

## MEMORANDUM

TO: File

FROM: Office of Economic Analysis

DATE: August 21, 2006

SUBJECT: Fails to Deliver Pre- and Post-Regulation SHO

This memorandum provides summary data on fails to deliver through May 2006. It examines fails to deliver before and after the implementation of the Rule 203 of Regulation SHO. The data, as reported by NSCC, cover all stocks with aggregate fails to deliver of 10,000 shares or more.

Table 1 shows the average daily fails to deliver statistics pre- and post-Rule for all stocks with aggregate fails to deliver of 10,000 shares or more. All six measures show declines after Rule 203 was implemented. The period from April 1, 2004 to December 31, 2004 is defined as the pre-rule period.<sup>1</sup> The period from January 1, 2005 to May 31, 2006 is defined as the post-rule period.

- The average daily aggregate fails to deliver declined by 34.0% after the effective date of Regulation SHO.
- The average daily number of securities with aggregate fails of at least 10,000 shares declined by 6.5% after the effective date of Regulation SHO.
- The average daily number of fails to deliver positions declined by 15.3%.
- The average age of a fail position declined by 13.4% after the effective date of Regulation SHO.
- The average daily number of threshold securities declined by 38.2% from the pre- to post-rule periods.
- The average daily fails of threshold securities declined by 52.4 %.

Table 2 shows the summary statistics for the securities that were on the published threshold lists from January 10, 2005 to May 31, 2006. On an average day, there were about 312 securities on the threshold list. These threshold lists securities had an average of 1,346 fails positions representing 189 million shares.

- The average daily number of threshold securities declined by 29.8% from January 2005 to May 2006.

Table 3 displays average daily threshold securities by market.

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<sup>1</sup> August 9, November 3 and November 4, 2004 were missing from the dataset. The previous day's fails data was used to fill-in the missing data for these dates.

- For exchange-listed issues, the average daily number of threshold securities during May 2006 was about 2.18% of all issues.
- For all issues traded in the U.S. (including OTCBB and Pink Sheets), the average daily number of threshold securities during May 2006 was about 0.38% of all issues.

Table 4 shows additional summary statistics for securities on the published threshold lists from January 10, 2005 to May 31, 2006.

- Over this period, the average daily number of threshold list securities was about 312, representing about 189 million shares in fails in 1,347 fail positions.
- A total of 6,223 securities “graduated” from the threshold list since January 10, 2005, representing 4.5 billion shares in initial fails.<sup>2</sup>
- The 6 securities that have “persisted” on the threshold list since January 10, 2005 have seen their fails drop by 68.6%.

We also estimate the amount of grandfathered fails relative to total fails for threshold list securities for the period from January 7, 2005 to December 31, 2005. Since the NSCC fails data do not allow us to definitively identify new fails or grandfathered fails and when they are closed out, we need to make a number of assumptions to estimate this number. We assume any increase in fails for a particular clearing firm on a given day represents a new fail created on that day. We estimate the percentage of grandfathered fails relative to total fails for each day during our period and then average those percentages.

- The average daily percentage of grandfathered fails to total fails for stocks on the threshold list is estimated to be about 48%.

We also estimate how many fails that existed prior to the implementation of the Regulation SHO continue to persist. We compare the fails on January 3, 2005 to fails on March 31, 2006 for all stocks with aggregate fails to deliver of 10,000 shares or more.

- 99.2% of the fails that existed on January 3, 2005 are no longer outstanding as of March 31, 2006.

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<sup>2</sup> Initial fails are the number of fails on the first day a security is included on the threshold list.

**Table 1**  
**Summary Statistics on Fails to Deliver**  
**Pre- and Post-Rule**

<b>Measure</b>	<b>Pre-Rule</b>	<b>Post-Rule</b>	<b>Change</b>	<b>Percent Change</b>
Number of Days	189	353		
Average Daily Aggregate Fails (millions)	810.7	534.7	-276.0	-34.0%
Average Daily Number of Securities	2,735.5	2,557.3	-178.2	-6.5%
Average Daily Number of Fail Positions	10,747.1	9,106.5	-1,640.6	-15.3%
Average Age per Position (days)	35.7	30.9	-4.8	-13.4%
Average Daily Number of Securities on Threshold List	298.2	184.4	-113.8	-38.2%
Average Daily Aggregate Fails for Securities on Threshold List (millions)	131.6	62.7	-68.9	-52.4%

Notes:

- 1) Statistics are estimated using raw Continuous Net Settlement fails data from the NSCC that include securities with aggregate daily fails to deliver of 10,000 shares or more.
- 2) Threshold list figures include only NYSE, Amex and NASDAQ securities that meet the threshold list requirements. Since no threshold lists were published prior to January 10, 2005, the threshold list securities must be determined by applying the Rule to historical data. We apply the same procedure for determining the threshold list during the post-Rule period. Thus, we independently determine the threshold list and do not rely on the threshold lists determined by the exchanges during the post-Rule period. There is little difference in results if the published threshold lists are used.
- 4) The pre-Rule period is from April 1, 2004 to December 31, 2004. The post-Rule period is from January 1, 2005 to May 31, 2006.

**Table 2**  
**Average Daily Number of Securities on the Published Threshold Lists**  
**January 2005 to May 2006**

<b>Year</b>	<b>Month</b>	<b>Number of Days</b>	<b>Number of Securities</b>	<b>Percent Change from January 2005</b>
2005	1	16	424.31	
2005	2	19	385.26	-9.2
2005	3	22	359.36	-15.31
2005	4	21	317.57	-25.16
2005	5	21	296	-30.24
2005	6	22	287.68	-32.2
2005	7	20	298.8	-29.58
2005	8	23	307.48	-27.53
2005	9	21	289.95	-31.67
2005	10	20	275.05	-35.18
2005	11	20	270.7	-36.2
2005	12	21	281.67	-33.62
2006	1	20	274.35	-35.34
2006	2	19	324.2	-23.6
2006	3	23	324.61	-23.5
2006	4	19	308.8	-27.22
2006	5	22	297.7	-29.84

Notes:

1) The first threshold lists were calculated for the January 7, 2005 settlement date. This threshold list became effective on January 10, 2005.

2) Statistics are calculated using data from the threshold lists published by NYSE, Amex, NASDAQ, and Archipelago.

**Table 3**  
**Average Daily Threshold Securities by Market**  
**May 2006**

Market Class	Number of Threshold Issues	Total Number of Issues	% of Total Issues
NYSE	51	3,598	1.42%
Amex	52	1,376	3.78%
Archipelago	1	194	0.52%
Nasdaq NM	55	2,766	1.99%
Nasdaq SC	27	585	4.62%
All Exchanges	186	8,519	2.18%
OTCBB	74.6	3,287	2.27%
Exchanges + OTCBB	260.6	11,806	2.21%
Other OTC	37.4	66,681	0.06%
Total	298	78,487	0.38%
OTCBB + Other OTC	112	69,968	0.16%

Notes:

- 1) Statistics are calculated using data from the threshold lists published by NYSE, Amex, Nasdaq, and Archipelago.
- 2) Dually listed securities are counted twice in the total number of issues for all exchanges (8,519). However, the number of dually listed securities is small. For example, there are approximately 11 securities dually listed on NASDAQ and the NYSE.
- 3) The total number of issues for Other OTC (66,681) includes securities not covered by the Rule. Regulation SHO's close-out requirement applies to any equity security of an issuer that is registered under Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act. NASD Rule 3210, which became effective July 3, 2006, applies the Regulation SHO close-out requirements to these non-reporting OTC equity securities.

**Table 4**  
**Summary Statistics for Securities on the Published Threshold List**  
**January 10, 2005 to May 31, 2006**

Measure	Value
Average Daily Number of Stocks	311.6
Average Daily Aggregate Fails (millions)	188.6
Average Daily Number of Positions	1,346.6
Number of Graduates from Threshold List	6,223
Total Initial Fails of Graduates from Threshold List (millions)	4,454.4
Number of Persistent Threshold List Securities	6
Total Initial Fails of Persistent Threshold List Securities (millions)	15.3
Total Current Fails of Persistent Threshold List Securities (millions)	4.8
Change in Fails for Persistent Threshold List Securities	-68.6%

Notes:

- 1) Statistics are estimated using two data sources: (1) raw CNS fails data from the NSCC that include securities with aggregate daily fails to deliver of 10,000 shares or more; and (2) the threshold lists published by NYSE, Amex, NASDAQ, and Archipelago.
- 2) A “graduate” is a security that dropped from the threshold list during this period.
- 3) A “persistent” threshold list security is any security symbol that was continuously on the list during the entire period.