

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

Summary

The June 2020 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. In addition to the core questions, the survey included a set of special questions about dealer financing to relative-value (RV) fixed-income hedge funds and mortgage real estate investment trusts (REITs) during the sharp liquidity deterioration in the Treasury and agency mortgage-backed securities (MBS) markets in mid-March 2020. 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 during the period between May 5, 2020, and May 18, 2020. The core questions asked about changes between February 2020 and May 2020.¹

Core Questions (Questions 1–79)²

Responses to the core questions in the June 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:

- A substantial fraction of respondents indicated having tightened price and nonprice terms on securities financing transactions and OTC derivatives across all classes of counterparties (see the exhibit “Management of Concentrated Credit Exposures and Indicators of Supply of Credit”). In particular, more respondents (roughly four-fifths) indicated so for hedge funds and trading REITs than for other client types. Across all counterparty types, the net fractions of respondents reporting tightened price and nonprice terms were at the highest levels since the survey began in 2011. In addition, more than half of respondents indicated dedicating increased resources and attention to managing concentrated credit exposure to dealers and central counterparties.
- A substantial fraction of respondents indicated increased volume and duration of mark and collateral disputes for most counterparty types, and more respondents indicated so for dealers, hedge funds, and trading REITs than for other client types.

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, more than three-fifths of dealers—the highest fraction since the survey began in 2011—indicated decreased use by hedge funds and trading REITs (see the exhibit “Use of Financial Leverage”). A small net fraction of dealers indicated a decrease in the use of leverage by the remaining types of counterparties.

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

- While nonprice terms in master agreements for OTC derivatives remained largely unchanged, dealers responded that initial margin requirements on OTC derivatives increased, on net, for both average and most-favored clients. The portion of dealers indicating increased initial margin requirements varied across different types of OTC derivatives, with the largest fraction (two-thirds) of dealers indicating so for OTC credit derivatives referencing securitized products.
- The volume and duration of mark and collateral disputes increased, on net, across all types of OTC derivatives, with varying net portions of respondents (ranging from one-sixth to one-half) indicating increases in the volume and duration of such disputes.

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

- A net fraction of more than one-half of dealers reported increased demand for funding of investment-grade bonds, high-yield bonds, non-agency residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and consumer asset-backed securities (ABS) (see the exhibit “Measures of Demand for Funding and Market Functioning”). The net fractions are record highs (since the survey began in 2011) for investment-grade bonds, high-yield bonds, CMBS, and consumer ABS. By contrast, a net fraction of approximately one-third of dealers reported decreased demand to fund equities. For agency RMBS, dealers reported no changes in funding demand on net.
- A substantial portion of dealers reported tightening funding terms for various types of securities. In particular, most dealers reported tightened terms for financing non-agency RMBS, CMBS, and consumer ABS.
- The volume and duration of mark and collateral disputes increased, on net, across all collateral types, with a net fraction of more than one-half of respondents indicating increases in the volume and duration of disputes involving non-agency RMBS and CMBS.
- A substantial portion of respondents indicated deteriorated liquidity and functioning across all types of markets except for the equity market. More than four-fifths of respondents indicated so for the non-agency RMBS and CMBS markets, and more than one-half did for the high-yield bond and consumer ABS markets.³

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.

Special Questions on Dealer Financing to Relative-Value Hedge Funds and Mortgage Real Estate Investment Trusts in Mid-March 2020

(Questions 81–90)

Liquidity conditions in the Treasury and agency MBS market deteriorated sharply in mid-March amid reports of position unwinds by RV fixed-income hedge funds as well as margin calls and forced liquidations by mortgage REITs. In the special questions, dealers were asked about changes in funding availability to and demand from RV fixed-income hedge funds and mortgage REITs and the main reasons for those changes.

With respect to funding collateralized by **Treasury securities** offered to **RV fixed-income hedge funds**, dealers reported the following:

- On net, dealers reported no changes in funding volume collateralized by Treasury securities to RV hedge fund clients.
- On net, approximately one-fourth of dealers reported a decrease in the availability of funding collateralized by Treasury securities to RV hedge fund clients.
 - Dealers did not cite one dominant reason for the decrease in the availability of funding to RV hedge funds. The deteriorated financial strength of RV hedge funds and Treasury market conditions (either the liquidity and functioning of Treasury markets or market uncertainty) were cited as the most important reasons.
- On net, approximately one-fourth of dealers reported an increase in the demand for funding collateralized by Treasury securities from RV hedge fund clients.
 - Dealers cited increased availability of trading opportunities and a deterioration in Treasury market liquidity and functioning as the two most important reasons for the increase in their RV hedge fund clients' funding demand.

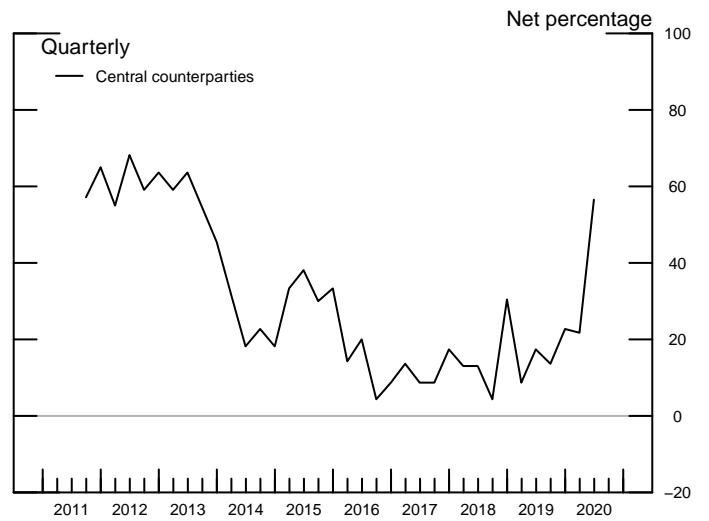
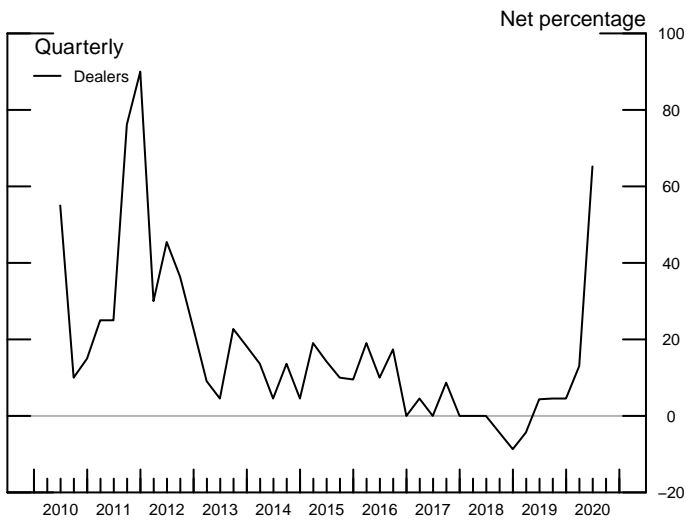
With respect to funding collateralized by **agency MBS** offered to **mortgage REITs**, dealers reported the following:

- On net, more than nine-tenths of dealers reported a decrease in funding volume collateralized by agency MBS to mortgage REIT clients.
- On net, approximately one-half of dealers reported a decrease in the availability of funding collateralized by agency MBS to mortgage REIT clients.
 - Dealers most frequently cited the deterioration in the financial strength of counterparties as the most important reason for the decrease in their funding availability to mortgage REITs.
 - The next most commonly cited reasons were a deterioration in agency MBS market liquidity and functioning and a diminished risk appetite.
- On net, approximately one-half of the dealers reported a decrease in the demand for funding collateralized by agency MBS from mortgage REIT clients.
 - Dealers cited diminished risk-taking capacity of mortgage REIT clients as the most important reason for the decrease in the demand for funding.
 - The next most commonly cited reasons for the decrease in the demand for funding were agency MBS market conditions (both liquidity and functioning as well as market uncertainty).

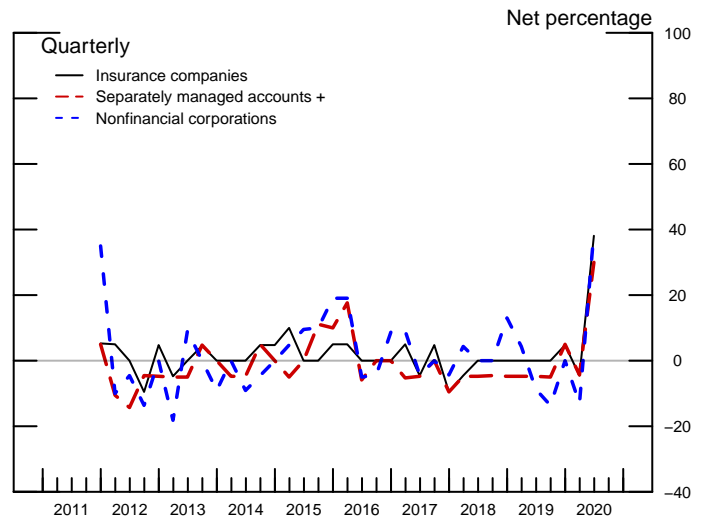
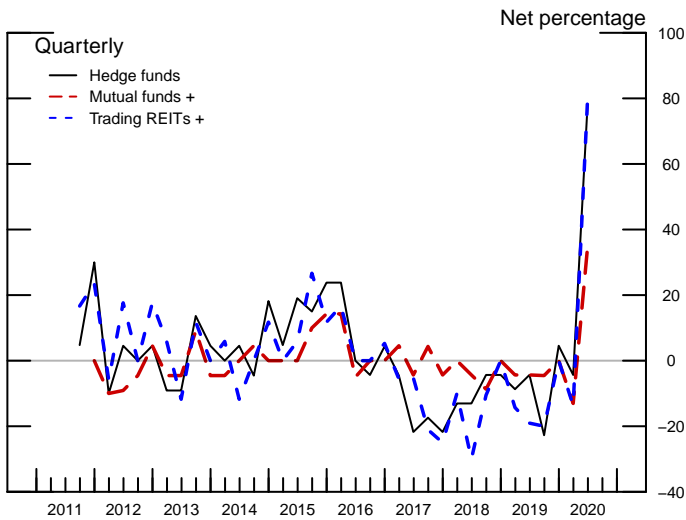
This document was prepared by Seung Kwak, Division of Monetary Affairs, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Capital Markets Function, the Statistics Function, and the Markets Group at the Federal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

Management of Concentrated Credit Exposures and Indicators of Supply of Credit

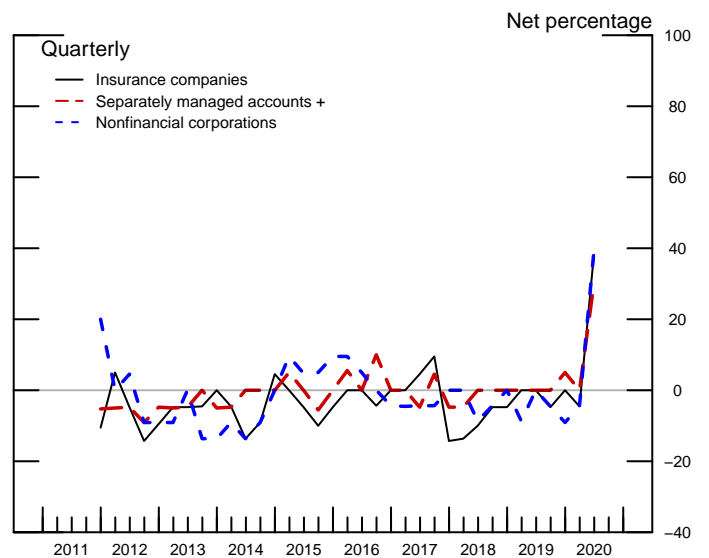
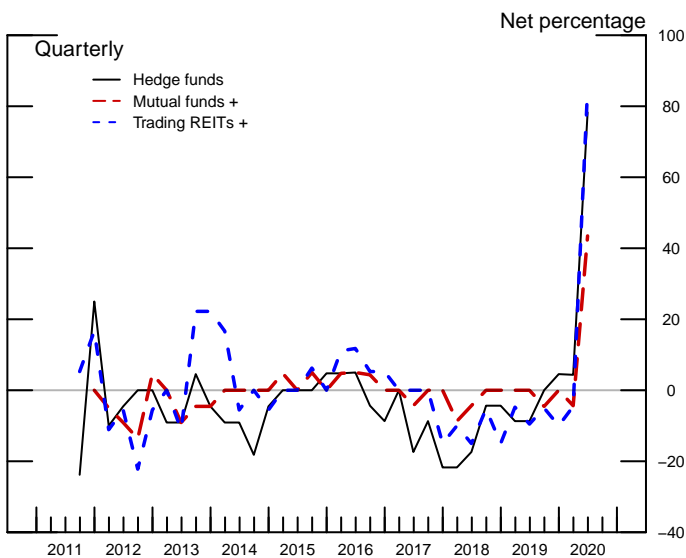
Respondents increasing resources and attention to management of concentrated exposures to the following:



Respondents tightening price terms to the following:



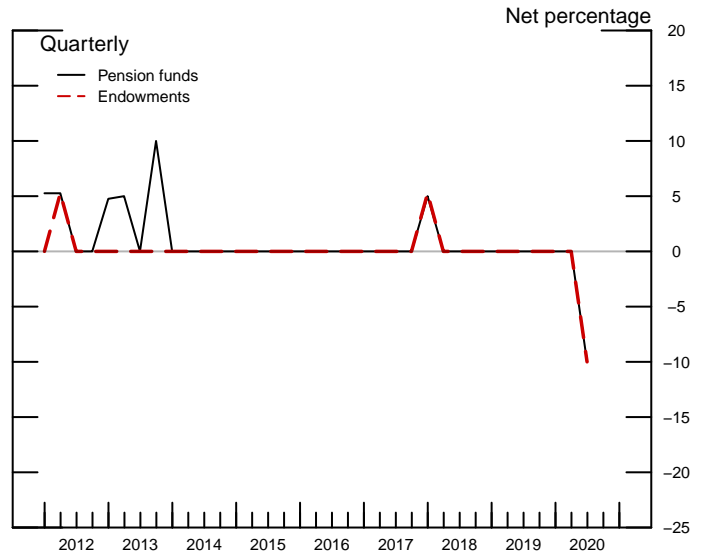
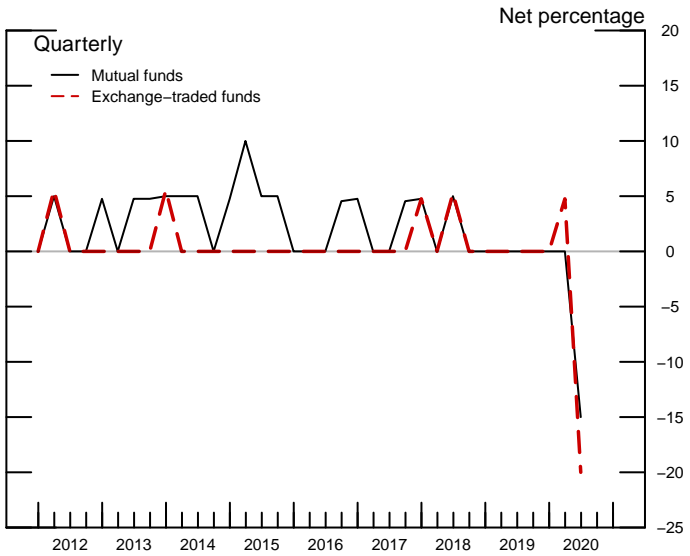
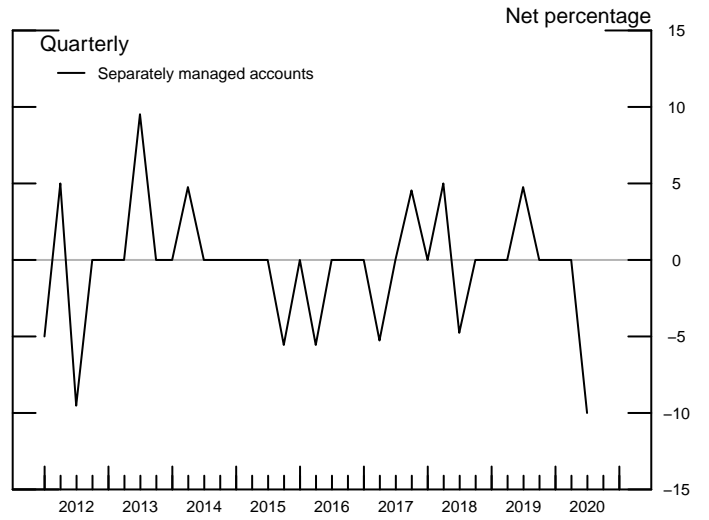
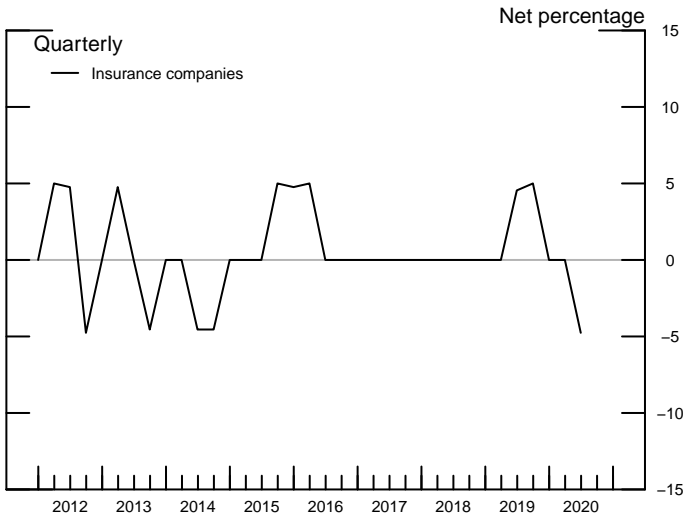
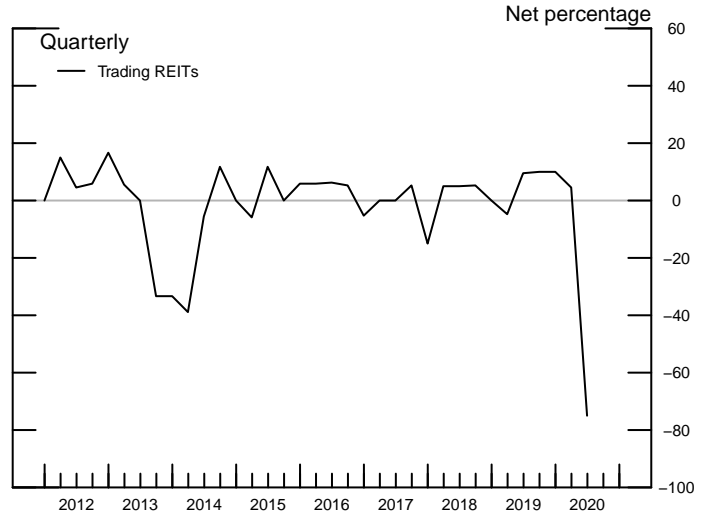
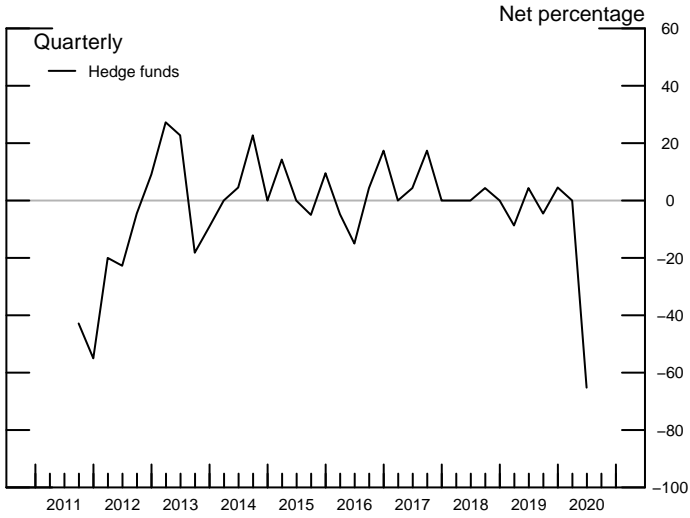
Respondents tightening nonprice terms to the following:



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

Use of Financial Leverage

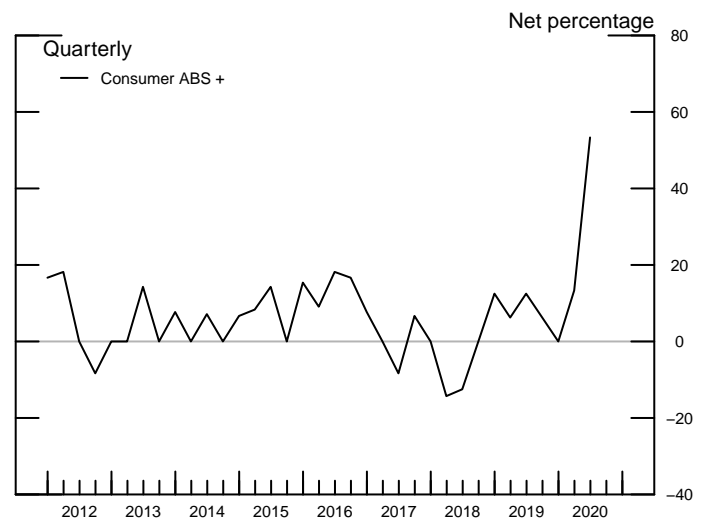
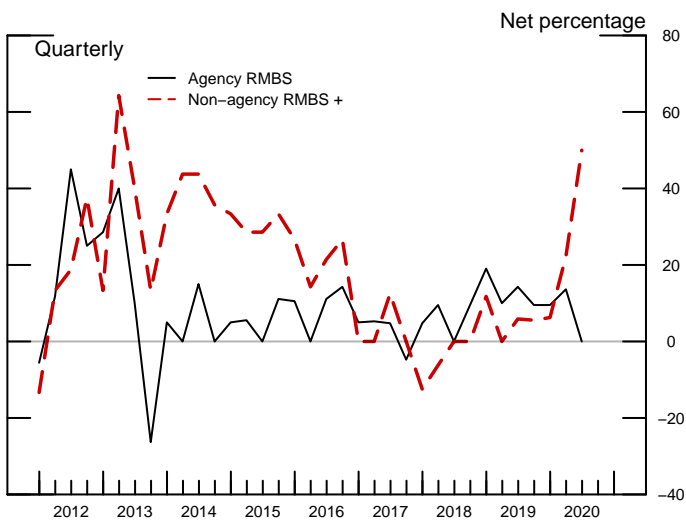
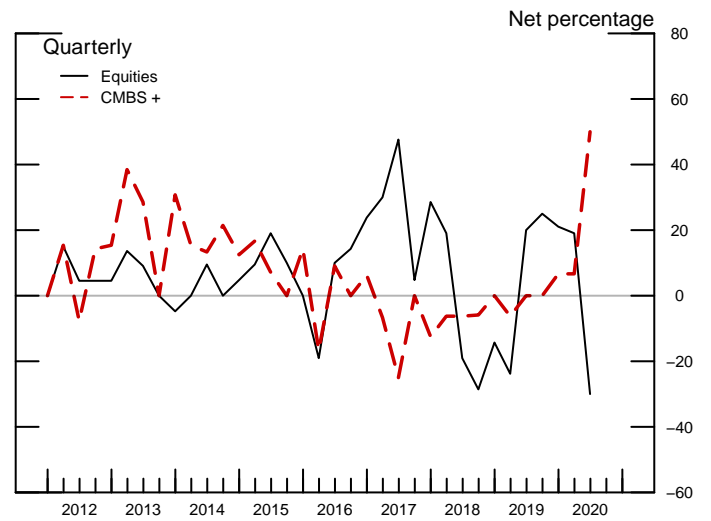
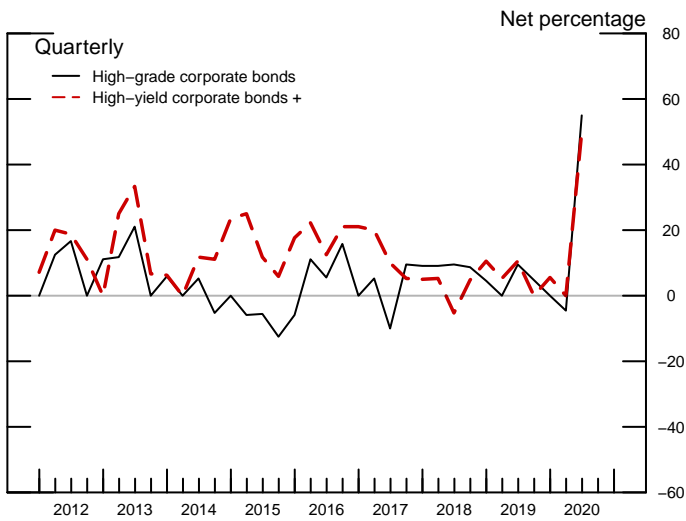
Respondents reporting increased use of leverage by the following:



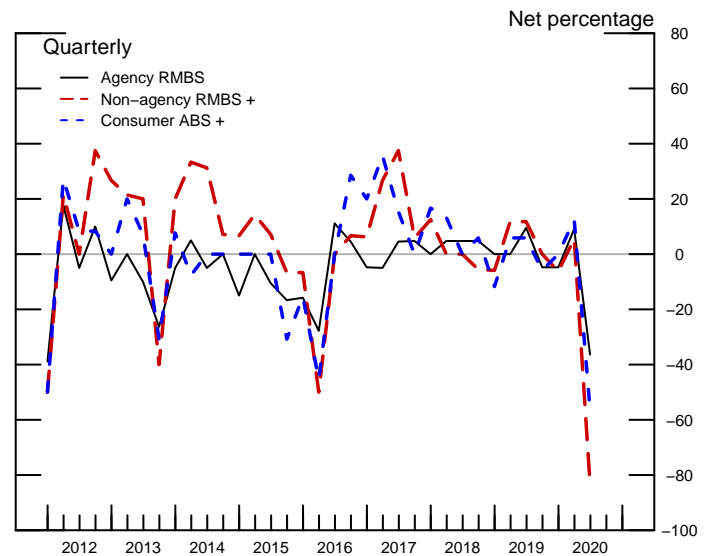
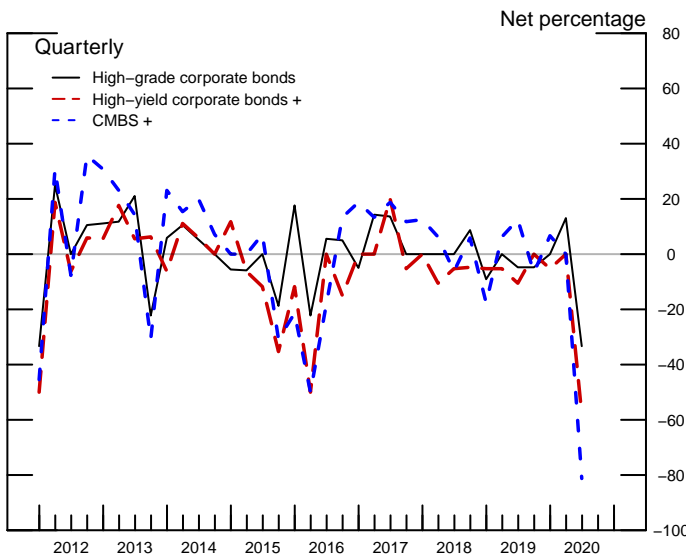
Note: REIT is real estate investment trust.

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.