



December 9, 2015

Submitted Electronically

Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: (IRS Reg—138526-14)

Dear Ms. Som de Cerff and Mr. Cross:

Thank you for your time and effort regarding the regulatory initiative to provide a revised definition of 'issue price' for tax-exempt bonds (IRS Reg—138526-14). BDA appreciates that you took the time to meet with our members to discuss the rulemaking and thought that the public hearing was productive and informative as well.

The purpose of this letter is to communicate BDA's view on several important questions that arose during our meeting with Internal Revenue Service (IRS) and U.S. Treasury staff and during the IRS public hearing. Please feel free to follow up with BDA regarding any topic related to the proposed issue price rule and thank for your engagement on this important issue.

How would you view a rule that requires an underwriter to hold the offering price at the initial offering price until such time that 10 percent of a maturity was sold to the public and the substantial amount standard was met?

If an underwriter is prohibited from selling bonds at prices higher than the initial offering price under any circumstance until the 10 percent of each maturity actual sales standard is met, pricing for issuers who pursue competitive and negotiated deals will likely be harmed. A fundamental point is that if underwriters are placed in a situation where they can suffer losses due to market movements they will likely be compelled to underwrite those issues at higher interest rates and lower bond prices to reflect anticipated difficulties in marketing the issues.

Requiring underwriters to hold bond prices until 10 percent of each maturity is sold magnifies this concern—especially for smaller issuances (less than \$30 million). Overall municipal market price movements, interest rate movements, changes in the yield curve, changes in market perception of municipal credit quality, and the pricing of other bond issuances that take place in the days and weeks after an issuance's sale date will all impact the prices within an issuance.

A rule that prohibits a dealer from reacting to natural market movements would likely have a detrimental impact on pricing for issuers because dealers would be in a position in which they would be unable to react if rates moved lower, but would have to accept the downside market-price risk of rates moving higher. It is very important to understand that “reacting to a market move” doesn’t just happen on the trading floor. For example, each firm is required to heed FINRA’s existing concern regarding intra-day price movements and risk, where current industry risk regulations mandate “moment-to-moment” capital requirements (FINRA 15c3-1) which includes price adjustments in all security positions, including inventory positions and underwriting commitments.

At the same time, from an issuer and underwriter perspective, we want to protect issuers and avoid building in a cushion of a higher interest rate at issuance. As we review the proposed issue price regulations, BDA thinks it is important that we not lose sight of current market concerns regarding higher interest rates. Higher interest rates and increased market volatility will increase the risk of competitively bidding new issues or making a firm commitment on a negotiated deal. Additionally, underwriters must be careful with the requirement to hold the original offering price until settlement or until the substantial amount standard is met as it may be in contradiction to “fair market pricing” rules already in place. If the dealer is required to “hold” the price until the threshold is met, the SEC and FINRA may challenge the fairness of pricing to customers with respect to the current markets. Because there isn’t a true fixed income benchmark that tracks the trading idiosyncrasies of the numerous niche markets, it may be difficult for dealers to justify higher prices. However, in a rising interest rate market the idea of holding the issue price to settlement or until the substantial amount standard is met will bring significantly more risk into the market for underwriters. In 2014, with approximately 4100 broker-dealers, there were only 145 unique broker dealers that actually bid on bond issuances.

In the context of the alternative rule, how could the proposed rule’s requirement to document a bond sale at a price higher be clarified?

There are numerous indices which track the U.S. municipal bond market using both broad and narrowly defined indices designed to capture the performance of most bonds within the marketplace. As you are aware, the municipal bond market is composed of bonds issued by state, county and local governments, as well as their respective agencies and there is an index for just about every category. Rating agencies and several large analytical departments at the largest firms compile the indexes.

Many issues are priced at a spread to the MMD (Municipal Market Data) curve, which is an index of AAA-rated municipal securities. This is MMD’s version of an independent assessment of overall market movement amongst highly rated securities. Understandably, it may not accurately reflect movement of supply and demand for specific municipal securities in specific markets. When reviewing an index, it is important to know these indices often do not reflect specific, important changes in one state or region that may impact a limited amount of state or regional issuances. But, at the

same time, there are a limited amount of indices that represent activity within certain states and territories where there is heavier issuance. Given the fact that there are 66 different rating categories spread across three rating agencies, excluding non-rated bonds, there is simply no existing index of municipal market securities that could be used to justify the price of a particular bond at a particular time of day in a manner that issuers, bond counsel, and underwriters would be comfortable with and would satisfy an IRS auditor.

BDA urges IRS and Treasury to continue to improve the alternative method by providing additional guidance on how to justify market movements. A “single index approach” does not appear to be sufficient. We believe that the justification and certification of higher sales prices should be based on a combination of all the available market information, including an index, Treasury rate and yield curve movements, in addition to idiosyncratic market movements that may impact a state or region. BDA believes that a 50% of a total issuance actual sales approach, in addition to explicitly stating that a variety of factors, and not just an index, could be used to justify higher bond prices would combine to reduce the likelihood that the alternative rule would need to be used while making it easier to comply with it in the limited instances where utilizing it would be required.

In conclusion, it is important for issuers and underwriters that the general rule is expanded so it will apply to a greater number of deals. Additionally, it is crucial that the structure of the alternative rule be amended so that it does not hinder issuer-pricing activity and still allows underwriters to reasonably react to market movements that may result in higher or lower bond prices with reasonable documentation and certification requirements. Lastly, the current focus on issue price appears to center on “upward price” movements in the market, but we should not let upward movement concerns override our concerns for what will happen to these issues and issuers in the anticipated rising interest rate market. In a rising rate environment, it is unlikely that underwriters will be spending a lot of time justifying higher prices on new issues. Consequently, the burden of interest rate risk will significantly shift toward the limited number of underwriters that bid on new issue deals for issuers.

How could one structure a potential safe harbor for competitive transactions that retains an actual-sales-to-the-public approach?

BDA would like to amend its previous recommendation in order to satisfy regulatory requirements of including a sales-to-the-public component. BDA initially recommended a safe harbor for competitive deals that receive two bids. After analyzing the issue further, BDA does not believe a safe harbor that includes a minimum bid requirement is in the best interests of the marketplace. A two-bid requirement would likely harm smaller issuers whose issuances are more likely to receive fewer bids. BDA recommends an actual-sales approach for competitive deals that acknowledges that the winning underwriter is immediately at risk and has done little or no pre-marketing of the issuance. Competitive deals pose increased risks for underwriters and issue price regulations should reflect the increased risks so that issuers who want to pursue a

competitive underwriting, or are required by state law to engage in a competitive underwriting, benefit from a competitively priced marketplace.

In the corporate market, the majority of most bond issues come with one or two maturities. The proposed regulatory structure would be suitable for those corporate issuances. In the municipal market, most of the deals come with multiple serial maturities and term maturities with self-amortizing debt structures. This creates significant reductions in interest rate costs to the issuers that issue self-amortizing debt. Another option provided to the issuer and bidder, usually due to small issue size (typically \$30 million or less), is that maturities can be combined in order to structure the deal to align with investor demand. A beneficial result of the scrutiny of municipal issuances by regulators and industry strategists has been the realization that different finance structures work better for different industries. Municipal issuers sell one bond issue and utilize multiple maturities because it reduces interest costs. Instead of penalizing a municipal issuer due to their preferred structure, an additional recommendation specifically for competitive deals is to amend the proposed rule to allow for 25% of the entire issue to be sold to the public to fulfill the actual sales requirement to establish issue price. This will allow the issuer to fulfill the rule's requirements by selling parts of each maturity, several maturities, or a single maturity to meet the actual sales to the public component.

For competitive deals, BDA believes that if an underwriter documents that it has publicly offered bonds at the initial offering prices and sells 25% of an overall issuance at those prices to the public, it should then be deemed sold at the issue price. BDA believes this recommendation for competitive deals would help to ensure that the rules for competitive deals would encourage bidders because it acknowledges the increased risks associated with competitive deals while also satisfying the sales-to-the-public regulatory requirement.

Thank you, in advance, for your consideration of these additional comments and recommendations. We look forward to continuing to work with you as you move forward with this important rulemaking.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Nicholas", with a stylized, cursive script.

Michael Nicholas
Chief Executive Officer