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Treasury and IRS Re-Propose Issue Price Rules.

WASHINGTON - The Treasury Department and Internal Revenue Service released new proposed rules on the definition of issue price that market participants consider to be a significant improvement over rules proposed on the topic in 2013.

The re-proposed rules, which were released Tuesday and are scheduled to appear in Wednesday's edition of the Federal Register, would allow issuers to rely on the initial offering price under certain circumstances and provide a narrower definition of an underwriter. The document that contains the re-proposed rules also withdraws issue price rules proposed in September 2013.

"[The new proposal] provides more flexibility than the 2013 proposal," said Michael Decker, managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association.

"Based on an initial reading, the new proposal is a vast improvement over the 2013 issue price amendments," said Mike Nicholas, chief executive officer of the Bond Dealers of America. "Retaining the current regulatory framework for establishing issue price based on a substantial amount of an issuance being sold and providing a mechanism to permit reliance on the initial offering prices are especially positive developments for the municipal market."

National Association of Bond Lawyers president Tony Martini said there's "a lot to be encouraged by" in the new proposal.

The re-proposed rules apply to bonds that are sold at least 90 days after the rules are adopted in final form, but issuers can rely on them for bonds sold on or after Wednesday, the regulators said. A public hearing on the proposal is scheduled for Oct. 28.

Issue price is used to determine the yield on bonds for purposes of arbitrage investment restrictions.

Existing rules generally provide that the issue price of a maturity is the first price at which a substantial amount of the bonds is sold to the public, with substantial defined as 10%. But for bonds that are publicly offered, the issue price is the first price at which 10% of the bonds are reasonably expected to be sold to the public. When there is a bona fide public offering, the issue price is determined as of the sale date - the date when the underwriter signs the agreement to buy the bonds from the issuer and when the terms of the bonds are set — based on reasonable expectations of the initial offering price.

The rules proposed in 2013 eliminated the "reasonable expectations" standard and the definition of substantial as 10%. Instead, they provided a safe harbor that would allow the issuer to treat as the issue price of a maturity the first price at which at least 25% of the bonds is sold to the "public," with that term referring to anyone other than an "underwriter."

Those rules defined underwriter as "any person that purchases bonds from the issuer for the purpose of effecting the original distribution of the bonds, or otherwise participates directly or

indirectly in the original distribution."

Market participants raised a number of concerns about the issue price rules proposed in 2013 and wanted them to be withdrawn or re-proposed. The new proposed rules aim to address market participants' concerns about the 2013 proposed rules.

Kim Betterton, a partner at Ballard Spahr in Baltimore who took the lead on NABL's comments on the 2013 proposal, said it looks like Treasury and the IRS accepted most of NABL's suggestions.

Under the re-proposed regulations, as in the existing regulations, the general rule would remain that the issue price is the first price at which 10% is sold to the public. But issuers could use an alternative method to determine issue price if 10% of a maturity hasn't been sold by the sale date. In those cases, an issuer could use the initial offering price to the public as of the sale date as the issue price if certain requirements are met. Those requirements include that the underwriters fill all orders from the public on or before the sale date at the initial offering price, and that the lead or sole underwriter provide a certification that no underwriter will fill an order from the public after the sale date and before the issue date at a higher price than the initial offering price unless the market moves after the sale date.

Underwriters could document the initial offering price with a copy of the pricing wire. They should document an order that's higher than the initial offering price after the sale date by including both pricing information and information regarding the corresponding market change, such as proof that there were changes to the values of a muni interest rate index, Treasury and the IRS said.

"The issuer must not know or have reason to know, after exercising due diligence, that the certifications are false," the agencies said.

Market participants had some questions about the alternative method.

Decker said he thought the regulators' proposal could suggest that if the market moves, the price of bonds may have to keep the same spread compared to the index. However, that approach doesn't take into account market reasons why the spread could change.

Since the certification would be a new requirement for underwriters, it's unclear how easy it would be for the underwriters to comply with it, Decker said.

Betterton said she wants to make sure that underwriters can comply with the certification requirements and wants to get more information about the documents needed to demonstrate market changes.

She and Matthias Edrich, a lawyer at Kutak Rock, both said that there could be clarifications about what type of due diligence issuers would need to do to determine the veracity of the underwriters' certifications.

The re-proposed rules define underwriter to include anyone who "contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or into a contract with a lead underwriter to form an underwriting syndicate" and anyone who directly or indirectly enters into a contract or other arrangement to sell the bonds with any of the syndicate members.

Tom Vander Molen, a partner at Dorsey and Whitney in Minneapolis, said he particularly appreciates "the recognition that a dealer without a contract before the sale date is considered part of the 'public.'"

The Bond Buyer

by Naomi Jagoda

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