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Final Issue Price Rules Make Allowances for Competitive Sales.

WASHINGTON – The Treasury Department and Internal Revenue Service have finalized issue price rules that contain special allowances for competitive sales.

Under the rules, which are to be published in the Federal Register on Dec. 9 and would take effect 180 days later, the issue price for competitive sales will be the reasonably expected initial offering price if several certain conditions are met, including that the issuer receives bids for the bonds from three underwriters.

The rules also clarify that, for bonds issued for money in a private placement to a single buyer that is not an underwriter or related party, the issue price is the price paid by that buyer.

In addition, the rules contain a simplified "hold-the-offering-price" anti-abuse rule, place less emphasis on certifications, and narrow the definition of an underwriter.

"We tried to respond to the comments and make the final rules more flexible and more workable," said John Cross, Treasury's associate tax legislative counsel.

On competitive sales, Cross said, "As a policymaker, we think that competitive sales promote competition and price transparency and we wanted to provide a workable rule to accommodate this important market sector."

Market participants praised some aspects of the new rules, but said they have questions about and want to review other provisions more closely.

Emily Brock, director of the Government Finance Officers Association's federal liaison center, said, "We are pleased to see the Treasury and IRS addressed our concerns with regard to competitive pricing." She said the GFOA's debt committee plans to discuss the three-bid requirement for competitive sales and the five-day "hold-the-offering-price" requirement with Cross at its meeting here tomorrow.

Cliff Gerber, president of the National Bond Lawyers Association, also is pleased to see the special rule for competitive sales. "And they've now created a modified hold-the-offering-price rule, which I think is good," he said. But he worried that bad underwriter behavior could hurt issuers' bonds under the final rules.

Michael Decker, managing director and co-head of municipal securities for the Securities Industry and Financial Markets Association, said, "We are pleased that the issue price rule is now final. While we are still reviewing the release, several provisions of the final rule represent welcome changes. In particular, we support the provision specifying that the general rule will apply at any time the 10-percent sales threshold is met as well as the clarification that underwriters can sell bonds at prices below the initial offering price without breaking the rule. We are also pleased about the provision for special treatment for competitive offerings."

John Vahey, Bond Dealers of America's director of federal policy, said, "BDA appreciates the efforts of the IRS and Treasury to adopt improvements to the issue price rule. However, we have concerns with how the final rule's requirement to hold the initial offering price for five days will alter the market and, also, how the three-bid requirement for competitive deals has the potential to negatively impact the competitive offerings of smaller issuers."

Issue price is important because it is used to help determine the yield on bonds and whether an issuer is complying with arbitrage rebate or yield restriction requirements. It is also used to determine whether federal subsidy payments to issuers for direct-pay bonds such as Build America Bonds are appropriate.

Under existing rules that have been in place for years, the issue price of each maturity of bonds that is publicly offered is generally the first price at which a substantial amount, defined as 10%, is reasonably expected to be sold to the public.

But tax regulators became concerned several years ago that some dealers were "flipping" bonds — selling them to another dealer or institutional investor who then sold them again almost simultaneously — with the prices continually rising before the bonds were eventually sold to retail investors. The regulators worried that the "reasonably expected" issue prices for bonds were not representative of the prices at which the bonds were actually sold.

To address their concerns, the Treasury and IRS proposed issue price rules in 2013, eliminating the reasonable expectations standard and basing the determination of issue price on actual sales. They also proposed raising the "substantial amount" of bonds standard to 25% from 10%.

The rules were strongly criticized as unworkable by issuers and underwriters. They complained about the 25% standard and said they often don't sell 10% or 25% of every maturity right away.

The tax regulators scrapped those rules and re-proposed them in June 2015. Under the re-proposed rules, the issue price for each maturity of bonds generally would be the price at which the first 10% of the bonds are actually sold to the public.

Issuers could use an "alternative method" of determining issue price when 10% of a maturity was not sold by the sale date. The issue price would be the initial offering price of the bonds sold to the public as of the sale date, as long as the lead or sole underwriter certified to the issuer that no underwriter filled an order from the public after the sale date and before the issue date at a higher price, unless market changes justified the higher price. The lead underwriter would then have to document any market changes that justified a higher price.

Dealers complained about the lead underwriter having to provide certifications about the actions of other underwriters.

The final rules contain a general rule under which the issue price is the price at which the first 10% of a maturity of bonds is actually sold to the public.

The rules include a special rule, under which the issue price is the initial offering price as long as the underwriter sticks with the IOP for bond sales during the five business days after the sale date (or a shorter period if 10% of a maturity of bonds is sold to the public at a price that does not exceed the IOP).

The five-day "hold-the-offering-price" provision is an anti-flipping or an anti-abuse provision. The lead underwriter must certify the IOP to the issuer, as well as provide documentation, such as the pricing wire. Each underwriter in a syndicate must agree in writing that it will not offer or sell the bonds at a price higher than the IOP for five business days after the sale date.

Under a special rule for competitive sales, an issuer may treat the reasonably expected IOP of the bonds to be sold to the public as the issue price if the issuer obtains a certification from the winning underwriter bidder as to the reasonably expected IOP upon which it based its bid.

To achieve a competitive sale: the issuer must disseminate the notice of sale in a manner reasonably designed to reach potential underwriters; all bidders must have an equal opportunity to bid; the issuer must receive bids from at least three underwriters "who have established industry reputations for underwriting new issuances of municipal bonds;" and the issuer must award the bonds to the bidder who offers the highest price or lower interest cost.

Issuers have the option of using any of these rules up until the closing (issue) date for their bond transactions.

The IRS also modified the definition of "underwriter" in response to concerns that it was vague and unworkable.

The definition still says "an underwriter is any person that 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."

But the final rules remove the phrase "or other arrangement" from provisions that say an underwriter "includes any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement with any of the foregoing to sell the bonds."

The tax regulators certified that the final rules "will not have a significant economic impact on a substantial number of small entities.

The Bond Buyer

By Lynn Hume

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