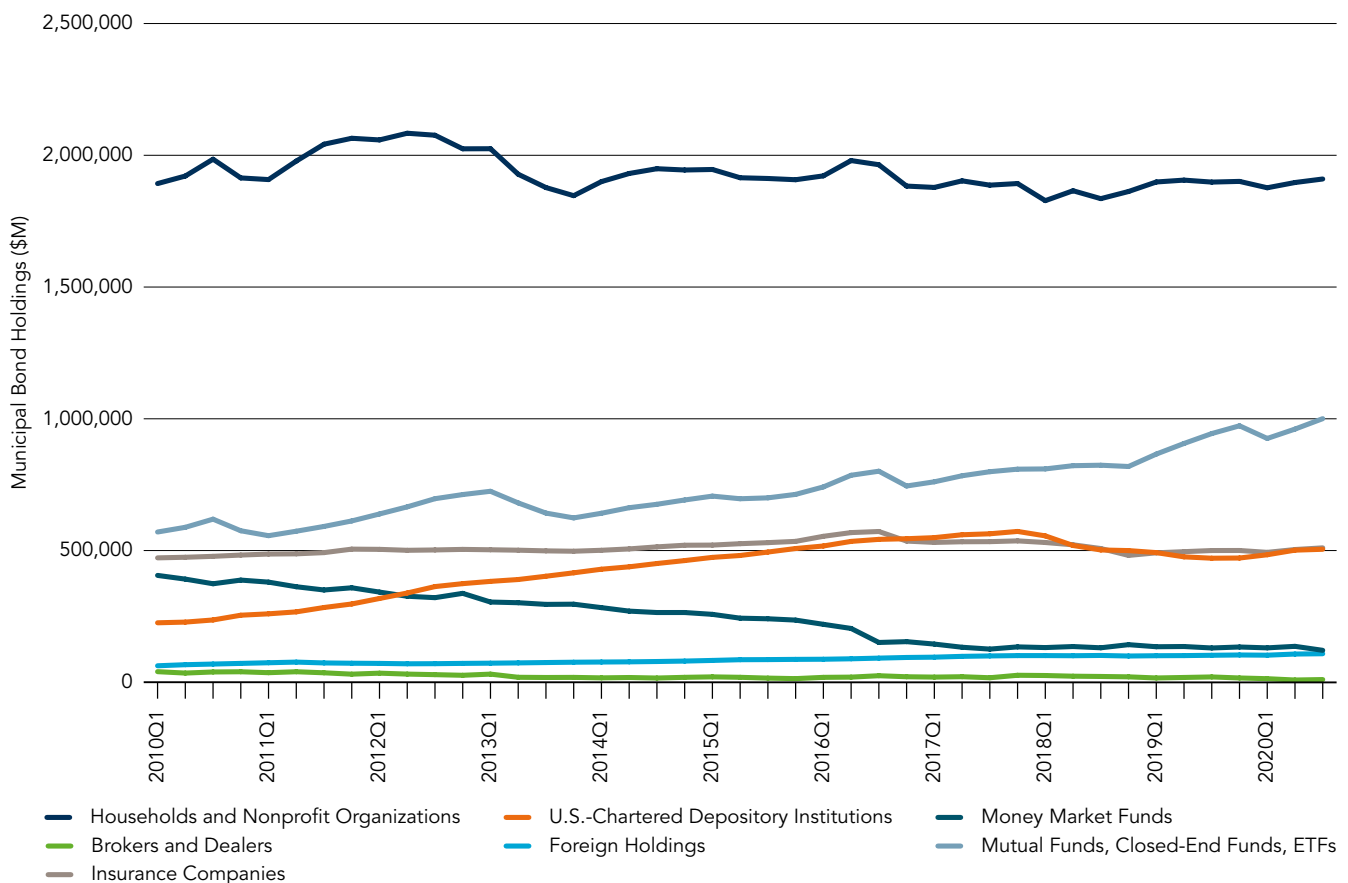


BACKGROUND

Ownership of municipal bonds as measured by the Federal Reserve Board’s Financial Accounts of the United States report continue to offer an interesting view into market dynamics and changes among different categories of investors. Individual investors continue to hold the plurality of the \$4.2 trillion outstanding municipal bond market, accounting for 45.2% of all direct holdings as well as indirect holdings through mutual funds, exchange-traded funds (ETFs), and closed-end funds.¹ Additional trends in the ownership of the municipal bonds also offer interesting insights into the marketplace, including an increase in holdings of ETFs and in foreign ownership since 2010, as well as a recent decline in bank holdings.

Chart 1: Municipal Bond Holdings by Sector, Q1 2010–Q3 2020



Source: Federal Reserve Board Financial Accounts of the United States

¹ [Federal Reserve Board Financial Accounts of the United States](#), Table L.212 Municipal Securities, December 11, 2020.

The Trends

Overall market size has increased since 2010, with about \$3.7 trillion in municipal bond holdings in 2010 and about \$4.2 trillion as of the end of September 2020, a growth of about 10% over the decade. The \$4.2 trillion in municipal securities outstanding at the end of the third quarter in 2020 is the second highest volume after the second quarter of 2016, likely due to increased levels of new issuance after the market disruption in March and April 2020.

Apart from a two-year increase in 2011 and 2012, household holdings of municipal securities have remained stable from 2010 through September 2020. Household municipal holdings reached \$1.91 trillion at the end of September 2020, with variations of less than 1% between 2010 and 2019, and continued to see small fluctuations into the first three quarters of 2020.

In general, mutual fund holdings (including mutual funds, ETFs, and closed-end funds) have increased by 74% since 2010, with \$575 billion at the end of 2010 and \$1.0 trillion at the end of the third quarter in 2020. Within the mutual fund category, trends in municipal bond ownership are distinct between typical mutual funds, closed-end funds, and ETFs. Mutual funds, the largest category, increased holdings of municipal bonds by 73% from 2010 to the third quarter of 2020. Holdings in closed-end funds increased by 21% from 2010 to the third quarter of 2020, from \$77 billion to \$93 billion. Finally, a notable trend is the increase in municipal bond investment through ETFs. Representing roughly 1% of

municipal assets, ETFs are the fastest growing mechanism for municipal bond investment, with approximately 670% growth from \$7.6 billion in holdings in 2010 to over \$58 billion in the third quarter of 2020. This includes 18% growth from 2019 to the third quarter of 2020.

Meanwhile, money market funds saw the opposite trend than mutual funds, closed-end funds, and ETFs. At the end of 2010, there were \$388 billion of municipal bond holdings in money market funds, compared to \$121 billion at the end of September 2020, a decrease of 69% since 2010 and a decrease of 9% from 2019 to the third quarter of 2020.

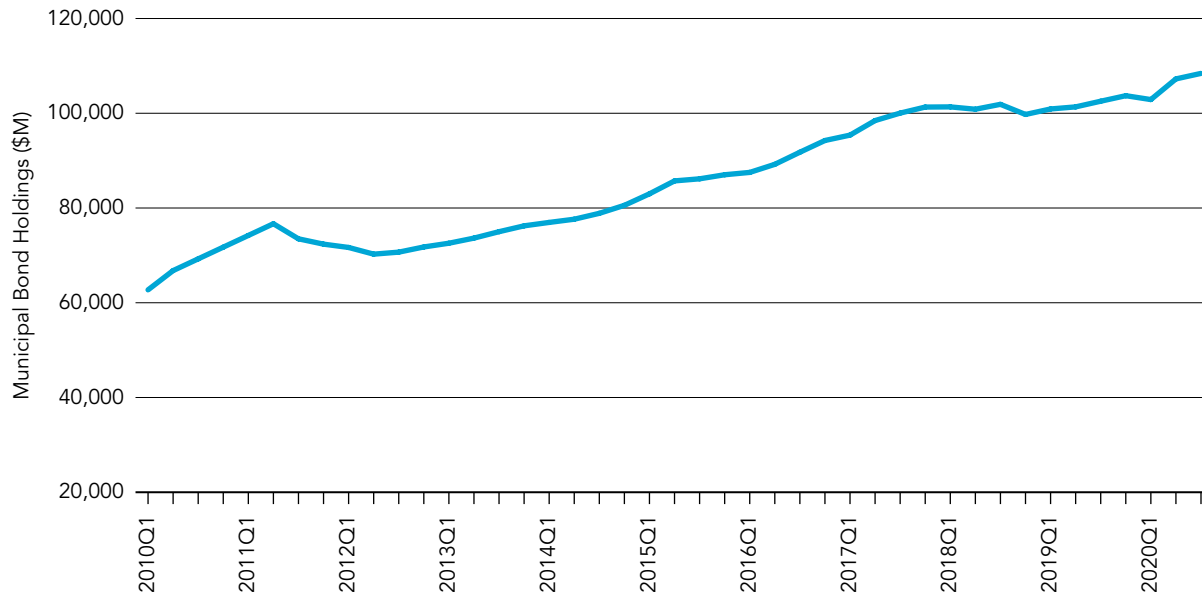
While municipal bond holdings by banks have increased in general since 2010, holdings have decreased 12% since 2017. The Tax Cut and Jobs Act of 2017, which reduced the corporate tax rate to 21% from 35%, has contributed to a reduced appetite for municipal bonds by banks. The reduction in the effective corporate tax rate results in increased after-tax yields on taxable securities, thereby reducing the desire for banks to hold municipal bonds compared to corporate bonds. This dynamic may have contributed to the decline in holdings. However, during the first nine months of 2020, bank holdings increased by 7%, possibly related to the market disruption earlier in the year.

After an increase in holdings from 2010 to 2016, insurance companies' holdings have fallen back to 2010 levels, with \$510 billion in holdings in September 2020. However,

Chart 2: Municipal Bond Holdings by Broker-Dealers, Q1 2010–Q3 2020



Source: Federal Reserve Board Financial Accounts of the United States

Chart 3: Municipal Bond Holdings by Foreign Investors, Q1 2010–Q3 2020

Source: Federal Reserve Board Financial Accounts of the United States

differentiating between life insurance companies and property-casualty insurance companies reveals that life insurance companies have increased holdings consistently since 2010 while property casualty insurance companies have decreased holdings consistently since 2010. In September 2020, life insurance companies had \$217 billion in municipal bond holdings, a 92% increase from 2010. Meanwhile, property-casualty insurance companies had \$292 billion in municipal bond holdings in September 2020, a 21% decrease from 2010.

In general, holdings by brokers and dealers have decreased significantly since 2010, though there have been fluctuations, especially between 2015 and 2017. Municipal bond holdings by brokers and dealers decreased by 37% between 2019 and the third quarter of 2020. At the end of the third quarter of 2020, dealer inventories amounted to \$10 billion, the second-lowest volume since 2010. The lowest volume was in the second quarter of 2020, with under \$9 billion in municipal bond holdings by brokers and dealers that

quarter. A MSRB report from 2019 found that, despite the decreasing number of MSRB-registered dealers and reduced dealer inventories, trading activity in municipal securities has remained relatively stable over the past several years with overall activity becoming less concentrated among top dealers.² This indicates that a large proportion of the dealers who have recently left the market may have participated only minimally in municipal securities trading.

Finally, foreign holdings have shown a fairly steady climb since 2010, from \$72 billion in 2010 to \$108 billion in September 2020, up 51% from 2010 and up 5% from 2019. Foreign holdings began to increase during the implementation of the Build America Bonds program and has continued since.³ The increase in holdings of foreign investors has reached its highest level so far in the third quarter of 2020 as the taxable municipal market experienced a resurgence and allowed these types of investors to diversify their holdings.

² MSRB, [Dealer Participation and Concentration in Municipal Securities Trading](#), May 1, 2019.

³ Build America Bonds were introduced in 2009 as a part of the American Recovery and Reinvestment Act of 2009 (ARRA). Foreign holdings increased from \$48 billion at the beginning of 2008 to \$59 billion by the end of 2009.

About the MSRB

The MSRB protects investors, state and local governments and other municipal entities, and the public interest by promoting a fair and efficient municipal securities market. The MSRB fulfills this mission by regulating the municipal securities firms, banks and municipal advisors that engage in municipal securities and advisory activities. To further protect market participants, the MSRB provides market transparency through its Electronic Municipal Market Access (EMMA[®]) website, the official repository for information on all municipal bonds. The MSRB also serves as an objective resource on the municipal market and conducts extensive education and outreach to market stakeholders. The MSRB is a self-regulatory organization governed by a board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is overseen by the Securities and Exchange Commission and Congress.

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