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Market Response to MSRB ESG Survey Shows Frustration.

The Municipal Securities Rulemaking Board's request for information on environmental, social and governance considerations has elicited irritation at the board's attempt to regulate ESG matters and illustrated the challenges the board faces in trying to decide what if any steps it might take related to ESG.

The comment period for the RFI ended on Tuesday and the challenges ahead will be even more pressing now that the board kicked off its fact-finding mission to much industry fervor. Initial comments indicated that standardized ESG disclosures would add quite the workload for issuers, as was previously indicated in the Government Finance Officers Association's best practices on ESG, a document the group touched on significantly in its own submission.

But the board collected a total of 36 submissions from issuers, individuals, and industry groups that outline clearly the limits the board faces.

"We all agree that a bright line exists in practice between (i) the ESG risk-based disclosures that relate to and have a nexus to all credits and obligations, (ii) the process designated/labeled bonds and (iii) the disclosures that relate to and are requested by investors for such designated/labeled bonds," said the Disclosure Industry Working Group's joint letter, signed by the Securities Industry and Financial Markets Association, Bond Dealers of America, National Association of Municipal Advisors, National Association of Bond Lawyers, among many others, and led by the Government Finance Officers Association.

"It is important not to confuse or actively conflate these topics because each is different," the joint letter said.

Many of the letters the MSRB received note the fact that the board is responsible for regulating broker-dealers and municipal advisors and that any regulations attempting to add a disclosure burden or to establish materiality should be reserved for the Securities and Exchange Commission.

"The MSRB does not have the authority to determine materiality and the content of issuer disclosures and market participant preferred activity, outside of the MSRB's own rules over broker-dealers and municipal advisors," the DIG letter said.

"While the board is charged with protecting issuers and investors, that authority is limited to the regulation of municipal securities dealers and municipal advisors, neither of whom have control over issuer disclosure documents or issuer ESG designation practices," the Bond Dealers of America letter said. "This lack of authority means there is no meaningful action the MSRB could take to address any hypothetical issues associated with issuer ESG designations, so the purpose of the notice is unclear."

But there are some things that respondents feel the board can do to help ESG investments in the muni market to become more transparent.

“There are many areas where the MSRB can contribute to the ESG conversation and where their authority rests,” the DIG joint letter said. “The primary contribution would be to improve EMMA and allow for disclosures to be readily entered and accessed,” the DIG letter said. “We cannot emphasize enough our consensus on this point and the need for general EMMA improvements to occur.”

Respondents were also quick to point out that if regulators want to get serious about ESG, referring to concepts generally is probably not going to win over the muni market.

“The RFI continues to reference these types of issuances as “ESG-Labeled Bonds” which is a misnomer as there is presently no such label,” the GFOA letter said. But that term is used throughout the market generally to discuss the topic of green or social bonds. Respondents urge the board these matters are disclosed and discussed separately.

“It is imperative to ensure that the topics of designated bonds, disclosures related to designated bonds, and general disclosure of ESG factors are kept separate,” the GFOA letter said. “Going forward, these discussions should be held separately from one another since they are about two very different concepts.”

Many of the issuer respondents disclose some information to credit ratings agencies, as the information provided often doesn’t differ much from what is provided in offering documents and does have a material effect on ratings. But when it comes to bond designations, some feel that a third-party opinion doesn’t matter, given how quickly the market for ESG investments is changing.

The New York City Housing Development Corporation, an issuer of both green and social bonds, doesn’t feel the need to get a third-party opinion on its bond designations because “it is not necessary to market HDC’s bonds and the market is constantly evolving,” Ellen Duffy, executive vice president of debt issuance and finance at the New York Housing Development Corporation said in a letter.

“Also, issuers do not see any pricing benefit of marketing ESG bonds to warrant this extra expense,” she added.

While the fact that bond designations don’t add any pricing benefit has been observed, others in the market are seeing it differently.

“Our members are beginning to see that in some cases, an ESG designation on a bond may affect pricing, suggesting that the designation is material information,” the BDA letter said.

But the NYCHDC does plan to provide annual updates connected with the disbursement of the proceeds for its Sustainable Development Bonds and the financing of mortgage loans, of which the reporting is completely separate from its obligations under its Continuing Disclosure Agreement.

The New Jersey Infrastructure Bank issued green bonds and like the NYCHDC, follows guidance from the International Capital Market Association. The Official Statement for any green bond issuance includes a use of proceeds section, but the NJIB has further suggestions for how issuers could handle disclosing this type of information.

“Municipal issuers could include a separate section in their Official Statement and other offering documents expressly devoted to ESG-Related Disclosures,” the NJIB letter said.

The letter even goes even further to suggest the MSRB take a larger role in disclosure, departing from many of the submissions where respondents felt that such a move would be overstepping its mandate. “Guidance from MSRB for content would be helpful to establish guidelines about what

should be reported."

The State of Florida Division of Bond Finance has not issued any designated bonds but agrees that some ESG-related information should be included in offering documents, as they include an "environmental risk factors" disclosure in addition to an "information technology security" disclosure. But these weren't considered as part of the ESG movement when Florida began to include them in offering documents.

"Municipal issuers have customarily provided this kind of information long before it was categorized as 'Governance' or 'Social' within the ESG moniker," said Ben Watkins, director of bond finance for the State of Florida in his letter.

"We do not feel that rearranging or renaming sections of offering documents as 'ESG' is necessary to meet the information needs of investors," he added. "If the relevant information disclosure information is included in a rational order and easy to follow, it should not require a label for investors to locate it within the offering document."

The RFI has offered the muni market an outlet to share ESG experiences, but what the board plans to do with this information is another question.

"MSRB has not established a roadmap for what it intends to do with the information gathered in this exercise or even possible options – perhaps because it has no legitimate role," the National Association and Educational Facilities Finance Authorities letter said. "The MSRB's considerable resources should be focused on regulatory issues relating to the regulated entities it oversees – not issuers/borrowers – and making enhancements and improvements to EMMA which all sectors of the public finance community have been imploring be undertaken for many years."

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