EUROPEAN CENTRAL BANK

EUROSYSTEM

Survey on credit terms and conditions in euro-denominated securities financing and OTC derivatives markets (SESFOD)

Guidelines

Introduction

Background information

As a follow up to the recommendation in the Committee on the Global Financial System (CGFS) study group report on "The role of margin requirements and haircuts in procyclicality" published in March 2010,[1] the Eurosystem has decided to conduct a quarterly qualitative survey on credit terms and conditions in euro-denominated securities financing and over-the-counter (OTC) derivatives markets. This survey is part of an international initiative to collect information on trends in the credit terms offered by firms in the wholesale markets and insights into the main drivers of these trends. The information collected is valuable for financial stability, market functioning and monetary policy objectives.

Overview

Survey participants are large banks active in targeted euro-denominated markets. Euro area-headquartered institutions report to the central bank of a country where their headquarters are, which in turn submit data to the ECB. Non-euro-area-headquartered participants report directly to the ECB.

The survey is conducted quarterly, in late February, late May, late August and late November. It provides information on average market conditions during the following **three-month reference periods**: 1 December to 28/29 February, 1 March to 31 May, 1 June to 31 August, and 1 September to 30 November respectively.

All individual institution data collected will be treated confidentially. **Only aggregate results covering all respondents will be made public.** No country-level results will be disclosed, but an exception may be made for a regional breakdown into aggregate euro area and non-euro area results. Aggregate data may also be

[1] Committee on the Global Financial System, The role of margin requirements and haircuts in procyclicality, *CGFS Papers*, No 36, March 2010.

published by the Bank for International Settlements as part of an international dataset on conditions in global wholesale markets.

Survey structure and questions

The survey questions are grouped into three sections:

1. **Counterparty types** – covers credit terms and conditions for various counterparty types in both securities financing and OTC derivatives markets;
2. **Securities financing** – focuses on financing conditions for various collateral types;
3. **Non-centrally cleared OTC derivatives** – credit terms and conditions for various derivatives types.

All responses should focus on **euro-denominated** instruments in securities financing and OTC derivatives markets. For securities financing, this refers to the euro-denominated securities against which financing is being provided, rather than the currency of the loan. However, ideally firms should focus on transactions where the currency is the same for the collateral and the loans, as credit terms are often tighter when different currencies are involved to take into account of the exchange rate risk. For OTC derivatives, at least one (and ideally both) of the legs of the derivative contract should be denominated in euro (for FX derivatives, only one leg will be in euro).

Reporting institutions should report about their **global credit terms** and thus the survey is directed to the **senior credit officers** responsible for maintaining a consolidated perspective on the management of credit risks. Where material differences exist across different business areas, for example between traditional prime brokerage and OTC derivatives, please answer with regard to the business area generating the most exposure and explain in the appropriate comment space.

Credit terms should be reported from the perspective of the firm as a **supplier of credit to customers** (rather than as receiver of credit from other firms).

The questions focus on how terms have changed over the past three months; why terms have changed; and expectations for the future. Change data should reflect **how terms have tightened or eased over the past three months, regardless of how they stand relative to longer-term norms.** Changes in the enforcement of existing policies are to be reported as changes in terms. "Future" data should look at expectations of how terms will change over the next three months. Please comment if material differences exist with respect to instruments denominated in other currencies. Firms are encouraged to answer all questions (see the full list of questions in the Annex). If some market segments are of marginal importance to firm's business, please answer “not applicable”.

Some questions differentiate between **average and most-favoured clients** and the distinction between these two groups is a consequence of breadth, duration and extent of relationship.

Valuation disputes refer to situations whenever the counterparties do not agree on the valuation of the collateral or derivative position associated with a securities financing or an OTC derivatives transaction respectively.

1 Counterparty types

The questions in Section 1 refer to the tightness of **credit terms applicable to different counterparty types** across the entire range of securities financing and OTC derivatives transactions, why these may have changed, and expectations for the future.

The six given counterparty types are:

1. **Banks and dealers** – the main financial intermediaries in wholesale markets. The focus should be on large banks and large global dealers, not smaller independent dealers;
2. **Hedge funds** – specialist investment funds that undertake a wider range of investment and trading activities than conventional investment funds, are subject to less regulation, and are often leveraged;
3. **Insurance companies** – firms that provide life and non-life insurance and re-insurance services.
4. **Investment funds (including exchange-traded funds), pension plans and other institutional investment pools** – institutional investors other than hedge funds and insurance companies. They are often regulated, have more conservative investment mandates, and much lower levels of leverage;
5. **Non-financial corporations** – entities whose principal activity is the production of non-financial goods and services.
6. **Sovereigns** – general government and its agencies, including, for example, debt management offices, municipalities, domestic state-owned entities such as KfW in Germany, CADES in France, NAMA in Ireland or FROB in Spain. Excludes profit-seeking state-owned banks, central banks and supra-national entities such as EBRD, EIB or ESM/EFSF.

In some questions, the survey differentiates between price and non-price terms:

1. **Price terms** refer to the compensation demanded for bearing credit risk, as reflected, for example, by financing rates/spreads. Please report only changes that are not directly related to changes in policy rates;

2. **Non-price terms** are the contractual provisions used to mitigate risk exposures, including, for example, haircuts, maximum maturity, covenants, cure periods, cross-default provisions or other documentation features.

To the extent that credit terms have tightened or eased, respondents are asked to provide **up to three most important reasons** why their credit terms (both price and non-price) have changed across the entire spectrum of securities financing and OTC derivatives transaction types. Please note that reasons should be provided **only if** a change in credit terms was reported. By contrast, the influence of CCP practices should be reported **irrespective** of whether terms applied to clients across the entire spectrum of securities financing and OTC derivatives transaction types have tightened or eased over the past three months.

Survey respondents should pick their reasons from the following list:

1. **Current or expected financial strength of counterparties,** including, among other things, changes in public external credit ratings;
2. **Willingness of your institution to take on risk;**
3. **Adoption of new market conventions** (e.g. collateral terms and agreements, ISDA protocols);
4. **Internal treasury charges for funding;**
5. **Availability of balance sheet or capital at your institution;**
6. **General market liquidity and functioning;**
7. **Competition from other institutions;**
8. **Other** (please specify).

Survey participants are also asked to indicate how has the **amount of resources and attention devoted to the management of concentrated credit exposures** to large banks/dealers and central counterparties changed.

In addition, for all counterparty types respondents are asked to report changes in the following:

1. **Use and availability of unutilised financial leverage** – unutilised financial leverage refers to the availability of additional (and currently unutilised) financial leverage under agreements currently in place (for example, under prime brokerage agreements and other committed but undrawn or partly drawn facilities);
2. **Client pressure and provision of differential terms to most-favoured clients** – client pressure is defined as the intensity of efforts to negotiate more favourable price and non-price credit terms;

3. **Valuation disputes** – refer to situations whenever the counterparties do not agree on the valuation of the collateral or derivative position associated with a securities financing or an OTC derivatives transaction respectively.

2 Securities financing

The questions in Section 2 refer to securities financing, i.e. the provision of finance (lending) to clients that is **collateralised by euro-denominated securities.** Such activities may be conducted by a repo desk, by a trading desk engaged in facilitating institutional clients and/or proprietary transactions, by a funding desk or from a prime brokerage platform. For each collateral type, respondents are asked to report the changes in price and non-price terms over the past three months.

The ten collateral types are listed below:

1. **Domestic government bonds** – these are euro-denominated government bonds issued by the government of the country where a respondent's headquarters are;
2. **High-quality government, sub-national and supra-national bonds** – excludes domestic euro-denominated government bonds, but includes euro-denominated government-guaranteed (issued by both private and public entities), state, provincial and municipal bonds, as well as euro-denominated bonds issued by supra-national organisations such as the World Bank, IMF or multilateral development banks. Considered to be of high credit quality and may also have an investment-grade credit rating issued by a credit rating agency;
3. **Other government, sub-national and supra-national bonds** – same debt securities as in the previous point, but not considered to be of high credit quality;
4. **High-quality financial corporate bonds** – high credit quality bonds issued by financial corporations; may also have an investment-grade rating issued by a credit rating agency;
5. **High-quality non-financial corporate bonds** – high credit quality bonds issued by non-financial corporations; may also have an investment-grade rating issued by a credit rating agency;
6. **High-yield corporate bonds** – bonds issued by either financial or non-financial corporations that are not considered to be of high credit quality and thus may also have a speculative-grade rating issued by a credit rating agency;
7. **Convertible securities** – bonds which can be converted into equities;
8. **Equities** (including funding through stock loan) – an ownership interest in a corporation in the form of common stock or preferred stock;
9. **Asset-backed securities** – debt securities backed by a specific pool of assets;

10. **Covered bonds** – debt securities that are backed by a specific pool of assets as well as a general claim on the issuing financial institution.

The six price and non-price credit terms are:

1. **Maximum amount of funding;**
2. **Maximum maturity of funding** – the maximum duration of a securities financing transaction (in days);
3. **Haircuts** – the amount by which a collateral asset's market value is reduced in secured lending, typically expressed in percent;
4. **Financing rate/spread** – the effective interest rate on a securities financing transaction. Please report only changes that are not directly related to changes in policy rates;
5. **Use of central counterparties (CCPs)** – respondents' decisions to process trades through a CCP, rather than bilaterally, in order to reduce counterparty credit risk;
6. **Covenants and triggers** – covenants are the legal restrictions that are placed on the counterparty to help mitigate risk. Triggers are the specific factors that cause additional collateral to be posted.

For the same set of collateral types, respondents are asked to report the associated changes in market conditions that are grouped into three categories listed below:

1. **Demand for lending against collateral** – counterparties' demand for funding from banks to finance their positions. This could include the degree of leverage that counterparties are willing to take on;
2. **Liquidity and functioning of the collateral market** – an assessment of overall conditions in that particular market. This could be based on factors such as trading volumes, bid-ask spreads, ability of the market to absorb large trades, and the ease of financing positions;
3. **Collateral valuation disputes** – refer to situations where the valuation of the collateral associated with a securities financing transaction by the party with the contractual role of "valuation agent" is not accepted by the counterparty.

3 Non-centrally cleared OTC derivatives

This section covers changes in price and non-price terms and market conditions in OTC derivatives **that are not cleared through a CCP**, differentiating among various underlyings or market risk categories (foreign exchange, interest rate, credit, etc.). For each derivative type, respondents are asked to report the changes in credit terms or market conditions over the past three months.

The derivative types are outlined below:

1. **Foreign exchange (FX)** – transactions with exposure to more than one currency, be it in interest or exchange rates;

2. **Interest rate** – transactions in which there is exposure to only one currency's interest rate. This category should include all fixed and/or floating single-currency interest rate contracts including forwards, swaps and options;

3. **Credit referencing sovereigns** – credit derivatives where the reference entity is a sovereign issuer;

4. **Credit referencing corporates** – credit derivative contracts referencing corporate credits (single-name and indices);

5. **Credit referencing structured credit products,** such as asset-backed securities (specific tranches and associated indices);

6. **Equity** – transactions with a return, or a portion of their return, that is linked to the price of a particular equity or to equity indices;

7. **Commodity** – transactions involving a commodity or commodity index exposure;

8. **Total return swaps referencing non-securities** – only total return swaps referencing non-securities, such as bank loans, should be included.

The five credit terms and types of market conditions are as follows:

1. **Initial margin** – the sum of money which must be deposited, and maintained, in order to provide protection against default by a counterparty to the trade;

2. **Maximum amount of exposure** – a credit limit for an OTC derivatives transaction;

3. **Maximum maturity of trades** – the maximum duration of an OTC derivatives transaction (in days);

4. **Liquidity and trading** – the general trading conditions for OTC derivatives, rather than the specific terms of a contract;

5. **Valuation disputes** – refer to situations where the valuation of the derivatives transaction by the party with the contractual role of “valuation agent” is not accepted by the counterparty.

The five non-price credit terms applicable to new and renegotiated master agreements are listed below:

1. **Margin call practices** – requirements, timelines and thresholds for posting additional collateral or margin;

2. **Acceptable collateral;**

3. **Recognition of portfolio and diversification benefits,** including from securities financing trades where appropriate agreements are in place;

4. **Covenants and triggers** – covenants are the legal restrictions that are placed on the counterparty to help mitigate risk. Triggers are the specific factors that cause additional collateral to be posted.

5. **Other documentation features.**

The last question in Section 3 asks about posting of non-standard collateral (for example, other than cash and high-quality government bonds) pursuant to OTC derivatives contracts.

4 Feedback

Please comment if there are any other recent survey-related market developments that you regard as particularly significant and which were not fully addressed in the prior questions.

5 Annex – List of questions

Section 1: Counterparty types

1.1 Realised and expected changes in price and non-price credit terms

Over the past three months, how have the [price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities financing and OTC derivatives transaction types changed, regardless of [non-price] terms?

Over the past three months, how have the [non-price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities financing and OTC derivatives transaction types changed, regardless of [price] terms?

Over the past three months, how have the [price and non-price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities financing and OTC derivatives transaction types changed [overall]?

Over the next three months, how are the [price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities financing and OTC derivatives transaction types likely to change, regardless of [non-price] terms?

Over the next three months, how are the [non-price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities

financing and OTC derivatives transaction types likely to change, regardless of [price] terms?

Over the next three months, how are the [price and non-price] terms offered to [counterparty type/ all counterparties above] as reflected across the entire spectrum of securities financing and OTC derivatives transaction types likely to change [overall]?

1.2 Reasons for changes in price and non-price credit terms

Please report three most important reasons only if [price/ non-price] terms applied to clients across the entire spectrum of securities financing and OTC derivatives transaction types have tightened or eased over the past three months.

To the extent that [price/ non-price] terms applied to [counterparty type] have tightened or eased over the past three months (as reflected in your responses in Section 1.1), what was the [first/ second/ third] most important reason for the change?

Please report the influence of CCP practices irrespective of whether terms applied to clients across the entire spectrum of securities financing and OTC derivatives transaction types have tightened or eased over the past three months.

To what extent have changes in the practices of central counterparties, including margin requirements and haircuts, influenced the credit terms your institution applies to clients on bilateral transactions which are not cleared?

1.3 Resources and attention to the management of concentrated credit exposures

Over the past three months, how has the amount of resources and attention your firm devotes to the management of concentrated credit exposures to [large banks and dealers/ central counterparties] changed?

1.4 Leverage

Considering the entire range of transactions facilitated by your institution for such clients, how has the use of financial leverage by [hedge funds/ insurance companies/ investment funds (incl. ETFs), pension plans and other institutional investment pools] changed over the past three months?

Considering the entire range of transactions facilitated by your institution for [hedge funds], how has the availability of additional (and currently unutilised) financial leverage under agreements currently in place (for example, under prime brokerage agreements and other committed but undrawn or partly drawn facilities) changed over the past three months?

1.5 Client pressure and differential terms to most-favoured clients

How has the intensity of efforts by [counterparty type] to negotiate more favourable price and non-price terms changed over the past three months?

How has the provision of differential terms by your institution to most-favoured (as a consequence of breadth, duration, and extent of relationship) [counterparty type] changed over the past three months?

1.6 Valuation disputes

Over the past three months, how has the [volume/ duration and persistence] of valuation disputes with [counterparty type] changed?

Section 2: Securities financing

2.1 Credit terms by collateral type for average and most-favoured clients

Over the past three months, how have the [maximum amount of funding/ maximum maturity of funding/ haircuts/ financing rate/spreads/ use of CCPs/ covenants and triggers] under which [collateral type] are funded changed for [average/ most-favoured] clients (as a consequence of breadth, duration, and extent of relationship)?

2.2 Demand for funding, liquidity and disputes by collateral type

Over the past three months, how has demand for funding of [collateral type/ all collateral types above] by your institution's clients changed?

Over the past three months, how has demand for [term funding with a maturity greater than 30 days] of [collateral type/ all collateral types above] by your institution's clients changed?

Over the past three months, how have liquidity and functioning of the [collateral type/ all collateral types above] market changed?

Over the past three months, how has the [volume/ duration and persistence] of collateral valuation disputes relating to lending against [collateral type/ all collateral types above] changed?

Section 3: Non-centrally cleared OTC derivatives

3.1 Initial margin requirements, credit limits, liquidity and disputes by type of derivatives

Over the past three months, how have [initial margin requirements] set by your institution with respect to OTC [type of derivatives] changed for [average/ most-favoured] clients?

Over the past three months, how has the [maximum amount of exposure/ maximum maturity of trades] set by your institution with respect to OTC [type of derivatives] changed?

Over the past three months, how have [liquidity and trading] of OTC [type of derivatives] changed?

Over the past three months, how has the [volume/ duration and persistence] of disputes relating to the valuation of OTC [type of derivatives] contracts changed?

3.2 Changes in new or renegotiated master agreements

Over the past three months, how have [margin call practices/ acceptable collateral/ recognition of portfolio or diversification benefits/ covenants and triggers/ other documentation features] incorporated in new or renegotiated OTC derivatives master agreements put in place with your institution's clients changed?

3.3 Posting of non-standard collateral

Over the past three months, how has the posting of non-standard collateral (for example, other than cash and high-quality government bonds) as permitted under relevant agreements changed?

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