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Relief For The Digital Data-Starved $3.9 Trillion Municipal Bond Market.

Like a bug trapped in amber, crucial financial information on thousands of bonds in multi-billio--dollar municipal bond mutual fund portfolios held by millions of shareholders is in a similar fossilized state, embedded in decades-old technology.

The municipal bond market is a $3.9 trillion capital market without digital financial data.

Financial Reporting: Digitized and Machine-Readable

The Financial Data Transparency Act (S. 4295 – "FDTA"), pending before the Senate, offers a readily available solution to free that information, making it widely available and usable. In doing so, FDTA expands the adoption of machine-readable, digitized financial reporting. Wholly based on existing information that is already required, collected, and making it available to anyone for free, this legislation is potentially transformative for the $3.9 trillion municipal bond market. It ushers in access to and transparency in government financial reporting that, while standard for public companies in the U.S. and the rest of the world, is unprecedented in the public sector.

All of these are why the co-sponsors of the legislation, U.S. Senators Mark R. Warner (D-VA) and Mike Crapo (R-ID) introduced the bill. FTDA provides "greater transparency and usability for investors and consumers, along with streamlined data submissions and compliance for our regulated institutions," offered Senator Warner. Senator Crapo noted the bill would be an important step forward in "making financial data used by federal regulators more accessible and accessible to the American public" as well as "improving government transparency and accountability."

Machine-readable, digitized, standardized, transparency, accountability. All very technical and aspirational, but what does this mean practically for investors and regulators?

It means all the financial information available from cities and towns and authorities—assets, debts, tax and fee revenues, cash flows, and so forth—can be easily downloaded or uploaded into a spreadsheet and treated just like any other bunch of numbers. It means it can be readily categorized, analyzed, tracked, charted, graphed, and the dozens of other things you do with financial information to better understand what it means. That's just for starters.

Just as an individual investor, investment advisor, or portfolio manager cannot effectively make prudent investment decisions without this essential data in a readily accessible structured format, neither can regulators perform their Congressionally mandated roles to ensure fair and efficient markets without consistent, standardized financial data.

How much is at stake for investors as well as capital markets regulators?

Start with this number. Six hundred thirty-one eight hundred fifty-nine million. Sounds like one of those made-up numbers used for exaggeration, right? Floating somewhere between a bazillion and a gazillion? It's kind of hard to take seriously.

Yet $631,859,490,332 is exactly the total amount of assets under management held in the open-end funds of the top 10 municipal bond mutual fund managers as of July 2022, according to Morningstar direct.

Now here's another number: $908.9 billion. That's the total assets in all open-end municipal bond mutual funds as calculated by the Federal Reserve as of the end of Q2-2022.

(For the intrepid, data on municipal bond holdings of the entire market is in the Municipal Securities section of the Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release Z.1 Financial Accounts of the United States, Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts).

Align the time frames and compare the Fed number to the prior AUM number. You'll quickly find that close to 70% of all municipal bond mutual fund holdings are held by these top 10 fund managers.

It is a uniquely stunning concentration of assets in this sector of the financial markets, raising a host of concerns for investors and regulators alike. Not the least of these are liquidity risk in general, liquidity during market dislocations, increased volatility, interest-rate commodification, a redefinition of systemic risk, and fair market pricing.

Keeping It Together

For the mutual fund managers overseeing these vast amounts of other people's money at that size, it becomes less of an investment strategy and more of an operations and logistics challenge.

Give this some thought. A multibillion-dollar mutual fund has thousands upon thousands of holdings in its portfolio. Vanguard Tax-Exempt Index Fund is an example, but any one of the funds in the Top 10 will do. It has $19.2 billion invested in 6,330 bonds (as of 9/30/22). Now expand that by the billions held in all the other funds making up the Top 10. In those portfolios, there are tens of thousands of bonds.

There is no way to manage portfolios of these sizes without very carefully established and coordinated structures to keep track of all the various facets of managing billions of dollars, from trading to accounting to valuation to surveillance to analysis to compliance…the list goes on.

What holds all of these pieces together is standardized, machine-readable, digitized data. Data capturing information on the bond, its coupon, maturity, purchase price, premium, discount, rating, and call features. Data on interest accruals, capital gains, capital losses, dividends, shares bought, and shares sold. Data on valuations, variance, and spread relationships. Data on compliance parameters, shareholder fees and expenses.

All these data fields and a myriad more track each and every component of managing thousands of bonds and billions of dollars.

Every day.

Except for one series of data.

A $3.9 Trillion Capital Market with No Digital Financial Data

There is no readily publicly available, comprehensive, digitized, downloadable, structured financial data source on the underlying issuers of the bonds. None. Not from the Securities and Exchange

Commission, not from the Department of the Treasury, not from the Federal Reserve Board, and not from other the four capital markets regulators noted in the FTDA.

Not even the Municipal Securities Rulemaking Board, the regulatory agency with the Congressional mandate to "protect municipal securities investors, municipal entities, obligated persons and the public interest." Not even the MSRB's central disclosure repository for the municipal bond market, EMMA, where nearly every financial report by municipal bond issuers has to be filed. From states to cities to towns to authorities, all their financial disclosures filed in EMMA are in an unstructured format: the PDF.

A PDF is not digitized data. The numbers aren't even really numbers, just pictures of numbers, images comprised of pixels, like a picture you take with your camera. It is not directly convertible into digital data. As research has shown, even the best attempts to scrape the PDF to digitize the data have serious shortcomings. Most of the time, to convert the information on the PDF pages to digital data, it has to be entered into a spreadsheet by hand.

Like a bug trapped in amber, crucial financial information on tens of thousands of bonds held in multi-billion-dollar investment portfolios, information essential to assessing, surveilling, accounting, and valuing these investments held by millions of mutual fund shareholders, sits locked like a Lucite-entombed relic.

A Simple Fix

It is a simple fix. By and large, this financial information is already collected as data and organized to match the widely followed rules established by the Government Accounting Standards Board as generally accepted accounting principles. It requires only a modest effort to digitally tag this data, linking it to the already well-defined GAAP categories.

Which is all this legislation gives regulators the ability to request. No new disclosures. No new authority. No changes in data governance. Just more information available, for free, to any investor with a computer can use—from multi-billion-dollar mutual fund managers or individual investors—in the $3.9 trillion municipal bond market.

Transparency at a click.

Forbes

by Barnet Sherman

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