

SEC Rule 10b-10 Confirmation Delivery Requirements: Clearinghouse Confirmation Relief

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The following is an overview of no-action relief by the Securities and Exchange Commission (“SEC” or the “Commission”) staff to the Depository Trust Company (“DTC”) and the Mortgage-Backed Securities Division (“MBSD”) of the Fixed Income Clearing Corporation (“FICC”), whereby confirmations issued by such organizations to institutional customers of broker-dealers are deemed to comply with the broker-dealer’s confirmation delivery obligations under Rule 10b-10 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

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I. Equity and Fixed Income Transactions

The SEC staff has granted specific no-action relief to DTC to permit its broker-dealer members to rely on confirmations delivered to institutions participating in the DTC institutional delivery (“ID”) system in satisfaction of the broker-dealer’s confirmation delivery obligations under Rule 10b-10.¹ Under the DTC no-action relief, brokers-dealers provide DTC with all of the data necessary to generate a confirm in accordance with Rule 10b-10, and DTC, in connection with its operation of the ID System, provides the information to the brokers-dealers’ customers in the form of an ID confirm. Under the circumstances, the brokers-dealers need not provide duplicate confirms to their customers. Each participating broker-dealer, nonetheless, remains *legally responsible* for full compliance with Rule 10b-10 with respect to confirms issued to its customers by DTC. Similar relief was granted by the Commission staff to Merrill Lynch, Pierce, Fenner & Smith, Inc. to permit the registered broker-dealer to rely on the DTC ID confirm in satisfaction of its obligations under Rule 10b-10.¹

¹ See No-Action Letters to *Depository Trust Co.* (Oct. 29, 1974, Jan. 31, 1983 and Apr. 17, 2001).

¹ See No-Action Letter to *Merrill Lynch, Pierce, Fenner & Smith, Inc.* (Mar. 25, 1991). Merrill Lynch undertook to inform each institutional customer that the firm would no longer issue confirms to the customer and that, in lieu of such confirms, the customer would be entitled to rely on the DTC ID system confirm with respect to its trades with Merrill Lynch. The firm also agreed to send monthly or quarterly account statements to the customers. The relief would not apply to customers that did not receive confirms through the ID system, whether or not ID confirms were received by investment managers for such accounts.

II. No Analogous Relief for Options Transactions

Neither the DTC no-action relief nor the Merrill Lynch no-action relief applies to the confirmation of options transactions. Options contracts traded on U.S. securities exchanges generally are cleared by the Options Clearing Corporation (“OCC”). We are not aware of any analogous relief granted to OCC or any broker-dealer in connection with reports generated by the OCC. Accordingly, confirmations compliant with Rule 10b-10 should be issued for all options transactions in lieu of an OCC confirm absent a request for specific relief by the Commission staff.

III. Mortgage Backed Securities Transactions

No-action relief was provided by the SEC staff to MBS Clearing Corporation (“MBSCC”) (the predecessor of MBSD) in 1997 enabling broker-dealer participants of MBSCC to rely on confirmations generated by MBSCC to confirm principal transactions in mortgage-backed securities with MBSCC customer participants. As a result, a broker-dealer could rely on delivery of the “Purchase and Sale Report” (and the “Message Detail Report” regarding pool allocation information) furnished by MBSCC to its customers, reflecting such customers’ compared transactions in eligible securities, in lieu of confirmations delivered in accordance with Rule 10b-10.² As reflected in the 1997 No-Action Letter, the relief applied solely to trades in mortgage-backed securities of government sponsored enterprises (Fannie Mae, Freddie Mac and Ginnie Mae) compared by MBSCC for its participants, and only to trades in which the broker-dealer acted as principal. Agency trades cleared through MBSCC were required to be confirmed separately in accordance with Rule 10b-10.³

In 2007, the Commission staff granted no-action relief to FICC (successor to MBSCC) affirming the ability of MBSD broker-dealer participants to continue to rely on the 1997 No-Action Letter, and enabling broker-dealers to rely further on two new reports to be generated by the MBSD for specified pool trade activity, the “RTTM Purchase and Sale Report” and the “RTTM Open Commitment Report.”⁴ Otherwise, the facts and representations were the same as the 1997 No-Action Letter.⁵

IV. MBS Options Transactions

Neither the 1997 No-Action Letter nor the 2007 No-Action Letter refers expressly to reports or other confirmations generated by the MBSD with respect to transactions in *options* on MBS securities.⁶ We discussed the no-action relief with the FICC, which has confirmed that the relief does not specifically extend to MBS options transactions. Accordingly, the 1997 No-Action Letter and the 2007 No-Action Letter would not provide a sound basis for relying on the MBSD’s Full Open Commitment Report (analogous to the RTTM Open Commitment Report for trades in the underlying security), or any other report produced by the MBSD in

² See No-Action Letter dated June 27, 1997 (the “1997 No-Action Letter”).

³ At the time the relief was granted, the Purchase and Sale Report did not state the capacity in which the broker-dealer participant acted because broker-dealer participants always acted as principal in mortgage-backed securities transactions with their customer participants. The SEC staff made clear that if a broker-dealer participant engaged in an agency transaction with a customer participant, the transaction would have to be confirmed separately by the broker-dealer in compliance with Rule 10b-10.

⁴ See No-Action Letter dated May 23, 2007 (the “2007 No-Action Letter”).

⁵ The 2007 No-Action Letter did not address whether industry or MBSD practices had changed with respect to agency trades. Accordingly, it remains the position that the no-action relief with respect to MBSD confirmation reports does not apply to trades in which the broker-dealer acts as agent.

⁶ The MBSD provides trade for trade services to MBSD participants that trade MBS options, whereby options contracts are compared though the MBSD’s real-time trade matching (“RTTM”) service and, if exercised, are settled through the MBSD’s settlement system.

connection with MBS options transactions in lieu of providing to non-broker-dealer counterparties a confirmation that is fully compliant with Rule 10b-10.⁷

No-action relief with respect to reports generated by MBS in connection with options transactions similar to reports confirming transactions in the underlying mortgage securities would require no-action by the SEC staff on behalf of MBS or other affected industry participant.

V. Waiver of Rights Under Rule 10b-10 Ineffective

In general, any waiver by a customer with respect to its rights under Section 10(b) and Rule 10b-10 under the Exchange Act is ineffective.⁸ A broker-dealer generally is not permitted to substitute summary or periodic reports in lieu of a full 10b-10 confirmation. Any existing relief with respect to securities transactions is strictly limited to circumstances in which the broker-dealer has obtained an agreement from the customer designating an adviser managing the customer's account in a wrap fee program to receive confirmations on the customer's behalf. All confirmations must be timely delivered to the adviser and a report containing a summary of all trades must be sent to the customer on a periodic basis.⁹

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Please contact us if you would like to discuss this or related trade confirmation issues.

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⁷ Rule 10b-10 does not apply to transactions with other broker-dealers.

⁸ See Section 29(a) of the Exchange Act.

⁹ The relief has been granted on the theory that customers of wrap fee programs or other individually managed account programs retain the advisor as a fiduciary to manage their funds on a discretionary basis, and may not wish to receive, on a trade-by-trade basis, immediate confirmations. For the waiver to be effective, the broker-dealer must (1) obtain an agreement from the customer designating a fiduciary to receive immediate confirmations, and (2) send a periodic statement (at least quarterly) to the customer containing all information required by such confirmations (or send copies of the confirmations themselves on a periodic basis). The customer may not waive receipt of the periodic report. (See, SEC No-action letter to *Money Management Institute* (Aug. 23, 1999). See also SEC No-action letters to *Donaldson, Lufkin & Jenrette Securities Corp.* (Aug. 21, 1997), *Advest Inc.* (Jul. 19, 1999) and *Sanford Bernstein & Co., LLC* (Apr. 18, 2005).)