PIMCO

Via Electronic Submission

March 4, 2022

Mr. Ronald W. Smith, Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW, Suite 1000
Washington, DC 20005

Re: MSRB Notice 2021-17: Request for Information on ESG Practices in the Municipal Securities Market

Dear Mr. Smith:

Thank you for soliciting market input on ESG practices in the municipal securities market. We write to you from the perspective of one of the largest active fixed income managers in the world, managing $2.2 trillion as of December 31, 2021 across nearly all sectors of the fixed income market, on behalf of millions of individuals and thousands of institutions globally.[1] In all cases, we function in a fiduciary capacity, striving to maximize our clients' return objectives consistent with their investment guidelines, specific mandates, and risk tolerances.

We find the MSRB's interest in this topic a timely one, as attention to ESG-related issues has increased substantially in recent years. The number of Green, Social, and Sustainability (GSS)-labeled bonds continues to grow, equaling 9.7% of issuance in the municipal market in 2021, up from 5.5% in 2020.[2] Additionally, as we noted in our June 9, 2021 letter to the SEC on climate change disclosures,[3] over the last decade we have observed a dramatic increase in the focus on climate issues from our clients. This increase in attention incorporates both an interest in dedicated sustainability mandates and a desire for a better understanding of how climate risks factor into our broader investment process.

In addition to significant concern for climate and other environmental mandates, investor interest in social issues has grown substantially since the onset of the COVID-19 pandemic and the global protests over issues of racial justice and equity.

Determining what disclosures on developing ESG risks and GSS-labeled bonds should look like, as well as which disclosures are material to investors, is important. We welcome efforts to increase the quality and availability of disclosure on these topics. At the same time, we recognize that the municipal market is distinct from other asset classes and fixed income sectors given the significant number and diversity of issuers, often-scarce resources available to issuers to produce such disclosure, and the public nature of most municipal issuers.

We do not seek to answer all the questions posed by the MSRB but, rather, we highlight what PIMCO views as the most important considerations from a large investor's perspective regarding ESG practices in the municipal market.

[1] https://www.pimco.com/en-us/our-firm

[2] S&P Global. U.S. Municipal Sustainable Debt Issuance Could Surpass $60 Billion in 2022. February 10, 2022. https://www.spglobal.com/ratings/en/research/articles/220210-u-s-municipal-sustainable-debt-issuance-could-surpass-60-billion-in-2022-12259605

[3] PIMCO's letter to SEC re: Public Input Welcomed on Climate Change Disclosures. June 9, 2021. https://www.sec.gov/comments/climate-disclosure/cll12-8901049-242138.pdf

They include:

1) **ESG is a broad umbrella term. Being more specific with language and focusing on specific factors would be most helpful.** E, S, and G cover a wide range of risk factors, some of which have historically been included in municipal credit analysis. Focusing on specific factors, such as climate risk or race/equity concerns, and assembling relevant guidance on those concerns, will be more useful than trying to regulate or provide guidance for all potential factors that fall under the broad umbrella of ESG. Additionally, it is important to clearly differentiate between ESG factors that relate to credit risk and those related to values-based or impact-oriented investing.

2) **Utilizing existing disclosure infrastructure will allow for the greatest participation by both issuers and investors.** The existing reporting structure – official statements and annual or event-driven continuing disclosure documents – can incorporate necessary ESG information. In this way, the need to focus on *how* issuers should disclose is eliminated, and instead resources can be devoted to providing guidelines on *what* should be included and how to support all issuers in generating the data for inclusion.

3) **A baseline of disclosure on climate risk should be established.** Recognizing the limited regulatory role of the MSRB and the SEC over municipal issuers, we acknowledge that mandatory disclosure of climate risk information may not be feasible. However, consistent with our belief that climate-related risks are largely material risks in most cases, we believe that guidelines establishing a minimum baseline of climate risk disclosure would be prudent. Additionally, we suggest the MSRB consider working with the SEC to amend Rule 15c2-12 to mandate the inclusion of material climate-related information in continuing disclosure.

4) **A federal repository for ESG data, in particular climate data, would be welcomed.** Given the breadth and diversity of the municipal market, one roadblock to issuers providing information about climate risks to investors is data availability. We welcome any efforts the MSRB could make to help issuers obtain and utilize relevant environmental and other ESG data, including potentially convening other federal agencies.

5) **Independent reviews for GSS-labeled bonds can increase transparency.** At PIMCO, we conduct our own internal analysis of GSS-labeled bonds to evaluate their suitability for our strategies, regardless of whether the bonds have an independent review or are self-labeled.[4] While more municipal issuers continue to pursue independent certification/second opinions,[5] a significant number of municipal issuers self-label bonds under GSS labels. Independent reviews can provide additional transparency.

6) **A direct link between bond use of proceeds and UN SDGs is helpful.** We encourage issuers to formally align their use of proceeds with the UN Sustainable Development Goals (SDGs) where suitable, even if not pursuing a specific label. Many municipal issuers are issuing bonds for purposes that could align with the SDGs and this can be a way to provide standardization across the industry.

[4] PIMCO. December 2020. PIMCO's Best Practice Guidance for Sustainable Bond Issuance.

[5] S&P Global, *U.S. Municipal Sustainable Debt.*

We elaborate on each of these points below.

1) ESG is a broad umbrella term. Being more specific with language and focusing on specific factors would be more helpful.

Instead of attempting to find consensus over what constitutes all ESG risk factors, we would suggest beginning with those factors that are already well-established in the issuer and investor community – and yet are under-reported by issuers in disclosure. The most logical starting point would be to focus on climate risk given the SEC's attention to the topic as well as existing well-developed infrastructure and established consensus on its potential impact on an issuer's credit quality (see #3 for more on our climate risk recommendations).

Race/equity and other human capital and human rights concerns have also begun to receive significant focus and represent an area that could benefit from more attention and analysis.[6] Consensus has not yet been reached on which metrics to focus on here, and we expect research and the availability of data in this area will evolve over time. At a minimum, encouraging issuers to report on the existence of race/equity-related settlements or judgment bonds or federal consent decrees would be helpful.

Many other ESG risks have historically been part of municipal credit analysis and disclosure frameworks and are already broadly disclosed by issuers or by third-party sources, such as the U.S. Census Bureau. Examples of these include demographic information such as population trends, auditor concerns about management, or funding of pensions and other post-employment benefits.

Additionally, it is important to clearly differentiate between ESG factors that relate to credit risk and those related to values-based or impact-oriented investing, which could include GSS-labeled bonds. While frequently grouped together in the same conversation, they involve different metrics which may have differing levels of materiality. Therefore, ESG risks and GSS-labeled bonds should be treated as separate topics for regulation and for investigation by the MSRB. As we move forward, the MSRB can help advance the conversation around ESG risk factors and GSS-labeled bonds by being very clear in distinguishing between the two.

2) Utilizing existing disclosure infrastructure will allow for the greatest participation by both issuers and investors.

Given the size and diversity of the municipal market, we believe that utilizing the existing disclosure infrastructure – with issuers providing disclosure to investors primarily through official statements and continuing disclosure uploaded to EMMA – is the most efficient way to reach the largest number of investors and obtain the greatest participation from issuers. Issuers are already accustomed to providing financial and other material information to investors in this way. Incorporating ESG disclosure into these existing documents maintains consistency with current practice.

Where issuers may have specific ESG disclosure to share (e.g., a climate action plan), adding an additional ESG Data section on the EMMA Disclosure Documents page is one enhancement the MSRB could make to allow for ease in finding these documents and differentiating them from other disclosure documents.

3) A baseline of disclosure on climate risk should be established.

Like many others, we believe climate risks often pose a material financial risk, and as such can have a discernible impact on the overall credit quality of an issuer and should be disclosed. We recognize that the MSRB cannot mandate that municipal issuers disclose these risks. We believe, however, that creating guidelines for what issuers

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[6] One example is through efforts by the Public Finance Initiative, with funding from the Robert Wood Johnson Foundation, to develop an equity framework for inclusion of racial equity in municipal credit analysis.

should disclose and guidance on the materiality of these risks will help establish an expectation that these items be incorporated into disclosure. Additionally, we would suggest that the MSRB consider working with the SEC to explore an amendment to Rule 15c2-12 to mandate the inclusion of climate-related risks in continuing disclosure.

Within the municipal market, we currently view physical climate risk as being more impactful than fossil fuel transition risk, though we note transition risk could have a material impact on specific issuers, such as a community with tax base or employment concentration in a large fossil fuel provider. For physical climate risk, useful information to receive in issuer disclosures would include items such as the following:

- The types of climate/environmental hazards an issuer is exposed to
- The significance of this exposure, such as estimated property values at risk or specific assets/areas at risk
- The issuer's planned response to identified climate hazards, including mitigation or adaptation work being contemplated
- Whether and how future climate risk is incorporated into capital planning, zoning, and other planning initiatives, where applicable
- Financial, consultative, and internal resources to draw on to perform the work, including intergovernmental support and staff resources devoted to climate/sustainability concerns
- Expected costs of adaptation and potential funding sources

We expect transition risk to become a larger concern over time everywhere, though more rapidly in specific states with stronger renewable portfolio standards or net zero targets. While it is less common currently for public sector issuers to disclose greenhouse gas (GHG) emissions,[7] we believe that these disclosures will only grow in importance and should be encouraged, in particular by municipal issuers who are more enterprise-like and/or relatively large emitters, such as public power, airports, ports, and nonprofit healthcare facilities. For municipal sectors that are more enterprise-like, disclosure can more easily conform to existing frameworks, such as the Task Force on Climate-related Financial Disclosures (TCFD). We also believe that an accompanying explanation and discussion about the issuer's GHG reduction objectives, including specific targets, plans, and progress towards meeting objectives, would be helpful for investors, particularly in cities or states where affirmative commitments to reduce GHGs by a certain date have been made.

Partnerships with organizations, such as CDP (formerly called the Carbon Disclosure Project) or the TCFD could be useful in helping to develop guidelines on what to include. Additionally, we believe that the nature of such disclosure should be routinely reassessed to ensure that the scope of the disclosure evolves as the capability of issuers to produce disclosures improves and as the municipal market's understanding of climate risk and potential regulatory changes evolves.

4) A federal repository for ESG data, in particular climate risk data, would be welcomed.

We recognize that not all issuers have the same ability to assess their exposure to climate risks, nor to develop a comprehensive mitigation and adaptation plan to respond to those risks. A comprehensive repository of environmental risk data could help even the playing field among investors who have the means to buy such data, with those that do not, as well as issuers that have the means to purchase or produce data and consulting work versus those that do not.

Currently, the largest, most robust, and thorough repository of data for ESG purposes is the U.S. Census Bureau, which provides a wealth of data for understanding a variety of, though not all, social risks. Similar data infrastructure on the environmental side is lacking despite federal agencies, such as NOAA, FEMA, the U.S. Forest Service, and Drought.gov, being sources of data that are widely utilized by third-party private climate data

[7] EPA, Center for Corporate Climate Leadership, *Scope 1 and Scope 2 Inventory Guidance* (last updated Dec. 14, 2020), https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance.

providers. We would welcome the MSRB's aid in making climate and other material environmental data more accessible, available, and centralized, similar to what the U.S. Census Bureau provides.

5) Independent reviews for GSS-labeled bonds can increase transparency.

We have found that labeled bonds that have independent reviews typically provide the most GSS information for investors, often following International Capital Markets Association (ICMA) principles and guidelines[8] or other frameworks, such as the Climate Bonds Initiative's Climate Bond Standard and Certification Scheme.[9] GSS-labeled bonds with independent reviews tend to offer the most transparency, information about use of proceeds, and post-issuance reporting to investors, and we see independent reviews as a best practice.

At the same time, we acknowledge that many municipal issuers self-label their bonds as Green, Social, or Sustainability, and we consider them for our ESG strategies as well, depending on their framework, potential impact, alignment with overall targets, and overall transparency. We conduct our own internal analysis of both self-labeled GSS bonds and those with external reviews to determine suitability for our strategies.

The amount of information provided with self-labeling can vary substantially, with some containing no more than a few paragraphs, and some presenting more robust frameworks akin to what might be seen with an independent review. In terms of benefits to issuers in pursuing an independent review, we have observed that self-labeled bonds typically trade similarly to bonds without any GSS label. In contrast, taxable bonds with independent reviews have seen a slight trading premium in some cases.

6) A direct link between bond use of proceeds and UN SDGs is helpful.

We also encourage issuers to formally align their use of proceeds with the UN Sustainable Development Goals where suitable, even if not pursuing a specific label. Many municipal issuers are issuing bonds for purposes that could align with the Sustainable Development Goals, and this can be a way to provide standardization across the industry.

Conclusion

We welcome the MSRB's input in pursuing guidance and standards around ESG practices for the municipal market and look forward to an ongoing dialogue with the MSRB on these issues. We would encourage the MSRB to make sure everyone continues to have a seat at the table, as it has done by seeking input from a variety of stakeholders with this recent request for information. Issuers, underwriters, financial advisors, bond counsels, rating agencies, and investors all have a role to play in furthering the development of more robust disclosure on these issues. Given the wide variability of size and function within the municipal market's issuer community, we would encourage continued outreach to a broad spectrum of issuer participants to ensure that any movement towards guidelines is practical and flexible enough for all issuers to be able to successfully comply.

One idea to formalize stakeholder engagement would be to form a stakeholder advisory council, which would provide a forum for representatives of all market participants to help develop guidelines for these important topics. Regardless, we appreciate the MSRB's focus on these issues and look forward to continued engagement.

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[8] International Capital Markets Association. *The Principles, Guidelines, and Handbooks.* Last accessed March 1, 2022. https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/

[9] Climate Bonds Initiative. *Climate Bonds Standard and Certification Scheme.* Last accessed March 1, 2022. https://www.climatebonds.net/standard

Sincerely,

David Hammer
Managing Director
Head of Municipal Bond Portfolio Management
PIMCO

cc: Mark Kim, Chief Executive Officer, MSRB
Patrick Brett, Chairman, MSRB