

CONSULTATION RESPONSE

US MUNICIPAL SECURITIES RULEMAKING BOARD: REQUEST FOR INFORMATION ON ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) PRACTICES IN THE MUNICIPAL SECURITIES MARKET

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INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has now over 4,800 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US\$120 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to the MSRB's call for feedback on environmental, social and governance practices in the municipal securities market.

ABOUT THIS CONSULTATION

This document responds to the Municipal Securities Rulemaking Board's ("MSRB" or "the Board") request for information on Environmental, Social and Governance (ESG) Practices in the Municipal Securities Market.¹ In its request, MSRB welcomes input on (1) the disclosure of information regarding ESG-related risk factors and ESG-related practices and (2) the labeling and marketing of municipal securities with ESG designations.

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¹ MSRB Notice: <https://www.msrb.org/-/media/Files/Regulatory-Notices/RFCs/2021-17.ashx??n=1>

KEY RECOMMENDATIONS

The PRI is encouraged by MSRB's request for information as it considers how best to incorporate ESG-related information in its regulatory and oversight duties. Municipal bond issuers are often bound to infrastructure that cannot be relocated in order to mitigate or avoid the effects of climate change and consideration of ESG-related factors is an important step for MSRB to address this growing concern. PRI's recent report, "ESG Integration in Sub-Sovereign Debt: The US Municipal Bond Market" highlights some ongoing challenges facing the US municipal securities market as explicit ESG incorporation in investment decisions increases.² At the same time, because of their key role in providing public services and local infrastructure, municipalities can play a leading role in limiting environmental risks and promoting equitable social welfare.

Rather than being a separate type of consideration, or a practice only considered by "impact investors", ESG factors are relevant to all issuers and investors, and are increasingly integrated in standard investment processes and considered alongside other decision-useful data such as annual financial statements. It is increasingly important that investors have access to consistent, comparable ESG information across all securities offerings to enhance their analysis and engagement with issuers to convey their expectations. The PRI stands ready to assist the Board as it continues efforts to support market participants in further considering ESG factors.³

The PRI recommends the Board:

- **Encourage reporting on ESG information in standard disclosure documents.** While municipal securities vary, significant work has been done across the finance industry to develop a number of disclosure regimes fit for various markets. The Board should recommend best practice that fits the diverse set of issuers operating in the municipal securities market and encourage disclosure of relevant ESG factors for all issuers, not just those with "ESG" labelled products.
- **Continue to adapt the Electronic Municipal Market Access (EMMA) database to provide for standardized and comparable information on ESG-related factors across offerings.** Recent updates to the EMMA database to incorporate ESG provide opportunity for issuers to promote their efforts at incorporation. However, the current criteria for ESG labelling and disclosure can allow for issuer and investor confusion. MSRB should continue to expand and formalize the information presented about ESG factors on the EMMA database in an effort to promote consistency and comparability.
- **Encourage best practice standards to accompany any classification or labelling of offerings.** Whether labelled (e.g. green) offerings follow leading market standards or not, issuers should provide transparency over the bond's use of proceeds before and after issuance.
- **Support industry alignment on any disclosure and labelling efforts with other markets around the world to find common language for ESG considerations.** The Board should continuously look to efforts in similar markets in order to avoid market fragmentation.

² https://www.unpri.org/fixed-income/esg-integration-in-sub-sovereign-debt-the-us-municipal-bond-market/8079_article

³ <https://www.unpri.org/investment-tools/fixed-income>

DETAILED RESPONSE

CONSISTENT, COMPARABLE ESG DISCLOSURE

The PRI recommends the Board encourage best practice for reporting on ESG-related information for all issuers. The diversity of municipal issuers can lead to different exposure to ESG risks, as well as opportunities, such as those related to the transition to a net zero carbon economy. However, significant variability among issuers should not be a barrier to substantive ESG disclosure.

PRI signatories report that a lack of consistent, comparable data is the largest barrier to incorporation of climate and other ESG factors in investment practices.⁴ Given MSRB's role in market regulation, the Board establishing a recommended baseline of information for all issuers to disclose in a standardized way would help investors better compare risks between issuers.

For climate disclosure specifically, MSRB cites the recommendations of the Government Finance Officers Association (GFOA) which identify the main concerns and considerations on climate disclosure and includes a checklist of disclosures to consider for issuers.⁵ The PRI has endorsed the recommendations of the Taskforce on Climate Related Financial Disclosure (TCFD).⁶ TCFD can guide the Board on how issuers should structure disclosures in order to meet the information needs detailed by the GFOA's analysis. The foundation of TCFD remains flexible in a way that provides issuers a principles-based framework to address the most important climate-related information in a standard format. This could allow issuers to provide "TCFD-aligned disclosures", which signals to the market that they have assessed climate-related risks.

INCORPORATION OF ESG INTO EMMA DATABASE

MSRB should continue to build out ESG information availability across the EMMA database to ensure information is presented in a consistent and comparable manner.

The PRI commends the Board's recent update to the EMMA database to incorporate an optional ESG category in the description of offerings. However, the inclusion of an optional "ESG Type" classification could be interpreted as requiring issuers only to consider and/or disclose ESG factors for labelled securities. MSRB should clarify that all issuers should be considering and disclosing relevant ESG factors for all securities, not just those seeking to be classified as labelled products. The Board should further consider how to make relevant ESG information accessible in issuers' regular disclosures via the EMMA database.

⁴ <https://www.unpri.org/pri-blog/us-pri-signatories-support-mandatory-climate-and-esg-disclosure/7849.article>

⁵ <https://www.gfoa.org/materials/esg-disclosure>

⁶ <https://www.fsb-tcfid.org/>

CLARIFICATION OF LABELLED PRODUCTS

MSRB should issue guidance regarding “best practices” to accompany any classification or labelling of products in order to promote consistent, reliable and more comparable assessments of financial instruments.

Adding a green, social or other sustainable label to a financial product, such as a municipal debt security, may help attract investors and lead to positive environmental or social outcomes. However, the Board should be cautious of the potential for such labels to potentially mislead investors and other market participants, as financial products are often self-labelled using non-public, inconsistent, or unreliable criteria. This may even give rise to greenwashing.

The Board should consider ways to promote standardization for labelled bonds and disclosure of relevant information when issuers make claims related to ESG considerations. The Board could suggest that issuers fully explain the qualifications of their offering – including use of proceeds – to classify as an “ESG” labelled security. A separate disclosure would allow for easy comparability of those making claims of alignment with specific labels.

The Board should also consider the risks to investors from bonds that are “self labeled” without an external review. Self-labeled bonds could lack significant information necessary to protect investors from misrepresentation, whereas an external review opining that a bond aligns with accepted frameworks provides some security for investors. Relatedly, the Board should be careful that its “ESG Type” label is not seen as a tacit endorsement or verification of the product claims.

While the Climate Bonds Initiative (CBI) and International Capital Market Association (ICMA) have both developed usable guidance for issuers, MSRB has a role to play in monitoring additional standards and labelling criteria established by the market for inclusion in the EMMA database, adapting its system in lock step with market practice.

Further work should be done to educate users of the database as to what “ESG Type” classification means, and for issuers on how this feature is meant to be used. Providing clarification of any criteria would likely also increase the usage of the “ESG Type” categorization.

SUPPORT ALIGNMENT AND INTEROPERABILITY

Globally, incorporation of ESG factors continues to accelerate across securities markets. Investor demand continues to push markets to more quickly and fully incorporate environmental, social and governance considerations. The Board should look to other markets for best practice on ESG incorporation, disclosure and labelling, taking on board lessons learned but also seeking to coordinate efforts. Global alignment on ESG incorporation provides market efficiencies, and reduces risks for investors. Further, MSRB leading global practice can make the US an even more desirable market for global investors increasingly requiring standardized ESG information.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the MSRB to consider environmental, social and governance practices in the municipal securities market in the US.

Any question or comments can be sent to policy@unpri.org.