INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

March 8, 2022

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

Re: Request for Information on Environmental, Social and Governance (ESG) Practices in the Municipal Securities Market (2021-17)

Dear Mr. Smith:

The Investment Company Institute[1] appreciates the interest of the Municipal Securities Rulemaking Board (Board) in learning more about environmental, social and governance (ESG) practices in the municipal securities market. Perhaps one of the most significant recent global trends is the increasing interest in ESG matters. We provide the perspective of registered investment companies (funds), which are large investors in the municipal securities market. As of the third-quarter of 2021, US households held 29 percent of the $4.3 trillion in municipal securities through funds.

In the diverse and complex municipal securities market, ESG practices vary significantly and continue to evolve. Although municipal issuers must disclose material information, there is no "one size fits all" approach to issuer disclosure, including the type of information and level of detail provided. Nor is there a common approach to funds' investment strategies, including the information considered in a fund adviser's investment analysis. Given the diversity of the market and varied investment approaches by funds, there is no one answer to many of the questions raised in the request for information.

ESG-related investment practices are currently being shaped by the industry through, among other things, voluntary industry practices and market forces. These practices should be allowed to evolve before any regulatory actions are considered. As practices continue to evolve, we

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of $31.6 trillion in the United States, serving more than 100 million US shareholders, and $10.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

welcome additional opportunities to engage with the Board to help it stay informed about industry developments.

ESG practices vary significantly across the industry.

The municipal securities market is large, diverse, and complex. There are approximately 50,000 municipal securities issuers, including states, their political subdivisions (such as cities, towns, counties, and school districts), their agencies and instrumentalities (such as housing, health care, airport, port, and economic development authorities and agencies), as well as a variety of private entities that access the market through "conduit" financings (such as hospitals, senior living and continuing care retirement communities, and museums). Municipal securities offerings range in size from thousands of dollars to billions of dollars, and the payments of principal and interest on these securities come from a variety of sources, including general revenues, specific tax receipts, or revenues from a particular project.[2] Because of the diverse nature of this market, municipal issuer disclosures vary and depend on a wide variety of factors, including the size and location of the issuer and the type of securities offering.

Funds' considerations of ESG-related information for municipal securities also vary widely, depending on, among other things, a fund's investment objectives and strategies.[3] A fund's adviser might integrate ESG factors into its traditional investment process for the fund or use sustainable investing strategies, as summarized below.

> *Integration*. Some fund advisers integrate ESG factors into their traditional investment processes to the extent that they consider those factors to be financially material. Fund advisers typically seek to enhance performance, manage investment risks, and identify emerging investment risks and opportunities that face the issuers in which they invest. As a result, a fund's adviser may consider ESG factors along with other matters, such as interest rate risk, credit risk, duration, liquidity and the security's attributes (e.g., coupon and maturity). The extent to which an adviser integrates ESG factors into its investment process may vary adviser to adviser.
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> *Sustainable investing strategies*. Funds with sustainable investing strategies generally engage in one or a combination of exclusionary, inclusionary, or impact investing strategies.[4]

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[2] *See* SEC Chair Jay Clayton and Rebecca Olsen, Director of Office of Municipal Securities, *The Importance of Disclosure for our Municipal Markets* (May 4, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04.

[3] Likewise, funds' considerations of ESG-related characteristics of other types of securities vary.

[4] In 2020, more than 90 new ESG criteria funds—focused on climate and broader ESG criteria—were offered in the United States alone, representing about 16 percent of total US open-end fund launches that year. ESG criteria funds are determined based on ICI's application of predetermined rules and definitions to fund prospectus language. *See*

- An *exclusionary* investing strategy generally excludes certain issuers or sectors that do not meet certain sustainability criteria.
- An *inclusionary* investing strategy generally seeks to identify and invest primarily in issuers or sectors that reflect certain sustainability-related criteria or positively tilt the portfolio toward sustainability characteristics. Both approaches seek financial return.
- An *impact* investing strategy generally seeks to generate positive, measurable, reportable social and/or environmental impact alongside a financial return.[5]

The current regulatory framework requires disclosure of material ESG-related information.

A foundational and important component of the regulatory framework for municipal securities disclosure is that statements by municipal issuers are subject to the antifraud provisions of the federal securities laws.[6] Thus, a municipal issuer must disclose material information, including ESG-related material information. Given the diverse nature of the market, however, what may be considered to be material information with respect to one municipality or one municipal offering may not be material with respect to another municipality or its offerings. For example, while information related to the risk of rising sea levels may be material information with respect to a coastal community's securities offering, it may not be material for that of an inland community. Thus, although municipal issuers must disclose material information, there is no "one size fits all" approach to such disclosure.

ESG disclosure practices are evolving and should have the flexibility to continue to evolve.

The type of information and level of detail municipal issuers provide about ESG matters continue to evolve and are currently being shaped by the industry through, among other things, voluntary industry practices and market forces.[7] For instance, as with other disclosure topics, the

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ICI, *2021 Investment Company Fact Book*, *available at* https://www.ici.org/system/files/2021-05/2021_factbook.pdf.

[5] For more information and examples of these strategies, including funds using multiple sustainable investing approaches, see *Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction*, available at https://www.ici.org/system/files/attachments/20_ppr_esg_integration.pdf.

[6] In general, antifraud provisions prohibit the making of any untrue statement of material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. A fact is material if there is a substantial likelihood that the information would have been viewed by the reasonable investor as having significantly altered the total mix of information available. As the SEC has stated, whether a statement of a municipal issuer significantly alters the total mix of information for purposes of the antifraud provisions is determined based on the facts and circumstances in each instance. *See* SEC, *Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market: Staff Legal Bulletin No. 21 (OMS)* (Feb. 7, 2020), *available at* https://www.sec.gov/municipal/application-antifraud-provisions-staff-legal-bulletin-21 (Staff Legal Bulletin).

[7] Several industry groups are working on voluntary best practice recommendations or common approaches that can help shape disclosure practices. *See, e.g.*, National Federation of Municipal Analysts, Municipal Analysts Bulletin

information and level of detail that municipal issuers disclose may be influenced by investor demand and the ability of and cost to issuers of providing the information. Funds, as investors, seek robust, timely, and accurate issuer and security-specific information. A municipal issuer's access to financing and potentially the interest rates for its bonds may depend, in part, on the transparency and level of detail it provides.

The type of information provided also varies based on a range of factors, including the size and location of the issuer, type of debt issuance, and use of proceeds. For example, some municipal issuers may provide information related to environmental risks, such as historical weather events, flood zones, and insurance, among other things. A community located in an area prone to wildfires may provide information about earthquake risk, access to water, risk mitigation, and insurance, among other things. A municipal issuer seeking to finance a project with a social objective might disclose, depending on the objective, information relating to the number of children educated at a local school (access to education), clean water provided to economically disadvantaged areas (access to clean water), medical care provided to uninsured or low-income citizens (access to healthcare), or housing availability (access to affordable housing). It may also disclose the issuer's desired outcomes and measurement methods that are being utilized related to the financing project.

The relevance of ESG-related information to a fund depends on, among other things, the fund's investment objectives and strategies and the fund adviser's investment process. In general, material risks to the creditworthiness of a municipal issuer, whether or not they are ESG-related, is important information for funds investing in municipal securities. A fund that integrates ESG factors into the investment process may consider ESG-related information, such as climate change-related risks, along with other information, such as interest rate risk and liquidity.

Some funds may have an investment strategy to invest in securities whose proceeds, in the fund adviser's opinion, provide positive environmental and social benefits. In that circumstance, the fund's adviser might consider data and information relating to the bond's objective, such as access to education, clean water, healthcare or affordable housing as noted above.[8]

(Feb. 2022), *available at* https://www.nfma.org/assets/documents/bulletins/vol32no1.pdf (stating plans to release a paper on Green Bond disclosure); Government Finance Officers Association's best practices, *available at* https://www.gfoa.org/best-practices/debt-best-practices, and International Capital Market Association's *The Green Bond Principles, available at* https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-140621.pdf and *The Social Bond Principles*, *available at* https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf.

[8] Fund advisers use information from a variety of sources, including municipal issuers, third-party vendors, and published reports, as part of their own proprietary investment analysis, and may access municipal securities data and disclosure documents through the Board's Electronic Municipal Market Access (EMMA) website. The extent to which a fund adviser considers any of the information in its investment analysis, including, for example, an independent certification of a green or social bond, varies. For example, based on a fund adviser's proprietary analysis, it may determine that a bond meets its environmental criteria, regardless of whether it has an independent

Like all investors, funds benefit from broad and deep disclosures by municipal issuers and generally seek as much data and information about an offering as possible. The overall market benefits from robust disclosure as well. For example, when issuer disclosure includes measurement parameters for related projects, investors can better evaluate an issuer's follow-through in connection with those parameters.

Industry practices should be given the time and flexibility to evolve before any regulatory actions are considered. We note that the Securities and Exchange Commission (SEC) plans to propose new disclosure rules for public companies relating to climate change, human diversity, and board diversity.[9] The SEC's expected proposals for public companies follow years of evolving disclosure practices and use of voluntary standards, which may inform its considerations in connection with any proposed regulatory requirements.[10] The municipal securities market should follow a similar iterative process in this complex arena, with learning evolving through voluntary efforts, before any regulatory actions are considered.[11] Due in part to its fragmented and diverse nature, practices in the municipal securities market, are at a much earlier stage of development.[12]

As practices continue to evolve, we welcome additional opportunities to engage with the Board to help it stay informed about industry developments.

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certification. Disclosure by the municipal issuer enables the issuer to provide context regarding any ESG-related matters, such as risk mitigation steps, that may not be included in third-party vendor reports.

[9] *See* SEC Agency Rule List, Fall 2021, *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=F93DDA75B0D952E153B7019FC53F68D720E4F59FC01A0970832F3257162E20C7F1A9A0711058A0E670BDD754797D30C59BC4.

[10] *See, e.g.*, Task Force on Climate-related Financial Disclosures, *available at* https://www.fsb-tcfd.org/, and the Value Reporting Board's SASB standards, *available at* https://www.sasb.org/.

[11] In the absence of a statutory scheme for municipal securities registration and on-going reporting requirements for municipal issuers, the SEC's investor protection efforts in the municipal securities market is accomplished primarily through regulation of broker-dealers and municipal securities dealers, including through rule 15c2-12 under the Securities Exchange Act of 1934, SEC interpretations, enforcement of the antifraud provisions of the federal securities laws, and SEC oversight of the Board. *See* Staff Legal Bulletin, *supra* n. 6.

[12] We note that practices in the municipal securities market also may be influenced by practices in the public company securities market. Although not all of the disclosures that may be mandated by the SEC for public companies may be pertinent in the municipal securities markets, other important topics, including the materiality of ESG-related information, are likely to be addressed in the SEC's rulemakings and could help inform disclosure considerations in the municipal securities context.

We look forward to continuing this dialogue with the Board on this important topic. In the meantime, if you have any questions, please feel free to contact me at (202) 218-3563 or Annette Capretta, Associate General Counsel, at (202) 371-5436.

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue
Deputy General Counsel—Securities Regulation

cc: Mark T. Kim, CEO
Municipal Securities Rulemaking Board

Ernesto Lanza, Acting Director
Office of Municipal Securities
Securities and Exchange Commission