

Bond Case Briefs

Municipal Finance Law Since 1971

How to Avoid Political Jockeying With ESG Bond ETFs.

374 Like so many current issues, environmental, social, and governance (ESG), at least in the eyes of some experts, has an element of political polarization to it.

That situation is amplified by lack of clarity and uniformity pertaining to how index providers score securities on the basis of ESG, prompting some experts to speculate that this could be a legitimate issue to contend with as the universe of fixed income assets aiming for ESG consideration grows.

As reflected by exchange traded funds like the newly minted SPDR Nuveen Municipal Bond ESG ETF (MBNE), there is demand for fixed income strategies that combine bonds and ESG principles. In fact, despite its rookie status, MBNE could be at the right place at the right time because issuance of green munis is soaring, while some state financial regulators are clamoring for more clarity on exactly what constitutes ESG.

For example, Utah recently clashed with index giant and credit ratings agency Standard & Poor's (S&P) over ESG ratings, asserting that the firm's standards are too ideological.

"In addition to rating governments on meaningful financial criteria, in March the biggest of the top three credit-rating firms began to apply an environmental, social and governance, or ESG, rating system. But Utah isn't about to submit to these subjective standards. State officials, including myself, recently wrote a letter to S&P objecting to the ESG indicators and ratings it has assigned to Utah and calling for the company to withdraw them," writes Utah Treasurer Marlo Oaks in an op-ed for the Wall Street Journal.

Regarding MBNE, the ETF can allay concerns on both sides of the aisle. For starters, Utah isn't one of the top 10 state exposures in the new ETF, and that group combines for about 70% of the fund's roster.

Second, MBNE is actively managed, indicating that it can skirt some of the thorny political issues associated with some parts of ESG investing while focusing on the business of identifying the best opportunities among green municipal bonds.

That's not to say MBNE doesn't have standards — it does. Bonds entering the fund must meet certain ESG traits. However, as an actively managed fund, MBNE has flexibility in a space that needs it.

Markets "encapsulate many different views of the future and their organic structure allows for quick adaptation. ESG scores, by contrast, rigidly hold to one viewpoint and are slow to pick up on changes in the world," adds Oaks.

ETF TRENDS

by TOM LYDON

MAY 12, 2022

