

In 2015 there was a lot of activity regarding regulation of the municipal market, particularly relating to federal tax laws and federal securities laws. The most significant activity is summarized below.

Federal Tax Laws

Throughout 2015, the interest rate environment encouraged tax-exempt bond issuers and borrowers to finance new projects and to refund outstanding tax-advantaged debt. In addition, the Treasury Department promulgated the following regulations, which are two of the most significant tax-exempt bond regulations in the last decade.

Treasury Department Releases Taxpayer-Friendly Allocation and Accounting Regulations

On October 27, 2015, the Treasury Department promulgated Final Treasury Regulations ("Allocation Regulations") that dramatically enhance the ability of an issuer or borrower to allocate funds other than tax-exempt bond proceeds toward private business use of a mixed-use project. The Allocation Regulations settle a point of longstanding confusion in the tax-advantaged bond community by explicitly permitting qualified equity to "float" to offset private business use that occurs throughout the bond-financed project.

The Allocation Regulations also provide greater flexibility to accommodate public-private partnerships by treating a partnership as an aggregate of its partners rather than as a separate entity. Finally, under certain circumstances, the Allocation Regulations permit "anticipatory remediation" of a future deliberate action. Anticipatory remediation provides greater flexibility for issuers and borrowers and encourages redemption of tax-advantaged bonds. Anticipatory remediation is a commonsense provision long sought by public finance practitioners.

The Allocation Regulations apply to bonds sold on or after January 25, 2016 and may be applied to most governmental bonds issued before that date.

For more information, visit [Public Finance Tax Blog \(Final Allocation and Accounting Regulations\)](#).

Treasury Department Releases New Proposed Regulations on Issue Price That Address Some Concerns Raised by Tax Practitioners

On June 24, 2015, the Treasury Department withdrew controversial proposed regulations from 2013 ("Withdrawn Regulations") that, if finalized, would have fundamentally changed the definition of "issue price" of tax-exempt bonds (the balance of the 2013 proposed regulations, which have been well received by the tax-exempt bond community, have not been withdrawn and remain under Treasury's consideration). In their place, Treasury released a revised notice of proposed rulemaking addressing issue price ("2015 Proposed Regulations") (REG-138526-14) and fixing several of the more troubling provisions of the Withdrawn Regulations. For example, the 2015 Proposed Regulations sharpen the overly broad definition of "underwriter" that was set forth in the Withdrawn Regulations. In addition, the 2015 Proposed Regulations reverse the Withdrawn Regulations and retain the current law threshold that establishes issue price at the price at which the first 10% of bonds is sold to the general public (the Withdrawn Regulations would have raised this threshold to 25%).

However, the 2015 Proposed Regulations retain the most troublesome feature of the Withdrawn Regulations – they would generally require issuers of bonds for which a bona fide public offering has been made to determine the actual selling price of the bonds, rather than relying on reasonable expectations to establish the issue price of the issue.

For more information, visit [Public Finance Tax Blog \(Proposed Issue Price Regulations\)](#).

What To Look For In 2016

Tax Legislation

Most tax practitioners and policy experts do not expect comprehensive tax reform this year. The President has prioritized other initiatives in his final year in office and even tax reform proponents, such as Speaker of the House Paul Ryan, have indicated that it is unlikely that there will be tax reform while President Obama is in office. However, that does not mean that the Legislature will abstain from enacting legislation that impacts tax-exempt bonds.

As expected, the President's [Fiscal Year 2016 Budget of the US Government](#) included a limitation (a 28% cap) on the exemption for interest on state and local bonds as part of the President's efforts to broaden the tax base. Consistent with the previous few years, the limitation was not adopted as part of the omnibus spending bill that was eventually enacted by Congress this past December and immediately signed by the President. Although the President will likely include the limitation in his FY2017 Budget, it is expected to meet the same fate as the previous few years.

In 2015, Congress extended the use of "qualified zone academy bonds" (QZABs) by enacting legislation that authorized the issuance of an additional \$400 million of QZABs during 2016. Perhaps the most significant piece of tax-exempt bond legislation enacted in 2015 related to the Water Infrastructure Finance and Innovation Act (WIFIA). Enacted in 2014, WIFIA provides for low-interest federal loans for up to 49% of the costs for large drinking water, wastewater, stormwater and water reuse projects. As originally written, the other 51% of the project costs had to be financed using funds other than tax-exempt bond proceeds. Many of the organizations that would benefit from WIFIA's low-interest federal loans are eligible to finance projects using proceeds of tax-exempt bonds, so precluding such organizations from utilizing tax-exempt bond proceeds significantly diluted the positive impact of WIFIA. In December, legislation was enacted that removes the prohibition on the use of tax-exempt bond proceeds with WIFIA loans. In 2016, it is likely that many issuers and borrowers will seek to finance projects using tax-exempt bonds as well as WIFIA loans.

Tax Regulations

The Allocation Regulations discussed above were one of seven items included on the most recent list of priority guidance projects for 2015-2016 released by the Treasury and the IRS. In addition to this completed project, the list again includes regulations on arbitrage investment restrictions. Other notable projects include final regulations on the public approval requirements for private activity bonds under Section 147(f) of the Code and regulations on bond reissuance under Section 150 of the Code. In addition, there have been several unofficial indications that guidance concerning the definition of "political subdivision" will be released by the IRS later this year and possibly even in the next few weeks! The rate at which the Treasury and the IRS have released guidance has undoubtedly increased over the last few years, but it is unlikely that all of these projects will be completed in the current fiscal year (ending September 30).

Federal Securities Laws

SEC's MCDC Settlements with Underwriters Provide More Food for Thought About Adoption of Disclosure Procedures

The Securities and Exchange Commission (SEC) announced two rounds of settlement agreements with underwriters in 2015 under the SEC's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative. Included within the settlement agreements are bullet-point examples of what the SEC Division of Enforcement cited as misstatements (or omissions) about continuing disclosure compliance in official statements since 2010. The examples are devoid of context so it is not possible to draw meaningful conclusions that might be applied by analogy, however, the breadth of what the SEC found to be noncompliance worthy of disclosure was surprising to many market participants.

As we have previously stated, municipal issuers and obligated persons would be well-served to take a fresh look at their current compliance by discussing with their financial and/or administrative staff (or legal advisors) the following questions:

1. Are you current in all filings required under continuing disclosure agreements?
2. Have you filed all required material event notices over the past five years?
3. What is your procedure for developing new disclosure documents either for new bond issues or for annual reports?
4. What do your official statements for recent bond issues say about your prior compliance with continuing disclosure?
5. What is your procedure for review of information contained in your comprehensive annual financial report?
6. Do the employees responsible for the preparation and/or review of disclosure materials have sufficient training?

Voluntarily implementing or enhancing formal written disclosure policies and procedures is good practice and, when done in advance of an SEC investigation, has been looked upon favorably by the SEC. If this is done on a widespread basis, it will improve the overall quality of disclosure in the municipal market and, perhaps, allay the SEC's call for legislative authority to require municipal issuers to adopt SEC mandated policies and procedures.

MSRB Calls for Disclosure of Bank Loans and Private/Direct Placements (Again)

In 2015, the MSRB renewed its call for voluntary disclosure of bank loans and private/direct placements by municipal securities issuers. The MSRB remains concerned that investors and other market participants are often unaware of the potential impact of these non-public transactions on the status of existing bondholders and the credit or liquidity profile of an issuer. If an issuer or obligated person chooses to submit information regarding non-publicly offered debt on EMMA, they should consider including precautionary language to dispel any expectation in the market of any continuing obligation to update the information once filed. The MSRB published a notice in 2012 addressing certain matters relating to posting bank loan and private/direct placement disclosure on EMMA and an industry group published a paper discussing considerations relating to the same topic disclosure.

Municipal Advisor Regulatory Regime Takes Shape; Pilot Exam to be Given First Quarter 2016

The MSRB took more steps in 2015 to create the regulatory regime for municipal advisors, including publishing guidelines and adopting rules that address, among other things, professional qualification standards, gift restrictions and core conduct rules. The first examination (the Series 50 exam) will be given in 2016 on a pilot basis. Those passing the pilot exam will not have to take the permanent exam.

What To Look For In 2016

From the SEC, we expect at least one more round of underwriter settlements under the MCDC Initiative in early 2016, to be followed by one or more rounds of issuer settlements. It will be interesting to see whether any issuer settlement orders contain any context or legal analysis that will aid future disclosure analysis. We also expect continued focus to be placed on pension obligation reporting and disclosure.

An industry group has assembled and is looking at ways to improve continuing disclosure compliance and other disclosure matters. Look for a request to be made to the SEC on several matters, including interpretive guidance on amending continuing disclosure undertakings.

The MSRB will continue to develop the municipal advisor regulatory regime which could include disclosure requirements for municipal advisors with respect to bank loans and private/direct placements and, possibly, additional diligence responsibilities in competitive bidding transactions.