



THE ITEMS IN THIS DOCUMENT SERVE AS A DISCUSSION OF THE NON-EXHAUSTIVE LIST OF ISSUES RELATED TO NEW IRS REGULATIONS WHEN DETERMINING THE ISSUE PRICE OF BONDS FOR ARBITRAGE PURPOSES. THIS MEMO DOES NOT SERVE AS LEGAL ADVICE. MAs ARE STRONGLY ENCOURAGED TO REVIEW THE FULL RULEMAKING AND CONSULT COUNSEL IN THEIR MISSION TO UNDERSTAND THE NEW RULEMAKING AND ITS IMPLICATIONS WHEN PROVIDING ADVICE TO CLIENTS. THIS DOCUMENT SHOULD NOT BE VIEWED AS A SAFE HARBOR FOR MA PRACTICE PURPOSES.

Background

The new IRS issue Price Regulations went into on June 7, 2017. The most significant change to the rule is that the issue price for bonds will be determined based on a ten percent of actual sales test and not on the current reasonable expectations test. This test is applied to each maturity and individual CUSIP in an issuance. Another key change is that in competitive sales, there is an exception to the 10% of actual sales that can be utilized if the issuance receives at least three bids from underwriters or meets certain other requirements (as discussed below).

Along with the new regulations, SIFMA has revised and developed new model documents including Notice of Sales, Agreement Among Underwriters, Selling Group and Retail Distribution Agreements for underwriters and issuers. NABL has also developed model tax certificates that correspond with the SIFMA documents. NABL's model documents also include a new MA certificate. These documents are further discussed below.

GFOA has expressed concerns with these documents, and has notified their members that the documents should be used as a starting, not ending point, and that the issuer should always remain in control of their sale and the documents used in their bond sale.

Municipal Advisors should be aware of the rules, and how they will impact each client and bond issuances. This is especially needed when engaging in competitive sales, as the rules state that it is the issuer's responsibility to determine prior to the issue date of the bonds, how the Rule will apply to their sale. Below are some areas of particular interest to MAs that should be reviewed and further studied.

General Rule/10% Sales Test

The general rule calls for the issue price of bonds to be determined based on the price at which the first ten percent for each maturity is sold. A definitive answer from Treasury and the IRS has not been provided, and there may be some uncertainty on how to determine that 10%. Based on the language in the regulation, one school of thought is that the issue price is determined based on the first sale of at least 10% to investors at a single price. Another approach is to average multiple sales that reach the first 10% of sales (for instance, averaging the price the first 7% of the bonds were sold, with the next 3+% of sales). MAs should discuss with an issuer's bond counsel the approach to be used for each issuance. This is especially of interest to MAs when the 10% test is used in competitive sales, and the underwriter will need to know how to calculate for the 10% actual sales test.

MA Certificate

The NABL documents include a MA certificate that may be used in competitive sales. **MAs should carefully review this document in each transaction and understand their responsibilities when signing the document.** This certificate asks the MA to certify various components of the competitive sale. One area to highlight is when the exception from the 10% actual sales test is used due to receiving three bids from underwriters, the Rule state that the bidding underwriters must have an “established industry reputation for underwriting new issuances of municipal bonds.” There is no further guidance or definition of how to determine if an underwriter has an established industry reputation, or how to confirm in situations when a bidder may have both underwriting and bank businesses, how to know who the bid is coming from. The SIFMA model documents for competitive sales bids provide for a statement to be made by the underwriter that they are in fact an underwriter with an established industry reputation. However, in the NABL model MA certificate, the MA is asked to confirm such statement.

Many MA firms have expressed concerns with having the MA confirm this statement about bidding underwriters, especially due to the lack of guidance to make that determination. Therefore, MAs should carefully review this section of the MA certificate (#4) and make any changes as needed. It is also important to note that it is not known how bond counsel will react to these changes. Below are some examples of how some firms are changing that language –

- 4. The Issuer received bids from at least three bidders who represented that they have established industry reputations for underwriting new issuances of municipal bonds. ~~Based upon the Municipal Advisor’s knowledge and experience in acting as the municipal advisor for other municipal issues, the Municipal Advisor believes those representations to be accurate.~~ Copies of the bids received are attached to this certificate as Attachment 2.
- 4. The Issuer received bids from at least three bidders, each of whom, by submitting a bid in accordance with the Office Notice of Sale, represents that it has an ~~who represented that they have~~ established industry reputations for underwriting new issuances of municipal bonds. ~~Based upon the Municipal Advisor’s knowledge and experience in acting as the municipal advisor for other municipal issues, the Municipal Advisor believes those representations to be accurate.~~ Copies of the bids received are attached to this certificate as Attachment 2.
- 4. The Issuer received bids from at least three bidders who represented that they have established industry reputations for underwriting new issuances of municipal bonds. Based upon the Municipal Advisor’s knowledge and experience in acting as the municipal advisor for other municipal issues, the Municipal Advisor believes those representations to be accurate. This knowledge is based upon [insert data source here]. Copies of the bids received are attached to this certificate as Attachment 2.

Competitive Sales

As noted above, an exception from the 10% of actual sales test can be achieved if the issuance receives three bids from underwriters (of note, other parties can bid on the bonds and have the winning bid, if within the sale there are at least three bids from underwriters). In a competitive Notice of Sale, the issuer (in consultation with their MA and counsel) needs to state to bidders how the issue price will be established if the competitive sale exception (3 bids) is not met.

In their model competitive NOTICE OF SALE documents, SIMFA has developed four alternative approaches for the issuer to use if the competitive sale exception – 3 bids – is not met. Again, it is important that the issuer

remain in control of this process and the documents, and choose the alternative that is best for them, with advice from their MA. It is likely that underwriters will strongly urge issuers to use these documents and determine which alternative they will use ahead of the sale. **Therefore, MAs should work with their clients, and allow for extra time to determine the best Notice of Sale alternative as well as give underwriters and other investors additional time to review the Notice of Sale.** Also, be aware that numerous changes to the model documents could result in the underwriter not bidding due to the inability to understand the terms of their own bid.

Additionally, MAs should discuss with their client and counsel, as well as underwriters, if the issue price needs to be determined on the sale date. Some transactions - for instance an advanced refunding or a bank qualified financing that is close to the \$10m bank qualified limit – may call for knowing the issue price prior to the final sizing and structuring of the bonds on the sale date. Other transactions, most notably certain new money financings, may not require knowing the issue price on the sale date and the issuer may wish to thus rely upon the 10% actual sales test. Currently, there is no statement in the regulation providing a deadline for when the 10% actual sales test must be satisfied. MAs should discuss with their client and bond counsel the extent in which they are comfortable keeping the window open to meet the 10% actual sales test threshold. (see Decision Matrix to assist with client discussion)

Overview of SIFMA's Four Notice of Sale Alternatives for Competitive Sales

Below is a brief description of the four alternatives provided for in SIFMA'S model documents. **MAs are strongly urged to review the language and adjust as needed to fit the facts and circumstances of each client.** To assist with understanding these alternatives, please view the following flow charts developed by Ehlers Inc. [see below] The discussion related to using the competitive sale exception, receiving three bids, is in Alternative 3.

Alternative One - 10% Sales Test/General Rule

The issue price of the bonds will be determined using the 10% of actual sales price. MAs and issuers should consult with counsel as to how that 10% actual sales threshold is determined. Also of note, the 10% sales does NOT need to be completed on the day of sale, and there is no statement in the rulemaking that makes a determination for how long the sales window can remain open to meet the 10% in actual sales threshold. However, most market participants have commented that the sales would need to be completed by the closing date.

Alternative Two – Hold the Price for Five Days

Where an issuer may not receive three bids, and may not sell 10% of each maturity of an issuance, the issuer can require the underwriter to “hold the price” for five business days on all or certain maturities of the bond sale. This means that the underwriter will agree not to sell the bonds higher than the initial offering price for five days. If in fact 10% of each of those or some maturities are sold within those 5 days, the 10% test can be used. In this alternative, an issuer and underwriter can use a combination of alternatives, using both the 10% actual sales test and the hold the price options for different maturities. This alternative may be advantageous when issue price certainty is needed on the day of sale. However, in this scenario, MAs and issuers should be aware of possible yield premium imposed by the underwriter to compensate for the risk they take by holding the price for five business days.

Alternative Three – Three Bids from Underwriters/Alternatives When That is Not Met

In this scenario, the issuer intends to use the competitive sale exception of receiving three bids for their bonds. However, if that does not occur, this alternative provides for how the team should proceed.

In the event that this alternative is used with the intention and expectation of receiving three bids, and three bids are NOT received, then the issuer must contact the winning bidder and let them know that the three-bid competitive sale exception cannot be used. The bidder may then withdraw the bid or confirm the bid under a 5-day hold the price or 10% actual sales test, or in conjunction with the issuer develop another scenario (e.g. direct placement). The bidder has ninety minutes to confirm in writing with the issuer if/when the hold the price option or other alternative will be used.

Alternative Four – Issuer Does Not Receive Three Bids and Does Not Want to Use the 10% Actual Sales Test Nor the Hold the Price Options

In the event an issuer does not receive three bids and thus cannot rely upon the competitive sale exception, the sale will be cancelled by the issuer.

Resources

- [IRS Issue Price Regulation](#)
- [SIFMA Model Documents](#)
- [NABL Model Documents](#)
- [NAMA Competitive Sale Decision Matrix \(from Ehlers\)](#)
- [NAMA Issue Price Webinar recording and materials](#)
- [GFOA Alert](#)
- [GFOA Issue Price Conference Session Materials](#)

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