ESG 201: Practical Implications of Environmental, Social and Governance (ESG) Analysis in the Municipal Securities Markets

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1. INTRODUCTION AND PURPOSE.

This panel will take a deeper look at the effects of incorporating Environmental, Social and Governance (ESG) factors in credit analysis and investing in the municipal securities market. The panelists will discuss issues from "labeled" bonds to the incorporation of ESG criteria in traditional ratings analysis, and will address practical approaches to the legal considerations surrounding ESG disclosure in primary offerings and continuing disclosure. Participants will also hear the perspectives of representatives from the issuer and rating agency communities on ESG in the municipal securities market. Topics for discussion will include drafting standard disclosure with ESG factors in mind, developing ESG-specific risk factor disclosures, tools to diligence ESG disclosures, and industry accepted frameworks for disclosure. The panel will also touch on the SEC's proposed rules on climate change disclosures for public companies and review the latest regulatory moves in the ESG space.

2. BACKGROUND AND FRAMEWORK

   a. In 2022, the municipal securities market saw continued growth in the ways in which the term "ESG" inserts itself into a municipal bond offering, from "labeled" bonds to the incorporation of ESG factors into ratings analysis to expanded disclosure covering risk factors that are ESG-related.

   b. Moving into 2023, it appears that consideration of ESG-related risk factors is becoming – or has become – integrated into standard credit analysis, potentially raising the level of materiality of many ESG-related risks in all disclosure - regardless of whether the bonds are labeled. Key questions emerging in the ESG discussion for 2023 include:

      (1) How do the differences between the corporate securities and the municipal securities market play a role in ESG analysis and ESG-related credit decisions?

      (2) If a goal of the "labeled" bond programs is to push business practices in a particular direction (green, sustainable, socially-conscious etc.), does it make sense in a municipal bond space, where most issuers and/or projects can claim that their entire mission is to do social good? In contrast with the corporate space, does the label really further this agenda in the municipal space? And assuming that municipal/public sector credits generally score high on "Governance" and

most of what they do is "Social" and/or "Environmental" does a label really matter?

(3) Assuming this statement of goals for labeled bonds, how does this compare to or contrast with the goal of integrating ESG analysis into traditional financial risk and credit rating analysis?

c. U.S. Securities and Exchange Commission

i. Regulatory Activities

(1) Over the past year, SEC regulatory activities related to ESG considerations ramped up, particularly in the area of climate-related disclosures. (See https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities.)

(2) Proposed rules (the "Proposed Rules") on corporate disclosures relating to climate change were released by the SEC in March 2022. (See https://www.sec.gov/rules/proposed/2022/33-11042.pdf (the "Proposing Release"))

(a) The Proposed Rules would require issuers of corporate securities to include specific information in their registration statements and annual reports about certain climate-related risks that are "reasonably likely to have a material impact on its business, results of operations, or financial condition." These proposed requirements specifically includes detailed information on greenhouse gas (GHG) emissions and other climate-related financial risks and climate-related financial metrics.

(b) The stated intent of the rulemaking is to provide "consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments."

(c) The initial comment period was extended to November 1, 2022. (A summary of comments can be found here: https://corpgov.law.harvard.edu/2022/11/23/review-of-comments-on-sec-climate-rulemaking/)

(d) The SEC is aiming for publication of final rules applicable to corporate securities markets later this spring (before May 2023). (https://www.cfodive.com/news/sec-aims-set-climate-risk-cybersecurity-rules-before-may-ESG-buybacks-SPACs/640553/)

(e) Much remains to be seen about how the corporate rulemaking will play out before there is a clear understanding of how these rules will affect disclosure in the municipal market. It is noted that the SEC's justifications for its rulemaking activity include an observed underlying shift in investor-driven demand for climate-related information, the growth of international attention to climate-related risk, and the entrance of third-party reporting and analysis frameworks. These would appear to be equally applicable to the municipal market. Considerations for municipal market participants should include:

(i) Because of the Tower Amendment, which prohibits the SEC and the Municipal Securities Rulemaking Board from requiring municipal securities issuers to submit information to them prior to the sale of securities, municipal disclosure has developed based on market practice rather than direct regulation and consideration of what is "material" to a reasonable investor in considering an investment decision. In the Proposing Release, the SEC stated that "Investors need information about climate-related risks…because climate-related risks have present financial consequences that investors in public companies consider in making investment and voting decisions." Although this statement specifically calls out "investors in public companies," given the direction the SEC has taken with these proposed rules, it is not likely to conclude that investors in municipal bonds are any less interested in climate-related risks than investors in public companies. The proposed corporate rules, therefore, provide a clear statement that the SEC considers climate-related risks to be "material" and the final rules should provide further insight into the SEC's perspective and a framework for developing municipal disclosure.

(ii) The Proposed Rules provide a framework for defining and disclosing climate-related risks and focuses on the ways in which these risks can affect a company's operations and its financial performance. Many of these may be applicable to entities that issue debt in the municipal markets, including, e.g., the impacts of more frequent or severe natural disasters; the impacts of changes regulation of carbon and GHG emissions; and the impacts of changes in consumer preferences (which, for general government, may translate to impacts of climate-related migration or other climate-related population shifts, or for municipal utilities, have impacts on consumer preference or demand for services).

(iii) The Proposed Rules would also expand the use of various climate-related metrics for reporting, and it is likely that those metrics will become more broadly used and more frequently required for operational and planning purposes. At some point, if those metrics are available, it is likely that municipal issuers will find that some of the metrics will have become "material" to a reasonable investor and will need to be disclosed, regardless of whether a specific rule requires it of municipal market participants.

(iv) In addition to requiring additional data, the Proposed Rules focus on providing greater consistency and comparability in disclosures and ensuring that disclosures include the information needed to understand and compare climate-related disclosures. The SEC notes in the Proposing Release that one of its concerns is the wide variation in the types of disclosures and the reliability and comparability of the information provided (this is no less true in the municipal market). Therefore, the Proposing Release expands the attention paid to disclosure of the "methodologies, data sources, assumptions and key parameters used to assess climate change risk."

(v) This is a good reminder to municipal market participants that as climate-related risks are incorporated into disclosure, the discussion and use of metrics needs to be consistent with good disclosure practices. This reinforces that municipal market participants should be sure that the disclosure provides the reader with the underlying information necessary to understand any climate-related metrics and key assumptions that can affect those metrics. It also underscores a need for consistency between climate-related disclosures and financial disclosures.

(vi) Therefore, regardless of the precise content of the final corporate regulations, the elevation of climate-related risks and metrics in the corporate context will almost certainly require municipal issuers (particularly those in sectors that compete with private sector, such as utilities) to move toward greater disclosure surrounding their own consideration and measurement of these climate-related risks.

(3) Applicability of legal challenges to other federal rulemaking authority

(a) *West Virginia v. EPA*, 142 S. Ct. 2587, 213 L.Ed.2d 896 (2022)

(i) In June 2022, the U.S. Supreme Court struck down the Environmental Protection Agency's ("EPA") proposed Clean Power Plan promulgated in 2015 to regulate certain greenhouse gas emissions under the EPA's authority under the federal Clean Air Act. The majority of the Court held that legislative delegation of authority was insufficient under the "major questions doctrine" and, thus, concluded that the EPA lacked clearly delegated authority to promulgate the regulation.

(ii) Justice Roberts, writing for the majority stated:

> …Nonetheless, our precedent teaches that there are "extraordinary cases" that call for a different approach—cases in which the "history and the breadth of the authority that [the agency] has asserted," and the "economic and political significance" of that assertion, provide a "reason to hesitate before concluding that Congress" meant to confer such authority.

West Virginia v. EPA, 142 S. Ct. 2587, 2608 (2022) (citations omitted).

(iii) What does this say for the SEC's rulemaking authority in this area?

1. In response to the SEC's request for input on potential climate-related disclosures prior to publication of the Proposed Rules, it received certain responses (including some from parties to the *West Virginia* lawsuit) suggesting that the SEC lacked regulatory authority to promulgate rules regarding climate-related disclosures. It is anticipated that those parties may file a similar challenge if and when the SEC's climate-related disclosure rules are finalized.

2. Applicability of the "major questions doctrine" utilized by the current majority of the Supreme Court would look to the legislation delegating to SEC the authority to promulgate the rule and would ask (i) whether the question of climate-related disclosures is a "major" question involving the assertion by the SEC of an unprecedented breadth of regulatory authority, effecting "a fundamental revision of the statute" or making a "radical or fundamental change to a statutory scheme"; and (ii) whether the legislative delegation of this authority is sufficiently specific and constitutes a "clear congressional authorization" to the agency to assert the regulatory authority.

3. The Proposed Rules make every effort to describe their scope and breadth as well within the SEC's traditional role in regulating the financial markets. Many comments submitted, however, claim that specific disclosures are a departure from the SEC's traditional approach and expansive assertion of regulatory authority. The handing down of the *West Virginia* decision during the comment period on the Proposed Reules presumably gives the SEC advance notice of how to prepare its final rule to best withstand a challenge based on the major questions doctrine, but it remains to be seen whether such a challenge will be mounted and whether the SEC would prevail.

ii. <u>SEC Enforcement Activities</u>

(1) In 2022, the municipal market began to see the outcomes of the SEC 2021 examination priorities that placed climate and ESG considerations on the front burner, including:

(a) 2021 creation of the Climate and ESG Task Force within the enforcement division (https://www.sec.gov/news/press-release/2021-42#)

(b) Enforcement actions during 2022 focus on "greenwashing" and false and misleading statements and omissions around ESG-related disclosures. (See https://www.sec.gov/spotlight/enforcement-task-force-focused-climate-esg-issues.)

(i) *In the Matter of Goldman Sachs Asset Management, L.P., Administrative Proceeding File No. 3-21245 (November 22, 2022).* The SEC brought an enforcement action against investment adviser Goldman Sachs Asset

Management (GSAM) under the Investment Advisers Act of 1940 for failing to follow its policies and procedures involving ESG investments. The alleged violations involve disclosures made to potential investors in certain ESG-related funds regarding the selection process and criteria used to select investments for these funds based on ESG-related principles. According to the SEC, GSAM had neither adopted nor systemically implemented any such written policies and procedures for selection of ESG-appropriate investments and therefore misled potential ESG-fund investors regarding those criteria and their use. The takeaway from this action is that fund managers should "establish reasonable policies and procedures governing how the ESG factors will be evaluated as part of the investment process, and then follow those policies and procedures, to avoid providing investors with information about these products that differs from their practices."

(ii) *In the Matter of Compass Minerals International, Inc., Administrative Proceeding File No. 3-21145 (September 23, 2022).* The SEC brought an enforcement action against Compass Minerals International Inc. for misleading investors about the costs and risks associated with a certain technology upgrade and those relating to environmental liabilities for certain of its operations. The SEC's leveled charges against disclosures by the company that failed to "jibe with the facts on—or under—the ground" regarding environmental risks and liabilities.

(iii) *In the Matter of BNY Mellon Investment Adviser, Inc., Administrative Proceeding File No. 3-20867 (May 23, 2022).* The SEC brought an enforcement action against BNY Mellon Investment Adviser, Inc. for misstatements and omissions about ESG considerations in making investment decisions for certain mutual funds that it managed. According to the SEC, the investment adviser made representations about its selection and evaluation criteria for investments in its ESG funds, but in fact not all investments had undergone such an ESG evaluation or quality review. The emphasis by the SEC was on ensuring that funds accurately describe their incorporation of ESG factors into their investment selection process.

(iv) *In the Matter of Vale, S.A., (May 23, 2022).* The SEC filed a Complaint in U.S. District Court for the Eastern District of New York, charging Vale, S.A., a Brazilian mining company, with violating antifraud and reporting provisions of the federal securities laws, citing information provided to investors in certain sustainability reports produced by the company, which misled investors as to the safety of a dam which later collapsed, killing 270 people, causing environmental and social harm, and leading to significant financial losses. This case is significant because it alleges securities law violations based on information contained in annual reports disclosing ESG-related risks in a misleading manner. The SEC specifically noted that investors rely on these types of annual reports in making investment decisions.

d. Municipal Securities Rulemaking Board (MSRB)

i. Over the last couple of years, the MSRB has been engaged in separate initiatives relating to climate-related and ESG-related investing.

(1) In October 2021, the MSRB published a guide "*Making an Impact: ESG Investing and Municipal Bonds*." (https://www.msrb.org/Making-Impact-ESG-Investing-and-Municipal-Bonds)

(a) This framework provides the following description of the what "ESG" might look like for issuers of municipal bonds:

> In the municipal bond market, ESG factors might include:
>
> 1. **Environmental** factors such as the issuer's readiness to withstand or mitigate effects of storms, fires, droughts and other climate-related events on physical infrastructure and the lives and property of people in their community; transition to cleaner and more renewable energy sources; efforts to reduce carbon emissions and control pollution; investments in sustainable public transportation; nature conservation; and sustainable water and wastewater management.
>
> 2. **Social** factors such as accessible education, quality healthcare, affordable housing and reliable water supply for underserved communities.
>
> 3. **Governance** factors such as sound internal controls, financial practices and long-term planning.

(2) The MSRB also disseminated a Request for Information in December 2021 (MSRB Notice 2021-17). https://www.msrb.org/sites/default/files/2021-17.pdf

(a) A summary of responses was released in August 2022. https://www.msrb.org/sites/default/files/2022-09/Summary-of-Responses-to-MSRB-ESG-RFI-August-2022.pdf

(i) NABL submitted a letter in response to the RFI (March 7, 2022).

(3) The MSRB added an "ESG Type" column to EMMA's New Issue Calendar for all new issues: https://emma.msrb.org/ToolsAndResources/NewIssueCalendar

e. Rating Agencies

i. ESG Integration in Rating Agency Frameworks. Throughout 2021 and 2022, the major rating agencies (Fitch, Moody's, & S&P) continued integrating ESG considerations into their ratings analyses.

(1) "ESG integration" refers to the integration of the analysis of how environmental, governance, and social factors create risk that translates to financial risk. This is then integrated into the overall credit rating. All three major rating agencies generally provide a discussion of whether a specific E, S, or G factor influenced the overall credit rating. Fitch estimated that in 2021 7% of US public finance ratings were influenced by an ESG factor, with Governance elements having a stronger influence than Environmental or Social elements.

(a) Fitch: https://www.sustainablefitch.com/products/esg-ratings/#about-esg-ratings

(b) Moody's: https://esg.moodys.io/esg-credit

(c) S&P: https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/12085396

ii. Applicability to Different Credits and Credit Sectors. Not every E, S, or G factor creates a risk that has consequences that will affect financial performance. This will vary on a sector-wide basis, as well as based on the type of issuer or the project financed. Rating agencies have generally recognized these differences, while maintaining consistency across sectors in the U.S. and aligned with global credit ratings frameworks.

(1) How are ESG factors applied to tax-supported entities and general obligation or tax-supported credits?

(2) How are ESG factors applied to revenue-supported entities such as utility or enterprise issuers? Conduit transactions? Special or limited purpose entities (perhaps supported by limited taxing powers but primarily reliant on revenues)?

(3) Are certain specific infrastructure types more or less vulnerable to ESG factors?

(4) International Markets and Foreign Regulatory Frameworks – For those selling in European markets, the EU's forthcoming requirements re: "green" terminology should be kept in mind.

f. Politicization of ESG

i. Rating agencies and investment banks have argued that ESG analysis is primarily a reaction to investor demand and investor interest in being able to consider how ESG factors may pose financial risks, and that ESG analysis in not a judgment about the particular policy direction taken on any particular issue.

ii. However, in the current political climate, the integration of ESG analysis into investment advice and rating decisions has drawn criticism, largely leveled at the question of whether attention to ESG factors furthers a particular policy agenda.

iii. In certain states there has been pushback against investment banks and rating agencies for employing an ESG framework.

(1) What does this mean for issuers seeking a rating from an agency that uses these frameworks? (*See* https://www.reuters.com/business/sustainable-business/texas-ag-paxton-joins-probe-into-sp-globals-use-esg-credit-ratings-2022-09-28/).

iv. This controversy has also affected where investment banks can do business, as some issuers refuse at the local level (or are prohibited by their State) to utilize investment banking services offered by banks who utilize ESG factors in the running of their respective financial institutions, make investments in certain types of projects, or take certain political positions.

(1) What does this mean for issuers making (or being forced to make) those choices, which limit the pool of potential financial institutions from whom they may procure services?

3. LABELED BONDS

a. <u>Overview – What is a Labeled Bond?</u>

i. The term "labeled bond" refers generically to a class of securities offered with a designation indicating that it has been deemed a "green," "social-equity," "climate-friendly" or other type of investment. The type of label – and whether it relates to ESG or a combination of factors – varies depending on the label. The standards applied to make the determination also vary.

(1) Self-labeled bonds –

(a) Some issuers simply determine that their entity or project is worthy of special consideration by investors interested in "socially responsible" investing, without obtaining a "Second Party Opinion" (SPO) from an independent verifying agency.

(b) In this category, there is little standardization in terms of criteria for making the determination or in the framework for disclosure or ongoing monitoring or reporting of the labeled status. Anecdotally, the popularity of self-labeled bonds may be waning as more options are available for obtaining a SPO at little or no cost to the issuer.

(2) Second Party Opinions (SPOs)

(a) Over the last decade there has been significant expansion in the number of independent analysts that will evaluate an issuer (on an entity-wide basis) or a particular offering in terms of its alignment with certain principles. This independent party will then provide an analysis and opinion that investors may review to determine whether the investment aligns with their investing goals.

(b) *Standards*. This provides a degree of standardization, but there has also been a proliferation of sets of principles developed by several organizations claiming to provide oversight. Examples of analysis principles or standards include:

(i) Green Bond Principles (GBPs) (ICMA) https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

(ii) Climate Bonds Initiative (CBI) Green Bond Standards (V3.0: https://www.climatebonds.net/climate-bonds-standard-v3; v4.0: https://www.climatebonds.net/climate-bonds-standard-v4)

(iii) Sustainability Linked Bond Principles (SLBPs) (ICMA) https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/

(c) *Types of SPOs*. Some SPO providers engage in intensive interaction with the issuer in developing their analysis and require ongoing reporting and monitoring of metrics supporting their conclusions. Others review the offering document and do independent research, but have little influence on the project development, reporting, or monitoring. Fees – and who pays them - for obtaining an SPO (and maintaining the designation) also vary.

(i) ESG evaluations or Second-Party Opinions (SPOs) may be offered by "independent" evaluators or by parties (or related entities) already involved in the transaction. Consider

1. S&P (acquired "Shades of Green" from CICERO in December 2022) (https://www.spglobal.com/ratings/en/products-benefits/products/second-party-opinions)

2. BAM GreenStar (https://buildamerica.com/green-bonds/bam-greenstar/) (https://buildamerica.com/wp-content/uploads/2020/10/2020-BAM-GreenStar-V2-March-2021.pdf)

3. Moody's SPOs (https://esg.moodys.io/sustainable-finance)

b. <u>Issuer Considerations when Issuing Labeled Bonds</u>

i. For issuers who have decided to issue labeled bonds, several considerations arise:

(a) What are the benefits to an issuer to issue labeled bonds? Is there a quantifiable economic benefit? Are there other benefits? What are the impediments to increased market (economic) realization of economic benefits?

(b) Is a label an investor “shortcut”? How does a label relate to the integration of ESG in the credit rating?

(c) What are the advantages or disadvantages of self-labeling vs. obtaining an SPO? Are reasons to choose on set of standards or principles over another?

(d) What are the up-front costs and risks? Ongoing costs and risks? (Monitoring? Disclosure?)

4. DISCLOSURE AND ESG

a. <u>Drafting Standard Disclosure with ESG Factors in Mind</u>

i. The topic of integrating ESG-specific disclosures into standard disclosure applies to both labeled and non-labeled bonds. Determinations regarding whether an ESG-specific item should be disclosed rests on a facts and circumstances analysis.

(1) As with any risk disclosure, the key consideration is materiality: would a reasonable investor take the information into account in making an investment decision?

(a) The main consideration confronting municipal issuers is whether the circumstances surrounding ESG integration into the overall financial risk and credit analysis framework has shifted the “reasonable investor’s” interest in ESG-related risks. Many would argue that we have reached – or at least are approaching – a tipping point.

(b) It is important to keep in mind, however, that the key touchstone is whether (and how) the ESG-related risk may affect the financial performance of the issuer.

(c) ESG-related risk factors often involve remote and uncertain risks. This poses similar challenges to the issuer to make a determination about just how material a remote risk is. As with any other remote risk, an issuer would need to weigh the potential consequences of the risk against the likelihood of its occurrence.

(d) Any disclosure should be specific as it relates to the credit, issuer or borrower location, and other pertinent characteristics related to the offering. Generic climate risk or environmental risk, or other ESG-risk, disclosure is not sufficient, and the SEC discourages generic disclosure.

(e) The final corporate market climate-related disclosure rules will be informative in thinking about what matters and level of detail the SEC thinks are material in the context of the issuance of municipal securities.

ii. Specific considerations or tools for developing an ESG-related disclosure framework:

(1) Governance issues generally tend to be discussed in a fair amount of detail in municipal disclosure. Consider whether additional detail is needed, particularly focusing on the ability of the entity to respond to risks such as environmental risks (e.g., natural disasters, extreme weather events, events involving environmental liability or changes in environmental regulation), social risks (from events involving social unrest to shifting demographics), or governance risks.

(2) When identifying an ESG-related risk and developing specific ESG-related risk factor disclosure:

(a) Make a determination whether the disclosure is a stand-alone risk factor or is a deeper explanation of a topic that is already addressed within "standard" disclosure. This should be a case-by-case determination, recognizing that generic stand-alone descriptions may be insufficient.

(b) Describe management's approach to the risk. Has a task force been formed, a study been undertaken? Has another approach been taken to address impacts?

(c) Is there a mitigation plan in place? Describe the mitigation steps taken to measure and address the risk. If the adequacy of the mitigation approach has been evaluated, consider disclosing this evaluation and any steps taken to alter the mitigation strategy, if warranted.

(d) What is known about potential financial impacts?

(i) Are there any federal or other grant funds or insurance funds available? Is insurance sufficient?

(ii) Would new regulations, consent decrees or orders, or other similar governmental requirements lead to potential increases in operating costs? Additional capital investments?

(e) Explore whether there areas in which the issuer is engaging in efforts – planning for, mitigating, reacting to - ESG-related factors that have not previously seemed relevant in bond disclosure?

(i) Are there projected reductions in tax revenue or operating revenue as a result of consumer climate change adaptation (e.g., water conservation efforts, shifts in motor vehicle usage, etc.) or other ESG-related legislation?

b. <u>Due Diligence and ESG-Related Disclosure Considerations</u>

i. How should one approach due diligence of ESG-related disclosures?

(1) As with any other type of information disclosed in an offering document, the starting point is the issuer's representation and any studies, reports or similar background that the issuer is utilizing to make decisions about its operations.

(2) Questions arise when outside entities – sometimes regional consortia to which an issuer belongs – produce broad-based assessments of risk. Examples of these abound, from studies of impacts of sea-level rise, wildfire risks, severe weather events, etc.

   (a) Consider how to handle other (unsolicited) third-party assessments of risks:

      (i) Is there an obligation to discover whether they exist?

         1. Risk assessments performed by state, federal or other governmental agencies

         2. Independent nonprofit third-party research organizations/NGOs or scholarly research

         3. Other publicly available risk assessments

            a. Example: State of Alaska – Consider how/whether these types of studies might affect approach to disclosure. Do they need to be mentioned? How should materiality be evaluated?

               i. https://www.commerce.alaska.gov/web/dcra/climatechange.aspx;

               ii. https://www.scientificamerican.com/article/alaskas-coastal-communities-face-a-growing-climate-threat/;

               iii. https://www.pnas.org/doi/10.1073/pnas.1611056113;

               iv. https://www.nytimes.com/interactive/2016/11/29/science/alaska-global-warming.html;

               v. https://nca2014.globalchange.gov/report/regions/alaska

      (ii) Consider whether the existence of these studies is material to the issuer's financial performance or poses a material financial risk to the issuer or project. Is the issuer managing based on the information in those reports and studies? Consider whether and to what level ESG-related disclosures need to describe risks in the abstract compared to focusing on how that risk is impacting (or has the potential to impact) the particular issuer or project.

c. Specific Disclosure Concerns Relating to Labeled Bonds

i. Considerations When Issuing Labeled Bonds

(1) One seemingly esoteric question is whether the label itself is material. To the investor it may be a material consideration in whether to purchase the bonds. However, the label itself has no direct financial impact on the issuer or its operations.

(2) Even if the fact of the label is not material, consider that underlying data used to reach the conclusion that the bonds satisfy the labeling criteria may be material.

(3) Be careful in considering issues relating to selective disclosure of such information.

(4) Ongoing monitoring or data collection & disclosure is typically required under most of the standardized labeled bond principles.

(a) If the issuer has agreed to provide such information, consider whether the type and frequency of such reporting should be described in the disclosure document. Also consider whether selective disclosure concerns would suggest that it needs to be made publicly available.

(b) If the issuer has not agreed to provide such information on an ongoing basis, consider whether this fact needs to be disclosed in the primary offering document.

(5) Some issuers incorporate such requirements into a continuing disclosure undertaking under Rule 152-12. There are others who are concerned about doing so. Consider whether this is required or advisable based on the facts and circumstances.

(6) Consider whether the label will be maintained over the life of the bonds.

(a) If so, consider whether the primary disclosure describe whether, for how long, or by whom or by what mechanism the applicability of the label will be maintained. Be wary of representations by the issuer about a label continuing to apply at any time after the bonds are issued, particularly if the decision is outside of control of the issuer.

(b) What happens if a label is "revoked"? (Could a label be revoked?)

(i) Are there secondary market considerations? For example, based on the 2022 enforcement actions against Goldman and BNY Mellon, there could be a question of whether dealers can sell ESG bonds to an investor specifically looking for ESG bonds if ESG compliance is not being monitored – or if that monitoring reveals that the security or the issuer no longer satisfies the investor's (or the fund's) ESG-related criteria for being an eligible investment.

(ii) Although municipal debt issuers are not generally affected by secondary market trades, a question could arise regarding future liquidity of the investment. Consider whether this could create an initial disclosure issue`.

(7) Consider whether it is necessary to disclose when the provider of an SPO is related to a party who is otherwise involved in the transaction, such as a bond insurer, rating agency, or investment bank.

ii. <u>Continuing Disclosure Considerations</u>

(1) Once an issuer has decided to issue labeled bonds, several considerations arise:

(a) What kind of information (if any) should be covered by the continuing disclosure undertaking or continuing disclosure agreement ("CDA") and provided on an ongoing basis in connection with a label?

(2) Has additional data or information been included in the official statement (or submitted to a verifier/third-party label-provider) that now needs to be subject to a CDA?

(a) Has the issuer contractually agreed to provide certain data on an ongoing basis to a SPO provider? Is there some sort of agreement or promise to "maintain" a designation/label?

(b) Does it make a difference if the issuer actively applied for a label vs. if the label was applied either after-the-fact or at the request (and cost) of the underwriter? (Competitive sale example.)

(3) If no information relating to the label is going to be provided via the CDA, do you need to disclose that there will be no updates regarding the labeling or the criteria that established the basis for the labeling?