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Socially Responsible Investing

Can investors do well by doing good?

Socially responsible investing, which combines financial goals with the aim of improving society through stock screening, shareholder activism and other methods, has grown into a multi-trillion-dollar industry. Concerns about climate change, worker rights and other issues are prompting big institutional accounts as well as small investors to put more and more emphasis on social, environmental and corporate-governance factors in weighing investment decisions. But critics say stock-screening methods used by mutual funds are subjective and that socially responsible investments tend not to perform as well as conventional ones. Some of the harshest criticism has been directed at public pension funds using social-investing approaches, such as the California State Teachers' Retirement System, which uses a "double bottom line" approach to investing.

Investments in tobacco and other "sin" stocks are being avoided by a growing number of investment funds, pension plans and other investors. Above, a cigarette vendor on a street in Hong Kong.

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RECIPIENT OF SOCIETY OF PROFESSIONAL JOURNALISTS AWARD FOR EXCELLENCE ◆ AMERICAN BAR ASSOCIATION SILVER GAVEL AWARD

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Socially Responsible Investing

By Thomas J. Billitteri

The Issues

When Ann B. Alexander and her husband sold their natural-foods store in Durham, N.C., they pocketed a tidy sum. But they didn't want their profits to simply sit in a typical investment fund, even if they did grow in value. They also wanted their money to do good.

So the Alexanders chose a financial adviser who specializes in "socially responsible investing," an increasingly popular approach that combines investors' financial goals with a desire to improve society and hold corporations accountable.

"To have these corporations pay attention and be more responsible, it's good for all of us — not just the people who have money," Mrs. Alexander says.

She's not alone in that view. Socially responsible investing — sometimes called "sustainable investing," "ethical investing" and simply SRI — involves screening investments according to social or environmental, as well as financial, criteria, plus other strategies.

From a small niche of the financial world during the protest era of the 1960s and '70s, SRI has evolved into a complex and controversial trillion-dollar global industry spanning mutual funds, pension plans and big institutional and private holdings.

Many investors are attracted to social investing for moral or ethical reasons stemming from such concerns as climate change, workers' rights, workplace diversity, skyrocketing CEO pay and corporate political influence. Others may choose it out of a practical belief that companies that treat their employees well and protect the environment will be more profitable, more open about their operating methods and less prone to lawsuits and regulatory sanctions.

But the SRI movement also has vocal critics. They argue that stock-screening methods used by SRI mutual funds are ill-defined and highly subjective, that social investments tend not to perform as well as traditional ones and that SRI techniques have no place in the public pension world, where money managers have a fiduciary duty to maximize investment returns. (*See "At Issue," p. 689.*)

Getty Images/Melanie Conner

Solar panels generate electricity from the roof of the state capitol in Salem, Ore. Many socially responsible investors seek out firms that address environmental concerns, such as climate change and energy conservation. But critics say social investments tend not to perform as well as traditional ones.

Despite the controversy, the movement is growing.

According to the Social Investment Forum, the industry's main trade group, assets under management using at least one of three core SRI strategies — investment screening, shareholder advocacy and "community investing" in areas underserved by traditional financial institutions — totaled $2.71 trillion last year, more than four times the amount in 1995 and about one of every nine dollars under professional management in the United States. [1]

As it has grown, social investing has evolved from its roots of simply avoiding tobacco, alcohol and other so-called sin stocks. It is placing more and more weight on companies that pay close attention to environmental, social and corporate-governance issues — "ESG" factors in investing parlance.

That emphasis is spreading to the broader financial world. For example, Goldman Sachs Group developed a 179-page report last year that recommended 44 companies based on a formulation that included ESG performance. [2] Most SRI assets — an estimated $1.9 trillion, according to the forum — are in accounts professionally managed for big institutional and high-net-worth clients. [3] Institutions embracing the responsible-investing approach include religious groups, private foundations, hospitals and labor unions and some of the nation's biggest public pension funds.

"In the old days, most people associated with SRI were just taking tobacco, alcohol and gambling stocks out of portfolios," says Paul Hilton, director of advanced equities research

Social Investments Did Well Over Long Term

*Over its 18-year life span, the Domini 400 Social Index (DS400) — composed of companies regarded as socially responsible — has outperformed the Standard and Poor's 500 (S&P 500). At one-, three-, five- and 10-year intervals, however, the DS400 lagged behind the S&P. **

DS400 Performance Statistics

	Total returns as of July 31, 2008							
	July 08	Last Qtr	Year to Date	One Year	Three Year	Five Year	10 Year	Since 5/1/90
KLD's DS400 Index	0.24%	-3.84	-12.67	-11.49	1.32	5.49	2.46	10.40
S&P 500	-0.84%	-2.73	-12.65	-11.09	2.85	7.03	2.91	9.91

** The S&P 500 is a broad stock market index (indicator) representing 500 publicly traded companies.*

Source: KLD Research and Analytics

at the Calvert Group, a major SRI mutual fund company. "More recently, there's an understanding that what we're trying to do is use environmental, social and governance factors as another way to identify risk and better-quality management. That's getting through to institutional investors in a way that it hasn't before."

Even so, some critics argue that social investments have tended to produce mediocre returns compared to the broader stock market, causing investors to give up potential profits. The Domini 400 Social Index, a main SRI benchmark, has lagged the broader Standard & Poor's 500 index at the last one-, three-, five-, and 10-year intervals, although it is ahead of the S&P 500 over its entire 18-year life. (*See chart above.*) [4]

The use of socially responsible investing approaches in public pensions has been especially controversial. In California, which adopted a so-called double-bottom-line approach eight years ago, the $239 billion California Public Employees' Retirement System — the nation's largest pension fund — missed $400 million in gains by forgoing investments in China and other countries, according to *Business Week*. And a ban on tobacco stocks cost the $172 billion California State Teachers' Retirement System $1 billion, though returns for both pension funds still outpaced the S&P 500 over the past five years, the magazine said. [5]

California's pension system reportedly is considering reversing its tobacco policy, which critics of socially responsible investing say could undermine support for the movement. [6] (*See "Current Situation," p. 688.*)

And while the SRI mutual fund industry's stock-picking methods have become more refined over the years, they have occasionally led to stumbles. This summer Pax World Management Corp., a venerable SRI firm founded in 1971, settled charges with the Securities and Exchange Commission that it violated its own guidelines against buying shares in such businesses as alcohol, gambling, tobacco and defense. [7]

The company agreed to a $500,000 fine. The actions took place from 2001 through 2005 in two Pax funds, though not in its World Balanced Fund, which held over 90 percent of Pax World assets at the time, the company said. [8]

"We regret and take full responsibility for what occurred," said Joseph F. Keefe, who became CEO in 2005 after the SEC began its investigation.

Despite such missteps, supporters say responsible investing is fast moving into the mainstream. While investors may be attracted to it for different reasons, "the remarkable thing is the coming together of these investors with literally, now, trillions of dollars to press companies, or encourage companies, to act in a responsible way," says Timothy Smith, senior vice president of the environment, social and governance group at Walden Asset Management, an SRI firm in Boston.

Concerns over global climate change and natural-resource sustainability have provided perhaps the biggest impetus for the recent growth. So-called green funds new to the market include the Global Alternative Energy fund, started by the Calvert Group in May 2007, the Winslow Green Solutions Fund, started last November, and the five-month-old Global Green Fund, part of Pax World Funds.

Climate concerns are heavily reflected not only in mutual funds but also in shareholder activism. In this year's proxy season, 54 global-warming resolutions were filed with U.S. companies by public pension funds, labor and religious groups, and other institutional investors, according to the *Environmental Leader*, an online trade publication. Many of the investors belong to the Investor Network on Climate Risk, an alliance of 60 institutional investors with combined assets of more than $5 trillion. [9]

Also driving the responsible-investing movement are concerns about corporate behavior. Scandals at Enron and Tyco International earlier this decade, outrage over child exploitation in overseas sweatshops making goods for the West, and corporate links to human-rights hotspots like Sudan have led some investors

to look carefully at which companies are in their stock portfolios.

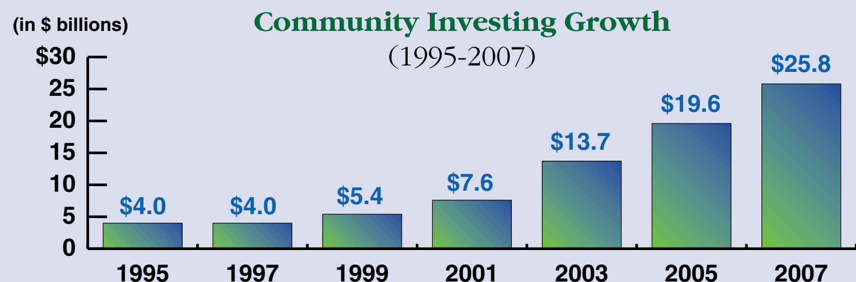
Social investing is getting a boost, too, from the ongoing intergenerational transfer of wealth that is putting unprecedented sums of inherited money into the hands of baby boomers — a group weaned on '60s-era activism. [10]

"More and more and more people are asking themselves the question: What do I want to profit from?" says Cliff Feigenbaum, managing editor of the *Green Money Journal*, a Santa Fe, N.M., publication that promotes social and environmental values in investing.

As socially responsible investing attracts more followers and gains more scrutiny, here are some key questions that proponents and skeptics are asking:

Community Investing Continues to Expand

The amount of money that social investors directed to communities that are underserved by traditional financial services grew sixfold since 1995, and 32 percent from 2005 to 2007.



Source: "2007 Report on Socially Responsible Investing Trends in the United States," Social Investment Forum Foundation, 2008

Do socially screened investment funds perform as well as regular ones?

Meir Statman, a professor of finance at Santa Clara University in California, has done several studies examining the performance of socially responsible mutual funds and ones that don't apply social screens.

"The performance is about the same," he says. "Not better or worse."

Scores of other studies have reached similar conclusions. Yet they have not convinced everyone.

"The use of social criteria may be fine for the affluent who gamble their own money as a feel-good, vanity investment — but for those who can't afford to take a chance, SRI is a bad bet," argues Jon Entine, an adjunct fellow at the conservative American Enterprise Institute and a longtime critic of socially responsible investing. [11]

But Mercer, the international consulting firm, along with the United Nations Environment Program Finance Initiative, said last year after reviewing 20 academic studies on the subject, "Investors incorporating environmental, social and corporate-governance factors within their investments don't have to give up returns." Mercer formed a "Responsible Investment" business unit in 2004. [12]

Likewise, researchers at Lehigh University in Pennsylvania studied SRI-screened portfolios and concluded that "there is no cost to being good." [13]

And Alex Edmans, a finance professor at the University of Pennsylvania's Wharton School, found that stocks of companies on *Fortune* magazine's "Best Companies to Work For" list robustly outperformed the overall market. [14]

Yet, other evidence has fed doubts about the correlation between socially responsible investing and stock performance. Robert F. Stambaugh, a finance professor at Wharton, and two colleagues found that when returns are adjusted for risk, index-style investors don't give up much when they use socially responsible funds, but investors who select actively managed funds can lose more than 3.5 percentage points of return a year. [15]

"Sometimes being socially responsible is costly, and sometimes it isn't," Stambaugh said. "It depends on what kind of investor you are." [16]

And research published in the *Harvard Business Review* this year found only a minor correlation between corporate social responsibility and good financial results. [17]

Some of the most spirited debate over social investing has involved SRI barometers like the benchmark Domini 400 Social Index. The index limits or avoids stocks in some industries that have performed well in recent years, such as gambling and military weapons, and is significantly weighted in industries like banking and information technology that hit rough patches.

Peter D. Kinder, president of KLD Research & Analytics, a Boston SRI research firm that owns the Domini 400 Social Index, says a key reason the index has lagged the S&P 500 is that it generally excludes stocks in companies that extract natural resources, such as oil-drilling and mining. Those sectors have soared recently.

"When industries we typically either exclude or underweight are doing very well, we will perform less well," Kinder says. On the other hand, "we are going to perform better relative to the broad market indexes when these companies underperform."

Amy Domini, who as a KLD partner helped develop the index before

starting her own company, Domini Social Investments, says social investing has been hurt by market shifts stemming from the post-Sept. 11 "war economy."

"People look for hard assets — gold, copper, oil — and those are not very robust for social investment funds to find opportunities in," she says.

Domini's flagship Social Equity Fund was down nearly 12 percent for the year ending July 31 and, partly because of the bursting of the tech bubble earlier this decade, has lagged the S&P 500 over time.

Amy Domini has felt the pressure that so-so stock performance can bring to bear. Since the Social Equity Fund's inception in 1991 it had tracked the Domini 400 index, but two years ago she changed that strategy. Now the fund is actively managed through a computer-driven stock-picking strategy.

"Emotionally, this is difficult," Domini said in 2006, after making the hard decision to change the fund's management approach. "But I can't ask my shareholders to be patient forever." [18]

Entine argues that the lag in benchmarks like the Domini 400 Social Index points to a larger flaw in the social-investment approach. To avoid investing in defense, energy and tobacco — areas viewed negatively in the SRI world but that have soared in recent years — social funds made unwise bets on banking and technology, only to be slammed by speculative bubbles, he charges.

"They overweighted based on social prejudices, not on metrics," he says. And "when you overweight, essentially you're gambling with someone's money."

Squabbling over SRIs' performance compared with conventional investments isn't likely to be settled soon. "This debate is going to continue," insists Walden Asset Management's Smith, a 40-year veteran of SRI. "There's no definitive knockout blow on either side."

Are screening methods used by mutual funds sound?

Walden Asset Management bills itself as "a leader in socially responsive investing," but that doesn't mean it shuns one of the world's most controversial industries. For years Walden has owned shares in British Petroleum (BP).

Smith calls the company a "work in progress" on health and safety issues and expresses discouragement over a deadly BP refinery explosion in Texas in 2005 and an oil spill in Alaska in 2006. Still, he says, the company continues to be a leader among energy producers on the climate-change issue.

"In some industries, companies stand out, and therefore there are some positive reasons to approach them," he says.

Walden's approach is known as "best in class," one of the strategies that SRI funds use to choose which stocks fit their missions.

The Domini Social Equity Fund holds stock in McDonald's — a company that, over the years, has been accused of everything from destroying rainforests for food production to polluting the environment with packaging waste. But Amy Domini says McDonald's has answered the critics, setting standards for beef production, addressing the packaging issue and participating in a coalition to improve international labor standards.

"Am I going to throw out the company that has been highly responsive to consumers and third parties time after time?" she asks.

Screening industries and companies has always been tricky for social investors, leaving the field open to charges that it compromises too much, lacks uniform screening standards and uses methods that are confusing or even misleading to people who want to invest with a conscience.

The research can be "shoddy," Entine charges, adding, "It depends on how well companies manage their reputations, more or less."

Social-investment advocates strongly disagree, however. "We are more sophisticated than we've ever been, and we'll be more sophisticated tomorrow," says the *Green Money Journal's* Feigenbaum. "We're screening as thoroughly as we possibly can."

When it comes to SRI mutual funds, investment companies use different approaches to decide which industries and stocks to avoid, embrace or include with reservations.

In *Socially Responsible Investing: Making a Difference and Making Money*, a 2001 overview of the field, Domini noted that "[r]esponsible investors struggle with how best to deal with . . . troubling industries. Many have come down on the side of avoiding problematic industries completely. Others decide to underweight some industries while avoiding others." [19]

Social funds may also use their shares to exert pressure on companies through shareholder resolutions or direct talks. "There are companies that we invest in that on balance have a positive record but still have some problems, and then we use our shareholder voice to engage those companies and urge them to change," Smith says.

In addition, SRI portfolios may shift to keep up with changing times or circumstances.

Last November *The Wall Street Journal* reported that Pax World discontinued its policy of rejecting alcohol- and gambling-related investments after the policy led it three years ago to divest from Starbucks Corp. — widely regarded as socially progressive — for licensing the Starbucks name to a coffee liqueur. "Now, while they still decline to invest in weapons and tobacco makers, portfolio managers . . . weigh potential investments based on a mix of financial and ESG metrics, including corporate governance, community relations, product integrity, human rights and climate change," the newspaper said. [20]

The Calvert Group, based in Bethesda, Md., traditionally has avoided the nuclear-power industry. But Hilton, the advanced equity research director, says

the company's two newest funds — Global Alternative Energy and International Opportunities — are willing to invest in certain companies that have existing nuclear plants but are doing excellent work in wind or solar power. "That's not so much of an endorsement of nuclear as the fact that we want to invest in companies pushing ahead in alternative energy," he says.

SRI proponents regard such attempts at nimbleness as signs that the SRI field is maturing. But the field's methods have also invited sharp criticism, some of it from people dedicated to the cause of sustainability and social responsibility.

In 2004, environmentalist and entrepreneur Paul Hawken — cofounder of the Smith & Hawken garden-supply business and executive director of the Natural Capital Institute, a research group in California — wrote a stinging critique of the SRI mutual-fund industry, saying he wanted to help it better respond to investors seeking "to invest with a conscience and a purpose." [21]

Hawken charged, in part, that SRI mutual funds lack common standards, definitions and codes of practice; that taken as a whole, the investment portfolio of the combined SRI fund industry "is virtually no different" than that of conventional mutual funds and that the field is marred by a "lack of transparency and accountability in screening and portfolio selection." He also said the language used to describe social-investment mutual funds is "vague and indiscriminate" and that "fund names and literature can be deceptive."

This year he was quoted in a British newspaper as saying that "the situation has not got better. [Financial] performance has become the primary driver. They [ethical funds] are doing everything they can to be acceptable to the broadest possible clientele, and with that has come dilution of meaning and standards." [22]

Julie N. W. Goodridge, president of Northstar Asset Management, a Boston social-investment firm, wants the SRI industry to adopt stronger disclosure policies to give investors a better understanding of what funds are investing in, and why.

Getty Images/Ethan Miller

Cold cash totaling $12 million awaits the winner of the World Series of Poker main event at Harrah's in Las Vegas. Investment funds that screen for gambling stocks had more than $41 billion in assets under management in 2007.

"The consumer doesn't necessarily know that different funds do different things," she says. "I worry that consumers . . . find that Coca-Cola is sitting right smack in the middle of their fund, and they would never purchase the product, let alone invest in it."

Many social investors have avoided Coke for reasons as varied as its use of precious water resources in developing countries and its sponsorship of this year's Olympics in China, which has been accused of human-rights abuses.

Joe Nocera, a business columnist for *The New York Times*, last year criticized KLD Research & Analytics, upon whose analysis many SRI funds rely for guidance. Nocera said KLD had only two dozen researchers monitoring 3,000 companies and that they relied on media reports, blogs, interactions with activist groups and conversations with companies themselves. "That hardly seems like enough to make a decision on whether a company is good or bad," Nocera wrote. [23]

But Kinder, KLD's president, says his company "takes full advantage of Internet tools" to research companies and that "companies don't fundamentally change that often.

"We've been looking at these companies for 20 years. I feel as confident as any researcher can be in our research."

Can socially responsible investors influence corporate behavior?

Last year, activists led by Christian Brothers Investment Services — an investment advisory firm for Catholic dioceses, hospitals and other organizations — put forth a shareholder resolution seeking an independent examination of the environmental and social impact of Newmont Mining Co.'s operations around the globe.

But the Denver-based gold-mining company didn't fight the resolution — in fact, it endorsed it before the shareholder vote was taken. [24]

Social-investment proponents point to that endorsement as a sign of the SRI movement's growing influence, although the resolution's ultimate effect on Newmont's operations remains to be seen.

Socially Responsible Investments Near $3 Trillion

The amount of money in socially responsible investments (SRI) in the United States has increased more than fourfold since 1995, to $2.7 trillion. The number of funds offering SRI has also increased from 55 in 1995 to 260 in 2007 (not shown).

Socially Responsible Investing in the United States, 1995-2007
(in $ billions)

Year	Social screening	Shareholder advocacy	Community investing	Total*
1995	$162	$473	$4	$639
1997	$529	$736	$4	$1,185
1999	$1,497	$922	$5	$2,159
2001	$2,010	$897	$8	$2,323
2003	$2,143	$448	$14	$2,164
2005	$1,685	$703	$20	$2,408
2007	$2,098	$723	$26	$2,711

** The sum of the three columns for each year is less than the total shown because overlapping assets involved in screening and advocacy are subtracted to avoid double counting.*

Source: "2007 Report on Socially Responsible Investing Trends in the United States," Social Investment Forum Foundation, 2008

"It's hard to say at this point what the results will be," says Julie Tanner, assistant director of socially responsible investing at Christian Brothers and a member of a panel reviewing the issue. "We look forward to the board's recommendations," due before Newmont's 2009 annual meeting, she says.

As the SRI movement matures, it has shifted more and more of its focus toward engaging companies directly on a variety of issues, ranging from CEO pay to human rights in overseas factories.

"Responsible investors are no longer simply avoiding stocks in companies they have problems with," says Smith of Walden Asset Management. "They are, with trillions of dollars behind them, engaging companies, writing letters, talking with them, voting their proxies, filing shareholder resolutions and voting and debating at stockholder meetings. These are not investors that are seeking an illusory, pure corner of the marketplace, they are investors who are engaged in the [real] marketplace."

Shareholder resolutions are the most visible manifestation of that engagement. From 2005 through the first half of 2007, a total of 1,065 resolutions were filed on social, environmental and governance issues. Support for resolutions filed in the first half of 2007 stood at 15.4 percent of votes cast, compared with 9.8 percent in 2005 and 13.3 percent in 2006. [25]

Even so, shareholder activism can be a tough road. Companies often resist resolutions, especially those that are costly or disruptive. Even resolutions that pass may not lead to real change.

"A company can do something because of a shareholder resolution," says Tanner, "but the real question is, how robust and substantive is the company's implementation going to be?"

SRI advocates often prefer to try engaging in direct talks with management on issues of concern before going the resolution route. "The preferable outcome is negotiated settlement," says KLD's Kinder. "It doesn't start with a proxy resolution. A proxy resolution in the context of socially responsible investing typically represents failed negotiations."

In the Newmont Mining case, Tanner says, "We were in dialogue with the company, we had been speaking to them for a while; it wasn't necessarily that we were having a failed negotiation [but] I don't think things had gotten to where the company was going to take action to the extent we wanted them to."

Jeanne M. Logsdon, a professor of business ethics, and Harry J. Van Buren III, an assistant professor of business and society, both at the University of New Mexico, study shareholder activism. In one study they classified more than 1,700 shareholder resolutions filed over seven years with companies listed on the New York Stock Exchange by members of the Interfaith Center on Corporate Responsibility (ICCR), an association of 275 faith-based institutional investors. More than 40 percent of the resolutions — 707 in all — related to "justice" issues, with employment and economic-development concerns the most prevalent. [26]

Logsdon says that while few such resolutions are approved by the majority of a corporation's stockholders, they can be effective in raising the public profile of an issue.

"You don't do it because you're going to win, you do it to bring attention to an issue — to take a stand

and to signal to corporate leaders that the companies should be dealing with the issue."

Van Buren, who engages in shareholder activism on behalf of the Episcopal Church, says the church doesn't do much stock screening but has been an active filer of shareholder resolutions.

For years, he says, the church has been raising red flags about predatory and sub-prime lending, issues now at the center of Wall Street upheaval. "If you look at shareholder resolutions that are being filed today, in many cases they represent leading-edge issues that corporations or other stakeholders pick up in years to come," Van Buren says.

In a study published this summer, Logsdon and Van Buren looked at how social activists influence companies through direct dialogues with management. They studied nearly 1,200 new and ongoing dialogues initiated by ICCR members from 1999 through 2005 with such firms as Citigroup (20 dialogues), Wal-Mart Stores (19), Coca-Cola (15) and Bank of America and Target (14 each). [27]

Van Buren says no researchers have systematically tracked whether shareholder activists are getting concrete results from such talks. But one "imperfect" measure of such progress, he says, is the number of shareholder resolutions that are withdrawn. Such withdrawals may occur if a company makes enough of an effort to change to satisfy the concerns of activists.

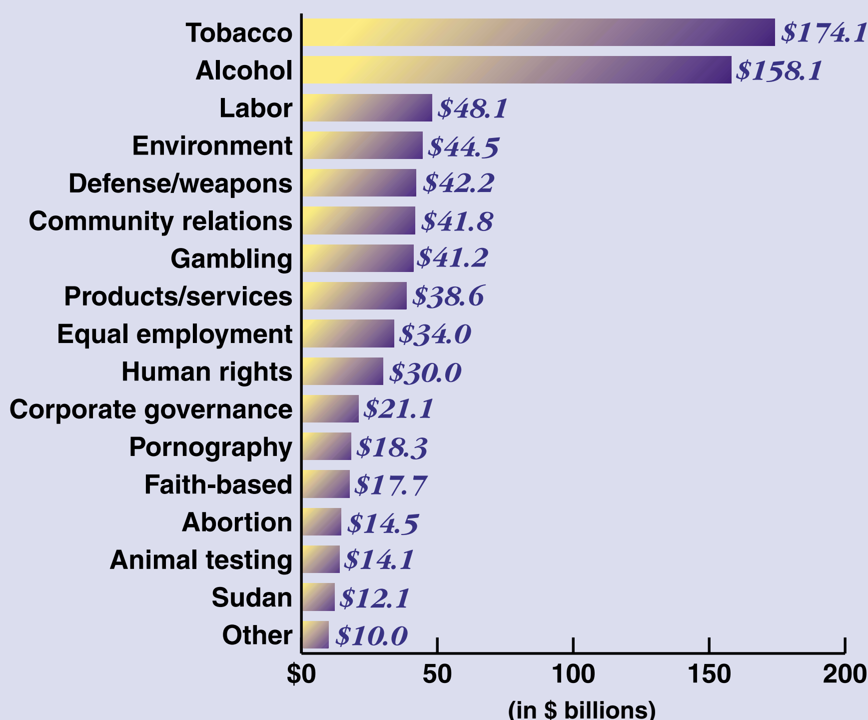
"The real work of shareholder activism gets done in ongoing corporate dialogue," Van Buren says. "You file a resolution, you may withdraw the resolution, but with a condition of withdrawal the company will agree to do something."

According to the Social Investment Forum, of the 1,065 resolutions filed from 2005 to mid-2007, 319 were withdrawn, and 561 were voted on. [28] ■

Tobacco and Alcohol Are Top Social Screens

Among funds that screen for social and environmental concerns, tobacco is the most prevalent criterion incorporated into portfolio management. It was employed by 166 of the 260 funds identified, with more than $174 billion in total net assets under management, or more than 86 percent of the total assets of socially screened funds. Alcohol is the second most predominant social screen, with more than $158 billion managed by 125 funds.

Total Net Assets of Socially Screened Funds by Category, 2007



Source: "2007 Report on Socially Responsible Investing Trends in the United States," Social Investment Forum Foundation, 2008

BACKGROUND

Early Activism

Socially responsible investing boasts a venerable history. In an 18th-century sermon titled "The Use of Money," Methodism's founder, Anglican minister John Wesley, warned against engaging in liquor production, industries that pollute, such as tanning, and practices such as bribery. [29] "We ought not to gain money at the expense of life," he declared. [30]

Quakers and Methodists in early America refused to invest in ways that might help the slave trade. [31] And during the 19th century, many religious investors refused to put money into such activities as liquor and tobacco production, gambling and weapons manufacturing.

Mutual funds that practice social screening emerged in the 20th century. The Pioneer Fund began screening out "sin" stocks in 1950 to serve Christian investors. [32] Then, in 1971, two United Methodist Church activists in peace, housing and employment issues started the Pax World Fund, which the company calls the first broadly diversified, publicly available mutual fund to use social as well as financial criteria in making investment decisions. [33]

During the late 1960s and early '70s intense social activism by advocacy and religious groups began placing more and more emphasis on corporate responsibility.

The Interfaith Center on Corporate Responsibility (ICCR) was founded in 1971 partly as a result of opposition to the Vietnam War. Progressive clergy questioned whether churches were profiting from the war, such as by holding the stocks of arms manufacturers. The questioning spread further, to such issues as production of nuclear weapons, sale of military goods abroad, creation of space weapons and apartheid in South Africa. [34]

"One of the things our founding members looked at was, if we're going to be endowed institutional investors, do we choose to own companies that make money on some of the precise social ills we're trying to counteract?" says Laura Berry, executive director of the ICCR.

South Africa's system of racial separation was becoming a highly visible cause among many socially conscious investors during this period. In 1971 the Episcopal Church filed the first church-sponsored shareholder resolution, which called on General Motors (GM) to close down operations in South Africa because of the government's apartheid policy.

That same year, Leon Sullivan, an African-American Baptist minister, was elected a GM director. He used his influence on the GM board to campaign against apartheid and later in the decade developed a code of conduct for companies doing business in South Africa, known as the Sullivan Principles.

By the 1980s, growing anti-apartheid fervor, including pressure from Sullivan, helped lead a number of churches, pension plans and other institutional investors to either divest themselves of stock in U.S. corporations operating in South Africa or use their shares to urge companies to withdraw from the country. By the end of the 1980s scores of companies were leaving South Africa.

"The anti-apartheid campaigns of the 1980s provided a galvanizing moment in the history of SRI," according to the Social Investment Forum. [35]

Apartheid was not the only concern that led social investors to examine their stock portfolios. Environmental catastrophes such as a poison-gas leak at a Union Carbide factory in Bhopal, India, that killed thousands in 1984, a nuclear disaster in Chernobyl, in what is now Ukraine, in 1986 and the *Exxon Valdez* oil spill in Alaska in 1989 "served as flashpoints for investor concerns over pollution and corporate responsibility," the forum noted. [36]

By the 1990s and early 2000s, social investing had percolated into the mainstream investment world, leading to the creation of an entire infrastructure of investing vehicles.

SRI indexes — for example, the Domini 400 Social Index, Dow Jones Sustainability Indexes (started in 1999) and London-based FTSE4Good indexes (2001) — have helped track the financial performance of companies and provided yardsticks for corporations to measure their social progress against their peers.

And as social investing grew, it also evolved and diversified. "We started looking for positive things to invest in," says Goodridge of Northstar Asset Management, "and we then moved into shareholder activism in a big way, and then into community investing."

Key Rulings

Several key government rulings have added to the movement's momentum.

In 2003, the Securities and Exchange Commission (SEC) required all mutual funds to disclose their proxy votes on corporate issues — the kind of disclosure that had long been sought by social investors. [37] In 1999 Domini Social Investments says it became the first mutual fund manager to publicly disclose its proxy votes.

Critics of the SEC decision said it would be costly for shareholders and wouldn't help them much, but SRI proponents hailed the new regulation. "What [mutual funds] are really worried about is the end of all their conflicts of interest," said Tim Grant, then-president of Pax World Funds. [38]

Another key government decision involved the question of whether company-sponsored "defined contribution" retirement plans, such as 401(k) plans, could include socially responsible funds among their investment choices.

A decade ago, many plan administrators shied away from SRI investments out of concern that they would violate the Employee Retirement Income Security Act (ERISA) rule that assets be invested for the exclusive benefit of plan participants. [39]

However, William M. Tartikoff, general counsel of the Calvert Group, requested an advisory opinion from the Labor Department, which said in a May 1998 letter that ERISA's fiduciary standards don't rule out socially screened funds as long as "the investment was expected to provide an investment return commensurate to investments having similar risks." [40]

"The letter gave us great optimism," Tartikoff said on the 10th anniversary of the opinion. "It gave us comfort and validated what we were doing and what we were saying was correct

Continued on p. 684

Chronology

1700s-1950

Roots of socially responsible investment movement are developed.

1700s
Methodism founder John Wesley warns against making money "at the expense of life."

1800s
Religious investors shun liquor and tobacco production, gambling and weapons-making.

1950
Pioneer Fund becomes first mutual fund to screen for "sin" stocks.

1970s

Opposition to South African apartheid and Vietnam War helps establish social-investing practices.

1971
Interfaith Center on Corporate Responsibility is founded. . . . Pax World launches nation's first publicly available socially responsible investment fund. . . . Episcopal Church files first church-sponsored shareholder resolution.

1977
African-American pastor Leon H. Sullivan develops code of conduct on human rights and equal opportunity for companies operating in South Africa, eventually helping to dismantle apartheid; in the late 1990s Sullivan announces successor set of principles for industries worldwide.

1980s-1990s

Anti-apartheid campaigns help spur companies to leave South Africa, and socially responsible investing moves increasingly into the mainstream investment world.

1982
Calvert Social Investment Fund becomes the first U.S. mutual fund to prohibit investments in companies doing business in South Africa.

1985
Social Investment Forum launched.

1989
Ceres, a national network of investors and others addressing environmental sustainability, is formed.

1990
Domini 400 Social Index, first index to measure performance of broad group of socially responsible stocks in the U.S., is created.

1998
U.S. Department of Labor tells Calvert Group federal law doesn't preclude use of "socially responsible" funds in retirement plans.

1999
Domini Social Investments becomes first mutual fund manager to publish its proxy-voting record. . . . Dow Jones Sustainability Indexes are launched.

2000-Present

Public pensions impose tobacco and other screens; climate change rises as social-investment priority.

2000
Nation's largest pension fund, the California Public Employees' Retirement System (CalPERS), announces it will sell its tobacco holdings.

2001
London-based FTSE4Good indexes begin tracking social investing.

2003
Securities and Exchange Commission requires mutual funds to disclose proxy votes.

2004
Environmentalist and entrepreneur Paul Hawken issues report critical of the socially responsible investment mutual fund industry, arguing it "has no standards, no definitions and no regulations other than financial regulations." . . . Mercer, a worldwide consulting firm, starts a "responsible investment" unit.

2006
United Nations launches "Principles of Responsible Investment" to help large investors integrate environmental, social and governance factors into their investment decisions. . . . Sudan Divestment Task Force established to persuade states, universities and other groups to restrict Sudan-linked investments.

2007
Mercer survey finds that 19 percent of defined-contribution retirement plans include a social-investment option, and 41 percent plan to add one over the next three years. . . . *Los Angeles Times* publishes stories critical of investment policy of Bill & Melinda Gates Foundation.

2008
California public pensions reportedly re-examining policy on tobacco investments. . . . New Hampshire orders its public pensions to divest Sudan-related investments, sparking resistance from pension officials. . . . Social Investment Forum identifies $2.7 trillion in assets under management using socially responsible investing strategies.

Big Financial Institutions Are Going 'Green'

Investors say profits and principles go together.

Climate change may be bad for planet Earth, but it's good for the bottom line, Deutsche Bank decided last fall, launching its new "climate change investment initiative."

The big German-based institution was one of the latest mainstream financial institutions and socially responsible investment companies to focus on issues like global warming, renewable fuels and environmental sustainability.

"Companies and investors are quickly realizing that climate change is not merely a social, political or moral issue — it is an economic and business issue as well," declared Kevin Parker, Deutsche Bank's global head of asset management. [1]

Environmental funds have been attracting stronger investor interest lately than some other social-investing vehicles. Inflows of money into so-called green funds totaled $766 million for the year ending May 31, compared with net outflows among religion-based funds of $37 million for that 12-month period, according to Morningstar, which tracks both categories under the heading of socially responsible investing. [2]

"It's not just tree huggers" who are concerned about global warming, Holly Isdale, managing director and head of wealth advisory at Lehman Brothers, the big New York investment bank, told *The Wall Street Journal* last year. "There's money to be made, and people want to know how to make it." [3]

New green funds have sprouted at longtime social-investment companies such as Pax World, whose five-month-old Global Green Fund invests in companies focused on "mitigating the environmental impact of commerce," and Calvert, which launched the Calvert Global Alternative Energy Fund last year and plans to launch a Global Water Fund later this year. [4]

And new funds are popping up at traditional financial firms in Europe, the United States and elsewhere.

"In a little more than two years," Parker of Deutsche Bank wrote in March, "we estimate retail investors all over the world have pumped around $66 [billion] into more than 200 newly launched mutual funds and exchange-traded funds investing in companies that help to mitigate or adapt to climate change." [5]

Last November Deutsche Bank, through its U.S. retail unit, launched the DWS Climate Change Fund, which focuses on alternative energy, energy-efficient products and companies that deal with damage to the environment.

One overarching factor is behind the growth in socially responsible investing, says Peter Kinder, president of KLD Research & Analytics, a social-investing research firm: "There's always more than one answer [but] the short answer is, global warming is driving this. There is in my mind no question that is true."

KLD's Global Climate 100 Index, which the company bills as the first global index focused on climate change, marked its third anniversary this summer. It holds companies engaged in renewable energy, clean technology and "future fuels." [6]

In an analysis of social-screening trends among all invest-

Continued from p. 682

and that, in fact, there was no inherent reason for Calvert's socially screened funds not to be chosen on a 401(k) platform and as a plan option." [41]

SRI has made inroads into the retirement-plan field since then. A survey last year by Mercer found that 19 percent of defined-contribution retirement-plan sponsors had an SRI option, and an additional 41 percent expected to be doing so within three years. [42]

As the responsible-investing movement moves more and more into the mainstream, investors and money managers are increasingly using environmental, social and corporate governance factors — or ESG principles — to guide their investment decisions, a trend driven in no small way by concern over climate change.

Traditional investing firms have picked up on the trend. For instance, State Street Global Advisors has been using some ESG-applied research over the past couple of years, according to *The Wall Street Journal*. "We are seeing these factors start mainstreaming," said William Page, chairman of State Street's ESG Team. He said the team uses ESG research for accounts of some wealthy investors and private institutional investors. [43]

While ESG principles are consistent with the traditional moral or ethical impulses that have long driven the SRI movement, many institutional investors are embracing them because they help shape financial performance.

In 2006, the United Nations issued a set of voluntary "Principles for Responsible Investment" that aimed to help institutional investors and others integrate environmental, social and governance factors into their investment decisions and ownership practices with the goal of improving long-term returns.

As of this past May, the principles had garnered 362 signatories, with European investors leading the way with 148 signatories representing $9.7 trillion in assets under management. North America counted 70 signatories with $2.3 trillion. [44]

"The great majority of new signatories continue to be mainstream pension funds, insurance companies and investment managers, with a minority coming from the dedicated socially responsible investment sector," according to the latest progress report on the effort. [45]

ment funds, the Social Investment Forum found that environmental concerns were more frequently incorporated into fund management than either labor-friendly criteria or alcohol restrictions, though the 146 funds that incorporate environmental criteria managed fewer assets overall than either labor-friendly or alcohol-restricted funds. [7]

As environmental issues heat up, social investors are joining with others in public-policy advocacy efforts.

This summer, for example, an investor group that includes officials from a number of social-investment companies, pension funds, foundations and other organizations, called on the U.S. Senate to extend tax credits for renewable energy and energy-efficiency projects that are set to expire at the end of the year. [8] In May investors urged senators to enact legislation dealing with global warming. [9]

The efforts were organized by Ceres, a 19-year-old Boston-based network of investors, environmental groups and other public-interest groups, and its Investor Network on Climate Risk, made up of more than 70 institutional investors with roughly $6 trillion in assets.

Ceres also started the Global Reporting Initiative, based in Amsterdam, which provides a framework for companies and other organizations to report their environmental, social and governance performance. The framework is used by more than 1,200 companies worldwide. [10]

"While U.S. policy makers are running in place on climate change," Ceres President Mindy S. Lubber wrote in a blog this month, "global investors are moving quickly to make money from its far-reaching risks and opportunities." [11]

[1] Deutsche Asset Management, "Investing In Climate Change," October 2007, p. 1.

[2] Elizabeth O'Brien, "Green Investing — The Gold Rush," *Financial Planning*, Aug. 1, 2008.

[3] Jilian Mincer, "Why 'Green' Investing Has Gained Focus," *The Wall Street Journal*, June 21, 2007.

[4] O'Brien, *op. cit.*

[5] Kevin Parker, "Investment is key in climate change battle," *Financial Times*, March 24, 2008.

[6] "KLD Global Climate 100 Index Marks Three Year Anniversary," www.kld.com/newsletter/archive/press/pdf/1216311527_GC100%203rd%20Anniv%20release_Final%20(2).pdf.

[7] Social Investment Forum, "2007 Report on Socially Responsible Investing Trends in the United States," p. 11.

[8] Ceres, "Investors with $1.5 Trillion in Assets Call on Congress to Extend Renewable Energy and Energy Efficiency Tax Credits," press release, July 29, 2008, www.ceres.org/NETCOMMUNITY/Page.aspx?pid=923&srcid=705.

[9] Ceres, "Investors Managing $2.3 Trillion Call on Congress to Tackle Global Climate Change," press release, www.incr.com/NETCOMMUNITY/Page.aspx?pid=900.

[10] Ceres, www.ceres.org/NETCOMMUNITY/Page.aspx?pid=415&srcid=552.

[11] Mindy S. Lubber, "Climate Change: Investors' Next Global Mega-Trend? Harvard Business Publishing, Aug. 1, 2008, http://blogs.harvardbusiness.org/leadinggreen/2008/08/climate-change-investors-next.html.

The U.N. principles are not the only effort to frame investment decisions around corporate responsibility. For example, the Carbon Disclosure Project, a British nonprofit group, serves institutional investors with some $57 trillion in assets under management globally. It analyzes how major companies around the world are responding to climate change and examines the commercial risks and opportunities it presents to corporations. This year it sought emissions data from 3,000 companies.

Investment-consulting firms also are adopting ESG principles in their work. For example, Mercer's "responsible investment" unit employs 16 people around the world who rate institutional money managers according to how they use environmental, social and governance factors in their investment decisions. That information helps guide Mercer clients, such as pension-plan administrators and private foundations, in selecting investment managers.

"It's a big growth area for us," says Craig Metrick, U.S. head of responsible investments for Mercer Investment Consulting. "Increasing numbers of institutional investors are coming to look at social responsibility as way to manage risk and look for opportunities in their portfolios long term."

Sharp Critiques

As responsible investing has become a more prominent part of the investing scene, it also has invited sharp critiques — particularly where mutual funds and stock screening are concerned.

In his 2004 report, for example, environmentalist Hawken took issue with screening methods among SRI funds, saying they "allow practically any publicly held corporation to be considered as an SRI portfolio company." [46] The single most important criterion for a company, he argued, is whether "its services and products [are] helpful to the world we inhabit. . . . What does it matter if one fast-food company is singled out as 'best in its class. . . ?" he posited. ". . . [I]f you are going the wrong way, it doesn't matter how you get there." [47]

In his influential book *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility*, David

Should Foundations Screen Their Investments?

Some experts question the benefit to society.

With some $39 billion in assets, the Bill & Melinda Gates Foundation is the nation's largest private foundation — and a revered leader in global philanthropy. But early last year, the *Los Angeles Times* questioned the huge philanthropy's investment practices.

The newspaper concluded that the foundation "reaps vast financial gains every year from investments that contravene its good works" and had holdings in companies that had "failed tests of social responsibility because of environmental lapses, employment discrimination, disregard for worker rights, or unethical practices." [1]

In one example, it noted that the foundation had spent $218 million on polio and measles immunization and research worldwide, including in the Niger Delta, but that it had invested $423 million in companies responsible for most of the oil-plant flares that spew pollution in the delta. [2]

The articles touched off a spirited debate in philanthropy circles about whether foundations, which together control some $670 billion in assets, should do more to align their investments with their charitable missions. [3]

"Creating an immutable firewall between investments and grants is nonsensical, a strategy worthy of ostriches, not leaders," Allison H. Fine, a senior fellow at Demos: A Network for Ideas and Action, said at a panel discussion last year prompted by the articles on the Gates Foundation. [4]

But some philanthropy experts question whether efforts by foundations to screen their investment holdings can do very much to help society.

"There is definitely a virtue to aligning the investments of the foundation with its mission," says Mark Kramer, founder and managing director of FSG Social Impact Advisors, a non-profit consulting organization in Boston. But, he adds, while shareholder advocacy "can absolutely have a demonstrable impact" on companies, "it's not clear that screening public equities has any demonstrable social impact."

"It would be very hard to have enough volume [of shares] to truly affect the [stock] price of a large publicly traded company, and even if you did, in a sense what you might be doing is simply giving a better investment to someone who's less ethically inclined because they can pick up a valuable stock at a lower price.

"So there is something around the advocacy piece — the pressure that . . . foundations can put on companies — but whether they are not buying tobacco stocks, or are buying stocks in companies they believe are more sustainable, it's a good thing to do in terms of aligning your values, but it's not clear that it's a high impact strategy."

Gates keeps its grant making and investment management separate. It says Bill and Melinda Gates guide the foundation's endowment managers in voting proxies in a manner "consistent with the principles of good governance and good management" and that "they have defined areas in which the endowment will not invest, such as companies whose profit model is centrally tied to corporate activity that they find egregious." The foundation singles out tobacco stocks. [5]

On the issue of investments in Sudan, the foundation says the Gateses have directed the investment team "to be consistent with the approach taken by the endowment managers for Harvard, Yale and Stanford universities." The Gates endowment "no longer has any holdings in the companies identified by these institutions in their investment policy statements on Sudan."

If Gates does not apply broader screens to its investments, it is hardly alone among foundations. A *Chronicle of Philanthropy* survey of the 50 wealthiest private foundations in 2006 found that 34 applied no screens or declined to comment. At least 13 foundations said they screened for tobacco, and several of those screened other investments, such as those in alcohol, firearms or gambling. [6]

The newspaper also found that most foundations don't do much to influence shareholder votes. The survey found that 30 of the 50 big foundations allow their money managers to make all decisions about proxy voting. [7]

Even so, some foundations are strengthening efforts to bring their philanthropic aims into closer alignment with their endowments.

A study last year of 92 foundations by FSG Social Impact Advisors found that the number of philanthropies involved in mission-related investing doubled in the previous decade. Making loans to charities, a process known as program-related investments, was the most common approach. [8]

The F. B. Heron Foundation, Annie E. Casey Foundation and Meyer Memorial Trust have challenged other grant makers to dedicate at least 2 percent of assets to mission-related investments. [9]

Vogel — a professor of both business ethics and political science at the University of California, Berkeley — questioned some of the underlying tenets of the SRI movement.

Vogel noted, for example, "that the social-investment community was no more able than any other investors to identify the failures of corporate governance that created such massive shareholder losses at the beginning of the twenty-first century." He pointed out that Enron and WorldCom, among other troubled companies, were widely held by SRI funds. [48]

"Implicit in the very existence of SRI is the claim that it is possible to identify which firms are more or less responsible," Vogel also wrote. "Not only is this claim questionable, but

Also, the W.K. Kellogg Foundation last year earmarked $100 million for social and mission-driven investments in Africa and the United States. "Few foundations have fully realized the potential of what is commonly referred to as 'double-bottom-line investing,' " Sterling Speirn, the foundation's CEO, said. "We want to maximize our social return on the investment front." [10]

AFP/Getty Images/Nicholas Roberts

Bill and Melinda Gates, with investor Warren Buffett, don't invest in companies whose profit is tied to "egregious" corporate activity, such as tobacco production.

The John D. and Catherine T. MacArthur Foundation formalized a policy for voting shareholder proxies "to reduce or eliminate a substantial social injury caused by a company's actions," according to the *Los Angeles Times*. [11]

The William and Flora Hewlett Foundation screens tobacco stocks from its portfolio but says it generally is not attracted to investment screening. Instead, it is attracted to proxy voting, which "appears to be having an increasing influence on management decisions" and "is unlikely to degrade investment returns."

"We believe that we can be most effective in voting proxies that implicate climate change or forestry practices," the foundation says, adding that it "may selectively choose to exercise proxies when doing so is seen to have a particularly beneficial impact." [12]

Philanthropy experts say that actions like proxy voting remain the exception rather than the rule among philanthropies, though.

"Proxy voting is a basic first step in aligning investments and mission," according to As You Sow, a nonprofit shareholder-advocacy organization in San Francisco engaged in social and environmental issues. Yet, it adds, "when it comes to using the proxy process, most foundations still passively follow management recommendations even when they are not aligned with the foundations' own mission and values." [13]

Still, Larry Fahn, the group's executive director, says that "slowly but surely," more and more foundations are trying to align their investments with their missions by voting their proxies, engaging companies in dialogue on social and environmental issues and publishing information showing which proxy issues are important to them and how they are voting.

He says that while a foundation may dedicate its annual payout, typically 5 percent of assets, to a mission-related cause, what is needed is a "95 percent solution" in which the rest of the assets are used "proactively" through shareholder engagement.

[1] Charles Piller, Edmund Sanders and Robyn Dixon, "Dark cloud over good works of Gates Foundation," *Los Angeles Times*, Jan. 7, 2007.

[2] *Ibid.*

[3] Figure based on Foundation Center data.

[4] Ian Wilhelm, "Philanthropy Experts Debate Merits of Socially Responsible Investments," *The Chronicle of Philanthropy*, Feb. 22, 2007. The panel was organized by the Hudson Institute's Bradley Center for Philanthropy and Civic Renewal.

[5] Bill and Melinda Gates Foundation, "Our Investment Philosophy," www.gatesfoundation.org/AboutUs/OurWork/Financials/RelatedInfo/OurInvestmentPhilosophy.htm.

[6] "Stock-Investment Policies at the 50 Wealthiest Private Foundations," *The Chronicle of Philanthropy*, May 4, 2006.

[7] Harvy Lipman, "Meshing Proxy With Mission," *The Chronicle of Philanthropy*, May 4, 2006.

[8] Ian Wilhelm, "Foundations Seek to Tie Investments to Their Charitable Missions," *The Chronicle of Philanthropy*, April 19, 2007. The study is Sarah Cooch and Mark Kramer, "Compounding Impact: Mission Investing by US Foundations," Social Impact Advisors, March 2007, www.fsg-impact.org/images/upload/Compounding%20Impact(5).pdf.

[9] Social Investment Forum, "2007 Report on Socially Responsible Investing Trends in the United States," 2008, p. 22.

[10] "W.K. Kellogg Foundation Launches Mission-Driven Investing," press release, Oct. 23, 2007, www.wkkf.org.

[11] Charles Piller, "Foundations align investments with their charitable goals," *Los Angeles Times*, Dec. 29, 2007.

[12] "The William and Flora Hewlett Foundation Social Investment Policy," www.hewlett.org.

[13] Michael Passoff, "Proxy Season Preview 2008," As You Sow, www.asyousow.org.

the selection criteria employed by SRI fund managers and researchers can be criticized on several grounds." [49]

In *The Atlantic* magazine last fall, former Wall Street stock analyst Henry Blodget concluded, in the words of the article's subtitle, that "socially responsible investing is neither as profitable nor as responsible as advertised." [50]

Blodget himself is no stranger to Wall Street controversy, as he acknowledges in the article. In 2003 regulators banned him from the securities industry and fined him $4 million for putting out misleading stock research in violation of federal laws. [51] He has since become a prominent financial writer.

In *The Atlantic* article Blodget argued that "the central dilemma for most

socially responsible investors" is that "virtue can cost you."

He points out that an investor who put $1,000 in the S&P 500 in 1957 would have ended up with $124,000 in 2003, but about 5 percent less than that amount if tobacco company Philip Morris (now Altria) — the index's single best-performing stock for 46 years through 2003 — had been excluded. If the investor had put the entire $1,000 into Philip Morris alone, the ending figure would have been $4.6 million.

Blodget's critique touched on a litany of other points as well, but ended on a conciliatory note.

"[S]ocially responsible investing certainly deserves to go mainstream," he wrote. "Capital allocation decisions *can* help shape behavior. Even with different investors emphasizing different priorities, there is usually some common ground. And we need to stop insisting that SRI should be both socially *and* financially superior to traditional alternatives. It is unlikely to be both. . . .

"A lifetime of investing in SRI funds might cost you a lot more than organic milk and hybrid cars," he concluded.

"But as SRI investors become both cannier and more numerous, the sacrifice involved need not amount to the 5 percent you might have lost by boycotting Philip Morris. Perhaps, even if SRI returns are no higher than can be achieved through traditional investing — or even a bit less — the practice can be its own reward." ■

CURRENT SITUATION

Taking Stock

Generalizing about the performance of the SRI field in this year's volatile stock market is difficult, partly because of the field's broad array of holdings and investment strategies.

Getty Images/William Thomas Cain

Noted shareholder activist Evelyn Davis addresses Ford directors at the company's annual meeting in Wilmington, Del., on May 8, 2008. Agenda items included discussion of a proposed report on global warming sought by the Free Enterprise Action Fund, which owns Ford shares. Many socially responsible investors seek to influence workplace and corporate governance issues.

"Socially responsible funds are such a diverse group that it's hard to make a judgment on how well they do," David Kathman, an analyst at Morningstar who follows SRI mutual funds, noted earlier this year. "Comparisons are not all that helpful." [52]

The Domini 400 Social Index provides at least a clue, though. Through the first seven months of 2008 the 400 corporations charted by the Domini index performed about the same as the S&P 500 — roughly a negative 12.7 percent for the period. The Domini index did better than the S&P 500 in July, rising 0.24 percent compared with a 0.8 percent decline in the broader index.

Business Week noted this spring that some socially responsible funds were seeing inflows of money as investors shifted out of riskier investments and looked for ways to make money in energy. [53]

SRI managers didn't think the market downturn had shaken investor confidence in socially responsible investing, the magazine said. Geeta Aiyer, a portfolio manager at Boston Common Asset Management, said a bigger test of investors' willingness to stick with SRI has occurred during the past five years, as energy-extraction and defense stocks — shunned by social investors — have been among the strongest categories.

"For years we've been addressing the opportunity costs — what you give up by being a social investor," Aiyer said. "Now we see there's opportunity from being a social investor." [54]

Still, this year's collapse of financial stocks has left the social-investing field open to sharp criticism from those who argue that it has put too much faith in banking stocks, just as it invested heavily in technology shares early this decade.

Almost every company "that went south in the '01 collapse [in communication technology], and almost every major financial company that has imploded during the current bubble was ranked high by social investors," says Entine at the American Enterprise Institute (AEI).

Yet some SRI managers did see trouble coming. *Business Week* noted

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At Issue:

Should public pensions engage in socially responsible investing?

TIMOTHY SMITH
SENIOR VICE PRESIDENT, WALDEN ASSET MANAGEMENT

WRITTEN FOR *CQ RESEARCHER*, AUGUST 2008

yes

Public pension funds have a fiduciary duty to protect the financial interests of their beneficiaries and are obliged to keep their eye on that target. However, a responsible fiduciary is also obliged to consider a range of non-financial factors that can and do affect shareholder value.

Increasingly, it is understood that environmental, social and governance (ESG) issues have a bottom-line impact. Thus, it would be a limited and ideologically rigid perspective to flatly state these ESG issues have no place in the investment process because they are "social." In fact, pension funds around the globe increasingly have integrated ESG as a necessary ingredient, not as an afterthought.

Investment responsibility, as practiced by pension funds with literally trillions of dollars under management, includes a wide variety of strategies. Critics often define ESG or Responsible Investing as "all about screening" — thus setting up a convenient but historically inaccurate premise.

In fact, active, responsible investors are involved in:

- Voting their proxies thoughtfully and conscientiously;
- Discussing issues with companies seeking forward-looking policies and practices;
- Filing shareholder resolutions urging companies to improve environmental, social or governance practices; and
- Integrating ESG into their investment process.

Globally, investors managing more than $14 trillion in assets have endorsed the U.N.'s "Principles for Responsible Investing," which hold that part of an investor's fiduciary duty is making ESG a part of their investment process. Several issues are before such pension funds, including:

- Governance Reforms — Pension funds from unions to states and cities promote governance reforms as a means of building accountability to investors and improving value for investors.
- Climate Change — Future global devastation from climate change is well documented. As a result, investors globally with more than $50 trillion in assets under management have supported the Carbon Disclosure Project, which urges companies to reveal and reduce their carbon emissions. Hundreds of companies have stepped up as climate leaders — not for narrow, "green" reasons but because it makes long-term business sense.

Should responsible pension funds engage in ESG investing? If hundreds of companies agree that it is in their business interests to be good corporate citizens, forward-looking pension funds are simply ensuring this is reflected in their investment philosophy.

ALICIA H. MUNNELL
DIRECTOR, CENTER FOR RETIREMENT RESEARCH, BOSTON COLLEGE

WRITTEN FOR CQ RESEARCHER, AUGUST 2008

no

Social investing by public pension plans is generally ineffective and potentially dangerous. Federal law prohibits private plans from introducing social considerations into their investment decisions. And the case for public plans is even stronger.

Advocates suggest that screening out, say, tobacco stocks will hurt tobacco companies, thereby reducing cigarette supplies. But the evidence suggests the opposite. With efficient capital markets, the price of the stock is equal to the present discounted value of future cash flows. Boycotting tobacco stocks may result in a temporary fall in the stock price, but as long as some buyers remain they can swoop in, purchase the stock and make money. So ridding portfolios of "sin" has no impact on the targeted firm.

The same is true for stock prices of "good" companies. But how does one identify desirable firms? Corporations that pass ideological litmus tests today with respect to good governance, protecting the environment or having diverse workforces may turn into tomorrow's disasters. Enron had independent directors; Arthur Andersen prided itself on quality. And Odwalla was dedicated to producing healthy juices, but flaws in its systems led to injuries and a death.

Private pension plans hold virtually no investments in companies that have been screened for either "good" or "bad" characteristics. From the beginning, the Department of Labor has stringently enforced the duties of loyalty and prudence set by ERISA (Employee Retirement Income Security Act). In 1994, the Labor Department reminded fiduciaries that they are prohibited from "subordinating the interests of participants and beneficiaries . . . to unrelated objectives." And the department has just reiterated this warning, so social investing remains a public pension fund phenomenon.

But public pension funds are particularly ill-suited to social investing. First, in many instances, the environment surrounding public pension fund investing is politically charged, and encouraging fund trustees to take "their eyes off the prize" of the maximum return for any given level of risk is asking for trouble. Public pension funds have made serious mistakes in the past when they have introduced social concerns into their investment decisions. Second, the decision-makers and the stakeholders are not the same people. The decision-makers are either the fund boards or the state legislatures. The stakeholders are tomorrow's beneficiaries and/or taxpayers. If social investing produces losses either through higher administrative costs or lower returns, tomorrow's taxpayers will have to ante up, or future retirees will receive lower benefits. Public plans should just say "No" to socially responsible investing.

Continued from p. 688

that Patrick McVeigh — president of Boston-based Reynders, McVeigh Capital Management, which engages in social investing — sent a letter to *Business Ethics* magazine back in 2004 after it named government-supported mortgage-funding provider Fannie Mae the most socially responsible company that year. The letter attacked Fannie Mae for having become a big hedge fund by taking on piles of debt as it grew into new markets, *Business Week* said. Fannie's stock has plummeted this year amid huge credit losses.

"*Business Ethics* said Fannie was in the business of building dreams," McVeigh said. "We said they're in the business of building nightmares by putting people in homes they can't afford." [55]

As the SRI movement becomes larger and more prominent, it can expect to become a bigger target for critics, including those who do not think it belongs in the pension world.

AEI's Entine is among the most vocal. "In some states and municipalities, including California, New York and New York City, elected and appointed politicians responsible for overseeing public retirement funds are embracing highly controversial social and environmental criteria to decide on which companies to invest in or publicly lobby against," he wrote in a 2005 book examining public pensions and socially responsible investing. [56]

He went on to say that "social investors and advocacy groups have allied themselves with union leaders and sympathetic politicians, introducing ideology into the management of public pension funds with a stated goal of more directly influencing corporate and public policy."

The California Public Employees' Retirement System (CalPERS) and State Teachers' Retirement System (CalSTRS) have been under scrutiny for a "double bottom line" approach to investing that was introduced in 2000 by former state Treasurer Philip Angelides. His idea, according to *Business Week*, was to take pension fund money out of two asset classes that were performing poorly back then — tobacco stocks and emerging markets — and reinvest in businesses and real estate in low-income California neighborhoods. The aim was to produce both a social return and a healthy financial return. [57]

AFP/Getty Images/Paul Ellis

Walden Asset Management, which calls itself "a leader in socially responsive investing," owns shares of British Petroleum despite its mixed environmental record. Walden says BP has been a leader among energy producers on the climate-change issue. Above, BP's refinery in Grangemouth, Scotland.

But a recent CalSTRS report revealed that the $172-billion fund would have had $1 billion more had it not shunned tobacco stocks, *Business Week* said. What's more, real estate investing by the $239 billion CalPERS has been "particularly painful," it said, adding: "Among other bad deals, it faces a loss of nearly $1 billion on one land investment alone.

"The performance of the double bottom line plan illustrates the potential drawbacks of socially responsible investing," *Business Week* wrote. "While it's fine for individual investors to vote their conscience by putting money into the growing number of socially responsible mutual funds, they should know that it could lead to weaker investment performance. . . . Like it or not, people do gamble, smoke and buy expensive nuclear-powered war machines."

Pension Problems

How long the California public pension system plans to stick with its investing approach is in question, however. The system reportedly is considering reversing its anti-tobacco policy. The State Teachers' Retirement System could vote on such a move as early as this fall, and the California Public Employees' Retirement System is also monitoring the issue, according to a report in August in *The New York Sun*. [58]

Entine at AEI says a retreat by the California funds would be a "watershed" event and a sign that "from a fiduciary standpoint [SRI] doesn't hold water."

In New Hampshire the legislature passed a law requiring its two public pension systems to sell its investments supporting Sudan, which has been accused of genocide, but pension officials said the law may be unconstitutional, The Associated Press (AP) reported in August. [59] Pension officials were studying whether to challenge the law after Democratic Gov. John Lynch refused a request to veto the bill.

In a letter obtained by the AP, a pension system lawyer told Lynch the divestiture provision violated the state constitution "because it would require the board to make investment decisions

for [a] purpose other than providing benefits to members and beneficiaries and divest assets in order to further the foreign policy objectives of the New Hampshire legislature."

Public-pension squabbles aren't alone in stirring up controversy on the social-responsibility front. Shareholder activism by religious investors and union pension funds also has been controversial.

Last year the Securities and Exchange Commission asked for public comment on proposals to limit the right of shareholders to file proxy resolutions and participate in nominating corporate board members. The curbs were supported by business groups and opposed, in part, by thousands of investors through a Web site formed by the Social Investment Forum and Interfaith Center on Corporate Responsibility (ICCR). [60] The SEC dropped the proxy-resolution idea, but the board-nomination proposal remains on hold, according to Smith at Walden Asset Management.

Meanwhile, the SEC, in a shift of policy, told corporations this year they have to let shareholders vote on a proposal for universal health insurance coverage — a topic of great concern to many social investors. [61] The proposal, backed by such groups as the ICCR, urges companies to adopt "principles for comprehensive health-care reform" such as those reported by the Institute of Medicine, part of the National Academy of Sciences.

The SEC said it was appropriate for shareholders to tell companies what they think by voting on "significant social policy issues" that go beyond day-to-day business matters. [62]

Religious groups and labor unions have submitted the same basic health-care proposal to several dozen corporations, according to *The New York Times*. "We are working for a national policy that provides universal access to health care, and we do hold more than 30,000 shares of General Electric stock," Barbara Kraemer, a Roman Catholic nun who is national president of the School Sisters of St. Francis, told the newspaper. "As we pursued the proposal with G.E., the company requested a dialogue in lieu of the shareholder resolution, so we withdrew it. The dialogue was productive, resulting in G.E.'s public endorsement of the Institute of Medicine principles." [63]

A shareholder campaign by the AFL-CIO that includes the health-care proposal has met stiff resistance from the U.S. Chamber of Commerce. Last year the chamber asked the Labor Department to weigh in on whether a shareholder campaign by the labor group on health care and other issues was in line with ERISA, the federal retirement-security law. The opinion, issued in December, said pension trustees risk running afoul of their fiduciary duty when they "attempt to further legislative, regulatory or public policy issues through the proxy process when there is no clear economic benefit to the plan." [64]

The letter "sends a clear message that union pension trustees need to put workers' retirement security first, instead of any political agenda," Chamber President Thomas J. Donohue said. "Union pension savings belong to beneficiaries and retirees and must not be tapped to advance goals other than the economic enhancement of those funds." [65]

But Daniel Pedrotty, director of the AFL-CIO's Office of Investment, argues that the advisory opinion broke no new ground and does not preclude investor groups proposing shareholder resolutions that affect their members and beneficiaries.

That, he says, was borne out by the SEC's recent change in policy allowing shareholders to vote on the health-care principles.

"The No. 1 competitive concern for companies is the cost of health care," he says. "We felt like it was a legitimate issue." ■

The integration of environmental, social and governance standards into investment analysis is already widespread in Europe, and many SRI advocates believe the approach will continue to gain favor in the United States among professional money managers.

OUTLOOK

Continued Growth?

As global warming, health-care access, employee rights in overseas factories and other issues continue to emerge on the public-policy scene, the appeal of socially responsible investing seems likely to grow.

But the sector also faces challenges in convincing skeptics that its screening methods are sound and that financial returns on social investments are at least competitive — if not superior — to those found in conventional ones.

The integration of environmental, social and governance standards into

investment analysis is already widespread in Europe, and many SRI advocates believe the approach will continue to gain favor in the United States among professional money managers.

"To the degree that we can demonstrate that this integration approach can improve performance, that's where you're going to attract more investors" to SRI, says Hilton of the Calvert Group. "In some ways, if we're successful, it will almost put us out of a job, meaning if we're really good at integrating ESG performance and we have better performance, then at some point everybody's going to start doing that."

SRI advocates point to the fact that progress reports on environmental sustainability have become standard among many of the nation's biggest corporations as climate and energy issues have gained prominence. While some of those companies may engage in "greenwashing" — substituting public relations spin for substance in promoting their environmental efforts — the reports are nonetheless significant, SRI advocates say.

"Yes, [the corporate sustainability reports] might not be as honest as they could be," the *Green Money Journal's* Feigenbaum says. But "they're putting it in print, they're putting themselves out there in a way they have never done before. There is an unstoppable movement [among] every board in this country" to address the sustainability issue.

Besides environmental issues, a range of other concerns is likely to animate the SRI movement in coming years, either through investing practices or shareholder activism. Those issues range from excessive CEO pay, which many SRI proponents see as a social as well as governance concern, to divestment in stocks of companies profiting from commerce in Sudan.

As advocates of socially responsible investing look back on the movement's early roots, they express the hope that it continues to move into the mainstream.

"This industry is a lot like the natural-foods industry," says Alexander, the former grocery store owner in Durham, N.C. "When we started, people thought we were just a bunch of wacko hippies. Twenty or 25 years later, at the convenience store they're selling soy milk. I'm hoping socially responsible investing is like that." ■

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About the Author

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As You Sow, 311 California St., Suite 510, San Francisco CA 94104; (415) 391-3212; www.asyousow.org. Shareholder advocacy group that seeks to bring about change within public companies.

Calvert Group, 4550 Montgomery Ave., Suite 1000N, Bethesda, MD 20814; (800) 368-2748. Mutual fund company engaged in socially responsible investing.

Ceres, 99 Chauncy St., 6th Floor, Boston, MA 02111; (617) 247-0700; www.ceres.org. Coalition of investors, environmental organizations and other public-interest groups working with companies and investors to address "sustainability" issues such as climate change.

Domini Social Investments, P.O. Box 9785, Providence, RI 02940; (800) 762-6814; www.domini.com. Mutual fund company engaged in socially responsible investing.

Interfaith Center on Corporate Responsibility, Room 1842, 475 Riverside Dr., New York, NY 10115; (212) 870-2295; www.iccr.org. Association of 275 faith-based institutional investors.

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