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Fitch: First Volcker-Compliant TOB Helps Muni Market Liquidity.

NEW YORK, Jun 17, 2014 (BUSINESS WIRE) — The development of a tender option bond (TOB) structure that complies with the Volcker rule paves the way for tax-exempt money market funds to remain a buyer of municipal bonds. However, this structure does not provide a clear means for bringing outstanding TOBs into compliance. The Securities Industry and Financial Markets Association estimated the TOB market at \$80 billion. Fitch rated a new Volcker-compliant TOB structure brought to market by Merrill Lynch, Pierce, Fenner & Smith last week.

We expect other banks that participate in the tender-option bond market to utilize similar structures for new TOBs in the second half of the year. For existing TOB trusts, banks may unwind the trusts and create new joint venture trusts or may potentially use a third-party non-banking entity as a sponsor to make those structures compliant.

In a typical TOB structure, the sponsor will deposit a fixed-rate bond or note into a trust that then issues one floating rate certificate (with a tender option) and one residual certificate. Tax-exempt money market funds may buy TOBs as the floating rate certificate's tender option is often issued by the sponsor, shortening the maturity of the deposited bond.

The Volcker rule, which is expected to be fully implemented by July of 2015, prohibits banks from sponsoring the trust and providing any liquidity, credit, or remarketing services for the floating and residual certificates issued by traditionally structured TOBs.

The new structure establishes a joint venture trust that the liquidity provider, the floating interest holders, and the residual interest holders join. Each joint venture must have 10 or fewer parties. Joint ventures of this size were exempted from the Volcker Rule.

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