

U.S. Treasury Securities Fails Charge Trading Practice

Introductory Note: The Treasury Market Practices Group (“**TMPG**”)¹ and the Securities Industry and Financial Markets Association, including its Asset Management Group, (“**SIFMA**”)² (collectively, the “**Sponsors**”) are publishing this Trading Practice to provide a standard procedure that market participants may elect to use to assess and pay “fails charges” for certain delivery failures in the market for U.S. Treasury securities (“**Treasuries**”). For these purposes, a “**Delivery Failure**” occurs when one party (the “**Failing Party**”) fails to deliver Treasuries to another party (the “**Non-Failing Party**”) by the date (the “**Delivery Date**”) previously agreed by the parties.

The Sponsors, together with the Federal Reserve Bank of New York, are recommending this Trading Practice in order to preserve and enhance the efficiency and operational integrity of the marketplace for Treasuries by reducing the incidence of Delivery Failures. Widespread and chronic Delivery Failures impede efficient market clearing and can undermine overall market liquidity by causing market participants to withdraw from the Treasury market. This in turn impairs hedging and market making activity in the cash market, resulting in poorer overall functioning of the Treasury market. Given the benchmark status of the Treasury market, such dysfunction has negative consequences for capital markets more generally.

In addition, this Trading Practice is intended to provide a mechanism for compensating a Non-Failing Party in connection with a Delivery Failure. A Delivery Failure may cause harm to the Non-Failing Party, including (i) by preventing or making more costly the Non-Failing Party’s delivery of the relevant Treasuries in respect of other transactions (and thereby potentially subjecting the Non-Failing Party to a fails charge), and (ii) by creating for the Non-Failing Party credit exposure to the Failing Party, potential market risk exposure with respect to the relevant Treasuries, and potential funding costs. The actual damages to the Non-Failing Party in the event of a Delivery Failure are difficult to ascertain.

This Trading Practice is published as a recommendation only, and adoption of this Trading Practice by any market participant is strictly voluntary. The Federal Reserve Bank of New York has participated in the development of and endorses this Trading Practice, and has indicated that

¹ The TMPG is a group of market professionals committed to supporting the integrity and efficiency of the U.S. Treasury market. The TMPG is composed of senior business managers and legal and compliance professionals from securities dealers, banks and buy-side firms and is sponsored by the Federal Reserve Bank of New York. The TMPG meets periodically to discuss Treasury trading issues and promote best practices in Treasury cash, repurchase and related markets.

² SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA’s Asset Management Group is a unique leadership community of asset managers focused on advancing market practice and enhancing legislative and regulatory effectiveness to improve the operations, efficiency, and trust in our markets. SIFMA has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

it will adopt it in connection with its transactions in Treasuries. Additionally, the Fixed Income Clearing Corporation (“**FICC**”) subjects each of its members to a substantially similar fails charge in the event such member fails to deliver Treasuries in respect of a transaction settling through FICC.

A market participant who elects to adopt this Trading Practice should consider taking appropriate steps to incorporate the Trading Practice into the terms of its relevant transactions in Treasuries. Such steps may include the following: (i) sending a letter substantially in the form set forth in Annex A to its counterparties to inform them that the market participant has adopted this Trading Practice, and that their future transactions in Treasuries will be deemed subject to this Trading Practice, and (ii) incorporating a statement substantially in the form set forth in Annex B into its confirmations or similar trade notifications to indicate that the relevant transaction is subject to this Trading Practice. These steps are only recommendations. A market participant adopting this Trading Practice should consider appropriate modifications to the suggested language in Annexes A and B and whether other additional steps may be appropriate to achieve effective implementation of the Trading Practice in light of its particular circumstances.

Market participants should note that this Trading Practice does not relieve any person from its obligations to comply with any statute, rule or regulation regarding delivery failures that may be applicable to it (e.g., the U.S. Department of the Treasury’s buy-in rules at 17 C.F.R. §§ 403.4(h) and (m)).

A. General

In the event of a Delivery Failure in any transaction that (i) is between two market participants (the “**Parties**”) who have entered into the transaction subject to this Trading Practice and (ii) provides for the delivery of Treasuries against the payment of funds (delivery-versus-payment) or the transfer of securities (delivery-versus-transfer), the remedies of the Non-Failing Party will include a charge (a “**Fails Charge**”) calculated in the manner described in Part B hereof and payable by the Failing Party to the Non-Failing Party.

Notwithstanding the foregoing, a Failing Party will not be subject to a Fails Charge under this Trading Practice with respect to a Delivery Failure (i) in respect of any transaction settling through a clearing agency (as that term is defined in Section 3(a)(23)(A) of the Securities Exchange Act of 1934) where the rules of such clearing agency subject such Failing Party to a fails charge in respect of such transaction or (ii) if the Fails Charge (calculated as described below) over the life of such Delivery Failure is less than or equal to \$500. However, clause (ii) shall be revised as follows for transactions entered into on or after September 1, 2016: if the sum of the aggregate Fails Charges (calculated as described below) of all Delivery Failures by a Failing Party to a Non-Failing Party for a given calendar month is less than or equal to \$500. For purposes of clause (ii), when a transaction is executed by an investment manager or other agent on behalf of multiple principals and the allocation of the transaction to such principals is disclosed to their counterparty in the ordinary course, the \$500 threshold will be applied separately to the Fails Charge calculated for each principal.

For the avoidance of doubt, a Delivery Failure shall not exist (i) where a Party is not required under the terms of the relevant transaction to make delivery (e.g., due to a default by the other

Party) or (ii) in respect of any transaction where delivery is *not* against the payment of funds or the transfer of securities (i.e. where there is a “free delivery,” such as where a Party is to deliver or deposit Treasuries for margin purposes).

Failure by a Non-Failing Party to enforce a Fails Charge in any one transaction or in multiple transactions shall not constitute a waiver of any right of the Non-Failing Party under this Trading Practice with regard to any other transactions. The claim of a Fails Charge as a remedy of the Non-Failing Party in the event of a Delivery Failure shall be without prejudice to any other rights or remedies of the Parties under the applicable agreement governing the transaction or under applicable law, and shall not constitute a waiver of the Non-Failing Party’s right to exercise any other remedy.

B. Calculation of Fails Charges

Upon a Delivery Failure in any transaction subject to this Trading Practice, the Fails Charge accrued on each calendar day in the period from and including the date of such Delivery Failure to but excluding the date the Delivery Failure is resolved (by delivery of the Treasuries or otherwise) is calculated according to the following formula:

$$C = \frac{1}{360} * 0.01 * \max(3 - R, 0) * P$$

where: C = the Fails Charge amount;

R = for each day, the “TMPG reference rate”, in percent per annum, is the target level for the federal funds rate that is effective on such day, as announced by the Federal Open Market Committee (the “**FOMC**”) or, if the FOMC specifies a target range in lieu of a target level, the lower limit of the target range announced by the FOMC. If the FOMC shall terminate its policy of specifying or announcing a target level or range for the federal funds rate, then the “TMPG reference rate” shall be a successor rate and source recommended by the TMPG; and

P = the amount of funds due from the Non-Failing Party (in respect of a transaction settling on a delivery-versus-payment basis) or an amount equal to the market value on the date such Delivery Failure began of the securities due from the Non-Failing Party against delivery of Treasuries by the Failing Party (in respect of a transaction settling on a delivery-versus-transfer basis) (each such amount, the “**Trade Proceeds**”).

C. Payment of Fails Charges

All Fails Charges accrued over the life of a Delivery Failure will become due and payable upon resolution of the Delivery Failure (by delivery of the Treasuries or otherwise). Following such resolution, the Failing Party shall make full payment of all such charges to the Non-Failing Party no later than the last business day of the month following the month in which the resolution occurs, provided that the Non-Failing Party has provided notice of the amounts owed by the 10th business day of such month, unless otherwise agreed by the Parties.

To the extent permitted by applicable law, in the event that the Failing Party fails to make a Fails Charge payment when due and payable, such Failing Party will be liable to the Non-Failing Party for interest on any Fails Charges still owed to the Non-Failing Party, from the date the Failing Party becomes liable for such Fails Charges until such Fails Charges are paid by the Failing Party. Such interest shall be set at a reasonable rate agreed by the Parties (including any rate set forth by the terms of any existing agreement governing the transaction to which the Fails Charge relates) or otherwise consistent with market practice for interest payable on late payments in connection with the relevant type of transaction.

D. Application to Common Transaction Types

Without limiting the general application of the Fails Charge as described above, the guidelines set forth below describe the application of the Fails Charge to common transaction types involving the delivery of Treasuries against the payment of funds or the pledge or title transfer of securities.

1. Cash Market Transactions

In respect of any cash market transaction in which the securities agreed to be sold are Treasuries and to which this Trading Practice applies, any failure by the seller to transfer those securities to the buyer by the scheduled settlement date constitutes a Delivery Failure, and in such event the Delivery Date is the scheduled settlement date, the Failing Party is the seller, the Non-Failing Party is the buyer and the Trade Proceeds are the purchase price for those securities.

2. Repurchase Transactions

In any repurchase transaction governed by a Master Repurchase Agreement or Global Master Repurchase Agreement, each published by SIFMA (each, an “**MRA**”) in which the Purchased Securities are Treasuries and to which this Trading Practice applies, any failure by the Seller to deliver Purchased Securities on the applicable Purchase Date constitutes a Delivery Failure, and in such event the Delivery Date is the Purchase Date, the Failing Party is the Seller, the Non-Failing Party is the Buyer and the Trade Proceeds are the Purchase Price. Furthermore, in any such transaction, any failure by the Buyer to deliver Purchased Securities on the applicable Repurchase Date constitutes a Delivery Failure, and in such event the Delivery Date is the Repurchase Date, the Failing Party is the Buyer, the Non-Failing Party is the Seller and the Trade Proceeds are the Repurchase Price. For purposes of this paragraph, the terms “Buyer,” “Purchase Date,” “Purchase Price,” “Purchased Securities,” “Repurchase Date,” “Repurchase Price” and “Seller” have the meanings ascribed to them in the MRA.

In any repurchase transaction governed by any agreement other than an MRA in which the securities to be sold and repurchased are Treasuries (“**Purchased Treasuries**”) and to which this Trading Practice applies, any failure by the seller in the initial sale (the “**Seller**”) to deliver Purchased Treasuries to the buyer in the initial sale (the “**Buyer**”) on the applicable scheduled date for purchase by the Buyer (the “**Purchase Date**”) constitutes a Delivery Failure, and in such event the Delivery Date is the Purchase Date, the Failing Party is the Seller, the Non-Failing Party is the Buyer and the Trade Proceeds are the price at which the Purchased Treasuries were to be transferred from the Seller to the Buyer upon commencement of the transaction. Furthermore, in any such transaction, any failure by the Buyer to deliver Purchased Treasuries to the Seller on the applicable scheduled date for repurchase by the Seller (the “**Repurchase Date**”) constitutes a Delivery Failure, and in such event the Delivery Date is the Repurchase Date, the Failing Party is the Buyer, the Non-Failing Party is the Seller and the Trade Proceeds are the price at which Purchased Treasuries were to be transferred from the Buyer to the Seller upon termination of the transaction.

3. Securities Loan Transactions

In any securities loan transaction governed by a Master Securities Loan Agreement published by SIFMA (an “**MSLA**”) in which the Loaned Securities are Treasuries and to which this Trading Practice applies, any failure by the Lender to transfer Loaned Securities to the Borrower by the Cutoff Time on the date agreed by the Borrower and the Lender for the commencement of the Loan constitutes a Delivery Failure, and in such event the Delivery Date is the date agreed to by the Borrower and the Lender for the commencement of the Loan, the Failing Party is the Lender, the Non-Failing Party is the Borrower and the Trade Proceeds are the Market Value on the date such Delivery Failure began of the Collateral agreed by the Parties to be delivered with respect to the Loan by the Borrower on the Delivery Date. Furthermore, in any such transaction, any failure by the Borrower to transfer Loaned Securities to the Lender by the Cutoff Time on the termination date of the Loan constitutes a Delivery Failure, and in such event the Delivery Date is the termination date of the Loan, the Failing Party is the Borrower, the Non-Failing Party is the Lender and the Trade Proceeds are the Market Value on the date such Delivery Failure began of the Collateral for the Loan. For purposes of this paragraph, the terms “Borrower,” “Business Day,” “Close of Trading,” “Collateral,” “Cutoff Time,” “Lender,” “Loan,” “Loaned Securities” and “Market Value” have the meanings ascribed to them in the MSLA.

In any securities loan transaction governed by a Global Master Securities Loan Agreement published by the International Securities Lending Association (a “**GMSLA**”) in which the Securities are Treasuries and to which this Trading Practice applies, any failure by the Lender to deliver or procure the delivery of the Securities to the Borrower on or before the date agreed by the Borrower and the Lender for commencement of the Loan constitutes a Delivery Failure, and in such event the Delivery Date is the date agreed to by the Borrower and the Lender for commencement of the Loan, the Failing Party is the Lender, the Non-Failing Party is the Borrower and the Trade Proceeds are the Market Value on the date such Delivery Failure began of the Collateral agreed by the Parties to be delivered or deposited with respect to the Loan by the Borrower on the Delivery Date. Furthermore, in any such transaction, any failure by the Borrower to redeliver or procure the redelivery of Equivalent Securities to the Lender on the termination date of the Loan constitutes a Delivery Failure, and in such event the Delivery Date is the termination date of the Loan, the Failing Party is the Borrower, the Non-Failing Party is

the Lender and the Trade Proceeds are the Market Value on the date such Delivery Failure began of the Posted Collateral in respect of the Loan. For purposes of this paragraph, the terms “Borrower,” “Business Day,” “Close of Business,” “Collateral,” “Equivalent Securities,” “Lender,” “Loan,” “Market Value,” “Posted Collateral” and “Securities” have the meanings ascribed to them in the GMSLA.

In any securities loan transaction governed by any agreement other than an MSLA or a GMSLA (the “**Loan Agreement**”) in which the securities to be loaned are Treasuries (“**Loaned Treasuries**”) and to which this Trading Practice applies, any failure by the lender to deliver Loaned Treasuries to the borrower on or before the date agreed by the borrower and the lender for commencement of the loan constitutes a Delivery Failure, and in such event the Delivery Date is the date agreed by the borrower and the lender for commencement of the loan, the Failing Party is the lender, the Non-Failing Party is the borrower and the Trade Proceeds are the market value on the date such Delivery Failure began of the collateral agreed by the Parties to be delivered with respect to the loan by the borrower on the Delivery Date, with such market value determined in accordance with the terms of the Loan Agreement or, if not so agreed, in accordance with market practice. Furthermore, in any such transaction, any failure by the borrower to deliver Loaned Treasuries (or their equivalent, as agreed by the Parties) to the lender on the termination date of the loan constitutes a Delivery Failure, and in such event the Delivery Date is the termination date of the loan, the Failing Party is the borrower, the Non-Failing Party is the lender and the Trade Proceeds are the market value at the close of business on the date prior to the date such Delivery Failure began of the collateral for the Loaned Treasuries, with such market value determined in accordance with the Loan Agreement or, if not so agreed, in accordance with market practice.

4. Option Transactions

In any option transaction governed by a Master OTC Options Agreement published by SIFMA (an “**MOTCOA**”) in which the Underlying Securities are Treasuries and to which this Trading Practice applies, in the case of an Option that is a call, any failure by the Writer to transfer the Underlying Securities to the Holder on the Settlement Date constitutes a Delivery Failure, and in such event the Settlement Date is the Delivery Date, the Failing Party is the Writer, the Non-Failing Party is the Holder and the Trade Proceeds are the Exercise Value. Furthermore, in any such transaction, in the case of an Option that is a put, any failure by the Holder to transfer the Underlying Securities to the Writer on the Settlement Date constitutes a Delivery Failure, and in such event the Delivery Date is the Settlement Date, the Failing Party is the Holder, the Non-Failing Party is the Writer and the Trade Proceeds are the Exercise Value. For purposes of this paragraph, the terms “Exercise Value,” “Holder,” “Option,” “Settlement Date,” “Underlying Securities” and “Writer” have the meanings ascribed to them in the MOTCOA.

In any option transaction governed by any agreement other than an MOTCOA in which the instruments underlying the option are Treasuries (“**Underlying Treasuries**”) and to which this Trading Practice applies, in the case of an option that is a call, any failure by the Party selling the option (the “**Writer**”) to transfer the Underlying Treasuries to the Party purchasing the option (the “**Holder**”) on the defined date for settlement following the date on which the relevant option is exercised (the “**Settlement Date**”) constitutes a Delivery Failure, and in such event the Delivery Date is the Settlement Date, the Failing Party is the Writer, the Non-Failing Party is the

Holder and the Trade Proceeds are the amount agreed to be paid by the Holder to the Writer upon settlement. Furthermore, in any such transaction, in the case of an option that is a put, any failure by the Holder to transfer the Underlying Treasuries to the Writer on the Settlement Date constitutes a Delivery Failure, and in such event the Delivery Date is the Settlement Date, the Failing Party is the Holder, the Non-Failing Party is the Writer and the Trade Proceeds are the amount agreed to be paid by the Writer to the Holder upon settlement.

5. Forward Transactions

In any forward transaction governed by a Master Securities Forward Transaction Agreement published by SIFMA (an “**MSFTA**”) in which the Securities are Treasuries and to which this Trading Practice applies, any failure by the Seller to deliver the Securities to the Buyer on the Settlement Date constitutes a Delivery Failure, and in such event the Delivery Date is the Settlement Date, the Failing Party is the Seller, the Non-Failing Party is the Buyer and the Trade Proceeds are the amount of funds agreed by the Parties to be paid by the Buyer to the Seller on the Settlement Date against delivery of the Securities. For purposes of this paragraph, the terms “Buyer,” “Securities,” “Seller” and “Settlement Date” have the meanings ascribed to them in the MSFTA.

In any forward transaction governed by any agreement other than an MSFTA in which the securities to be purchased or sold for delayed delivery are Treasuries (“**Forward Treasuries**”) and to which this Trading Practice applies, any failure by the seller to deliver the Forward Treasuries to the buyer on the date agreed by the Parties for the payment of funds and the delivery of the Forward Treasuries (the “**Settlement Date**”) constitutes a Delivery Failure, and in such event the Delivery Date is the Settlement Date, the Failing Party is the seller, the Non-Failing Party is the buyer and the Trade Proceeds are the amount of funds agreed by the Parties to be paid by the buyer to the seller on the Settlement Date against delivery of the Forward Treasuries.

Annex A
to U.S. Treasury Securities Fails Charge Trading Practice:
Form of Notice to Counterparties

IMPORTANT – NOTICE REGARDING
CHARGES FOR FAILURES TO DELIVER U.S. TREASURY SECURITIES

Dear [Client/Counterparty]:

We are writing to inform you of an important change that we are making with respect to our transactions involving U.S. Treasury securities (“Treasuries”). As you may know, the Treasury Market Practices Group (the “TMPG”) and the Securities Industry and Financial Markets Association (“SIFMA”) have published a “U.S. Treasury Securities Fails Charge Trading Practice” (as modified and in effect from time to time and published by the TMPG and SIFMA at http://www.sifma.org/capital_markets/docs/Fails-Charge-Trading-Practice.pdf, the “Fails Charge Trading Practice”). We have decided to adopt this Fails Charge Trading Practice for purposes of our transactions with you, and accordingly, are notifying you that any delivery-versus-payment or delivery-versus-transfer transaction in Treasuries entered into between you and us on or after 12:01 a.m. New York time on [_____] ³ (the “Effective Date”) shall be deemed to be subject to the Fails Charge Trading Practice, unless otherwise agreed in respect of a particular transaction, as described more fully below.

By way of background, the Fails Charge Trading Practice provides a standardized procedure that market participants may elect to follow in order to assess and pay “Fails Charges” in connection with delivery failures involving Treasuries. The TMPG and SIFMA have recommended the Fails Charge Trading Practice in order to reduce the overall incidence of fails in the marketplace, which prevent efficient market clearing and undermine overall market liquidity, and to compensate a non-failing counterparty for the potential economic harm to it resulting from a fail (which is difficult to ascertain). The Federal Reserve Bank of New York participated in the development of and endorses the Fails Charge Trading Practice, and has indicated that it will adopt it in connection with its transactions in Treasuries.

By entering into any transaction with us for the delivery of Treasuries against the payment of funds or the transfer of securities on or after the Effective Date (including any cash purchase or sale, forward purchase or sale, Treasury option, repurchase (“repo”) or reverse repo transaction, or bonds borrow or loan transaction), you will be deemed to have agreed that such transaction will be subject to the Fails Charge Trading Practice, unless explicitly agreed otherwise with respect to a specific transaction. Similarly, by entering into any such transaction, we shall be deemed to have agreed that such transaction will be

³ There should be a reasonable time (e.g., 30 days) between the Effective Date and the date of this notice. The current TMPG timeline recommends that fails charges be implemented by May 1, 2009 and, accordingly, market participants who plan to adopt the Fails Charge Trading Practice by that date should endeavour to send this letter by early April. In the event that the TMPG recommends a different date for implementation, market participants should revise the date by which they send this letter correspondingly.

subject to the Fails Charge Trading Practice, unless explicitly agreed otherwise with respect to a specific transaction. Both of us also shall be deemed to have agreed for any such transactions that the failure to enforce such a Fails Charge in any one transaction or in multiple transactions shall not constitute a waiver of the foregoing rights with regard to any other transactions subject to a Fails Charge. The claim of a Fails Charge shall be without prejudice to any other rights or remedies under the applicable agreement governing the transaction or applicable law, and shall not constitute a waiver of the non-failing party's right to exercise any other remedy.

[Market participants should consider inserting other appropriate information, such as specific implementation instructions or billing practices. Market participants may also wish to remind counterparties of their willingness to cash settle failing transactions on mutually agreeable terms.]

We appreciate your anticipated cooperation and understanding and thank you for your continued business and support. Should you have any questions regarding the foregoing, please contact [each market participant to insert].

Very truly yours,

Annex B
to U.S. Treasury Securities Fails Charge Trading Practice:
Form of Standard Confirmation Language

Market participants who have elected to adopt the Fails Charge Trading Practice should consider including a statement in their relevant trade confirmations or other trade notifications that the transaction is subject to the Trading Practice. The language set forth below provides a suggested example of such a statement; market participants should consider whether any modifications to this language would be appropriate in light of their particular circumstances or for operational or other reasons.

SUBJECT TO US TREASURY SECURITIES FAILS CHARGE
TRADING PRACTICE PUBLISHED BY TMPG AND SIFMA AT
www.sifma.org/capital_markets/docs/fails-charge-trading-practice.pdf