September 17, 2015

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 200444

Attention: CC:PA:LPD:PR (REG—138526-14)

Submitted to www.regulations.gov

The Securities Industry and Financial Markets Association ("SIFMA") is pleased to provide comments with respect to proposed rulemaking REG-138526-14, issued on June 24, 2015, as corrected July 29, 2015 (the "2015 Proposed Regulations"). The proposed rules would modify the definition of "issue price" for purposes of the rules governing tax-exempt municipal bonds and other tax-advantaged bonds.[1] In addition, this letter serves as SIFMA's request to testify at the public hearing on the 2015 Proposed Regulations scheduled for October 28, 2015 at 10:00 a.m.

SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets for businesses and municipalities in the U.S. and manage more than $62 trillion in assets for individual and institutional clients. SIFMA's Municipal Securities Division includes all major banks and securities firms that underwrite and trade municipal securities. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

SIFMA appreciates the efforts of the Treasury Department and Internal Revenue Service ("IRS") personnel which have resulted in withdrawal of the portions of the 2013 Proposed Regulations dealing with "issue price" and issuance of the 2015 Proposed Regulations. We believe that the 2015 Proposed Regulations are a significant step forward and with certain clarifications and modifications, can establish a regulatory structure that will impede neither the efficient and aggressive marketing of new issues nor enforcement of the limitations mandated by Congress.

[1] The 2015 Proposed Regulations withdrew those portions of regulations proposed in 2013 (the "2013 Proposed Regulations") which would also have changed the definition of "issue price."

The major suggested clarifications and modifications are:

- Clarify that the alternative method can be used to definitively establish the issue price as of the sale date, regardless of subsequent sales of the bonds or inaccuracies in the certification by the lead underwriter;
- Clarify that the 10-percent standard may be satisfied between the sale date and the issue date, establishing the issue price, notwithstanding the alternative method;
- Clarify under the alternative method that underwriters may fill orders from anyone at prices lower than the initial offering price and, absent a market change, at higher prices only from other underwriters and related parties that are not members of the "public;"
- Modify the definition of "public" to make it clear that a person, even if an underwriter or related person, buying for investment and not for redistribution as part of the offering of the new issue, is a member of the public as to those bonds;
- Clarify the reference in Proposed Treas. Reg. §1.148-1(f)(3)(ii)(B) to an "other arrangement;"
- Clarify the meaning of "the first price" at which a substantial amount of bonds are sold to the public by providing guidance as to how to count bonds sold at different prices;
- Include a special rule for competitively bid and sealed bid offerings; and
- Modify the certification and due diligence requirements to provide that the lead underwriter's certification with respect to compliance by the underwriters with the pricing restrictions in the 2015 Proposed Regulations are limited to a certification that the members of the underwriting group and selling group have covenanted in the Agreement Among Underwriters ("AAU") or related document to comply with those restrictions.

A. Inter-Relationship of the General Rule and Alternative Method. Proposed Treas. Reg. §1.148-1(f)(2)(i)[2] would set forth the general rule[3] that the issue price of bonds having identical credit and payment terms and issued for money is the first price at which a substantial amount (i.e., 10 percent) of the particular bonds is, in fact, sold to the "public." If the 10-percent standard of the general rule is not satisfied as of the sale date, Proposed Treas. Reg. §1.148-1(f)(2)(ii) allows use of the "initial offering price" as the issue price if --

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[2] Except as otherwise expressly stated, all references to "Proposed Treas. Reg." are references to the 2015 Proposed Regulations.

[3] Under Treas. Reg. §1.148-1(a), this rule would apply for purposes of Section 148 of the Code and, presumably, for purposes of the related provisions of the Code and regulations which incorporate the §1.148-1 definitions by reference.

i. The underwriters fill all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date, and no underwriter fills an order placed by the public and received by the underwriters received on or before the sale date at a price higher than the initial offering price; and

ii. The issuer receives certifications by the lead underwriter as to the following –

   a. The initial offering price;

   b. That the underwriters met the requirements with respect to the filling of orders from the public described in i. above;

   c. That no underwriter will fill an order placed by the public and received after the sale date and before the issue date at a price higher than the initial offering price unless the higher price is a result of a market change; and

   d. That the lead underwriter will provide the issuer with documentation supporting the certifications described above or, if appropriate in the case of c., that there were no sales at higher prices.

We believe the 2015 Proposed Regulations represent a significant improvement over the 2013 Proposed Regulations. In particular, because it is a common occurrence that at least 10 percent of one or more maturities of a bond issue is not sold as of the sale date, it is vital that the final regulations provide an alternative means of establishing issue price. However, as proposed, the alternative method provided in the 2015 Proposed Regulations is not workable, with the most significant issue being the requirement under the alternative method that the lead underwriter certify as to the actions of other underwriters. The clarifications and changes we recommend are detailed in this letter. In addition, we believe additional clarifications to the general rule are necessary in order to minimize compliance costs and risk and to provide issuers, underwriters and bond lawyers additional clarity as to how the rule will be applied.

Moreover, it is our understanding that the 2015 Proposed Regulations are intended to permit the issue price of bonds to be definitively established as of the sale date, regardless of subsequent sales of bonds at different prices. That interpretation is far from clear under the 2015 Proposed Regulations as currently drafted and, if that interpretation is correct, the 2015 Proposed Regulations should be revised to so expressly state and provide examples of the proper application of the regulations.

While such an interpretation should resolve many of the concerns voiced by industry participants who have read the 2015 Proposed Regulations to provide otherwise, there remain points under both the general rule and the alternative method which we believe require modification or clarification.

B. The General Rule

The clarifications and modifications that we believe should be adopted to facilitate application of the general rule are:

i. Modification of the definition of "public" in Proposed Treas. Reg. §1.148-1(f)(3)(i) to make it clear that a person, even if an underwriter or related person, buying for investment and not for redistribution as part of the offering of the new issue, is a member of the public as to those bonds;

ii. Clarification of the reference in Proposed Treas. Reg. §1.148-1(f)(3)(ii)(B) to an "other arrangement;"

iii. Clarification of the meaning of "the first price" at which a substantial amount of bonds are sold to the public; and

iv. Inclusion of a special rule for competitively bid and sealed bid offerings.

The Definition of "Public." Proposed Treas. Reg. §1.148-1(f)(3)(i) would define the "public" as any person other than an underwriter or related party to an underwriter. An underwriter is any person (i) that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or with the lead underwriter to form an underwriting syndicate, or (ii) that enters into a contract or "other arrangement" with a person described in (i) to sell the bonds.

The focus of the 2015 Proposed Regulations on members of the underwriting syndicate and selling group is a welcome change from the rule proposed in the 2013 Proposed Regulations. We are concerned, however, that the blanket exclusion of underwriters and related parties from the definition of "public" will exclude an important portion of the buyer base from the process of establishing the issue price of bonds in new offerings.

Consider, for example, an asset manager for a separately managed account program or a family of mutual funds that places an order for one of the funds. The ticket written for the order will show only the name of the asset manager and, if the asset manager is related to any member of the underwriting syndicate or selling group, the lead underwriter would be forced to disregard that transaction when attempting to determine whether the 10-percent standard of the general rule had been met. The same concern is present with respect to sales to a myriad of separate entities which are related parties, an underwriter itself which may be purchasing portions of an offering for internal investment or treasury management purposes, as assets on its balance sheet or by "lines of business" such as tender option bond operations within the underwriting firm.

A better approach would be to include a provision similar to Proposed Treas. Reg. 1.148-1(f)(3)(ii)(C) of the 2013 Proposed Regulations to the effect that a person, regardless of whether an underwriter or related party, that holds bonds for investment and not for redistribution as part of the offering of the new issue is treated as a member of the public with respect to those bonds.

"Other Arrangements." Proposed Treas. Reg. §1.148-1(f)(3)(ii)(B) defines "underwriter" to include any person that, on or before the sale date, directly or indirectly, enters into a contract or "other arrangement" with an issuer or an underwriter to sell bonds. It is unclear what constitutes an "other arrangement."

The term “arrangement” is broad enough to include virtually any interaction or relationship between two or more parties. However, the structure of Proposed Treas. Reg. §1.148-1(f)(3)(ii)(B) indicates that the phrase is not intended to refer to a contractual undertaking, but must involve, in some undisclosed manner, the sale of bonds in an initial offering. We urge clarification of the meaning of the term in the context of the definition of “underwriter” and, at the very least, the definition should be limited to written arrangements.

Counting to Ten. The general rule is that the issue price is the “first price at which…[ten percent]…of the bonds is sold to the public.” In the simplest of cases under the existing regulations, an initial offering price is set and, if ten percent of the bonds are sold to the public at that price by the sale date, the initial offering price is the issue price.[4] If ten percent have not been sold as of the sale date, the reasonable expectations of the issuer and underwriters have been relied on to establish the issue price as of the sale date. Heretofore, there has been little reason to consider what methodology should be used to determine the price at which the ten percent standard has been met when, after the sale date, the bonds are free to trade and there are multiple prices for the same bonds.[5] To our knowledge, there is no guidance under Sections 148, 1273 or 1274 of the Internal Revenue Code as to the methodology to be applied in such circumstances.

As an example of the quandary that may be encountered, assume an entire issue consists of a $10 million term bond. If the “first price” test requires identification of a single price at which at least $1 million (ten percent) of the bonds have been sold to the public, what happens if there are many different prices with respect to amounts all below $1 million? Would the determination of issue price be handled like a Dutch auction in which the issue price is the “clearing price” of the lowest priced $1 million? Or, is the highest “clearing price” the proper measure? Given the reliance of the general rule on actual sales, we urge the IRS to provide guidance with regard to setting forth how underwriters should count those sales to get to ten percent.

If the alternative method is intended to establish the issue price of bonds as of the sale date, the question as to counting methodology would continue to be relevant in those situations in which (i) the general rule has not been satisfied as of the sale date and the requirements of the alternative method are not satisfied, or (ii) the issuer chooses not to apply the alternative method. Under such circumstances, the issue price would presumably be determined under the general rule, based on actual sales as of and after the sale date, possibly at multiple prices, presenting the question as to the appropriate counting methodology.

Competitively Bid and Sealed Bid Offerings. It is common for competitive bids to be submitted with minimal, if any, premarketing by the bidders. The same is also true with respect to sealed bids for the

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[4] Given the rules governing initial offerings, all sales prior to the sale date should be at the initial offering price.
[5] Under the alternative method discussed below, some constraints would be imposed on sales at above the initial offering prices during the period between sale and closing. However, during that time frame, there is no prohibition of sales below the initial offering prices, potentially resulting in multiple prices for the same bonds. In addition, the alternative method contemplates sales at above the initial offering prices if there has been market movement.

earliest maturities of a larger negotiated transaction in which the lead firms are invited to submit bids on the sale date. In the absence of extensive premarketing, we believe many competitive or sealed bid transactions will fail to meet the 10-percent standard of the general rule as of the sale date and will be forced into the alternative method discussed below. This, in turn, would result in an incentive for underwriters to bid less aggressively in competitive auctions in order to minimize the likelihood of the need to rely on the alternative method, translating into higher borrowing costs for bond issuers.

The objective of the definition of "issue price," both for purposes of Section 148 of the Code as well as the more general purposes of Section 1273 is to provide a market-based measure of the value of bonds. In the case of a transaction in which competing bidders have been put on notice of an issuer's plan to request bids for an issue, whether in a competitive offering for an entire issue or a sealed bid for specific maturities, the competitive bidding process itself provides a similar market-based measure of value. Given that value assessment, establishing issue price by reference to the anticipated public sale price set forth in the winning bid, without the restrictions imposed by the alternative method on sales after the sale date and before the issue date, does not seem inappropriate or the likely subject of abuse. We urge the IRS to adopt this approach for competitive and sealed bid transactions.

C. The Alternative Method of Determining Issue Price

Ambiguity of Proposed Regulations. Given the significant likelihood that many offerings will have one or more maturities that do not meet the 10-percent standard, the availability of an alternative to the determination of issue price by actual sales is welcome. However, the 2015 Proposed Regulations are ambiguous as to the precise nature of the requirements of the alternative method. Combined with the constraints that would apply, the alternative method as proposed in the 2015 Proposed Regulations does not provide a workable alternative for establishing issue price, principally due to the requirement that lead underwriters certify as to the actions of others.

It is unclear whether the operative element with respect to establishing issue price under the alternative method is the certification by the lead underwriter as to compliance (or agreement to comply) by the underwriters or actual compliance by the underwriters. What are the consequences if the required certifications by the lead underwriter are given but are incorrect? Perhaps even more important, the proposed alternative method suggests that the lead underwriter would be required to certify on the sale date as to circumstances that have not yet occurred.

Proposed Treas. Reg. §1.148-1(f)(2)(ii)(A) requires under the alternative method that (a) the underwriters fill all orders at the initial offering price received from the public on or before the sale date (to the extent not in excess of the amount of bonds to be sold), and (b) no underwriter fills an order placed by the public and received by the underwriters on or before the sale date at a price higher than the initial offering price. Proposed Treas. Reg. §1.148-1(f)(2)(ii)(B)(4) further requires that the lead underwriter certify that, among other things, every underwriter met the requirements set forth in the preceding sentence. These provisions appear to apply as of the sale date to actual historical compliance by the underwriters on or prior to the sale date.

However, the lead underwriter is also expected to address the period between the sale date and closing and certify that no underwriter will fill an order placed by the public and received during that period at a price higher than the initial offering price, absent a "market change." Clearly, the lead underwriter cannot certify as to events which have not yet occurred. The most that the lead underwriter can be reasonably expected to certify to is that the Agreement Among Underwriters ("AAU"), the contract governing the activities of syndicate members with respect to an issuance transaction, or other relevant document contains an undertaking from each member of the syndicate and selling group that the member (and any non-member with whom the member has a distribution agreement or "other arrangement") has agreed to comply with that rule.

We urge that the Proposed Regulations be modified to clearly address the questions as to the operative element of these requirements and the consequences of violations.

Application of the General Rule between Sale and Closing. With respect to the period between the sale date and the issue date, we urge that the following items be clarified:

i. The 10-percent threshold can continue to apply during this period. If the underwriters fill orders from the public at the initial offering price and those orders cause the sales to the public to first reach the 10-percent level after the sale date and before the closing, the initial offering price for all of the bonds with the same credit and payment terms can be established at the initial offering price without further compliance with the restrictions imposed under the alternative method;

ii. The underwriters may fill orders from anyone at prices lower than the initial offering price and, absent a market change, at higher prices only from other underwriters and related parties that are not members of the "public;"[6]

iii. Depending on the answer to the counting methodology questions under "**The General Rule**-*Counting to Ten*," sales at lower prices do or do not count toward the general rule 10-percent standard as applied to the initial offering price; and

iv. Sales during this period would establish the issue price under the general rule at a price lower than the initial offering price only at the option of the issuer.

If the general rule has not been satisfied as of the sale date, application of the alternative method requires, among other things, that on and prior to the sale date, the underwriters must have complied with the requirements of Proposed Treas. Reg. §1.148-1(f)(2)(ii)(A) with respect to the filling of public orders received on or prior to the sale date. In addition, the alternative method can be applied only if, commencing immediately after the sale date, the underwriters commence compliance with Proposed Treas. Reg. §§1.148-1(f)(2)(ii)(B)(3) and (4), restricting sales to the public to prices no higher than the initial offering prices, absent a market change.

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[6] See the discussion under "**The General Rule**-*The Definition of "Public"*" which argues that underwriters and related parties that are purchasing bonds for investment should be treated as members of the public as to those bonds.

There is no requirement that the alternative method be used. The issue price of bonds with respect to which the alternative method is not or could not be applied would continue to be governed by the general rule and issue price established under the 10-percent standard. Although the 2015 Proposed Regulations seem clear that the general rule can first be met by sales at the initial offering price after the sale date and before closing, even though the underwriters may be complying with the rules under the alternative method until the general rule is met, an expressed statement or example to that effect would clarify this issue.

One of the objectives of the modifications to the existing regulations should be to provide reasonable certainty as to the issue price of bonds as of the sale date in order to ensure that the various tests for tax exemption based on issue price are satisfied. If post-sale date sales of bonds at prices lower than the initial offering price can establish an issue price lower than the initial offering price, the certainty as to an issue price determinable as of the sale date is lost. Despite the conventional (and erroneous) wisdom that a lower issue price (and resulting higher yield) than anticipated as of the sale date would not adversely affect the tax-exempt status of an issue of bonds, depending on the facts and circumstances, a lower issue price than anticipated could have significantly adverse effects.

For example, consider a $10,000,000 issue of additional bonds under an existing financing program with a required deposit to a debt service reserve fund of $1,000,000. Section 148(d)(2) of the Code provides that a "bond issued as part of an issue shall be treated as an arbitrage bond if the amount of the proceeds from the sale of such issue which is part of any reserve…fund exceeds 10 percent of the proceeds…" Treas. Reg. §1.148-2(f)(1) provides that the 10-percent limit is measured against the stated principal amount of the bonds unless the issue has more than a *de minimis* amount of original issue discount in which case the issue price is used in testing the 10-percent limit. If the issue price anticipated as of the sale date based on the initial offering prices and the alternative method, a reduction in the issue price due to sales at less than the initial offering price can clearly be a problem.

Similar problems may arise in any instance in which the bond issue is sensitive to limitations or calculations directly or indirectly measured by issue price. Such limitations or calculations may include calculations of bond yield, measurements of private business use, measurements of private payments and security interest, determination of the weighted average maturity limit of §147 of the Code, calculation of the universal cap, and others.

If sales at prices less than the initial offering prices are allowed to establish a lower issue price without the consent of the issuer, certain bond issues in which the determination of issue price is critical could be at risk if the alternative method is used. Proposed Treas. Reg. §1.148-1(f)(2)(ii) already provides the issuer with the opportunity to apply either the general rule or, if the general rule 10-percent standard is not met by the sale date, the alternative method. However, we ask for clarification that the alternative method can be applied at the option of the issuer and the issue price set at the initial offering price, even if the 10-percent standard is satisfied at a lower price during the period between the sale date and the issue date.

Market Changes. We believe that the "market change" exception which permits sales at above the initial offering price during the period between sale date and closing would be exceedingly difficult to implement. In the event that an underwriter asserts that a sale above the initial offering price is justified by a market change, it is unclear who would determine that the change in fact occurred at the time of the higher sale and who would determine that the market change justifies the amount of the increase above the initial offering price. Given the certification requirements imposed on the lead underwriter discussed below, the initial answer may be the lead underwriter. The ultimate answer, unfortunately, may be the bond counsel, whose expertise does not extend to the pricing of municipal bonds.

Objective measures of market changes and their effects on the price of a particular bond do not exist. There is no true national index of municipal bond prices and yields. Price indicators, such as the Thomson Reuters Municipal Market Data (MMD) AAA Curve, are not traded actively on a two-way basis and do not necessarily reflect actual sales, intraday market movement, or the localized nature of the tax-exempt market.[7] Absent reliable and well-established market indexes, it is unclear how underwriters, issuers or bond counsel would establish or document "market change" as a justification for bonds selling at prices other than the initial offering price.

The net effect would be incentives for underwriters to meet the 10-percent standard, leading at least in some cases to structural changes that will increase the likelihood of meeting that standard or minimize the potential adverse consequences of being subject to the restrictions of the alternative method. Such steps might include structuring the issue to eliminate smaller serial maturities and replacing the serial maturities with term bonds subject to mandatory sinking fund redemption, shortening the period between sale and closing or, the easiest solution, less aggressive pricing or repricing of the bonds. Even if pricing of the bonds remains aggressive, any changes in issue structure or marketing due to these rules are more likely to result in lower rather than higher prices for the bonds and higher financing costs for states and localities.

Certification and Diligence Requirements. Under Proposed Treas. Reg. §1.148-1(f)(2)(ii)(B), use of the alternative method requires that the lead underwriter certify to a number of specific items and provide the issuer with supporting documentation for the matters covered by the certifications. Those items include a certification that all orders at the initial offering price placed by the public and received by the underwriters on or before the sale date were filled. While the forms of Bond Purchase Agreements, the AAU or distribution agreements can all be modified as necessary to impose a duty on each member of the underwriting syndicate and selling group and entities operating under distribution agreements to comply with that standard, the only person who will know that a particular underwriter has in fact complied with its commitment is that particular underwriter. No underwriter can be expected to allow the lead underwriter, an obvious competitor, access to records that would establish, in fact, that all orders from the public at the initial offering price have been filled. The most that the lead underwriter can be reasonably expected to certify to is that the AAU or other relevant document contains an

[7] An offering in State X may be significantly affected by a competing offering from another issuer in State X, particularly if State X is a specialty state with an in-state tax-exemption, without either affecting national indices.

undertaking from each member of the syndicate or selling group that the member (and any non-member with whom the member has a distribution agreement or "other arrangement") has agreed to comply with that rule.

SIFMA publishes a model "Master Agreement Among Underwriters" ("MAAU") for municipal securities underwritings and a "Master Selling Group Agreement" ("MSGA"). We believe a large number of actual contracts governing syndicate activity for municipal new issue transactions are based on our model MAAU and MSGA. If and when the 2015 Proposed Regulation is finalized, we can commit to undertake a process to review and amend our MAAU and MSGA to account for duties applicable to syndicate members under the final issue price rule. We emphasize, however, that our MAAU and MSGA are model documents only. Each syndicate or selling group executes its own AAU or SGA which may not reflect all or any of the terms of the SIFMA model MAAU or MSGA for municipal securities transactions. Moreover, we reiterate that even with an amended MAAU or MSGA that would include provisions reflecting the terms of the final issue price rule, it would be impossible for a lead underwriter to certify on the sale date of an issue that all syndicate members will not offer bonds at prices other than the initial offering price until the closing. The most a lead underwriter could do would be to certify as to the terms of the AAU or SGA that address the issues relevant to the issue price rule, and that co-managers have sign the AAU or SGA with those relevant covenants. Finally, any amendments to the SIFMA model MAAU and MSGA would require industry consensus before they could be adopted in the documents.

The same comments apply to the representations described in the remainder of Proposed Treas. Reg. §§1.148-1(f)(2)(ii)(A), (B)(3) and (B)(4). A more workable approach would be to obtain a representation from the lead underwriter to the effect that each member of the underwriting syndicate and selling group has committed, by execution of the bond purchase agreement, agreement among underwriters, selling group agreement or other appropriate document, to comply (and cause any entity with whom it has a distribution agreement or "other arrangement" to comply) with the requirements of those sections of the proposed regulations.

D. Conclusion

As stated, SIFMA appreciates the work of the Treasury and IRS personnel that has resulted in the issuance of the 2015 Proposed Regulations. We believe that, with the modest clarifications and modifications described herein, the 2015 Proposed Regulations provide a workable framework to resolve questions in a difficult area.

Thank you for the opportunity to present our views and we look forward to continued discussions in the future.

Best regards,

Michael Decker
Managing Director