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# Institutions take center stage in taxable trade

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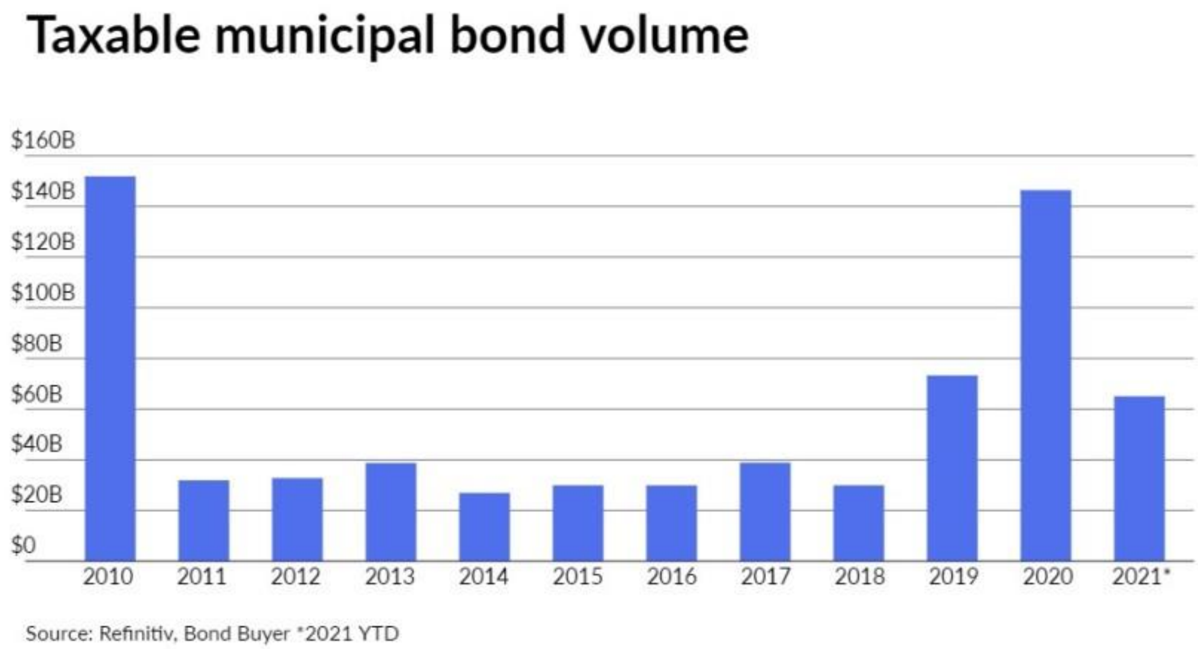
The taxable municipal securities market was primarily driven by institutional trading in 2020, in contrast to the individual-investor-driven Build America Bonds-era boom. The increasing influence of institutional market participants is consistent with overarching trends in the tax-exempt market, but is seen more so in taxables, a Municipal Securities Rulemaking Board report finds.

"Both the taxable and tax-exempt municipal bond markets have become more dominated by institutional-sized trades over time, but the shift away from individual investor-sized trades is particularly marked in the taxable market," according to the report, published Wednesday.

Build America Bonds were created under the American Recovery and Reinvestment Act as a direct-pay bond program that allowed municipal issuers to sell taxable bonds with a 35% interest subsidy provided by the federal government. The program expired at the end of 2010.




The MSRB focused on 2010 and 2020 because both years were so unlike any other of the years in between, given BABs in 2010 and then the pandemic disruption in 2020.

“The rate of this change was much faster in the taxable space than we’d seen in the tax-exempt space,” said John Bagley, chief market structure officer at the MSRB.

The report compared taxable bond volume and trading activity from 2010 to 2020, focusing on those two years in particular as 2010 included BABs — and about $150 billion of total taxable volume — and 2020, which came in just shy of that at $146.425 billion. Last year's record $480-plus billion of total muni issuance was 30% taxable. In 2010, taxables, including BABs made up nearly 36%.

"Although 2020 had similar new issuance volume to 2010, MSRB analysis of trade data shows a significant change in trading patterns for taxable municipal bonds in 2020 compared to 2010," the report said. "Among other differences, trading of taxable municipal securities was dominated by institutional investors in 2020, with significantly less participation from individual investors than in 2010 or 2015."

Among taxable trades of $1 million or more, often used as a proxy for institutional investors, there were 41% more trades in 2020 than in 2010. Among trades of $100,000 or less, a proxy for trades by individual investors, there were 50% fewer taxable trades in 2020 than 2010.

In 2020, 66% of taxable trades were of $100,000 or less, compared to 81% in 2010 and 80% in 2015.

"While there were 41% more institutional-sized trades of taxable securities in 2020 than in 2010, there were 50% fewer individual investor-sized trades of $100,000 or less in the taxable municipal bond market in 2020 than in 2010," the report noted.

In 2020, there were 435,959 individual investor-sized trades of taxable municipal securities, compared to 868,671 in 2010 and 487,400 in 2015.

The trade disparity was greater in the primary market than in the secondary market. In 2010, there were 35,760 individual investor-sized trades of taxable securities in the primary market. In 2020, there were 13,085, a decrease of 63%.

“Similarly, there was much more institutional-sized trading of taxable securities overall in 2020 than in 2010, and that increase was larger among primary market trades than in the secondary market,” the report found. In 2010, there were 18,412 institutional-sized primary market trades of taxable securities, compared to 30,271 in 2020, an increase of 64%

In general, the MSRB notes, these changes are similar to decade-long trends in the tax-exempt market, but the difference between 2010 and 2020 trading volume is larger in the taxable market than in exempts.

In the taxable market, there were 50% fewer individual investor-sized trades in 2020 compared to 2010. In the tax-exempt market, there were 16% fewer trades of this size in 2020 compared to 2010.

Average trade size for tax-exempt securities was also larger in 2020 than in 2010, by 25%. However, that increase was significantly lower than the 77% increase in average trade size for the taxable market.

“In the BABs era, that was a very well-known program where individual investors were more keenly aware of this taxable product," Bagley said, adding that traditional taxable municipals might not be as much of a focus for retail this time around.

Another factor to consider, Bagley said, is that rates were dramatically higher in 2010 than 2020 and retail generally favors higher rates.

“We think those two factors had something to do with individual investors buying more in 2010 than 2020," he said.

He said the growth in separately managed accounts, exchange traded funds and mutual fund growth may also contribute to the changes.

“One thing the taxable market does is it widens the investor base," Bagley said.

More international interest, more bank buying in the taxable space, "that is an overall positive."

"This is a market that is very reliant on a few types of buyers," Bagley said.

Years ago, it seemed like it used to be if a taxable muni was not large enough to be index eligible, a lot of participants didn’t pay attention to it, said Patrick Luby, senior municipal strategist at CreditSights.

One of the takeaways from the recent taxable growth, Luby said, is that it doesn’t matter how big or how small a taxable muni issue is, there is huge appetite for it — but more from institutions.

"There is enormous demand for the diversifying benefit of adding muni credit to an investment grade portfolio," Luby said.

The change in tax rates from 2018 also is a factor. A lot of institutions can’t do with tax-exempts what they can with taxables. Banks, property and casualty insurance companies, and pension funds, among others, are larger players in taxables, Luby noted. They're also buying larger blocks of taxable munis.

As for fewer individual account buying for both exempts and taxables, “It’s what I call the professionalization of the muni market," Luby said.

Growth in separately managed accounts, exchange traded funds and mutual funds has altered the municipal landscape.

“Years back when individuals didn’t use SMA accounts … they bought bonds on their own account. If there were 6 million different investors that’s 6 million objectives," Luby said.

Now a large number of retail investors are getting their exposure through some professionally managed accounts, whether ETFs, mutual funds or SMAs.

"So the number of different strategies driving behavior is different," Luby said.

The demand in the primary is much different than in the secondary market. The concentration of demand has moved into a much smaller number of strategies.

"The compression of spreads, meaning, markups, has made it more and more difficult for individual advisors to justify spending the time necessary to talk about individual bonds to their clients," Luby said. "The acceleration of economic and market changes has also increased the awareness among investors and advisors of the benefit of having full-time supervision and management of municipal bond portfolio risks."

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