
Transparency Could Save Governments Billions in Borrowing.

Transparency is a divisive issue in the state and local financial market. The main sticking point is time. Governments, the argument goes, cannot be expected to operate at the speed or with the savviness that corporate markets do. But for those dragging their feet on the issue, keep this in mind: States and localities are potentially leaving billions of dollars on the table by not having financial transparency on par with the corporate world.

A new study from the University of Oregon supports this idea. Looking at the municipal bond market, researchers found that timelier information can reduce transaction fees on trades by up to 30 percent. This is particularly true for individual investors, who make up the bulk of the $3.6 trillion U.S. municipal bond market. The report, co-authored by finance professor John Chalmers, looked at the difference in municipal bond trading before and after the Municipal Securities Rulemaking Board's (MSRB) Real-Time Transaction Reporting System kicked off at the start of 2006. The system required trades to be reported in 15 minutes instead of at the end of the day. It allowed for much better price comparison by buyers.

Although Chalmers is studying trades on municipal bonds by dealers or individuals after the issuer initially sells them, he said transparency still could lead to lower costs for issuers. "The lower these trading costs, it ultimately should affect the [interest rate] you need to set on your bonds to get them sold," he said. "An investor is going to look at their return after costs and taxes. If those costs are lower, they'd be willing to settle for less."

The idea builds on work published in 2006 by Lawrence Harris and Michael Piowar, which found that poor market quality was the primary reason that municipal bond trades were significantly more expensive than similarly sized trades in the corporate market. Additional research by Andrew Ang and Richard C. Green for the Brookings Institution in 2011 concluded that state and local governments might be paying billions of dollars each year in unnecessary fees, transactions costs, and interest expense due to the lack of both transparency and liquidity in the municipal bond market.

Ang and Green estimated that the liquidity cost alone represents approximately $30 billion per year on the current $2.9 trillion stock of outstanding bonds. "When the market is liquid and transparent, both borrowers and investors incur fewer fees and lower costs," wrote Ang and Green. "All of these factors contribute to reduced interest expense for issuers."

Massachusetts has adopted this concept and is taking a cue from the way the corporate world interacts with its investors. It launched a new investor website that has 40,000 downloadable documents on things like bond authorizations, revenue reports, budgets, audits, official statements, economic reports and pension valuations. Free software is also available so that investors can download and manipulate data.

A year ago this March, the state launched its MassDirect Notes program in which the state sells its bonds directly to investors for a two-week period each month, allowing individual investors to buy the state's bonds directly. This is akin to buying NFL tickets directly from the team versus paying more on secondary markets like StubHub. More recently, Massachusetts became the first U.S. government to launch a smartphone app for investors.

Assistant State Treasurer for Debt Management Colin MacNaught said this effort will save taxpayers millions in borrowing costs over the long term. "Whether the credit news for Massachusetts is good or bad, investors know that they'll always get good and current disclosure from the state," he said. "We think that gives them an added measure of confidence in our bonds, thus enhancing the liquidity of our paper. And every dollar we save on our borrowing is one more dollar we can redirect elsewhere to other budget areas."

What Massachusetts is doing is potentially groundbreaking. But despite the data on investor costs, there's no concrete proof that issuers can lower their borrowing costs via transparency, said Lynnette Kelly, MSRB's executive director. The Bay State is providing the market a test case in this theory.

That is reason enough to keep an eye on Massachusetts' success in this arena but here's one more: The Securities and Exchange Commission is getting tough on the municipal market and disclosures is a big part of the picture. In this respect, the more governments can take this responsibility on themselves, the better.

To that end, the MSRB is telling smaller governments, which tend to be less savvy about financial disclosures because they issue few, how they can increase transparency on their own. Most governments post their Comprehensive Annual Financial Reports online, said Kelly. But they could also make available such relevant information as meeting minutes, budgets and a list of top local employers. "This stuff is pretty easily accessible," she said. "So we're trying to make sure smaller issuers know that it should be top-of-mind and it's very, very easy to do."

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