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Earth Day: Municipal Bond Climate Change Disclosure Update

Climate Change Disclosures are Growing in Importance, Writes BB&K's Mrunal Shah in PublicCEO

In recent years, bond investors have increasingly demanded information on environmental disclosure, including climate change, social and governance (ESG) disclosure. With such increased demand by bond investors, public agencies have also increasingly disclosed climate-related change and risks. However, no consistent framework exists for such disclosure. California's state leadership set out to learn more about this ever-evolving topic and tasked the California Debt & Investment Advisory Commission to conduct a study to learn more.

The Study's Findings
The study analyzed content in over 200 official statements of enterprise revenue bonds issued between 2016 and 2019 to understand how California's municipal bond issuers are disclosing the risks in climate change. The results of the Commission's study can be found in the "Climate Change Disclosure Amount California Enterprise Issuers." The study found that, despite growing expectations to report climate risk, most issuers in the study did not mention climate change in their disclosure documents. Robust disclosures were notably linked to issuance size and high-frequency issuers. Geography was also a major factor, finding coastal counties and urban counties tended to include more thorough disclosure than inland and rural areas. The Commission's report also found that, of the 39 counties in the report sample, 14 did not mention any disclosure of climate change.

Regulatory Focus
The Securities and Exchange Commission has increased its focus on ESG as it has increasingly become a priority for investors. On March 15, the SEC's Division of Corporate Finance invited public input on a number of ESG disclosure-related considerations in an effort to evaluate its current disclosure rules. While the Division of Corporate Finance does not govern municipal securities, its actions and guidelines could provide useful insight for municipal bond issuers. In a public statement issued in conjunction with the SEC's request for public input, Acting Chair of the SEC Division of Corporate Finance Allison Herren Lee stated "[s]ince 2010, investor demand for, and company disclosure of information about, climate change risks, impacts, and opportunities has grown dramatically…Consequently, questions arise about whether climate change disclosures adequately inform investors about known material risks, uncertainties, impacts, and opportunities, and whether greater consistency could be achieved."

Why Disclosure is Important
When offering securities to the public, municipalities have an obligation to disclose information so potential purchasers can make informed investment decisions. From California's fire-ravaged towns to Texas' devastating winter storms, some state municipalities are on the forefront of dramatic global climate change impacts.

In 2020 alone, the west coast was significantly impacted by wildfires, including five of the top 10 largest wildfires in California history. It is estimated the damage caused by the 2020 wildfire season will have a direct cost of over $20 billion, not including indirect costs such as insurance hikes and loss of revenue. According to the Dallas News, damages from the Texas freeze is estimated to have damages of approximately $155 billion due to crop losses, power outages, water disruption and infrastructure loss.

Although projected effects of climate change have received increased media attention in recent years, consideration of climate change in disclosure documents is a relatively new and evolving expectation. However, depending on the type of security being issued, such risks maybe material to potential investors. Municipal issuers should evaluate their current practice related to disclosure of climate risk to investors to ensure that such risks and uncertainties are being completely and accurately disclosed. Additionally, issuers should develop best practices for monitoring the ever-changing impacts of climate change and plan for disclosure of such risks for future issuances.

Municipal issuers should also be aware that disclosure of such risks may be utilized outside of the context of issuance of securities. According to the Commission's study, a climate change disclosure – or lack thereof – became the focus of litigation in 2018 by ExxonMobil against a group of California cities and counties that had filed suit against the company for future damages from sea-level rise and coastal flooding due to greenhouse gas emissions from fossil fuel products sold by the company. ExxonMobil countered that the public agency claims were not made in good faith because these climate-related issues were not included in the cities' and counties' bond disclosures. While litigation did not move forward, it prompted public agencies to review and disclose climate change risk in their offering documents.

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