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Fitch Expects Unwinding, Restructuring of TOB Programs.

WASHINGTON — Fitch Ratings said Thursday that it expects a gradual unwinding or restructuring of tender option bond programs over the next few months since they were not exempted from the Volcker Rule.

The rating agency said it will continue to monitor developments in the \$70-\$80 billion TOB market as market participants try to find alternative structures of financings before the rule goes into effect on April 2014, and conformance is required by July, 2015.

TOB programs have historically been used to provide short-term tax-exempt munis to money market funds.

In a typical 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 and a residual certificate.

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 and shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

TOB programs account for about 25% to 30% of the assets of muni money market funds.

But under the Volcker Rule, banks and their affiliates will no longer be able to sponsor a TOB program, own a residual certificate issued by a TOB trust, or provide credit enhancement, liquidity, or remarketing services these programs.

"Fitch expects a gradual unwinding of the programs as liquidity facilities expire," the rating agency said. "Under this scenario, there would likely be some increase in supply side pressure arising from tax-exempt money market funds tendering their floating rate certificates to liquidity banks and the liquidity banks looking to sell the previously deposited bonds or notes into the market."

The Securities Industry and Financial Markets Association is talking to members about the impact of TOB programs not receiving an exemption, David Cohen, SIFMA associate general counsel said Thursday. SIFMA has formed a working group, comprised of both buy- and sell-side members, to explore ways in which municipal financings can be done in compliance with the final Volcker Rule, he said, adding, "We are in the preliminary stages and are hopeful that a compliant structure can be effected with minimal market impact."

SIFMA had urged federal regulators to exempt TOB programs from the definition of a "covered fund" like a hedge fund, arguing that because the underlying asset in the trust is a state or local bond, a TOB should be treated as such.

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