ROSENTHAL COLLINS GROUP

March 31, 2009

Via electronic submission
Securities and Exchange Commission
Washington, D.C. 20549
Attn: Division of Market Regulation

Re: Proposed Rule Change by Fixed Income Clearing Corporation
Your File Number: FICC 2009-03

Ladies and Gentlemen:

The Fixed Income Clearing Corporation ("**FICC**") has submitted to the Securities and Exchange Commission ("**Commission**") a proposed rule change to section 14, Fails Charge, of Rule 11, Netting System, of the Government Securities Division Rulebook, which if adopted, would impose a penalty charge by the Government Securities Division of FICC on failed Treasury positions. By a previous letter to the Treasury Market Practices Group ("**TMPG**"), Rosenthal Global Securities, LLC., ("**RGS**"), a registered broker dealer and a wholly-owned subsidiary of Rosenthal Collins Group, LLC, a registered Futures Commission Merchant, and an active participant in the government securities market, expressed its concerns regarding adoption of this rule change. We have set forth these concerns below, have expanded upon them, and respectfully submit them to the Commission for its consideration.

RGS has developed its own successful government securities trading operation, and has grown to the point where it makes a significant impact as liquidity providers to other dealers, particularly in the off-the-run Treasury market. As an active and significant market participant, RGS is in favor of sound market practices aimed at preserving and strengthening the market. We understand the intent of the proposed rule change is to discourage activities that lead to fails; however, we believe that implementing it will result in "unintended consequences" that will undermine the market.

In the normal course of business, there are circumstances, while not intentional, that can result in a "fail to deliver" securities on settlement date. For example, all of RGS' trading is processed through the FICC, which manages sizes of the securities that we deliver and must receive. Frequently, our fails result purely from our inability to effect how trades are allocated during the FICC matching process, regardless of how we try to avoid fails. Although RGS takes all necessary steps to resolve these fails as quickly as possible, it is not possible to avoid fails without incurring significant additional expense. We are particularly concerned that, should the fail penalty be adopted, the charges will be prohibitive to the point where we anticipate that firms with similar trading activities to ours will curtail trading and repurchase activities to avoid the risk of fails and the ensuing charges. Such reduction in the trading activity would result in a drastic decrease in market liquidity.

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Given the recent economic history of counterparty failures, it is imperative that such counterparty risk be minimized to the greatest extent possible. This can be accomplished in the Treasury market by ensuring that business is cleared through the FICC. However, since fails are more easily controlled in transactions between individual counterparties not cleared on the FICC, another consequence of adopting the fails penalty is a shift of business from the FICC to individual counterparties, thereby increasing the risk of counterparty failure.

RGS is an active market maker that, through its market-making activities, makes significant contribution to price-discovery, transparency and liquidity. In such role, we, and other firms such as RGS, provide important data to end-users. However, if the fails penalty is adopted, we and such other firms will be seriously impeded in this function.

Most often RGS trades through interdealer brokers to provide liquidity to dealers who rely on such liquidity to service their customers. If the fail penalty is adopted, we expect the structure of the market to change such that we, and others, no longer would be able to function in this role. For example, in today's markets, if asked to offer a current issue, a firm may not hesitate knowing the position can be easily hedged. If the fail penalty is adopted and if such current issue begins to "get tight" in the repurchase market, a firm may be unwilling to offer the security, thereby reducing liquidity. In addition to reducing liquidity, the adoption of a fail penalty will also result in wider spreads between bid and offer prices. The current disparity between the large spread of the penalty charge and the narrow trading spread could introduce new opportunities for players to "game" the system, taking advantage of those inadvertently caught in a fail situation. In the scenario where the fail penalty artificially inflates offering prices on the popular issues, as the supply of "specials" are held back or offered at pumped-up prices, a late-day market with "negative rate repos" priced close to the penalty fee will emerge. In the current market environment with a minimal profit in a trade, we expect the result to be that market makers, such as RCG, will consider the possibility of a fail in setting prices.

Although the U.S. government securities market is currently the most liquid and efficient in the world, reduced liquidity and wider spreads could rapidly erode investor confidence at this critical time. As an abundant new supply of U.S. Treasuries is forthcoming, it is imperative that we attract investors and increase demand rather than discourage investors by potentially negatively impacting liquidity in this market.

While we do agree with the goal of the intended rule change that a low instance of fails is important to maintain an efficient market, we respectfully contend that the current environment does not warrant the introduction of a fail penalty. We wish to emphasize that the fails problem has been significantly reduced, perhaps due to the mere threat of its implementation. The market has self-corrected itself without the need for the rule change. With a minimum of fails currently, we strongly recommend that, at the very least, the adoption of the proposed rule be postponed while alternative solutions are explored that will not produce such damaging effects on the market.

We further respectfully submit that the implementation of a fails penalty may result in an unlevel playing field, in that larger cash-rich entities (typically with their own financing desks) will have an unfair advantage over smaller players as it relates to fail avoidance and manipulation of fails. Liquidity providers such as RGS may be unable to participate due to potential fails risk with the result being less competitive pricing and an unwillingness to provide liquidity. This will force investors to seek alternative investments to reduce their reliance on short term treasuries and any implications of a negative rate market will send them away more quickly.

Another concern related to the potential impact that a fails charge may have is illustrated by the following quarter-end scenario:

Due to restrictions on customers at quarter end, they are big buyers of short term T-Bills. During the week of March 16, 2009 through March 23, 2009, there was tremendous buying in the T-Bill market as most issues, 3 months on in, rallied 8 – 10 basis points ("**bps**"). The 1 month T-Bills, 4/23 CUSIP 912795L58, was trading at 10 bps prior to the auction, came in at 5 bps with almost 50% indirect buyers in the auction. This T-Bill was 35 billion in size, and by Thursday, March 19th, when it settled, this issue was 0 bid and also traded at 0 in the repo market. All T-Bills short of the 1 month were also 0 bid and traded between 2 bps and 0 in the repo market. T-Bills from 1 month to 2 months traded as low as 4 bps as customer's demand pushed them farther out the curve, and *because there was inadequate supply,* shorter term 2 month to 3 month paper traded as low as 10-14 bps from the earlier week low of 20 bps. Longer dated maturities barely moved as investors had to stay in the shorter maturities, which is typical for quarter end.

If the fails charge is enacted, the demand for short bills will remain but the supply would be less. Dealers would offer the bills short because they expect to buy them back from customers at a later date or will purchase them in later bill auctions. Repurchases will be tight or they may fail but time will clear the markets, which is evident as the number of fails has dropped since last fall. It is respectfully submitted that *with a penalty of 300 basis points, dealers will not take that chance and will offer only what they own.* This reluctance to participate will greatly decrease the amount of offers and investors will not be able to buy what they need thus leading to further problems as liquidity dries up and customer demand remains unmet. Such a scenario could result in disruptions and have consequences far beyond what was intended. Thus, we respectfully submit that it is advisable to review the T-Bill market for the quarter ending March 31, 2009, the customer demand and assess how the scenario would have been impacted if the penalty had been enacted.

In summary, RGS suggests that, for the following reasons, the proposed rule not be adopted:

1. The pervasive fails situation that the proposed rule is intended to remedy no longer exists and the instances of fails can be held to a minimum if the industry commits to follow best practices and conduct business with integrity;

2. The potential for increased counterparty risk as more Treasury business would move away from the FICC to avoid the fails penalty; and,

3. The *unintended consequences* of adopting this proposed rule change may be severe and detrimental to the global market for U.S. government securities, including significantly reduced market liquidity, erosion of investor confidence, discontinuation of lending and potential for gaming.

With all due respect to the FICC and the TMPG and their continuing efforts in developing best practices aimed at promoting integrity, investor confidence and liquidity in the U.S. government securities market, we respectfully recommend that, in lieu of adopting the proposed rule change, at the very least, further study be conducted of the above mentioned unintentional consequences to determine if the penalty will cause severe market disruption, as RGS fears. We respectfully submit that the overall objective of the proposed rule change (to ensure the effective clearance of Treasuries) must be accomplished without negatively impacting liquidity, transparency and competitive pricing.

We trust that you will consider our comments as trading firms such as ours weigh their ability to sustain the viability of their business models going forward.

We appreciate the opportunity to comment and express our views on the proposed rule and welcome any questions you might have regarding any of our comments. In this regard, please contact the undersigned, Leslie Rosenthal, at the telephone number below.

Very Truly Yours,

Leslie Rosenthal

Leslie Rosenthal
Managing Member
Rosenthal Collins Group, L.L.C.

Cc: Fixed Income Clearing Corporation