

Investing With a Conscience: 7 Things You Should Know

The changing face of 'socially responsible' funds

By [KATY MARQUARDT](#)

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Mutual funds that follow "socially responsible" investing philosophies aren't always what they seem. Pax World Management, a pioneer of sustainable investing in the fund world, recently caused a stir when it agreed to pay \$500,000 to settle Securities and Exchange Commission charges that it strayed from its own guidelines by buying stocks of companies involved in alcohol, tobacco, gambling, and defense. (In a statement, the company said it has since implemented a "top-to-bottom reorganization" of its operations, which included a management overhaul and revamp of its procedures and controls.)

Although clearly a blemish on Pax's record, the settlement won't likely bruise the burgeoning socially responsible investing (SRI) industry, which has ballooned to \$2.7 trillion in assets held by individuals and institutions, according to the Social Investment Forum (assets held in mutual funds, ETFs, and other funds rose to nearly \$202 billion in 2007, up 13 percent from \$179 billion in 2005.) Despite its rapid growth, the industry is still maturing: Former off-limits industries are gaining acceptance, environmentally oriented funds are gaining steam, and SRI strategies are making their way into 401(k) plans. Here are seven facts to bring you up to speed on the world of SRI investing:

The SRI moniker is a bit outdated. It's tough to avoid the phrase "socially responsible investing" when discussing this category. Some critics say the term paints other investors (or investments) as socially irresponsible, and others feel that it's not inclusive enough. "I'm not crazy about the term," says Art Tabuenca, founder of Blue Marble Investments, a San Luis Obispo, Calif.-based firm that specializes in, well, socially responsible investments. "The emphasis on social is great, but it's kind of old-fashioned because it leaves out the environmental and governance aspects." Alternative labels include "socially conscious," "socially active," and "socially motivated," but these terms have yet to catch on within the industry.

Approaches vary widely. Nearly 150 socially screened mutual funds are on the market, according to Morningstar. [Faith-based funds](#), which make up about 10 percent of total SRI fund assets, impose "morally responsible" screens, and may shun companies that support abortion, casinos, and pornography. Examples include [Amana](#), which invests in line with Islamic principles, the conservative Christian Timothy Plan funds, and the Roman Catholic Ava Maria mutual funds. Secular SRI funds, such as those managed by Pax, typically evaluate companies based on a combination of issues, including environmental stewardship, human rights, and diversity in the workplace. The category even includes a few "SRI lite" offerings, which screen based on just one or two issues, such as American Century's Livestrong funds that exclude tobacco-related companies on account of their link to the Lance Armstrong Foundation.

Screens are evolving. Instead of applying exclusionary screens, some funds are using "positive screens" to find companies with above-average standards on issues such as the environment. Others are incorporating "best of class" exemptions: Instead of excluding all companies in an industry—such as oil—these funds consider companies with forward-thinking views on the environment. This might mean investing in an oil company that's working to control emissions. A fund that engages in both positive and best-of-class screening is Winslow Green Growth, which hunts for environmentally proactive companies, and fills remaining slots with benign companies that don't harm the environment, and occasionally "best in class" companies that set an example for their industry. "SRI standards are clearly high, but there are gray areas," says Bill Rocco, a Morningstar analyst. "Exxon may be an easy call, but there is a lot in between. My approach is to be a little flexible, because there will be the occasional stock that's not quite what you'd like."

Standards are softening on traditional "sin stocks." Some SRI funds are moving away from categorical bans on industries such as alcohol, gambling, and nuclear. After Pax reluctantly pulled out of its investments in Starbucks in 2005 because the coffee chain licensed its name to Jim Beam Brands for a coffee-liqueur drink, the fund family relaxed its screens on companies that derive revenue from alcohol and gambling. Recently, Pax imposed more flexible guidelines on nuclear power plants, and voted to permit investments in Treasury bonds, which were previously off limits because they are used to fund defense spending. Calvert Group, a Bethesda, Md., family of SRI funds, also recently adjusted its criteria on nuclear plants by considering companies with existing nuclear power if they are also developing alternative energy.

Climate change is a major growth catalyst. Although socially responsible investing has religious roots, the modern SRI movement grew out of antiwar sentiment in the 1960s, when investors objected to supporting companies that were supplying the Vietnam War. During the 1980s and 1990s, SRI strategies were embraced by investors opposed to apartheid in South Africa, as well as tobacco and alcohol. Today, concerns about climate change are a key driver of the SRI industry's growth, according to a recent TIAA-CREF report on socially responsible investing. "What's given climate change its widespread impetus is the impact of oil," says Tabuenca. "Today, people are more aware and more affected by this issue than ever before."

"Green" funds are winning over liberals and conservatives. According to a recent survey from Allianz Global Investors, nearly half of 1,003 investors surveyed said they were likely to invest in a company or fund that addresses environmental problems over the next year, and 17 percent said they have already done so. Of those who said they're likely to make an environmental investment, 41 percent described themselves as politically conservative and 36 percent said they are liberal.

Coming soon: SRI 401(k)'s. Socially conscious 401(k) investment options are [on the way](#). Roughly one fifth of employees currently have access to socially responsible investing funds, according to a 2007 Mercer Investment Consulting survey. By 2010, 60 percent of retirement plan sponsors surveyed expect to add SRI funds. (Currently, healthcare and government agencies are the most likely to offer SRI options, and most are funds from [Calvert](#) or [Domini](#).)