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SIFMA Plugs New TOB Structure.

WASHINGTON — The Securities Industry and Financial Markets Association has sent a letter to numerous federal regulators arguing that the joint venture structure used for the first time last week to sell tender option bonds is compliant with the Volcker rule.

The five-page letter was signed by David Cohen and Matthew Nevins, managing directors and associate general counsel for SIFMA's municipal securities division and the asset management group, respectively. It was addressed to the regulators responsible for implementing the Volcker rule, including the Securities and Exchange Commission, Federal Reserve, Federal Deposit Insurance Corporation, Comptroller of the Currency, and Commodity Futures Trading Commission. The letter seeks to communicate to the regulators that the joint venture trust structure laid out in an accompanying term sheet is a legal solution for the TOB market, the SIFMA lawyers said.

TOB programs have traditionally provided a supply of short-term tax-exempt bonds to money market funds, and have generally accounted for approximately 25%-30% of the assets of muni MMFs, according to Fitch Ratings. In a traditional TOB program, the sponsor will deposit a fixed-rate bond or note into a trust, which will issue two new certificates — a floating rate certificate sold to a money market fund and a residual certificate which may be sold to a mutual or closed-end fund or held by a bank. The floating rate certificate will have a tender option, through a liquidity facility that is typically issued by the program's sponsor or an affiliate, that shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

But the Volcker Rule, finalized late last year, prevents banks and their affiliates from sponsoring a TOB program, owning a residual certificate issued by a TOB trust, or providing credit enhancement, liquidity, or remarketing services to these programs.

The joint venture solution, first used by Merrill Lynch, Pierce Fenner & Smith in an $8.5 million deal last week, relies on an exemption in the rule. Joint ventures that exist between banks or their affiliates and unaffiliated parties, and are exempt from the rule as long as they have no more than 10 unaffiliated co-venturers and only engage in activities permitted of banking entities. Under the new structure, banking entities will provide liquidity while a co-venturer holds the floating note and another holds the residual note.

Some experts have warned that regulators might view the JVTs as a re-definition of an existing structure to get around the rules, but Cohen and Nevins said in an interview that the structure represents months of work by "various SIFMA stakeholders" and the letter is intended to inform the regulators of the group's reasoning.

"We wanted to inform the regulators of our solution," Cohen said. "It allows the market to move forward in an orderly fashion."

Nevins said the various attorneys and market experts who worked on the project came to the consensus that the JVT structure complies with Volcker and is the most logical way forward.

“I think what we’ve done is in the spirit of what the regulators have done under the Volcker rule,” he said.

The JVT structure is likely to be the way the TOB market is going to operate going forward, said Cohen. Some market participants have floated a second idea, which would swap the bank sponsor out for a non-banking entity such as a mutual fund or a dealer. That option would not work for banks.

Rating agencies had previously said that the TOB market would “unwind” in the months following the final Volcker Rule, but have since dubbed the emergence of the JVT structure a positive development that can keep the market functioning.

BY KYLE GLAZIER
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