PACIFICA
LAW GROUP

Society and Municipal Bonds: ESG Disclosure

This installment of Pacifica's "Society and Municipal Bonds" series will briefly discuss developments in municipal disclosure relating to Environmental, Social, and Corporate Governance ("ESG") characteristics of an issuer or a specific bond-financed project. ESG disclosure includes both disclosure of the *risks* that these factors pose to the issuer or a project, and disclosure of the ESG *benefits* a "green" or "social impact" bond offers to investors. Recently, the SEC has increased the agency's focus on ESG disclosure noting on its new website on climate and ESG risks and opportunities that as "investor demand for climate and other environmental, social and governance (ESG) information soars, the SEC is responding with an all-agency approach."[1]

ESG *risks* include environmental risks associated with natural disasters, pollution prevention and remediation (including legal and regulatory requirements), climate change and related extreme weather events; social risks including affordability concerns and labor disputes; and governance risks including those related to pension and other retirement benefit liability, deferred maintenance, conflict of interest and other management risks. ESG risk disclosure has typically been provided in "Bondholder Risk," "Investor Considerations," environmental or regulatory compliance, labor relations, governance, and other sections of disclosure documents. In recent years, bond issuers have included expanded discussions of pension, OPEB and deferred maintenance risks. Most recently, many official statements now generally note climate change-related risks, particularly in regions that have begun experiencing sea level rise or other effects of climate change.

ESG *benefits* disclosure focuses on describing the project attributes that demonstrate the bond fits within investing parameters or guidelines of those seeking environmentally- and/or socially-responsible investments. This disclosure is provided in a separate "green bonds," "social bonds," or "ESG" section of the disclosure document. Green bond disclosure, and more recently social bond disclosure, generally includes a detailed description of the characteristics of the project of particular interest to green bond or social impact bond investors. The disclosure document often includes a third-party review of the project through this lens. The issuer may agree to provide ongoing reporting specific to green or social impact objectives. We anticipate the disclosure expected in connection with the sale of green, social and other labeled bonds to continue to evolve as one or more standard models emerge, and we address labeled ESG bonds more specifically in a forthcoming article.

Whether ESG disclosure is focused on sustainability risks or benefits, the same legal standard applies. Any disclosure must meet the antifraud requirements that make it unlawful, in connection with the purchase or sale of any security, to make a misstatement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Whether a statement is material depends on whether there is a substantial

[1] Available at https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities.

likelihood that a reasonable investor would find the statement important in making a decision to invest or as having significantly altered the total mix of information available. A particular ESG risk may be material to an issuer or a bond issue and therefore require disclosure under the antifraud requirements. Whether an ESG risk is material depends, like other risks, on the facts and circumstances of the issuer and bond issue. By proactively reviewing potential ESG topics with risk management, other internal staff, and with the finance team, an issuer can identify which ESG risks should be disclosed under its particular facts and circumstances.[2]

Like any risk disclosure, ESG risk disclosure should not be a boilerplate or generic recitation of risks that apply generally to issuers or to municipal bonds. More effective risk disclosure explains the particular risk faced by the issuer and the bonds being offered. For example, an issuer may have undertaken studies to identify the risk that certain extreme weather made more likely by climate change may affect particular operations, may result in increased damage to particularly vulnerable facilities, may materially exceed the issuer's insurance coverage, or may increase the cost of its capital improvement program. Some of these extreme weather events may already have occurred. The issuer may have taken steps to mitigate some but not all of these risks including requiring that future capital projects meet sustainability standards. A risk subsection that outlines the risk and includes this more specific information is more helpful than a risk subsection that notes simply that climate change is occurring and may cause an increase in extreme weather events. By reviewing potential ESG risk disclosure with internal staff and the finance team, an issuer can tailor the disclosure to the particular facts and circumstances, and include meaningful disclosure—including cautionary language—regarding the risk.

As values-based investors and ratings agencies (also attentive to the long-term risks associated with ESG factors) express growing interest in understanding how municipal bond issuers are addressing ESG factors or are responsive to values-based investment objectives, issuers may choose to expand disclosure beyond identifying ESG risks and marketing labeled bonds, to including more general information on issuers' proactive ESG strategies and progress in implementation. Many public entities—in advancing their own missions—are adopting strategies for sustainability, equity, and good governance that align with the objectives of values-based investing, and might consider noting these in bond disclosure. As noted above, bond disclosure always should be tailored to the particular facts and circumstances of an issuer and a credit. Expanded disclosure of ESG and other values-based investing factors likewise should be tailored to the particular risks, strategies and actions of the issuer. This information may be added throughout the official statement where relevant or presented in a focused ESG initiatives section of the disclosure document.

As the SEC takes further action (for example if the SEC requires public companies to include more specific ESG disclosures in filings), values-based investors continue to invest in municipal bonds, and public entities adopt and implement sustainability policies, ESG disclosure in the municipal bond market

[2] On March 8, 2021, the Government Finance Officers Association published ESG Best Practice guidance for its members, focusing on environmental risk disclosure and including potential steps in reviewing, identifying and disclosing these risks. Available at https://www.gfoa.org/materials/esg-disclosure.

will continue to evolve. Municipal ESG disclosure will always be subject to the federal antifraud requirements, but we expect the particular form and content of ESG disclosure to continue to change in response to these and other developments.

If you have any questions regarding this information, please contact:

Alison Benge	Alison.Benge@pacificalawgroup.com	206.602.1210
Deanna Gregory	Deanna.Gregory@pacificalawgroup.com	206.245.1716
Faith Li Pettis	Faith.Pettis@pacificalawgroup.com	206.245.1715
Stacey Lewis	Stacey.Lewis@pacificalawgroup.com	206.245.1714
Jon Jurich	Jon.Jurich@pacificalawgroup.com	206.245.1717
Tobias Tobler	Tobias.Tobler@pacificalawgroup.com	206.602.1215

Dated: May 24, 2021

A Note: This publication is for informational purposes and does not provide legal or investment advice. It is not intended to be used or relied upon as legal advice in connection with any particular situation or facts. The information herein is provided as of the date it is written.

Copyright © 2021 Pacifica Law Group LLP. All rights reserved.

To subscribe to our mailing list, please contact Mia Wiltse at Mia.Wiltse@pacificalawgroup.com.