



## Investors in Municipal Securities

The MSRB seeks input from investors in municipal securities regarding ESG-Related Disclosures and ESG-Labeled Bonds, including input on the following questions.

- 1. Do you consider ESG-related information material to your investment decisions? If so, in what way? Is ESG-related information important to your evaluation of a municipal issuer's creditworthiness? If so, what ESG-related information do you consider most relevant to a municipal issuer's creditworthiness and why?**

Yes, we consider ESG information material to our investment decisions. We have developed a proprietary rating system which we apply to every bond we purchase. Our system is based on sector-specific matrices which enable us to identify and quantify the materiality of ESG characteristics for each issue. The degree to which each individual factor may impact our decisions will vary by sector. For example, environmental factors tend to be more material for Utilities while social factors generally tend to warrant a heavier weighting in housing bonds.

For the Lord Abbett Sustainable Municipal Bond Fund, we also analyze the use of proceeds for each issue considered for inclusion in the portfolio. In cases where disclosure is not clear, we typically will not purchase the bond for this portfolio.

- 2. Do you generally have access to all the ESG-related information you need to make an informed investment decision? If so, can you identify the source(s) of the information you use (e.g., municipal issuer disclosures on the EMMA® website, other municipal issuer communications, time-of-trade disclosures, third-party data vendors or proprietary analyses)? If not, please identify the gaps in information and market transparency.**

No, we do not have access to all the ESG information we need, and it is a very manual process to gather relevant ESG-related information for municipal bonds. We consider issuer disclosure, but we tend to acquire more ESG-related information from other sources, including census data, real estate data, and industry association websites. We continually evaluate third-party research providers but, to date, we have not identified an external resource that can provide enough ESG-related data to be considered a long-term solution. We have reviewed some offerings where we believe opportunistic vendors are exploiting the need in the market by offering information that, while interesting, falls short of our needs in terms of relevance to investment decision-making.

- 3. Does your expectation as to the availability and sufficiency of ESG-related information change depending on whether the purchase of municipal securities is made in the primary market or the secondary market? If so, how?**

Generally, we tend to receive better disclosure and access to issuers when they bring new issues. For ESG-related information, however, we typically do not receive sufficient data from issuers in the primary or secondary markets. When we engage with issuers, they often indicate that they only provide information that is required by lawyers and financial advisors. Some appear to have more information but do not provide it unless they are legally required to do so. Some suggest that they would provide more if the request was in the Request for Information associated with the deal. Some issuers have encouraged us to voice our opinion regarding the need



for inclusion of ESG-related data. We hope to see improvements in municipal bond disclosure as issuers recognize the increasing demand.

- 4. In light of the potential availability of ESG-related information from other sources, how can municipal issuers best present and disseminate their ESG-related information to investors? What topic areas do you believe are most relevant for municipal issuers to include when providing ESG-Related Disclosures? In your view, is it sufficient for ESG-Related Disclosures to just describe material ESG-related risk factors? Is there a benefit to municipal issuers further describing the initiatives and other projects they are pursuing to address such risks?**

We believe the best practice would be to submit ESG disclosure information on EMMA, in the same manner as official statements, financial statements and operating data are currently posted. Simply describing potential risks in generic language is not sufficient. We would like to see issuers describe initiatives and other projects they are pursuing and disclose specific metrics to demonstrate their progress in ESG-related areas. For example, a hospital should focus on social factors by providing Medicaid revenues compared to industry averages. Housing issuers should disclose demographic data on the populations for which they provide housing, including but not limited to income data. Educational facilities should disclose how they are helping to make college affordable and how many first-in-family college students are enrolled. In the Utilities sector, we would like to see specific disclosure about carbon footprint and renewable/carbon plans. In all sectors, we would like to see disclosure of Board diversity as well as overall diversity plans and initiatives. While issuers might oppose disclosure expansion to these levels, the demand for ESG-related investments is growing and we anticipate that issuers will be more likely to be able to borrow at lower rates in the future if they can increase demand for their credit by enhancing ESG-related disclosure.

Additionally, the MSRB can play a role by moving this disclosure into a format that facilitates efficient review. For example, by encouraging text-searchable documents for all disclosure items, enforcing separation of disclosure documents, and requiring a consistent labeling framework in EMMA, both institutional and retail investors would be able to access and use the data more efficiently.

- 5. Certain market participants have expressed concerns that, while analysts and investors have expressed their desire for more standardized ESG-Related Disclosures, there is no consensus on which data and metrics are important or essential.<sup>16</sup> Do you believe such disclosures should be standardized? Do you believe there is a consensus on which data and metrics are important or essential? If so, can you provide insight as to what consensus you believe does or could exist? If not, what barriers do you believe exist in reaching a consensus?**

We view the need for standardization of ESG-related disclosure as being like standardization of all other disclosure currently provided by issuers to facilitate credit analysis. It would be helpful to have standards in each sector, but we recognize the challenges associated with comprehensive disclosure harmonization across all sectors. Some metrics, such as board diversity, can be standardized across all sectors. Other metrics, however, may be applied differently by different sectors. For example, net zero plans and diversification of power sources are relevant for utilities and may require more detail than other sectors. We believe cities should provide standard data regarding the racial framework for their police forces. Hospitals typically report the percent of Medicaid revenue, but standardization and greater emphasis would be helpful. So, while we recognize that comprehensive standardization presents challenges, we believe there is room for sector-specific standards that would help



investors better understand key risk factors. We also believe sector-specific frameworks can leverage existing standards, such as SASB for healthcare and the “STARS” rating system for higher education.

**6. When purchasing municipal securities for ESG-Designated Funds, what ESG-related information is most useful for the investment decision? How do fund managers screen securities to ensure that they meet a fund’s criteria? Once purchased, what information is most relevant in assessing that a security continues to meet the ESG criteria established for an ESG-Designated Fund?**

There are several ways to approach an investment strategy for an ESG-focused fund. We apply proprietary ESG ratings to issuers for all our municipal bond investments. For our Sustainable Municipal Bond Fund (ESG-designated offering), we add another level to the research process by analyzing the use of proceeds of bond issues in the context of impact themes. Both ESG scores and the use of proceeds analysis are considered when purchasing a bond for our Sustainable Municipal Bond Fund. We also determine if the use of proceeds aligns with UN SDGs. We assess the same factors during ongoing surveillance of portfolio holdings. If at any point the information is no longer available, we would sell the bond. Use of proceeds generally do not change over time, but our ESG rating of an issuer may evolve. A negative change in our ESG rating may lead to sale of a bond.

Analyzing use of proceeds can present challenges. Most of the time, use of proceeds disclosure for new issues is clear. At times, however, use of proceeds as stated in the official statement is very broad and we are unable to clearly identify the projects. In those cases, we would not purchase the bond for our ESG-designated fund. Another challenge in analyzing use of proceeds occurs with refunding. In such cases we review official statements from previous deals because most often, the use of proceeds in the refunding documents do not include the use of proceeds disclosure from the original bonds being refunded. When there are multiple refundings within one official statement, it makes his analysis extremely difficult and, in some cases, impossible. As a result, issuers bringing issues with strong ESG purposes might not even qualify for purchase if the use of proceeds is not clear.

**7. When purchasing ESG-Labeled Bonds, do you evaluate municipal securities with an independent certification differently from bonds that do not have such a certification? If so, how? If not, why not? In your view, what are the benefits to an investor of purchasing a bond with an independent certification?**

An independent certification does not change our research process. Since many of these independent firms are trying to create a new business and may have varying standards, we have not developed full confidence in their conclusions. With many firms offering a range of labels to designate bonds, it has caused confusion among investors. So far, we have not observed any benefit in market pricing associated with such a designation, but as these firms evolve their processes, we believe they may have an impact in the future. In the current market, if the pricing for an issuer is the same for independently certified bonds and their non-certified bonds, we would buy the certified bonds with the hope that the market will price in that benefit in the future. The independent certification is a positive element, but it does not replace or eliminate the need for our own fundamental research.

**All Municipal Market Participants**

The MSRB seeks input from all municipal market participants, including input on the following questions.



- 1. Are there any ESG-related factors that could pose a systemic risk to the municipal securities market? If so, how might the MSRB approach such systemic risks from a regulatory perspective? Are there non-regulatory approaches the MSRB could take that would advance issuer protection, investor protection, and the overall fairness and efficiency of the market?**

At this point in the ESG cycle, we do not believe there are systematic risks to the market due to ESG-related factors. In terms of fairness and efficiency, institutional investors, like our firm, have a distinct advantage over individual bond investors in our ability to gather ESG-related information. The information is publicly available, but individual investors typically do not know where to search for it. This is not an impropriety, per se, as we are dealing with public information, but without a well-structured central repository for the information, the result is an uneven playing field. Similarly, with fewer resources and less understanding, individual investors are more likely to assume that “green” or “social” labels are being assigned based upon a uniform and regulated set of principles, whereas we understand the need to evaluate the underlying bond rather than rely solely upon such certifications.

- 2. There are a number of organizations establishing voluntary standards for the issuance of ESG-Labeled Bonds, such as the ICMA and CBI.<sup>17</sup> Does the availability of these voluntary, market-based standards provide adequate guidance for issuers and transparency for investors in the municipal securities market? If not, what additional guidance or transparency do you believe are warranted with respect to ESG-Labeled Bonds?**

With multiple sources applying different standards, transparency and guidance are still inadequate as the market lacks consistency. While it would be a challenge to get everyone to agree on all aspects of guidance, the market would benefit from a standard starting framework. There could be a short list of standard disclosures for all issues, and an additional list of optional disclosures that might be beneficial but not required. This would ensure a minimum level of consistency while enabling more bespoke guidance where warranted.

- 3. There are a number of industry-led initiatives underway intended to improve the quality of ESG-related information available in the municipal securities market. Does the availability of these voluntary, market-based initiatives enhance the ability of investors and other market participants to make informed decisions in the municipal securities market?**

Yes, these voluntary market-based initiatives are positive for the market. Many investors and issuers have their own ideas, and it is good to try many different methods in the beginning to see what works best. This is all new and issuers need to get a sense of what investors want from them to understand how to organize their resources. If we do not start by testing different ideas, we will never know what is possible. As more initiatives surface, the industry will be able to determine what works best. Eventually, an ideal state would be mandatory standards for essential items and a range of guidance on additional information that could be beneficial. We believe many issuers want to disclose more information and they may take varying approaches. We will not be able to determine which ideas work until they are tested.

- 4. There are numerous vendors providing ESG data for the municipal securities market. Does unequal access to ESG data result in disparate impacts to investors and other market participants? Does competing ESG data create investor confusion? How could the MSRB use the EMMA website to reduce information asymmetry or investor confusion?**



Yes, there is unequal information. For example, Bloomberg has started to indicate which bond issues have use of proceeds that could be considered for ESG purposes. They only have about 2,000 bonds categorized so far, but this list is growing, and they recently created indices with issuers that qualify, so we expect the number with a categorization to increase substantially. This gives a distinct advantage to Bloomberg subscribers, which are typically institutional investors. This information is integrated into our own fundamental analysis. Individual investors typically do not have access to this information. While this disparity may not have a great impact today, we believe it has the potential to create material information asymmetry in the future.

- 5. Does the availability of ESG-related information (or lack thereof) in other financial markets directly or indirectly influence the functioning of the municipal market? If so, how? For example, when evaluating competing investment opportunities, do taxable ESG investors expect the same timeliness and quality of ESG-related information for a municipal issuer as for a corporate issuer? And how might the differing expectations of different classes of investors (e.g., foreign versus domestic; retail versus institutional; or tax-exempt versus taxable) regarding ESG-related information affect pricing, underwriting, trading, and other market activities?**

In the current market, much more is expected on the corporate side than the municipal side. Corporations already must provide information on various ESG metrics, such as board diversity, and there are third party research providers assigning them ESG ratings. Hence, weak disclosures result in lower ratings. The ESG rating services provide a fair amount of information to support their ratings, which gives corporate issuers the opportunity to respond by addressing those factors. We are seeing corporate issuers engage with investors to learn what information they need to provide. The municipal bond market has not yet reached this stage, but we expect that it will do so in the not-too-distant future.

In terms of taxable investors' expectations, we are seeing demand for ESG-related information as well as pressure to improve overall timeliness of all disclosure. In the municipal market, the lack of timely information creates a significant headwind for institutional investors. Without timely disclosure, we are forced to take a leap of faith that they will eventually provide the information, and, in some cases, information material to the quality of the investment is not disclosed until well after it should be available.

- 6. The MSRB recently incorporated an ESG indicator from an independent data vendor, IHS Markit, into the New Issue Calendar shown on the EMMA website.<sup>18</sup> This ESG indicator denotes when an issuer has self-labeled a bond issue as green, social, or sustainable, or if the issuer includes an independent ESG certification as part of the offering document. Does making this ESG indicator available on the EMMA website enhance market transparency regarding ESG-Labeled Bonds? Specifically, is it valuable to investors, municipal issuers or other market participants?**

While any additional information is a plus, we do not yet have confidence in any data vendor's ability to make these decisions. Self-labeling by issuers further challenges our faith in this reporting. As a result, we continue to perform our own analysis. It is a good starting point to recognize that someone has made that determination, but we would still need to complete independent analysis to either ratify or challenge that conclusion. This is like bond credit ratings, where we always look at the major ratings agencies' ratings but also perform our own analysis to determine whether we agree.





**7. What improvements could the MSRB make to the EMMA website regarding ESG-Related Disclosures, ESG-Labeled Bonds and other ESG-related information? Which improvements to the EMMA website would most enhance access for investors and other market participants to ESG-related information? Which improvements to the EMMA website would most enhance the fairness and efficiency of the municipal market?**

It would help to have a framework on the website and perhaps a standardized questionnaire for issuers to answer. Even if the issuer does not decide to provide certain information, it would help to know that they made such a choice. Another benefit of posting would be that issuers might feel pressure when seeing other issuers post critical ESG-related information, which would ultimately lead to enhanced disclosure on a broad basis. And, finally, improving the ability to search efficiently on EMMA would be a significant benefit for investors.

**8. Is there any additional information that you would like to share with the MSRB regarding any other ESG-related activities or trends in the municipal securities market?**

Generally, advancements in ESG-related disclosure are moving much faster in other markets, even though there are a lot more ESG investments in the municipal bond market. The market is heavily dominated by individual investors and would benefit from a wider range of investors, much like the way insurance companies and banks were more involved before the recent tax bill lowered rates and decreased their participation. Increased ESG disclosure is likely to be good for issuers because it presents the opportunity for them to receive lower borrowing rates if it spurs interest from a wider range of investors, and it is good for individual investors because more investors will result in more sources of liquidity in outflow cycles. During March 2020, individual investors who wanted withdrawals paid a high price for liquidity because there were not enough alternative buyers at market rates until they adjusted higher. ESG-focused investors could help facilitate the healthy functioning of the market by increasing demand, but they are less likely to increase participation until ESG disclosure improves.

**Daniel S. Solender**

Partner & Director of Tax Free Fixed Income  
Lord, Abbett & Co. LLC