

## **Request for Information on Environmental, Social and Governance (ESG) Practices in the Municipal Securities Market**

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- (1) Are there any ESG-related factors that could pose a systemic risk to the municipal securities market? If so, how might the MSRB approach such systemic risks from a regulatory perspective? Are there non-regulatory approaches the MSRB could take that would advance issuer protection, investor protection, and the overall fairness and efficiency of the market?**

*The number one systemic risk to the municipal securities market is “greenwash” defined as the loss of market confidence due to the lack of evidence-based verification of specific conformance to self-declared requirements, accepted industry standards or compliance with official government regulations for pre- as well as post-issuance of Muni ESG Bonds.*

*From a regulatory perspective, a certain level of transparency must be required. For example, the sector criteria (via self-declared, third-party program, stated taxonomy – National (e.g., Canada), Regional (e.g., EU), or International (e.g., CBI or ISO 14030-3 – soon to be released) should be clearly stated and if conformance has been truly 3<sup>rd</sup>-party verified to accepted international assurance standards (e.g., ISAE 3000, ISO 14030-4) by an accredited validation/verification body or licensed accounting firm. It is important to realize that CBI’s (Climate Bond Standard) verifiers are “approved” by a small non-profit and not accredited by an international assurance organization that assesses competency, qualifications, and professional due care or a regulatory agency that assesses an auditing firm’s ability to meet minimum registration requirements to provide public assurance services. Because of the potential complexities of ESG-related bonds, any municipality that fails to comply with specified disclosure requirements should be allowed to publicly explain why (Comply or Explain doctrine – similar to Europe).*

*From a non-regulatory standpoint, MSRB can start by issuing specific voluntary guidance and guidelines as to best practices when issuing a ESG Muni Bonds. Once best practices are identified, MSRB could assess the evidence for which best practices are or not being followed as disclosed via the POS and/or Final Offering Document on EMMA (see question 4 and 7). The results could be posted via a simple assessment matrix (core elements of the ESG bond Principles vs. alignment with Best practices with citations to specific evidence) on EMMA or a separate Website. The assessment matrix could include core elements of ICMA’s bond Principles in columns and corresponding best practices in rows with citations to specific evidence supporting the level of alignment. If MSRB does not have the resources to conduct these assessments, it could be done by 2<sup>nd</sup>-party external reviewers or 3<sup>rd</sup>-party verifiers. Any issuer who opts out of having an external review, the bond assessment matrix would state “Not Conducted” for the external review attributes.*

*Because of the voluntary (non-binding nature) of this approach, it would require posting of both pre- as well as post-issuance assessment matrices. This ensure that the stated pre-issuance intent is followed-up by post-issuance action that is verified or publicly stated “Not Conducted.” In the rare event that disclosure may involve confidential information, the issuer would be given a chance to explain.*

- (2) There are a number of organizations establishing voluntary standards for the issuance of ESG-Labeled Bonds, such as the ICMA and CBI. Does the availability of these voluntary, market-based standards provide adequate guidance for issuers and transparency for investors in the municipal securities market? If not, what additional guidance or transparency do you believe are warranted with respect to ESG-Labeled Bonds?**

*The ICMA ESG-bond Principles has been a great help in providing insight into best practices. However, they are Principles and not standardized requirements that can be independently confirmed or verified for conformance. The vast majority of second opinions that address alignment to ESG Principles are limited to the issuer's ESG bond framework documents – **NOT** that actual bond issuance. These types of external reviews assess intent, NOT actual evidence of conformance of a specific ESG bond issuance. Unfortunately, this is not understood by most stakeholders, including ESG investors in the ESG ecosystem.*

*Having been a co-author of the original Climate Bonds Standard 2.0, it was designed to be verifiable. The latest version 3.0 is now aligned with the Green Bond Principles. Although not of regulatory quality, CBI certification offers a great deal of credibility and transparency to sophisticated ESG investors – less so for retail ESG investors. For all its strengths, CBI certified bonds have some weaknesses. Climate Bonds are a subset of Green Bonds which in turn are a subset of ESG bonds. Thus, only a fraction of the ESG bond market is eligible for CBI certification. The newly released ISO 14030 series of green bond standards addresses multiple environmental objects, beside just climate. It also, by design, aligns well with the objectives of the EU's emerging green bond standard and Sustainable Financial Disclosure Regulations. Unlike CBI certification which relies on a handful of "approved verifiers" that are not formally accessed or accredited to any internationally accepted criteria, ISO 14030 follows internationally accepted criteria and a formal accreditation process. The focus, however, is limited to green bonds. The EU bases its environmental verification process on ISO 17020: Conformity assessment — Requirements for the operation of various types of bodies performing inspection.*

- (3) There are a number of industry-led initiatives underway intended to improve the quality of ESG-related information available in the municipal securities market. Does the availability of these voluntary, market-based initiatives enhance the ability of investors and other market participants to make informed decisions in the municipal securities market?**

*There are a few proprietary initiatives to provide quality ESG-related data in the municipal securities market. Even so, these data are not readily available – rather these vendors process public and private data into proprietary ESG performance scores. There are even fewer industry organization-led initiatives providing open-source access to quality ESG related data. Extremely little information is available that assesses the "quality" of these data. Basic information such as a clear citation and whether the information has been verified, scrubbed for errors (e.g., duplicates, outliers, etc.) is not offered on product web sites. Even though much of the data are from public sources (US Census, NOAA, and especially US EPA's EJScreen tool and database), the combined and checked data is not readily available. ESG scores can be*

*readily purchased, but it is very rare that the combined and QC'd databases are available for purchase. ESG "data" vendors typically charge access to its data platform or "engine." This allows clients to calculate their own geospatial KPI's (for given census tracks or Zip codes). Users typically never sees the actual data, just the analytical results.*

**(4) There are numerous vendors providing ESG data for the municipal securities market. Does unequal access to ESG data result in disparate impacts to investors and other market participants? Does competing ESG data create investor confusion? How could the MSRB use the EMMA website to reduce information asymmetry or investor confusion?**

*Here again, the vendors don't provide access to ESG data sets but rather to ESG scoring that is based on their proprietary data "engines." Obviously most retail investors can't afford to pay to access custom ESG scores, much less build their own data sets – even though much of the data are publicly available. With that said, there are some very good publicly available ESG datasets and tools such as EPA EJScreen. Not only is the tool easy to use but all the QC'd data sets are available for free download.*

*In my opinion, the real reason for ESG investor confusion is not unequal access to data but rather the inconsistencies in ESG vendor scoring. The correlation between bond credit scoring is .99 whereas the correlation between major providers of ESG score is .3.<sup>1</sup> In addition, most ESG data and resulting scores focus on ESG risks to the bond investment. However, most ESG investors value a score that includes "double materiality" (ESG risks to the bond and the bond's ESG impact on planet and people – "Do no significant harm"). There is no easy solution to this confusion because assessing ESG attributes is hard – much harder the assessing credit ratings.*

*As outlined in the response to question (1), at a minimum MSRB can answer key questions focused on the quality and credibility of ESG muni bonds. Such as: Is there a publicly available ESG bond framework document that explains the pre-issuance alignment with the ICMA family of ESG bond principles? Is there a link to this document? Has this document been externally reviewed for alignment to ICMA principles? [Remember most second opinions assess the bond framework – NOT the ESG bond]. Has each ESG labeled bond been externally reviewed against the framework and/or independently verified against internationally accepted standards, pre- and post-issuance reviews? Is there an annual impact reporting?*

**(5) Does the availability of ESG-related information (or lack thereof) in other financial markets directly or indirectly influence the functioning of the municipal market? If so, how? For example, when evaluating competing investment opportunities, do taxable ESG investors expect the same timeliness and quality of ESG related information for a municipal issuer as for a corporate issuer? And how might the differing expectations of different classes of investors (e.g., foreign versus domestic; retail versus institutional; or tax-exempt versus taxable) regarding ESG-related information affect pricing, underwriting, trading, and other market activities?**

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<sup>1</sup> The Inconsistency of ESG Ratings: Implications for Investors, Eco-Business, Feb. 17, 2020. [The inconsistency of ESG ratings: Implications for investors | Opinion | Eco-Business | Asia Pacific](#)

No. The municipal bond market will continue selling non-labeled and labeled ESG bonds as well as the variations and to submarkets. However, misrepresentations (green and social washing) will continue and grow until there is clear regulatory guidance and, as necessary, regulations to ensure regulatory quality ESG-related information is available to all investors who feel it is needed. Since there is no formal enforcement or real threat of litigation, market makers probably feel the current “wild west” situation is working well.

**(6) The MSRB recently incorporated an ESG indicator from an independent data vendor, IHS Markit, into the New Issue Calendar shown on the EMMA website. This ESG indicator denotes when an issuer has self-labeled a bond issue as green, social, or sustainable, or if the issuer includes an independent ESG certification as part of the offering document. Does making this ESG indicator available on the EMMA website enhance market transparency regarding ESG-Labeled Bonds? Specifically, is it valuable to investors, municipal issuers or other market participants?**

*Yes – but it is just a start. How reliable is the certification? Is it based on a truly independent verification (following professional auditing or verification codes of conduct)? Does it answer all the market-based questions presented in the response to question (4)? Having a comprehensive assessment matrix with citations to evidence as described in the response to question (1) would be better than presenting just one, somewhat ambiguous, indicator.*

**(7) What improvements could the MSRB make to the EMMA website regarding ESG-Related Disclosures, ESG-Labeled Bonds and other ESG-related information? Which improvements to the EMMA website would most enhance access for investors and other market participants to ESG-related information? Which improvements to the EMMA website would most enhance the fairness and efficiency of the municipal market?**

*As described in response to question (1), MRSB could identify best practices to provide ESG investors with an assessment matrix pointing to the available ESG related information (e.g., on-line access to ESG bond framework documents) and independent assurance (external reviews) of voluntary alignment with ESG bond principles and conformance with existing and future ESG related standards (e.g., ISO 14030 parts 1 to 4) – for the framework documents and the POS.*

*Unfortunately, it appears some Muni ESG bond issuers are pointing to statements from MSRB to justify that no such assurance can be given to investors! The following was taken from a recent (Dated February 17, 2022) POS:*

***“In a press release ‘New EMMA Feature Helps Investors Identify Green, Social, Climate and Sustainable Bond Investments,’ dated October 25, 2021, the Municipal Securities Rulemaking Board MSRB CEO Mark Kim stated ‘...there is no universally accepted [environmental, social and governance (ESG)] standard or definition on labeling an ESG security in the municipal market...’ No assurance can be given that a clear definition will develop over time, or that, if developed, will include the program to be financed with the proceeds of the Offered Bonds. Accordingly, no assurance is or can be given to investors that any uses***

**of the Offered Bond will meet investor expectations regarding ‘social’ or other equivalently labeled performance objectives”<sup>2</sup>**

*Having spoken to Mr. Kim regarding his green bond experiences while he was at DC Water, I do not think he meant to take Third-Party assurance off-the-table as suggested by the above POS excerpt. On the contrary, Mr. Kim seemed to hold external assurance in high regard as evidenced by his quote to the Climate Bond Initiative’s Sean Kidney regarding DC water’s 2014 green bond: “It was a no-brainer to do a second opinion. To us, not having one is really equivalent to saying you would consider going to market with unaudited financials!”<sup>3</sup>*

*This apparent confusion over the lack of standards as well as assurance being best practice for ESG Muni investors must be addressed by MRSB. If it goes unaddressed, why is MSRBB even bothering to request information when according to New York Mortgage Agency’s preliminary official bond statement – MSRBB has already decided on important issues such as 3<sup>rd</sup> party assurance or the ability to develop standardized definitions?*

**(8) Is there any additional information that you would like to share with the MSRBB regarding any other ESG-related activities or trends in the municipal securities market?**

*The U.S. government is very far behind other parts of the world when it comes to developing a regulatory framework for dealing with green and other ESG-related bonds. Because of this lack of leadership, U.S. municipalities and government supported entities feel they must hire foreign entities to conduct 2<sup>nd</sup> opinions or provide advisory services. It is time the U.S started to provide leadership in the fastest growing financial investment trend that is not going away.*

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<sup>2</sup> [State of New York Mortgage Agency \(bondlink-cdn.com\)](https://www.bondlink-cdn.com), Feb 17, 2022

<sup>3</sup> [Microsoft Word - DC Water case study - final.docx \(climatebonds.net\)](https://climatebonds.net)