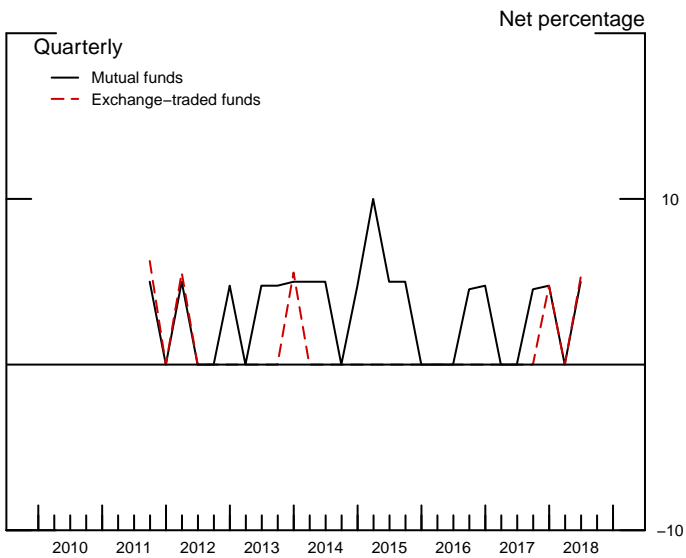
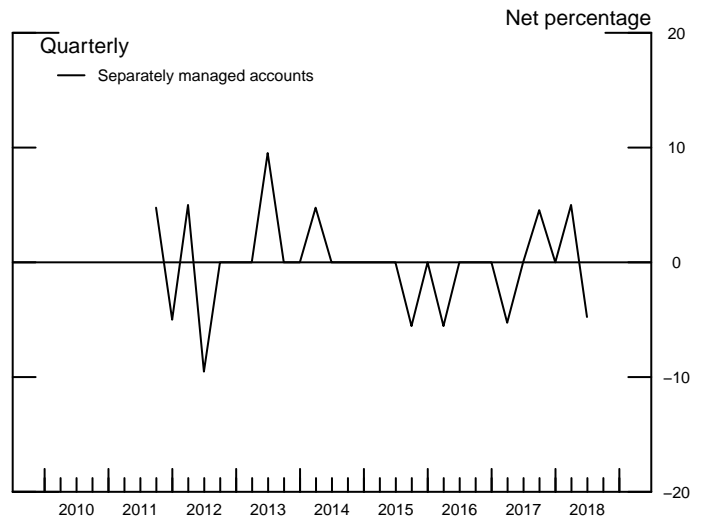
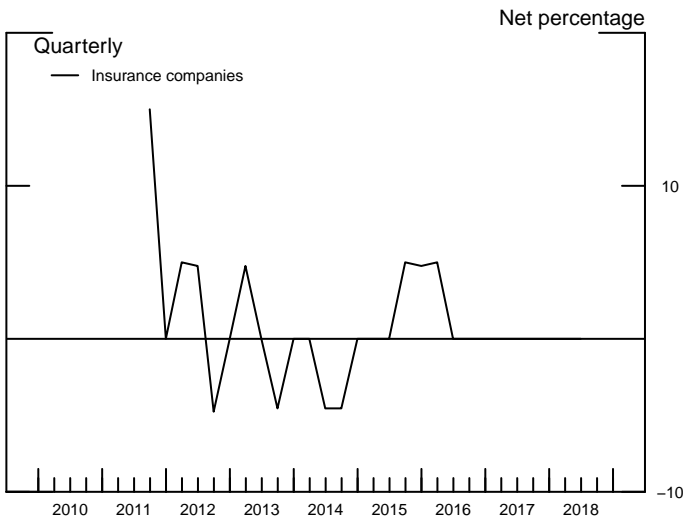
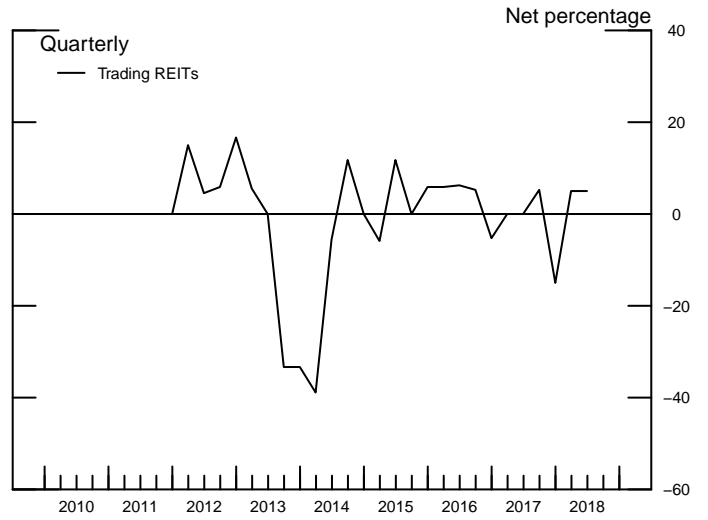
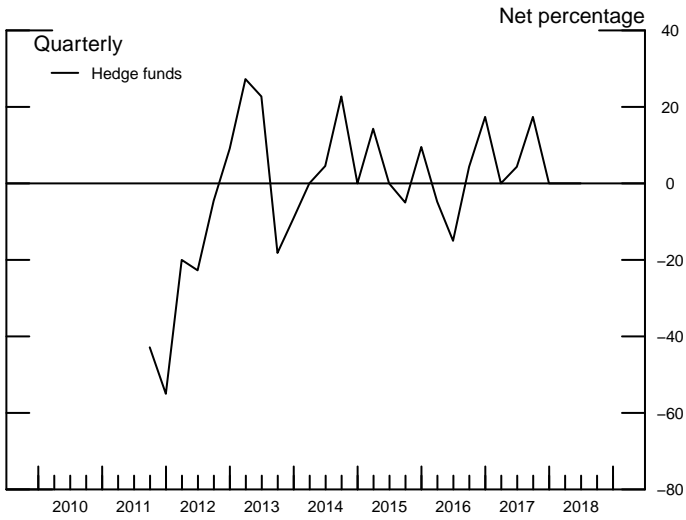


Respondents tightening non-price terms to the following:



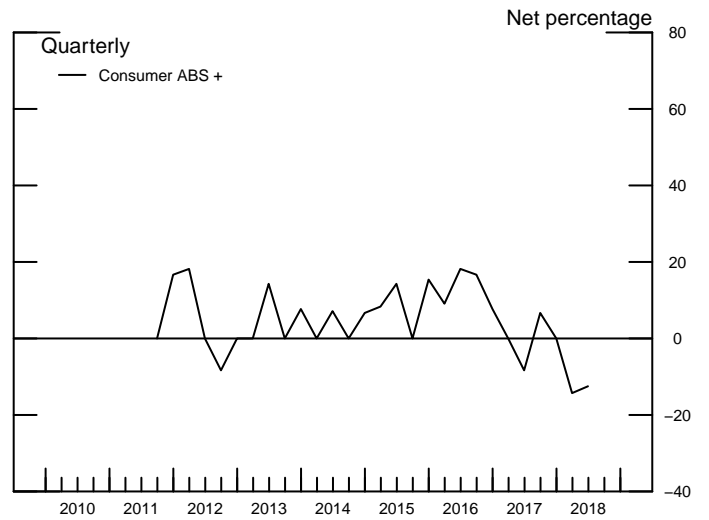
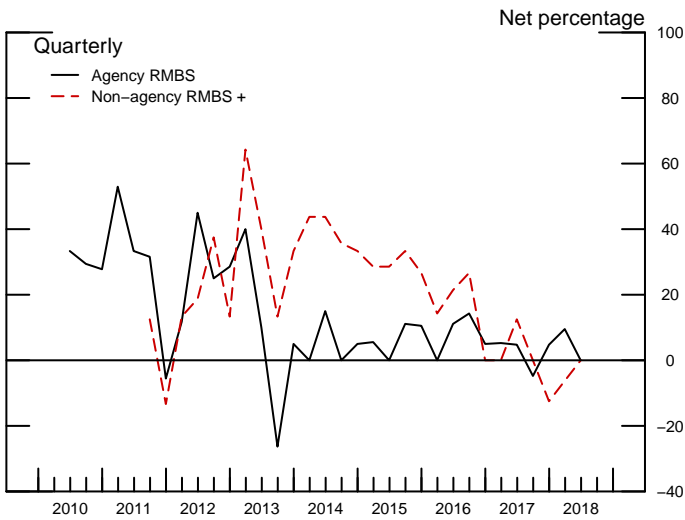
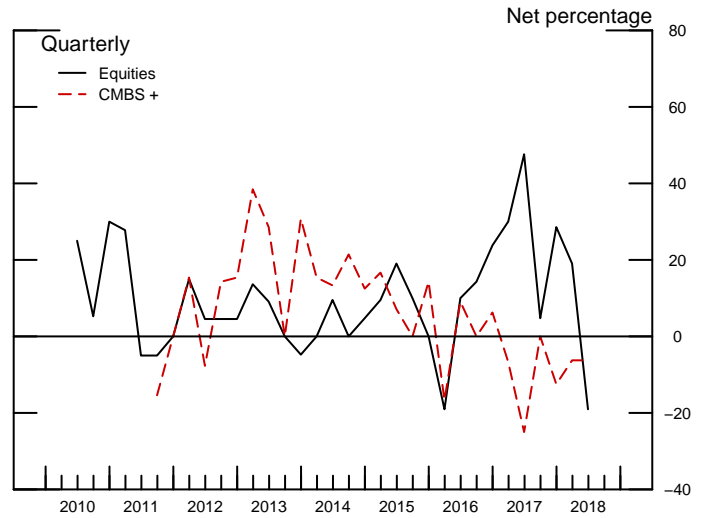
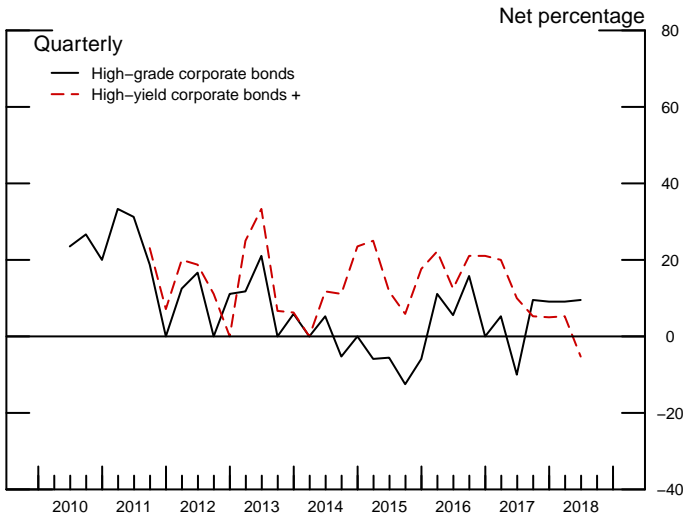
# Use of Financial Leverage

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:

