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Here's One Way to Get the Municipal Bond Market to Come Clean on Climate Change Risks.

The SEC might consider offering issuers a grace period before cracking down, this firm suggests

As climate change continues to take a toll on the built environment in the United States, investors are often in the dark about its effects. State and local governments, which issue roughly \$500 billion of bonds each year, are being urged to be more proactive about addressing climate change, as MarketWatch has reported.

Now, a new proposal from a longtime muni-bond research firm offers a suggestion for [regulators focused on climate risks](#) and looking to encourage municipal issuers to be more upfront with buyers of their bonds.

The solution: “a Climate MCDC program that allows muni borrowers not making sufficient disclosure of their material credit vulnerabilities via climate change a short period to officially post the related information they possess,” wrote analysts at Municipal Market Analytics in a Nov. 22 report.

MCDC stands for “Municipal Continuing Disclosure Cooperation,” and it refers to a successful 2014 initiative of the U.S. Securities and Exchange Commission, which offered more favorable terms for any municipal bond issuer willing to voluntarily self-report earlier instances of being out of compliance with disclosure regulations.

As the Municipal Market Analytics report notes, “In the past month of the MCDC safe harbor window (December 2014), 30 municipal issuers filed their first notices of past technical (23) and monetary (7) defaults. Even considering the COVID-19 pandemic, December 2014 still holds the record for most monthly new impairments since the Great Recession.”

MMA President Thomas Doe has been vocal about his skepticism of the municipal bond market’s approach to pricing climate-change risk. In a series of interviews with MarketWatch in August, he called migration to the sunshine states of the U.S. “denial”: “you may be able to live there for a short period, but it’s not going to be a 20-year experience.”

Muni-bond defaults are scant: 0.10% compared to 2.25% of all corporate bonds, according to the Municipal Securities Rulemaking Board, but advocates of better disclosure, like Doe, say climate risk is very mispriced. It might take only one bad weather event and one Congress reluctant to keep bailing out states and locals for an issuer to have trouble paying its debts.

Few other public finance observers have been quite as hawkish, but many share some concern that state and local issuers aren’t being as candid about the climate risks they face as investors might want — whether deliberately, or unintentionally.

The Nov. 22 note echoed much of what Doe told MarketWatch last summer: to the extent that the

muni market needs discipline, it most likely won't come from investors, since market supply and demand are so out of whack.

"Investors urge issuers to disclose 'more and better information' about risks, but don't enforce true market discipline, the analysts wrote.

Yet, "Industry organizations representing issuers are encouraging voluntary disclosure with the hopes of avoiding a future regulatory mandate. But history suggests that efforts to obtain new voluntary disclosures may not generate the participation warranted and ultimately lead to a regulatory response."

MMA concludes its proposal by noting that there are plentiful, often free, tools for issuers to use to quantify their climate risk. The SEC would be well within its rights to review bond documents to see if they "adequately disclosed reasonably known material risks to investors;" and, more broadly, to "convey its disclosure expectations."

States are better-positioned to lead these efforts than local governments are, MMA writes, adding: "It is inefficient and not as credible for tens of thousands of local governments— varying in size, sophistication, and resources and many overlapping—to individually assess highly complex data, determine how their tax-bases, revenues, and operations could be impacted, develop resiliency plans, and make appropriate disclosures, all while fighting to retain or grow their respective allocations of local aid as their states decide what to pay for and where."

MarketWatch

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