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FICC Proposes Charge for Fails-to-Deliver in Treasury Securities

[23351]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 8-09
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 10-09
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 11-09
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 11-09
SEC RULES MEMBERS No. 32-09 RE: FICC PROPOSES CHARGE FOR FAILS-TO-DELIVER IN TREASURY SECURITIES

The Fixed Income Clearing Corporation ("FICC") has filed a rule change with the Securities and Exchange Commission proposing to impose a charge on its members with a fail-to-deliver position in treasury securities. [1] The proposed charge is designed to promote prompt and accurate clearance and settlement of securities transactions by discouraging persistent fails-to-deliver. Comments on the proposal are due to the SEC by April 9, 2009.

The Government Securities Division of FICC ("GSD") has been asked by the Treasury Markets Practices Group ("TMPG") to impose a charge on failed positions involving treasury securities within FICC. The TMPG is a group of market participants active in the treasury securities market that is sponsored by the Federal Reserve Bank of New York ("FRBNY"). [2] The TMPG has been analyzing ways to address the persistent settlement fails in treasury securities transactions that have arisen, according to the TMPG, due to the recent market turbulence and low short-term interest rates. To encourage market participants to resolve fails promptly, the TMPG has proposed for adoption a "best practice" that would call for the market-wide assessment of a charge on fail-to-deliver positions. [3] As part of this implementation of this "best practice," the TMPG has asked the GSD to impose the aforementioned charge.

According to FICC's proposal, the charge would be equal to the product of net money due on the failed position and three (3) percent per annum minus the Target Fed funds target rate that is effective at 5:00 p.m. Eastern Standard Time on the business day prior to the originally scheduled settlement date, and would be capped at three (3) percent per annum. [4] The charge would be applied daily and would be a debit on the member's GSD monthly bill for a fail-to deliver position and a credit on the member's GSD monthly bill for those with a fail-to-receive position. [5]

In the event that FICC is the failing party because, for example, it received securities too close to the close of the Fedwire for redelivery, the fail charge would be distributed pro rata to the netting members based upon usage of the GSD's services. [6]

The proposed rule change would provide that the Credit and Market Risk Management Committee of FICC's Board of Directors would retain the right to revoke application of the charge if industry events or practices warrant such revocation.

Heather L. Traeger
Associate Counsel

endnotes

[1] See SEC Release No. 59569 (March 12, 2009), 74 FR 11797 (March 19, 2009). The proposal may be found on the SEC's website at: http://www.sec.gov/rules/sro/ficc/2009/34-59569.pdf.

[2] More information about the TMPG is available on the FRBNY's website at: www.newyorkfed.org/tmpg.

[3] For more information about the TMPG's proposal, see Claiming a Fails Charge for a Settlement Fail: Frequently Asked Questions, Treasury Market Practice Group (Revised February 2, 2009), available on the FRBNY's website at: http://www.newyorkfed.org/tmpg/faqs.pdf.

[4] The TMPG has proposed a target implementation date of May 1, 2009 for commencing accruals of fails charges, and a date of June 12, 2009 for the first monthly submission of claims. This proposed implementation date is subject to SEC approval of FICC's proposal.

[5] For example, Member A fails to deliver today on a $50 million position on which he is owed $50.1 million. The Target Fed funds rate yesterday at 5:00 p.m. was one (1) percent. The fails charge will be two (2) percent per annum and will be applied to the funds amount of $50.1 million, thus equaling a charge of $2,783.33 for that day. The bill of the member failing to deliver will reflect a debit of $2,783.33.

[6] This is the same methodology that is used when FICC incurs finance charges.
