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Treasury, IRS Seem Open to Changes to Proposed Issue Price Rules.

WASHINGTON – Treasury Department and Internal Revenue Service officials appeared open to modifying the proposed issue price rules they released in June, asking muni market group representatives at a public hearing Wednesday about their concerns and recommended changes.

The speakers were members or staff of the National Association of Bond Lawyers, the Securities Industry and Financial Markets Association, Bond Dealers of America and Government Finance Officers Association.

Under existing rules, for bonds that are publicly offered, the issue price of a maturity is the first price at which 10% of the bonds are reasonably expected to be sold to the public.

But under the proposed rules, for both competitive and negotiated sales, the general rule would be that the issue price is the first price at which 10% of a maturity is actually sold to the public. If 10% of a maturity hasn't been sold by the sale date, issuers can employ an "alternative method" in which they can use the initial offering price to the public as of the sale date as the issue price if certain requirements are met. One requirement is that the underwriters fill all orders from the public on or before the sale date at the initial offering price. Another is that the lead or sole underwriter certify 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. Also, the issuer can't know or have reason to know that the certifications are false.

Several market groups have recommended that there be a safe harbor for competitive sales. Michael Imhoff, BDA's representative and a managing director at Stifel, Nicolaus & Co., suggested that the safe harbor be for sales awarded after a certain number of bids. GFOA debt committee chair and Philadelphia Treasurer Nancy Winkler suggested competitive sales be allowed to use current rules, but would be open to discussing a safe harbor based on bids.

Treasury associate tax legislative counsel John Cross said "we fully appreciate the value of competitive sales." He asked Imhoff why the alternative method would not be the right safe harbor for competitive sales. Imhoff said that bond yields would be higher under the alternative method because using it would require more risk. A safe harbor for competitive deals could save issuers money, he said.

Cross asked Winkler if it would be too difficult for issuers to comply with a safe harbor for competitive sales that required three bids. Winkler said that she's mostly been involved in competitive sales for higher-grade and larger issuers that commonly receive three bids, but that there may be issuers that receive less. She said she wouldn't want an issuer to receive only two bids and have to reject both of them because it wouldn't be able to establish issue price.

Imhoff and Winkler both recommended an alternative method based on sales of at least 50% of the aggregate amount of bonds to address situations when there are unsold maturities. They argued that such a safe harbor could be helpful for small issuers. Winkler specifically recommended this approach for negotiated sales.

Johanna Som de Cerff, senior technician reviewer in the IRS chief counsel's office, asked Winkler if a safe harbor for competitive sales could be based on sales of 50% of the total issue. Winkler said it that would not work because the percentage is too high for those types of deals.

Cross pointed out that most of the muni market is comprised of small issuers, so it would be challenging to come up with a rule specific for small issuers. Imhoff said that perhaps a 50% safe harbor should apply for the whole market.

SIFMA had not recommended a safe harbor based on sales of 50% of the total issue, but Cross asked Michael Decker, a managing director and co-head of municipal securities for the group, for his thoughts about such a rule. Decker said that this suggestion is worth looking at and that he suspects that it's often the case that issues with unsold maturities have 50% of the overall deal sold.

Market groups have also said that it would be very difficult to document market movements under the alternative method.

Som de Cerff asked Decker what might be a more appropriate way to document market movements than using a national benchmark. Decker said that market movements is "a little bit of you know it when you see it" and is a difficult concept to define in terms of clean compliance.

Cross asked Decker if it might be better just to get rid of the market movement exception and have underwriters agree not to sell bonds at a price higher than the initial offering price after the sale date and before the issue date unless 10% of a maturity is sold during that time. Decker said that such a rule would be "workable."

When Cross and Som de Cerff asked Imhoff similar questions, he replied that it would be hard for underwriters to hold at the initial offering price because they want to be able to respond to market changes.

Linda Schakel, a partner at Ballard Spahr who spoke on behalf of NABL, expressed concern about one of the conditions for the alternative method — that the issuer not know or have reason to know that certifications are false. She recommended that Treasury and the IRS clarify that the issuer's due diligence obligation is that of a "prudent person." Cross asked her why there would be less certainty under the standard in the proposed regulation than with the prudent person standard. Schakel replied that the standard in the proposal suggests the need for independent verification.

THE BOND BUYER

BY NAOMI JAGODA

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