Why Brokers Like to Sell Municipal Bonds

Today's Wall Street Journal has an article that analyzes the transactions costs, or commissions, faced by retail investors in municipal bonds. They find that the cost of buying a typical muni is about twice that of a high grade corporate bond. I wrote about this in my book, Bonds Are Not Forever; The Crisis Facing Fixed Income Investors. The SEC published a 2012 Report on the Municipal Bond Market in which they also identified relatively high transactions costs.

The problem isn't necessarily the high costs faced by investors; it's the effort the industry makes to avoid full disclosure. Finance routinely benefits from opaque pricing of its products, from brokers knowing more about pricing than clients. There's a basic conflict of interest between a municipal bond broker, who wants to sell bonds at a high price, and a retail client who wants to buy them at a low price. The type of price transparency that exists for equities would clearly benefit the clients, but not the brokers since it would impede their ability to charge such a high commission. The industry is generally against improved price disclosure, for obvious reasons.

If brokers had to invest in what they push on their clients, such as overpriced municipal bonds, the problem would probably solve itself quite quickly. But that's unlikely to happen anytime soon, so in the meantime retail investors in municipal bonds should approach the market with a healthy level of skepticism and recognize that their is no alignment of interests between the retail bond buyer and their broker.