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Muni Market's Regulator Is Seeking Standards for Disclosure on ESG Debt.

- **MSRB asks for feedback on how issuers disclose credit risk**
- **Government finance officers released best practices in 2021**

There's a big mess in MuniLand, and the Municipal Securities Rulemaking Board wants to clean it up.

The mess is "Environmental, Social and Governance" practices by municipal issuers, and the MSRB, the self-regulatory organization in charge of the $4 trillion market, wants feedback — from bankers to public officials to investors and the general public — about what borrowers disclose on how ESG relates to their bonds.

The MSRB put out its Request for Information in December, and said it wants comments by March 8. It's an issue that Mark Kim, the MSRB's chief executive officer, flagged back in September as ESG munis were headed for a banner year: Issuance of green debt alone, the largest part of the muni ESG segment, totaled a record $24.6 billion in 2021, data compiled by Bloomberg show. But one analysis last year found that borrowers don't disclose relevant data consistently or effectively, such as risks related to the environment.

The regulator's request for comment contains the word "standard" or a variation at least nine times. It also uses terms such as uniform and metrics. So you can see where this may be going — ultimately, the establishment of disclosure standards.

Right now, as is typical in the municipal market, everything is optional. The MSRB reminds readers that it is charged with enhancing both issuer and investor protection and "the overall fairness and efficiency of the municipal securities market." So the current state of affairs will never do, at least according to the MSRB.

Self-Styled Issuance

I blame green bonds for the regulatory interest in this topic. The securities are increasingly common in the U.S. corporate market, where investors are pushing for more sustainable debt. Municipal borrowers began offering them in 2013, when Massachusetts sold $100 million in self-styled green bonds to pay for improvements to water quality, energy efficiency and pollution control, according to the MSRB website.

Now, I always saw most munis as green bonds, used to improve the environment in some fashion. The key term in that description in the paragraph above was "self-styled." States and local governments seemed eager enough to slap the green label on certain bond issues, and when you'd ask them about it, about who decided what was a green bond, it turned out that they did. It was a marketing tool, and if certain investors were willing to go out of their way to buy a municipal bond labeled "green," well, terrific! There was no standard to it, no independent verification. At least, not at the beginning, and even now, not uniformly.

As the MSRB's request makes clear, that may be about to change.

"Many investors and other market participants are seeking ESG-related information beyond what historically has been provided to the market. In response, private vendors are offering ESG certification services." And you can stop right there. Once there's a multiplicity of sources for information, there's the possibility that some investors will get more or better information than the legally required disclosures in offering documents. The MSRB request lists five private vendors who currently certify green bonds, including Build America Mutual, Kestrel Verifiers and Sustainalytics.

And then toward the end of the request, the MSRB asks bluntly whether the ESG indicator from IHS Markit that it has incorporated on its EMMA website's new-issue calendar enhances market transparency. And then it asks, "What improvements could the MSRB make to the EMMA website regarding ESG-Related Disclosures, ESG-Labeled Bonds and other ESG-related information?"

Best Practices

The Government Finance Officers Association in 2021 released best practices concerning ESG disclosure, and best practices aren't just concocted overnight, so I asked them about it. Keep in mind that the MSRB in a footnote in its request quotes the GFOA as citing the impracticality of developing uniform metrics to gauge risks.

"One thing that stood out to us is the RFI at times tends to blur the bright line that exists between two things: 1. ESG disclosures on everyday bonds issued and 2. Designated Bonds (i.e. green or social bonds) which are designed to be issued for specific purposes," wrote Emily Swenson Brock, director of the GFOA's Federal Liaison Center, in an email. "We will do our best to clarify that bright line (by pointing to our best practices here) and provide the MSRB ideas on how the municipal bond industry can work together to advance issuer awareness and practice in ESG."

And Dave Erdman, Wisconsin's capital finance director and a member of the GFOA Debt Committee, said in an email, "Yes some metrics or standardization of criteria and requirements that must be met to have designated bond (such as green, social, etc) would be beneficial to all, in other words, everyone is playing the same game and aiming for the same fences when designating a bond, but do we really want to open the regulatory and reality door on standardization of disclosure language?"

It's clear that the age-old fight between the analysts who want more and issuers who already feel beleaguered by their demands is about to enter a new phase.

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