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Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
Docket Number OCC-2011-0014
RIN 1557-AD44

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket Number R-1432
RIN 7100-AD82

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AD85

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
File Number S7-41-11
RIN 3235-AL07

The logo for Ashurst LLP, featuring the word "ashurst" in a lowercase, orange, sans-serif font.

RE: Restrictions on Proprietary Trading and Certain Interests In, and Relationships with, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

The undersigned financial institutions¹ (the "Undersigned") submit this letter in response to the request of the Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; the Federal Deposit Insurance Corporation; and the U.S. Securities and Exchange Commission (the "SEC") (collectively, the "Agencies") for comments on proposed rules (the "Proposals") to implement the requirements of section 13 of the Bank Holding Company Act of 1956 (12 U.S.C. §1851) (the "BHCA"), as added by section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Each of the Undersigned, either directly or through an affiliate, is an underwriter and/or dealer of municipal securities and an active participant in the market for tender option bonds. The Undersigned appreciate the opportunity to comment on the Proposals.

¹ Each of the undersigned financial institutions is a "banking entity" as defined in section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

SUMMARY OF RECOMMENDATIONS

The Undersigned believe that, as currently drafted, the Proposals unnecessarily impede the ability of banking entities to engage in activities that are vital to the healthy functioning of the municipal securities markets.

- (1) State and Municipal Agency Securities. With respect to the permitted activity exemption for government obligations, the Undersigned respectfully offer the view that section 13 provides the Agencies flexibility to conclude that securities issued by state or municipal agencies should be properly considered to reside in that exemption. If the Agencies do not believe they have the statutory authority or flexibility to otherwise make this clarification, then the Agencies should use the authority given to them under section 13(d)(1)(J) to include a permitted activity exemption for state and municipal agency obligations. We do not believe that Congress intended to limit the permitted activity in the manner the Agencies stated in the release accompanying the Proposals ("Proposing Release"). Further, we are not aware of any legal or credit reason for treating state and municipal agency securities differently than securities issued by states or political subdivisions under section 13.
- (2) Tender Option Bond Programs. With respect to the trading and other activities of banking entities in connection with tender option bond programs ("TOB Programs"), the Undersigned do not believe that Congress intended to prohibit banking entities from (a) owning interests in or sponsoring TOB Programs, which differ fundamentally from hedge funds and private equity funds, whose risks the ownership and sponsorship restrictions in section 13(a)(1)(B) are designed to address, or (b) engaging in other activities related to TOB Programs that may be related to the creation of TOB Trusts or involve ownership in TOB Program securities (as defined herein), such as transferring securities into a TOB Trust or acting as liquidity provider or remarketing agent.

To address the issues regarding TOB Programs, the Undersigned respectfully request that:

- (i) the Agencies provide a permitted activity exemption for transactions in TOB Program securities, on the basis that TOB Programs are pass through vehicles of municipal securities; and
- (ii) the Agencies narrow the definition of "covered fund" to exclude TOB Program trusts, as they are clearly distinguishable from private equity funds and hedge funds.

GENERAL BACKGROUND

A. *Municipal Securities Market*

State and local governments and agencies issue municipal securities to finance hospitals, education, transportation, housing and many other projects that are critical to the infrastructure and functioning of the country. The municipal securities market is highly heterogeneous and diverse, with estimates of the number of municipal issuers (including states, counties, cities, towns, and state and local government agencies) ranging from 46,000² to 78,000³ and at least 1.1 million separate securities outstanding.⁴ Estimates of the percentage of the municipal securities market that consists of securities issued by agencies and authorities range from 41.1%⁵ to over 50%.⁶ The municipal

² "Municipal Securities: Overview of Market Structure, Pricing and Regulation", Report to Congressional Committees of the United States General Accountability Office (January 2012) ("GAO Study"), at 6.

³ Letter to the Agencies from Citigroup Global Markets Inc. (January 27, 2012) ("Citi Letter"), at 3.

⁴ GAO Study at 6; see also Letter to the Agencies from the Municipal Securities Rulemaking Board (January 31, 2012) ("MSRB Letter"), at 2.

⁵ MSRB Letter at 2.

⁶ "US Municipal Strategy Special Focus: Volcker Rule - Potentially Negative Implications for Municipals," Citigroup Global Markets Inc. (November 20, 2011), at 3.

securities market is dominated by retail investors. Individual investors hold over half the securities in the market and mutual funds hold almost a quarter of the securities in the market.⁷ Unlike equity securities, the majority of municipal securities are traded through over-the-counter markets that are decentralized and involve the active participation of many dealers, a large majority of which are banking entities. Due to the nature of most municipal securities as exempt from federal income tax and, in some cases, from state and local income tax, dealers often limit their inventory and focus to a well-defined geographic area that corresponds to the needs of their customers.⁸

Although the market has a large number of issuer, dealer and investor participants, it is not particularly active relative to the equity markets. In general, a municipal security will trade actively when it is first issued, when an institutional investor sells a large position, or when economic news causes investors to buy or sell. Otherwise, trading in any particular municipal security tends to be sporadic. In 2010, 99% of outstanding municipal securities had no trading activity on any given day.⁹ In general, buyers and sellers are not standing by when a dealer's customer wants to trade a particular municipal security. To provide liquidity for their customers, dealers often maintain their own inventories. Dealers often also trade with other dealers to expand the pool of municipal securities they can make available for sale and to expand the universe of potential buyers. It is uncommon for both the selling and purchasing dealer to be acting as riskless principals. In fact, 90% of all trades in 2011 were principal trades.¹⁰ The market making and liquidity intermediation activities of municipal securities dealers are absolutely essential to the health of the over-the-counter municipal securities market. Uncertainty about the extent to which banking entities can continue to engage in those activities will adversely affect that market and, in this regard, we note that there is considerable concern in the industry about the uncertainty associated with the terms of the market-making-related permitted activity set out in the Proposals.

The undersigned believe that, if the Agencies adopt the government obligations permitted activity exemption as drafted, the municipal securities market may experience a dramatic decrease in liquidity for investors. This in turn would increase the financing costs of municipal issuers. Higher financing costs could have a profoundly negative impact on the financial condition of municipal issuers, especially when added to the strain many of them are currently facing from declining budgets and growing pension and other obligations. The Undersigned urge the Agencies not to underestimate the potential damage to municipal issuers, investors and citizens that adopting the current Proposals could cause.

B. TOB Programs

For nearly twenty years, TOB Programs have been used as a vehicle to efficiently allocate capital in connection with the acquisition of tax-exempt debt securities issued by state and local United States governments and agencies ("municipal securities").¹¹ Developed as a tax-efficient alternative to repurchase agreements, TOB Programs have become an indispensable source of funding for the long-term municipal securities market and an important source of supply for the tax-exempt money

⁷ "Flow of Funds Accounts of the United States," Board of Governors of the Federal Reserve System (December 8, 2011).

⁸ GAO Study at 7.

⁹ MSRB Letter at 3.

¹⁰ Id.

¹¹ For the sake of brevity the Undersigned have limited the focus of this letter to TOB Programs designed to finance direct ownership interests in tax-exempt municipal securities, which constitute most of the TOB Program market. We note that TOB Programs are prominent in the financing of securities in both the primary and secondary market and, in limited circumstances, may be used to finance taxable municipal securities, credit enhanced municipal securities and shares of registered municipal investment companies. We believe the discussions and recommendations described herein would apply to all securities financed in TOB Programs and, as such, the Undersigned respectfully request that the Agencies provide the relief described herein on that basis.

markets, with approximately \$75-\$100 billion of municipal securities currently on deposit in TOB Programs.¹²

In a TOB Program, either the TOB Program sponsor or a third-party institutional investor acquires municipal securities available in the market and deposits them into a trust (a "TOB Trust"), which in turn issues two classes of securities: (a) floating rate certificates (each a "TOB Floater") sold to tax-exempt money market funds regulated by Rule 2a-7 of the Investment Company Act of 1940, as amended (the "Investment Company Act"), which may be tendered at any time upon specified notice for repurchase by the TOB Trust at par plus accrued interest (the "Tender Option"), and (b) residual floating rate certificates (each a "TOB Residual Interest" and, together with a TOB Floater, may be referred to herein as "TOB Program securities") issued to either the TOB Program sponsor (or an affiliate of the TOB Program sponsor) or such third-party investor. The issuer in a TOB Program typically relies on the exception to the definition of "investment company" in section 3(c)(1) or 3(c)(7) of the Investment Company Act.

In addition to establishing the TOB Trust, a TOB Program sponsor or an affiliate often acts as remarketing agent, liquidity provider and/or credit enhancer to a TOB Program. A remarketing agent (a registered broker-dealer) attempts to resell TOB Floaters that holders have tendered pursuant to their Tender Option. A remarketing agent may, but is not obligated to, purchase the tendered TOB Floaters. Arrangements for liquidity in TOB Programs may differ, but often a liquidity provider commits to purchase tendered TOB Floaters from holders who have exercised their Tender Option (or from the remarketing agent) in the event that the remarketing agent is unable to remarket to other buyers all tendered TOB Floaters.¹³

As drafted, the Proposals would prohibit or limit purchases and sales of TOB Floaters and TOB Residual Interests, as well as the purchase and sale of certain of the municipal securities by and to TOB Trusts when the TOB Trusts are established. Additionally, the effect of treating a TOB Trust as a covered fund would be to prohibit banks and their affiliates from owning TOB Residual Interests and from sponsoring a TOB Program. Moreover, the limitation on covered transactions between banking entities and a covered fund would prevent a bank from providing credit enhancement, liquidity support, remarketing and other services required in connection with TOB Programs. To state it simply, TOB Programs would not be able to function to the extent any of the foregoing restrictions applies to them.

The Undersigned believe that none of the above-mentioned activities of banking entities with respect to TOB Programs should be subject to the restrictions of section 13 for the following reasons, each of which is supported by both the legislative history of section 13 and the policy objectives articulated in the Proposing Release:

- TOB Programs are vital to both the municipal securities market and the tax-exempt money markets. TOB Programs provide a source of capital and liquidity for municipal issuers and a source of eligible portfolio investments for tax-exempt money market funds, each of which promotes the financial stability of the United States and its state and local governments. If the Proposals are adopted without change, then the issuers of long-term and other municipal securities will have less demand for their securities and tax-exempt money market funds will experience a dramatic decrease in available investments, all of which could have a negative impact on the financial stability of the United States and its state and local governments.
- Municipal securities that are deposited into a TOB Trust are often the debt securities of a single issuer, are generally publicly issued, in most instances have received a high credit quality rating, and always are subject to the anti-fraud provisions of the federal securities laws;

¹² Because TOB Program securities are privately placed, it is not possible to know with certainty the size of the TOB Program market. The numbers provided are based on recent market estimates.

¹³ We have attached at [Appendix A](#) to this letter a more detailed description of TOB Program assets and the TOB Program structure.

furthermore, TOB Programs provide transparency with respect to the municipal securities in each TOB Trust.

- TOB Trusts are economically similar to repurchase agreements, which the Proposals expressly exclude from the proprietary trading restrictions. TOB Programs are generally used in the municipal securities market instead of repurchase agreements solely for tax reasons.
- Unlike hedge funds and private equity funds, TOB Programs do not present the risk that a TOB Program sponsor will be obligated (contractually or otherwise) to compensate investors for any losses with respect to their investments, because the TOB Program structure provides for specific investor protection mechanisms and allocation of losses between the TOB Floaters and TOB Residual Interest that are disclosed in advance to investors and that are accepted as market standard.

We address below our specific concerns with the Proposals. For ease of your review, we have included in our letter the specific requests for comment to which we are responding.

PROPRIETARY TRADING

1. THE AGENCIES SHOULD REVISE THE PROPOSALS TO MAKE CLEAR THAT SECURITIES ISSUED BY STATE AND MUNICIPAL AGENCIES ARE COVERED IN THE PERMITTED ACTIVITY FOR GOVERNMENT OBLIGATIONS OR USE THEIR AUTHORITY UNDER SECTION 13(D)(1)(J) TO PROVIDE AN EXEMPTION FOR SECURITIES ISSUED BY STATE AND MUNICIPAL AGENCIES

1.1 Background: Section 13 and the Proposals prohibit proprietary trading unless a specific exemption or exclusion applies. Section 13(d)(1)(A) permits the purchase, sale, acquisition, or disposition of, among other things, "obligations of the United States or any agency thereof" and "obligations of any State or of any political subdivision thereof." Section 6(a) of the Proposals identifies as a permitted activity proprietary trading in "government obligations," but the Proposing Release states that the statutory language does not extend the permitted activity exemption to transactions in obligations of an agency of any state or municipality. As we describe below, we believe the statutory language should be understood to include transactions in state and municipal agency securities in the permitted activity exemption for trading in government obligations.

1.2 Agency Questions:

- (a) Question 120: Should the Agencies adopt an additional exemption for proprietary trading in State or municipal agency obligations under section 13(d)(1)(J) of the BHC Act? If so, how would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?
- (b) Question 124: Are the definitions of "government security" and "municipal security" in sections 3(a)(42) and 3(a)(29) of the Exchange Act^{14,15} helpful in determining the

¹⁴ Section 3(a)(29) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") defines "municipal securities" to include "securities which are direct obligations of, or obligations guaranteed as to principal and interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in section 103(c)(2) of the Internal Revenue Code of 1954) the interest on which is excludable from gross income under section 103(a) of Such Code if, by reason of the application of paragraph (4) or (6) of section 103(c) of such Code (determined as if paragraphs (4)(A), (5), and (7) were not included in such section 103(c)), paragraph (1) of such section 103(c) does not apply to such security."

¹⁵ Section 3(a)(16) of the Exchange Act in turn defines "state" to mean "any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States." See also the definition of "state" in Section 2 of the Dodd-Frank Wall Street Reform and Consumer Protection Act: "The term 'State' means any State, commonwealth, territory, or possession of the United States, the District of Columbia, the

proper scope of this [additional] exemption? If so, please explain their utility and how incorporating such definitions into the exemption would be consistent with the language and purpose of section 13 of the BHC Act.

1.3 Responses:

- (a) The Agencies have the statutory flexibility to broaden the government obligations permitted activity exemption. The Undersigned respectfully disagree with the Agencies that the proposed rule is "consistent with the statutory language."¹⁶ Section 13(d)(1)(A) does not actually define the term "government obligations," but instead provides a list of obligations that a banking entity may trade as a permitted activity. None of the items on that list is further defined, either directly or by reference to another statute. The Agencies presumably interpret the fact that the statute refers to "obligations of the United States or any agency thereof" on the one hand and "obligations of any State or of any political subdivision thereof" on the other hand to mean that state and municipal agency obligations are not included within the exemption. We offer another interpretation: the language is different because the term "political subdivision" is broader than and inclusive of, not separate from, the term "agency." The narrower term "agency" was used with respect to United States government obligations because the United States does not have political subdivisions. The term "political subdivision" has been defined elsewhere in federal statutes and regulations to include a state or municipal agency.¹⁷ In other words, the distinction was meant to be descriptive, not exclusive. Further, we can find no legislative history to suggest that Congress intended to exclude obligations of state and municipal agencies from the exemption. Accordingly, we believe that the Agencies can broaden the government obligations permitted activity exemption in the Proposals to include state and municipal agency obligations instead of adding a separate permitted activity exemption for these obligations. We believe this approach is straightforward and within the scope of the Agencies' authority.^{18, 19}
- (b) If the Agencies do not believe that they have the statutory flexibility to broaden the proposed government obligations permitted activity exemption, then the Agencies should adopt an additional exemption to treat state and municipal agency obligations under section 13(d)(1)(J) in the same way that other government obligations are treated under the Proposal. The Undersigned understand that any permitted activity must meet the high standard of promoting and protecting the safety and soundness of banking entities and the financial stability of the United States, and believe that such an exemption meets that standard for the following reasons:

Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, or the United States Virgin Islands."

¹⁶ Vol. 76, Federal Register 68846, 68878, footnote 165.

¹⁷ 12 USC Section 24(Seventh); see also MSRB Letter, at 5-8; Citi Letter at 5-9.

¹⁸ We note that the Agencies have requested comment in questions 120 and 124 as to whether the definition of municipal securities should be expanded for purposes of proprietary trading and whether the definition of municipal security in Section 3(a)(29) of the Exchange Act would be helpful in determining the scope of the exemption from the Volcker Rule. We strongly believe that the exemption for municipal securities should be expanded as described herein. Specifically, for the reasons described herein, the definition in Section 3(a)(29) is the appropriate guidepost for the municipal securities permitted activity exemption. We would further note that the recently proposed risk retention rules also adopt the Exchange Act definition. See Vol. 76 Federal Register 24089, 24137.

¹⁹ In light of the public policy purpose of the rule and the potential negative impacts on the securities discussed below, the Undersigned request that the Agencies also consider whether it is appropriate to provide a permitted activity exemption for (i) securities issued by charitable organizations under Section 501(c)(3) of the Internal Revenue Code that are exempt under section 3(a)(4) of the Securities Act of 1933, as amended, and (ii) obligations issued by Indian tribal governments. See Internal Revenue Service Notice 2009-57.

- (i) We believe there is no policy or credit reason to treat state and municipal agency securities differently from those issued by a state or a political subdivision. The Undersigned are unaware of any evidence to suggest that securities of state or municipal agencies represent higher risks than other municipal securities. In addition, and importantly, the determination of whether or not a particular issuer is a political subdivision versus an agency can only be made on a state by state basis and is not consistent across states. For example, a housing authority might be a political subdivision in one state but an agency in another. Moreover, a municipal issuer may be identified in statutory language as well as offering documents as both an agency and a political subdivision. Obviously so critical a distinction as whether an issuer's securities are the subject of a trading restriction should not be made on the basis of an arbitrary and in some cases confusing standard.
- (ii) Subjecting state and municipal agency obligations to the proprietary trading restrictions would create a two-tiered market for municipal securities without a sound basis for doing so. This will result in agency securities becoming far less liquid and less marketable than they are currently. To compensate for the relative lack of liquidity and marketability, state and municipal agency issuers and the related obligors will be forced to pay higher interest rates than their state or political subdivision counterparts. State and municipal agencies often provide critical infrastructure and services such as water, power, transportation and hospitals. The Undersigned believe that adopting the rule as proposed could seriously impede the ability of those agencies to raise capital, thereby significantly adversely affecting the availability and increase the cost of capital for essential economic sectors and fundamental national priorities.
- (iii) It is also likely that, as drafted, section 6(a) of the Proposals would have negative consequences for the municipal securities market as a whole. As noted above, the municipal securities market is characterized by its large number of unique issuers compared to other markets. The offering document for a particular issue of municipal securities may not include information about the precise status of the issuer within its state. In such circumstances, as well as the circumstances described above with respect to issuers that appear to be both agencies and political subdivisions, market participants may be uncertain about whether for purposes of section 13 a particular municipal security is subject to the proprietary trading prohibition. Those market participants will likely incur increased costs to determine and document the correct status of a particular issuer. In some instances, the answer may be impossible to confirm. This uncertainty may cause the entire municipal securities market to suffer a decrease in liquidity for investors, many of whom are individuals, and an increase in borrowing costs to municipal issuers to compensate investors for greater liquidity risk. In addition, the uncertainty may cause an increase in volatility in the municipal securities market, resulting in higher transaction costs as dealers widen bid/ask spreads in response to decreased liquidity. Further, some institutional market participants such as registered open-end investment companies are subject to liquidity requirements; for them, the uncertainty may result in a decision not to invest in and commit capital to the municipal markets at all, or not to the same extent, which would further constrict the market.

2. **THE AGENCIES SHOULD ADOPT AN ADDITIONAL PERMITTED ACTIVITIES EXEMPTION FOR TRANSACTIONS IN TOB PROGRAM SECURITIES**

- 2.1 **Background:** Proprietary trading is defined as engaging as principal for the trading account of a covered banking entity in any purchase or sale of one or more covered financial positions. Proprietary trading does not include acting solely as agent, broker, or custodian for an unaffiliated third party. Under the Proposals, TOB Program securities would be "covered financial positions" subject to the proprietary trading restrictions even if the municipal security

underlying the TOB Program securities would be exempt from the proprietary trading prohibition by virtue of section 6(a) of the Proposals. We believe that this is the wrong outcome.

2.2 Agency Question 142: Should the Agencies adopt any exemption from the prohibition on proprietary trading under section 13(d)(1)(J) of the BHC Act? If so, what exemption and why? How would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

2.3 Responses:

(a) As noted above, TOB Trusts are at their essence a repackaging and pass-through of the deposited municipal securities. In the context of a proprietary TOB Program, the transfer of the municipal securities from the banking entity to the TOB Trust is ignored for accounting purposes: the Undersigned do not list TOB Residual Interests on their balance sheets; instead, they list the underlying municipal securities on their balance sheets and include the related TOB Floaters as liabilities. In other words, for accounting purposes the TOB Trust is considered merely a pass-through of the municipal security that is deposited into the TOB Trust. However, the effect of the Proposals would be to prohibit proprietary trading in TOB Program securities even if proprietary trading in the underlying municipal security were permitted.²⁰ The Agencies should afford TOB Program securities the same treatment as the underlying municipal securities to which they directly relate.²¹

(b) The Agencies should either separately exempt transactions in TOB Program securities from the proprietary trading restrictions or include them within the exemption for transactions in state and municipal agency obligations that the Undersigned have proposed in section 1 of this letter. As with certain other transactions that Congress expressly permitted in, or excluded from, section 13, transactions in TOB Program securities are undertaken in connection with financing activities. Similar to other financing activities that have been excluded from section 13, banking entities earn fees for providing these TOB Program-related services, which is the principal purpose of entering into these arrangements. Banking entities have provided these services for decades, even during times of extreme market stress. It is not clear that prohibiting transactions in TOB Program securities will further the statutory premise of section 13. The Undersigned believe an exemption would promote the financial stability of the United States by contributing to the financial health of the municipal securities market as well as reducing costs for municipal issuers and the related taxpayers, each of which is a vital component of the national economy.

COVERED FUNDS

3. THE DEFINITION OF 'COVERED FUND' SHOULD NOT INCLUDE A TOB TRUST

3.1 Background: Notwithstanding the use of the terms "private equity fund" and "hedge fund" throughout the statute, the flexibility in the statutory definitional language, and the

²⁰ The Agencies ask in Question 78 of the Proposing Release, in part: "Should the sale of the security by a banking entity to an intermediate entity as part of the creation of the structured security be permitted under one of the exemptions to the prohibition on proprietary trading currently included in the proposed rule (e.g. underwriting or market making)? Why or why not?" If the Agencies adopt an exemption for state and municipal agency obligations as we request in section 1 above, then with respect to TOB Programs such transactions will be permitted by virtue of the government obligations permitted activity exemption. If the Agencies do not adopt this exemption, then the Agencies should include such transactions in the TOB-specific exemption we request in this section 2.

²¹ TOB-related activities identified as permitted activities would still be subject to the backstop prohibitions and limitations. As specifically identified permitted activities under the BHCA generally, a banking entity's activities related to TOB Programs already are subject to the safety and soundness standard that applies to any permitted activity.

recommendations of the Financial Stability Oversight Council ("FSOC"),²² the Proposals define a "covered fund," in part, solely by reference to whether an issuer would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act. TOB Programs rely on either section 3(c)(1) or section 3(c)(7). Therefore, TOB Trusts would be captured by the definition of "covered fund" if adopted as proposed. Unlike many other structured products, TOB Programs as currently structured may not meet the requirements of rule 3a-7, the Investment Company Act rule designed for asset-backed securities programs.²³ Nor could TOB Programs as currently structured satisfy the conditions of any other exclusion or exemption under the Investment Company Act. Moreover, the prohibition on covered transactions between banking entities and a covered fund in the Proposals would prevent a banking entity from providing credit enhancement, liquidity support, remarketing and other services that are necessary in connection with TOB Programs.

3.2 Agency Questions:

- (a) Question 217: Does the proposed rule's definition of "covered fund" effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute?
- (b) Question 221: Should the definition of "covered fund" focus on the characteristics of an entity rather than whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act? If so, what characteristics should be considered and why? Would a definition focusing on an entity's characteristics rather than its form be consistent with the language and purpose of the statute?
- (c) Question 225: Are there any entities that are captured by the proposed rule's definition of "covered fund," the inclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?
- (d) Question 227 (in part): Do[es] the proposed rule's definition[] of "covered fund" ... pose unique concerns or challenges to issuers of asset-backed securities and/or securitization vehicles? If so, why?...Are certain asset classes...more likely to be impacted by the proposed definition of "covered fund" because the issuer cannot rely on an exemption other than 3(c)(1) or 3(c)(7) of the Investment Company Act?

3.3 Responses:

- (a) Congress did not intend to limit banking entities' ownership of and activities with respect to products that are not private equity funds or hedge funds, as these terms are commonly understood. We have been unable to find anything in the statute or the legislative history²⁴ to suggest that Congress meant to include, in the prohibitions

²² "Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds ("FSOC Study"), at 62.

²³ TOB Floaters may be deemed to be redeemable securities and TOB Residual Interest holders typically have the right to buy and sell portfolio assets to capture a gain or avoid a loss, both of which are outside the requirements of rule 3a-7. The Undersigned urge the SEC separately to consider amending rule 3a-7 or providing formal guidance to clarify that TOB Programs may avail themselves of this exemption.

²⁴ The following colloquy on the floor of the House of Representatives between Representative Jim Himes and Representative Frank strongly suggests that Congress intended for the Joint Regulators and the CFTC to have a significant amount of discretion in interpreting the Volcker Rule and in excluding certain entities that rely on the Section 3(c)(1) and Section 3(c)(7) exclusions:

Mr. HIMES. Madam Speaker, I rise to enter into a colloquy with Chairman FRANK. I want to clarify a couple of important issues under section 619 of the bill, the Volcker Rule. The bill would prohibit firms from investing in **traditional** private equity funds and hedge funds (*emphasis added*). Because the bill uses the very broad Investment Company Act approach to define private equity and hedge funds, it could technically apply to lots of corporate structures, and not just the hedge funds and private equity funds.

contained in section 13(a)(1)(B) and section 13(f), entities other than traditional private equity funds and hedge funds. In fact, it is clear that it was precisely those funds (and only those funds) about which Congress was concerned. As the Agencies know, in addition to covering most private equity funds and hedge funds, the Investment Company Act exemptions in the statutory definition also would cover countless securities programs, accounts and investment vehicles (including TOB Programs) that were not meant to be the subject of the legislation. By replacing the terms "private equity fund" and "hedge fund" with the term "covered fund" and narrowly interpreting the statutory definition by ignoring the flexibility it contains (as described in section 3.3(b) below), the Agencies have failed to adhere to the statutory premise that it is the specific characteristics of private equity funds and hedge funds, as those terms are commonly understood, that Congress intended to address. In order to implement the statute as Congress intended, the Agencies must use their authority under section 13(h)(2) and 13(b)(2) of the BHCA to narrow the definition of "covered fund" in section 10(b)(1) of the Proposals.²⁵ The definition should be based upon the specific characteristics of the particular entity, as explained in more detail below.

- (b) The Agencies have the authority to revise the definition of "covered fund." Congress expressly defined both a private equity fund and a hedge fund as a section 3(c)(1) fund or a 3(c)(7) fund "or such similar funds as the [Agencies] may, by rule, as provided in subsection (b)(2), determine." This language permits the Agencies the flexibility either to rely exclusively on the first half of the definition, to expand upon that part of the definition, to shrink it, or to abandon it altogether. As evidenced in the recent hearing of the House Finance Committee, Congress is concerned that the definition of covered fund is too broad. The Undersigned agree with the testimony of SEC Chairman Schapiro that the proper definition of this key term is critical to the proper implementation of BHCA section 13.²⁶ The Undersigned urge the Agencies to redefine "covered fund" to exclude TOB Trusts.
- (c) TOB Programs do not have the characteristics of traditional private equity funds and hedge funds. Section 13(a)(1)(B) of the BHCA was intended to prohibit banking entities from owning and engaging in certain activities with private equity funds and hedge funds. Congress determined that this prohibition was appropriate based upon its conclusion that the risks associated with those funds were often either inappropriately high or insufficiently understood by banking entities.²⁷ Private equity funds are actively managed, often have specific and sometimes aggressive investment objectives and typically invest in equity securities of private companies. Portfolio company securities generally are not the subject of a registration statement or an offering memorandum.

I want to confirm that when firms own or control subsidiaries or joint ventures that are used to hold other investments, that the Volcker Rule won't deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings.

Mr. FRANK of Massachusetts. If the gentleman would yield, let me say, first, you know, there has been some mockery because this bill has a large number of pages, although our bills are smaller, especially on the page. We do that—by the way, there are also other people who complain sometimes that we've left too much discretion to the regulators. It's a complex bill dealing with a lot of subjects, and we want to make sure we get it right, and we want to make sure it's interpreted correctly.

The point the gentleman makes is absolutely correct. We do not want these overdone. We don't want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do.

²⁵ This is consistent with the specific recommendation in the FSOC Study. "The Council recommends that Agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) and consider whether it is appropriate to narrow the statutory definition by rule in some cases." FSOC Study at 62 (citation omitted).

²⁶ Testimony of Mary Schapiro on "Examining the Impact of the Volcker Rule on Markets, Businesses, Investor and Job Creation" (January 18, 2012), available at www.sec.gov/news/testimony/2012/ts011812mls.htm.

²⁷ See 156 Cong Rec S3896 (statement of Sen. Merkely).



Hedge funds are also actively managed and characteristically take large risks based on speculative strategies, generally allow for the fund to take long and short positions, use leverage and derivatives, and invest in multiple markets. Moreover, private equity funds and hedge funds are generally blind pools and investors often have little or no information about the specific issuers of securities held in the fund. In short, private equity funds or hedge funds have well-defined characteristics that differentiate them from other types of funds and investment vehicles.

TOB Programs and, in particular, TOB Trusts, do not share any of the characteristics that would generally define a private equity fund or hedge fund. Specifically, the assets in a TOB Trust typically consist entirely of specifically identified municipal securities,²⁸ which are highly rated securities or otherwise credit enhanced by a highly rated provider. TOB investors receive specific information about each issuer and security in the TOB Trust,²⁹ and the securities are generally the subject of a detailed disclosure statement. Under most circumstances, the TOB Floater holders have the right to tender their interests, for any reason, for a repurchase price equal to 100% of their face amount, plus accrued interest.

Further, as a result of the transparent nature of the TOB Program structure, a banking entity is able to perform its own due diligence on each municipal security when the banking entity is the TOB Residual Interest holder and also when it acts as liquidity provider. Thus, the assets in a TOB Trust expose banking entities to a lower degree of investment risk and the level of transparency is significantly greater than in a true private equity fund or hedge fund. In fact, a reliance on section 3(c)(1) or 3(c)(7) is the only material similarity between TOB Trusts on the one hand and private equity funds and hedge funds on the other hand. This similarity represents a coincidental technical reliance on the same exemption from registration, rather than an indicator of credit or other relevant risk.

- (d) TOB Trusts are economically similar to repurchase agreements, which the Agencies specifically propose to exclude from the prohibitions on proprietary trading. TOB Programs exist because for tax reasons repurchase agreements are not an efficient means of financing in the municipal securities market.³⁰ A TOB Trust in a proprietary TOB Program, from the banking entity's perspective, is not an investment fund at all, but rather a way to finance its ownership of the underlying municipal securities.³¹ Similarly, banking entities enter into repurchase agreements with counterparties who provide cash funding to the banking entity in exchange for exposure to the banking entity's assets and a specified rate of return. As an economic matter, and from the

²⁸ Brokers that underwrite and trade municipal securities are subject to rules of the Municipal Securities Rulemaking Board regarding, among other things, fair dealing, prices and trade reporting.

²⁹ TOB Floater holders are provided with a link to the statement for the underlying municipal securities as posted on EMMA (Electronic Municipal Market Access), the official source for municipal disclosures and market data. See <http://emma.msrb.org>. They also receive a copy of the TOB Program liquidity facility, relevant legal opinions and rating letters. In addition, the municipal securities issuer typically undertakes to provide continuing secondary market disclosure in accordance with Exchange Act rule 15c2-12, which is available to investors and brokers. See GAO Study, at 13.

³⁰ Under the Internal Revenue Code, interest on a municipal security is excludible from the gross income of the owner of the security. Under a repurchase agreement, only one person owns the security that is the subject of the agreement at any point in time, because the security is sold from one person to another, subject to repurchase in the future. As a result, if a repurchase agreement were to be used to finance an investment in municipal securities, only one of the parties to the agreement would receive tax-exempt income at any point in time. TOB Programs were designed to allow multiple parties to share in the ownership of a security (and therefore the tax treatment) simultaneously, thereby providing an economically efficient vehicle for financing investments in tax-exempt municipal securities.

³¹ As noted above, for transactions where a banking entity is the owner of the TOB Residual Interest, it typically does not appear on a banking entity's balance sheet for accounting purposes; rather, the banking entity lists the underlying municipal securities as an asset and the obligation to pay the interest on the TOB Floaters as a liability.

perspective of a banking entity's credit exposure and risk, TOB Trusts are no different, and subjecting them to the covered fund and related restrictions by virtue of the fact that the interests are sold to investors pursuant to a particular section of the Investment Company Act would be to ignore the economic reality of the transaction and focus instead on an unrelated, non-substantive structural characteristic.³²

- (e) TOB Programs address the mismatch between the long-term borrowing needs of municipalities and the short-term investing needs of tax-exempt money market funds. States, political subdivisions and agencies use long-term debt to finance long-term capital projects such as construction of governmental buildings, transportation and other infrastructure projects, water and sewer systems, and health care facilities. Money market mutual funds are permitted to invest only in securities that are of high credit quality and short duration. Through the TOB Program structure, banking entities provide a vehicle that benefits both markets. TOB Programs represent a significant source of funding to municipal issuers. Imposing the restrictions of section 13(a)(1)(B) and 13(f) on TOB Program sponsors and/or institutional investors who are third-party holders of TOB Residual Interests would have significant adverse effects on liquidity and pricing in the municipal securities market. An estimated \$75 - \$100 billion in long-term municipal securities are currently being financed in TOB Trusts. If the activities of TOB Program sponsors and/or third-party institutional investors that are banking entities are subject to section 13(a)(1)(B) and 13(f), then those entities will be forced out of the TOB Program business. Banking entities have created and administer virtually all TOB Programs, because (i) they typically have municipal securities trading desks that allow them to efficiently and effectively perform due diligence on municipal securities to select for investment, and (ii) they can provide the liquidity facility and associated short-term rating necessary for the TOB Program structure. It is unlikely that other industry participants will fill the gap in establishing TOB Programs because they lack the experience, expertise and liquid capital to do so. Accordingly, it is likely that applying section 13(a)(1)(B) and 13(f) to TOB Programs will result in a dramatic decrease in the number and size of TOB Programs, which would eliminate a significant source of funding for the municipal securities market, increasing the cost of funding for the constituents of state and local governments and municipalities. Furthermore, investments in TOB Programs comprise a significant segment of the securities available for municipal money market funds to purchase. In fact, based on recent estimates, TOB Floaters comprise approximately a third of the securities in tax-exempt money market fund portfolios. If the section 13 requirements are imposed on TOB Program sponsors and/or third-party institutional investors, the volume of TOB Programs will be significantly reduced, resulting in far fewer investment opportunities available to the individual and institutional investors in tax-exempt money market funds.
- (f) If TOB Trusts are not excluded from the covered fund definition, then section 13(f) of the BHCA and section 16 of the Proposals would prevent banking entities that sponsor TOB Programs from engaging in many of the activities necessary for a TOB Program to function. The limitation on covered transactions between banking entities and a covered fund would prevent a bank from providing credit enhancement, liquidity support, remarketing and other services required in connection with TOB Programs. Banking entities should be permitted to continue providing these services to a sponsored TOB Program because (i) banking entities have financed municipal securities through TOB Programs for twenty years, (ii) there are not other market participants equipped to assume these responsibilities if banking entities can no longer do so, and (iii) the risks inherent in the TOB Program structure are transparent to banking entities and investors.

³² We believe there are strong arguments to exclude transactions and activities related to TOB Programs from the definition of "covered financial position" based on their economic similarity to repurchase agreements. We urge the Agencies also to seriously consider that approach. See Citi Letter at 12-14.

For all of the reasons set forth above, the Undersigned believe that the Agencies can and should revise the definition of "covered fund" in the Proposals. This approach is simple and effective.³³

CONCLUSION

The Undersigned believe that, as currently drafted, the Proposals unnecessarily impede the ability of banking entities to engage in activities that are vital to the healthy functioning of the municipal securities markets. Accordingly, we urge the Agencies to revise the Proposals to clarify that securities issued by state and municipal agencies are covered in the permitted activity for government obligations or use their authority under section 13(d)(1)(J) to provide an exemption for state and municipal agency securities. With respect to TOB Programs, the Undersigned respectfully request that the Agencies (i) provide a permitted activity exemption for transactions in TOB Program securities, on the basis that TOB Programs are pass through vehicles of municipal securities; and (ii) narrow the definition of "covered fund" to exclude TOB Trusts, as they are clearly distinguishable from private equity funds and hedge funds.

The Undersigned and our counsel are more than happy to respond to any questions that you may have and/or to assist you in developing specific language to implement the proposals in this letter. We could be available to meet with any of the Agencies at your convenience, and/or you may contact us by email or telephone. For your convenience our contact information is attached on Appendix B.

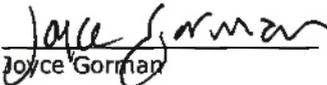
Very truly yours,

ASHURST LLP

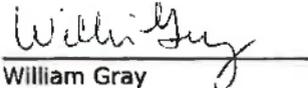
By:


Margaret Sheehan

By:


Joyce Gorman

By:


William Gray

³³ In fact, this may also be the only approach that will provide all of the relief needed to ensure that TOB Programs can continue and that will not force banking entities that own TOB Residual Interests to divest themselves of these interests. The Agencies may be able to use the authority provided under Section 13(d)(1)(J) of the BHCA to address individually some of the issues raised for TOB Programs described in the Background section of this letter. For example, the Agencies could explicitly permit banking entities to sponsor TOB Programs, exempt the purchase and sale of TOB Program securities from the proprietary trading restrictions, permit banking entities to own and hold TOB Residual Interests without restriction, and exclude TOB Programs from the risk retention requirements of Section 15G, all of which would be necessary elements of such an approach. However, there does not seem to be clear authority given to the Agencies to exempt activities required in connection with the functioning of a TOB Program from the limitations contained in section 16 of the Proposals regarding impermissible relationships between covered funds and certain entities, such as sponsors of covered funds. These limitations would prevent TOB Program sponsors from, among other things (i) providing the liquidity and remarketing services needed to establish TOB Trusts; (ii) providing credit enhancement; or (iii) undertaking other contractual arrangements with respect to the TOB Trust. The ability to engage in these activities is essential to the functioning of a TOB Program.

JPMORGAN CHASE & CO.



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Barry L. Zubrow

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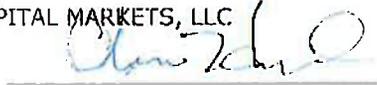
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By: 
Svetlana Segal

Title: Vice President

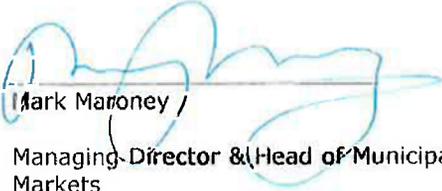
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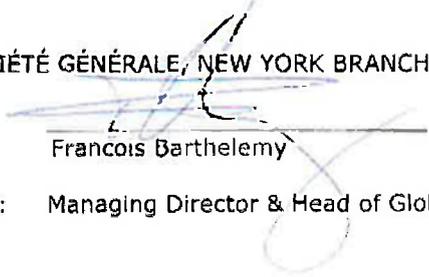
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Mark Maroney /

Title: Managing Director & Head of Municipal Capital Markets

SOCIÉTÉ GÉNÉRALE, NEW YORK BRANCH

By:



Francois Barthelemy

Title: Managing Director & Head of Global Markets

DESCRIPTION OF TOB PROGRAM ASSETS AND TOB PROGRAM STRUCTURE**TOB Program Assets**

Typically the TOB Trust assets consist of a single issue of highly rated, fixed rate, long-term municipal securities¹ of a municipal issuer.² In the less common instance in which TOB Trust assets consist of the securities of more than one municipal issuer, the TOB Trust has specific, written deposit criteria governing the eligibility of assets for deposit. In either case, because the municipal securities deposited and/or eligible for deposit are both limited and specified in advance, holders of both classes of TOB Program certificates know exactly what assets are (or in the future may be) deposited in the TOB Trust. In addition, if additional deposits are permitted in accordance with the established eligibility criteria, the investors holding TOB Floaters are apprised in advance of any such deposit and may elect not to continue their investment after the deposit, in which case they are entitled to payment of their TOB Floaters at par.

In order to ensure that the TOB Floaters meet the portfolio security eligibility requirements of Rule 2a-7, the municipal securities in a TOB Trust either are rated Aa3/AA- (or the equivalent) or better by an independent credit rating agency or are the subject of a credit enhancement arrangement that results in a rating of at least Aa3/AA-. An official statement or other detailed disclosure document covers each offering of municipal securities, and the antifraud provisions of the securities laws apply to purchases and sales. In cases where there may not be a detailed underlying disclosure document, the underlying municipal securities are wrapped by credit enhancement and the TOB Trust provides the TOB Floater holders and the TOB Residual Interest holder with disclosure about the credit enhancement.

The disclosure document for each TOB transaction is robust and includes a description of the TOB Program structure and a description of the underlying tax-exempt municipal bonds. TOB Floater holders are also provided with a link to the relevant official statement for the underlying tax-exempt municipal bonds as posted on EMMA, the liquidity facility, legal opinions and rating letters. In addition, in connection with the closing of the underlying bond transaction, the issuers of underlying tax-exempt municipal bonds have typically agreed to provide continuing secondary market disclosure in accordance with Rule 15c2-12 of the Exchange Act.

Because a secondary market generally exists for municipal securities, they are liquid and are capable of being marked to market. The broker-dealers selling municipal securities are also subject to the antifraud provisions of the federal securities laws as well as the disclosure and sales practice rules of the Financial Industry Regulatory Authority. Municipal securities offer a steady income stream, making them a common component of investors' portfolios.

¹ For the sake of brevity the Undersigned have limited the focus of this letter to TOB Programs designed to finance direct ownership interests in tax-exempt municipal securities, which constitute most of the TOB Program market. We note that TOB Programs are prominent in the financing of securities in both the primary and secondary market and, in limited circumstances, may be used to finance taxable municipal securities, credit enhanced municipal securities and shares of registered municipal investment companies. We believe the discussions and recommendations described herein would apply to all securities financed in TOB Programs and, as such, the Undersigned respectfully request that the Agencies provide the relief described herein on that basis.

² The municipal issuer generally does not work with or coordinate with any TOB Program sponsor when issuing the municipal securities, although a TOB Program Sponsor or an affiliate that is a broker-dealer may on occasion participate in the underwriting of the underlying municipal securities, subject to applicable securities laws and other customary legal and rating agency requirements.

TOB Floaters

TOB Floaters are variable rate, short-term, high quality, liquid securities. TOB Floaters bear interest at a variable interest rate, reset periodically based on prevailing short-term tax-exempt market rates, which generally are lower than the fixed rate payable on the underlying municipal securities. Under most circumstances, the TOB Floater holders have the right to tender their interests, for any reason or no reason, for a repurchase price equal to 100% of the face amount of the TOB Floaters, plus accrued interest.³ The tender option allows those TOB Floater holders that are money market funds (offering a stable net asset value of \$1 per share pursuant to Rule 2a-7) to treat the TOB Floaters as having an extremely short maturity, i.e., the next interest rate reset date.

The purchase of TOB Floaters is generally limited to "Qualified Institutional Buyers," as defined in Rule 144A under the Securities Act of 1933 and "Qualified Purchasers," as defined in section 2(a)(51)(A) of the Investment Company Act of 1940, who possess such "knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of an investment in...and are able and prepared to bear the economic risk of investing in" the TOB Floaters. Any investor who purchases TOB Floaters must, prior to investing, provide written attestation of the foregoing. The primary buyers of TOB Floaters are Rule 2a-7-regulated, tax-exempt money market funds. For this reason, if there are any future changes to the credit quality requirements of Rule 2a-7, TOB Program sponsors are expected to amend TOB Program terms to conform to the new credit requirements so that TOB Floaters are eligible securities.

The tender option feature of TOB Floaters is made possible through a liquidity facility that provides funds for payment of both principal and interest on the TOB Floaters whenever a TOB Floater holder exercises its tender option or a TOB Floater is called for mandatory tender.⁴ The liquidity facility⁵ may be provided by the TOB Program Sponsor, one of its affiliates or another bank or other entity. The liquidity provider's obligation to pay the TOB Floater holders terminates without notice upon the occurrence of any of the following very limited and remote events known as "TOTES" (an acronym for "Tender Option Termination Events"): a default on the underlying municipal securities and credit enhancement, where applicable; a credit rating downgrade below investment grade; the bankruptcy of the issuer and, when applicable, the credit enhancer; or the determination that the municipal securities are taxable. (Inclusion of TOTES in TOB Program structures is required for tax reasons.)

In some instances, the liquidity provider is the same entity as, or an affiliate of, the holder of the TOB Residual Interest. When that is not the case, the liquidity provider may require that the holder of the TOB Residual Interest enter into a reimbursement agreement with the liquidity provider to reimburse the liquidity provider for all amounts paid to TOB Floater holders and not otherwise reimbursed from a remarketing of tendered TOB Floaters or, if the TOB Floaters are not remarketed, from the proceeds of sale of the municipal securities. Because the liquidity provider bears the market risk of any difference between the par amount of TOB Floaters outstanding and the market value of the municipal securities (whose sale would generate proceeds to reimburse the liquidity provider for any

³ TOB Floaters also are subject to mandatory tender under certain circumstances.

⁴ The TOB Floaters have a short-term credit rating (based on the short-term rating of the liquidity provider) as well as a long-term credit rating (based on the credit quality of the assets on deposit in the TOB Trust, including any credit enhancement). The combination of a high quality credit rating and a short-term rating makes TOB Floaters eligible for purchase by money market funds.

⁵ In some TOB Programs, often described as "net liquidity" TOB Programs, the liquidity provider does not have an obligation to pay the full purchase price of TOB Floaters that have been tendered but not successfully remarketed. Instead, the first source of funds for the redemption of TOB Floaters is the sale proceeds of the municipal securities in the TOB Trust; the liquidity provider's obligation is a standby obligation to pay an amount equal to the difference, if any, between the aggregate redemption price of the tendered but unremarketed TOB Floaters and the aggregate proceeds of the sale of the municipal securities.

liquidity draws) the liquidity provider typically has the right to direct the termination of the TOB Trust prior to the occurrence of a TOTE. If the liquidity provider exercises this termination right, it must pay the TOB Floater holders in full.

TOB Residual Interest

The TOB Trust issues a TOB Residual Interest that effectively creates the economic equivalent of a leveraged position in the underlying municipal securities. The price of the TOB Residual Interest is generally reflective of the amount of leverage, which is generally similar to the leverage under a repurchase agreement. The TOB Residual Interest holder receives all interest on the municipal securities not paid to the TOB Floater holders (net of the TOB Trust's expenses) as well as typically 90-95% of any gain share recognized upon any sale of the municipal securities. The TOB Residual Interest holder has the right, exercisable at periodic intervals, to cause the sale of the municipal securities and the forced redemption of the TOB Floaters for 100% of par value plus accrued interest and the applicable Gain Share. TOB Residual Interests typically have significant restrictions on transfer. In addition, there is no established secondary market for TOB Residual Interests.

In many cases, the TOB Residual Interest holder is the TOB Program sponsor or an affiliate of the TOB Program sponsor. In cases in which the TOB Residual Interest holder is not the TOB Program sponsor or an affiliate, it is a third-party institutional investor and in some limited cases, a high net worth investor.

Tax and Accounting Treatment of TOB Program Certificates

TOB Program sponsors design TOB Programs so that the tax-free nature of the income on the underlying municipal securities passes through to the TOB Floater holders and the TOB Residual Interest holder. In order to ensure pass-through tax treatment, TOB Programs provide for termination of the liquidity facility upon the occurrence of a TOTE, the pro rata sharing of credit risk as between the TOB Floater holders and the TOB Residual Interest holder, and the gain share payable to TOB Floater holders. These features provide the necessary indicia of ownership to allow the income to remain tax-free to the holders of the TOB receipts.

For accounting purposes, the TOB Residual Interest holder typically carries the underlying municipal securities as assets and the TOB Floaters as debt, because the TOB Residual Interest holder is acquiring the municipal securities and financing its acquisition with the proceeds of the TOB Floaters.

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