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

Summary

The December 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 September 2024 and November 2024.[1] In addition to the core questions, the survey included a set of special questions about clients' positioning and trading of OTC foreign exchange (FX) derivatives around the early August selloff.

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 types of counterparties. For real estate investment trusts (REITs), a small net fraction of dealers reported tightening of price terms such as financing rates (see the exhibit "Management of Concentrated Credit Exposures and Indicators of Supply of Credit"). One-fourth of dealers indicated an increase in REITs' efforts to negotiate more-favorable price and nonprice terms, while a small fraction of respondents reported that the intensity of efforts by hedge funds to negotiate more-favorable terms increased somewhat over the period.

- A small fraction of dealers indicated that resources and attention devoted to managing concentrated credit exposure to central counterparties increased somewhat, while resources and attention for managing concentrated credit exposure to dealers remained basically unchanged. Roughly four-fifths of respondents indicated that changes in central counterparty practices, including margin requirements and haircuts, 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 one-fifth of dealers indicated a decrease in the volume and duration of such disputes with nonfinancial corporations.

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[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 November 12, 2024, and November 25, 2024.

[2] Question 80, not discussed here, was optional and allowed respondents to provide additional comments.

With respect to clients' **use of financial leverage**, dealers reported that the use of leverage remained basically unchanged for all client types.

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

- Almost 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.
- A small fraction of respondents indicated that the posting of nonstandard collateral (that is, other than cash and U.S. Treasury securities) increased over the past three months.
- The volume and duration of mark and collateral disputes remained largely unchanged for most types of contracts. However, roughly one-third and a small fraction of respondents reported a decrease in the volume of such disputes for OTC derivatives contracts referencing securitized products and equities, respectively. Furthermore, a small fraction of dealers indicated a decrease in the duration and persistence of such disputes for commodity 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. For agency residential mortgage-backed securities (RMBS), a small fraction of respondents indicated a tightening of collateral spreads for average clients.
- On net, about one-third of dealers reported increased demand for funding equities and agency RMBS, while a small fraction of respondents indicated an increase in demand for funding of high-grade corporate bonds. Demand for funding of all other asset classes was largely unchanged (see the exhibit "Measures of Demand for Funding and Market Functioning").
- Across all collateral types, the demand for term funding remained basically unchanged.
- Roughly one-fifth of dealers reported that liquidity and functioning in the high-grade corporate bond and in the consumer asset-backed securities markets improved somewhat over the past three months. For all other asset classes surveyed, liquidity and market functioning remained basically unchanged.
- The volume, duration, and persistence of mark and collateral disputes remained basically unchanged over the past three months across all collateral types.

Special Questions on OTC FX Derivatives Trading during the Early August Selloff
(Questions 81–90)

Heightened volatility in financial markets in early August 2024 was reportedly associated with an unwinding of FX carry trades. Such trades typically involve a short position in a lower-yielding currency combined with a long position in a higher-yielding currency. Many of these trades had reportedly been established with OTC FX derivatives.[3] In the special questions, dealers were asked about clients' use of OTC FX derivatives in June 2024 and changes in their use during and after the early August selloff, with a focus on positions associated with FX carry trades. Roughly four-fifths of dealers indicated that they are active in intermediating client positions in OTC FX derivatives.

Dealers were asked to characterize the use of OTC FX derivatives by clients as of the end of June 2024. Responses indicated significant use across all client types.

- Nearly three-fourths of dealers reported that a large number of hedge fund and commodity trading adviser (CTA) clients widely employed OTC FX derivatives as of the end of June 2024, and roughly one-fifth reported that OTC FX derivatives were used by some of these clients.

- For insurance company clients, close to one-half of respondents indicated that OTC FX derivatives were widely used by a large number of clients, and about two-fifths reported that these instruments were employed by some of these clients.

- For other client types—nonfinancial corporations; mutual funds, exchange-traded funds (ETFs), and separately managed accounts (SMAs) established with investment advisers; and pension plans, endowments, and sovereign wealth funds—around two-fifths of respondents indicated that OTC FX derivatives were widely used by a large number of clients, and fractions of between roughly one-third and one-half indicated that OTC FX derivatives were used by some of these clients.

Dealers were asked about how frequently clients used OTC FX derivatives for FX carry, speculative or directional positioning, and hedging purposes as of the end of June 2024.

- For all client types except hedge funds and CTAs, hedging was the most cited reason by dealers for clients' frequent use of OTC FX derivatives, with between roughly four-fifths and nearly all respondents indicating that clients frequently used OTC FX derivatives for this purpose.

- For hedge fund and CTA clients, nearly all dealers responded that clients frequently used OTC FX derivatives for speculative or directional positioning purposes, while close to four-fifths of respondents indicated that these instruments were also frequently used for FX carry positioning and slightly less than three-fourths indicated they were frequently used for hedging.

- For the combined category of pension fund, endowment, and sovereign wealth fund clients, nearly two-fifths and close to one-third of respondents indicated that such clients frequently

[3] In these questions, OTC FX derivatives are broadly defined to include any OTC instruments referencing foreign currencies and any structured instruments with such derivatives embedded.

used OTC FX derivatives for FX carry positioning and for speculative or directional positioning, respectively.

- For mutual fund, ETF, and SMA clients, a small fraction of dealers reported frequent use of these instruments for speculative or directional positioning.

For the clients who employed OTC FX derivatives for carry trade positioning as of the end of June 2024, dealers indicated that for all client types, FX forwards were the most commonly used instrument in taking such positions, while FX swaps were reported as the second most frequently used instrument. FX options were reported as the third most frequently used instrument across clients.

Dealers were asked to characterize how clients using OTC FX derivatives were positioned with respect to lower-yielding currencies as of the end of June 2024 and how such positions changed during the early August selloff.

- For hedge funds and CTAs, a net fraction of two-thirds of dealers reported either that most of these clients were net short or that more clients were net short than net long as of the end of June 2024.

- For the combined category of pension funds, endowments, and sovereign wealth funds, nearly three-fifths of respondents, on net, indicated either that most of these clients were net short or that more clients were net short than net long.

- For the combined category of mutual funds, ETFs, and SMAs, nearly one-fourth of respondents, on net, reported that most of these clients were net short or that more clients were net short than net long over the period.

- For insurance companies and nonfinancial corporations, over one-fourth and two-fifths of respondents, respectively, indicated that most clients did not have net directional exposure in FX derivatives as of the end of June 2024.

- With respect to changes in such positions during the early August selloff, for all client types except nonfinancial corporations, net fractions of between one-fifth and one-half of dealers reported that clients increased, on net, their long OTC FX derivatives positions in lower-yielding currencies.

    - A net fraction of nearly one-half of dealers indicated that hedge funds and CTAs were more long, on net, than they were before the selloff.

    - Almost all dealers reported that the OTC FX derivatives positions in these currencies held by nonfinancial corporations did not change significantly. For all other client types except hedge funds and CTAs, fractions of between one-half and over two-thirds of dealers reported no significant net change in such positions.

For clients trading OTC FX derivatives at the time of the survey, dealers were asked to characterize the net change in clients' OTC FX derivatives positions in lower-yielding currencies since the peak of the early August selloff.

- A net fraction of nearly one-third of dealers reported that hedge fund and CTA clients were more long, on net, on lower-yielding currencies relative to their positions at the peak of the selloff.

- For mutual fund, ETF, and SMA clients, one-fifth of dealers, on net, indicated that clients were somewhat more long on OTC FX derivatives positions in lower-yielding currencies, while two-thirds reported no significant net change in their positions.

- For nonfinancial corporations, all respondents indicated no significant net change in clients' positions in lower-yielding currencies since the peak of the early August selloff, while roughly four-fifths reported the same for insurance companies. For the combined category of pension funds, endowments, and sovereign wealth funds, one-half of dealers indicated no significant net changes in such positions.

Finally, dealers were also asked to characterize the change in liquidity conditions in OTC FX derivatives markets during the early August selloff.

- Around one-half of respondents indicated that liquidity conditions in OTC FX derivatives markets deteriorated between late July and the peak of the early August selloff, while the remainder indicated no change in liquidity conditions.

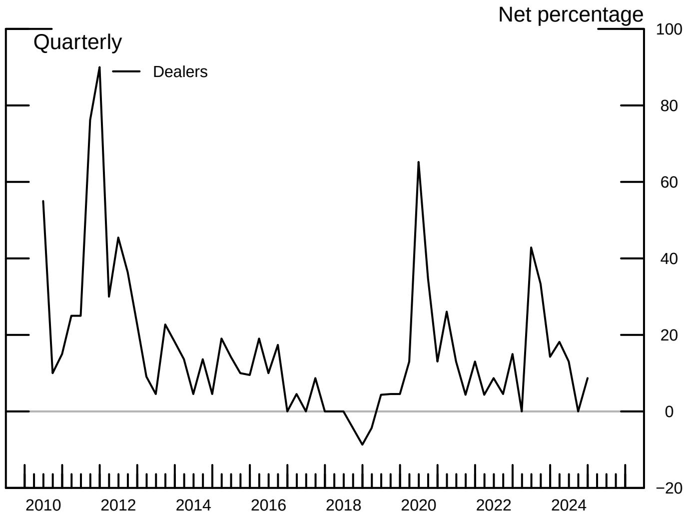
- Of the dealers that reported a deterioration in liquidity conditions, three-fifths pointed to a rapid unwinding of FX carry trades as a very important reason for the deterioration. In addition, diminished dealer intermediation activity and reduced willingness of dealers to take risks in FX derivatives markets were reported by close to one-third of dealers as very important reasons for the deterioration.

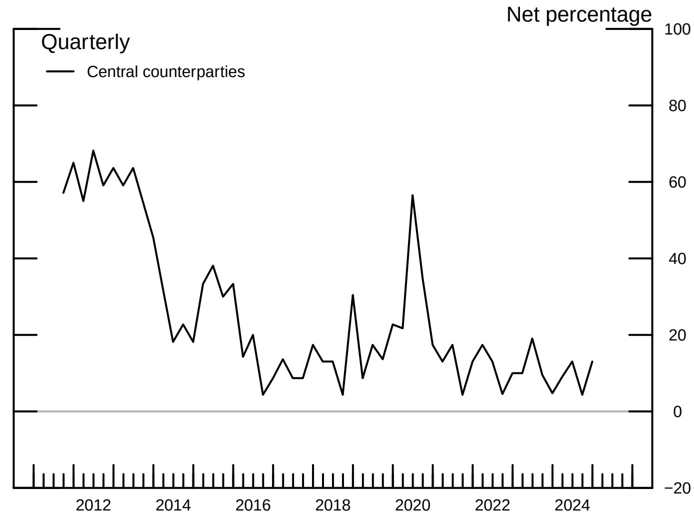
- About four-fifths of dealers reported that their initial margin requirements with respect to noncentrally cleared OTC FX derivatives remained basically unchanged during the selloff.

This document was prepared by Ayelén Banegas, 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.

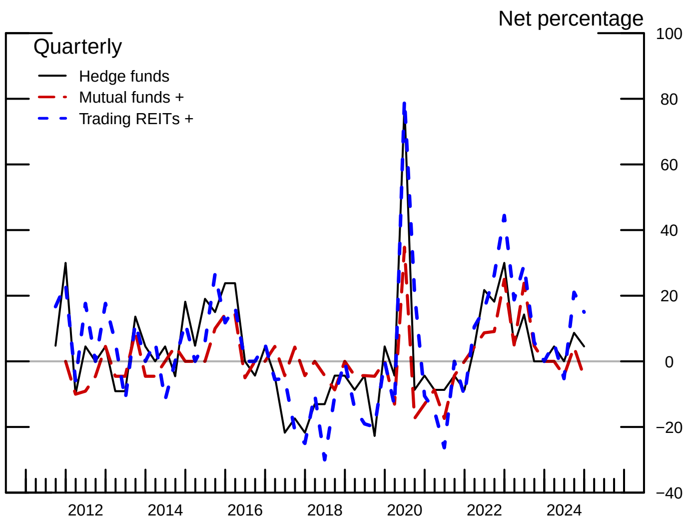
Management of Concentrated Credit Exposures and Indicators of Supply of Credit

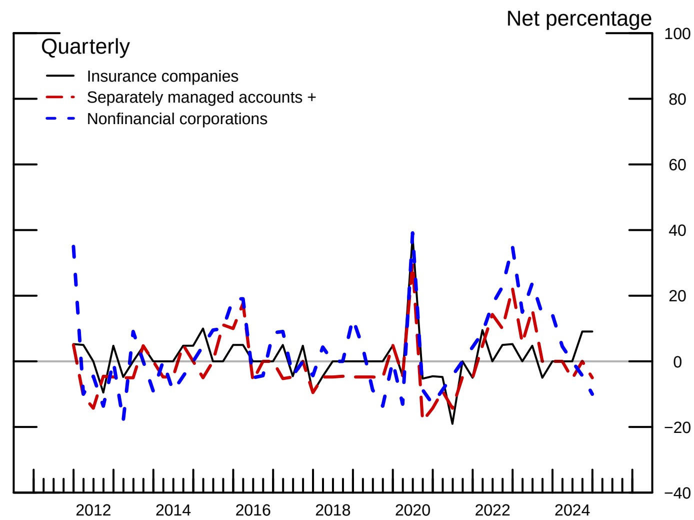
Respondents increasing resources and attention to management of concentrated exposures to the following:



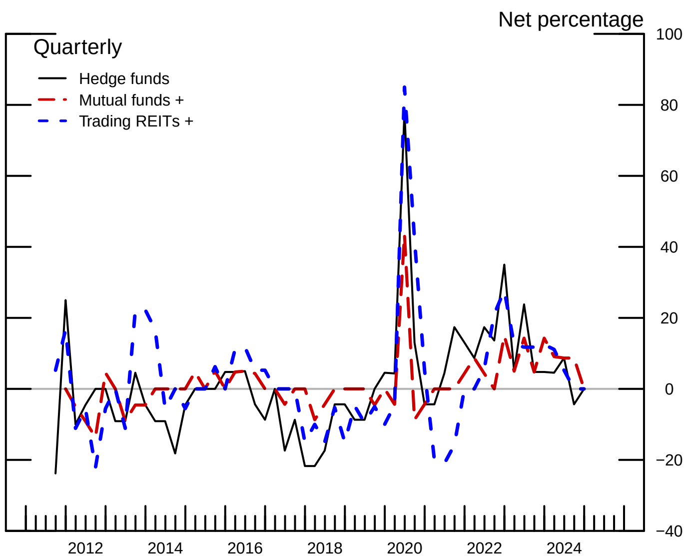


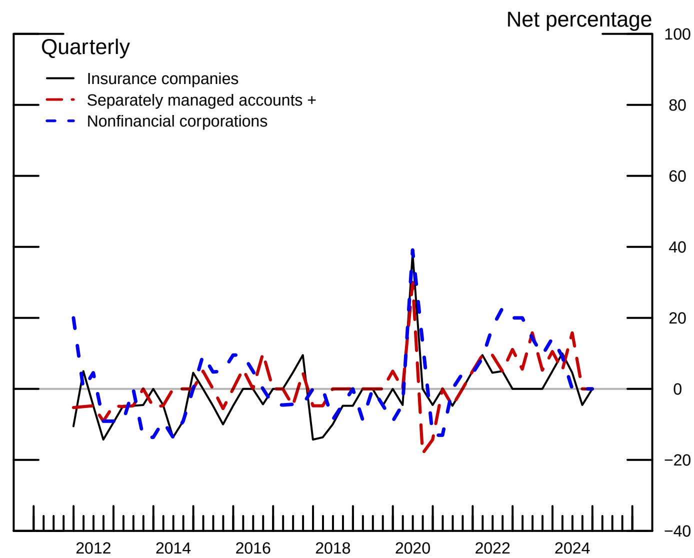
Respondents tightening price terms to the following:





Respondents tightening nonprice terms to the following:

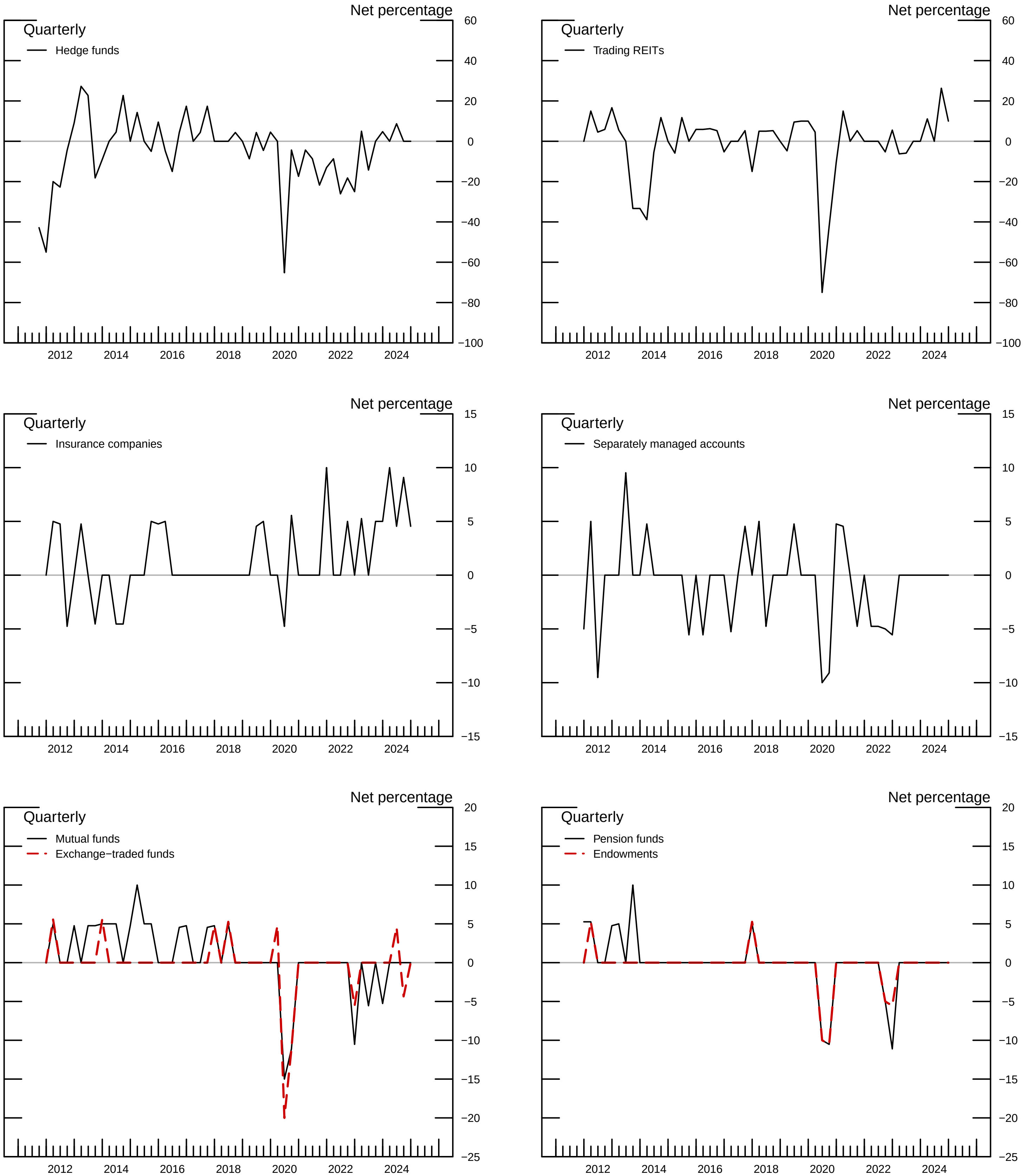




Note: REIT is real estate investment trust.
+ The question was added to the survey in September 2011.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

Use of Financial Leverage

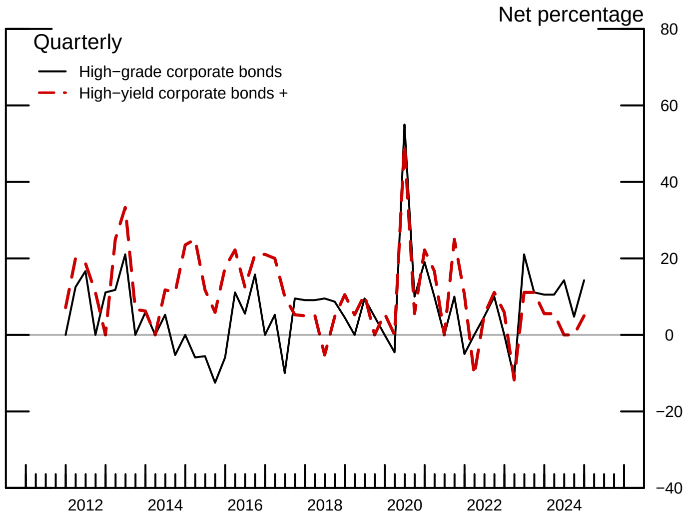
Respondents reporting increased use of leverage by the following:

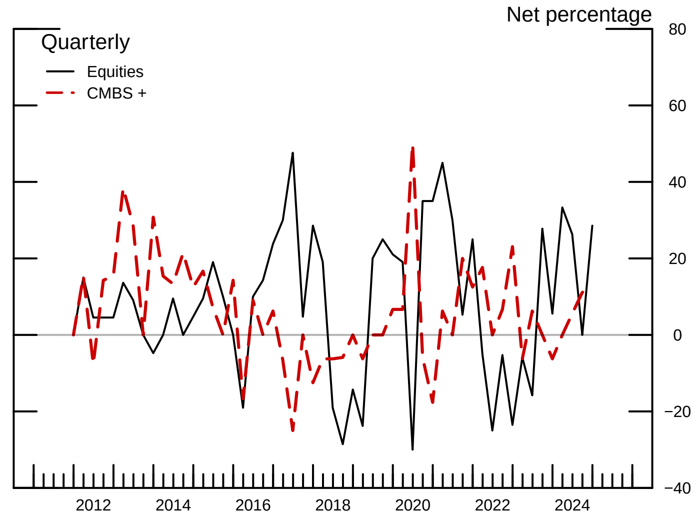


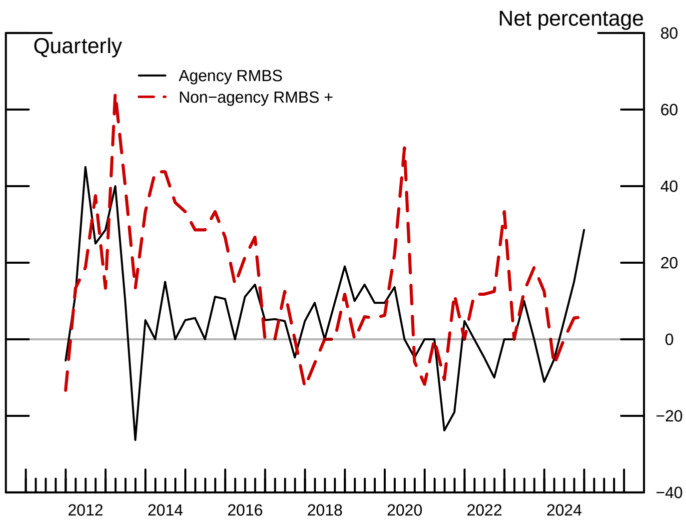
Note: REIT is real estate investment trust.
Source: Federal Reserve Board, Senior Credit Officer Opinion Survey on Dealer Financing Terms.

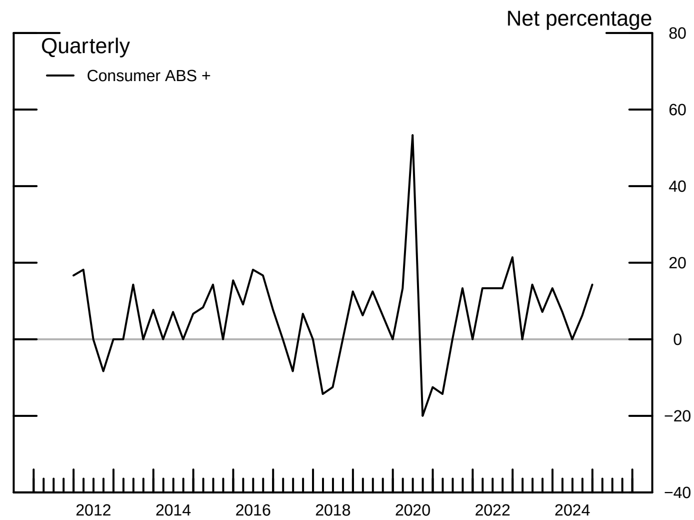
Measures of Demand for Funding and Market Functioning

Respondents reporting increased demand for funding of the following:

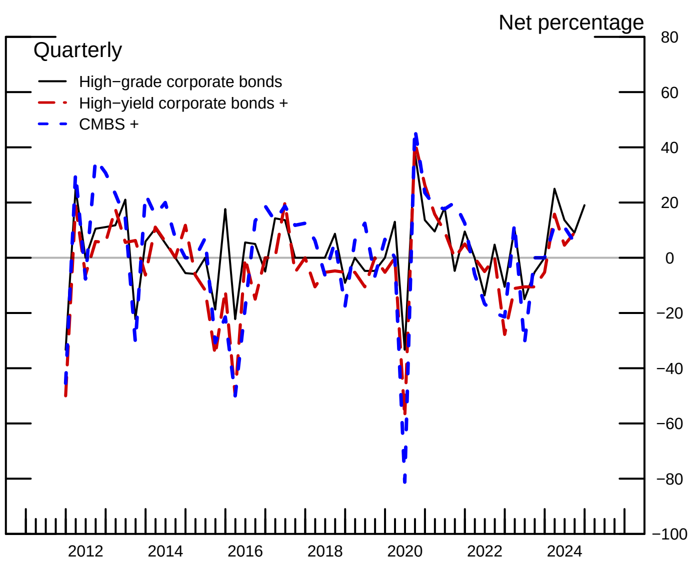


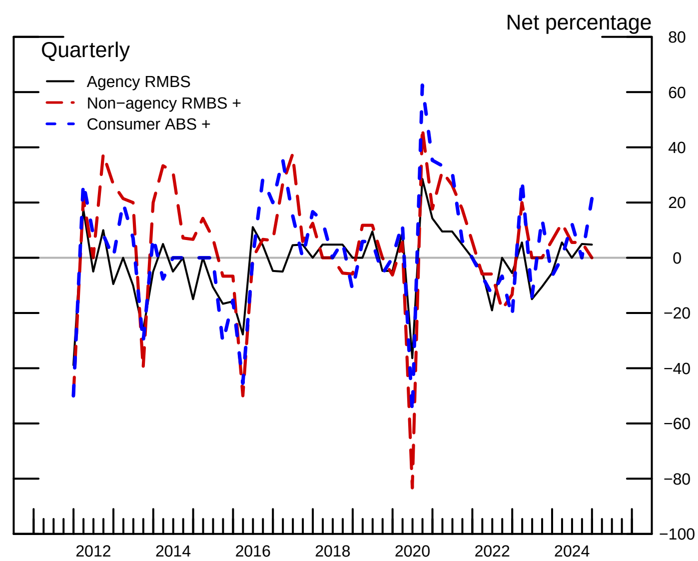






Respondents reporting an improvement in liquidity and functioning in the underlying markets for the following:





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.