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December 16, 2013

VIA E-MAIL

Internal Revenue Service
CC:PA:LPD:PR (REG-148659-07)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044
www.regulations.gov (IRS REG-148659-07)

Re: Proposed Arbitrage Regulations Addressing Definition of "Issue Price" for Tax-Exempt Bond Purposes (REG-148659-07)

Ladies and Gentlemen:

The National Association of Bond Lawyers ("NABL") respectfully submits the enclosed comments relating to the definition of "issue price" in the proposed arbitrage regulations, REG-148659-07, which were published in the Federal Register on September 16, 2013 (the "Proposed Regulations"). NABL is separately submitting comments on other aspects of the Proposed Regulations. These comments were prepared by members of NABL's Tax Law Committee listed on Appendix I, and were approved by the NABL Board of Directors.

NABL appreciates the substantial efforts made by the Department of the Treasury and the Internal Revenue Service in the preparation of the Proposed Regulations and, as explained in its separate comments, believes that other aspects of the Proposed Regulations should be finalized as soon as possible; however, as explained in the enclosed comments, NABL respectfully suggests that the proposed definition of "issue price" be withdrawn and that any other change in the issue price definition be re-proposed.

NABL requests an opportunity to speak at the public hearing to be held on February 5, 2014 at 10:00 AM. An outline of the topics to be discussed is attached as Appendix II.

NABL exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

If you have any questions regarding the enclosed comments, please contact Bill Daly in our Washington, D.C., office at (202) 503-3300.

Sincerely,

Allen K. Robertson

Allen K. Robertson
President

COMMENTS OF THE NATIONAL ASSOCIATION OF BOND LAWYERS ON THE DEFINITION OF "ISSUE PRICE" IN THE PROPOSED ARBITRAGE REGULATIONS PUBLISHED ON SEPTEMBER 16, 2013

EXECUTIVE SUMMARY

On June 18, 1993, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") published comprehensive final regulations on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149 and 150 of the Internal Revenue Code of 1986, as amended (the "Code").

On September 16, 2013, Treasury and IRS published proposed regulations that would amend the existing regulations in a number of respects, including significant revisions to the definition of "issue price" that eliminate the "reasonable expectations" standard for determining the issue price of publicly offered municipal bonds as of the sale date in favor of an "actual sales" approach.

For the following reasons, the National Association of Bond Lawyers ("NABL") respectfully suggests that the definition of "issue price" in the proposed regulations be withdrawn and that any other change in the issue price definition be re-proposed.

The proposed definition of "issue price" is not required or appropriate to address the policy objectives and stated concerns of Treasury and IRS.

The preamble to the proposed regulations, the proposed definition of "issue price" in the proposed regulations and public comments made by Treasury and IRS officials after publication of the proposed regulations emphasize that the amendments to the issue price definition are intended to make that definition more consistent with current regulations under sections 1273 and 1274 of the Code, which implies that such consistency, including an "actual sales" approach, is required by the cross-reference to sections 1273 and 1274 in section 148(h) of the Code. A review of the history and purpose of the arbitrage statutes and regulations, including the existing regulations, confirms that an "actual sales" approach is not required.

In the preamble to the proposed regulations, Treasury and IRS also state that the significant amendments to the issue price definition would "address [certain] concerns" and "provide greater certainty." As discussed below, NABL believes that the proposed definition is not administrable by issuers and, therefore, will result in less certainty. The concerns described in the preamble generally relate to the manner in which municipal securities are offered and distributed, and imply that the conduct of municipal underwriters is sometimes inappropriate and perhaps illegal. Concerns about the offering and distribution process for municipal securities should be addressed by working with municipal securities regulators, not through tax policy. Treasury and IRS should share their concerns with the Securities and Exchange Commission, the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority and request that they investigate and take appropriate regulatory and enforcement action.

The proposed definition of "issue price" is not administrable by issuers under existing law and market practices.

The proposed definition of "issue price" is not administrable by issuers because issuers and bond counsel do not have access to the information necessary to determine issue price based on actual sales to the "public" as defined under the proposed regulations.

The proposed definition of "issue price" also is not administrable by issuers because it does not assure that the issue price of publicly offered municipal bonds can be determined as of the sale date. To be administrable by issuers, any definition of "issue price" of publicly offered municipal bonds must enable issue price to be determined as of the sale date, when the terms of the issue are established. Determination of issue price as of the sale date is important for three reasons. Issuers may violate applicable State law, policy or authorizing resolutions if issue price cannot be determined as of the sale date. Because compliance with numerous other provisions of federal tax law depends on the determination of issue price, issuers may unintentionally violate those provisions if issue price cannot be determined as of the sale date. Finally, bond counsel must confirm on the sale date whether they can give an unqualified approving opinion at closing.

Attempts to comply with the proposed definition of "issue price" will impose substantial additional expense on issuers and alter longstanding practices in the municipal market.

If the proposed definition is adopted and municipal bonds continue to be marketed in ways that result in unsold maturities on the sale date, issuers will bear substantial additional expense attempting to determine issue price based on actual sales to the public. To eliminate unsold maturities on the sale date in negotiated underwritings, issuers would be forced to accept lower prices and higher yields. Because issuers may not be able to eliminate the possibility of unsold maturities in competitively sold deals, the ability of issuers to sell bonds competitively may be limited.

INTRODUCTION

Under section 103(a) of the Code, interest on a State or local bond (*i.e.*, an obligation of a State or political subdivision thereof) is excludable from the gross income of the owner thereof; however, section 103(a) does not apply to any "arbitrage bond" within the meaning of section 148.

The original and principal purpose of the restrictions relating to arbitrage bonds is to prevent issuers from earning a profit by investing the proceeds of tax-exempt bonds in higher yielding taxable investments (*e.g.*, Treasury securities). In light of this purpose, section 148(a) defines "arbitrage bond" as follows:

> For purposes of section 103, the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are *reasonably expected (at the time of issuance of the bonds)* to be used directly or indirectly –
>
> (1) to acquire higher yielding investments, or
>
> (2) to replace funds which were used directly or indirectly to acquire higher yielding investments.
>
> For purposes of this subsection, a bond shall be treated as an arbitrage bond if the *issuer intentionally* uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2). [Emphasis added.]

Under section 148(a), the *prima facie* determination regarding whether a bond is an arbitrage bond must be made no later than the date on which the bond is issued, based on the issuer's contemporaneous reasonable expectations.

Section 148(b)(1) defines "higher yielding investments" as any "investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue."

To determine whether bond proceeds have been used to acquire higher yielding investments, one must compare the yield on the bond issue to the yield on the investments. Section 148(h), which was added to the Code as part of the Tax Reform Act of 1986,[1] provides that:

> For purposes of [section 148], the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).

On June 18, 1993, Treasury and IRS published comprehensive final regulations on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103,

[1] Pub. L. No. 99-514 (1986).

148, 149 and 150, which generally became effective in 1993.[2] Since that time, those final regulations have been amended in certain limited respects. The regulations issued in 1993 and the amendments thereto are collectively referred to herein as the "Existing Regulations."

In § 1.148-1(b) of the Existing Regulations, "issue price" is defined as follows:

> Issue price means, except as otherwise provided, issue price as defined in sections 1273 and 1274. Generally, the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. *The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price.* If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining the issue price under section 1274. The issue price of bonds may not exceed their fair market value as of the sale date. [Emphasis added.]

The issue price definition under the Existing Regulations generally follows the issue price definition used for computing original issue discount on debt instruments under sections 1273 and 1274, with certain modifications. Specifically, consistent with section 148(a), the issue price definition under the Existing Regulations applies a reasonable expectations standard, determined as of the sale date, for determining the issue price of bonds that are publicly offered, not a standard based on actual sales. Under this standard, the first price at which a substantial amount (using ten percent as a safe harbor) of the bonds is reasonably expected to be sold to the public is treated as the issue price and is used in determining the yield on the issue, provided that all of the bonds of that maturity (and with the same terms) are offered to the public in a *bona fide* public offering.

In 1995, the Municipal Securities Rulemaking Board ("MSRB")[3] began the limited dissemination of prices for the municipal securities market, and increased price transparency in a series of measured steps. By 2000, MSRB was making all trade data public with a one-day delay. On January 31, 2005, MSRB began disseminating "real-time" (or more accurately, contemporaneous) municipal bond prices (within 15 minutes of a trade).[4] The resulting public

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[2] T.D. 8476, 1993-2 C.B. 13.

[3] MSRB is a self-regulatory organization created by Congress in 1975 to write rules regulating the behavior of bank and securities firm dealers in the municipal securities market in order to "protect investors and the public interest." MSRB is subject to oversight by the Securities and Exchange Commission ("SEC"), and its rules, once approved by SEC, have the force and effect of federal law. MSRB rules are enforced by the Financial Industry Regulatory Authority ("FINRA") for securities firms and by the various bank regulatory agencies for bank dealers, as well as SEC.

[4] This real-time information was initially posted and available publicly for free on an investor education website, www.investinginbonds.com, maintained by The Bond Market Association (now known as the Securities Industry and Financial Markets Association). Subsequently, MSRB established the Electronic Municipal Market Access

availability of trading data enabled municipal market participants and academics to analyze trading and pricing in newly issued municipal bonds.[5] Analysis of the trading data confirmed two general conclusions: (1) for many municipal new issues, it takes some amount of time (days or weeks) for the bonds to settle into the hands of investors, such as individual or "retail" buyers, whose intent is to "buy and hold"; and (2) during this "settling out" process in the secondary market, there is an often an upward trend in the prices of the bonds (referred to as "trading up"). Analysis of the trading data also confirmed that some investors (generally institutional investors) purchase bonds from the underwriters and then, a short time after that initial sale (including prior to the closing of the bond issue, or even prior to the date of the signing of the bond purchase agreement between the issuer and the underwriters (the "BPA")), resell some or all of the bonds they purchased to broker/dealers (who may or may not have been part of the original underwriting group) or other investors. These resales are referred to as "flipping."[6]

By 2006, IRS, in certain audits of publicly offered municipal bonds, began to challenge the determination of issue price, questioning the accuracy of certificates regarding issue price customarily provided by underwriters in connection with the issuance of the bonds. The resulting uncertainty among issuers and bond counsel led NABL to create an issue price study group, which in August 2006 submitted to Treasury and IRS its recommendations for changes to the Existing Regulations that would provide clarification regarding the determination of issue price in light of existing practices and potential interpretation of the Existing Regulations. The August 2006 recommendations of the NABL issue price study group are attached hereto as **Exhibit A**. The principal recommendation was that the reasonable expectations provisions of the Existing Regulations be given substantive meaning by providing guidance and/or safe harbors as to what constitutes a *bona fide* public offering, as well as greater clarity around sales to parties that are not clearly members of the "public."

For municipal market participants, Treasury and IRS, questions about issue price naturally began to receive less attention as the credit crisis and "Great Recession" began to unfold in 2008; however, the popularity of taxable, direct-subsidy "Build America Bonds" ("BABs"), authorized to be issued in 2009 and 2010 under the American Recovery and Reinvestment Act of 2009[7] ("ARRA" or the "Stimulus Act") brought the issue back to the forefront because of the requirement that BABs not be sold with more than a *de minimis* amount

("EMMA") website, www.emma.msrb.org, to increase access to important disclosure and transparency information in the municipal securities market. EMMA provides market transparency data, which includes real-time prices and yields at which bonds and notes are bought and sold, for most (but not all) trades occurring on or after January 31, 2005.

[5] *See, e.g.,* Green, Hollifield & Schurhoff, "Dealer Intermediation and Price Behavior in the Aftermarket for New Bond Issues" (June 21, 2006), http://dev3.cepr.org/meets/wkcn/5/5534/papers/Schurhoff.pdf. Earlier versions of this paper were distributed in 2005.

[6] Flipping is not unique to the municipal bond market. Pricing and performance of new corporate bonds has been found to be consistent with a "flipping" hypothesis. *See* Kozhanov, Ogden & Vaghefi, "The Pricing and Performance of New Corporate Bonds: TRACE-Era Evidence" (July 6, 2011), https://secure.northernfinance.org/2011/Submissions/modules/request.php?module=oc_program&action=view.php&id=171.

[7] Pub. L. No. 111-5 (2009).

of original issue premium. The struggles of issuers and others in the municipal marketplace with matters regarding the issue price of BABs led the Government Finance Officers Association ("GFOA"), NABL, the Regional Bond Dealers Association ("BDA") and the Securities Industry and Financial Markets Association ("SIFMA") to jointly submit a request to Treasury for guidance regarding issue price. The August 2010 submission by GFOA, NABL, BDA and SIFMA is attached hereto as **Exhibit B**. This joint submission included data compiled by SIFMA that demonstrated that all markets (corporate, tax-exempt and BABs) have upticks in secondary market trading, and that compared to other markets, there was nothing unusual about trading in the BABs market. (In fact, observed changes in BABs pricing were actually lower than in other markets.) Like the 2006 NABL submission, this multi-association submission requested that separate safe harbors for competitive and negotiated transactions be established under the Existing Regulations. Again, not surprisingly, after the Stimulus Act provisions authorizing the issuance of BABs expired on December 31, 2010, concerns about issue price became somewhat less acute.[8]

On September 16, 2013, Treasury and IRS published proposed regulations (the "Proposed Regulations")[9] that would amend the Existing Regulations in a number of respects,[10] including significant revisions to the definition of "issue price" that eliminate the "reasonable expectations" standard for publicly offered municipal bonds in favor of an "actual sales" approach. Under the Proposed Regulations, issue price would be defined as follows:

> (f) Definition of issue price —
>
> (1) In general. Except as otherwise provided in this paragraph (f), issue price is defined in sections 1273 and 1274 and the regulations under those sections. In determining the issue price under section 1274 of a bond that is issued for property, the adjusted applicable Federal rate, as computed for purposes of section 1288, is used in lieu of the applicable Federal rate in determining the issue price.
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> (2) Tax-exempt bonds issued for money —
>
> (i) In general. The issue price of tax-exempt bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public (as defined in paragraph (f)(3)(i) of this section). See paragraph (f)(4)(ii) of this section for an issue including bonds with different payment and credit terms.
>
> (ii) Safe harbor for determining issue price of tax-exempt bonds issued for money. For purposes of paragraph (f)(2)(i) of this section, the issuer may treat the first price at which a minimum of 25 percent of the bonds is sold to the public as the issue price. However the preceding sentence applies only if all orders at this

[8] In recent years, the inability of issuers to earn positive arbitrage on investments of bond proceeds, e.g., because of historically low interest rates on Treasury securities, also has made determination of issue price and bond yield less important.

[9] Notice of Proposed Rulemaking and Notice of Public Hearing, 78 Fed. Reg. 56,842 (Sept. 16, 2013).

[10] NABL is separately submitting comments on the remainder of the Proposed Regulations.

sale price received from the public within the offering period are filled to the extent the public orders at such price do not exceed the amount of bonds sold.

(3) Definitions. For purposes of this paragraph (f), the following definitions apply:

(i) Public. Public means any person (as defined in section 7701(a)(1)) other than an underwriter.

(ii) Underwriter —

(A) In general. Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, the term underwriter means any person (as defined in section 7701(a)(1)) that purchases bonds from an issuer for the purpose of effecting the original distribution of the bonds or that otherwise participates directly or indirectly in such original distribution. An underwriter includes a lead underwriter and any member of a syndicate that contractually agrees to participate in the underwriting of the bonds for the issuer. A securities dealer (whether or not a member of an underwriting syndicate for the issuer) that purchases bonds (whether or not from the issuer) for the purpose of effecting the original distribution of the bonds is also treated as an underwriter for purposes of this section.

(B) Certain related parties included. Except as otherwise provided in paragraph (f)(3)(ii)(C) of this section, an underwriter includes any related party (as defined in § 1.150-1(b)) to an underwriter.

(C) Holding for investment. A person (as defined in section 7701(a)(1)) that holds bonds for investment is treated as a member of the public with respect to those bonds.

(iii) Securities dealer. Securities dealer means a dealer in securities, as defined in section 475(c)(1).

(4) Special rules. For purposes of this paragraph (f), the following special rules apply:

(i) Subsequent sale at a different price. The issue price as determined under paragraph (f)(1) or (2) of this section does not change if part of the issue is later sold at a different price.

(ii) Separate determinations. The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately.

The preamble to the Proposed Regulations, the proposed definition of "issue price" in the Proposed Regulations and public comments made by Treasury and IRS officials after publication

of the Proposed Regulations emphasize that the amendments to the issue price definition are intended to make that definition more consistent with current regulations under sections 1273 and 1274 of the Code, which implies that such consistency, including an "actual sales" approach, is required by the cross-reference to sections 1273 and 1274 in section 148(h) of the Code. In the preamble to the Proposed Regulations, Treasury and IRS also state that the significant amendments to the issue price definition would "address [certain] concerns" and "provide greater certainty." Treasury and IRS state that their general concern is "that certain aspects of the Existing Regulations for determining the issue price of tax-exempt bonds are no longer appropriate in light of market developments since those regulations were published." In particular, Treasury and IRS state the following concerns:

- The ten-percent test does not always produce a "representative price for the bonds," because underwriters may be executing the first ten percent of sales at the lowest price (and thus the highest yield) and thereby causing the issue price to be a lower price than is representative of the prices at which the remaining bonds are sold;

- The reasonable expectations standard may not produce a "representative issue price," based on pricing data that shows actual sales to the public at prices that differ significantly from the issue price used by the issuer; and

- Based on reported trade data, sales to underwriters and security dealers may be included as sales to the public in determining issue price in certain instances.

As discussed below, the definition of "issue price" contained in the Proposed Regulations should be withdrawn and any other change in the issue price definition should be re-proposed. To understand why the proposed definition of issue price should not be adopted, it is helpful to review the history and development of the arbitrage restrictions and some key differences between the municipal and corporate bond markets.

BACKGROUND

History and Development of the Arbitrage Statutes and Regulations

Treasury and IRS first addressed the problem of arbitrage bonds in a technical information release which announced that IRS would not issue rulings about whether interest on certain State or local bonds was exempt from federal income taxation. These bonds were:

> issued by . . . governmental units where a principal purpose is to invest the proceeds of the tax-exempt obligations in taxable obligations, generally United States Government securities, bearing a higher interest yield. The profit received by the governmental units on the difference between the interest paid on the exempt obligations and the interest earned on the taxable obligations is in the nature of arbitrage.[11]

[11] T.I.R. 840 (Aug. 11, 1966), STAND. FED. TAX. REP. ¶ 6701 (CCH 1966).

This release effectively resulted in a moratorium on most advance refundings, which remained in effect until the passage of the Tax Reform Act of 1969.[12]

As part of the Tax Reform Act of 1969,[13] Congress addressed the problem of arbitrage bonds by adding section 103(d) to the Internal Revenue Code of 1954. Section 103(d) was redesignated section 103(c) in the Tax Reform Act of 1976.[14] That section provided, in pertinent part, that:

> the term "arbitrage bond" means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly –
>
> > (A) to acquire securities . . . or obligations . . . which may be reasonably expected at the time of issuance to produce a yield over the term of the issue which is materially higher (taking into account any discount or premium) than the yield on obligations of such issue[.]

To compute yield on a bond, one must know the purchase price of the bond, its coupon (*i.e.*, stated interest rate), the principal and interest payment dates and its stated redemption price at maturity. Following passage of the Tax Reform Act of 1969, Treasury consistently proposed that the purchase price paid to the issuer, taking into account any costs of issuing the bonds, should be used in computing yield on the bonds.[15] Treasury's earliest view, reflected in Temp. Reg. § 13.4(a)(5), was that "an amount equal to the sum of the reasonably expected administrative costs of issuing, carrying and repaying [an] issue of obligations shall be treated as a discount in the selling price of such issue" for computing "yield." Thus, yield was initially determined based on the price paid to the issuer by the underwriter for the bonds, which already reflected the "underwriter's spread" (also referred to as the "underwriter's discount"), minus any other costs of issuance paid directly by the issuer (*e.g.*, attorneys' fees, printing and delivery costs, preparation and distribution costs).

By 1978, because States and municipalities were advance refunding bonds in increasingly large numbers, Treasury concluded that permitting an issuer in an advance refunding to earn enough arbitrage to cover "most or all" of its administrative costs encouraged issuers to advance refund bonds in marginal situations and resulted in "inflated and excessive fees to lawyers, accountants, underwriters, and others."[16] As a consequence, Treasury changed

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[12] *See* Manly W. Mumford, "Arbitrage and Advance Refunding," 1976 *Duke L. J.* 1239, 1246 (1976).

[13] Pub. L. No. 91-172 (1969).

[14] Pub. L. No. 94-455 (1976).

[15] *See* Temp. Reg. § 13.4(a)(5)(i)(b), T.D. 7072, 35 Fed. Reg. 17,406 (Nov. 13, 1970), *as amended by* T.D. 7174, 37 Fed. Reg. 10,932 (Jun. 1, 1972) and T.D. 7273, 38 Fed. Reg. 10,927 (May 3, 1973); *see also* Prop. Reg. § 1.103-13(c)(3)(i)(b)(1972).

[16] *See* Notice of Proposed Rulemaking, LR-1671, 43 Fed. Reg. 39,822 (Sept. 7, 1978).

its position regarding calculation of yield and proposed, effective September 1, 1978, that yield would be computed based on the "purchase price" of the bonds, with no reduction for an issuer's costs. For bonds that were to be publicly offered, "purchase price" would be the "initial offering price to the public (excluding bond houses, brokers, and other intermediaries)."[17] The proposal was adopted in the so-called "final arbitrage regulations" of 1979.[18]

The 1978 change in the regulations was intended to require yield to be computed without deducting the underwriter's spread or other costs of issuance paid directly by the issuer. Arithmetically, this meant that the purchase price would be determined by adding the underwriter's spread back to the price paid to the issuer by the underwriter for the bonds. MSRB, in its Glossary of Municipal Securities Terms, defines "underwriter spread," with respect to a new issue of municipal securities, as "the difference between the price paid by the underwriter to the issuer for the new issue and the prices at which the securities are initially offered to the investing public."[19] Thus, by defining purchase price to be the "initial offering price to the public," the 1978 change in the regulations was requiring that the underwriter's spread be included in the purchase price in computing yield on the bonds.

The State of Washington challenged the 1978 change in the computation of yield and, in *State of Washington v. Commissioner*, 692 F.2d 128 (D.C. Cir.1982), the United States Court of Appeals for the District of Columbia held that the regulations went beyond the permissible rulemaking authority of the Treasury and interpreted the statute in a way that was plainly inconsistent with the purpose of Congress in enacting the statute.

In response, Treasury turned to Congress, and in the Tax Reform Act of 1986, Congress specifically overruled *State of Washington* by adding section 148(h) to the Code, which requires that "yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274)." The primary purpose of section 148(h) was to assure that an issuer would not be able to recover any of its costs of issuance (other than bond insurance and similar guarantee fees) through the investment of the bond proceeds at a higher yield. The Senate Report stated:

> The committee believes that it is important for issuers of tax-exempt bonds to pay the costs associated with their borrowing. The bill provides that the costs of issuance, including attorneys' fees and underwriters' commissions, must be paid by the issuers or beneficiaries, rather than recovered through arbitrage profits . . . .[20]

[17] In an earlier Notice of Proposed Rulemaking, LR-1671, 43 Fed. Reg. 19,675 (May 8, 1978), the language was explained as being the same definition of issue price as the one used in Reg. § 1.1232-3 relating to original issue discount. Note that this initial regulation did not require that a substantial amount of the bonds be sold to the public at these offering prices.

[18] Reg. §1.103-13(d)(2) (1979).

[19] http://www.msrb.org/glossary/SPREAD.aspx. Note that this definition also does not require that a substantial amount of the bonds be sold to the public at these offering prices.

[20] S. REP. NO. 99-313 at 828.

The House Report described the change as requiring that yield on an issue be determined based on the issue price, "taking into account the Code rules on original issue discount and discounts on debt instruments issued for property (sections 1273 and 1274)."[21] The Conference Report described the change in the following way:

> Yield on bonds is determined on the basis of the original issue discount rules of the Code rather than as under the present general arbitrage restrictions. Thus, yield is determined based on the price at which a substantial number of the bonds are sold to the public and must reflect a current market price.[22]

By adopting section 148(h) and referencing the original issue discount provisions of sections 1273 and 1274, Congress clearly intended to prevent issuers from deducting the underwriter's spread in computing the yield on tax-exempt bonds.[23]

Treasury's first attempt at implementing section 148(h) was the temporary regulations adopted in 1989 (the "1989 Temporary Arbitrage Regulations").[24] The definition of "issue price" in the 1989 Temporary Arbitrage Regulations was revised several times before reaching its final form in 1993 in the Existing Regulations. The original definition of "issue price" in the 1989 Temporary Arbitrage Regulations took more of an "actual sales" approach, requiring the issue price for substantially identical bonds sold at one price to the general public and to institutional or other investors at a discount from that price to be determined separately.[25] Importantly, however, even these initial temporary regulations provided that the issue price for bonds that were publicly offered would be determined "based on actual facts and reasonable expectations as of the sale date and shall not be adjusted to take into account actual facts after such date."[26] The scope of the reasonable expectations test for publicly offered bonds was limited by allowing it to be applied only to bonds actually offered to the general public in a *bona fide* public offering at those issue prices.[27]

The 1989 Temporary Arbitrage Regulations were viewed, in general, as being far too complex, and Treasury undertook a simplification of the regulations. Notice 89-78[28] issued July 24, 1989 provided that future regulations would eliminate separate books for public and

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[21] H.R. REP. NO. 99-426 at 554 (1985).

[22] H.R. REP. NO. 99-841, at II-745 (1985) (Conf. Rep.).

[23] In adopting Section 148(h), Congress did not intend to abandon the "reasonable expectations" methodology. *See* footnote 42.

[24] T.D. 8252, 1989-1 CB 25.

[25] Temp. Reg. §1.148-8T(c)(1).

[26] Temp. Reg. §1.148-8T(c)(2)(i).

[27] Temp. Reg. §1.148-8T(c)(2)(iii).

[28] Notice 89-78, 1989-2 CB 390.

institutional sales, and instead look at the average offering price of the bonds. The notice also provided that issue price would be based upon the initial offering price at which a substantial amount of the bonds was actually sold.

In 1991 Treasury further simplified the regulations.[29] The 1991 changes provided that issuers and underwriters were no longer required or permitted to identify and segregate bonds expected to be publicly offered to the general public at one price from those publicly offered to institutions at a concession. This simplification represented a trade-off for issuers: a lower arbitrage yield in exchange for a lesser administrative burden. Most significantly in the current context, the simplification was also a departure from theoretical perfect adherence to section 1273 for the apparent purpose of administrability. In making the 1991 changes, Treasury explained why a reasonable expectations test for publicly offered bonds was appropriate:

> For a publicly offered bond, the issue price is the initial offering price to the general public and not the price paid by the underwriter. This is the same definition of issue price as is used in section 1273 and section 1274. *A reasonable expectations test is used to determine the initial public offering price because, on the date of issue, the exact price at which the bonds subsequently will be sold to the general public may not be known*. [Emphasis added.][30]

In May 1992 Treasury published final arbitrage regulations (the "1992 Regulations").[31] The 1992 Regulations implemented the changes described above and adopted a definition of "issue price" that is substantially the same as in the Existing Regulations, including the reasonable expectations test for publicly offered bonds. The 1992 Regulations, however, required that the issue price of bonds be adjusted to take into account sales to the public after the date of the issue. When the Existing Regulations were published, they further simplified the determination of issue price by specifically providing that issue price would not be adjusted if portions of the issue later sold for different prices.

As discussed in the "INTRODUCTION" above, the Existing Regulations generally became effective in 1993. The definition of "issue price" has not been amended in the twenty years since then.

Differences between the Municipal and Corporate Bond Markets

The municipal bond market and the corporate bond market are different in a number of important respects.

First, on average, the aggregate principal amount of a municipal bond issue is much smaller than that of a corporate bond issue. In 2011, there were over one million different

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[29] T.D. 8345, 1991-1 C.B. 33.

[30] *Id*.

[31] T.D. 8476, 1993-2 C.B. 13.

municipal bond issues outstanding, totaling $3.7 trillion in principal, in comparison to fewer than 50,000 corporate bond issues, totaling $11.5 trillion in principal (including foreign bonds).[32]

Second, municipal bond issues often have a 30-year final maturity, consisting of serial bonds maturing in each of the first ten years or so and two or more term bonds with required annual redemptions; these issues often provide the issuer with the option to redeem the bonds after ten years with little or no redemption premium. This structure may reflect legal requirements and/or the need of government issuers and many conduit borrowers to have relatively equal annual debt service payments on their bonds (*e.g.*, for budgeting or covenant purposes). In contrast, corporate bond issues typically have a shorter final maturity (*e.g.*, 5 years, 10 years), consist of a single, bullet maturity (*i.e.*, no required principal payments prior to final maturity) and can be optionally redeemed only pursuant to a "make-whole" redemption provision which limits the ability of the issuer to refinance the debt to obtain interest savings.

Third, the essentially exclusive means by which corporate bonds are sold are negotiated underwritings and private placements.[33] In contrast, a substantial portion of municipal bonds are sold through competitive bidding,[34] often because some types of municipal securities, including general obligation bonds, may be required by State law to be offered under competitive bidding. For example, during 2011, 42.4% of the 13,463 municipal securities issuances were done through competitive sales.[35]

Fourth, underwriters of corporate bonds rarely agree to purchase the bonds unless they have orders to re-sell all of the bonds. Municipal bond underwriters, however, regularly purchase bonds for which they do not have orders (*e.g.*, because they purchased bonds in a competitive sale for which they were able to do little or no premarketing due to the inherent uncertainty as to whether they will be successful in their bid to purchase the bonds or because insufficient or no orders were received for certain maturities in a negotiated underwriting). As discussed above, because of legal, covenant and other considerations relating to municipal bonds, an underwriter may not be able to avoid structuring a transaction with unsold maturities, whereas the maturity and other terms of a corporate bond generally can be adjusted based on prevailing market conditions and investor demand.

Finally, municipal securities, particularly tax-exempt municipal securities, are largely held by individual or "retail" investors. As of the end of 2011, approximately 50.2% of the outstanding principal amount of municipal securities was held directly by individuals and up to 25% was held on behalf of individuals by mutual, money-market, closed-end and exchange-

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[32] U.S. Securities and Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) (the "SEC 2012 Municipal Market Report"), at 5.

[33] For a brief description of negotiated underwriting, see Exhibit A at 3-5.

[34] For a brief description of a competitive sale, see Exhibit A at 5-6.

[35] SEC 2012 Municipal Market Report at 15-16 & n.75. In terms of principal amount issued in 2011, competitive sales comprised 26.3%.

traded funds.[36] In contrast, the corporate bond market is dominated by institutional investors. For example, as of the third quarter of 2013, households held only approximately 17.7% of corporate debt.[37]

COMMENTS

I. The proposed definition of "issue price" is not required or appropriate to address the policy objectives and stated concerns of Treasury and IRS.

A. The issue price of publicly offered municipal bond issues is not required to be, and based on how municipal bonds are sold cannot be, determined through an "actual sales" approach.

The preamble to the Proposed Regulations, the definition of "issue price" in the Proposed Regulations and public comments made by Treasury and IRS officials after publication of the Proposed Regulations emphasize that the amendments to the issue price definition are intended to make that definition more consistent with current regulations under sections 1273 and 1274 of the Code, which implies that such consistency, including an "actual sales" approach, is required by the cross-reference to sections 1273 and 1274 in section 148(h) of the Code. In analyzing whether determination of "issue price" for purposes of the arbitrage rules should be the same as under the original issue discount rules, it is helpful to consider the very distinct purposes of section 148 and sections 1273 and 1274 and the differences between the municipal and corporate bond markets.

The original and principal purpose of the restrictions relating to arbitrage bonds is to prevent issuers from earning a profit by investing the proceeds of tax-exempt bonds in higher yielding taxable investments. The need for section 148 arose from the fact that an issuer of tax-exempt bonds could receive a yield from taxable investments (acquired with bond proceeds) that exceeded the yield being paid by the issuer on its tax-exempt bonds. The purpose of section 148(h) is to specify how the issue price of the bonds, which is an essential component of the computation of yield on the bonds, is to be determined. Thus, determining issue price under section 148, which sets the upper limit on an issuer's permitted investment earnings, is focused on, and impacts, issuers.

Sections 1273 and 1274 were inserted into the Code to ensure that the accruals of original issue discount on taxable debt instruments are treated consistently with interest paid on taxable debt instruments; thus, the focus of a determination of issue price under sections 1273 and 1274 is on holders, not issuers. Congress recognized that, for example, a debt instrument with a zero coupon sold at a discount resulting in a yield of 6% is economically equivalent to a debt instrument sold at par with a 6% coupon; however, without current recognition of income

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[36] SEC 2012 Municipal Market Report at 12.

[37] *See* Federal Reserve Statistical Release, Z.1: Financial Accounts of the United States, Third Quarter 2013, www.federalreserve.gov/releases/z1/Current/z1.pdf, Table L.100, Line 14 minus Table L.100.a, Line 11, divided by the sum of Table L.2, Line 19 plus Table L.3, Line 5.

accruing, a cash-basis holder of the instrument purchased at a discount would not only defer recognition until receipt of the principal amount at maturity (or earlier sale), but might also be able to treat the income received as capital gain. This treatment is in contrast to the holder of a par instrument, who would have ordinary income in each year. Sections 1273 and 1274 are designed to solve this disparate treatment problem by identifying original issue discount that is directly comparable to current interest and, together with sections 1271 and 1272, providing for current inclusion of accruing original issue discount (and appropriate adjustments to the holder's basis in the instrument). By determining issue price based on purchase price paid by the original public investors in a debt instrument, instead of the purchase price paid by the underwriter to the issuer, the underwriter's spread is not treated as original issue discount, which means investors are not required to recognize the underwriter's spread as ordinary income. (The underwriter, of course, must recognize the spread as ordinary income.) Although the focus of the original issue discount rules is on taxable debt instruments, original issue discount on municipal bonds also must be computed under sections 1273 and 1274. Under section 1272(a)(2)(A), however, such original issue discount is treated as additional tax-exempt interest (*i.e.*, the accruing income is not required to be included in the gross income of the owner).

Because corporate bonds are sold in relatively large principal amounts with bullet maturities, largely or even exclusively to institutional investors, in negotiated underwritings (pursuant to a "fixed price" rule)[38] or private placements, it is relatively easy to apply the actual sales approach in determining issue price under the original issue discount rules. For example, in a $300,000,000 corporate debt offering that consists of a single five-year bullet maturity, it is not difficult to determine the initial offering price to the public at which a substantial amount was sold. In contrast, in a $10,000,000 municipal bond offering (whether negotiated or competitively sold) that includes serial bonds maturing in the first ten years and term bonds maturing in years 20 and 30 (with required annual sinking fund redemptions), there may be particular maturities for which no orders are received as of the sale date ("orphan maturities") and yet, contrary to practice in corporate bond underwritings, the underwriters will agree to deploy some of their capital and purchase all of the bonds.

Treasury has been granted broad authority in the context of section 148 to draft regulations that are designed to accomplish the goals of limiting arbitrage bonds. At the time of the enactment of the Technical and Miscellaneous Revenue Act of 1988,[39] the House Ways and Means Committee outlined this authority:

> The bill further deletes and re-inserts the term "necessary" in the specific regulatory authority granted the Treasury Department under the arbitrage restrictions. This amendment is intended to clarify that Treasury's regulatory authority is to be interpreted broadly, rather than in a literal, dictionary manner . . . . That regulatory authority is

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[38] Publicly offered corporate bonds can be offered only at the stated public offering price to investors, not at "reduced prices," also referred to as "concessions," to certain investors. *See* FINRA Rule 5141. In 1981, one of SIFMA's predecessors, the Public Securities Association, requested that MSRB consider adopting a "fixed price" rule for publicly offered municipal securities, which MSRB concluded was not necessary or appropriate. *See* MSRB Reports, Vol. 1, No. 4 (November 1981).

[39] Pub. L. No. 100-647, sec. 1013(a)(34)(A), 102 Stat. 3342, 3544.

> intended to permit Treasury to eliminate any devices designed to promote issuance of bonds either partially or wholly as investment conduits in violation of the provisions adopted by Congress to control such activities and to limit the issuance of tax-exempt bonds to amounts actually required to fund the activities for which their use specifically has been approved by Congress. Further, that regulatory authority is intended to permit Treasury to adopt rules (including allocation, accounting, and replacement rules) necessary or appropriate to accomplish the purpose of the arbitrage restrictions, which is to eliminate significant arbitrage incentives to issue more bonds, to issue bonds earlier, or to leave bonds outstanding longer.[40]

Over the course of four years, from 1989 to 1993, Treasury exercised this broad authority, proposing and revising the definition of "issue price" multiple times, before settling on the definition in the Existing Regulations that has now been in effect for twenty years. Beginning with the 1989 Temporary Arbitrage Regulations, Treasury recognized that a special rule was needed for the determination of issue price of publicly offered municipal bonds. As Treasury explained in making the 1991 changes to the arbitrage rules:

> A reasonable expectations test is used to determine the initial public offering price because, on the date of issue, the exact price at which the bonds subsequently will be sold to the general public may not be known.[41]

Unless Treasury believes that it lacked authority to adopt the Existing Regulations, then determination of the issue price for publicly offered municipal bonds is not required to be determined based on an "actual sales" approach. And because section 148(a) requires that arbitrage compliance be determined as of (*i.e.*, no later than) the issue date, any definition of "issue price" that does not ensure that issue price can be determined no later than the issue date conflicts with section 148(a).[42] More importantly, as the existing issue price definition recognizes (and as discussed in more detail below), the determination of issue price of publicly offered municipal bonds must occur by the sale date (*i.e.*, when the terms of the bonds are fixed) and, for so long as the marketing of municipal bonds continues to result in unsold maturities as of the sale date, it will be impossible to determine the issue price of such maturity (and, therefore, the issue) based on an actual sales approach. Said differently, an actual sales approach

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[40] H.R. REP. NO. 100-795 at 327-328.

[41] T.D. 8345, 1991-1 C.B. 33.

[42] For evidence of Congressional intent regarding the reasonable expectations test under section 148(a), s*ee* Joint Committee on Taxation General Explanation of the Tax Reform Act of 1986, JCS-10-87, at p. 1201:

> The Act codifies the "reasonable expectations" test of prior law with respect to subsequent deliberate and intentional acts to earn impermissible arbitrage taken subsequent to issuance of the bonds. Under the Act (as under prior law), the determination of whether bonds are arbitrage bonds generally is based upon the reasonable expectations of the issuer on the date of issue. If such subsequent acts are taken after the date of issue to earn arbitrage, however, the reasonable expectations test does not prevent the bonds from being taxable arbitrage bonds. (See, e.g., Rev. Rul. 80-91, 1980-1 C.B. 29; Rev. Rul. 80-92, 1980-1 C.B. 31; and Rev. Rul. 80-188, 1980-2 C.B. 47.)

as of the sale date cannot work for maturities for which there are no actual sales as of the sale date.

B. Concerns about the offering and distribution process for municipal securities should be addressed by working with municipal securities regulators, not through tax policy.

In addition to attempting to make the determination of issue price under section 148 more consistent with the determination of issue price under sections 1273 and 1274, the preamble to the Proposed Regulations makes clear that the proposed definition of issue price is intended to "address [certain] concerns" and "provide greater certainty." As discussed below, NABL believes that the proposed definition is not administrable by issuers and, therefore, will result in less certainty. NABL also believes that the concerns described in the preamble should be addressed by municipal securities regulators, not through tax policy.

The concerns described in the preamble generally relate to the manner in which municipal securities are offered and distributed, and imply that the conduct of municipal underwriters is sometimes inappropriate and perhaps illegal. While NABL does not have access to the information that has given rise to these concerns, NABL takes them seriously and believes that, if problematic, they should be addressed. Because the activities of municipal underwriters are regulated by SEC, MSRB and FINRA, however, NABL believes that Treasury and IRS should share their concerns with these regulators and request that they investigate and take appropriate regulatory and enforcement action. Issuers do not have the resources to police these perceived activities, nor do they benefit from the perceived manipulation; nevertheless, the Proposed Regulations would force issuers to bear the penalty for perceived misconduct of others.

We believe it may be helpful to provide an illustration of how the concerns cited in the preamble may be more appropriately addressed through municipal securities regulation than tax policy. The preamble states that one concern is that, in some cases, underwriters may make a public offering of only 10% of a maturity to establish a lower issue price, holding back the remaining 90% to be sold at higher prices. If this practice is in fact happening, then even under the Existing Regulations the use of the "reasonable expectations" test would not be permitted, since such an offering is not a "*bona fide* public offering" of the bonds. Moreover, it would be inconsistent with contractual obligations that underwriters generally have with issuers and may violate securities law and rules. This concern is more properly addressed by enforcement of existing law and contracts against the offending underwriters, rather than establishing a new regulatory requirement that will inevitably result in additional costs to issuers.

In attempting to address concerns about the municipal bond offering and distribution process through tax policy, the proposed definition of issue price is not only unfair to issuers, but conflicts with securities law rules governing this process. The effect of the proposed definition would be to include, as part of the underwriter's spread, profits from sales of bonds that may be earned by entities or persons outside of the underwriting syndicate with which the issuer has contracted. This result is unfair to issuers because it would lower their arbitrage yield on the bonds (*i.e.*, the upper limit on their investment earnings) without increasing the proceeds they receive from the sale of the bonds, as a result of actions taken by third parties with whom issuers have no contractual relationship. In some cases, this unfairness would be compounded by the

fact that all or a portion of such profits resulted from fluctuations in the market after the sale date, changes over which issuers have no control. Moreover, this result conflicts with the determination of underwriter's spread under MSRB Rule G-32 that is required to be disclosed to investors in the final official statement for a negotiated underwriting.[43]

II. The proposed definition of "issue price" is not administrable by issuers under existing law and market practices.

A. Issuers and bond counsel do not have access to the information necessary to determine issue price based on actual sales to the "public."

The proposed definition of "issue price" is not administrable by issuers because issuers and bond counsel do not have access to the information necessary to determine issue price based on actual sales to the "public" as defined under the Proposed Regulations. The best way to illustrate this problem is through an example. Assume an underwriter is unable to sell a particular bond maturity to the public for any one of a variety of commonly occurring reasons (*e.g.*, small principal amount of a particular maturity, yield curve on a particular day) and, therefore, the underwriter sells 100% of that maturity to a broker (who is not a member of the underwriting syndicate) at the initial offering price on the sale date. Under the Proposed Regulations, to determine issue price, an issuer and bond counsel would need to know to whom and at what prices that broker sold the bonds, as well as whether the persons who bought the bonds did so for the purpose of investment (*i.e.*, were they members of the "public"). Neither the broker nor its customers are required by law or contract to provide that information to the issuer and bond counsel, so the question becomes whether the information is otherwise available.

The preamble to the Proposed Regulations does not specify any particular source for this type of information. Currently, EMMA is the only free and public platform for detailed municipal bond trading data, and the operating assumption (apparently based on the use of EMMA by the IRS, which includes access to some data that is not publicly available) appears to be that EMMA is in fact a reliable source of such data. However, EMMA data is not sufficient to determine issue price under the Proposed Regulations.[44] While EMMA provides *some*

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[43] Ironically, the proposed definition may result in a different determination of issue price for municipal bonds under section 148 versus sections 1273 and 1274 because original issue discount on municipal bonds has been, and may continue to be, determined based on the initial offering prices disclosed in the final official statement and reported on EMMA.

[44] MSRB rules make it unlikely that EMMA could be used "as is" to calculate issue price in most cases. Specifically, except in the case of short-term notes, MSRB Rule G-34 requires the underwriter to set a "Time to First Execution" for trades by members of the syndicate. That time must be no less than two hours after the underwriter has submitted information about the issue to DTC's new issue information dissemination system ("NIIDS"). Indeed, the NIIDS submission process generally does not begin until after the "Time of Formal Award" (i.e., the execution of the BPA for negotiated issues or the announcement of a winner for competitive issues). Trades by syndicate members at the initial offering price are reported with an "L" (i.e., list price) indicator beginning at the Time of First Execution until the end of the day. The "L" indicator is not used for trades by non-syndicate members or even by syndicate members on subsequent days. These rules apply only to syndicate members. There are no restrictions on dealers that are not syndicate members trading securities before the Time of First Execution under MSRB rules, despite an industry convention that securities should not trade before the underwriter has declared them "free to trade." Accordingly, it is not uncommon to see trades reported on EMMA prior to the Time of First

information about actual sales, it is difficult to correctly interpret this information within the constraints of the Proposed Regulations. More importantly, EMMA does not provide all of the information required to determine issue price under the Proposed Regulations (*e.g.*, record of orders as opposed to completed trades, true timing of trades, information necessary to determine whether a purchaser is an "underwriter" or a member of the "public").

Before requiring that issue price be determined based on actual sales, Treasury and IRS should first make sure that issuers will have access to the data necessary to make this determination. Significant lead time (*e.g.*, two to three years) should be provided to ensure that data bases, whether through EMMA, from underwriters or by other means, are in place to establish dates, times, and prices of actual sales to ultimate investors. Prior to effectiveness of the regulations, Treasury and IRS should review the data bases (and undertake "dry runs") to ensure that compliance with an actual sales standard can be satisfied.

B. To be administrable by issuers, any definition of "issue price" of publicly offered municipal bonds must enable issue price to be determined as of the sale date, when the terms of the issue are established.

1. Issuers may violate applicable State law, policy or authorizing resolutions if issue price cannot be determined as of the sale date.

In agreeing to sell bonds to the underwriters in a negotiated or competitive offering, the issuer must comply with any applicable State law or policy and the authorizing resolutions it has adopted. For example, in a refunding, the issuer may be required to meet a certain threshold for debt service savings. If issue price cannot be determined as of the sale date, when the terms of the bonds are set and debt service savings are calculated, then the issuer may violate applicable law, policy or resolutions. Even if issue price can be determined after the sale date and before closing, it may not be possible to restructure the terms of the bonds, because the BPA has already been signed (or the bonds have been awarded in a competitive sale). And, if issue price cannot be determined until after closing, there may be no effective way to cure the violation.

The Proposed Regulations do provide one remedy for post-sale issue price changes by allowing yield reduction payments. While making a yield reduction payment may resolve an arbitrage problem under section 148 of the Code, the payment may result in the issuer not

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Execution and those trades may or may not be at the initial offering price. Only syndicate members bind themselves to offer the securities at the initial offering price. Thus, there can be a curious result that secondary market trades (i.e., trades by customers or dealers that purchased securities from a syndicate member) may be displayed on EMMA as "when issued" trades (with a "W" indicator) even before the primary market trades are displayed. To add to the confusion, even when the primary market trades are reported at the Time of First Execution, the time of trade reported is the time the underwriter reports the trade to EMMA, not the time the underwriter and customer actually agree to the trade. For example, an underwriter and customer might have agreed on Tuesday at 10 a.m. to a trade at the initial offering price, but the time of trade will be no earlier than 2 p.m. that day, assuming a BPA signed by noon and a Time of First Execution of 2 p.m. In the meantime, the customer may have entered into a when-issued trade with a non-syndicate member dealer, which trade may be reported at 1 p.m.

obtaining the required level of debt service savings, thereby violating applicable State law or policy or the issuer's authorizing resolutions. Moreover, unlike rebate, where payments to Treasury can be made from investment earnings actually received by the issuer, an issue price-related yield reduction payment will need to come from an additional source of funds, which may not exist or be available (from either a legal and/or an economic standpoint).

2. Because compliance with numerous other provisions of federal tax law depends on the determination of issue price, issuers may unintentionally violate those provisions if issue price cannot be determined as of the sale date.

Although the term "issue price" is used specifically in relatively few places in sections 103, 141-150, and 54AA, it has become central to the meaning of "sale proceeds," "net proceeds," "proceeds," "face amount"[45] and "amount," each of which is an important concept in the Existing Regulations as well as Code provisions applicable to municipal bonds. Taken together, these definitions affect most of the tests for determining whether a bond is described in section 103(b)(1), (2) or (3), and thus tax-exempt, or tax-advantaged in more limited instances.[46] These tests include the 2% costs of issuance limit, private activity limitations, volume caps, output facility limits, small issue bond limits, weighted average maturity calculations and related tests, debt service reserve fund limits, small issuer status and certain transition rules. Attached as **Exhibit C** is a more comprehensive list illustrating where the failure to determine the issue price of bonds as of the sale date could result in lack of certainty with respect to, or even unintentional violations of, various provisions of the Code or Existing Regulations as of the issue date. The Proposed Regulations do not provide any means for issuers to remedy these violations.

3. Bond counsel must confirm whether they can give an unqualified approving opinion on the sale date.

If issue price cannot be determined as of the sale date, then, as discussed above, it will not be possible to confirm on the sale date whether the bonds will comply with all of the relevant tests for tax exemption under the Code as of the issue date. A customary condition to issuance and delivery of bonds contained in the BPA (which is signed on the sale date) is that bond counsel delivers an unqualified approving opinion on the closing date with respect to the tax-exempt status of interest on the bonds. If the BPA is signed with this condition, and issue price is determined after the sale date to be different than reasonably expected on the sale date based on the initial offering prices to the public, then in many cases bond counsel will not be able to deliver an unqualified approving opinion. And if issue price cannot be determined until after the issue date, then bond counsel would not be able to be able to deliver an unqualified approving opinion on the issue date. In either case, the bonds would not be issued and the BPA would terminate after it was signed and before closing (often referred to as the "cratering" of a deal

[45] In common parlance, "face amount" means stated principal amount and is not linked to purchase or offering price. However, over time in various non-precedential guidance, IRS has determined that face amount and similar terms are more appropriately equated with "issue price." *See*, *e.g.*, Letter Ruling 9431007 (Apr. 26, 1994).

[46] Notice 2010-35 (2010-1 CB 660) provides that the definition of issue price under Reg. §1.148-1(b) applies for certain purposes of direct pay bonds under sections 54A and 54AA.

between pricing and closing), which historically has almost never occurred in the municipal (or corporate) bond markets.[47]

III. Attempts to comply with the proposed definition of "issue price" will impose substantial additional expense on issuers and alter longstanding practices in the municipal market.

A. If the proposed definition is adopted and municipal bonds continue to be marketed in ways that result in unsold maturities on the sale date, issuers will bear substantial additional expense attempting to determine issue price based on actual sales to the public.

If the proposed definition of "issue price" were to become final, issuers would bear substantial additional expense attempting to determine issue price based on actual sales to the public if they continue to allow their bonds to be marketed in ways that result in unsold maturities on the sale date. Issuer employees, bond counsel or the issuer's financial advisor would be required to spend additional time obtaining, reviewing and documenting the facts relating to actual sales, in order to attempt to determine issue price under the proposed definition. In certain cases, these efforts could extend from the sale date to the issue date and even beyond the issue date, until issue price is determined or it becomes clear that it cannot be determined. To the extent that issue price is determined to be different than reasonably expected on the sale date based on initial offering prices to the public, the issuer may be required to make a yield reduction payment from its own funds and bear the cost of curing noncompliance with other provisions of the Code.

As discussed above, if issuers are successful in determining issue price under the definition in the Proposed Regulations, the result may be that they are forced to accept a lower arbitrage yield based on profits earned by persons or entities with whom they had no contractual relationship and which may have resulted from fluctuations in the market after the sale date over which issuers have no control.

B. To eliminate unsold maturities on the sale date in negotiated underwritings, issuers would be forced to accept lower prices and higher yields.

To avoid the result described above, issuers may determine that they should alter the ways in which they allow their bonds to be marketed in negotiated underwritings in order to eliminate unsold maturities. Bonds would need to be marketed at lower prices/higher yields to ensure that the 25% safe harbor could be met for each maturity, resulting in higher interest costs for issuers. Further, investors will almost certainly be aware that an issuer in many cases must ensure that at least 25% of each maturity of an issue is sold; if they become aware (or suspect) that certain maturities are not in demand from other investor classes, they will be in a position to ask for – and get – lower prices/higher yields than might otherwise be available. This will fundamentally shift the dynamics of marketing by empowering investors to demand higher yields.

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[47] The failure to close could have significant adverse consequences for the issuer, including liability for breach of contract and a reduced ability to market bonds in the future.

C. Because issuers may not be able to eliminate the possibility of unsold maturities in competitively sold deals, the ability of issuers to sell bonds competitively may be limited.

Issuers also could attempt to require that bidders in competitive sales actually sell 25% of each maturity to the public at the initial offering prices in order to satisfy the safe harbor in the Proposed Regulations. If underwriters were willing to bid under that condition, they would be forced to lower their bids (*i.e.*, increase yields) to the point where they were confident they could satisfy this condition. And, if the winning bidder did not satisfy this condition, the issuer still would be required to bear the costs associated with attempting to determine issue price without the benefit of the safe harbor (if issue price could be determined at all). The greater likelihood of complying with the safe harbor in a negotiated underwriting would probably result in fewer competitive sales, except to the extent competitive sales are required by applicable State law, inappropriately causing issuers to adopt a method of sale based on tax policy.

IV. If Treasury and IRS continue to consider applying an actual sales approach to the determination of issue price for publicly offered municipal bond issues, a revised definition of "issue price" should be re-proposed.

A. Any re-proposed definition of "issue price" for publicly offered municipal bond issues should continue to provide that issue price is and can be determined as of the sale date.

Any re-proposed definition of "issue price" for publicly offered municipal bond issues should continue to provide that issue price is and can be determined as of the sale date. If Treasury and IRS continue to consider applying an actual sales approach to publicly offered municipal bond issues, any re-proposed definition of "issue price" based on actual sales should provide that the relevant offering period ends on the sale date; however, as discussed above, if municipal bonds continue to be marketed in ways that result in unsold maturities on the sale date, issue price cannot be determined as of the sale date based on an actual sales approach. As a result, any attempt to provide greater certainty in the determination of issue price must retain, and provide safe harbors under, the reasonable expectations test in the Existing Regulations.

B. Certain aspects of the proposed definition of "issue price" should be revised and clarified if they are to be included in any re-proposed definition.

If Treasury and IRS consider re-proposing a definition of "issue price" that incorporates aspects of the proposed definition, NABL suggests that the following revisions and clarifications to the proposed definition be considered and that certain collateral consequences be addressed.

1. Revise the Definition of "Public"

Other than the actual sales approach, the most problematic concept in the Proposed Regulations is the definition of "public." For purposes of the section 148 definition of issue price, NABL suggests that Treasury and IRS consider defining "public" to be anyone other than the underwriting syndicate and parties related to any member of the underwriting syndicate,

utilizing the concept of privity. Under this definition, as long as (1) 25% of the bonds of each maturity (and interest rate, for split coupons) was sold at the initial offering price to entities outside of the underwriting syndicate (and its related parties), and (2) all orders at the initial offering price were filled to the extent submitted by persons other than registered broker-dealers, the safe harbor under the Proposed Regulations could be met.

2. Provide for Competitive Bid Safe Harbor

As discussed in Section III.C. above, the actual sales approach is least workable for competitively bid bond issues. Because competitive bidding is required by State law in some cases and generally considered to produce a good result for issuers, NABL believes that regulations should not discourage the use of competitive bidding. In other areas where Treasury has been concerned with ascertaining fair market value in an objective manner (such as the pricing of guaranteed investment contracts and open-market securities escrows), competitive bidding was a suitable solution. Therefore, NABL suggests the creation of a safe harbor using initial offering prices for proof of issue price in competitively bid bond sales, assuming that the bonds are awarded to the highest bidder.

3 Provide for Synthetic Markup Safe Harbor

As an alternative to strict tracing of all actual sales to the ultimate investors, NABL suggests a safe harbor where a pre-determined markup could be added to the initial offering price to compute issue price for (1) maturities for which no orders have been received or maturities that would otherwise fail to meet the 25% safe harbor, or (2) sales to brokers or other persons where investment intentions were unknown, such that those sales could be treated as sales to the public.

4. Lower Safe Harbor Standard from 25% to 10%

Municipal market participants are accustomed to the 10% standard for "substantial amount" that has been in place in the Existing Regulations for the last twenty years. Moreover, 10% has long been accepted in the taxable area as a "common law" standard for purposes of sections 1273 and 1274.[48] Since the Proposed Regulations already materially depart from long-standing law, NABL suggests maintaining as much constancy as possible by retaining standards where there is no clear reason for change. The tax law pertaining to State and local bonds uses a more-than-5% (and, in some cases, a more-than-10%) standard for substantial amounts in many contexts ranging from private activity tests to working capital tests to public approval amounts.

5. Accommodate Issue Price-Related Yield Reduction Payments

The Proposed Regulations would allow an issuer to make a yield reduction payment to remedy an advance refunding escrow that turns out not to be yield-restricted due to a post-sale revision to the expected issue price. Many issuers may not have funds available to make a required issue price-related yield reduction payment ("IPYRP"), which may cause issuers to

[48] *See* James M. Peaslee & David Z. Nirenberg, *Federal Income Taxation of Securitization Transactions and Related Topics* 673, n. 29 (4th ed. 2011).

choose to finance a contingency IPYRP. Absent additional exceptions to provisions of the Existing Regulations, this may not be feasible.

Currently, under the working capital general *de minimis* exceptions of Reg. § 1.148-6(d)(3)(ii)(A)(4), an issuer may bond-finance yield reduction payments without complying with the "proceeds spent last" rules typically applicable to the financing of working capital expenditures. Along similar lines, NABL suggests that an exception be added under "excess gross proceeds" (Reg. § 1.148-10(c)(3)) in order that an IPYRP contingency would not count as excess gross proceeds. Further, IPYRPs should be excepted from all definitions of proceeds such that they would not confound the application of other tests (*e.g.*, private activity tests, rebate spending exceptions). Finally, in order to ensure a financed IPYRP contingency did not remain permanently unspent, Treasury and IRS could create a rule requiring all IPYRP contingency remaining after the issue price has been established and the IPYRP has been paid to be spent on debt service.

6. Clarify Offering Period and Original Distribution

The concepts of "offering period" and "original distribution" are pivotal under the Proposed Regulations, yet they are not defined. The exception for unfulfilled orders under the 25% safe harbor only applies during the "offering period," but it is unclear when the offering period begins and ends. Similarly, an underwriter is defined, in part, as any person who participates directly or indirectly in the "original distribution," but it is unclear whether the original distribution is coterminous with the offering period or possibly extends beyond that point. Issuers must have certainty regarding the time at which it will be appropriate to finalize the calculation of issue price under the Proposed Regulations. Therefore, NABL suggests clarification of "offering period" and "original distribution." To maintain consistency among regulatory regimes, we also suggest the definitions equate to the current "order period" under MSRB Rule G-11 and sales that occur during that period.

7. Provide Examples of Issue Price Substantiation

As described in these comments, application of the Proposed Regulations will be confusing and difficult for many issuers. NABL suggests the addition of examples elucidating the process of substantiating issue price under the Proposed Regulations in order to alleviate uncertainty.

8. Address Collateral Consequences of Unknown Issue Price at Sale Date

Unless the Proposed Regulations are revised to ensure computation of issue price as of the sale date, NABL strongly encourages de-coupling of the definition of issue price under section 148(h) from all other tests for determining whether a bond is tax-exempt or tax-advantaged to avoid the collateral (*i.e.*, non-yield related) consequences of an unknown issue price at the sale date.

Many of these collateral problems could be solved by revising the definition of "sale proceeds" to include only amounts actually received by the issuer plus underwriters' discount or

compensation as disclosed pursuant to federal securities laws in the final official statement, or otherwise stated. Ultimately, this would equate sale proceeds with the initial offering price rather than the new definition of issue price, eliminating concerns regarding post-sale recalculation of many required tests for tax-exemption.

An additional set of problems could be solved by clarifying prior guidance that links terms such as "face amount" and "amount" to issue price, replacing issue price in those cases with sale proceeds, as redefined.

Finally, in the cases where the term "issue price" is actually used in statutory or regulatory language, providing that "sale proceeds," as redefined, may be used as a proxy would effectively maintain the current state of the law, thus reducing uncertainty created by the new definition of issue price.

CONCLUSION

NABL respectfully suggests that the definition of "issue price" in the Proposed Regulations be withdrawn and that any other change in the issue price definition be re-proposed. To the extent that Treasury or IRS is concerned with the manner in which municipal securities are offered or distributed, these concerns should be shared with SEC, MSRB and FINRA, so that appropriate regulatory and enforcement action may be taken. Any re-proposed definition of "issue price" for publicly offered municipal bond issues should continue to provide that issue price is and can be determined as of the sale date in a manner consistent with Congressional intent, *i.e.*, by adding the underwriter's spread back to the purchase price paid to the issuer by the underwriter for the bonds. Because MSRB rules govern the offering and distribution of municipal securities and require the computation and disclosure of underwriter's spread, computation of issue price for purposes of section 148 should be consistent with what is computed and disclosed publicly for securities law purposes. If municipal bonds continue to be marketed in ways that result in unsold maturities on the sale date, issue price cannot be determined as of the sale date based on an actual sales approach. As a result, any attempt to provide greater certainty in the determination of issue price must retain, and provide safe harbors under, the reasonable expectations test in the Existing Regulations.

EXHIBIT A

National Association *of* Bond Lawyers

RECOMMENDATIONS
BY THE
NATIONAL ASSOCIATION OF BOND LAWYERS
ISSUE PRICE STUDY GROUP
FOR THE
DEPARTMENT OF THE TREASURY
OFFICE OF TAX POLICY
AND THE
INTERNAL REVENUE SERVICE
COMMENTS RELATING TO THE DETERMINATION OF THE "ISSUE PRICE" OF TAX-EXEMPT BONDS FOR PURPOSES OF INTERNAL REVENUE CODE SECTIONS 103 AND 141 THROUGH 150
AND TREASURY REGULATION § 1.148-1(b)

AUGUST 25, 2006

The following comments are submitted on behalf of the National Association of Bond Lawyers (NABL) Issue Price Study Group ("Study Group"). These comments relate to the definition of the "issue price" of a tax-exempt obligation for purposes of Sections 103 and 141 through 150 of the Internal Revenue Code of 1986, as amended (the "Code"), and the specific definition contained in Treasury Regulation § 1.148-1(b).

Recently, questions have arisen about the interpretation of the definition of the issue price of bonds, particularly in situations in which the facts surrounding the sale of the bonds do not neatly fit within the exact parameters of the regulations. In such situations, uncertainty has existed among issuers and bond counsel as to, for example, whether or to what extent one should look to the regulations and guidance under Sections 1273 and 1274 of the Code to determine the issue price. Concerns have also been raised about the accuracy of certificates customarily provided by underwriters in connection with the issuance of tax-exempt bonds regarding the issue price of the bonds for purposes of Section 148 of the Code.[1]

The Study Group was formed to recommend changes to the current regulations that would provide clarification regarding the determination of the issue price of bonds, in light of existing practices and potential interpretation of the current rules.

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[1] For example, one academic paper states that "a substantial fraction of the issues [examined by the authors] show less than the required 10% of the issue being sold at or below the [documented] reoffering price." The authors suggest that, depending on the methodology employed, between 7.3% and 20% of the "issues" they examined failed to meet the 10% threshold. The Study Group takes no position on the validity of the market-related conclusions stated in this paper. The Study Group does note, however, that this paper <u>does not</u> accurately state the requirements of the tax law; specifically, there <u>are no</u> "IRS requirements that 10 percent of the bonds are sold at the reoffering yield." Green, Hollifield & Schurhoff, "Dealer Intermediation and Price Behavior in the Aftermarket for New Bond Issues," p. 4 (October 5, 2005).

EXHIBIT A

Executive Summary

The Study Group believes that any examination of the legal issues surrounding the definition of the "issue price" of a bond take into account how bonds are structured and sold — including the underwriting and distribution processes. An overview of those processes, particularly as they relate to negotiated and to competitively bid underwritings of bonds, appears below.

Largely because of the need to ascertain the arbitrage yield on bonds when structuring tax-exempt bond issues, the Study Group strongly recommends that the "reasonable expectations" provisions of the regulation be given substantive meaning by providing one or more "safe harbors" to the effect that, if certain standard marketing procedures are followed, the initial offering price at which the bonds are offered to investors by the underwriter shall be deemed to be the issue price of a bond, regardless of the prices at which they are actually sold, and regardless of prices at which other trades may occur.

The Study Group believes that, in the context of a negotiated offering, the offering prices established by the underwriter, as part of a bona fide offering to the public and as set forth in a bond purchase agreement (the "BPA"), be used to establish the amount of the "underwriters' commissions" that Section 148(h) of the Code was intended to address. The Study Group recommends the use of this offering price regardless of other facts relating to the sale of the bonds, including: (i) whether the bonds are actually sold by the underwriter at those prices (*i.e.*, if less than 10% of the bonds are actually sold at the offering price); and/or (ii) whether the buyers at those prices subsequently re-sell the bonds to other investors (*e.g.*, place the bonds in a so-called "tender option bond" ("TOB") program trust, or resell them to other broker/dealers).

Using the offering price that is shown to investors as the issue price of a bond would have the virtue of simplicity and transparency: in almost all negotiated underwritings, the offering price (or corresponding yield) of a bond being offered is disseminated virtually immediately upon its establishment by the senior underwriter to the broker/dealer and investor community via Dalcomp (to other members of the underwriting syndicate) and The Bond Buyer (TM3) and/or Bloomberg news wires. This process provides substantial assurance that the offering price is exposed to a variety of investors, allowing other potential investors to place an order for the bonds if they feel the offering price is too low. Further, the pricing wire is a readily ascertainable document for purposes of the conduct of due diligence by bond counsel; attaching a copy of the final pricing wire to a "tax certificate" as part of the due diligence documentation generally would be a simple matter.

With respect to competitive underwritings, the Study Group recommends that, if the underwriter has reoffered a bond to the public and has disseminated the offering price via a Dalcomp wire to other members of an underwriting syndicate or to other members of the municipal bond investing community via The Bond Buyer (TM3) and/or Bloomberg news wires, the price shown on the pricing wire be deemed the issue price of the bond.

The Study Group also recommends guidance on the following points, which have broad application to all underwritings: (i) that a bona fide sale to an entity that is not, on its face, an underwriter or a broker/dealer (as defined and regulated by the National Association of Securities Dealers ("NASD") and the Securities and Exchange

Commission ("SEC") should be deemed to be a sale to the general public, even if that entity later re-sells the bonds to other parties; and (ii) that trust programs and similar repackagings of a bond are disregarded.

DISCUSSION

Background – The Distribution Process for Municipal Bonds

The Study Group believes that any examination of the tax questions surrounding the definition of the "issue price" of a bond should take into account how bonds are structured and sold – including the underwriting and distribution processes. Broadly speaking, municipal bonds are sold through one of three methods: (i) a negotiated underwriting; (ii) a competitive bid underwriting; or (iii) a private placement. In 2005, some 69% (measured by number of issues) to 80% (measured by par amounts) of the long-term tax-exempt bonds issued were sold in negotiated underwritings; most of the balance were sold though a competitive bid process, with approximately 1% sold through the private placement mechanism.[2] There are significant distinctions among these three methods of distribution of municipal bonds to investors that will affect the prices at which bonds are offered and sold to the public; accordingly, set forth below are brief outlines of the negotiated and competitive bid processes.[3] The Study Group has not separately discussed private placements because, in general, the issue price in a private placement is established by the price at which the bonds are actually sold in the private placement, and, therefore, many of the ambiguities in interpretation of issue price discussed herein do not arise in a private placement.

Negotiated Underwriting. In a typical negotiated underwriting, an issuer of municipal bonds selects one or more investment banks and broker/dealers (collectively, the "underwriters") to distribute the bonds to municipal bond investors. One of the underwriters is usually selected as the "book running" or "senior managing" underwriter for the bond issue; the senior managing underwriter acts on behalf of the entire group of underwriters (generally referred to as the underwriting "syndicate"). The senior managing underwriter is typically the party responsible for the structuring of the transaction based upon consultations with the issuer and its advisors and upon market feedback from both its own customers and the other underwriters. The senior managing underwriter is also generally responsible for the bookkeeping details of the distribution process – tracking orders and allotments of bonds among the syndicate members and customers, and making the final decision, in consultation with the issuer and its advisors, and the other underwriters, of the prices and yields at which the bonds are to be offered to investors.

Prior to the marketing of the bonds, many discussions will be held among the underwriters (led by the senior managing underwriter), the issuer, and its advisors as to the sizing and structure of the transaction. This process will reflect a wide variety of

[2] Source: The Bond Buyer, "Year-End Review Table," p. 2A (February 13, 2006).
[3] For a more extensive discussion of the municipal bond underwriting and distribution process, *see* The Bond Market Association, "Fundamentals of Municipal Bonds," pp. 90-103 (5th ed. 2001) (copy attached), which notes that the underwriting process, including syndicate practices, are governed by a number of rules and regulations promulgated by the Securities and Exchange Commission, the National Association of Securities Dealers, and the Municipal Securities Rulemaking Board.

factors: tax law constraints, state law constraints on how bonds must be structured, and probable investor demand (*e.g.*, bonds in "specialty" states such as New York, California, and Massachusetts may have a more retail-oriented focus), among others. Preliminary discussions as to the amount of underwriters' spread (or "commissions") generally will also take place. Thus, many of the expected terms of the bond issue will be broadly defined by the issuer and the underwriters before any distribution of information to the investor community.

After the broad terms of the transaction are agreed upon, a Preliminary Official Statement ("POS") typically is completed by the issuer for distribution to prospective investors that are the customers of the underwriters; the POS is either mailed to the investors or made available electronically. After a period of time allowing the investor community to digest the data in the POS, the underwriters, working with the issuer and its advisors, commence an order period. Commonly, larger transactions have a one- or two-day "retail" order period followed by a one-day order period for institutional investors (*e.g.*, mutual funds, property and casualty insurance companies, banks, and hedge funds). These order periods are typically commenced with a preliminary pricing of the bonds (*i.e.*, tentative maturities, amounts, prices, and yields) based upon the underwriters' judgment of prospective investor demand and interest rate levels. The preliminary pricing of the bonds is disseminated via a "preliminary pricing wire" distributed to the underwriting syndicate via the Dalcomp system, and often to the larger investor and broker/dealer community via the The Bond Buyer (TM3) and/or Bloomberg news wires. During the order period, based on a wide variety of factors, including the "book" of preliminary orders from investors, general market tone, and comparable trades that might be executed in the secondary market, the underwriters (again, in consultation with the issuer and its advisors) will adjust (up or down) the pricing of the bonds, and orally agree on: (i) the price at which the underwriters will buy the bonds; and (ii) the prices and yields at which the bonds will be reoffered to the investors. At the end of the order period, the issuer and the underwriters orally agree to these terms, subject to the actual signing of a BPA, which typically occurs one to two days later. The revised pricing of the bonds is disseminated via a "final pricing wire," again distributed to the underwriting syndicate via the Dalcomp system, and often to the larger investor and broker/dealer community via the The Bond Buyer (TM3) and/or Bloomberg news wires.

One important aspect of this process to note is that, even though an investor's order is, as a legal matter, subject to the signing of the BPA, and, in theory, could be withdrawn at any time prior to the actual signing of the BPA, investors honor their oral commitments almost without exception and do not withdraw the orders prior to the signing of the BPA, even in situations in which it might be to their advantage to do so (*e.g.*, an increase in interest rates between the oral order and the actual signing of the BPA). Thus, the actual pricing and sales of bonds is based on orders received by the underwriters and on market conditions at the time of the oral agreement between the issuer and the underwriters and at the end of the order periods, rather than the date on which the BPA is signed.[4]

[4] The Study Group believes that this area is one in which the current issue price definition may not correspond to the marketplace, seemingly focusing on the date of the signing of the BPA. *See* Treas. Reg. § 1.148-1(b) ("The issue price of bonds may not exceed their fair market value as of the sale date."); Treas. Reg. § 1.150-1(c)(6) ("The sale date of a bond is the first date on which there is a binding contract in writing for the sale or exchange of a bond."). Please note, however, the Study Group's comments above are made in the context of the federal tax issues raised by the transactions between underwriters and investors and not in the context of any securities or contract law issues that may arise.

The difference between the price at which the underwriters will agree to buy the bonds and the prices and yields at which the bonds will be reoffered to bond investors is the "underwriting spread" (or "commission"). Rather than taking the form of a direct payment by the issuer, the underwriting spread is usually in the form of a price difference between that which the bonds are bought by the underwriters and that which they are offered to the public. This underwriting spread is set forth in the BPA and, pursuant to Municipal Securities Rulemaking Board ("MSRB") Rule G-32, must also be disclosed to investors and is typically included in the final official statement of the terms of the bonds. Thus, the underwriting spread – the "commission" to which the issuer has agreed as part of the process of issuing its bonds – is a known and defined amount.

Moreover, under standard negotiated underwriting syndicate agreements, members of the underwriting or selling group generally are under an obligation during the underwriting period (*i.e.*, the period before the actual signing of the BPA) to offer and attempt to sell the bonds at (not higher than, not lower than) the agreed-upon offering prices that have been negotiated with the issuer.[5] In addition, an underwriter has a strong incentive to retain as much of the underwriting spread for itself, rather than to allow other broker/dealers, who are not party to the BPA, to obtain a portion of the spread from marketing the bonds. Thus, in general, the underwriting spread: (i) is a known amount, determined as part of the negotiations between the issuer and the underwriters; and (ii) generally defines a maximum amount of expected underwriting profit for the underwriters as a group.

Competitive Bid Underwriting. Although many of the mechanics of a competitive bid underwriting are similar to those of a negotiated underwriting, there are several significant differences in the process that bear on the establishment of a bond's issue price. In the competitive bid model, the issuer, working with its advisors alone, establishes in a notice of sale the terms of the bonds (for which the parameters as to maturity, amounts, coupon ranges, etc. are fairly tightly drawn), as well as the bidding terms. The time deadline for submission of the bids typically is fixed in the notice of sale as a date and time certain, and the award of the bonds is based upon the submitted bid that results in the lowest interest cost to the issuer. Bids may be received either electronically or via a paper-based process (fax or signed sealed bid). Underwriters and broker/dealers can either bid alone for the bonds, or can group together into two or more competing syndicates to bid on the bonds. Because of the time certain by which the bids must be submitted, typically the separate underwriting syndicates will compare notes on the bids submitted immediately after the bid submission deadline. Thus, the "winning bid" is usually very quickly known, generally before the formal award. In addition, the formal award of the bonds occurs in a much more expedited fashion than in a negotiated underwriting – normally within minutes of the bid submission deadline.

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[5] "Master Agreement Among Underwriters – Negotiated Offerings of Municipal Securities," § VI, p. 14 (2002), available on the web site of The Bond Market Association at http://bondmarkets.com/agrees/master_aau_neg.pdf. Compare "Master Agreement Among Underwriters – Competitive Offerings of Municipal Securities" (2002), available at http://bondmarkets.com/agrees/competitive_aau.pdf, which does not contain comparable language. Please note that, in some cases, a BPA will allow the underwriting syndicate to offer certain investors price "concessions," typically to institutional investors for large purchases or other commitments to other investors which help to support the pricing of the transaction. However, these concessions must be offered by agreement among the syndicate members, and, if granted, will result in a lower underwriters' compensation.

However, unlike a negotiated underwriting, the terms of a competitive bid normally do not require any particular reoffering of the bonds, as evidenced by a typical competitive bid form. Moreover, there is no assurance that a particular underwriter or broker/dealer which is bidding for the bonds will actually have bonds of the issuer available to distribute to its customers; in turn, those investors may be reluctant to commit to purchasing a bond of the issuer without knowing that the order can, in fact, be filled. Underwriters try to mitigate some of the risks involved in bidding for bonds by soliciting conditional orders from potential investors or groups of investors prior to the submission of bids to the issuer. These conditional orders could include orders from institutional investors (who may place such orders with more than one underwriting syndicate); a firm's trading desk, or the retail distribution network within a broker/dealer. When an underwriter is, in fact, awarded the bonds, these orders are given priority, and other underwriters would not offer those bonds to other investors. In Street parlance, these bonds would be "NRO" (not reoffered), even though some may have, in fact, been sold to members of the investing public. Even with such "pre-sale" orders, there often are a substantial number of bonds that would be owned by the underwriters who won the bid at the moment of the award of the bonds. Unlike a negotiated underwriting, in which every member of a syndicate is obligated to offer the bonds during the sale period at the offering price established, a typical competitive bid syndicate has no such constraint. Each syndicate member is liable for the underwriting of a specified portion of the bonds; any unsold balances not sold by the syndicate are distributed proportionately among the syndicate members, each of which is then free to hold the bonds for its own account or offer them to other investors at whatever price it can obtain. Therefore, to the extent that bonds are not actually sold prior to or shortly after the time of the submission of the bid, one conceivably could find as many "offering prices" of bonds as there are members of the syndicate. Finally, in many cases, bonds may be purchased by a brokerage firm single-handedly; in turn, the firm may reoffer the bonds only to its retail and institutional customers; the prices of the bonds at which the bonds are being reoffered would not be available on the Dalcomp syndicate wire or The Bond Buyer (TM3) and/or Bloomberg news wires. In many cases, the process of distributing bonds though a retail system means that large unsold balances may persist for a substantial period of time.

Secondary Market Transactions. Investors (generally institutional investors) may purchase bonds from the underwriters of the bonds and then, a short time after that initial sale (including prior to the closing of the bond issue, or even prior to the date of the signing of the BPA), resell (or flip) some or all of the bonds that they purchased to broker/dealers (who may or may not have been part of the original underwriting group) or other investors. This "flipping" is a secondary market trading practice (in both negotiated and competitive bid underwritings), but not part of the underwriting process itself.

The Study Group knows of no rules or guidelines that define or govern this practice. Moreover, absent a legal restriction imposed by the issuer on the investor's ability to trade the bonds, underwriters cannot directly control the practice nor determine whether or for how long a particular investor intends to hold bonds. Because flipping is not conducted by the underwriters as part of the underwriting process, the Study Group believes that it should have no relevance to the definition of issue price.

Definition of Issue Price

The determination of the issue price of tax-exempt obligations is one of the linchpins for measuring compliance with the provisions of Sections 141 through 150 of the Code. A wide variety of the constraints on and rules governing the issuance of tax-exempt bonds use the definition of issue price as their starting point. These rules include, but are not limited to:

- The determination of the arbitrage yield of an issue for purposes of Section 148 of the Code;
- The determination of the amount of "volume cap" required to be allocated to a private activity bond issue under Section 146 of the Code;
- The determination of the amount of allowable private use under Section 141 of the Code;
- The determination of the amount of "bad money" under Section 142 of the Code;
- The 2% costs of issuance limitation under Section 147 of the Code; and
- The limitation on sizing for purposes of Sections 1311 and 1313 refunding transition rules of the Tax Reform Act of 1986.

The definition of issue price is currently contained in Treasury Regulation § 1.148-1(b), and is carried over by an explicit cross reference into the private activity bond rules of Section 141 of the Code, and by implication in other applicable subsections of Sections 142 through 150 of the Code, and the regulations thereunder. Treasury Regulation § 1.148-1(b) defines the issue price of a tax-exempt bond as follows:

> *Issue price* means, except as otherwise provided, issue price as defined in sections 1273 and 1274. Generally, the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining the issue price under section 1274. The issue price of bonds may not exceed their fair market value as of the sale date.

The need to determine the issue price of the bonds of an issue is mandated by the enactment of Section 148(h) of the Code as part of the Tax Reform Act of 1986; Section 148(h) was enacted by Congress to overturn the holding in the State of Washington[6] decision, which concluded that an issuer's arbitrage yield should reflect the "all-in" costs of its borrowing, including the costs of issuance associated with the issuance of its bonds.

As required by the general provisions of Section 148(h), Treasury Regulation § 1.148-1(b) uses as a starting point the definition of issue price of a bond as measured under Sections 1273 and 1274 of the Code. Moreover, this regulation explicitly provides

[6] State of Washington v. Commissioner, 692 F.2d 128 (1982).

that the sale of at least 10% of a maturity is deemed to be the sale of a substantial amount of the bonds of that maturity. However, this helpful guidance is not contained in Sections 1273 and 1274. Treasury Regulation § 1.148-1(b) provides further useful guidance by clarifying that the sale of a portion of the bonds at a later point in time at a different price does not affect the issue price determined as of the sale date. And finally, the regulation explicitly provides that the issue price of the bonds is "determined as of the sale date based on reasonable expectations regarding the initial public offering price (emphasis added). . . ."

Difficulties of Application of Definition

Notwithstanding the helpfulness of the 10% rule and the reasonable expectations provision of Treasury Regulation § 1.148-1(b), there are many issues that are not addressed by this regulation. Some bond counsel may be reluctant to rely upon the "reasonable expectations" language of the regulation in situations in which it is not self-evident that at least 10% of each maturity of the bonds has actually been sold to members of the general public. A few examples of current market transactions that the regulation does not directly address may help to illustrate this concern:

1. An issue of bonds of Issuer is sold in a competitive sale; as is common with competitively bid sales, there are no constraints on the reoffering of the bonds by Underwriter. Underwriter buys the bonds from Issuer at a price of 98.5 and offers the bonds to its customers at a price of 99, but does not sell any of them at that price on the date of sale. After accepting the winning bid, Underwriter subsequently sells 5% of the bonds to Retail Broker at a price of 98.5; Retail Broker sells the bonds at par.

2. Same facts as in Example 1, except that, because of subsequent changes in interest rates, Underwriter sells the bonds at a price of 96.5, and Retail Broker sells the bonds to its customers at a price of 98.

3. Same facts as in Example 1, except that Underwriter does not sell the bonds to others, but instead continues to hold them in a short-term account through the date of closing of the bond issue.

4. In a negotiated underwriting, Underwriter sells advance refunding bonds to Mutual Fund at a price of 98.5. Four days after the signing of the BPA but before the bond issue is closed, Mutual Fund sells 5% of the bonds to Retail Broker at a price of 99; in turn, Retail Broker sells the bonds to its customers at par. Alternatively, 11% of the bonds are sold by Mutual Fund and Retail Broker. Alternatively, the sales by Mutual Fund and Retail Broker all occur after the closing of the bond issue.

5. In a competitively bid issue, the bonds are sold by Underwriter to Hedge Fund on the date of sale of the bonds. After the closing date on the bond issue, in accordance with its usual practice, Hedge Fund places the bonds in a trust program. As is customary in trust program structures, Hedge Fund sells 99% or so of the interests in the program at par to floating rate investors (typically, money market mutual funds), retaining for its own account a 1% interest. Hedge Fund is not registered or regulated as a broker/dealer with the NASD or SEC. The trust program is treated as a partnership for federal income tax purposes. Due to an increase in market interest rates, the trust program purchases the bonds at a price less than the price paid by Hedge Fund. Alternatively, the depositor and

owner of the 1% interest in the TOB program trust could be the proprietary (long-term holdings) trading desk of the Underwriter.

6. In either a competitive or negotiated underwriting, the bonds are offered to the public, but no bonds of a given maturity are sold to the public, and, as a result, all bonds of that maturity are taken into inventory by the underwriter. Underwriter obtains secondary market insurance at its expense and immediately resells the now-insured bonds to the public at a price that differs from the initial offering price.

These examples (and the many variations thereon) serve to highlight some of the issues that confront bond counsel in trying to apply the provisions of Treasury Regulation § 1.148-1(b). Specifically, the following situations are not addressed by the regulation, and the Study Group respectfully requests that there be additional guidance:

- In many instances, all of the bonds of a maturity are offered to the public, but less than 10% of them are actually sold as of the sale date (*i.e.*, the date on which the BPA is actually signed). In this situation, some bond counsel and issuers may be reluctant to determine the issue price of the maturity based upon the underwriter's "reasonable expectations" that it could sell the bonds at the initial offering price on the sale date, particularly if reported trade data show actual sale prices at different prices than the initial offering price.

- Bonds are often sold to parties who may act both as investors for their own account and as traders in the bonds; these investors in turn sometimes will resell the bonds to other investors at higher prices than the prices at which they purchased the bonds. These investors may or may not be regulated by the NASD and SEC as broker/dealers. In such situations, uncertainty exists as to whether those investors should be treated as "bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers" for purposes of Treasury Regulation § 1.148-1(b), particularly when investors' actions "after the fact" arguably could determine their status.

- Bonds are often securitized or "repackaged" through trust programs, floater/inverse floater structures, or similar vehicles, by sophisticated investors and traders. Again, these investors may or may not be regulated as broker/dealers.

Overlaying all of these potentially ambiguous situations is the important (and indeed critical) fact that the structure of a bond issue must be established by the pricing date of the bonds. On that date, the issuer, underwriter, bond counsel, credit enhancer and investors must know whether the bonds to be settled are, in fact, in compliance with the Code and will be issued as planned and in the amount planned. In turn, the determination of the issue price of a bond must be made as of the pricing date, so as to assure that the transaction as planned meets all of the rules and regulations that turn, directly or indirectly, on the definition of issue price. This is particularly true in the context of advance refundings (the type of transaction that is probably the most sensitive to the question of the issue price of the bonds) in large part because the yield-restricted escrow investments typically must be purchased on that date.

Consistency with Congressional Intent

The primary purpose of Section 148(h) of the Code was to assure that an issuer was not able to recover any of its costs of issuance (other than bond insurance and similar guarantee fees) through the investment of the bond proceeds at a higher yield.[7] Thus, in a real sense, the regulation is attempting to define and measure the issuer's issuance costs, and in particular, the underwriting spread that the issuer has agreed to pay for the marketing of the bonds. Further, the regulation does not attempt to define the cost basis in the bond to the investor, nor does it attempt to capture trading or securitization profits of secondary market participants in the arbitrage analysis.

In order to further this legislative intent, the legislative history relating to the Tax Reform Act of 1986 provides for the yield on the bonds to be determined "based on the issue price, taking into account the Code rules on original issue discount and discounts on debt instruments issued for property (sections 1273 and 1274 of the Code)."[8] For this reason, the definition of issue price in Treasury Regulation § 1.148-1(b) references Sections 1273 and 1274 of the Code, but varies from the literal and specific requirements of those sections, for example, by providing that the issue prices for which a bona fide public offering is made is determined as of the sale date based on reasonable expectations regarding the initial public offering price.

The Study Group believes that the definition of issue price and its application should remain focused on the elimination of issuance expenses, primarily underwriters' commissions, from the computation of bond yield, rather than any application of the literal requirements of Sections 1273 and 1274 of the Code. The Study Group believes this recommendation is consistent with the Congressional intent. The focus of the Study Group's recommendations is to identify the underwriter's commissions in the deal struck between the issuer and the underwriter and to avoid taking into account secondary market transactions, transactions by parties other than the underwriter, and other similar factors that are irrelevant to the underwriter's commissions.

The concept of issue price as defined under Treasury Regulation § 1.148-1(b) has been carried over to other Code requirements that affect tax exempt bonds by cross-reference in Treasury Regulation § 1.141-1(a) and by simple analogy or other extension of analysis. However, the Study Group believes that for many of these Code sections, there is not the same policy or Congressional intent that would clearly require that the principle of Sections 1273 and 1274 of the Code be applied. For example, for purposes of applying the 90/10 "private use" test of Section 141 of the Code or the 95/5 "exempt use" test of Section 145 of the Code or determining the amount of volume cap under Section 146 of the Code, developing rules that simply identify the proceeds that are received by the State or local governmental issuer of the bonds would appear to be consistent with Congressional intent. The Study Group does not believe there is any clear legislative policy for requiring that the issue price paid by the public purchaser of

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[7] *See* Senate Report No. 99-313, p. 828 (1986): "The committee believes it is important for issuers of tax-exempt bonds to pay the costs associated with their borrowing. The bill provides that the costs of issuance, including attorneys' fees and underwriters' commissions, must be paid by the issuers or beneficiaries, rather than recovered through arbitrage profits . . . ." The focus on the elimination of costs of issuance in the computation of bond yield and the reversal of State of Washington, supra at fn. 6, is repeated in the House and Conference Committee reports relating to the Tax Reform Act of 1986.

[8] House Report No. 99-426, p. 554 (1986).

the bonds be the basis for measuring these tests. Nevertheless, the Study Group recognizes that applying the concept of issue price for the various purposes of Sections 141 through 150 of the Code is possible, provided the application reasonably recognizes the fundamental purpose of the Code requirements. The Study Group suggests that the focus of the definition and its application should be on identifying the proceeds received by the issuer of the bonds and the amount of underwriters' commission paid by the issuer.

Moreover, (in the words of one IRS official who was involved in the drafting of the arbitrage regulations) Treasury Regulation § 1.148-1(b) was designed to achieve "rough justice" in the prohibition and capture of arbitrage.

Issue Price Verification

Bond counsel typically require and rely upon a certificate from the underwriters to establish the issue price of bonds. Information currently available is not sufficiently detailed so as to permit bond counsel (and others) to independently reach a definitive, reliable conclusion on the issue price question, (*i.e.*, the first price at which bonds are actually sold to the public). Specifically, currently available information (*e.g.*, MSRB trade data) only differentiates among sales to customers, sales from customers, and interdealer trades, and is not designed to address federal income tax issues relating to the establishment of issue price: it is provided on sites such as The Bond Market Association web site and Bloomberg for other purposes.

Additionally, in their current structures, these services do not permit bond counsel to verify the ***first*** price at which 10% or more of a maturity of bonds is sold. This problem is further exacerbated by the fact that sales that occur prior to the execution of the BPA are not reported until after the BPA is signed – a process that can take as many as two or three days. Currently, there is no way to differentiate between the sales by the underwriters that occurred on the date of pricing of the bonds (which are the "first sales" that should determine the issue price) from those trades that occur after the pricing date but before the award date, or from those that occur on the date of the formal award. The tax law analysis may also be complicated by the way "interdealer" trades are reported on the MSRB web site. For example, the Study Group believes that any purchase by an entity that is registered or known to be a dealer is marked as an interdealer trade and would include a purchase by an investment bank for its proprietary trading account (or arbitrage account).

While the MSRB has proposed rule changes designed to differentiate between "conditional" trades (*i.e.*, those that occur before the signing of the BPA or the award of the bonds), and "list offering price transactions/takedown transactions" (*i.e.*, those that occur in connection with the underwriting of the bonds),[9] such rules are not yet in place. Moreover, these rules, when finalized, may or may not provide conclusive public trade reporting data in a manner suitable for establishing the issue price of bonds under Section 148(h) of the Code.

More generally, issuers and underwriters can provide and certify definitive information only with respect to what the issuer or underwriter did in conjunction with

[9] *See* MSRB Notice 2006-10 (April 21, 2006), available on the MSRB web site at http://www.msrb.org/msrb1/whatsnew/2006-10.asp.

the offering and sale of bonds, *but not* with respect to what other investors do or will do in the context of the sale and trading of bonds absent the underwriter. In other words, underwriters and bond counsel cannot reasonably be expected to develop accurate and legally meaningful information for trading activity outside of the underwriting process.

Therefore, the Study Group recommends the following rule: generally, the issue price inquiry ends when the offering price is shown to the prospective investors to whom the underwriters offer the bonds (*i.e.*, not when the BPA is signed). The Study Group also strongly recommends that the concept of "reasonable expectations" continue to be given substantive meaning by the establishment of safe harbors, as provided below.

The Study Group urges that issue price for purposes of Section 148 of the Code not be interpreted as the issue price determined under the original issue discount rules, due to the necessity of identifying the arbitrage yield (and other related measures of tax law compliance) on the bond issue at the time it is structured and priced -- particularly acute for advance refundings.

Recommended Guidance in Negotiated Underwritings

Given the large number of bond issues that are distributed through a negotiated underwriting process, the Study Group believes that, if workable safe harbor guidelines are crafted to address the situations that arise in negotiated underwritings, much of the uncertainty that currently arises from the interpretation of the definition of issue price could be resolved.

In light of the legislative intent behind Section 148(h) of the Code as well as the business arrangement embodied in a BPA, the Study Group suggests that, in the context of a negotiated offering, the offering price established by the underwriter, as part of a bona fide offering to the public and as established in the BPA, be used to establish the amount of the underwriters' commissions that Section 148(h) was intended to address. The Study Group recommends use of this offering price regardless of other facts, including: (i) whether the bonds are actually sold by the underwriter at that price *(i.e.*, if less than 10% of the bonds are actually sold at the offering price) and/or (ii) whether the buyers at that price subsequently resell the bonds to other investors (*e.g.*, place the bonds in a TOB program trust, or resell them to other broker/dealers).

Using the offering price that is shown to investors as the issue price of a bond would have the virtue of simplicity, transparency and administrability: in almost all negotiated underwritings, the offering price (or corresponding yield) of a bond being offered is disseminated virtually immediately upon its establishment by the senior underwriter to the broker/dealer and investor community via Dalcomp (to other members of the underwriting syndicate) and the The Bond Buyer (TM3) and/or Bloomberg news wires. This process provides substantial assurance that the offering price is exposed to a variety of investors, allowing other potential investors to place an order for the bonds if they feel the offering price is too low. Further, the pricing wire is a readily ascertainable document for purposes of the conduct of due diligence by bond counsel; attaching a copy of the final pricing wire to a "tax certificate" as part of the due diligence documentation generally would be a simple matter.

For a variety of reasons, the Study Group also recommends the issuance of guidance to the effect that trust programs and similar bond repackagings should be disregarded in determining the issue price of bonds. First, in such situations, as a technical matter, the bonds are typically being resold to an entity (or a group within the entity) in which the first purchaser (the trust creator) is a general partner and the owner of the residual interests in the trust, and, thus, maintains a sufficiently continuing interest in the bond as to make the sale to this TOB partnership a transaction that should be disregarded. More generally, treating the placement of the bonds into a TOB program trust as the act that established the issue price of the bonds raises the opportunity for the IRS to be "whipsawed" under current arbitrage regulations: if the value of the bonds increases between the sale date of the bonds and the date of deposit of the bonds into the TOB program trust, the last sentence of the definition of issue price in the regulations would preclude the use of the higher price in computing the arbitrage yield (which would otherwise lower the arbitrage yield on the bond issue). If, however, the market value of the bond at the time of the deposit to the TOB program trust is lower than the fair market value as of the sale date, treating this deposit as the act that establishes the issue price of the bonds would have the effect of increasing the arbitrage yield. An appropriate solution, therefore, would be to focus on the price paid by the TOB program trust creator as establishing the issue price of the bonds.

Exceptions. The Study Group further recommends that this proposed safe harbor rule not cover situations in which an underwriter has a pre-existing arrangement with another broker/dealer in which the second broker/dealer would be allowed to sell bonds during the order or underwriting period at prices higher than the offering price. Instead, the Study Group recommends that, in such infrequent circumstances (to the Study Group's knowledge), the offering prices of the second broker/dealer be reflected in the issue price of the bonds. Also, a negotiated underwriting syndicate may bid out a particular maturity among members of the syndicate; the winning syndicate member can then establish its own offering price for that maturity independent of the guidance of the senior manager. The Study Group suggests that in that case, the offering price of the winning syndicate member is the relevant offering price of the bond, not the price at which the syndicate "sells" the bonds to the winning syndicate member.

Additional Recommended Guidance for Competitive Underwritings

The Study Group believes that many of the principles enumerated above in the context of negotiated underwritings should be equally applicable to competitive bid underwritings. Specifically, the Study Group recommends that, if the underwriter has reoffered a bond to the public and has disseminated the offering price via a Dalcomp wire to other members of an underwriting syndicate or to other members of the municipal bond investing community via The Bond Buyer (TM3) and/or Bloomberg news wires, the price shown on the pricing wire be deemed the issue price of the bond. In addition, the Study Group requests guidance to the effect that a bona fide sale to an entity that is not, on its face, an underwriter or a broker/dealer (as defined and regulated by the NASD and SEC) be deemed a sale to the general public, even if that entity later resells the bonds to other parties.

Summary

As noted above, the main objective of the Study Group is to identify areas with respect to the interpretation of "issue price" which may need clarification and to provide recommendations for such clarification. The Study Group has set forth its recommendations in this paper to further that goal and would welcome the opportunity to be of further assistance, if appropriate, in achieving the clarity, certainty and administrability needed for this important matter.

EXHIBIT A

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EXHIBIT B

Government Finance Officers Association
National Association of Bond Lawyers
Regional Bond Dealers Association
Securities Industry and Financial Markets Association

August 5, 2010

Mr. John J. Cross III
Associate Tax Legislative Counsel
Office of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear John:

Thank you very much for meeting last month with representatives of the organizations listed above. These representatives have developed this letter which serves to answer many of the questions that were asked and discussed at the meeting. We have also developed possible solutions for your review.

Issuers and others in the marketplace continue to struggle with matters surrounding the question of issue price in the Build America Bonds (BABs) market. Although statements by IRS officials regarding audits of BABs have been very helpful, the BABs questionnaire and other statements by IRS personnel continue to create uncertainty regarding the IRS's interpretation of the rules for establishing "issue price." Therefore, we reiterate the urgent need for further guidance from the Treasury Department.

The best way to alleviate these concerns and difficulties created for the market is to clarify the existing regulatory framework for tax-exempt bonds and apply this directly to Build America Bonds – and other direct pay bond programs. This is the most efficient way to provide clear guidance for the marketplace, address the uncertainties, create the least amount of disruption, and ensure continuity in the municipal securities market. The issue price for tax-exempt bond purposes has been based on the initial offering price to the public for over 25 years. We submit that there is no reason to depart from this approach.

Below is an outline of the issues that we believe should be addressed through IRS guidance:

Issue Price and Reasonable Expectations. The existing regulations provide that the issue price for publicly offered bonds is the initial offering price to the public. In various forms, this has generally been the rule since the early 1980s. We strongly believe this is the correct approach to use and should not be abandoned in favor of an approach based on actual sales or secondary market trading activity. There is nothing in the process of issuing BABs or tax-exempt bonds that necessitates a change from this long-standing regulatory approach. Additionally, requiring verification of sales or an analysis of secondary market trading activity is a fundamental departure from current market practices and places an unreasonable burden on issuers by subjecting tax compliance to the randomness of subsequent market movements and causing uncertainty and second-guessing after a legal commitment has been executed. If, as we suggest, the approach based on the initial offering price to the public is retained, there is no need to modify the 10 percent rule for actual sales to the public.

The current regulatory regime effectively relies on more than just issuer expectations to establish the issue price; the applicable MSRB regulations require much more than that. First, there must actually be a bona fide offering of the bonds to the public at the initial offering price. Second, the issuer and its advisors must establish that it is reasonable to expect that a substantial amount of the bonds will be sold to the public at that initial offering price. The processes that the industry goes through in offering the bonds to the public and developing the price at which the bonds are expected to be sold are both extensive and well documented. Further, the issuer has a direct economic incentive to ensure that the bonds are widely offered and that the bonds are sold at the lowest possible yield. Long before the IRS expressed concerns about issue price determinations, issuers and their financial advisors were regularly participating in marketing efforts, conference calls regarding feedback from investors, and traveling great distances to personally attend the pricings of their bonds. In light of these existing requirements, we see no reason to modify the long-standing regulatory approach, particularly when the current rules require an actual offering of the bonds to the public at their initial offering price.

Moreover, once the initial offering price has been established, the issuer and the underwriter have effectively established the amount of consideration that the issuer is willing to pay the underwriter—increases or decreases in price from that point forward will be a function of a number of factors that have nothing to do with the issuer (for example, movements in interest rates, the success of the underwriter in selling the bonds, etc.). Movements in the pricing of the bonds after the signing of the Bond Purchase Agreement can not be viewed as effecting/impacting the issuer's costs of issuance when the issuer does not realize any benefit or detriment from those changes. An issue price regime based on the actual sales prices of bonds would create a great deal of added complexity and cost to issuers of BABs and tax-exempt bonds; much more than "merely" adjusting the arbitrage yield to reflect actual sales prices and adjusting the amount of BAB subsidy payments to reflect actual prices. The rules applicable to tax-exempt bonds and BABs use "issue price" as a measurement tool for a significant number of rules that would be affected by changes in the issue price of a bond issue after the sale date, and it is essential that issuers and their counsel be able to conclusively determine compliance with these requirements on the date the purchase agreement is signed.

We have developed two charts demonstrating the manner in which negotiated and competitive BABs are priced and sold in the market today. These charts demonstrate the extensive process involved in both developing the offering price for bond issues and ensuring that members of the investing public have the opportunity to buy those bonds. See Exhibit A. We have also prepared a detailed explanation of this process that includes an explanation supporting our view that the forthcoming guidance should follow the procedures currently used in the market with issue price determined based on the initial offering price as documented in the final pricing wire. See Exhibit B.

The information set forth in the final pricing wire represents the culmination of a lengthy process involving the underwriters, the issuer, and the investors, which includes the underwriter and the issuer agreeing to the terms of the transaction. This process, together with the related supporting documentation, establishes the necessary proof of the reasonableness of the parties' expectations regarding the pricing of the bonds at the time the contract of purchase is executed. This pricing scale is the data upon which bond counsel bases its analysis for purposes of demonstrating compliance with the different requirements and constraints of the Internal Revenue Code. The final pricing wire, substantiated by evidence of the offering process, provides the basis for the parties' reasonable expectations regarding the proper issue price of the bonds, irrespective of actual sales executed once the bonds become available to investors.

Price Changes in the Secondary Market Trading are a Function of the Market. There has been a great deal of attention focused on indications that, after the initial sale of BABs, some investors may immediately resell those bonds at a higher price, raising the issue of whether those initial investors are acting in a manner similar to underwriters. (It should be noted that where such investors are actual investors and not persons with either a corporate or contractual relationship with the members of the underwriting syndicate, such transactions should be treated as true secondary market transactions affecting neither the yield on the bonds nor the compensation to the underwriters.) To illustrate the point that all markets (corporate, tax-exempt, and BABs) have upticks in secondary market trading, the Securities Industry and Financial Markets Association has compiled data (Attachment C) which demonstrates the fact that compared to other markets, there is nothing unusual about the trading in the Build America Bond market. As you will see, the changes in BABs pricing are actually lower than other markets. For this reason, the "trading up" that may occur should not be a concern.

Safe Harbors. The forthcoming guidance should include separate safe harbors for competitive and negotiated transactions. In Attachment B, we have included examples to demonstrate the differences between the two types of transactions. We agree with the comments made at the meeting to the effect that transactions done by competitive means inherently address many of the concerns raised. Competitive sales, when conducted consistent with normal market practices, (i.e., public notice, competitive bids by unrelated parties, and award or sale to the bid representing lowest interest cost) should de facto establish that the "issue price" is the reoffering price/yield on the bonds. Subsequent sales at reoffering prices/yields different than the initial offering prices/yields are irrelevant and should not affect the "issue price" established by the competitive market forces at the time of sale.

Parity for all Municipal Securities. As we discussed in our meeting, we strongly believe that the forthcoming rules should apply to both tax-exempt and Build America (and other direct subsidy) Bonds.

Penalties. In the event that penalties for noncompliance with these rules must be assessed, we reiterate the point we made in our April 26, 2010 letter stating that the penalty should be tailored to the violation, rather than causing harm to the entire issue.

Sincerely,

Frank Hoadley, Chairman-Governmental Debt Management Committee, Government Finance Officers Association

Perry Israel, Chairman-Tax Committee, National Association of Bond Lawyers

William Daly, Senior Vice President, Regional Bond Dealers Association

Leslie Norwood, Managing Director and Associate General Counsel, Co-Head of Municipal Securities, Securities Industry and Financial Markets Association

EXHIBIT B

Attachment A

Summary of BABs Competitive Pricing Process
Summary of BABs Negotiated Pricing Process

EXHIBIT B

Summary of BABs Competitive Pricing Process

The pricing of Issuer's Taxable BABs will generally occur over a two or three day period.

Before Pricing

- Notice of the upcoming issue in a publicly available medium (such as through the calendar of upcoming issues in the Bond Buyer, a Bloomberg wire, or the MMD calendar)
- Several days prior: POS posted and distributed

Pricing Day 1 (this may occur over Day 1 and 2)

- Potential bidder (a "Manager") assesses the market and develops a preliminary pricing scale*
- Manager sends preliminary scale and goes to any syndicate members for consensus
- Syndicate distributes its pricing views in order to obtain pre sale orders or indications of interest from market participants
- Final conference call with any syndicate members to set the final bid and finalize underwriting commitments in order to submit the bid to the issuer.

* Similar steps are being taken by other potential bidders and the members of their syndicates

Pricing Day 2

- Final conference call with any syndicate members to set the final bid and finalize underwriting commitments in order to submit the bid to the issuer.
- Bids are submitted to the issuer
- Award of bonds to winning bidder (typically 1 hour after the bid time)
- Winning manager/syndicate fills any pre-sale orders and runs an order period for about 1 hour.
- At the end of the order period any unsold bonds are taken into inventory, syndicate is closed, unsold bonds are hedged and the issue is on the secondary market
- Issuer's board passes its final resolution and the BPA is signed

EXHIBIT B

Summary of BABs Negotiated Pricing Process

The pricing of Issuer's Taxable BABs will generally occur over a two or three day period.

Before Pricing	**Pricing Day 1 – Syndicate Develops Price Views**	**Pricing Day 2**	**Pricing Day 3 (on small issues Days 2 and 3 may be combined)**
•Notice of the upcoming issue in a publicly available medium such as listing of financing on *Bond Buyer* and/or Bloomberg new issue calendar (and *New York Times* Monday calendar for financings over $100mm) •Several days prior: POS posted and distributed	•Syndicate Manager solicits price views from Co-Managers (if any) •Syndicate Manager prepares proposed indicative spreads to applicable Treasury maturities •Syndicate Manager and members distribute indicative spreads to sales people who obtain feedback from investors on proposed spreads •Syndicate distributes proposed indicative spreads to Treasuries to Issuer •Meeting/call for Syndicate to provide Issuer with a market update and to discuss the proposed indicative spreads to Treasuries •Issuer and Syndicate agree on proposed indicative spreads to Treasuries for use on Day 2	•Syndicate Manager distributes proposed indicative spreads to Treasuries to the market using Dalcomp and/or Bloomberg •Syndicate solicits "indications of interest" from investors, based on the proposed spread range •Meeting to review indications of interest and proposed tightening (lowering) or widening (increasing) of spreads to Treasuries (if any), based on indications of interest received (if any) •Issuer and Syndicate agree to any changes to spreads to Treasuries, or agree to take new indications of interest	•Take new indications of interest, if necessary, and adjust spreads accordingly. •Launch BABs. Investors notified by wire or Bloomberg and salespeople call investors to provide opportunity to place orders. •Issuer provides Syndicate with the verbal award for the bonds •Syndicate Manager makes allotments of sold bonds to investors and unsold bonds to syndicate members •Coupons and yields on the bonds are locked in, based on spreads to Treasuries and actual Treasury yields as of noon. Investors and Dealers hedge positions •Syndicate prepares final cash flows based on final pricing results •Final pricing established by signing BPA or sending final pricing wire

EXHIBIT B

Attachment B

Issue Price

1. **Background.** The definition of "issue price" in Treasury Regulations §1.148-1(b) provides a workable and appropriate interpretation of the statute. In particular, with respect to bonds that are sold to the public, that definition recognizes that the crucial date for determining "issue price" is the sale date, which precedes any sales of bonds to the public and certainly is prior to the date that any trade data becomes publicly available on EMMA or other sources. For purposes of determining issue price for publicly offered bonds under §1.148-1(b), both (1) a bona fide public offering of the bonds must be made and (2) the reasonably expected reoffering prices at which a substantial amount of the bonds are expected to be sold must be determined.

2. **Regulatory, Contractual, and Market Factors.** When considering any rule relating to issue price, it is important to have an understanding of the regulatory, contractual, and market factors that govern the municipal market (both tax-exempt and taxable). First, all municipal securities dealers are bound by certain fair dealing rules, such as MSRB Rule #G-17, which states that "[i]n the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." This rule has been interpreted by the MSRB to require that, if an underwriter offers all of the bonds pursuant to a syndicate wire, the bonds must in fact be available for sale to recipients of the wire at the prices stated.

   Additionally, issuers regularly enter into contractual relationships with underwriters or winning bidders (in competitive sales) that mandate that the underwriter make a bona fide public offering of all the bonds to the public at the prices stated. The following is an example of common bond purchase contract language:

   > The Underwriter agrees to make a bona fide public offering of the Bonds at the initial offering prices or yields set forth on the inside cover of the Official Statement; however, the Underwriter reserves the right to make concessions to dealers and to change such initial offering prices or yields as the Underwriter shall deem necessary in connection with the marketing of the Bonds.

   Similarly, the official notice of sale, which states the contractual arrangement between the issuer and the winning bidder, usually requires a bona fide public offering. Here is an example of common language from a notice of sale:

   > The winning bidder will be required, as a condition to the delivery of the Bonds by the City, to deliver to the City a certificate identifying the prices at which it reasonably expects to initially offer each maturity of the Bonds to the general public (the "Initial Offering Prices") as of the date of purchase of the Bonds (the "Sale Date"). *The winning bidder will also be required, on or prior to the date of issue of the Bonds, to actually offer 100% of each maturity of the Bonds to the general public in a bona fide public offering for prices equal to or less than the Initial Offering Prices.*

   Through these types of contractual arrangements, the issuer has taken steps to ensure that all the bonds will be reoffered to the general public at the initial offering prices. (The practice in this area continues to develop, so it is possible that some issuers do not currently impose similar contractual obligations upon the underwriters and winning bidders. However, the bond market

community would not object to a rule requiring similar language in bond purchase agreements and notices of sale.)

In situations where there is more than one underwriter or member of the selling group, an agreement among underwriters or members of the selling group imposes a similar obligation on all members of the group. The TBMA Master Agreement Among Underwriters (the "AAU"), for example, requires the lead underwriter to send a pricing wire to all members of the selling group indicating the terms of the proposed purchase of the bonds, including the initial public offering prices. The AAU further requires that the lead underwriter send a final pricing wire to all members of the selling group. The members of the selling group are then required to reoffer their allocated bonds at the prices stated in the final pricing wire.

Finally, there are market forces that essentially obligate the underwriter to reoffer all identical bonds at the same prices (with possible adjustment for concessions). The clients of an underwriter interested in purchasing bonds at a publicly offered price can readily determine that the underwriter is not acting in the best interest of the client if the underwriter falsely states to the client that no more bonds are available at that price, and then later resells the bonds at higher prices. An underwriter or broker who deals with its clients in such a cavalier manner will not only be violating the regulatory obligation of fair dealing, but will be punished by its clients through denial of further business with the clients.

Thus, in summary, the regulatory environment, the contractual arrangements with the issuer, and market forces in general all work together to create a bona fide public offering of the bonds to the public at the prices stated in either the final pricing wire or the official statement. Any tax-driven rule relating to issue price should take into account the fact that a bona fide public offering is generally compelled by forces other than tax rules.

3. **Bona fide public offering:** The requirement of a bona fide public offering in the income tax regulations is not intended to establish new requirements for the market. Accordingly, whether a bona fide public offering has taken place must take into account normal market procedures. The scope and form of a bona fide public offering will differ from bond issue to bond issue and reflect, among other things, the number of underwriters or members of the selling group, the size of the bond issue, the characteristics of the bonds, and the clientele of the underwriter, underwriters, or selling group. A bona fide public offering does not require that the bonds be offered to **all** potential buyers; an offering to a sufficiently large group (such as the customers of the selling group) should suffice. Moreover, normal market mechanisms, such as notice of the coming offer and making available the details and prices of the bonds in some of the ways described below, should be enough to constitute a public offering of the bonds.

   In the context of tax-exempt bonds, the issue price is largely used for the purpose of establishing the yield on the bonds (although it is also used to determine the amount of proceeds for purposes of the private activity bond rules). Congress, in overriding the *State of Washington* case (692 F.2d 128, 1982), wanted to make sure that costs of issuance, including underwriters' compensation, are not taken into account in determining yield. Accordingly, the term "bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers," used in Treasury Regulation section 1.148-1(b) in the definition of issue price, should be interpreted to be limited to sales to underwriters or others directly purchasing the bonds from an issuer and bound by the terms of the syndicate, their "related persons," others in privity of contract with respect to the issuance of the bonds, such that compensation payable by the issuer to the underwriter may not be disguised in the difference between the price paid to the issuer and the issue price of the bonds. Sales of bonds (or offers of bonds) to other retailers (including both those in the regular business of retailing and those not in the regular business but

who take advantage of an opportunity to resell the bonds) who are not part of the underwriting or sales groups and sales to other investors that arise as part of the offering of the bonds to the general public should be permitted, even if those retailers or other investors in turn resell to their clients or other persons. Sales by those retailers or investors should be treated as secondary market transactions not taken into account in determining issue price. **This clarification alone would go a long way toward solving concerns about after-sale trading.**

A public offering may take many forms, and the details will vary from transaction to transaction. Moreover, as technology and media change, the means of making a public offering have changed and will continue to change. Because of these variables, the issue price rules should not mandate one particular set of steps or means of communication. Instead, whether there has been a bona fide public offering should be determined based upon all the facts and circumstances and should involve an examination of how the offering took place. Reasonable indicators of a bona fide public offering might include some of the following: (a) notice of the upcoming issue in a publicly available medium (such as through the calendar of upcoming issues in the Bond Buyer, a Bloomberg wire, or the MMD calendar); distribution of the notice may, in smaller offerings, be limited to customers of the underwriter or underwriters; (b) notice of the upcoming issue and possible pricing to the sales force (such as through internal sales force meetings or distribution of one or more wires or emails internally to the sales force indicating the coming availability or current availability of the bonds); (c) solicitations of “indications of interest” from potential investors, even if limited to clients of the underwriting group; and (d) publication of final pricing (for example, through a final pricing wire, a Bloomberg communication, or similar means), even if limited to clients of the underwriting group.

4. **Reasonable expectation of prices.** As with a bona fide public offering, the process for determining the reasonably expected prices at which the bonds will sell to the public in the public offering varies from bond issue to bond issue and may differ fairly substantially from a large issue to a small issue. Typically, the pricing process takes a number of steps, which may include some of the following: (a) solicitation of pricing views from co-managers, (b) distribution of proposed indicative spreads to benchmark interest rate index (e.g. MMD scale or Treasuries), (c) meetings with the issuer and possibly financial advisor to discuss market updates, comparable transactions, and proposed spreads, (d) solicitations of interest from investors (even if limited to customers of the underwriter) based upon the proposed spreads and adjustment of those spreads based upon indications of interest received, (e) pre-sales or contingent sales of bonds, and (f) adjustment of allotments of bonds to investors and possibly among members of the underwriting syndicate or selling group.

   Thus, whether the stated prices at the time of the sale are reasonable will depend on all the facts and circumstances and could include a number of factors, such as market pricing analysis by the underwriter, pricing analysis by the underwriter and other members of the selling group, discussions between the underwriter with the issuer and its advisors, and solicitation of interest from potential investors.

   As a safe harbor, we believe the information recorded in the final pricing wire or the bond purchase agreement, as supported by evidence of the negotiations between the underwriters, on behalf of issuers, and bondholders, establishes the reasonable basis for the issue price of tax-exempt bonds or Build America Bonds. The final pricing wire and the bond purchase agreement document the culmination of negotiations between the underwriters, the issuer, in certain instances, the issuer’s financial advisor, and the investors that take place at the actual point in time at which the underwriter and the issuer agree to the terms of the bond transaction.

The final pricing wire and/or the bond purchase agreement, together with documentation evidencing the processes, provide prima facie proof of the reasonableness of the parties' expectations regarding the pricing of the bonds at the time the contract is executed. This pricing scale is the data upon which bond counsel should be able to base its analysis for purposes of demonstrating compliance with the different requirements and constraints of the Internal Revenue Code. Absent evidence of unfair dealing, the information set forth therein should not be affected by subsequent events relative to the execution of sales of the bond (i.e. secondary market trading).

The pricing of the bonds shown in the final pricing wire and/or the bond purchase agreement also represents the risk accepted by the underwriter in respect of the bond issue. The issuer is guaranteed the benefit of its bargain with the underwriter; the underwriter must then seek to realize the conditional sales agreed to before the bonds were offered to investors. Assuming the process works as it should, the underwriter will be at risk (although the risk may be hedged) for the actual sales to investors of the bonds. That risk is not the issuer's risk, and consequently should not affect the tax analysis undertaken in respect of the issuer's bond deal.

Markets have expanded exponentially in the past fifteen years. The investor population has infinite amounts of information available to it globally and instantaneously. Markets also move with an unprecedented rapidity, responding to all sorts of information immediately available through the means of the internet. This can be seen in the examination of the operation of any market.

The final pricing wire and/or the bond purchase agreement, substantiated by evidence of the offering process, should provide the basis for the parties' reasonable expectations regarding the proper issue price of the bonds, irrespective of actual sales executed once the bonds become available to investors.

5. **IRS Compliance**. Clarification of the issue price rule for tax purposes as proposed above is also readily administrable. There are a number of documents that the IRS could use for audit and compliance purposes. These documents include:

   a. final pricing wire;

   b. bond purchase agreement; and

   c. any other wires or communications to syndicate members or salespeople.

EXHIBIT B

Attachment C

Quantitative Analysis of Municipal Securities Pricing

MUNICIPAL SECURITIES PRICING

EXHIBIT B

QUANTITATIVE ANALYSIS OF MUNICIPAL SECURITIES PRICING

The information in this booklet represents a quantitative analysis of municipal securities pricing, by tracking settlement period price movements of Build America Bond municipal securities. Information for corporate trades was included for comparison purposes.

Also, an analysis of representative issues for both municipal issues and corporate issues was included for illustrative purposes. The spread to U.S. Treasury securities on trade date was included, as this is the basis upon which dealers who trade these securities mark their relative value.

If you have any questions about this data, or would like further information, please contact Leslie Norwood (email: lnorwood@sifma.org; phone: 212.313.1130), Michael Decker (email: mdecker@sifma.org; phone: 202.762.7430), Kyle Brandon (email: kbrandon@sifma.org; phone: 212.313.1280) or Sharon Sung (email ssung@sifma.org; phone: 212.313.1330).

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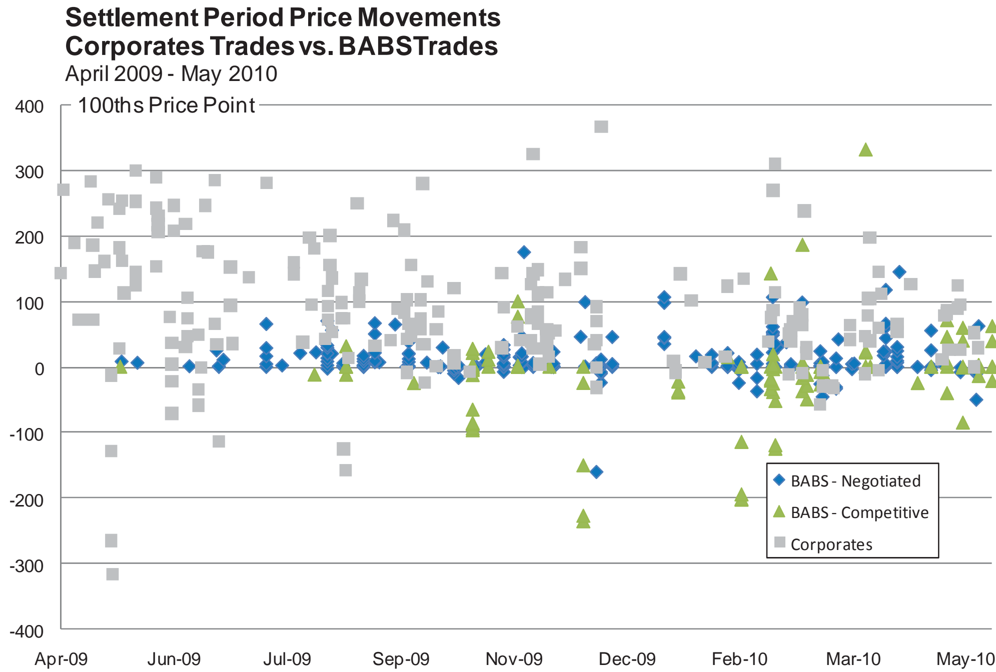
SIFMA
Securities Industry and Financial Markets Association

EXHIBIT B

Municipal BABs vs Corporates Price Movements

The chart below shows that negotiated Build America Bonds have the smallest price movements from pricing to first settlement with an average absolute price change of .161 points, followed by competitive Build America Bonds with an average price movement of .386 points. Corporate bonds had the greatest average price movement of 1.078 points.



The chart below, which is limited to customer trades only, shows the same trends as noted in the chart above. Again, negotiated Build America Bonds have the smallest price movement (.182 points) from pricing to first settlement, followed by competitive Build America Bonds (.456 points), then corporate bonds (1.062 points)

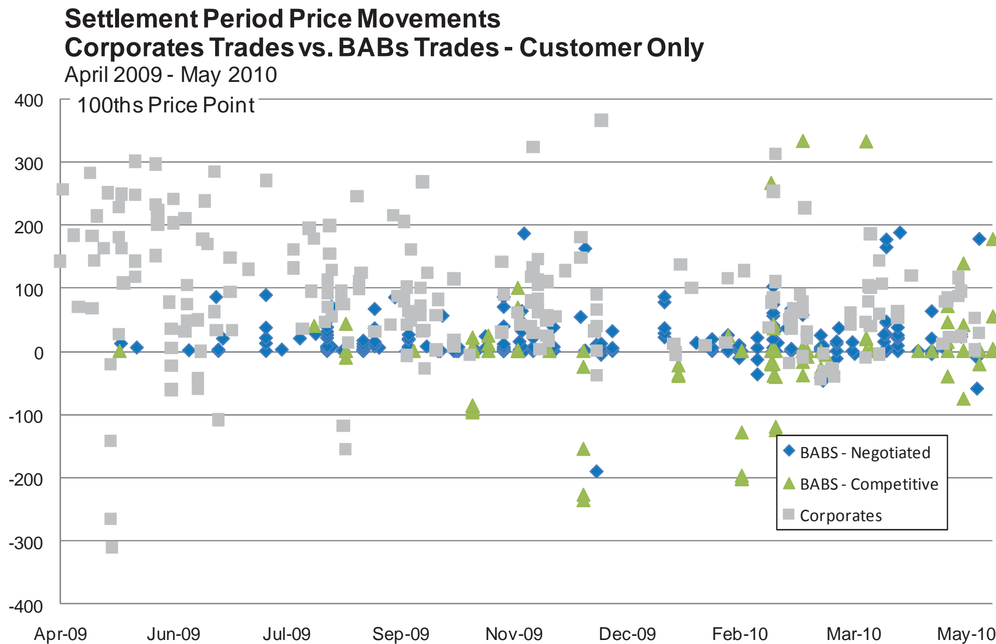
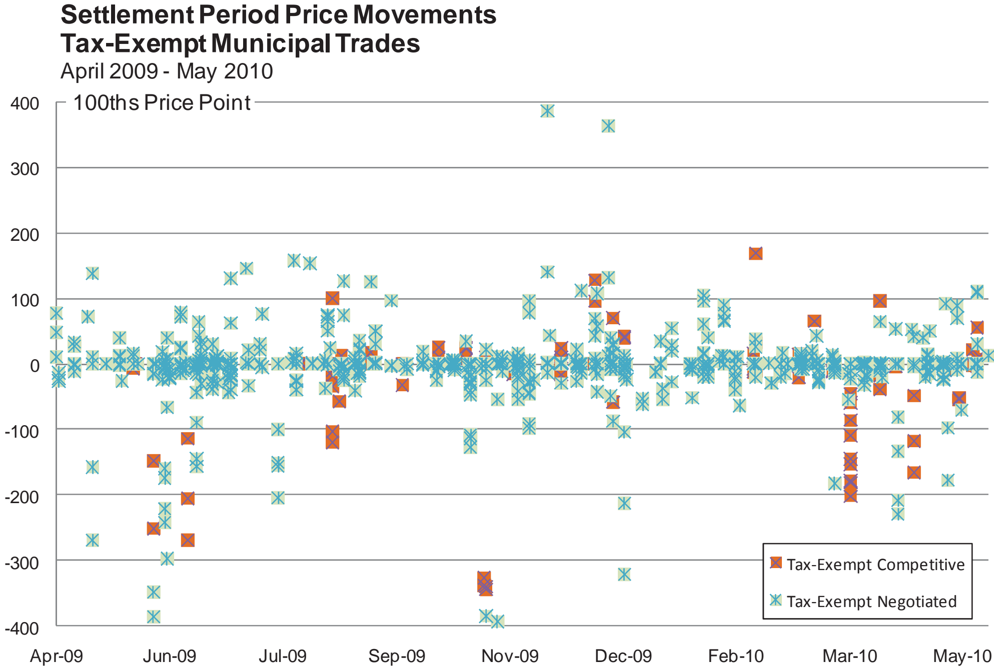


EXHIBIT B

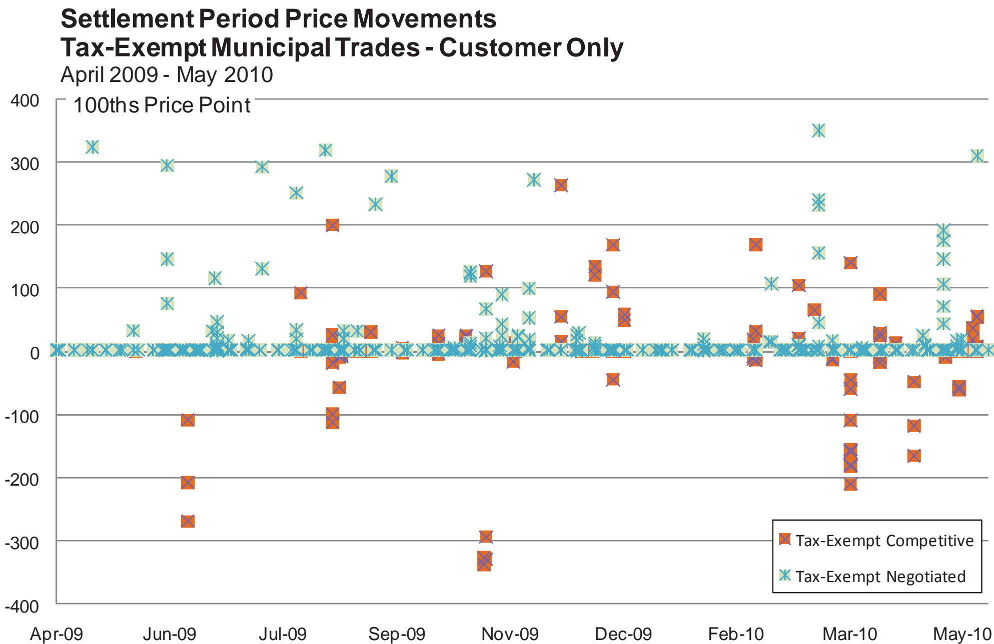
Tax-Exempt Price Movements

The chart below shows that tax-exempt municipal bonds exhibit similar characters to Build America Bonds. Negotiated tax-exempts have less price variability (.298 points) than competitive tax-exempt municipal bonds (.623 points) in the time period from pricing to first settlement.



Sources: Bloomberg, FINRA TRACE, MSRB EMMA, Thomson Reuters, SIFMA
Spreads reflect difference between initial price and trading prices between offer and settlement; a positive spread reflects prices trading up after initial pricing and vice versa.

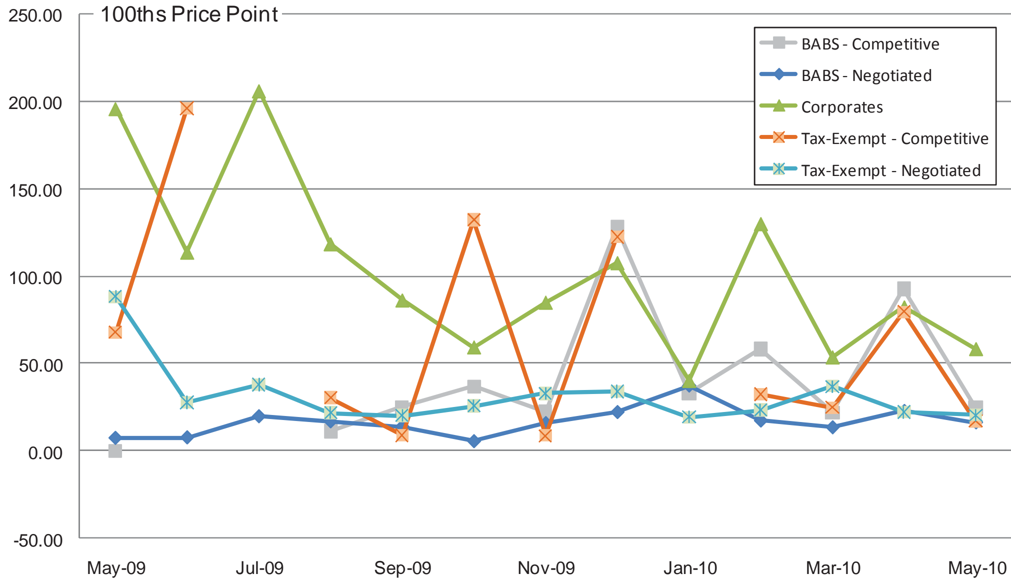
The chart below shows customer trades only. The customer-only trades show the same result as the chart above with dealer trades and customer trades, which is that negotiated tax-exempt municipal bonds have less price variability (.173 points) than competitive tax-exempt bonds (.696 points) in the time period from pricing to first settlement.



Sources: Bloomberg, FINRA TRACE, MSRB EMMA, Thomson Reuters, SIFMA
Spreads reflect difference between initial price and trading prices between offer and settlement of customer only trades; a positive spread reflects prices trading up after initial pricing

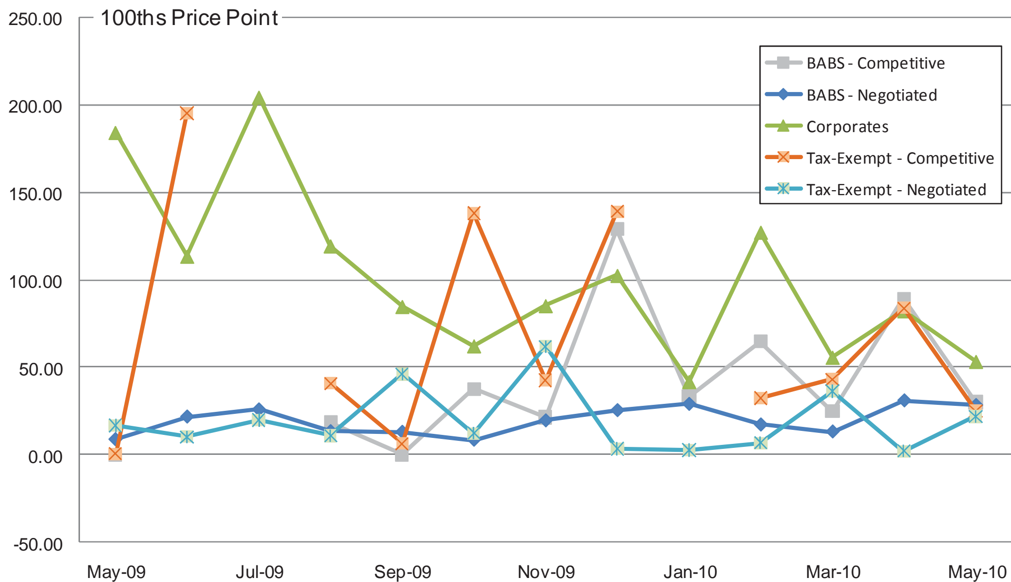
Municipals vs Corporates – Average Price Movement

The charts below display the monthly averages of price movements (by absolute value) by product type, to clearly show general trends for all trades in the products described.



Sources: Bloomberg, FINRA TRACE, MSRB EMMA, Thomson Reuters, SIFMA
Spreads reflect difference between initial price and trading prices between offer and settlement; a positive spread reflects prices trading up after initial pricing and vice versa.

The charts below display the monthly averages of price movements by product type, to clearly show general trends for customer-only trades in the products described.



Sources: Bloomberg, FINRA TRACE, MSRB EMMA, Thomson Reuters, SIFMA
Spreads reflect difference between initial price and trading prices between offer and settlement; a positive spread reflects prices trading up after initial pricing and vice versa.

EXHIBIT B

Methodology

Municipals – Tax-Exempt Bonds

- Securities Examined:
  - Total of 763 securities issued between April 2009 and May 2010 (653 negotiated; 112 competitive)
  - Maturity between 10-15 years from issue date; average 12.6 years (12.8 years negotiated, 12.0 years competitive)
  - CUSIP size between $10 million and $507.4 million; average $25.5 million ($26.1 million negotiated; $21.5 million competitive)
- Transactions Examined:
  - All trades tagged “W” in EMMA, defined as a trade in new issue security on or before final issuance and settlement of issue by issuer.
  - Settlement period, defined as the number of days between the offer and settlement date, ranged from zero to 35 days; average 6 days (negotiated 6 days; competitive 5 days).
  - Total number of trades examined: 53,576 trades
  - Average # of trades per security: 70 in a range of 1 to 2917 trades (80 for negotiated; 11 for competitive)

Municipals - Build America Bonds

- Securities Examined:
  - Total of 374 securities issued between April 2009 and May 2010 (262 negotiated; 112 competitive)
  - Maturity between 10-16 years from issue date; average 13.5 years (13.4 years negotiated; 13.6 years competitive)
  - CUSIP size between $10 million and $417.6 million; average $25.1 million (25.8 million negotiated; $23.5 million competitive)
- Transaction Examined:
  - All trades tagged “W” in EMMA, defined as a trade in new issue security on or before final issuance and settlement of issue by issuer.
  - Settlement period, defined as the number of days between the offer and settlement date, ranged from zero to 34 days; average 5 days (negotiated 3 days; competitive 5 days).
  - Total number of trades examined: 13,745 trades
  - Average # of trades per security: 37 in a range of 1 to 681 trades (47 for negotiated; 14 for competitive)

Corporate Bonds

- Securities Examined
  - Total of 214 investment grade, nonfinancial securities issued between April 2009 and May 2010
  - Maturity between 10-15 years from issue date; average 10.25 years
- Transactions Examined:
  - All trades between the offer and settlement date as recorded on FINRA’s TRACE system
  - Settlement period, defined as the number of days between the offer and settlement date, ranged from zero to 16 days; average 5 days
  - CUSIP size between $50 million and $3.75 billion; average $580 million
  - Total number of trades examined: 25,800 trades
  - Average # of trades per security: 120 in a range of 1 to 1066 trades

EXHIBIT B

Trade Aggregation and Price Calculation (p. 2-3)

Calculated trade price is an average price of all selected trades, weighted by trade size; therefore prices of a smaller trade size are given less weight in the average price used.

In the case of corporate trading data, all quantity sizes of “MM+” were converted to millions for purposes of this weighted calculation (e.g., “5MM+” trades were determined to be 5,000,000).

All trades are selected for this weighted average, including customer bought, customer sold, and interdealer.

Spreads are determined by: (calculated trade price - initial offer price) * 100; therefore, a positive price spread indicates a bond traded up after the initial pricing, and vice versa.

The “Customer Only” graph includes only trades where the reporting party is labelled customer bought or sold trades; interdealer trades are excluded.

Average price movements are an average of spreads of those securities issued in each month; gaps are where no qualifying securities were issued in that month.

Average Price Movement (p. 4)

Average price movement is calculated as an average of the absolute values of the spreads; in text it is an average of the universe; in the charts they are further split out by month. Hence the average is the average of the absolute change from initial price to calculated trade price and does not reflect whether the movement is positive or negative.

Sample Municipal BAB Trades with Treasury Spreads

Municipal BABs do typically trade up in the secondary market relative to U.S. Treasury securities, but to a lesser degree than corporate bonds. Representative examples of municipal BABs, their post-pricing trading history and relative spreads to U.S. Treasury securities are shown below.

Metropolitan Transportation Authority (A2/A/A)

Cusip: 59259YDH9 | **Settlement Date: 7/7/2010** | **Serial Maturity: 11/15/2020** | ***Coupon:*** **5.27%**

Par (000's): 12,735 | ***Spread at issuance: 230***

			Price					Treasury Spread (10yr)				
Date	Volume (M)	Trades #	First	High	Low	last	Average	First	High	Low	last	Average
7/7/2010	755	15	100.50	101.88	100.25	101.87	100.93	222 bp	226 bp	205 bp	205 bp	217 bp
7/6/2010	1,065	13	101.13	102.15	100.12	101.13	101.05	219	232	207	219	220
7/2/2010	60	6	101.87	101.87	101.78	101.87	101.86	206	207	206	206	206
7/1/2010	15,935	44	99.50	100.10	99.50	100.00	99.79	240	240	233	234	237

University of Texas System (Aaa/AAA/AAA)

Cusip: 9151375D1 | **Settlement Date: 6/15/2010** | **Serial Maturity: 8/15/2020** | ***Coupon:*** **3.99%**

Par (000's): 14,485 | ***Spread at issuance: 83***

			Price					Treasury Spread (10yr)				
Date	Volume (M)	Trades #	First	High	Low	last	Average	First	High	Low	last	Average
6/30/2010	20	2	101.14	102.91	101.14	102.91	102.02	90 bp	90 bp	69 bp	69 bp	79 bp
6/29/2010	300	6	102.50	102.50	101.00	101.00	101.50	72	90	72	90	84
6/28/2010	80	8	100.00	100.00	99.90	100.00	99.96	96	97	96	96	96
6/25/2010	710	16	100.00	100.00	99.90	100.00	99.96	87	89	87	87	88
6/24/2010	150	12	100.00	100.00	99.81	99.90	99.94	87	89	87	88	87
6/23/2010	15,355	28	100.00	100.00	99.81	100.00	99.93	87	90	87	87	88

Illinois (State of) (A1/A+/A)

Cusip: 452152FZ9 | **Settlement Date: 6/15/2010** | **Maturity: 7/1/2021** | ***Coupon:*** **6.50%**

Par (000's): 24,000 | **Average Life: 12/30/2020** | ***Spread at issuance: 292.5 Comp. bid***

			Price					Treasury Spread (10yr)				
Date	Volume (M)	Trades #	First	High	Low	last	Average	First	High	Low	last	Average
7/1/2010	80	4	102.97	104.85	102.96	104.84	103.91	319 bp	319 bp	295 bp	295 bp	307 bp
6/30/2010	60	4	105.34	105.34	103.47	104.73	104.26	286	310	286	294	300
6/29/2010	820	23	105.33	105.94	103.31	105.36	104.39	285	310	278	285	297
6/28/2010	720	14	104.42	104.44	102.55	102.56	103.49	290	314	290	314	302
6/25/2010	30	2	104.17	104.17	102.30	102.30	103.23	285	309	285	309	297
6/24/2010	310	8	104.44	104.44	102.56	103.00	103.30	281	304	281	299	295
6/23/2010	695	11	104.02	104.02	102.08	102.14	102.83	287	311	287	311	302
6/22/2010	21,145	21	101.00	102.88	100.00	101.00	101.01	320	333	296	320	320
6/21/2010	675	29	101.88	101.88	100.00	101.88	100.85	301	326	301	301	315
6/18/2010	350	9	100.68	101.88	100.68	101.38	101.08	319	319	303	310	313
6/17/2010	7,710	19	100.00	100.10	99.75	100.10	99.90	331	334	329	329	332

Bay Area Toll Authority (A1/A+/NR)

Cusip: 072024NU2 | **Settlement Date: 7/1/2010** | **Maturity: 4/1/2040** | ***Coupon:*** **6.92%**

Par (000's): 400,000 | **Average Life: 5/22/2036** | ***Spread at issuance: 287.5***

			Price					Treasury Spread (30yr)				
Date	Volume (M)	Trades #	First	High	Low	last	Average	First	High	Low	last	Average
7/1/2010	1,420	2	100.84	100.84	100.72	100.72	100.78	298 bp	299 bp	298 bp	299 bp	299 bp
6/30/2010	35,260	12	100.84	101.65	100.00	100.50	100.45	294	301	287	297	297
6/29/2010	4,770	14	100.00	102.44	99.75	100.10	100.40	297	299	277	296	294
6/28/2010	2,180	10	99.70	102.88	99.50	102.88	100.24	293	295	267	267	289
6/25/2010	2,100	8	99.47	100.10	99.47	100.02	99.92	289	289	284	285	286
6/24/2010	424,790	56	100.10	100.10	98.82	98.82	99.96	282	293	282	293	284

Massachusetts Water Pollution Abatement (Aaa/AAA/AAA)

Cusip: 57604P5P5 | **Settlement Date: 7/8/2010** | **Maturity: 8/1/2040** | ***Coupon:*** **5.19%**

Par (000's): 252,595 | **Average Life: 1/12/2028** | ***Spread at issuance: 125***

			Price					Treasury Spread (30yr)				
Date	Volume (M)	Trades #	First	High	Low	last	Average	First	High	Low	last	Average
7/6/2010	430	24	99.90	100.00	99.90	99.90	99.95	131 bp	131 bp	130 bp	131 bp	130 bp
7/2/2010	90	6	99.90	100.00	99.90	99.90	99.95	126	126	125	126	126
7/1/2010	160	8	100.00	100.00	99.90	99.90	99.95	133	133	133	133	133
6/30/2010	253,315	65	100.00	100.00	99.81	99.81	99.94	128	130	128	130	129

MUNICIPAL SECURITIES PRICING

EXHIBIT B

Metropolitan Transportation Authority (A2/A/A)

Cusip: 59259YDC0 | **Settlement Date: 7/7/2010** | **Maturity: 11/15/2040** | ***Coupon:*** 6.69%

Par (000's): 290,000 | **Average Life: 11/25/2036** | ***Spread at issuance:*** *275*

Date	Volume (M)	Trades #	Price: First	High	Low	last	Average	Treasury Spread (30yr): First	High	Low	last	Average
7/7/2010	5,790	16	100.19	104.38	100.13	104.38	102.70	272 bp	272 bp	239 bp	239 bp	252 bp
7/6/2010	11,235	21	100.02	104.75	99.84	99.93	103.17	279	281	242	280	254
7/2/2010	10,895	26	99.83	104.75	99.83	103.74	102.69	276	276	238	245	253
7/1/2010	337,270	73	100.00	104.80	99.40	100.10	101.18	282	287	244	281	273

University of Texas System (Aaa/AAA/AAA)

Cusip: 9151375F6 | **Settlement Date: 6/15/2010** | **Maturity: 8/15/2042** | ***Coupon:*** 5.13%

Par (000's): 251,990 | **Average Life: 1/29/2037** | ***Spread at issuance:*** *104*

Date	Volume (M)	Trades #	Price: First	High	Low	last	Average	Treasury Spread (30yr): First	High	Low	last	Average
6/30/2010	40	2	102.73	102.83	102.73	102.83	102.78	104 bp	104 bp	103 bp	103 bp	104 bp
6/28/2010	6,610	14	100.09	101.34	99.90	100.00	100.27	112	113	103	112	110
6/25/2010	1,210	5	99.78	100.00	99.78	99.99	99.92	108	108	106	107	107
6/24/2010	41,170	23	100.00	102.64	99.43	99.79	100.10	105	109	87	106	104
6/23/2010	252,990	34	100.00	100.00	100.00	100.00	100.00	108	108	108	108	108

New York City Municipal Water Fin. Auth (Aa2/AA+/AA+)

Cusip: 64972FT30 | **Settlement Date: 6/30/2010** | **Maturity: 6/15/2042** | ***Coupon:*** 5.72%

Par (000's): 324,045 | **Average Life: 6/15/2042** | ***Spread at issuance:*** *na*

Date	Volume (M)	Trades #	Price: First	High	Low	last	Average	Treasury Spread (30yr): First	High	Low	last	Average
6/30/2010	1,300	1	103.12	103.12	103.12	103.12	103.11	161 bp	161 bp	161 bp	161 bp	161 bp
6/29/2010	1,745	4	101.00	103.50	100.88	103.50	101.99	171	172	154	154	164
6/28/2010	390	4	105.22	105.25	102.65	102.65	104.59	137	153	137	153	141
6/25/2010	775	2	101.77	101.77	100.24	100.24	101.00	154	164	154	164	159
6/24/2010	20,570	5	99.75	102.09	99.75	101.64	101.11	166	166	150	153	156
6/23/2010	436,685	112	100.00	102.15	99.85	100.97	100.46	167	168	152	160	163

Bay Area Toll Authority (A1/A+/NR)

Cusip: 072024NV0 | **Settlement Date: 7/1/2010** | **Maturity: 4/1/2050** | ***Coupon:*** 7.04%

Par (000's): 850,000 | **Average Life: 5/20/2047** | ***Spread at issuance:*** *300*

Date	Volume (M)	Trades #	Price: First	High	Low	last	Average	Treasury Spread (30yr): First	High	Low	last	Average
7/1/2010	500	1	102.22	102.22	102.22	102.22	102.22	301 bp	301 bp	301 bp	301 bp	301 bp
6/30/2010	40,960	6	101.17	101.68	100.00	101.68	100.85	305	313	301	301	307
6/29/2010	1,050	5	100.56	101.33	99.67	99.67	100.81	305	312	300	312	304
6/28/2010	200,880	8	100.00	101.47	100.00	100.00	100.29	303	303	292	303	301
6/25/2010	2,000	3	99.25	99.25	97.82	97.82	98.77	303	314	303	314	307
6/24/2010	970,660	42	100.00	100.00	99.25	100.00	99.95	296	301	296	296	296

EXHIBIT B

Sample Corporate Trades with Treasury Spreads

MUNICIPAL SECURITIES PRICING

Corporate bonds typically trade up in the secondary market relative to U.S. Treasury securities, and to a greater extent than municipal Build America Bonds. Representative examples of corporate bonds, their post-pricing trading history and relative spreads to U.S. Treasury securities are shown below.

Duke Power (A2/A)

CUSIP: 263901AC4 | Issue Date: 7/6/2010 | Maturity: 7/15/2020 | *Coupon:* 3.75%

Par (000's) 500,000

			Price				Treasury Spread (10yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/13/2010	21,455	8	99.78	100.08	99.78	100.08	68 bp	68 bp	63 bp	63 bp
7/12/2010	3,000	3	100.19	100.19	99.97	99.97	70	71	70	71
7/9/2010	4,935	6	99.86	100.18	99.86	100.00	72	72	68	70
7/8/2010	3,000	3	100.33	100.39	100.06	100.06	72	73	71	73
7/7/2010	18,300	22	100.49	100.81	100.09	100.16	77	77	73	75
7/6/2010	46,750	56	100.16	100.58	99.93	100.29				

Covidien Med (Baa1/A/A)

CUSIP: 22303QAL4 | Issue Date: 6/21/2010 | Maturity: 6/15/2020 | *Coupon:* 4.20%

Par (000's) 600,000

			Price				Treasury Spread (10yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/13/2010	26,000	8	101.27	101.48	101.12	101.48	94 bp	95 bp	90 bp	90 bp
7/12/2010	29,430	6	101.77	101.84	101.57	101.57	94	96	93	95
7/9/2010	6,650	3	101.72	101.72	101.42	101.42	94	98	94	98
7/8/2010	6,690	7	101.59	101.70	101.59	101.64	97	97	95	97
7/7/2010	10,680	7	102.26	102.26	101.97	101.98	96	99	96	98
7/6/2010	5,530	2	101.98	102.40	101.98	102.40	98	98	97	97
7/1/2010	2,465	3	102.40	102.40	102.26	102.26	98	98	97	97
6/30/2010	5,000	1	102.34	102.34	102.34	102.34	96	96	96	96
6/29/2010	9,405	3	101.63	101.85	101.63	101.70	100	102	98	102
6/28/2010	9,235	7	101.24	101.57	101.19	101.51	98	101	98	99
6/25/2010	2,500	1	100.89	100.89	100.89	100.89	100	100	100	100
6/24/2010	14,000	4	101.03	101.35	100.86	101.06	98	100	94	98
6/23/2010	37,500	14	100.41	100.83	100.41	100.81	98	101	97	99
6/22/2010	46,325	56	100.16	100.54	99.66	100.54				
6/21/2010	1,000		99.90	99.90	99.90	99.90				

Puget Util (Baa1/A-)

CUSIP: 745332CC8 | Issue Date: 6/24/2010 | Maturity: 7/15/2040 | *Coupon:* 5.76%

Par (000's) 250,000

			Price				Treasury Spread (30yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/8/2010	15,000	3	102.44	103.14	102.44	103.14	154 bp	154 bp	154 bp	154 bp
6/29/2010	4,820	3	103.06	103.65	102.78	103.65	161	161	158	158
6/25/2010	3,250	6	100.64	101.49	100.00	101.49	160	170	158	160
6/24/2010	2,250	4	100.60	100.60	100.07	100.07				

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EXHIBIT B

Prudential (Baa2/A/BBB)

CUSIP: 74432QBN4 | Issue Date: 6/16/2010 | Maturity: 6/21/2040 | *Coupon:* 6.63%

Par (000's) 350,000

			Price				Treasury Spread (30yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/13/2010	325	1	102.92	102.92	102.92	102.92	230 bp	230 bp	230 bp	230 bp
7/12/2010	4,000	1	103.17	103.17	103.17	103.17	235	235	235	235
7/9/2010	524	1	103.03	103.03	103.03	103.03	236	236	236	236
7/8/2010	7,525	5	102.94	103.47	102.61	103.05	239	243	236	238
7/7/2010	2,135	2	103.43	103.63	103.43	103.63	246	246	244	244
7/1/2010	1,680	2	103.70	103.73	103.70	103.73	247	249	247	249
6/30/2010	11,560	7	102.91	103.52	102.75	103.52	246	248	245	245
6/29/2010	9,015	5	102.17	102.87	101.68	102.67	247	252	247	249
6/28/2010	10,500	4	101.99	102.05	101.99	102.05	244	244	244	244
6/25/2010	6,650	5	101.60	102.20	100.90	100.90	244	248	240	248
6/24/2010	1,000	1	101.15	101.15	101.15	101.15	245	245	245	245
6/23/2010	38,500	10	102.29	103.13	101.61	101.63	237	245	235	245
6/22/2010	360	1	101.79	101.79	101.79	101.79	239	239	239	239
6/21/2010	5,500	2	101.31	101.44	101.31	101.44	231	235	231	235
6/18/2010	17,000	5	101.40	101.77	101.27	101.77	237	238	234	234
6/17/2010	72,700	83	101.06	103.43	100.18	101.50	236	239	224	239
6/16/2010	13,250		100.57	101.24	100.13	100.91				

Lincoln National (Baa2/A-/BBB)

CUSIP: 534187BA6 | Issue Date: 6/15/2010 | Maturity: 6/15/2040 | *Coupon:* 7.00%

Par (000's) 500,000

			Price				Treasury Spread (30yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/13/2010	2,500	1	105.17	105.17	105.17	105.17	250 bp	250 bp	250 bp	250 bp
7/12/2010	2,500	2	105.15	105.16	105.15	105.16	256	256	255	255
7/8/2010	6,650	5	104.88	105.69	104.88	105.01	263	263	256	262
7/1/2010	4,230	4	106.24	106.62	106.24	106.45	265	265	262	264
6/30/2010	7,070	4	106.06	106.17	105.30	105.73	260	264	260	264
6/29/2010	5,250	2	105.77	105.77	105.76	105.76	262	262	262	262
6/25/2010	3,250	1	103.75	103.75	103.75	103.75	265	265	265	265
6/23/2010	10,320	3	104.11	104.73	103.68	103.68	263	266	259	266
6/22/2010	4,600	3	103.68	104.44	103.55	103.55	259	263	256	263
6/21/2010	12,100	3	102.36	102.36	102.30	102.30	259	261	259	261
6/18/2010	7,400	4	103.29	103.29	102.57	102.57	260	265	260	265
6/17/2010	1,000	1	102.42	102.42	102.42	102.42	264	264	264	264
6/16/2010	30,400	32	101.43	102.33	101.16	101.81	270	272	265	267
6/15/2010	22,000		100.15	101.39	100.15	100.41				

Walmart (Aa2/AA/AA)

CUSIP: 931142CV3 | Issue Date: 6/30/2010 | Maturity: 7/8/2040 | *Coupon:* 4.88%

Par (000's) 750,000

			Price				Treasury Spread (30yr)			
Date	Volume (M)	Trades #	First	High	Low	Last	First	High	Low	last
7/13/2010	3,075	1	95.67	95.67	95.67	95.67	106 bp	106 bp	106 bp	106 bp
7/12/2010	8,750	6	96.59	97.15	96.19	96.58	106	108	105	105
7/9/2010	6,400	3	96.31	96.79	96.31	96.38	109	109	106	106
7/8/2010	60,741	17	97.15	97.22	96.58	96.58	105	109	105	108
7/7/2010	5,000	1	97.49	97.49	97.49	97.49	108	108	108	108
7/6/2010	5,500	2	98.07	98.07	98.05	98.05	107	107	107	107
7/1/2010	69,450	66	98.62	99.35	97.87	98.91	112	114	105	105
6/30/2010	11,000		98.57	98.67	98.27	98.48				

EXHIBIT B

Sample Municipal Tax-Exempt Trades with MMD Spreads

Tax-exempt municipal bonds also typically trade up in the secondary market relative to the MMD indices, and to a lesser extent than corporate bonds. Representative examples of tax-exempt municipal bonds, their post-pricing trading history and relative spreads to MMD are shown below.

Illinois (State of) (NR/AAA/AA+)

CUSIP:	452227DN	Settlement Date:	6/25/2010	Serial Maturity Date:	6/15/2020	Coupon:	5.00%	First Call Date:	Non-Callable
Par (000's)	32,870			Issue Price:	107.99	Issue Yield:	4.02%	Spread at Issuance:	112 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/16/2010	39,170	27	107.99	108.67	107.99	107.99	108.05	103 bp	103 bp	95 bp	103 bp	102 bp

Connecticut (State of) (Aa2/AA/AA)

CUSIP:	20772G7B	Settlement Date:	6/23/2010	Serial Maturity Date:	12/1/2020	Coupon:	5.00%	First Call Date:	12/1/2019
Par (000's)	34,735			Issue Price:	114.30	Issue Yield:	3.23%	Spread at Issuance:	29 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/22/2010	23,160	1	114.38	114.38	114.38	114.38	114.38	26 bp	26 bp	26 bp	26 bp	26 bp
6/16/2010	275	7	116.77	116.77	114.94	115.04	115.26	(4)	17	(4)	16	13
6/15/2010	2,000	1	113.69	113.69	113.69	113.69	113.69	31	31	31	31	31
6/11/2010	37,245	27	113.80	114.30	113.80	114.30	114.07	36	36	31	31	33

Kentucky State Property and Building Authority (Aa2/A+/AA-)

CUSIP:	49151E5L	Settlement Date:	7/13/2010	Serial Maturity Date:	8/1/2020	Coupon:	5.00%	First Call Date:	Non-Callable
Par (000's)	45,780			Issue Price:	111.45	Issue Yield:	3.63%	Spread at Issuance:	97 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
7/7/2010	17,505	1	113.52	113.52	113.52	113.52	113.52	73 bp	73 bp	73 bp	73 bp	73 bp
7/6/2010	17,505	3	113.25	113.25	113.07	113.07	113.19	68	70	68	70	69
6/30/2010	40,780	7	111.45	111.45	111.45	111.45	111.45	84	84	84	84	84

Cook County (IL) (Aa2/AA/AA)

CUSIP:	213185DY	Settlement Date:	6/23/2010	Maturity Date:	11/15/2033	Coupon:	5.25%	First Call Date:	11/15/2020
Par (000's):	165,440	Average Life:	9/20/2032	Issue Price:	104.39	Issue Yield:	4.71%	Spread at Issuance:	177 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/23/2010	1,000	1	104.39	104.39	104.39	104.39	104.39	177 bp	177 bp	177 bp	177 bp	177 bp
6/18/2010	85	7	104.88	106.19	104.88	105.74	105.39	168	168	153	158	162
6/17/2010	225	5	102.84	103.56	102.84	103.21	103.20	193	193	184	188	188
6/11/2010	165,440	8	104.39	104.39	104.39	104.39	104.39	178	178	178	178	178

Puerto Rico Sales Tax Financing (A1/A+/A+)

CUSIP:	74529JLK	Settlement Date:	6/30/2010	Serial Maturity Date:	8/1/2039	Coupon:	6.00%	First Call Date:	8/1/2020
Par (000's)	150,000			Issue Price:	105.6	Issue Yield:	5.28%	Spread at Issuance:	249 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/29/2010	1,000	1	106.29	106.29	106.29	106.29	106.29	238 bp	238 bp	238 bp	238 bp	238 bp
6/25/2010	1,000	1	106.25	106.25	106.25	106.25	106.25	230	230	230	230	230
6/24/2010	155,000	24	105.57	106.37	105.57	106.37	105.67	236	236	226	226	235

Illinois Finance Authority (A3/A/A)

CUSIP:	45200F3R	Settlement Date:	6/29/2010	Maturity Date:	5/15/2039	Coupon:	6.00%	First Call Date:	5/15/2020
Par (000's)	162,905	Average Life:	8/10/2028	Issue Price:	97.32	Issue Yield:	6.20%	Spread at Issuance:	339 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/29/2010	185	6	101.00	101.90	101.00	101.85	101.72	305 bp	305 bp	293 bp	294 bp	296 bp
6/28/2010	890	18	99.60	102.82	99.60	99.72	100.94	318	318	277	317	302
6/25/2010	420	14	101.86	101.90	99.53	100.88	100.71	285	313	284	298	300
6/24/2010	4,070	41	99.46	101.86	98.76	101.71	100.90	312	317	283	285	296
6/23/2010	5,340	32	99.86	102.26	99.18	99.98	100.62	307	312	276	306	298
6/22/2010	1,115	37	100.75	102.96	97.50	101.00	100.67	294	323	265	290	295
6/21/2010	1,135	12	98.81	102.26	98.81	101.00	100.79	312	312	273	289	292
6/18/2010	72,170	64	98.25	101.90	97.32	101.90	99.47	316	323	277	277	307
6/17/2010	163,405	47	97.32	97.44	97.32	97.44	97.32	323	323	322	322	323

New York State Dormitory Authority (Aa1/AA/NR)

CUSIP:	649905R9	Settlement Date:	6/9/2010	Maturity Date:	7/1/2040	Coupon:	5.00%	First Call Date:	7/1/2020
Par (000's)	159,670	Average Life:	8/5/2038	Issue Price:	105.92	Issue Yield:	4.27%	Spread at Issuance:	142 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/9/2010	10,000	2	105.91	106.00	105.91	106.00	105.95	142 bp	142 bp	141 bp	141 bp	142 bp
6/1/2010	490	1	105.92	105.92	105.92	105.92	105.92	147	147	147	147	147
5/28/2010	185,440	27	105.42	105.92	105.42	105.67	105.80	153	153	147	150	149

EXHIBIT B

Puerto Rico Sales Tax Financing (A1/A+/A+)

CUSIP:	74529JLL	Settlement Date:	6/30/2010	Maturity Date:	8/1/2040	Coupon:	5.50%
Par (000's)	299,995	Average Life:	7/15/2040	Issue Price:	100.00	Issue Yield:	5.50%

First Call Date: 8/1/2020
Spread at Issuance: 550 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/24/2010	299,995	3	100.00	100.00	100.00	100.00	100.00	258 bp	258 bp	258 bp	258 bp	258 bp

Texas Private Activity Bond Surface Transportation Corporation (Baa3/NR/BBB-)

CUSIP:	882667AD	Settlement Date:	6/22/2010	Maturity Date:	6/30/2040	Coupon:	7.00%
Par (000's)	418,955	Average Life:	12/11/2037	Issue Price:	96.96	Issue Yield:	7.25%

First Call Date: 6/30/2020
Spread at Issuance: 429 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/22/2010	22,850	132	99.00	102.45	98.75	101.75	100.62	412 bp	414 bp	370 bp	380 bp	395 bp
6/21/2010	13,070	117	100.00	102.57	98.50	99.95	100.65	403	415	367	403	394
6/18/2010	37,915	215	98.50	101.90	98.37	99.23	100.22	415	416	377	409	400
6/17/2010	52,160	410	98.74	101.26	96.96	101.26	99.89	413	428	385	385	404
6/16/2010	495,785	400	96.96	100.00	96.96	100.00	99.04	426	426	401	401	409

Puerto Rico Sales Tax Financing (A1/A+/A+)

CUSIP:	74529JLM	Settlement Date:	6/30/2010	Maturity Date:	8/1/2041	Coupon:	5.25%
Par (000's)	668,440	Average Life:	4/19/2041	Issue Price:	96.7	Issue Yield:	5.47%

First Call Date: 8/1/2020
Spread at Issuance: 268 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/30/2010	18,870	132	100.00	102.50	97.75	100.00	99.61	246 bp	261 bp	214 bp	246 bp	249 bp
6/29/2010	14,920	157	100.38	102.60	97.85	97.88	99.70	239	258	211	258	246
6/28/2010	36,650	168	98.94	102.60	97.75	98.38	99.72	247	255	207	251	242
6/25/2010	11,631	157	97.75	101.40	97.62	100.00	99.32	250	251	217	235	239
6/24/2010	675,940	85	96.72	98.81	96.72	97.75	97.39	255	255	241	248	250

Puerto Rico Sales Tax Financing (Aa3/AAA/NR)

CUSIP:	74529JLN	Settlement Date:	6/30/2010	Serial Maturity Date:	8/1/2042	Coupon:	5.13%
Par (000's)	150,000			Issue Price:	99.75	Issue Yield:	5.14%

First Call Date: 8/1/2020
Spread at Issuance: 235 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
6/30/2010	5,790	72	103.98	103.98	100.99	102.56	102.47	184 bp	221 bp	184 bp	201 bp	202 bp
6/29/2010	3,835	82	103.00	103.98	100.43	101.98	102.23	194	226	182	206	203
6/28/2010	17,285	63	102.50	104.25	99.75	100.24	101.30	196	229	174	224	211
6/25/2010	25,856	151	100.25	102.75	99.75	101.75	100.78	219	224	188	200	213
6/24/2010	271,030	580	99.13	100.31	99.13	100.00	99.62	226	226	216	220	223

New York Liberty Development Corporation (NR/AA/AA)

CUSIP:	649519AD	Settlement Date:	7/8/2010	Maturity Date:	1/15/2044	Coupon:	5.13%
Par (000's)	206,200	Average Life:	7/9/2042	Issue Price:	98.04	Issue Yield:	5.25%

First Call Date: 1/15/2020
Spread at Issuance: 258 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
7/8/2010	12,895	54	98.88	102.23	98.69	100.79	100.00	253 bp	254 bp	216 bp	235 bp	245 bp
7/7/2010	5,755	33	99.42	101.50	98.14	99.00	99.45	249	257	226	252	249
7/6/2010	7,910	35	100.94	101.63	98.14	99.25	100.14	225	249	216	242	236
7/2/2010	10,690	43	98.14	101.88	98.14	101.00	99.68	248	248	212	223	238
7/1/2010	239,650	192	98.04	101.00	97.54	98.80	98.53	249	252	223	244	246

New York Liberty Development Corporation (NR/BBB-/BBB-)

CUSIP:	649519AF	Settlement Date:	7/8/2010	Maturity Date:	7/15/2049	Coupon:	6.38%
Par (000's)	211,300	Average Life:	8/1/2048	Issue Price:	100.00	Issue Yield:	6.38%

First Call Date: 1/15/2020
Spread at Issuance: 371 bp

								Spread to 10-Yr MMD				
Date	Volume (M)	Trades #	First	High	Low	Last	Average	First	High	Low	last	Average
7/8/2010	6,700	26	102.06	104.00	102.06	104.00	102.26	342 bp	342 bp	315 bp	315 bp	339 bp
7/7/2010	9,575	14	101.88	104.25	101.73	102.95	102.60	344	346	312	329	334
7/6/2010	3,700	8	101.75	102.00	100.10	102.00	101.52	338	361	334	334	341
7/2/2010	20,575	25	100.10	103.00	100.10	100.64	101.54	360	360	320	352	340
7/1/2010	269,750	114	100.63	101.75	99.97	100.54	100.36	353	362	337	354	356

Data for sample corporate, municipal tax-exempt, and municipal BABs trades with spreads are sourced from Bloomberg and SIFMA member firms.

EXHIBIT C

OTHER CODE AND REGULATORY PROVISIONS AFFECTED BY A CHANGE IN THE DEFINITION OF ISSUE PRICE

This list is meant for illustrative purposes and is not exhaustive.

Code Section	*Regulation Section*	*Impact*
54A		See Notice 2010-35, which cross-references the section 148 definition of "issue price" for purposes qualified tax credit bonds eligible for credits under section 6431.
54AA		"issue price" - cannot have more than a de minimis amount of premium (BABs)
141		"proceeds" – private activity tests
	1.141-1(b)	"proceeds" - means sale proceeds of an issue (other than those sale proceeds used to retire bonds of the issue that are not deposited in a reasonably required reserve or replacement fund)
142		"net proceeds" - 95% test for exempt facilities
143		"proceeds" - all (exclusive of costs of issuance and a reasonably required reserve fund) for qualified mortgage bonds "net proceeds" – 95% for qualified veterans mortgage bonds
144(a)		"face amount" - qualification as a qualified small issue "net proceeds" - 95% for use
144(b)		"net proceeds" – applicable percentage for qualified student loan
144(c)		"net proceeds" – 95% for qualified redevelopment
145		"net proceeds" – all property provided with net proceeds for ownership test; 5% of for private activity; 95% for qualified hospital bonds "face amount" - $150 million limitation on non-hospital bonds
146		"face amount" – general volume cap limits "amount" - carryforward

147(b)		"issue price" – weighted average maturity (note that WAM is used in other contexts, such as public approval exception, safe harbor for creation of replacement proceeds, and deemed designated test under section 265) "net proceeds" – average life of land based upon 25%; 95% for pooled 501(c)(3) financings; 95% test for FHA-insured loans "lendable proceeds" – 120% for pooled 501(c)(3) financings
147(c)		"net proceeds" – 25% for land acquisition "proceeds" – for farming test
147(d)		"net proceeds" – for existing property
147(g)		"proceeds" – for costs of issuance limits
148(a)		"proceeds" – for reasonable expectations regarding arbitrage bonds
148(c)		"proceeds" – temporary periods
148(d)		"proceeds" – reasonably required reserve funds
148(e)		"proceeds" – minor portion
148(f)		"gross proceeds" – temporary investments; 6-month spending exception to rebate "net proceeds"/"proceeds" – tax and revenue anticipation notes tests "available construction proceeds" – refers to "issue price" "net proceeds"/"face amount" – small issuers qualification and rebate exception
148(h)		"issue price" – for determination of yield
	1.148-1(a)	definitions under this section and under section 150 apply for purposes of section 148 and regulations under section 148
	1.148-1(b)	"gross proceeds" means any proceeds and replacement proceeds of an issue. "investment proceeds" means any amounts actually or constructively received from investing proceeds of an issue. [current definition] "issue price" means, except as otherwise provided, issue price as defined in sections 1273 and 1274. Generally, the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the

		public. Ten percent is a substantial amount. The public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. The issue price does not change if part of the issue is later sold at a different price. The issue price of bonds that are not substantially identical is determined separately. The issue price of bonds for which a *bona fide* public offering is made is determined as of the sale date based upon reasonably expectations regarding the initial public offering price. If a bond is issued for property, the applicable Federal tax-exempt rate is used in lieu of the Federal rate in determining the issue price under section 1274. The issue price of bonds may not exceed their fair market value. "net sale proceeds" means sale proceeds, less the portion of those sale proceeds invested in a reasonably required reserve of replacement fund under section 148(d) and as part of a minor portion under section 148(e). "proceeds" means any sale proceeds, investment proceeds, and transferred proceeds of an issue. Proceeds do not include, however, amounts actually or constructively received with respect to a purposes investment that are properly allocable immaterially higher yield under 1.148-2(d) or section 143(g) or to qualified administrative costs recoverable under 1.148-5(e). "sale proceeds" means any amounts actually or constructively received from the sale of the issue, including amounts used to pay underwriters' discount or compensation and accrued interest other than pre-issuance accrued interest. Sale proceeds also include, but are not limited to, amounts derived from the sale of a right that is associated with a bond, and that is described in 1.148-4(b)(4). See also 1.148-4(h)(5) treating amounts received upon the termination of certain hedges as sale proceeds.
	1.148-2(b)	"issue price" - exceptions to certification requirement for small issues
149(b)		"proceeds" - 5% for Federally guaranteed
149(e)		"net proceeds", "face amount" - for information reporting
149(f)		"net proceeds" – 30%/95% for certain pooled financing bonds, with alternation to section 150 definition of "net proceeds"
149(g)		"spendable proceeds"/ "proceeds"/ "net proceeds" – hedge bond rules
150(a)		"net proceeds" means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or

		replacement fund
150(e)		"net proceeds" – 95% for qualified volunteer fire department
	1.150-1(c)	"issue price" - the lesser of $50,000 and 5% special rules for draw down financings
	1.150-2(f)	"proceeds" - less of $100K or 5% for de minimis exception
265(b)		"amount" in various places: definition of qualified small issuer (including included and excepted bonds), allocations among multiple entities, limitation on bonds designated, size limitation on overall bond issue

APPENDIX I

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APPENDIX II

OUTLINE OF TOPICS TO BE DISCUSSED
AT THE PUBLIC HEARING ON
PROPOSED REGULATIONS IRS REG - 148659-07
ARBITRAGE RESTRICTIONS ON TAX-EXEMPT BONDS
FEBRUARY 5, 2014, 10:00 AM
THE NATIONAL ASSOCIATION OF BOND LAWYERS

I. The proposed definition of "issue price" is not required or appropriate to address the policy objectives and stated concerns of Treasury and IRS. (3 minutes)

A. The preamble to the proposed regulations, the proposed definition of "issue price" in the proposed regulations and public comments made by Treasury and IRS officials after publication of the proposed regulations emphasize that the amendments to the issue price definition are intended to make that definition more consistent with current regulations under sections 1273 and 1274 of the Code, which implies that such consistency, including an "actual sales" approach, is required by the cross-reference to sections 1273 and 1274 in section 148(h) of the Code. A review of the history and purpose of the arbitrage statutes and regulations, including the existing regulations, confirms that an "actual sales" approach is not required.

B. In the preamble to the proposed regulations, Treasury and IRS also state that the significant amendments to the issue price definition would "address [certain] concerns" and "provide greater certainty." As discussed below, NABL believes that the proposed definition is not administrable by issuers and, therefore, will result in less certainty. The concerns described in the preamble generally relate to the manner in which municipal securities are offered and distributed, and imply that the conduct of municipal underwriters is sometimes inappropriate and perhaps illegal. Concerns about the offering and distribution process for municipal securities should be addressed by working with municipal securities regulators, not through tax policy. Treasury and IRS should share their concerns with the Securities and Exchange Commission, the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority and request that they investigate and take appropriate regulatory and enforcement action.

II. The proposed definition of "issue price" is not administrable by issuers under existing law and market practices. (4 minutes)

A. The proposed definition of "issue price" is not administrable by issuers because issuers and bond counsel do not have access to the information necessary to determine issue price based on actual sales to the "public" as defined under the proposed regulations.

B. The proposed definition of "issue price" also is not administrable by issuers because it does not assure that the issue price of publicly offered municipal bonds

can be determined as of the sale date. To be administrable by issuers, any definition of "issue price" of publicly offered municipal bonds must enable issue price to be determined as of the sale date, when the terms of the issue are established. Determination of issue price as of the sale date is important for three reasons.

i. Issuers may violate applicable State law, policy or authorizing resolutions if issue price cannot be determined as of the sale date.
ii. Because compliance with numerous other provisions of federal tax law depends on the determination of issue price, issuers may unintentionally violate those provisions if issue price cannot be determined as of the sale date.
iii. Finally, bond counsel must confirm on the sale date whether they can give an unqualified approving opinion at closing.

III. Attempts to comply with the proposed definition of "issue price" will impose substantial additional expense on issuers and alter longstanding practices in the municipal market. (3 minutes)

A. If the proposed definition is adopted and municipal bonds continue to be marketed in ways that result in unsold maturities on the sale date, issuers will bear substantial additional expense attempting to determine issue price based on actual sales to the public.

B. To eliminate unsold maturities on the sale date in negotiated underwritings, issuers would be forced to accept lower prices and higher yields.

C. Because issuers may not be able to eliminate the possibility of unsold maturities in competitively sold deals, the ability of issuers to sell bonds competitively may be limited.