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The Thematic ESG Approach in US Municipal Bonds.

Executive summary

US municipal (muni) bonds play an important role in funding public services and infrastructure, hence they are fundamentally well positioned for responsible investment strategies. Muni bond issuers affect the quality of life of most Americans and will be key in the transition to a low carbon economy.

Like their peers across many fixed income asset classes, muni bond investors have started to address ESG factors more explicitly to mitigate risk in their portfolios. Some have also gone beyond seeking better risk-adjusted investment performance to adopt an ESG thematic strategy, which involves allocating capital to themes or assets that are tied to certain environmental or social outcomes. This approach, and more broadly weighing the real-world outcomes of muni bond holdings (both positive and negative), is less common than the risk mitigation approach, but momentum is building.

The two approaches are not necessarily mutually exclusive and could deploy the same techniques (for example exclusion or engagement). If anything, the US muni bond market is well suited to embracing both ESG strategies simultaneously, given the many public benefits funded by proceeds.

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Principles for Responsible Investment

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