TMPG | Treasury Market Practices Group

Announcement

March 30, 2009

Treasury Market Practices Group Announces Updates to Fails Charge Recommendation

The Treasury Market Practices Group (TMPG) today announced two updates to its fails charge recommendation. These include (1) the incorporation of a minimum threshold for fails charges and (2) support for the billing of claims on a one-time basis tied to the date when a transaction actually settles, rather than on a monthly basis during the life of the fail. The changes are described in greater detail below. In addition, the TMPG issued a clarification regarding the reference rate used to calculate fails charges.

The updates to the TMPG's fails charge recommendation were made following further consultation with market participants, including asset managers and custodians, in order to facilitate widespread adoption of this recommendation. The TMPG recognizes that these changes may require additional operational and systems changes for some market participants that have already devoted considerable time and effort to implementation of the fails charge. However, the TMPG expects that these updates will reduce the operational and administrative challenges faced by buy-side participants in implementing the fails charge recommendation and will therefore promote more widespread adoption of the best practice, which the TMPG believes to be of critical importance for Treasury market function and liquidity.

The TMPG continues to recommend that the Fails Charge Trading Practice be implemented with respect to transactions entered into on or after May 1, 2009. It is hoped that prior to this date, the Securities and Exchange Commission will have approved a rule filing by the Fixed Income Clearing Corporation (FICC) regarding the application of the fails charge to its members.[1]

The TMPG expects to publish revised documentation, including a list of Frequently Asked Questions and the Fails Charge Trading Practice, incorporating these updates by Tuesday, March 31, 2009.

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[1] The applicable rule filing SR-FICC-2009-03 is available on the FICC's website at http://www.dtcc.com/legal/rule_filings/ficc/2009.php

Minimum Threshold for Fails Charges

The TMPG understands from market participants that current operational considerations suggest that waiving a fails charge accrued over the life of a delivery failure when these accrued charges are less than or equal to $500, on a per trade basis, would significantly reduce the operational challenges faced by buy-side participants in implementing the fails charge recommendation in the near term. Although the TMPG believes that the ideal threshold for fails charges is zero for all market participants, the TMPG anticipates that adoption of a minimum threshold will facilitate widespread adoption of the Fails Charge Trading Practice. The TMPG may revisit this threshold recommendation should an industry utility emerge, or if the threshold leads to unexpectedly large asymmetries or materially undermines the pass-through of the fails charge. In addition, it is expected that the FICC will have no minimum threshold due to the nature of FICC netting and novation.

Monthly Claims Process for Settled Transactions

The TMPG recommends that fails charges accrue and be calculated over the life of a delivery failure, but that claims for such charges be issued only after the delivery failure is resolved. In other words, a delivery failure spanning more than one calendar month would result in a single claim, based upon the fails charge over the entire duration of the fail. This contrasts with the prior recommendation under which a claim would be sent for each month in which a transaction failed, with the fails charge based upon the number of days the transaction failed in each given month. This modification in the TMPG's fails charge recommendation results from the finding that most asset manager and custodian systems are based on trade settlement, and that the original fails charge recommendation would be overly burdensome to implement. Similar to its previous guidance, the TMPG recommends that claims for fails charges be issued by the tenth business day of the month following the month in which the delivery failure is resolved, and either paid or rejected by the last business day of the month in which they were submitted.

Recommended Rate for Calculating Fails Charges

The TMPG wishes to clarify the definition of the reference rate ("R") in the TMPG fails charge formula. The fails charge formula is:

$$\mathrm{C} \quad = \quad \frac{1}{360} * .01 * \max(3 - R,\ 0) * P$$

Under this formula, R= for each day, the TMPG reference rate* at 5:00 p.m. New York time on the *preceding business day*. This means that if there is a change in the TMPG reference rate in the middle of the term of a delivery failure, "R" will be that new rate for subsequent days of the fail (assuming that the TMPG reference rate does not again change during the remaining term of the delivery failure).

* The current TMPG reference rate is the target federal funds rate specified by the Federal Open Market Committee (FOMC) (if the Committee specifies a target rate) or the lower limit of the target band specified by the FOMC (if the Committee specifies a target

band in lieu of a target rate). In the event the FOMC specifies neither a target rate nor a target band, the TMPG will recommend some other similar, readily observable, short-term interest rate.