



STATE STREET.

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**VIA ELECTRONIC MAIL: RULE-COMMENTS@SEC.GOV**

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Comments to Proposed Rules under the Securities Exchange Act of 1934  
for Asset-Backed Securities, Release Nos. 33-9117; 34-61858; File No.  
S7-08-10

Dear Ms. Murphy:

State Street Bank and Trust Company and its affiliates (“**State Street**”), in our capacity as sponsor to certain municipal tender option bond programs, submit this letter in response to the request for comments of the Securities and Exchange Commission (the “**SEC**” or “**Commission**”) on the Proposed Rules for Asset-Backed Securities (Release Nos. 33-9117; 34-61858; File No. S7-08-10) (the “**Proposed Rules**”).

In the wake of the “credit crisis,” significant changes in the rules pertaining to “structured finance products” are being made. Specifically, the SEC will be promulgating rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”), has recently adopted revisions to SEC Rule 17g-5 and, pursuant to the Proposed Rules, has proposed revisions to SEC Rule 144A (“**Rule 144A**”). The changes will extend the scope of securities law regulation for a variety of structured products, such as CDOs and other privately placed structured products.

While the scope of these changes remains subject to regulatory interpretation, the proposed definition of “structured finance product” could encompass municipal tender option bond programs (“**TOBs**”), as further described below.<sup>1</sup> As discussed below, we

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<sup>1</sup> The release for the Proposed Rules states that the proposed definition of “structured finance product” is intended to be “broadly defined... to reflect the wide range of securitization products that are sold in the

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believe TOBs are fundamentally different from the structured finance products that are the intended focus of current regulatory efforts and should not be subject to regulations applicable to structured finance products.<sup>2</sup>

### **Role of TOBs in the Municipal Securities and Mutual Fund Markets**

TOBs are arrangements under which highly-rated, tax-exempt municipal securities (“**municipal bonds**”) are deposited into trusts (“**TOB trusts**”) that issue floating rate certificates (“**Floater**”) and inverse floating rate certificates (“**Inverse Floater**”) in respect of such municipal bonds. The Floaters are generally marketed to tax-exempt money market mutual funds and other short-term institutional investors, while the Inverse Floaters are marketed to banks, funds and other long-term institutional investors in municipal bonds.

TOBs are an important component of the approximately \$2.8 trillion municipal bond market and approximately \$343 billion tax-exempt money market mutual fund market. As of 2007, there were over \$200 billion of TOBs outstanding, although such amount has dropped to \$80 billion in the wake of the credit crisis.<sup>3</sup> Over the past twenty years and throughout the credit crisis, TOBs have represented a sizable portion of the supply of short-term tax-exempt investments available to tax-exempt money market mutual funds.

In addition, TOBs provide a vital financing method for long-term investors in municipal bonds, allowing them to finance their investments at short-term tax-exempt rates. This financing method is crucial to long-term institutional investors in the municipal securities market, as there is no “repo” market available for tax-exempt municipal bonds, thereby making TOBs the primary source of short-term funding for these investments. This method of financing, by also opening the long-term municipal securities market to short-term institutional investors, serves the added public benefit of absorbing a portion of the large supply of long-term municipal bonds issued by states and local governmental entities (“**municipal issuers**”).

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private markets” and would cover “a security that at the time of the offering is commonly known as an asset-backed security or a structured finance product.”

<sup>2</sup> Given the timing of the various regulatory efforts relating to structured finance products, this letter is being submitted to comply with the deadline for comments on the Proposed Rules. However, we believe this letter can also help provide additional information to the SEC regarding the nature of TOBs for future consideration when developing regulations under the Dodd-Frank Act.

<sup>3</sup> Figures for the size of the municipal bond market, tax-exempt money market mutual fund market and TOB market taken from The Wall Street Journal (June 13, 2010), The Bond Buyer (July 29, 2010) and The Bond Buyer (April 20, 2010), respectively.

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There exists strong demand for TOB Floaters because of the relatively limited supply of short-term municipal securities. This supply limitation exists because of the preference of municipal issuers to issue term debt with maturities of ten to thirty years, in order to “lock in” their debt service costs. This preference has only increased since the credit crisis, and has been facilitated by the Build America Bond program for long-term taxable municipal bonds. Money market funds, however, can invest only in short-term instruments under SEC Rule 2a-7 promulgated under the Investment Company Act of 1940 (“**Rule 2a-7**”). TOBs enable short-term tax-exempt money market funds to invest in long-term municipal bonds by effectively attaching onto the bonds a liquidity demand feature or “put option” that meets the eligibility criteria of Rule 2a-7.

### **General Structure of a TOB**

TOB trusts are typically organized as common law or statutory trusts under New York or Delaware law, and are permitted to invest only in municipal bonds. A primary consideration in the structure of TOB trusts holding tax-exempt municipal bonds is to allow the interest paid on the underlying municipal bonds to be passed through to TOB investors without losing its tax-exempt character.

A TOB trust typically issues only two classes of securities in respect of the municipal bonds that it holds (the aforementioned Floaters and Inverse Floaters and, together, the “**TOB securities**”). Upon the occurrence of a default, obligor bankruptcy, downgrade below investment grade or final determination of taxability of the municipal bond (each a “**Termination Event**”), each holder of Floaters and Inverse Floaters suffers a proportionate loss.

The Floater certificate issued by the TOB trust evidences a principal amount of each underlying municipal bond, plus the right to receive interest at a floating rate that is reset periodically (generally weekly) to reflect current short-term tax-exempt interest rates. The Floaters also evidence the right of their holder (*i.e.*, the money market fund) to tender such securities back to the TOB trust for par plus accrued interest thereon, typically on seven days’ notice (such right, the “**put option**”).

Upon exercise of the put option, a broker-dealer acting as agent of the TOB trust (the “**Remarketing Agent**”) attempts to remarket the tendered Floater to a subsequent holder. Payment to a Floater holder exercising the put option is made from the proceeds of such remarketing. In the event the Remarketing Agent is unable to remarket the Floaters to a new short-term investor, the put option is payable from a draw made under a liquidity facility (the “**Liquidity Facility**”) issued to the TOB trust. Such Liquidity Facility is issued to the TOB trust by a financial institution (the “**Liquidity Provider**”).

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carrying a high short-term rating so that the Floater qualifies as an “Eligible Security” under Rule 2a-7.<sup>4</sup>

The Inverse Floater issued by the TOB trust entitles its holder to receive its *pro rata* share of principal repayments on the underlying municipal bonds, plus interest at a rate equal to (a) the interest accrued on such underlying bonds minus (b) the sum of the interest payable to Floaters holders and the fees payable to the TOB trustee, the Liquidity Provider and the Remarketing Agent. Typically, the Inverse Floater also evidences the right of its holder to cause the Floaters to be redeemed at a price equal to par plus accrued interest thereon. Thus, the TOB trust effectively replicates the economics of a repo financing of the underlying municipal bonds by the Inverse Floater holder, but without compromising the tax-exempt character of the interest payments.

Floaters and Inverse Floaters issued by the TOB trust are sold only to “accredited investors” as defined in Regulation D or “qualified institutional buyers” as defined in Rule 144A, with resales limited to qualified institutional buyers under Rule 144A. As a result, the revisions to Rule 144A described in the Proposed Rules would affect the TOB market if TOBs were deemed to be “structured finance products.”

### **Fundamental Differences between TOBs and Structured Finance Products**

While TOBs may share certain features of structured finance products (*e.g.*, the creation of a trust to hold assets and issue securities), TOBs are fundamentally different from structured finance products.

#### *Extensive Disclosure Regarding Underlying Assets*

TOB securities investors receive extensive disclosure on the underlying municipal bonds (and the identity of the Liquidity Provider), which are specifically identified in the TOB trust documentation at the time municipal bonds are deposited into the TOB trust. This permits each TOB securities investor to conduct its own analysis of the risks of each municipal bond and the Liquidity Provider prior to its purchase of a Floater or Inverse Floater.

In this regard, TOBs are significantly different from the structured finance products that are the intended focus of the Proposed Rules. Unlike mortgages, auto loans and the assets of certain other types of structured finance products, each underlying asset of a TOB trust (*i.e.*, each municipal bond) is a security issued under applicable securities laws, generally pursuant to an official statement of a municipal issuer (an “**official**

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<sup>4</sup> The Liquidity Facilities for TOBs holding tax-exempt municipal bonds automatically terminate upon the occurrence of any Termination Event described above, such that the holders of both classes of TOB securities become exposed to losses on the underlying municipal bonds.

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**statement**) subject to the standards of SEC Rule 10b-5 (“**Rule 10b-5**”). Municipal bonds are also subject to the ongoing disclosure requirements of SEC Rule 15c2-12 (“**Rule 15c2-12**”), including regular filings with the Electronic Municipal Market Access website (“**EMMA**”) established by the Municipal Securities Rulemaking Board (the “**MSRB**”). Each investor in a TOB security essentially purchases a receipt evidencing its ownership of (or a right to receive payments secured by) the municipal bonds described in such official statement and filings.

It is noteworthy that this official statement is the same document provided to *retail* investors in the same municipal bonds, and is made available to each *institutional* investor purchasing the TOB securities. In the case of TOB trusts holding more than one municipal bond, the official statements for each municipal bond in the trust are provided to the purchasers of the TOB securities, regardless of whether the TOB trust holds only a *de minimis* investment in any one such underlying bond. Finally, the ongoing disclosures made by the underlying municipal issuers pursuant to Rule 15c2-12 are publicly available on EMMA, which enables each TOB security investor to monitor credit quality and material events on the assets underlying the TOB trust.

Moreover, while many sponsors of structured finance products are (or are related to) the originator of the underlying assets or collateral, the municipal bonds deposited into TOB trusts are often purchased by TOB sponsors in the secondary market in reliance upon existing disclosures of the related municipal issuers. Thus there is generally no relationship between the issuer of the municipal bonds and the TOB trust or TOB sponsor. Accordingly, there is no opportunity for the TOB trust or TOB sponsor to obtain more information about the underlying assets than any other investor. Rather, the TOB sponsor and TOB securities investors rely upon the official statement and EMMA filings made by the municipal issuers, which are the same disclosures used for resales of municipal bonds in the retail markets.

Thus, TOB securities investors receive more information concerning the underlying assets than do investors in typical consumer receivable and asset-backed securitizations, including ongoing disclosure directly from the underlying obligors, which disclosure is available for each asset without regard to minimum concentration thresholds.

Finally, in addition to the existing disclosure for the municipal bonds underlying TOB securities, a private placement memorandum containing additional material terms is prepared with respect to the TOB trust itself, including disclosure about the terms of the TOB trust agreement, the Liquidity Facility, the Liquidity Provider, any credit enhancement (if applicable), the fees payable to the trustee, Remarketing Agent and Liquidity Provider, and the tax treatment of the TOB securities. The TOB disclosure

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document is prepared by the sponsor of the TOB trust and, like the disclosure document for the municipal bonds, is subject to Rule 10b-5 standards.

*No Servicing of Assets; No Asset Managers*

Unlike typical asset-backed securitizations and structured finance products, the assets underlying a TOB trust are neither actively managed nor serviced.

The municipal bonds that will be held by a TOB trust are specified at the inception of the transaction. For instance, the TOB trust documentation may specify a particular issuer and municipal bond issue as the only asset in which the TOB trust may invest, in which case the TOB trust may only increase or decrease the principal amount of such investment (a “**single bond trust**”). In other cases, the TOB trust documentation may provide that the TOB securities investors are permitted to acquire multiple municipal bonds sharing distinct, predetermined criteria (a “**multiple bond trust**”).<sup>5</sup> In addition, in a multiple bond trust each new deposit is subject to approval by all investors in the TOB trust (*i.e.*, by virtue of the Floaters’ put option and the Inverse Floaters’ right to object to deposits of additional municipal bonds).

Whether the TOB trust is a single bond trust or a multiple bond trust, the features described herein are applied proportionately to each TOB security on a bond-by-bond basis. Accordingly, the deposit into a TOB trust of more than one municipal bond is generally for administrative purposes (*i.e.*, to lower transaction costs by essentially combining multiple single bond trusts into one set of trust documents), and not for the purpose of “pooling” credits in support of one another.

In a TOB transaction, payments on each underlying municipal bond are passed through to pay principal and interest at the applicable accrued rates to each class of investors and to pay fees as and when received by the TOB trust. Although the holders of the Floaters and Inverse Floaters receive different amounts in respect of interest (due to the floating and inverse floating nature of interest payments on TOB securities), the cumulative amount of payments owed by the TOB trust always equals the amount due on the underlying bonds. Deficiencies in amounts due to TOB investors arise solely due to defaults by a related municipal bond issuer in the payment due on its bond (subject to any credit enhancement also deposited into the TOB trust in support of any such bond). Such a default results in the prompt distribution to TOB investors of either the defaulted bond (an in-kind distribution) or proceeds from the liquidation thereof (if such proceeds would

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<sup>5</sup> Typically, these criteria may require each municipal bond in the TOB trust to be issued by municipal issuers of the same State, be rated no less than a minimum rating of “AA-” or an equivalent rating from another nationally recognized statistical rating organization, and in any case are subject to any other features required by money market investors to comply with the provisions of Rule 2a-7 regarding the monitoring of portfolio quality and diversification.

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be sufficient to redeem a proportionate amount of both classes of TOB securities evidencing such defaulted bond).

As a result of the foregoing passive investment dynamic, there is no servicer or manager responsible for determining whether or when to sell the defaulted bond or to pursue remedies against the defaulting bond issuer (or credit enhancer). As described above, any loss resulting from the default is borne by each class of TOB investors on a *pro rata* basis to the same degree as any other investor in such municipal bond.

### *Much Greater Liquidity Than Structured Finance Products*

TOB securities do not present the same “liquidity of investment” concerns that face investors in structured finance products. As previously discussed, each class of TOB securities investors owns an interest in one or more highly-rated municipal bonds. In the case of a market disruption or other event affecting underlying asset quality or prices, TOB securities investors have the benefit of ample safeguards.

First, information concerning each municipal bond in the TOB trust is disclosed in an official statement and EMMA filings that are used in the retail market and available to each TOB securities investor.

Second, TOB Inverse Floater investors generally have the right to cause the related TOB Floaters to be called and redeemed at par plus accrued interest at any time, typically upon three days’ notice, at which time the underlying municipal bonds may be resold in the municipal securities market to reimburse the TOB Inverse Floater investor.

Third, TOB Floater investors have the right to put their Floaters at a price of par plus accrued interest, typically upon seven days’ notice. Upon the exercise of such option, a Remarketing Agent attempts to sell the Floater to a new investor in the short-term markets, and a highly-rated financial institution is obligated to fund draws under a Liquidity Facility in the event a new investor is not found.

Finally, in the case of a failure of the Liquidity Provider to honor a draw on the Liquidity Facility, the TOB trust is automatically terminated, with all investors receiving either the cash proceeds of the underlying municipal bonds (if such proceeds would be sufficient to redeem all of the TOB securities issued by the TOB trust) or an in-kind distribution of the underlying municipal bonds, which may be sold in the municipal securities market.

Accordingly, TOBs do not present the same “liquidity of investment” concerns that face investors in structured finance products. This is due to the mechanics of the TOB transaction, which are modeled after repo financing, the provision of a put option

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for the benefit of TOB Floater investors, and the strength and liquidity of the underlying municipal securities market.

### *Ratings Based Upon Entities, Not Structural Elements*

Unlike typical structured finance products, it has been our observation that the ratings on TOB securities are a direct function of the credit rating of the underlying municipal bonds (or any credit enhancer) and that of the Liquidity Provider, rather than the structural elements of the TOB trust. We have observed that TOB securities have the following:

- a long-term rating that reflects the likelihood of payment when due on the underlying municipal bond, which is based solely upon the credit of the issuer of the municipal bond (or any credit enhancement, as described in footnote 6 below), and
- a short-term rating (for the Floater only) that reflects the likelihood of payment when due upon the Floater holder's exercise of the put option, which is based solely upon the short-term credit of the Liquidity Provider.

### *No Transfer of Default, Bankruptcy or Tax Risk from One Class of Investors to Another*

An investor in TOB securities acquires an interest in one or more municipal bonds and, in the case of the Floater holder, a put on the bonds at a price of par plus accrued interest. However, this put option is conditional, in that it does not protect the Floater holder from loss upon a determination that interest payments on a municipal bond are taxable, or upon a payment default, obligor bankruptcy or downgrade below investment grade of such bond. In these cases, the risk of loss on the municipal bond is borne by the holders of both classes of TOB securities on a *pro rata* basis.<sup>6</sup> Accordingly, unlike structured finance products, a TOB trust does not seek to tranche, subordinate or otherwise transfer default, bankruptcy or tax risk (or the risk of a downgrade below investment grade) from one class of investors to another.

### **TOBs Should Not Be Regulated as Structured Finance Products**

The Proposed Rules have the important goal of providing investors in the structured finance market with detailed information regarding underlying financial assets and receivables, as well as structuring risks. However, the enhanced disclosure required

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<sup>6</sup> In some TOB transactions, a form of secondary market credit enhancement may be added to certain bonds in the form of a guaranty or similar credit facility provided by a highly-rated financial institution (“**credit enhancement**”). This credit enhancement is an additional asset of the TOB trust for the benefit of both classes of TOB securities, both of which remain at risk for the failure of the credit enhancement.

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by revised Rule 144A described in the Proposed Rules would provide little, if any, additional relevant information to a TOB securities investor. This is due to the fact that TOB securities are comprised of one class of securities that is acquired by its holder to obtain a municipal bond attached to a put option, along with a second class of securities that is acquired by its holder to obtain a long-term interest in the same municipal bond, but subject to such other investor's put option.

Moreover, because the sponsor of the TOB trust is not the underlying municipal issuer, it can provide no greater disclosure than the mere identity of the underlying municipal bonds. This is acceptable to the investors in the TOB securities because they instead rely on the official statement and current EMMA disclosures available from the municipal issuer, each of which is subject to Rule 10b-5 standards.

In addition, any trust-specific disclosures (*e.g.*, information concerning the Liquidity Provider, the fees payable to the TOB trustee, Liquidity Provider and Remarketing Agent, as well as amendment and other similar provisions), are disclosed in a separate disclosure document prepared by the TOB sponsor. As with each underlying official statement, this disclosure document is subject to Rule 10b-5 standards.

As a result, the enhanced disclosures required under revised Rule 144A are unnecessary with respect to the marketing of TOB securities, and would present a standard that could not be met by anyone other than the underlying municipal issuers. Thus, the application of revised Rule 144A to TOBs would impose an unworkable standard on TOB issuers, which standard would nevertheless produce no incremental benefit to the investors in TOB securities. We are therefore concerned that if TOBs are not expressly removed from the scope of the proposed revisions to Rule 144A, then TOB sponsors such as State Street could be unable to continue their sponsorship of TOB programs.

In summary, it is not appropriate to impose upon a Rule 144A sale of TOB securities a requirement to provide the kind of information that would be required if the transaction were registered under the Securities Act of 1933 (the "**33 Act**"). Municipal bonds themselves are not subject to registration under the 33 Act and are already offered to *retail* investors under disclosure documents that are subject to Rule 10b-5 standards of the securities laws (and to the ongoing reporting requirements of Rule 15c2-12). These same disclosure materials are available to TOB investors. Accordingly, to apply the revised Rule 144A described in the Proposed Rules to TOB securities would have the anomalous effect of imposing upon sponsors of TOB trusts the obligation to provide more disclosure about the municipal bonds than the municipal issuers themselves, notwithstanding the fact that TOB securities are only sold to institutional investors and, in the case of Floaters, have the benefit of a put at par.

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*Request for Relief*

Accordingly, we request that the Commission either revise its definition of “structured finance product” or clarify in the issuing release for its final rulemaking that “structured finance products” will be deemed not to include any “municipal tender option bond securities.”

For purposes of the foregoing request, we propose that "municipal tender option bond securities" include any securities that:

- (i) are privately offered and subject to resale by their terms in accordance with Rule 144A;
- (ii) evidence an interest in or right to receive payment from one or more underlying assets, each of which is a municipal security the issuer (or other obligated person, if applicable) of which has undertaken to provide for the benefit of the holders thereof ongoing disclosure of the material events required under applicable securities laws;
- (iii) are on parity with each other in respect of the right to receive principal payments on each underlying municipal security; and
- (iv) at least one class of which is an “Eligible Security” under Rule 2a-7 at the time of its issuance.

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We thank the Commission for the opportunity to submit the foregoing comments on the Proposed Rules. We would be happy to discuss with you our comments or any other matters that would be helpful in connection with the finalization of the Proposed Rules.

Sincerely,



Frederick M. Ramos II  
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