

9. Structured Products Settlement Procedures

Chapter 9

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A. The Securities Industry and Financial Markets Association Recommended Settlement Guidelines for Secondary Market Transactions Involving Federal Agency CMOs

Government securities, including those issued by Fannie Mae, Freddie Mac and Ginnie Mae, are exempt from the SEC's T+3 settlement requirements. However, secondary market transactions that involve collateralized mortgage obligations (CMOs) issued by Fannie Mae, Freddie Mac or Ginnie Mae should settle not later than the third business day after the date of the transaction, unless otherwise expressly agreed to by the parties at the time of the transaction.

Note that Securities Industry and Financial Markets Association recommended guidelines with respect to T+3 settlement for federal agency CMOs are not intended to discourage other delayed-delivery arrangements that counterparties may properly agree to for such transactions.

B. Method of Delivery for Structured Products

Asset-Backed Securities (ABS), Collateralized Mortgage Obligations (CMOs) and Stripped Mortgage Securities (Mortgage Strips) and Small Business Administration products (SBAs) must be delivered through one of the following methods as per the table below:

	The Depository Trust and Clearing Corporation (DTCC)	Euroclear Clearstream	Fedwire Network	Physical Form
ABS	X	X		X
CMOs	X	X	X	X
Strips	X		X	X
SBA	X			X

C. ABS, CMOs and Strips in DTCC Book-Entry Form

1. Delivery

Most private-label ABS transactions are settled through The Depository Trust and Clearing Corporation (DTCC). Deliveries between broker, dealers and customers may be input to DTCC up to 3:20 p.m. E.T. (receiver authorization is required after 3:00 p.m.). Same-day reclamations can be made up to 3:30 p.m. DTCC's settlement process is generally completed by

5:15 p.m., after which time unvalued (free) deliveries may be made up until 6:15 p.m. Unless otherwise agreed to by both parties in advance, transactions will be delivered and received by DTCC book-entry.

a. Same-Day Funds Processing Schedule

Deliveries through DTCC must be processed in accordance with the following schedule (times subject to extension):

- (i) Cutoff for input of original deliver orders (DOs) without automatic routing to Receiver-Authorized Delivery (RAD) due to time of day — 2:59:59 p.m.
- (ii) Cutoff for input of original (DOs) with automatic routing to RAD (due to time of day) — 3:19:59 p.m.
- (iii) Deadline for authorization of valued DOs through RAD — 3:29:59 p.m.
- (iv) Deadline for reclamations (an earlier deadline applies if DTCC cannot “validate” the reclamation to a prior original delivery) — 3:29:59 p.m.
- (v) Cutoff for input of valued DOs (or pledges) to a Participant’s Settling Bank (subject to RAD, nonrecycling after 3:10 p.m.) — 4:59:59 p.m. (Prior arrangements must be made to be able to submit deliveries during this time frame.)
- (vi) Deadline for authorization of valued DOs to a Participant’s Settling Bank (subject to RAD, nonrecycling after 3:10 p.m.) — 4:59:59 p.m.
- (vii) Completion of DTCC settlement process — 5:14:59 p.m.
- (viii) Cutoff for input of unvalued (free) DOs — 6:14:59 p.m.

Input cutoff times for transactions processed through computer-to-computer links are slightly earlier.

b. New Issues – Cutoff times

- (i) Under \$100,000,000 (settlement value) — 1:14:59 p.m. E.T. No exceptions.
- (ii) In excess of \$100,000,000 (settlement value) — 1:44:59 p.m. E.T.¹

DTCC’s closing area must be informed through a telephone call of all new-issue closings, and DTCC procedures must be followed.

Once the deliveries for the initial syndicate distribution have been released, subsequent deliveries are subject to the time limits set forth in 1.a.

¹ In order to receive an extension beyond 1:15 p.m. ET on issues greater than \$100,000,000, DTCC must be notified by 1:00 p.m. E.T. that an additional 15 minutes are required. A maximum of two 15-minute extensions may be granted.

D. Book-Entry Deliveries of CMOs and Strips on the Fedwire Network

Deliveries and reversals must be made according to existing Fed guidelines. (See Chapter 11, Section A.)

E. Delivery Requirements for SBA Loans

1. General

- a. Each SBA loan must be properly closed and fully disbursed prior to settlement date.
- b. Allowable Accrued Interest on SBA Products:
 - (i) Monthly SBA Loans: The maximum accrued interest eligible for purchase on SBA-guaranteed loans shall be 45 days.
 - (ii) Non-Monthly Paying SBA Loans:
 - (a) Annual Paying Loans: Shall have no more than 10 months of accrued interest.
 - (b) Semi-Annual Paying Loans: Shall have no more than 5 months of accrued interest.
 - (c) Quarterly Paying Loans: Shall have no more than 2 months of accrued interest.
 - (d) Seasonal P&I Loans: Shall pay as agreed on a case-by-case basis.

2. Documentation

The seller of an SBA loan must provide the following documents to the purchaser thereof:

- a. SBA Form 1086 (Secondary Participation Guaranty and Certification Agreement)
 - (i) The lender must properly complete, execute and forward an SBA Form 1086 to the initial loan purchaser for each loan sold.
 - (ii) Corrections and alterations will not be accepted by the FTA.²
- b. Copy of SBA Form 147 (Promissory Note)
 - (i) On the original promissory note, an authorized officer of the lending institution must sign and date the following legend: "The guaranteed portion of the outstanding principal balance of this note has been transferred to a Registered Holder for value." Upon completion of this legend, lender should make a copy of the original promissory note (the signature on the legend will thus be a photocopy).
 - (ii) On the copy of the promissory note delivered by lender to purchaser, the following certification must appear: "We certify this document to be a true and correct copy of the Original Note." This certification must be manually signed and dated, preferably in blue ink.

² The FTA (funds transfer agent) serves a clearinghouse function, collecting payments from lenders and forwarding them to investors.

- (iii) SBA recommends that any promissory note dated after February 15, 1996 contain the following statement: "Borrower shall provide Lender with written notice of intent to prepay part or all of this loan at least 15 business days prior to the anticipated payment date. A prepayment shall be defined as any payment made ahead of schedule that exceeds 20 percent of the then outstanding balance."
 - (iv) On variable rate loans, the promissory note must contain a payment Amortization Clause, similar to the following example: "When a different rate of interest is established, the amount of monthly installments of principal and interest required hereby shall be increased or decreased, as appropriate, to an amount necessary to amortize principal remaining unpaid as of the date of the change in the interest rate over the remaining term of this note."
- c. Copy of SBA Form 529B (Authorization and Loan Agreement)
 - (i) Delivery of this form by the seller is optional.
- d. Payment History
 - (i) In the case of the initial sale of an SBA loan by the originator thereof, the seller should also provide the purchaser with a transcript showing the date(s) and amount(s) of disbursement(s) and the payment history. Any secondary seller of an SBA loan should provide the purchaser with a confirmation of the current paid-to date through the FTA.

3. Settlement

- a. Upon receipt and verification of the information specified in Section E.2. above from the lender, the loan purchaser should submit the complete document package to the FTA.
- b. FTA will, after review and approval of completed document package, notify the loan purchaser to arrange a settlement date no earlier than 2 days from date of receipt at the FTA.
- c. Prior to loan settlement, the purchaser will contact lender to verify the borrower's last payment date and remaining principal balance.
- d. Settlement will be made by wire transfer of funds on a designated date agreed to by the loan purchaser and the seller.

F. Delivery Requirements for SBA Loan Certificates and Pool Certificates

1. Documentation

- a. The purchaser of an SBA loan certificate or pool certificate should provide the seller thereof with a blank SBA Form 1088 (Form of Detached Assignment). This must be an original, SBA-designated form.
- b. An authorized officer of the seller should execute and return the SBA Form 1088 to the purchaser. The signature of the seller's authorized officer must be guaranteed. A properly designated corporate medallion stamp is required.

2. Settlement

- a. SBA loan certificates and pool certificates are eligible for book-entry settlement via the facilities of the Depository Trust Company (DTCC). All new issue SBA loan certificates and pool certificates must be delivered through DTCC. Dealer-to-dealer trades require DTCC delivery.
- b. For factored SBA pool certificates, unless the parties otherwise agree, “regular way” settlement effected via DTCC shall be T+3 unless otherwise specified.
- c. For trades with a settlement date prior to the record date, but with delivery and payment occurring between the record date and payable date, delivery must be accompanied by a due bill. Due bill procedures are generally set forth in Chapter 10 of the Uniform Practices.

G. Delivery Requirements for United States Department of Agriculture (USDA) Government-Guaranteed Loan Programs

1. General Delivery Requirements

- (a) These guidelines are effective with trades executed as of February 1, 2001.
- (b) All loans must be properly closed and fully disbursed prior to the secondary market settlement date.
- (c) Whiteouts, markouts and cross-throughs are not permitted except where necessary to bring agency forms into compliance with Year 2000 date requirements.³

2. Delivery Requirements for Guaranteed Loans Sold Through the Assignment Method.

- a. Documentation to be included in all transaction packages:
 - i. Assignment of Guarantee

Agency	Form Name	Form #
Farm Service Agency	Assignment of Guarantee	FSA-2242
Rural Business-Cooperative Service	Assignment Guarantee Agreement	RD-4279-6
Rural Utility Service	Assignment Guarantee Agreement	RD-449-36
Rural Housing Service: Community Facility	Assignment Guarantee Agreement	RD-449-36

³ Prior to the effective date of this guideline, the use of whiteouts, markouts and cross-throughs were acceptable except in paragraphs relating to amounts, servicing or loan identification number. Forms containing modifications, that were acceptable prior to the current effective date continue to be eligible for good delivery.

- (1) This form must be the current agency-issued document;
 - (2) All signatures must be original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable;
 - (3) No whiteouts, markouts, cross-throughs or any other method of correction may be used; and
 - (4) The original signatures of the lender and the holder must be affixed to the signature page and the corporate seal affixed, if available.
- ii. **The Note**
The Note, as defined in the applicable agency regulations, must be a copy. Any modifications to the original promissory note must accompany the Note. In addition, agency approval is required for any change that is dated subsequent to the date of the loan note guarantee.
- iii. **Loan Guarantee**

The Loan Guarantee/Loan Note Guarantee must be an executed and signed copy

Agency	Form Name	Form #
Farm Service Agency	Loan Guarantee	FSA-2235
Rural Business-Cooperative Service	Loan Note Guarantee	RD-4279-5
Rural Utility Service	Loan Note Guarantee	RD-449-34
Rural Housing Service: Community Facility	Loan Note Guarantee	RD-449-34

- iv. **Certificate of Incumbency and Signature**
The Certificate of Incumbency and Signature is no longer required for good delivery. This guideline applies to new-issue loans, as well as to outstanding loans which previously required a Certificate of Incumbency and Signature in order to be traded in the secondary market.
- v. **Transfer Document**
A transfer document assigning the loan to the purchaser must be executed for all subsequent sales into the secondary market. The transfer document must state at a minimum the following:
- (1) The effective date of transfer;
 - (2) A certification of the balance of the guaranteed portion, which must be produced upon request of the purchaser;
 - (3) The date from which accrued interest begins;
 - (4) A recitation of the prepayment penalty as listed in the note; and

- (5) Disclosure as to the percentage of prepayment penalty being passed on to the holder of record.

No whiteouts, markouts, cross-throughs or any other method of correction may be used. In addition, all signatures must be original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable.

3. Delivery Requirements for Guaranteed Loans Sold Through the Use of the Multi-Note Option.

- a. Documentation to be included in all transaction packages:

- i. Loan Note Guarantee

Agency	Form Name	Form #
Rural Business-Cooperative Service	Loan Note Guarantee	RBS-4279-5
Rural Utility Service	Loan Note Guarantee	RD-449-34
Rural Housing Service: Community Facility	Loan Note Guarantee	RD-449-34

- (1) These forms must be the current agency-issued document;
- (2) All signatures must be original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable; and
- (3) No whiteouts, markouts, cross-throughs or any other method of correction may be used.

- ii. The Note

- (1) This form must be the original;
- (2) All signatures must be the original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable; and
- (3) No whiteouts, markouts, cross-throughs or any other method of correction may be used.

- iii. The Assignment and Servicing Agreement

- (1) This lender prepared form must be the original;
- (2) All signatures must be the original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable;
- (3) Must define the pass through of any lender prepayment penalty;
- (4) No whiteouts, markouts, cross-throughs or any other method of correction may be used;

iv. Certificate of Incumbency and Signature

The Certificate of Incumbency and Signature is no longer required for good delivery. This guideline applies to new-issue loans, as well as to outstanding loans which previously required a Certificate of Incumbency and Signature in order to be traded in the secondary market.

v. Transfer Document

A properly executed Transfer Document (see Exhibit C) approved by The Securities Industry and Financial Markets Association assigning the loan to the purchaser. The Transfer Document must state the following:

- (1) Effective date of transfer;
- (2) A certification of the balance of the guaranteed portion, which must be produced upon request of the purchaser;
- (3) The date from which accrued interest begins;
- (4) A recitation of the prepayment penalty as listed on the note; and
- (5) Disclosure as to the percentage of prepayment penalty being passed on to the Holder of Record.

No whiteouts, markouts, cross-throughs or any other method of correction may be used. In addition, all signatures must be original signatures, which may be wet signatures or certified digital signatures. No copies or facsimile signatures are acceptable.

H. Deliveries in Physical Form

1. Delivery

- a. In addition to the delivery requirements listed below, physical deliveries of structured products are also subject to the physical delivery requirements listed in Chapter 11, "Delivery, Receipt and Reclamation."
- b. Physical deliveries of ABS, CMOs and Strips of less than \$1,000,000 are subject to minimum certificate denominations as stated in the offering documentation. Deliveries of \$1,000,000 or greater should be done in million-dollar increments, unless otherwise agreed to by both parties.
- c. Physical ABS, CMOs or Mortgage Strips that are new issues should be delivered to the initial Buyer on the date of issue within one hour after closing, but not later than 5:00 p.m. E.T. If delivery is after 3:00 p.m., a telephone call should be placed to the initial buyer stating the anticipated time of delivery.
- d. Physical residual securities require representation letters signed by the Purchaser. These letters are required to ensure that the Purchaser is fully aware of the risks and tax consequences of these securities.

2. Payment for ABS, CMOs and Strips Delivered in Physical Form

- a. ABS, CMOs and Mortgage Strips that are delivered in physical form must be paid for in Fed funds (cash available on the same day).

I. Restricted Securities Settlement Procedures

Restricted Securities are securities that are limited under the federal securities laws in terms of the time and manner in which they may be resold. In order to preserve their status as “exempt transactions” under the federal securities laws, transfers of Restricted Securities typically require written representations by either the Purchaser, the Seller or both, to document that the Purchaser is qualified or eligible to purchase the securities. A legal opinion may also be required in order to effect a proper transfer. The parties to a Restricted Securities transaction should consult, as appropriate, with qualified securities counsel to ensure compliance with all applicable laws and regulations. However, in order to promote greater efficiency and uniformity in settling Restricted Securities transactions, The Securities Industry and Financial Markets Association has established the following recommended guidelines:

- The Seller of a restricted security is responsible for notifying the Purchaser of the transfer requirements for the issue. If any transferor document is required, the Seller is responsible for delivering an originally executed transferor document with the securities. Delivery need not be accepted by the Purchaser without an executed original of this document. The Seller is required to send the Purchaser any offering memorandum for the issue, as well as a confirmation for the transaction, which should be sent by the Seller to the Purchaser prior to settlement date.
- If transferee documents are required, the Seller should deliver specimens of the appropriate documents, which should include any necessary seller identification information, to the Purchaser prior to settlement date. The Purchaser is responsible for executing these documents and ensuring that the originally executed transferee documents are attached to the securities before they are delivered to the Trustee for transfer. Therefore, it is not acceptable for a Purchaser to DK deliveries made without transferee documents, where such documents are required and the Seller has complied with its requirements to effect a proper transfer of the securities, as described above.

J. Unavailable Settlement Information

1. Unavailable Final Collateral on Yield-Maintenance CMO and Strips Trades

Trades on certain new-issuance tranches within a CMO and new-issuance Mortgage Strips can be done on a yield-maintenance basis prior to the availability of final collateral from the issuer. Once the final collateral is available, trades should be canceled and a new (corrected) trade should be processed. Both parties should agree upon the new price prior to processing correcting entries. Every effort should be made to cancel and correct the trade 48 hours prior to settlement.

2. Unavailable Factors/Coupons on Delayed-Payment ABS, CMOs and Strips

ABS, CMO tranches and Mortgage Strips with delayed payments of principal and interest should be settled on the previous factor/coupon if the current factor/coupon has not yet been released. In such circumstances, the Seller must make an appropriate adjustment. The following procedures apply in these circumstances:

- a. The original trade should be canceled and a new (corrected) trade should be processed once the current factor/coupon has been made available. New factor/coupon information can be obtained from the issuer and from other private vendors.
- b. The money difference between the original trade amount and the corrected trade amount should be disbursed or collected immediately after the corrected trade is processed.
- c. For certain securities settling through DTCC, the money difference resulting from the trade cancellation and correction process is automatically applied to the account of DTCC Participants. DTCC's CMO Trade Adjustment System (CTAS) tracks the delivery activity of certain issues with delayed-payment features (currently applies only to factor adjustments) for which settlement occurred based on noncurrent factor information. When the new factor is available, CTAS automatically refactors the trade settlement amount, and the appropriate adjustment is debited to the deliverer (seller) and credited to the receiver (buyer) on the relevant payment date.

K. Unavailable Factors for CMO Accrual Tranches

Transactions involving CMO accrual tranches where the current factor is not published as of the settlement date should settle based on an "estimated current factor," as described in Section F.2. of Chapter SF. Once the current factor is published, if it is different from the estimated current factor used to settle the trade, the "cancel & correct" procedures noted above in Sections F.2.a. and F.2.b. should be used.

L. Partial Delivery of ABS, CMOs/REMICs

Securities shall be deliverable in lots as confirmed. A seller may deliver an unlimited amount of partial lots for each transaction confirmed provided that the seller notify the purchaser by verbal transmission of the partial lot to be delivered no later than 5:00 p.m. E.T. a day prior to the delivery date. Note that firms have the option to complete a delivery at any time without notice.

The minimum lot delivered in settlement of a partial shall have a face value of \$500,000 and be in increments of \$1.00 thereafter for physicals and increments of \$1,000 thereafter for all other settlement types. The only exception to the minimum lot delivery of \$500,000 is in the final delivery that completes the transaction. In this final delivery, a lot under \$500,000 is acceptable.

Example of Acceptable Partial Delivery—ABS, CMOs and Strips

Seller A sells \$10,000,000 CMOs to Purchaser B. Seller A has \$5,000,000 in inventory and \$5,000,000 failing to receive. By 5:00 p.m. E.T., one day prior to the delivery date, Seller A telephones Purchaser B with the information that a \$5,000,000 partial of \$10,000,000 will be delivered on the following day. Purchaser B changes the receive ticket to reflect the partial delivery of \$5,000,000 and prepares another ticket for the remaining \$5,000,000. On the following day, Seller A delivers the \$5,000,000 partial.

Example of Unacceptable Partial Delivery—ABS, CMOs and Strips

Seller A sells \$20,000,000 Strips to Purchaser B. Seller A has \$5,000,000 in inventory and \$15,000,000 failing to receive. By 5:00 p.m. E.T., one day prior to the delivery date, Seller A telephones Purchaser B with the information that a \$5,000,000 partial of \$20,000,000 will be delivered on the following day. Purchaser B changes the receive ticket to reflect a partial delivery of \$5,000,000 and prepares another ticket for the remaining \$15,000,000. On the delivery date, instead of delivering the \$5,000,000 partial, Seller A attempts to deliver an amount that matches neither of the two tickets Purchaser B wrote as a result of Seller A's call. Without the prior approval of the Purchaser, this is an unacceptable delivery.

Numerical Examples of Completion of a Transaction with a Partial Delivery

Sale of \$1,600,000	On the initial delivery day, a partial of \$1,200,000 is delivered. On the next delivery day, \$400,000 is delivered, completing the transaction. Although this delivery is below \$500,000.00, it is acceptable because it completes the transaction.
Sale of \$2,000,000	On the initial delivery day, a partial of \$1,850,000.00 is delivered. On the next delivery day, \$150,000.00 is delivered, completing the transaction.

M. Partial Delivery of IOettes

IOettes may also be partially delivered in accordance with the above, except that the minimum face value delivered can be \$1,000 and have increments of \$1.00 thereafter.