

## **Agency Debt and Agency Mortgage-Backed Securities Fails Charge Trading Practice**

**Introductory Note:** The Treasury Market Practices Group (“TMPG”)<sup>1</sup> and the Securities Industry and Financial Markets Association, including its Asset Management Group, (“SIFMA”)<sup>2</sup> (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 agency debt and agency mortgage-backed securities (“MBS”). This Trading Practice applies initially to debentures issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks and agency pass-through MBS issued or guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae (“Agency Debt” and “Agency MBS,” respectively). For these purposes, a “Delivery Failure” occurs when one party (the “Failing Party”) fails to deliver Agency Debt or Agency MBS to another party (the “Non-Failing Party”) by the date (the “Contractual Settlement 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 Agency Debt and Agency MBS 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 Agency Debt and Agency MBS markets. This in turn impairs hedging and market making activity in the cash market, resulting in poorer overall functioning of the Agency Debt and Agency MBS markets. Given the status of the Agency Debt and Agency MBS markets as important fixed income markets, 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 Agency Debt or Agency MBS 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 Agency Debt or Agency MBS, and potential funding costs. The actual damages to the Non-Failing Party in the event of a Delivery Failure are difficult to ascertain.

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<sup>1</sup> The TMPG is a group of market professionals committed to supporting the integrity and efficiency of the U.S. Treasury market, agency debt, and agency mortgage-backed securities markets. 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 trading issues and promote best practices in the Treasury, agency debt, and agency mortgage-backed securities markets.

<sup>2</sup> SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit [www.sifma.org](http://www.sifma.org).

The current TMPG timeline recommends that market participants implement fails charges under this Trading Practice by February 1, 2012.

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 it will adopt it in connection with its transactions in Agency Debt and Agency MBS.

Additionally, the Fixed Income Clearing Corporation (“**FICC**”) plans to submit a rule filing to the Securities and Exchange Commission amending its rules to subject each of its members to a substantially similar fails charge in the event such member fails to deliver Agency Debt in respect of a transaction settling through FICC. FICC does not, however, plan to subject its members to such a fails charge in the case of fails to deliver Agency MBS in transactions processed by FICC’s Mortgage-Backed Securities Division. Accordingly, market participants would be responsible for imposing and collecting charges for failed Agency MBS transactions directly on their failing counterparties.

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 Agency Debt and Agency MBS. 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 Agency Debt and Agency MBS 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 who have entered into the transaction subject to this Trading Practice and (ii) provides for the delivery of Agency Debt or Agency MBS 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, (ii) in the case of Agency Debt, if the Fails Charge (calculated as described below) over the life of such Delivery Failure is less than or equal to \$500, (iii) in the case of Agency MBS, if the sum of the aggregate Fails Charges (calculated as described below) of all Agency MBS Delivery Failures by a Failing Party to a Non-Failing Party for a given calendar month is less than or equal to \$500, or (iv) in the case of Agency MBS, Delivery Failures that settle on either of the two business days following the Contractual Settlement Date.

References to the Failing Party and the Non-Failing Party (each, a “**Party**”) in this Trading Practice are intended to mean the legal entities that are counterparties to one another in an Agency Debt or Agency MBS transaction. When an Agency Debt or Agency MBS transaction is executed by an investment manager or other agent (an “**Adviser/Agent**”) on behalf of multiple principals and the allocation of the transaction to such principals is disclosed to their counterparty in the ordinary course, each principal (rather than the Adviser/Agent) will constitute a distinct Party for purposes of calculating Fails Charges under this Trading Practice. If a principal utilizes more than one Adviser/Agent, however, each Adviser/Agent’s transaction executed on behalf of the principal will constitute a transaction by a distinct Party (rather than be aggregated with other Adviser/Agent’s transactions executed on behalf of the same principal) for purposes of calculating Fails Charges under this Trading Practice.

#### *Example 1*

An investment manager (Asset Manager 1) executes Agency MBS transactions on behalf of three investment funds (Fund A, Fund B, and Fund C). The counterparty on the transactions is a broker-dealer (Securities Trading LLC). Fund A, Fund B, and Fund C each have accrued \$200 in aggregate Fail Charges for Delivery Failures to Securities Trading LLC for the month of June.

Fund A, Fund B, and Fund C would each be considered to be a distinct Failing Party. Securities Trading LLC, as the Non-Failing Party, would not be entitled to collect any of the Fail Charges from Fund A, Fund B, or Fund C because the amount of each of their aggregate Fails Charges for the calendar month is less than or equal to \$500.

#### *Example 2*

An investment fund (Fund D) utilizes three investment managers (Asset Manager 2, Asset Manager 3, and Asset Manager 4). Asset Manager 2, Asset Manager 3, and Asset Manager 4 each execute Agency MBS transactions on Fund D’s behalf. The counterparty on the transactions is a broker-dealer (Securities Transactions LLC). Fund D has accrued \$100 in aggregate Fail Charges for Delivery Failures to Securities Transactions LLC for the month of June on transactions executed on Fund D’s behalf by Asset Manager 2. Fund D has accrued \$200 in aggregate Fail Charges for Delivery Failures to Securities Transactions LLC for the month of June on transactions executed on Fund D’s behalf by Asset Manager 3. Fund D has accrued \$300 in aggregate Fail Charges for Delivery Failures to Securities Transactions LLC for the month of June on transactions executed on Fund D’s behalf by Asset Manager 4.

Fund D's transactions executed on its behalf by Asset Manager 2, Asset Manager 3, and Asset Manager 4 would each be considered to be transactions by a distinct Failing Party. Securities Transactions LLC, as the Non-Failing Party, would not be entitled to collect any of the Fail Charges from Fund D because the amount of the aggregate Fails Charges on transactions executed on Fund D's behalf by each of Fund D's investment managers for the calendar month is less than or equal to \$500.

*Example 3*

An investment fund (Fund E) utilizes three investment managers (Asset Manager 5, Asset Manager 6, and Asset Manager 7). Asset Manager 5, Asset Manager 6, and Asset Manager 7 each execute Agency MBS transactions on Fund E's behalf. The counterparty on the transactions is a broker-dealer (Securities Dealer LLC). Securities Dealer LLC has accrued \$100 in aggregate Fail Charges for Delivery Failures to Fund E for the month of June on transactions executed on Fund E's behalf by Asset Manager 5. Securities Dealer LLC has accrued \$200 in aggregate Fail Charges for Delivery Failures to Fund E for the month of June on transactions executed on Fund E's behalf by Asset Manager 6. Securities Dealer LLC has accrued \$300 in aggregate Fail Charges for Delivery Failures to Fund E for the month of June on transactions executed on Fund E's behalf by Asset Manager 7.

The transactions executed on Fund E's behalf by Asset Manager 5, Asset Manager 6, and Asset Manager 7 would each be considered to be transactions entered into by Securities Dealer LLC with a distinct Failing Party. Fund E, as the Non-Failing Party in each set of transactions, would not be entitled to collect any of the Fail Charges from Securities Dealer LLC because the amount of Securities Dealer LLC's aggregate Fails Charges on each set of transactions executed on Fund E's behalf by Fund E's investment managers for the calendar month is less than or equal to \$500.

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 Agency Debt or Agency MBS 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 Agency Debt or Agency MBS or otherwise) is calculated according to the following formula:

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

- where:
- $C$  = the Fails Charge amount;
  - $B$  = 2, when calculating the Fails Charge for an Agency MBS transaction, and 3, when calculating the Fails Charge for an Agency Debt transaction;
  - $R$  = for each day, the TMPG reference rate at 5:00 p.m. New York time on the preceding business day, in percent per annum. The current “TMPG reference rate” is the target level for the federal funds rate most recently announced by the Federal Open Markets Committee (the “**FOMC**”) or, if the FOMC specifies a target band in lieu of a target level, the lower limit of the target band announced by the FOMC. If the FOMC shall terminate its policy of specifying or announcing a target level or band 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 Agency Debt or Agency MBS by the Failing Party (in respect of a transaction settling on a delivery-versus-transfer basis) (each such amount, the “**Trade Proceeds**”).

The Fails Charge will apply to Agency Debt and Agency MBS transactions that were entered into prior to, and remain unsettled at, the date as of which the market participants implement Fails Charges under this Trading Practice (the “**Effective Date**”), as well as to Agency Debt and Agency MBS transactions that were entered into on or after the Effective Date. For those transactions that were entered into prior to, and remain unsettled at, the Effective Date, subject to the exceptions described in Section A., above, the Fails Charge will accrue from the later of (i) the Effective Date and (ii) each transaction’s Contractual Settlement Date.

### **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 Agency Debt or Agency MBS or otherwise). (As described in Section A., above, no Fails Charge is payable unless the applicable \$500 threshold described above is exceeded, or in the case of an Agency MBS Delivery Failure, if the Delivery Fail settles on either of the two business days following the Contractual Settlement Date.) 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 10<sup>th</sup> business day of such month, unless otherwise agreed by the Parties. The 10 business day timeframe for claim submission is not intended to provide a basis to reject a claim submitted in a reasonably timely manner, but instead sets a convenient administrative default which all market participants should endeavor to meet. Thus, the TMPG recommends that claims submitted reasonably timely, but after the recommended 10 business day time frame, nonetheless be paid or rejected in a timely manner. Counterparties should resolve any disputes as to the reasonable timeliness of any claim submission bilaterally and in good faith.

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 Agency Debt or Agency MBS 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 Agency Debt or Agency MBS 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 Contractual Settlement 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 Agency Debt or Agency MBS 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 Contractual Settlement 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 Contractual Settlement 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 Agency Debt or Agency MBS (“**Purchased Agency Debt or Agency MBS**”) and to which this Trading Practice applies, any failure by the seller in the initial sale (the “**Seller**”) to deliver Purchased Agency Debt or Agency MBS 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 Contractual Settlement 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 Agency Debt or Agency MBS 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 Agency Debt or Agency MBS 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 Contractual Settlement 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 Agency Debt or Agency MBS 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 Agency Debt or Agency MBS 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 Contractual Settlement 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 Contractual Settlement 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 Contractual Settlement 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 Agency Debt 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 Contractual Settlement 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 Contractual Settlement 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 Contractual Settlement 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 Agency Debt (“**Loaned Agency Debt**”) and to which this Trading Practice applies, any failure by the lender to deliver Loaned Agency Debt 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 Contractual Settlement 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 Contractual Settlement 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 Agency Debt (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 Contractual Settlement 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 Agency Debt, 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 Agency Debt or Agency MBS 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 Contractual Settlement 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 Contractual Settlement 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 Agency Debt or Agency MBS (“**Underlying Agency Debt or Agency MBS**”) 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 Agency Debt or Agency MBS 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 “**Option Settlement Date**”) constitutes a Delivery Failure, and in such event the Contractual Settlement Date is the Option 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 Agency Debt or Agency MBS to the Writer on the Option Settlement Date constitutes a Delivery Failure, and in such event the Contractual Settlement Date is the Option 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 an MSFTA in which the Securities are Agency MBS (including To-Be-Announced (TBA) Transactions, Specified Pool Transactions, or Dollar Rolls) or Agency Debt 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 Contractual Settlement 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 Agency MBS (including To-Be-Announced (TBA) Transactions, Specified Pool Transactions, or Dollar Rolls) or Agency Debt (“**Forward Agency Debt or Agency MBS**”) and to which this Trading Practice applies, any failure by the seller to deliver the Forward Agency Debt or Agency MBS to the buyer on the date agreed by the Parties for the payment of funds and the delivery of the Forward Agency Debt or Agency MBS (the “**Forward Settlement Date**”) constitutes a Delivery Failure, and in such event the Contractual Settlement Date is the Forward 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 Forward Settlement Date against delivery of the Forward Agency Debt or Agency MBS.

**Annex A**  
**to Agency Debt and Agency Mortgage-Backed Securities Fails Charge Trading Practice:**  
**Form of Notice to Counterparties**

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**IMPORTANT - NOTICE REGARDING**  
**CHARGES FOR FAILURES TO DELIVER**  
**AGENCY DEBT AND AGENCY MORTGAGE-BACKED 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, debentures issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks and agency mortgage-backed securities (“MBS”) issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (“U.S. Treasury”, “Agency Debt” and “Agency MBS,” respectively). As you may know, the Treasury Market Practices Group (the “TMPG”) and the Securities Industry and Financial Markets Association (“SIFMA”) have published the “U.S. Treasury Securities Fails Charge Trading Practice” and the “Agency Debt and Agency Mortgage-Backed 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/TMPG> or <http://www.sifma.org/Services/Standard-Forms-and-Documents/Securitized-Products/Securitized-Products-Fails-Charge-Trading-Practice/>, collectively, the “Fails Charge Trading Practices”). We have decided to adopt these Fails Charge Trading Practices for purposes of our transactions with you, and accordingly, are notifying you that any delivery-versus-payment or delivery-versus-transfer transaction in U.S. Treasury, Agency Debt or Agency MBS entered into or remaining unsettled between you and us on or after 12:01 a.m. New York time on [February 1, 2012]<sup>3</sup> (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. Please note that you may have previously agreed to be subject to the U.S. Treasury Securities Fails Charge Trading Practice. If so, such agreement remains in full force and effect and is not affected by this Notice.

By way of background, the Fails Charge Trading Practices provide standardized procedures that market participants may elect to follow in order to assess and pay “Fails Charges” in connection with delivery failures involving U.S. Treasury, Agency Debt or Agency MBS. The TMPG and SIFMA have recommended the Fails Charge Trading Practices 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 Practices,

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<sup>3</sup> 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 February 1, 2012 and, accordingly, market participants who plan to adopt the Fails Charge Trading Practice by that date should endeavour to send this letter by early January 2012. 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.

and has adopted the U.S. Treasury Securities Fails Charge Trading Practice in connection with its transactions in U.S. Treasuries and has indicated that it will adopt the Agency Debt and Agency Mortgage-Backed Securities Fails Charge Trading Practice in connection with its transactions in Agency Debt and Agency MBS.

**By entering into or failing to timely deliver in any transaction with us for the delivery of U.S. Treasury, Agency Debt or Agency MBS against the payment of funds or the transfer of securities on or after the Effective Date (including any cash purchase or sale, reverse repo transaction, bonds borrow or loan transaction, forward purchase or sale (including with respect to Agency MBS any to-be-announced (TBA) transaction, specified pool transaction or dollar roll), or option), you will be deemed to have agreed that such transaction will be subject to the respective Fails Charge Trading Practice, unless explicitly agreed otherwise with respect to a specific transaction. Similarly, by entering into or failing to timely deliver in any such transaction, we shall be deemed to have agreed that such transaction will be subject to the respective 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 Agency Debt and Agency MBS Fails Charge Trading Practice:**  
**Form of Standard Confirmation Language**

Market participants who have elected to adopt the Fails Charge Trading Practices should consider including a statement in their relevant trade confirmations or other trade notifications that the transaction is subject to the Trading Practices. 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.

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SUBJECT TO U.S. TREASURY OR AGENCY DEBT AND AGENCY MBS FAILS CHARGE  
TRADING PRACTICE PUBLISHED BY TMPG AND SIFMA AT  
[http://www.sifma.org/Services/Standard-Forms-and-Documents/Securitized-  
Products/Securitized-Products-Fails-Charge-Trading-Practice/](http://www.sifma.org/Services/Standard-Forms-and-Documents/Securitized-Products/Securitized-Products-Fails-Charge-Trading-Practice/)

or

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