The Effects of the Treasury Fails Charge on Market Functioning

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Abstract

Settlement failure has been an important and persistent issue in the U.S. Treasury securities market, with fails reaching record levels during the financial crisis. In response, settlement conventions were changed in May 2009. Using a novel dataset that comprises volume and specialness for individual securities we find that the change has led to a marked improvement in market functioning. First, we find that the change triggered a marked decrease in Treasury security settlement fails. Second, we find that the increased incentive to borrow securities has precipitated a widespread willingness to receive negative interest on cash pledged to secure such borrowings. Third, we show that the change has resulted in increased trading volume in the repo market and reduced segmentation between the over-the-counter market and the Federal Reserve’s securities lending program.

Keywords: Repurchase agreement; repo; specials, securities lending; fails charge

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