

SEC Rule 10b-10 Confirmation Requirements for Transactions in Mortgage-Backed Securities and other Asset Backed Securities

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The following is an overview of the transaction confirmation requirements applicable to broker-dealers who trade in mortgage-backed securities (“MBS”) and other asset-backed securities (“ABS”).

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I. Rule 10b-10 under the Exchange Act

Rule 10b-10 under the Securities Exchange Act of 1934 (the “Exchange Act”) provides that a broker-dealer effecting a transaction in securities shall, at or before the completion of the transaction, provide written notification to its customer disclosing certain information relating to the transaction.¹ (FINRA Rule 2232 (formerly NASD Rule 2230) contains similar requirements for confirmation disclosures.) The specific disclosures for MBS or other ABS transactions by a broker-dealer include the following:

- > the date and time of the transaction (or the fact that the time of the transaction will be furnished upon written request) and whether it is a purchase or a sale;
- > the identity, price and principal amount of the security;
- > the capacity (agent or principal) of the broker-dealer;²

¹ The confirmation requirements contained in the Securities Industry and Financial Markets Association (“SIFMA”) guidelines, discussed below, specify that a broker-dealer should promptly deliver a confirmation of the transaction in writing or, if agreed by the parties, electronically, *within one business day* following the trade date. Confirmations for pool transactions should be sent within one business day after pool information has been passed.

² A broker acting as agent for such transactions also would be required to disclose:

- (i) its capacity as agent for its customer, for some other person or for both its customer and some other person;
- (ii) the name of the person from whom the security was purchased, or to whom it was sold, for its customer or the fact that this information will be furnished upon request; and
- (iii) the commission or other remuneration in connection with the transaction.

- > the dollar price or yield, as applicable, at which the transaction was effected;
- > a statement indicating that the yield of the MBS/ABS may vary according to the rate at which the underlying assets are prepaid and a statement to the effect that information concerning the factors that affect yield (including, at a minimum, estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon written request;³ and
- > a statement that the security is unrated by a nationally recognized statistical rating organization (“NRSRO”), if applicable.⁴

Rule 10b-10 does not apply to transactions with other broker-dealers.⁵ However, industry standards, described below, generally apply to broker-dealer counterparties as well.

II. SIFMA Guidelines

SIFMA, the principal trade association for the securities industry, publishes guidelines governing the trading and settlement of MBS and other ABS. The guidelines, entitled “Uniform Practices for the Clearance and Settlement of Mortgage-Backed Securities and Other Related Securities” (the “SIFMA Guidelines”) contain detailed recommendations for MBS and ABS trade confirmations.⁶ The SIFMA Guidelines suggest that the disclosures should apply to dealer-to-dealer transactions as well as customer trades. The SIFMA Guidelines supplement the Rule 10b-10 requirements with further disclosures as industry best practice.

The confirmation requirements included in the SIFMA Guidelines for To-Be-Announced MBS (“TBAs”), “Specified Transactions” including Collateralized Mortgage Obligations (“CMOs”), and “Pool Transactions”, are as follows:

A. TBA Transactions

Confirms for TBA transactions should contain, at a minimum, the following information:

- > a description of the security including the settlement month (for the underlying loans), coupon rate and product type;
- > the confirming party’s name, address and telephone number;

³ A disclosure to the following effect should be included for an MBS transaction: “These securities are backed by mortgages that are continuously subject to prepayment. The yield on the securities may change depending on the speed at which the underlying mortgages prepay. Additional information concerning this and other factors that affect yield is available upon request.”

⁴ See Rule 10b-10a(8). In July 2008, the Securities and Exchange Commission (the “SEC”) proposed amendments to various rules under the Exchange Act that included a reference to NRSRO ratings. The proposed amendments were designed to address concerns that the reference to NRSRO ratings in various SEC rules and forms might have contributed to an undue reliance on NRSRO ratings by market participants (Exchange Act Release No. 34-58070). In February 2009, the SEC adopted certain of the proposed amendments, however no action was taken with respect to Rule 10b-10a(8) and the Rule continues to apply.

Rule 10b-10a(2) provides that a broker-dealer must disclose on a confirm whether it is a market maker in the security. Although the requirement by its terms applies to debt securities as well as equities, the SEC staff confirmed in a 1995 no-action letter that broker-dealers are not required to disclose that they are acting as market makers in debt securities. See Public Securities Association, SEC staff No-Action Letter (Mar. 30, 1995).

Rule 10b-10a(9) also specifies that confirms must disclose if the broker-dealer is not a member of the Securities Investor Protection Corporation (“SIPC”), or the broker-dealer clearing or carrying the customer account is not a member of SIPC, if such is the case.

⁵ See Rule 10b-10d(1).

⁶ The confirmation requirements are contained in Chapter 6 of the SIFMA Guidelines.

- > an identification of the “contra party” in the case of an agency trade;
- > the price;
- > the par amount;
- > the trade date;
- > the settlement date;
- > a reference to the material provisions of any initial margin or mark-to-market requirements applicable to the transaction (unless covered by a separate agreement); and
- > any other information needed to ensure that the parties agree on important details of the transaction (e.g., specific certificate denominations, additional information for “new pools” dated the same month as they are settled).

B. Specified Transactions (Including CMOs)

For specified transactions in MBS and CMOs, confirms should contain all of the information required above for TBA transactions as well as the information described below.

The following information should be included on confirms for MBS:

- > the pool, group, tranche, series or other identification number;
- > the original face amount for each pool or group number;
- > the maturity date; and
- > any other information that would differentiate the transaction from a TBA trade (e.g., weighted average maturity (“WAM”), weighted average coupon (“WAC”), issue date, etc.).⁷

The following information should be included on confirms for CMOs:

- > the CUSIP number, if assigned;
- > notional or nominal face amount;
- > notional or nominal interest rate;
- > the maturity date;
- > the settlement amount; and
- > a statement to the fact that the transaction is a private placement or 144A, if applicable.⁸

In addition, SIFMA recommends that the following (optional) information be included on confirms for each type of security:

- > how the security settles (e.g., physical, DTC, Fedwire Network);
- > how the security pays (e.g., monthly, quarterly, semiannually);
- > the factor/coupon and whether a current factor/coupon or previous factor/coupon is being used and whether an adjustment is pending;

⁷ Federal National Mortgage Association (“Fannie Mae”), Federal Home Loan Mortgage Corporation (“Freddie Mac”) and Government National Mortgage Association (“Ginnie Mae”) disclose the WAC and WAM for each pool on their respective websites on a continuous basis. Some private-label issuers also disclose WAC and WAM information.

⁸ If a transaction involves a private-label MBS or ABS that is offered and sold pursuant to a private placement or Rule 144A exemption from registration under the Securities Act of 1933, reliance on the particular exemption should be noted on the confirm.

- > whether or not it is a delayed payment; and
- > for new issuance Yield Maintenance Trades, indicative information used to derive the price on the trade (yield, prepay rate, etc.) and comments stating that the dollar price is subject to change once final deal collateral is available.

C. Pool Transactions

For pool transactions, confirms should contain the following information in addition to the TBA information specified above:

- > the pool, group or other identification number;
- > the original face amount for each pool or group number;
- > the current face amount;
- > the principal amount;
- > the amount of accrued interest;
- > the proceeds to be paid; and
- > any other information as may be agreed to by the parties to the transaction.⁹

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Please contact us if you would like to discuss confirmation requirements or related issues with us.

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⁹ Sellers of TBA contracts should inform purchasers of the specific mortgage pools being allocated to meet TBA contract obligations 48 hours prior to settlement of the pool. See Chapter 7 of the SIFMA Guidelines.