

## 6. Confirmations

# Chapter 6

## Confirmations

### A. Introduction

In general, a confirmation is a notification that sets forth the basic terms and details of a securities transaction between counterparties. Among other functions, confirmations enable buyers and sellers of securities to verify essential transaction terms and conditions and to detect and correct errors and misunderstandings.

Rule 10b-10 under the Securities Exchange Act of 1934 generally requires dealers effecting transactions in securities to provide a notification to their customers, at or before the completion of a transaction, disclosing certain information relating to that transaction. The specific content of these confirmation disclosures is set forth in Rule 10b-10. Specialized disclosures are required for certain types of mortgage-backed and asset-backed securities. For example, in the case of MBS or ABS supported by assets that are continuously subject to prepayment, the confirmation must include a statement indicating that the actual yield of such MBS or ABS may vary according to the rate at which the underlying assets are prepaid, and a statement of the fact 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 customer request. Legal counsel should be consulted to ascertain whether the confirmation for a given MBS or ABS product conforms in all respects to the disclosure requirements of Rule 10b-10.

Complete MBS and ABS transaction confirmations that are generated via The Depository Trust Company's (DTC) Trade Suite system, as well as transaction information that is supplied by MBS Clearing Corporation (MBSCC) to its participants for MBS pass-through trades, have been determined by the Securities and Exchange Commission (SEC) to comply with the requirements of Rule 10b-10. In the case of DTC, the SEC has issued no-action correspondence and approved certain rule changes that enable dealers who use the Trade Suite system for generating confirmations for their customer transactions to comply with the disclosure requirements of Rule 10b-10. Similarly, the SEC has issued a no-action letter to enable dealer participants in MBSCC to rely on the delivery to MBSCC customer participants of the following information to satisfy the disclosure requirements of Rule 10b-10: (1) the Purchase and Sale Report and the Message Detail Report, (2) the Purchase and Sale Report together with pool allocation information provided independently by the dealer, and (3) the Message Detail Report together with all other information required by Rule 10b-10 provided independently by the dealer to confirm the TBA portion of the transaction.

Although confirmations under Rule 10b-10 were once generated and delivered exclusively in physical (i.e., paper) form, it is now permissible, as result of SEC interpretive guidance, to transmit transaction confirmations to customers electronically, as long as certain conditions are met. These conditions are set forth in two SEC interpretive releases: Release No. 33-7233 (October 6, 1995), "Use of Electronic Media for Delivery Purposes," and Release No. 33-7288

(May 15, 1996), “Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information.” Again, legal counsel should be consulted regarding the specific terms and conditions that are required for DTC Trade Suite confirmations and MBSCC-generated information to satisfy the requirements of Rule 10b-10 for a particular MBS or ABS transaction.

It should be noted that the requirement to deliver confirmations set forth in Rule 10b-10 applies only to transactions executed between dealers and non-dealer customers. However, The Securities Industry and Financial Markets Association’s recommended guidelines for MBS transaction confirmations, set forth below, apply to all transactions (i.e., both dealer-to-dealer and dealer-to-customer transactions). These guidelines may supplement or overlap with Rule 10b-10 requirements.

## **B. General Confirmation Requirements on TBA, Specified and Pool Transactions**

Each party to a transaction in mortgage-backed securities or asset-backed securities must promptly deliver a confirmation of the transaction, in writing or, if agreed by the parties, electronically, to the other party within one business day following the trade date. Pool confirmations must be sent within one business day after pool information has been passed. The confirmation must contain, at a minimum, the information set forth below.

### **1. TBA Transactions**

For TBA transactions, confirmations should contain the following information, as applicable to the securities being confirmed:

- a description of the security, including the settlement month, coupon rate and product type;
- the confirming party’s name, address and telephone number;
- an identification of the “contra party”;
- a designation of “purchase from” or “sale to”;
- the price and par amount;
- the trade date;
- the settlement date;
- unless covered by a separate agreement, a reference to the material provisions of any initial margin or mark-to-market requirements applicable to the transaction; 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).

### **2. Specified Transactions**

For specified transactions (including specified forward transactions), confirmations should contain all the information required for TBA transactions, as set forth above, and the following, if applicable:

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

### 3. Pool Transactions

For pool transactions, confirmations should contain all the information required for TBA transactions, as set forth above, and the following:

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

## C. Confirmation Requirements for DTC Trade Suite Confirmations

The DTC Trade Suite system provides a single electronic channel to coordinate all post-trade activity among broker-dealers, institutions and custodians (agents), from trade confirmation through final settlement of DTC-eligible securities. The system also provides confirmation and affirmation capabilities for securities that are not DTC-eligible, as well as reports to facilitate settlement outside DTC.

DTC requires all Trade Suite system users to execute and deliver a System Agreement, indicating whether they will participate as a broker-dealer, an agent, an institution or an interested party. By executing the System Agreement, system users agree to be governed by the pertinent sections of DTC's Participant Operating Procedures.

Effective November 1, 1998, in addition to DTC's editing requirements, The Securities Industry and Financial Markets Association recommends that users of the Trade Suite system populate, at a minimum, the fields identified below when sending a DTC Trade Suite confirmation.<sup>1</sup> Recipients of DTC Trade Suite confirmations are required not only to receive the required minimum fields, but also to retransmit those fields in any subsequent rebroadcast.

#### *Record 1*

- |  |                                |
|--|--------------------------------|
| • Production/Test Indicator                  | • Principal Amount             |
| • Settlement Type                            | • Interest                     |
| • Role                                       | • Net Amount                   |
| • Market Code                                | • Expanded Security Type       |
| • Executing Broker-Dealer Trade Suite Number | • Settlement Location          |
| • Institution Trade Suite Number             | • Security Numbering System    |
| • Agent Trade Suite Number                   | • Currency Code                |
| • Security Identifier (CUSIP #)              | • Trade Date                   |
| • Side Code (buy/sell)                       | • Settlement Date              |
| • Face Value (original face)                 | • Account Type                 |
| • Price                                      | • Broker-Dealer Confirm Number |
|  | • Amortized Accreted Factor    |

<sup>1</sup> All additional fields in Records 1 & 4 are optional at this time.

*Record 4*

- Trade Type Indicator
- Current Face (Required for all non-TBA MBS/ABS transactions)
- Pool Number
- Delivery Date
- Issue Date
- Maturity Date
- Specification Code (required field if value of “Trade Type Indicator” is 2, 3 or 11)

## **D. Confirmation Requirements on CMO, ABS, Strip and Other Structured Mortgage Products**

All CMO, ABS, Strip and other structured mortgage products (structured products) are traded as specified transactions. Each party in a structured-product transaction should send a confirmation of the transaction to the other party within one business day following the trade date.

### **1. Required Information**

The confirmation must contain at a minimum:

- a description of the security;
- CUSIP number, if assigned;
- a designation of “purchase from” and “sale to”;
- the price, notional or nominal interest rate and original notional or nominal face;
- the trade date;
- the settlement date;
- the maturity date;
- the settlement amount (\$); and
- a statement to the fact that a security is a private placement or 144A.

### **2. Recommended Information**

The following information is not required on the confirmation but is recommended:

- the telephone number of the confirming party;
- 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;
- 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.

## **E. Confirmation Requirements on SBA Loans**

SBA loan trade confirmations should, at a minimum, include the following information:

1. Borrower Name
2. Guaranteed Portion (GP) Number (SBA 10 digit identifier)
3. CUSIP number, if applicable

4. Note Date
5. Trade Date
6. Price\*
7. Quantity (Guaranteed Balance)
8. Maturity Date
9. Payment Frequency
10. Adjustment Frequency
11. Cap/Floor if applicable
12. Coupon
13. Bid Expiration Date

## **F. Confirmation Requirements for SBA Loan Certificates and Pool Certificates**

SBA loan certificate and pool certificate confirmations should, at a minimum, contain the same information as the individual note level as set forth for SBA loans in section E of these Guidelines.

## **G. Comparison and Verification of Confirmations**

### **1. Discrepancies in Confirmations**

Upon receipt of a confirmation for either a TBA or a specified transaction, each party to the transaction is responsible for comparing and verifying the confirmation to ascertain whether any discrepancies exist. The party discovering any such discrepancy should promptly communicate the discrepancies to the contra party, and both parties should promptly attempt to resolve them.

- a. If the parties are able to resolve the discrepancies, the party in error should, within one business day following such resolution, send a corrected confirmation to the contra party. This second confirmation should be dated and should specify that it is a correction.
- b. If the parties are unable to resolve the discrepancies, they may resort to arbitration or other dispute-resolution mechanisms.

### **2. Unrecognized Trades**

If a party receives a confirmation for a transaction that it does not recognize, it should promptly seek to ascertain whether a trade occurred and the terms of the trade.

- a. If the receiving party determines that a trade did occur and the confirmation received was correct, the receiving party should immediately notify the confirming party by telephone and, within one business day thereafter, send a confirmation of the transaction to the confirming party.
- b. If the receiving party cannot confirm the trade, the receiving party should immediately notify the confirming party by telephone to that effect.

### **3. Failure to Receive a Confirmation**

If a party has sent a confirmation of a transaction, but fails to receive a confirmation or a nonrecognition notice from the contra party within five calendar days of the trade date, the

\*Pursuant to congressional authority, the SBA, acting through Colson Services Corp., the Fiscal and Transfer Agent (FTA), will collect 50 percent of any premium paid in excess of a price of 110 (par=100) on any loan purchased in the secondary market.

confirming party should, but is not obligated to, promptly seek to ascertain whether the confirmation was received by immediately notifying the nonconfirming party by telephone that a confirmation for a trade has been sent to it and no response has been received, and, within one business day thereafter, sending a notice to the nonconfirming party indicating failure to confirm.

Upon receipt of telephone notice from the confirming party, the nonconfirming party should check its records and respond to the confirming party as follows:

- a. If the nonconfirming party determines that a trade did occur, it should immediately notify the confirming party by telephone to that effect and, within one business day thereafter, send a confirmation of the transaction to the confirming party.
- b. If the nonconfirming party cannot confirm the trade, it should immediately notify the confirming party by telephone to that effect and, within one business day thereafter, send a notice to the confirming party indicating nonrecognition of the transaction.

#### **4. Content of Notices Regarding Verifications**

Any notice indicating nonrecognition of a transaction or failure to confirm a transaction should contain sufficient information to enable the recipient to identify the transaction and confirmation to which the notice relates. The notice should include the information required in confirmations for TBA transactions or specified transactions, as the case may be, as well as the confirmation number.

Additionally, the notice should specify the date and identify the firm and person providing the notice. The requirements of this paragraph may be satisfied by providing a copy of the confirmation of an unrecognized transaction, marked “don’t know,” together with the date and the name of the firm and person providing the notice.

#### **5. Settlement by Parties Prior to Verification**

Parties may settle transactions prior to receipt of confirmations, provided that each party to the transaction will be responsible for sending the other party, within one business day of settlement, a confirmation evidencing the terms of the transaction. For example, where parties enter into a specified trade on Monday for settlement Tuesday, the parties may settle on Tuesday even though they have not received each other’s confirmations, provided they agree to the terms of the transaction. In other words, a party cannot “DK” a transaction that it recognizes simply for failure to receive a confirmation. However, a party may “DK” an unrecognized trade.

### **H. Errors and Omissions**

Minor errors or omissions in the transmission of information that do not affect the buyer’s right to redeliver the securities (e.g., an error in the issuer’s name or month of maturity) shall not result in a postponement of delivery or payment.