Bond Case Briefs

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Wall Street Banks Want Muni Whistle-Blower Suit Dismissed.

- **Top underwriters say complaint lacks specificity, knowledge**
- **Size of municipal VRDO market estimated at about $160 billion**

Eight banks that help sell municipal bonds for Illinois asked a judge to dismiss a $1 billion lawsuit accusing them of fraud and collusion.

The remarketing agents for variable-rate demand obligations say that the suit filed on April 5 by Edelweiss Fund LLC under the Illinois False Claims Act doesn't identify specific statements made by any of the defendants, false or otherwise. They also claim that it's based upon conjecture rather than inside knowledge; and that the majority of deals cited were done through conduits "made on behalf of non-State entities who bear all of the financial risks of the transactions."

The banks seeking dismissal of the lawsuit are: Morgan Stanley; JPMorgan Chase & Co.; Citigroup Inc.; Bank of America Corp.; Barclays Capital; Fifth Third Bancorp; William Blair & Co.; and BMO Capital Markets Corp.

Michael Lissack, a spokesman for Edelweiss, declined to comment.

'Robo-Reset'

Variable-rate securities are long-term municipal bonds whose rates are reset periodically and are puttable back to the issuer. Remarketing agents set the rates and often take bonds that have been put back into inventory for resale.

Instead of "actively and individually" marketing and pricing bonds at the lowest possible interest rates, the banks "engaged in a coordinated 'Robo-Resetting' scheme where they mechanically set the rates en masse without any consideration of the individual characteristics of the bonds, the associated market conditions or investor demand," the Edelweiss lawsuit alleged. The suit was filed by a group of whistle blowers on behalf of the state of Illinois.

"Defendants 'Robo-Reset' these rates in order to keep the bonds in the hands of their holders, and thus alleviate the need for defendants to remarket the bonds," the suit said.

The lawsuit alleged that this method of setting rates kept those rates artificially high, and that it cost Illinois issuers $349 million. It sought triple that amount in damages and penalties.

In the early years of this century, issuers sold between $30 billion and $60 billion of such debt annually, often in conjunction with interest-rate swaps, according to Thomson Reuters Deals Intelligence.

In 2008, they sold more than $115 billion in such paper as they refinanced both auction-rate and insured floating-rate debt, as the auction market froze and insurance companies were downgraded.

Since then issuance has dwindled, totaling $5 billion in 2017. The total size of the outstanding VRDO market is about $160 billion, according to data compiled by Bloomberg.

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