The September 2024 Senior Credit Officer Opinion Survey on Dealer Financing Terms

Summary

The September 2024 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 May 2024 and August 2024.[1] In addition to the core questions, the survey included a set of special questions about equity volatility trading.

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:

- One-fifth of respondents indicated that price terms tightened somewhat for real estate investment trusts (REITs) (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). For all other types of counterparties, dealers reported, on net, that both price and nonprice terms on securities financing transactions and OTC derivatives remained basically unchanged over the past three months.

- Close to one-fifth of respondents indicated that the intensity of efforts by hedge funds to negotiate more-favorable price and nonprice terms increased over the past three months.

- Across most counterparty types, small fractions of respondents indicated that the volume of mark and collateral disputes increased over the past three months.

With respect to clients' **use of financial leverage**, responses to the core questions revealed the following:

- One-fourth of dealers reported that REITs increased their use of financial leverage somewhat over the past three months (see the exhibit "Use of Financial Leverage"). The use of financial leverage remained unchanged for all other types of clients.

[1] 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 between August 13, 2024, and August 26, 2024. The core questions asked about changes between mid-May 2024 and mid-August 2024.
[2] Question 80, not discussed here, was optional and allowed respondents to provide additional comments.

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

- Nearly all dealers reported no changes in nonprice terms in master agreements.

- Nearly all dealers reported no changes in initial margin requirements for all types of OTC derivatives.

- One-fourth of dealers indicated an increase in the duration and persistence of mark and collateral disputes relating to OTC derivatives contracts referencing corporate credits (single name and indexes). The volume, duration, and persistence of mark and collateral disputes remained basically unchanged for other types of OTC derivatives.

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

- The terms on securities financing were reported as basically unchanged for most collateral types. One-fifth of dealers indicated an easing over the past three months of collateral spreads for non-agency residential mortgage-backed securities.

- Across all collateral types, the demand for funding and the demand for term funding remained basically unchanged (see the exhibit “Measures of Demand for Funding and Market Functioning”). Unlike the past two quarters, the demand for funding of equities (including stock loans) has not increased.

- Dealers reported, on net, little change in the liquidity and market functioning across all types of securities.

- The volume, duration, and persistence of mark and collateral disputes remained basically unchanged over the past three months across all collateral classes.

Special Questions on Equity Volatility Trading
(Questions 81–90)

In special questions this quarter, dealers were asked about their clients’ current exposure to equity volatility and the strategies and instruments used by clients to take positions in equity volatility.

Dealers were asked to characterize the current **use of volatility strategies and products** by all clients. The responses indicated significant use across most client classes, most notably by hedge fund clients.

- More than one-half of respondents indicated that a large number of their hedge fund clients widely employ volatility strategies and products. Another one-third responded that volatility strategies and products are employed by some hedge fund clients or in some situations. About one-fourth of respondents reported that the use of volatility

strategies and products by hedge fund clients has increased somewhat since the start of 2023.

- For mutual funds, exchange-traded funds (ETFs), and separately managed accounts established with investment advisers, more than one-half of respondents indicated that volatility strategies and products are employed by some clients or in some situations. About one-half of respondents reported that the use by these clients has increased since the start of 2023.

- With regard to pension plans, endowments, and insurance companies, three-fifths of dealers reported that volatility strategies and products are either widely employed or employed by some clients or in some situations. On net, respondents indicated no change in use since the start of 2023.

Dealers were also asked to assess **how different types of clients were positioned for a sustained increase in equity volatility** and how the net positioning has changed relative to the start of 2023.

- Regarding hedge fund clients, one-third of respondents indicated either that most clients are long volatility or that more clients have long positions than short positions in volatility.[3] Only one dealer responded that more clients are net short than net long. Dealers indicated, on net, no change in positioning for hedge fund clients.

- For mutual funds, ETFs, and separately managed accounts, two-fifths of respondents reported either that most clients are short volatility or that more clients have short positions in volatility than long positions, whereas only one-tenth reported that more clients have long positions than short positions. A net fraction of one-fourth of dealers indicated that mutual funds, ETFs, and separately managed accounts have increased short positions, decreased long positions, or both relative to the start of 2023.

- More than one-third of respondents, on net, reported either that most clients are net long or that more clients are net long than net short for pension plans, endowments, and insurance companies. Dealers indicated, on net, no change in positioning for these clients.

Dealers were asked about the volatility strategies and instruments used by clients who dedicate a significant share of their trading to equity volatility products or strategies (henceforth, “volatility traders”).

- The most popular volatility strategy used by such clients was selling volatility. However, buying volatility and strategies that profit when the volatility of the Chicago Board Options Exchange Volatility Index (VIX) increases were reported to be similarly

[3] Buying volatility, or taking long positions in volatility, refers to taking positions that increase in value when volatility increases. Selling volatility, or taking short positions in volatility, refers to taking positions that decrease in value when volatility increases.

popular.[4] A smaller number of dealers also reported that such clients used dispersion trading.

- Relative to the start of 2023, one-half of dealers with volatility trader clients responded that the amount of capital dedicated to selling volatility by such clients has increased somewhat. In contrast, respondents indicated, on net, no change in the amount of clients' capital dedicated to buying volatility. One-third of dealers indicated that the amount of clients' capital dedicated to dispersion trading increased. Net fractions of two-fifths and one-third of dealers reported an increase in the amount of clients' capital dedicated to strategies that profit when the volatility of the VIX increases and when the volatility of the VIX decreases, respectively.

- Almost all dealers who have hedge fund clients who are volatility traders responded that exchange-traded equity options—excluding zero-days-to-expiry options—are most heavily used by such clients. A smaller number of respondents indicated the use of OTC equity options, VIX options, VIX futures, and variance swaps and volatility swaps by such clients.

- For non-hedge-fund clients who are volatility traders, dealers indicated that OTC equity options and exchange-traded equity options are most heavily used. Smaller numbers indicated the use of VIX futures and VIX options by such clients.

Finally, dealers were asked about the concentration of their clients' accounts with respect to equity volatility—measured in terms of vega notional.[5] Of the respondents who have clients who take substantial net positions in equity volatility, close to one-half reported a high concentration—that is, either a few clients or a small share of clients accounted for most of the net positions.

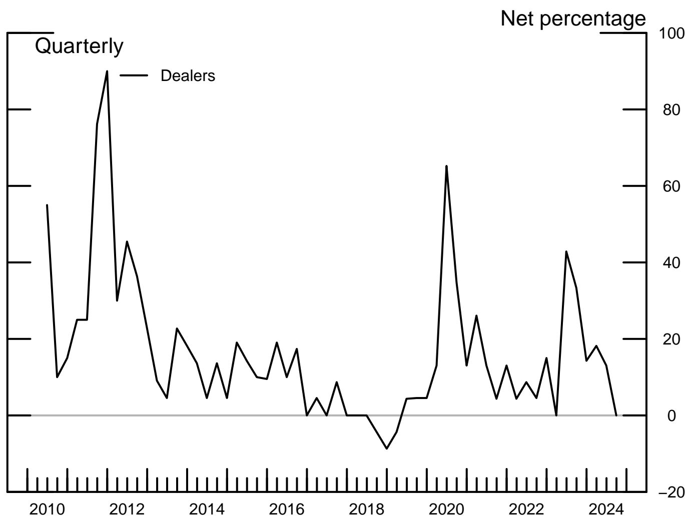
This document was prepared by Yesol Huh, Division of Research and Statistics, Board of Governors of the Federal Reserve System. Assistance in developing and administering the survey was provided by staff members in the Capital Markets Function, the Statistics Function, and the Markets Group at the Federal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

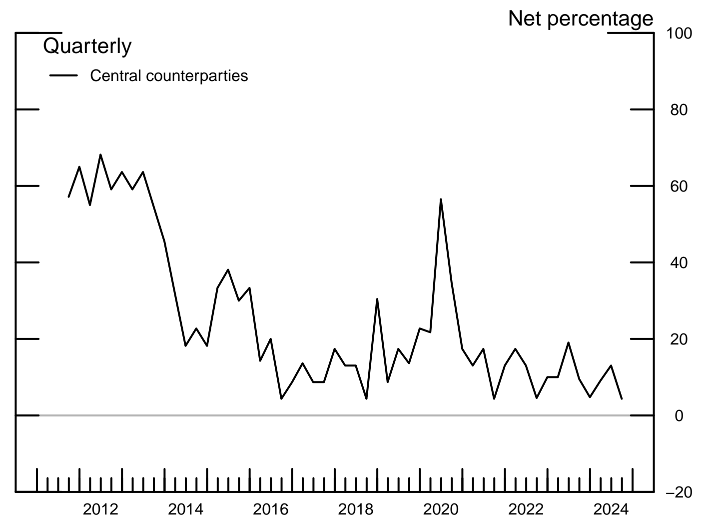
[4] The volatility of the VIX, or volatility-of-volatility, increases when there is greater uncertainty about future market conditions. Investors can profit from such contingencies—for instance, by using VIX options.

[5] Vega notional is a measure of the sensitivity of a position's market value to a change in volatility. Formally, it is defined as the change in the dollar value of the position for a 1 percentage point change in volatility.

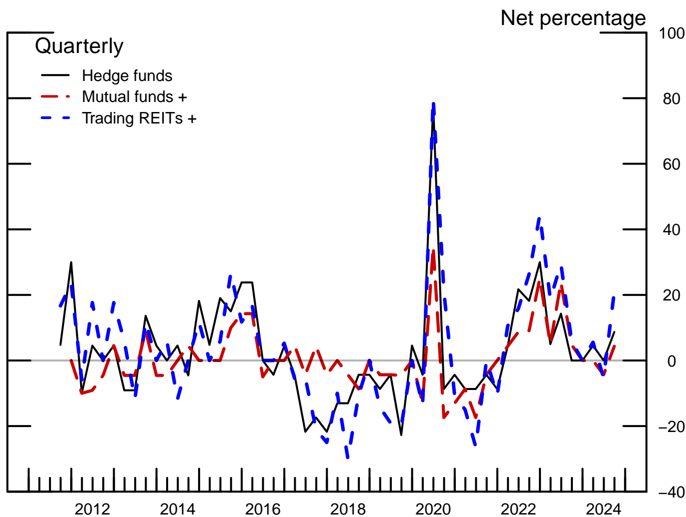
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

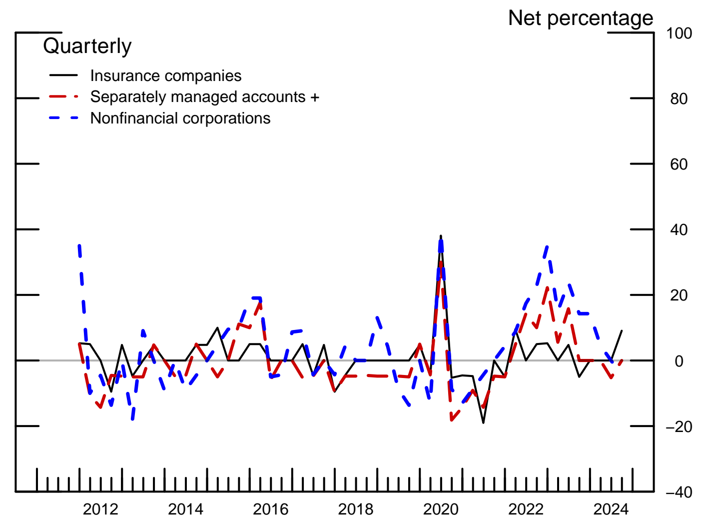
Respondents increasing resources and attention to management of concentrated exposures to the following:



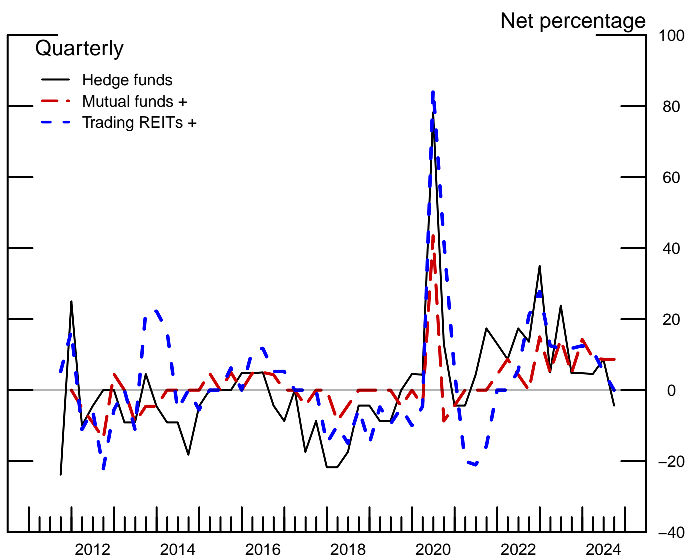


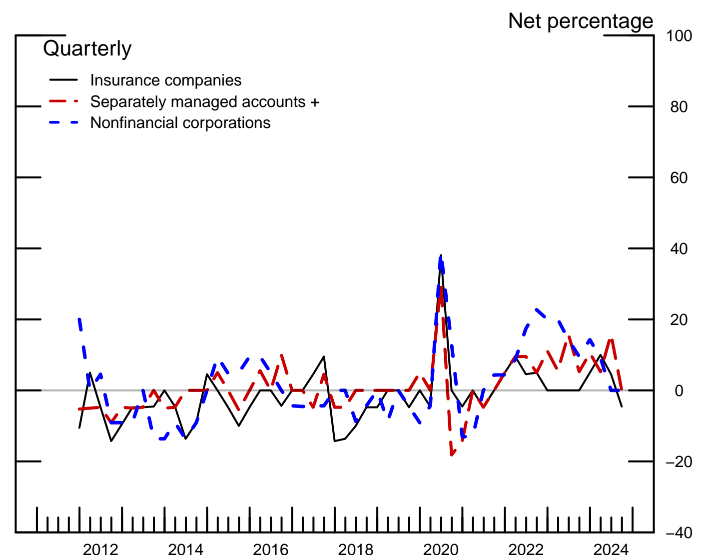
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

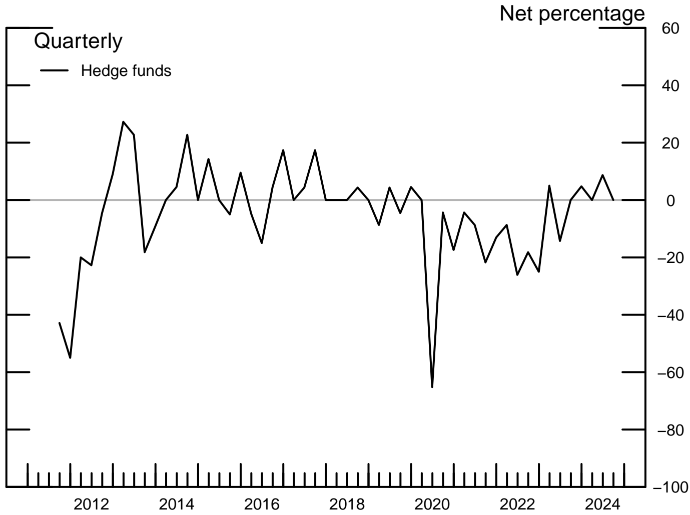


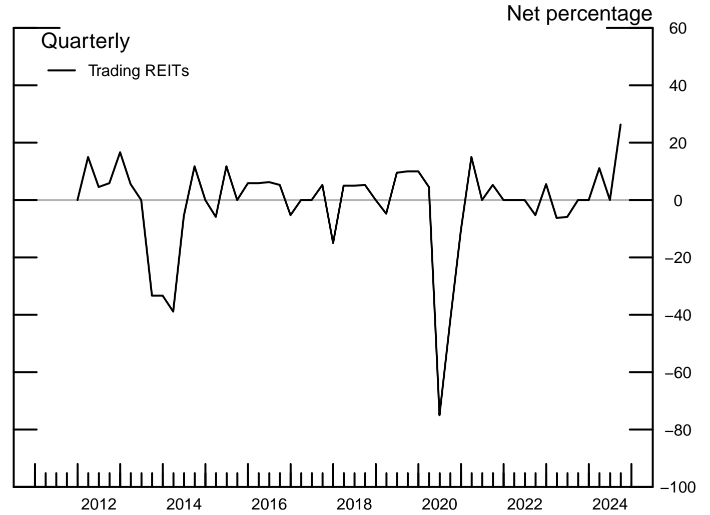


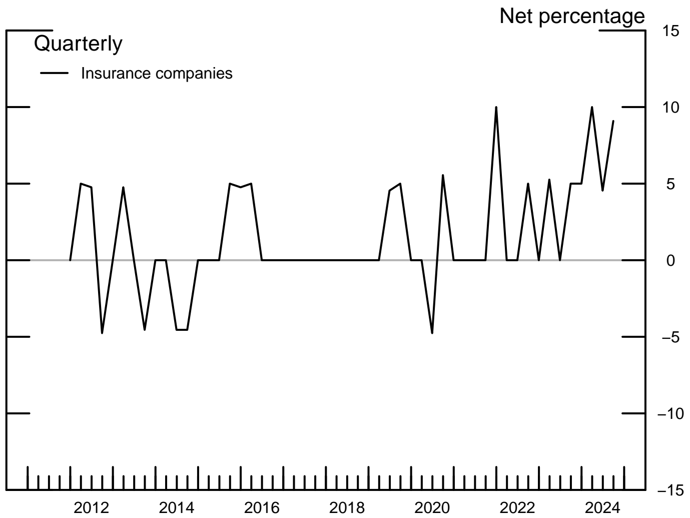
Note: REIT is real estate investment trust.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

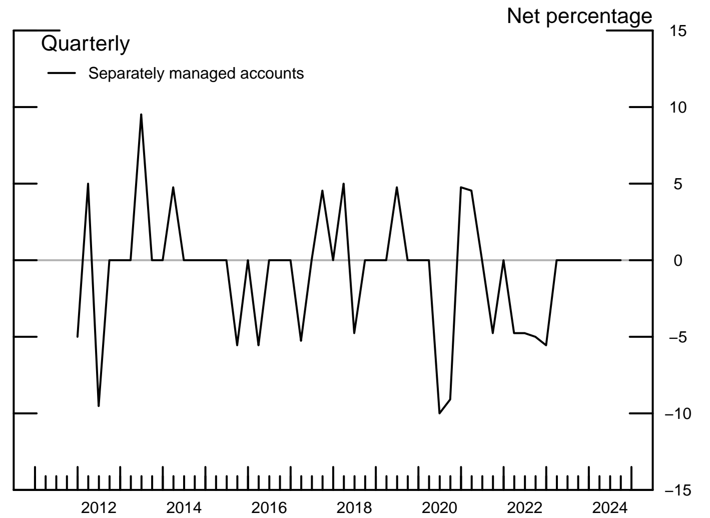
Use of Financial Leverage

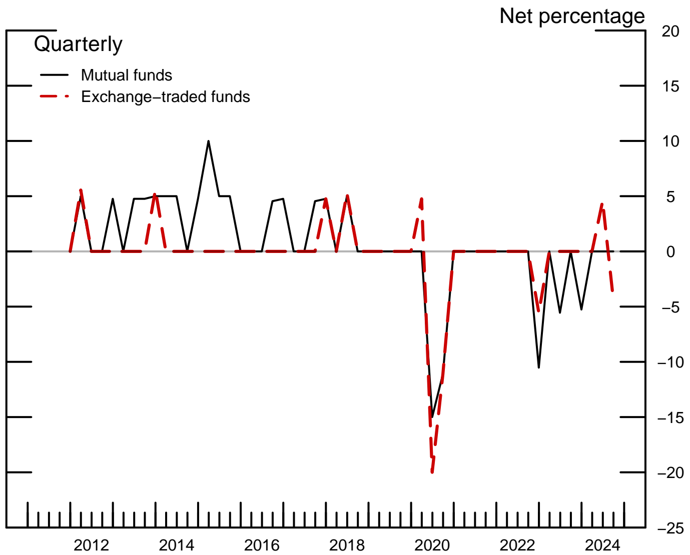
Respondents reporting increased use of leverage by the following:

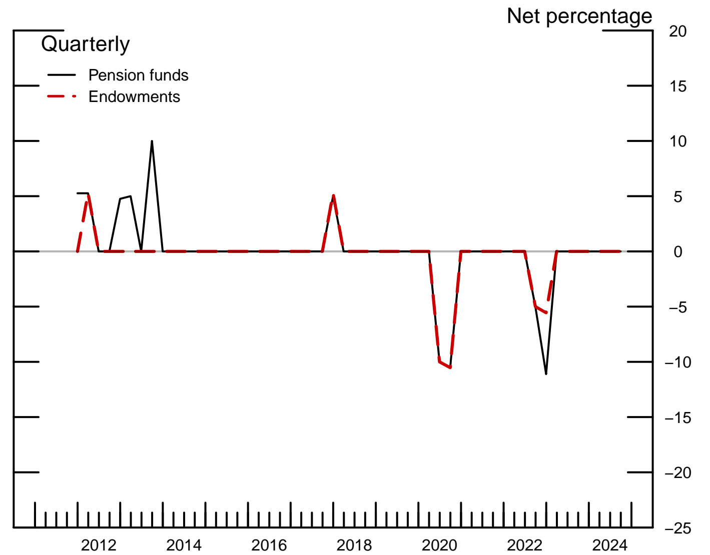








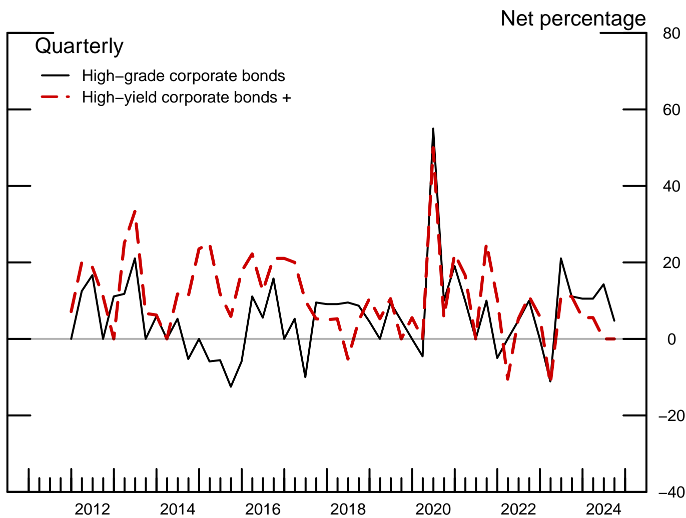


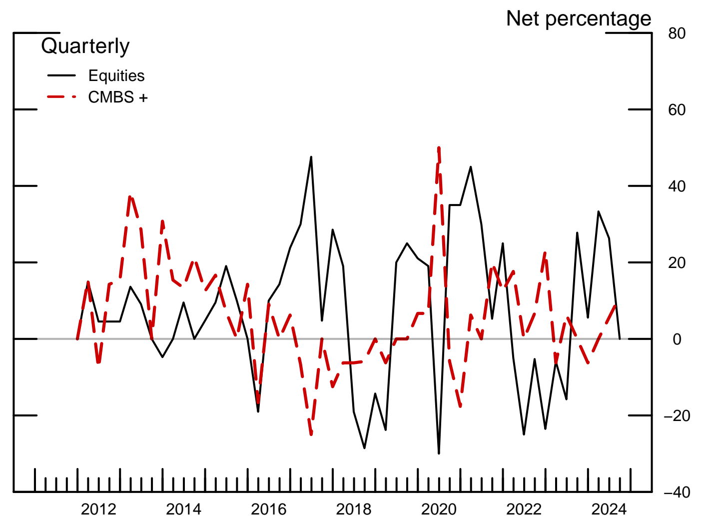


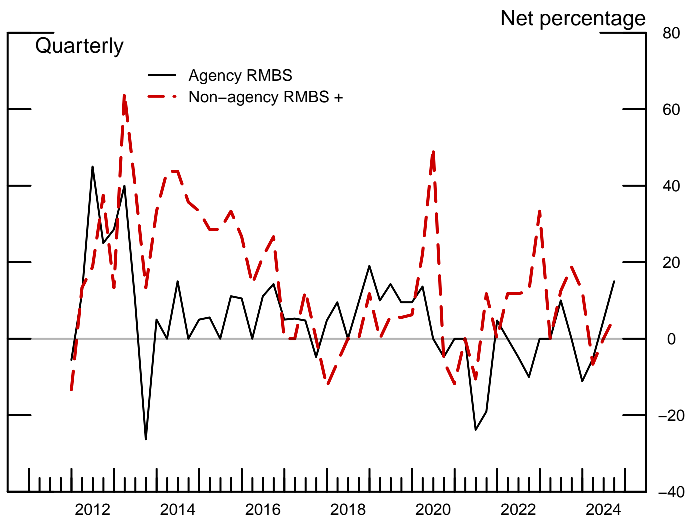
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

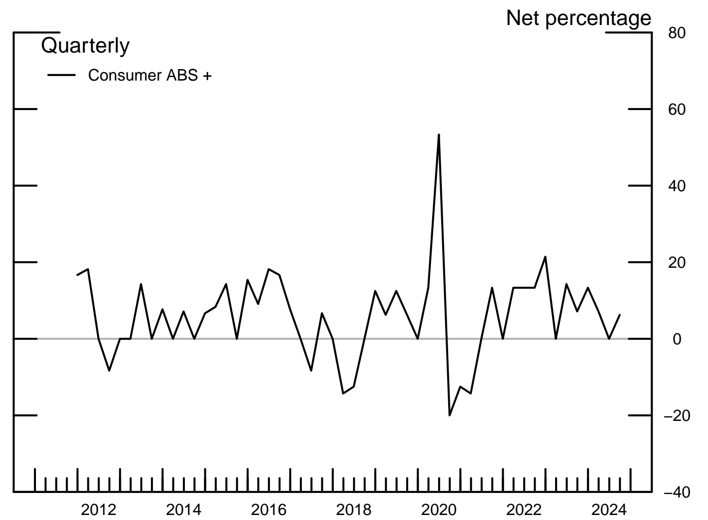
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

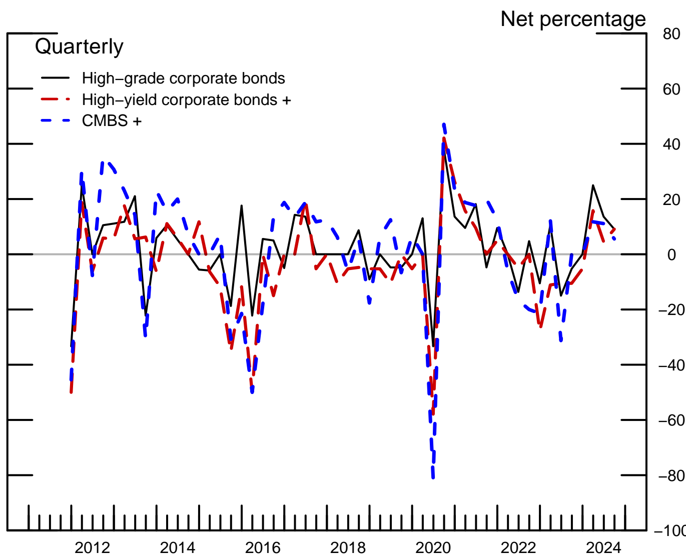


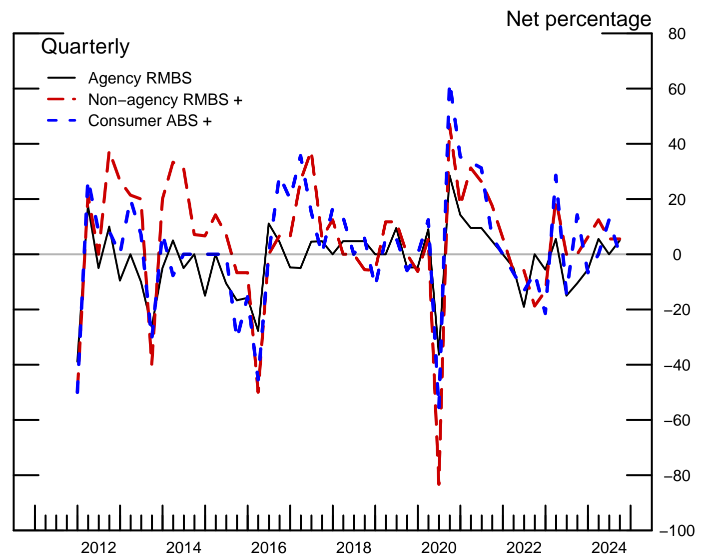






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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