Society and Municipal Bonds: ESG Disclosure Updates

This is the second installment of Pacifica's "Society and Municipal Bonds" series focused on developments in municipal disclosure relating to Environmental, Social, and Corporate Governance ("ESG") factors. Our first ESG disclosure paper can be found **here** and includes an introductory discussion of both ESG risk and ESG benefit disclosure. ESG disclosure practices are evolving rapidly and this article provides a brief update on some recent developments.

In March, the Government Finance Officers Association ("GFOA") published its first best practices paper on ESG disclosure, which focused on disclosure of environmental ("E") factors. In October, GFOA released best practices on ESG disclosure – social ("S") factors and ESG disclosure – governance ("G") factors. Broadly speaking, the GFOA best practices on ESG focus on voluntary disclosure in the primary market and encourage transparency. The GFOA best practices papers can be found at:

E -- https://www.gfoa.org/materials/esg-disclosure

S - https://www.gfoa.org/materials/esg-best-practice-s-social

G- https://www.gfoa.org/materials/esg-best-practice-g-governance

E Disclosure. The E disclosure best practices paper notes that the first step for issuers in developing E disclosure information is to consider the environmental risks applicable to the issuer and its bonds. To identify these risks, the paper suggests that issuers start by identifying internal resources, such as an emergency planner or sustainability officer, and relevant reports or studies. An issuer also can consult external resources, such as bond offering documents of other relevant jurisdictions, particularly because environmental and climate risks often affect other jurisdictions in the region. After identifying environmental risks, issuers should consider the potential operational and financial impacts of these risks (were they to materialize), evaluate whether the risks can be quantified, and consider whether the risks represent material risks that should be disclosed in bond offering documents, together with appropriate cautionary language and the steps the issuer is taking (if any) to address the risk. The GFOA best practices paper includes a detailed checklist of considerations in preparing E disclosure.

S Disclosure. The GFOA best practices paper on S disclosure starts with noting an important distinction between E risks and S factors: the lack of consensus regarding the relevant S factors to consider. The S category is broad and could include some or all of the range of many social factors that affect a jurisdiction. Issuers can start by considering the S factors that challenge their own community, evaluating whether these factors could have operational and financial impacts, and considering the potential materiality of these factors. Noted examples of S factors include: "Availability and affordability of housing for vulnerable populations; Demographic changes and population trends affecting demand for services or tax base; Income levels, wealth, and income disparities; Affordability of government services, tax rates, or eroding tax base; Labor relations challenges, union contracts (and any long-term fixed costs—OPEB and pensions); Availability, access, and quality of community health services; Quality of public education and vocational training; educational attainment; Labor force, employment/unemployment, and job opportunities; Internet access and affordability." The paper suggests that issuers start by reviewing what is already included on these topics in their bond offering documents, and consider whether to provide additional context for how these S factors are affecting the jurisdiction and how the factors are being addressed. Whether a particular factor is material may depend on whether the factor is one that is expected to continue over the long term and whether there is a nexus to payment of the issuer's bonds. Because there is less consensus on the S factors to consider, S disclosure may be most informative when it includes an explanation of the significance of the factor and a discussion of its potential impacts on the jurisdiction.

G Disclosure. The GFOA best practices paper on G disclosure recognizes that, by their nature, public entities are attentive to many of the G factors. Good governance and transparency are routine considerations for public bodies that are accountable to their taxpayers and other constituents, and that are subject to state sunshine laws requiring open public meetings and records. Most of the G factors are ordinarily included in offering documents. For example, offering documents include descriptions of governance, organizational structure, decision-making processes, legal authority for debt issuance, financial and budget management practices, and auditing/reporting practices. Other topics relate to risk management: cybersecurity, deferred maintenance, and pension and OPEB liability. Because so many of these topics are included in bond offering documents, the paper suggests that the first step in updating G disclosure is to assess the information that Is already included and verify that it covers the key G factors. The paper notes that G (and other disclosure) should be reviewed from time to time to take into account new developments.

Take-Aways. The GFOA ESG disclosure best practice papers encourage issuers to consider providing additional ESG disclosure. To the extent these factors are material to a particular issuer and bond issue, the information should be included in the relevant bond offering documents. Issuers also may choose to provide additional information voluntarily, including to investors that may have a particular interest in ESG investment. By providing additional ESG disclosure, issuers may simply be sharing with investors more of the work issuers are doing – for their own operational and financial purposes – to identify and address ESG risks. Many issuers have adopted and are implementing risk management, sustainability and other ESG policies, and may choose to share this information with ESG-focused and other investors.

Note that the GFOA best practices papers address ESG disclosure and do <u>not</u> address green or social impact "labeled" bonds. These labeled bonds are designated by the issuer as meeting specific standards (for example the International Capital Market Association's green or social bond principles) or are sold with a third-party verification opinion confirming that these standards are met. As issuers are increasingly focusing both on providing additional ESG disclosure and on considering whether to market particular bonds with a green or social impact bond label, these two, distinct topics often are merged into one. GFOA has taken care to address these topics independently: first by releasing the abovedescribed papers focused solely on ESG disclosure and second by noting a future paper that will focus separately on green bonds.

We continue to discuss ESG disclosure with issuers, as these practices evolve, as well as the considerations in labeling a particular bond issue as a green or social bond. If you have any questions, 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
Katherine Van Gunst	Katherine.VanGunst@pacificalawgroup.com	206.602.1213

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