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MSRB Staff Examines Change in Use of External Liquidity over Time: Cadwalader

In a new [report](#), MSRB staff examined the use of external liquidity in both “small” (\$100,000 or less) and “large” (\$1,000,000 or more) secondary market transactions over the past decade. As defined in the report, external liquidity is when “a customer purchase or sale is filled using the offering or bid of a dealer that is different than and not affiliated with the client’s dealer.”

MSRB staff analyzed how municipal market participants accessed the secondary market of fixed-rate, long-term securities in the years 2011, 2015, 2019 and 2020. As to small market transactions, from 2011 to 2019, the staff found an increase in external liquidity likely due to the increased use of online brokerages largely by individual investors. (From 2019 to 2020, there was a minimal decrease in small market transactions, likely attributable to the pandemic.) As to large market transactions, the MSRB found a decrease in external liquidity from 2011 to 2019. The researchers identified an increase in large market transactions in 2020. The MSRB concluded that the pandemic had a large impact on external liquidity usage in 2020. The staff researchers found that external liquidity usage varied greatly from month to month, peaking at the beginning of the pandemic and declining throughout the year.

The study also found a consolidation and decrease in the number of providers of external liquidity over the period. (In 2020, the top ten external liquidity providers accounted for 45% of all liquidity in trades, which was up from 42% in 2011). The MSRB suggested that those providers who left the market did not have a significant presence, and the number of firms providing “significant” external liquidity was on the rise.

MSRB staff said it will continue to monitor the use of external liquidity in the marketplace and will update the report when appropriate.

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