The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
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ICI Files Comment Letter on Application of Risk Retention Proposal to Third-Party Tender Options Bond Structure

[28272]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 11-14
MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 12-14
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 27-14
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 14-14
SEC RULES COMMITTEE No. 30-14 RE: ICI FILES COMMENT LETTER ON APPLICATION OF RISK RETENTION PROPOSAL TO THIRD-PARTY TENDER OPTION BOND STRUCTURE

On July 15, ICI filed a supplemental comment letter with the Securities and Exchange Commission ("SEC"), Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Department of Housing and Urban Development (together, the "Agencies"). The letter, which is attached and is summarized below, follows up on ICI's 2013 comment letter [1] on the Agencies' proposal ("Proposed Rules") to implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934 ("Exchange Act"). The ICI 2013 Letter focused on, among other issues, the application of the Proposed Rules to municipal tender option bond ("TOB") programs.

Since ICI submitted the ICI 2013 Letter, developments relevant to the Proposed Rules' application to TOB programs have occurred. Final regulations were adopted to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Volcker Rule"). The comment letter explains that market participants are concerned that the Volcker Rule's restrictions on banks' relationships with "covered funds," as defined under the Volcker Rule, will interfere with the ability of banks to perform their traditional roles with respect to TOB programs. As a result, industry participants are working to develop alternative TOB structures intended to be consistent with the Volcker Rule.

The comment letter addresses the application of the Proposed Rules to one of those alternative TOB structures, third-party trusts, in which a non-banking entity, most likely a registered investment company ("fund") such as a tax-exempt bond fund or closed-end fund, would assume certain roles that were previously assumed by a bank. The letter explains that several further modifications to the Proposed Rules are necessary to reflect

the changed roles and responsibilities of TOB program participants under the third-party trust structure.

Confirm that Residual Holders May Serve as Sponsor for Risk Retention Purposes

One key difference from the ICI 2013 Letter is that, in that letter, ICI had sought confirmation that residual holders be permitted to satisfy risk retention obligations of a banking entity sponsor without being deemed the sponsor themselves for purposes of the Proposed Rules. In light of the Volcker Rule, and because ICI members have gained additional comfort with the implications of funds being deemed sponsors under the Proposed Rules, we are now instead requesting that the Agencies confirm that funds or other institutional investors in municipal bonds that purchase residual interests in a municipal TOB trust may serve as "sponsor," and therefore "securitizer," for purposes of the Proposed Rules, and may satisfy the risk retention obligations with respect to the TOB trust. [2]

Definition of "Qualified Tender Option Bond Entity"

The comment letter, like the ICI 2013 Letter, also recommends that the Agencies clarify the definition of "qualified tender option bond entity" under the Proposed Rules to explicitly permit more than one fund in a fund complex to hold residual interests in a TOB trust, as is common practice in the TOB market. The letter explains that doing so would allow multiple funds to invest in the residual interests issued by a single trust, thus enabling smaller funds to have access to securities that otherwise would be unavailable to them.

The letter also addresses another aspect of the definition of "tender option bond entity" under the Proposed Rules. We recommend that the Agencies clarify explicitly that credit enhancement is a permitted asset for a TOB trust under the Proposed Rules. The letter explains that it is not unusual for a TOB trust to include credit enhancement, such as letters of credit, with respect to the underlying municipal securities and, indeed, this is explicitly contemplated by the Proposed Rules. In order to reflect the role of credit enhancement, in some cases, in assuring the timely distribution of proceeds to floater holders in TOB programs, we recommend that the Agencies clarify explicitly that "servicing assets," in the context of a TOB program, may include credit enhancement, if any, with respect to the underlying municipal bonds held by the TOB trust.

Recommended Revisions to TOB Risk Retention Options

ICI asserts that one of the options under the Proposed Rules must be clarified to reflect the cash flows characteristics of TOB programs, as currently structured and under the third-party trust structure. We also recommend two additional risk retention options be permitted for TOB program sponsors to reflect market practice, and to address the implications of the Volcker Rule.

Risk Retention Requirements Only Should Apply Prospectively

Finally, the comment letter reiterates ICI's strongly held view that any risk retention requirements the Agencies may adopt should apply only on a prospective basis, and requests confirmation that the rules will operate in this manner. The letter requests confirmation that the final risk retention rules will not apply retroactively to ABS structures in existence on the effective date of those rules, as such application would result in significant adverse operational and tax consequences. Instead, we request confirmation that the final rules will apply prospectively only to ABS structures created after the effective date of the final rules. The letter also reiterates ICI's concern that, because of the joint

nature of the rulemaking, the Agencies must develop workable standards for risk retention guidance prior to the rules' adoption, and emphasizes that this concern is even more urgent given the additional overlay of the Volcker Rule and its implications for TOB programs.

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Attachment

endnotes

[1] Letter to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, et al., from Karrie McMillan, General Counsel, Investment Company Institute, dated October 30, 2013 ("ICI 2013 Letter"), available at http://www.sec.gov/comments/s7-14-11/s71411-414.pdf.

[2] Under the Proposed Rules, a "securitizer" with respect to a securitization transaction means either: (1) the depositor of the asset-backed securities ("ABS") (if the depositor is not the sponsor); or (2) the sponsor of the asset-backed securities." "Sponsor" is defined under the Proposed Rules as "a person who organizes and initiates a securitization transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity." The definition of "securitizer" under the Proposed Rules is substantially similar to the statutory definition of securitizer in Section 15G(a)(3) of the Exchange Act.

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