

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65910; File No. SR-FICC-2011-08)

December 8, 2011

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change to Expand the Applicability of the Fails Charge to Agency Debt Securities Transactions

I. Introduction

On October 20, 2011, the Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-FICC-2011-08 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ The proposed rule change was published for comment in the Federal Register on November 1, 2011.² No comment letters were received on the proposal. This order approves the proposal.

II. Description

The purpose of this rule change is to expand the applicability of the fails charge to Agency debt securities transactions. The Treasury Markets Practices Group (the “TMPG”), a group of market participants active in the Treasury securities market sponsored by the Federal Reserve Bank of New York (the “FRBNY”), has been addressing the persistent settlement fails in Agency debt securities transactions that have arisen, in part, due to low interest rates.

To encourage market participants to resolve fails promptly, the TMPG recommended expanding the applicability of the fails charge (which currently applies to Treasury securities transactions) to Agency debt with the objective of reducing the incidence of delivery failures and supporting liquidity in this market.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 34-65632 (October 26, 2011), 76 FR 67519 (November 1, 2011).

The TMPG had previously recommended a charge for fails on Treasury securities, which the Government Securities Division (the “GSD”) implemented after Commission approval.³ At that time, the TMPG recommendation did not extend to Agency securities and, therefore, the GSD’s 2009 rule filing did not cover Agency debt. However, the TMPG recently has expanded its recommendation to cover certain Agency securities and, therefore, the GSD is proposing to apply the existing fails charge regime to Agency debt transactions as recommended by the TMPG. Specifically, transactions in debentures issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks now will be subject to this charge. The proposed fails charge for Agencies will be the same as that currently in place for Treasuries and is equal to the greater of: (a) 0 percent or (b) 3 percent per annum minus the federal funds target rate. The charge will accrue each calendar day a fail is outstanding.

The following examples illustrate the manner in which the proposed fails charge will apply:

Example 1: A settlement obligation fails and the next calendar date is a valid FICC business date. The GSD calculates the TMPG fail charge from the date the fail occurs to the next valid FICC business date. As the next valid business date is the next calendar date, the member’s credit/debit resulting from the TMPG fail charge is assessed for one day.

Example 2: A settlement obligation fails and the next calendar date is a holiday occurring on a Tuesday, Wednesday or Thursday. The GSD calculates the TMPG fail charge from the date the fail occurs to the next valid FICC business date. The TMPG fail charge is assessed for two days; the day the fail occurs and the date of the holiday.

³ See Securities Exchange Act Release No. 34-59802 (April 20, 2009), 74 FR 19248 (April 28, 2009).

Example 3: A settlement obligation fails on Friday and the following Monday is not a holiday. The GSD calculates the TMPG fail charge from the date the fail occurs to the next valid FICC business date. The TMPG fail charge is assessed for three days; Friday, Saturday and Sunday.

FICC's Board of Directors (or appropriate Committee thereof) will retain the right to revoke application of the proposed charges if industry events or practices warrant such revocation.

The expansion of the fails charge trading practice to the Agency debt market requires that Rule 11 (Netting System), Section 14 (Fails Charge) of the GSD rulebook be amended to make such rule applicable to debentures issued by any of Fannie Mae, Freddie Mac or the Federal Home Loan Banks. The current GSD rule states that the fails charge shall be the product of the (i) funds associated with a failed position and (ii) 3 percent per annum minus the target fed funds rate that is effective at 5 p.m. EST on the business day prior to the originally scheduled settlement date, capped at 3 percent per annum. FICC is proposing to restate the formula to make it clearer by amending section (ii) of the formula to read “the greater of (a) 0 percent or (b) 3 percent per annum minus the fed funds target rate” This change is not meant to affect the result of the formula in any way but rather is a more precise way of stating the formula.

The proposed rule change makes clear that FICC will not guaranty fails charge proceeds in the event of a default (i.e., if a defaulting member does not pay its fail charge, members due to receive fails charge proceeds will have those proceeds reduced pro-rata by the defaulting member's unpaid amount).

Timing of Implementation

The fails charges will apply to transactions in Agency debentures entered into on or after February 1, 2012, as well as to transactions that were entered into, but remain unsettled as of, February 1, 2012. For transactions entered into prior to, and unsettled as of, February 1, 2012, the fails charge will begin accruing on the later of February 1, 2012, or the contractual settlement date.

III. Discussion

Section 17A(b)(3)(F) of the Act⁴ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of security transactions and to generally protect investors and the public interest. Because the proposed rule discourages persistent fails in the marketplace by expanding the application of the fails charge to Agency debt securities transactions, the proposed rule change promotes the prompt and accurate clearance and settlement of security transactions and generally protects investors and the public interest and therefore is consistent with the requirements of Section 17A(b)(3)(F) of the Act.

⁴ 15 U.S.C. 78q-1(b)(3)(F).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act⁵ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change (File No. SR-FICC-2011-08) be, and hereby is, approved.⁷

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.⁸

Kevin M. O'Neill
Deputy Secretary

⁵ 15 U.S.C. 78q-1.

⁶ 15 U.S.C. 78s(b)(2).

⁷ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

⁸ 17 CFR 200.30-3(a)(12).