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SIFMA Proposes 'Revocable Bids' in Draft Document for Issue Price Rules.

WASHINGTON – The Securities Industry and Financial Markets Association has released draft riders to model bond documents to make it easier for dealers and issuers to comply with issue price rules, including one that would allow revocable bids in competitive sales – a new concept in the municipal market.

SIFMA is seeking industry comments on the draft documents by April 12, hoping to finalize them soon after that to give market participants plenty of time to include them in their policies and procedures before the Treasury Department issue price rules take effect on June 7.

Draft riders are proposed for the three existing SIFMA versions of master Agreements Among Underwriters, the master Selling Group Agreement, the Retail Distribution Agreement, the Bond Purchase Agreement and the Notice of Sale.

“The issue price model documents will help reduce legal costs and regulatory risk while increasing legal certainty,” said Leslie Norwood, managing director, associate general counsel and co-head of SIFMA’s municipal securities division. “They are designed to make it easier for our members to assist their issuer clients in complying with the issue price rules.”

“Part of our goal is to promote understanding of the expectations for all market participants and to promote transparency in the sales terms for issuers, underwriters, as well as financial advisors, to make sure there is no market disruption for transactions that sell on or after … June 7,” she added.

Issue price is important because it determines the yield on bonds and whether an issuer is complying with arbitrage rebate or yield restriction requirements. It also determines whether the subsidy payments 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 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. They found that some “reasonably expected” issue prices for bonds were not representative of the prices at which the bonds were actually sold.

So they adopted a new general rule under which the issue price will be the price at which the first 10% of a maturity of bonds is actually sold to the public. If 10% of a maturity is not sold, a special rule can be used under which the issue price is the initial offering price (IOP) as long as the underwriters hold the IOP for five business days after the sale date.

The five-day “hold-the-offering-price” requirement is designed to prevent pricing abuses such as flipping. 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.

There is an exemption from the new issue price rules for competitive sales under which an issuer may treat the reasonably expected IOP of the bonds to be 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. But this exemption is conditioned on, among other things, the issuer receiving at least three bids from separate underwriters and awarding the bonds to the bidder who offers the highest price or lowest interest cost.

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

It is in its draft riders to the Notice of Sale for competitive transactions that SIFMA introduces the concept of revocable bids because the exemption to the issue price rules for these deals is contingent on the issuer's receiving at least three bids for the bonds.

"This is really the most novel part of our documents," said Norwood. "This is a new concept to the industry where we are trying to assist issuers to get the best possible price within the set of new rules but also have all of the participants understand the terms of the sale."

There are two draft riders for Notices of Sale, one for revocable bids and one for non-revocable bids.

Under the draft rider to the Notice of Sale called Alternative 1, the bids are revocable. The general idea is the issuer expects to get at least three bids for the bonds but the underwriter doesn't want the risk that the issuer won't get the bids it needs for the competitive sale exemption and therefore wants an "out" from its bid.

"This is the least costly alternative if three bids are obtained and the sale qualifies for the competitive sale exemption," said Norwood.

In this case, if the issuer gets fewer than three bids for the bonds, it goes to the underwriters and asks whether they want to confirm or revoke their bids. If the underwriters revoke their bids, the sale fails. If the underwriters confirm their bids, they do so only after understanding whether the issuer wants them to hold bonds at the IOP for five business days or until 10% of the bond maturities are sold.

Under the draft rider to the Notice of Sale called Alternative 2, the bids would not be revocable. Here, the bidding underwriters know they can't revoke their bids, so they are put on notice, and they price in the risk that they may be asked to hold the IOP for five days.

"This is the most like current notices of sale," said Norwood. "There will be a higher cost for irrevocable bids because of the risk the underwriter may have to hold them at the IOP for five days."

These standardized Notices of Sale should "facilitate the understanding of sales terms and help issuers obtain as many bids as possible on the bid date in competitive deals," said Norwood, who noted dealers are more likely to bid with easy to understand and standardized documents.

Draft riders are proposed for SIFMA's three versions of AAUs, which are agreements between the managing underwriters and syndicate members. One is an electronic master AAU for negotiated deals published in 2002 and another is an electronic master for competitive deals issued that same year. The third is a paper AAU that can be used on a per-transaction basis.

The draft riders essentially say that if underwriters don't sell up to 10% of a maturity, they must promptly report that to the managing underwriter and that if the managing underwriter decides that syndicate members must hold the IOP of the bonds for five business days, the syndicate members will abide by that. The draft makes clear that if any underwriter fails to comply with the hold-th--price rule, it alone will be liable for that, and not the other underwriters.

Draft riders are proposed for retail distribution agreements, which are agreements between underwriters and retail distributors, in negotiated deals. Basically, retail distributors have the same responsibilities as underwriters under these riders.

Riders are proposed for selling group agreements, which are for the group of dealers selling the bonds.

SIFMA is also proposing inserts for bond purchase agreements between issuers and underwriters. Typically issuers have their own bond purchase agreements so that's why SIFMA's providing an insert. In the draft, SIFMA says the model issue price certificate, which is being drafted by the National Association of Bond Lawyers and may be issued next week, will be attached to the bond purchase agreement.

"We want to encourage and facilitate early discussions between issuers and underwriters about the expectation of how the issue price will be determined," said Norwood. Often underwriters will pre-sell or get indications of interest for bonds, letting them know if they can sell 10% of a maturity on the sale date or not in negotiated deals, she noted.

The Bond Buyer

By Lynn Hume

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