

Social Investment Forum

After South Africa:

The State of Socially Responsible Investing in the United States

SIF Industry
Research Program



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After South Africa: The State of Responsible Investing in the United States

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SECTION 1

EXECUTIVE SUMMARY

Socially responsible investing in the United States is alive and well in 1995, two years after the end of the South Africa divestment movement that helped fuel its rise during the 1970s and 1980s. This finding contradicts the "common wisdom" expressed in the media and elsewhere that the fall of apartheid in September 1993 would lead to the demise of responsible investing in the U.S. This comprehensive, year-long effort by the Social Investment Forum (SIF) to identify the extent of responsible investing in the U.S. reaches the following conclusions:

- ***Three out of four U.S. money managers who handled investments for clients opposing apartheid in South Africa continue to manage responsibly invested portfolios today.*** An estimated 78 percent of the private money managers who supported the dismantling of apartheid in South Africa are still handling portfolios of responsible investments for clients two years after the end of the divestment issue.
- ***Almost one out of every 10 dollars under management in the U.S. today is part of a responsibly invested portfolio.*** A total of 182 major investing institutions (including pension funds, community development funds, and foundations) were found to be making socially responsible investments of one type or another totaling \$639 billion in assets. This broad figure accounts for roughly 9 percent of the \$7 trillion in funds under management in the U.S., according to *Nelson's 1994 Directory of Money Managers*.
- ***An estimated \$473 billion of the total is controlled by investors who either sponsor shareholder resolutions or vote their proxies on the basis of formal policies embodying socially responsible goals.*** Through this shareholder activism, the socially concerned investors seek to gain maximum leverage from their roles as owners with a direct ability to influence company practices.
- ***An estimated \$162 billion of the total is under management in socially screened investment portfolios.*** This narrower figure applies only to portfolios employing specific, written screens in the process of making investment decisions. The \$162 billion in screened portfolio investments handled by an estimated 674 money managers fall into roughly equal portions for religious institutions (30 percent), individuals (23 percent), institutions other than government pension funds (24 percent), and government pension funds (23 percent).
- ***Over 90 percent of responsibly invested funds are managed today with three or more screens.*** This factor explains why the end of the South Africa divestment movement did not result in a dramatic fall-off in the ranks of money managers working in the responsible investment field.
- ***"Positive" criteria used in managing portfolios for socially and environmentally concerned investors are on a rapid rise today.*** Most money managers and institutions screening client portfolios continue to avoid tobacco (86 percent), alcohol (73 percent), and weapons (64 percent). The growing emphasis on responsible investing that is "positive," in the sense of encouraging improvements in company practices, is evident in the increasingly widespread use of screens for human rights (42 percent), the environment (38 percent), animal rights (24 percent), and employee rights (22 percent, including workplace treatment of women and minorities).

SECTION II

IMPACT OF THE END OF SOUTH AFRICA SCREENING ON RESPONSIBLE INVESTING

It is now two years after the historic moment on September 24, 1993, when Nelson Mandela appeared before the UN Special Committee on Apartheid in New York City and uttered the words: **"The international community should end all economic sanctions against South Africa."** Mandela's comments came just two days after South Africa's parliament approved a transitional council giving blacks their first meaningful role in controlling the affairs of the nation. Two days later, then-President Frederik de Klerk echoed Mandela's call in remarks delivered to the World Economic Development Congress in Washington.

Among the many parties that paved the way for the end of apartheid in South Africa was the social investment movement in the U.S. Beginning in the late 1970s and picking up speed throughout the 1980s, the anti-apartheid campaign resulted in scores of major U.S. corporations ending or withdrawing operations in South Africa, and institutions divesting their holdings of stocks in corporations that continued to do business under the then-racist regime. The divestment movement boosted interest in responsibly invested mutual funds, many of which also imposed "screens" forbidding investments in corporations manufacturing or promoting tobacco, alcohol, gambling, and the production of weaponry.

On the heels of the historic calls by Mandela and de Klerk for an end to divestment, leading U.S. investment companies specializing in responsible investments announced that they would no longer "screen" out corporations present or doing business in South Africa. This step led to statements by a number of market watchers and journalists that interest in the U.S. in responsible investing would wane. Without the catalyst of South Africa divestment, these individuals predicted, interest on the part of institutions and individuals in responsible investing would soon dry up.

In late 1993, the Social Investment Forum decided to undertake the first comprehensive survey of the extent of responsible investing in the United States. SIF researchers were commissioned to identify major trends in responsible investing, including the impact of the end of the South Africa divestment issue. The year-long process involved an exhaustive review of thousands of institutions and private money managers. The data under review in the SIF survey covered the period through June 1995.

The researchers found that 78 percent of all money managers in the U.S. making responsible investments on behalf of clients continued to do so after the South Africa divestment issue ended. How was it possible that more than three out four money managers remained in responsible investing after the "hot button" issue of apartheid was no longer a motivating issue for clients?

The answer here is that 91 percent of the money in responsibly invested portfolios today is managed with three or more screens. Only 9 percent of the total responsibly invested dollars are managed with two or fewer screens, according to the SIF data. As a result, the demise of the South Africa divestment issue addressed only one aspect of the screening systems used by money managers on

behalf of their socially concerned clients. Even with the apartheid issue removed, other screens remain in widespread use today by institutions and managers of responsibly invested portfolios.

SIF researchers found that, in a substantial number of cases where institutions (such as colleges and universities) focused narrowly on South Africa divestment for responsible investment purposes, a process remains in place for making similar investment decisions in relation to other human rights issues, the environment, workplace concerns, and other key matters important to investors. In response to calls for South Africa-related divestment, these institutions put in place committees and protocols for responsible investment decision making.

As a result, colleges and universities across America remain major targets for new responsible investment campaigns that are likely to come in the wake of the success of the South Africa divestment movement. Representatives of several of these educational institutions volunteered to SIF researchers that they remain receptive to the approach of responsible investing.

SECTION III

MOVEMENT FROM "SIN" TO "POSITIVE" SCREENS

Even before the rise of the South Africa divestment movement, most responsible investing in the United States operated on the principle of "avoidance." Institutions and money managers handling funds for clients shunned investments in firms engaged in the production or promotion of socially unproductive and even harmful products. Traditionally, the "sin" stocks involved corporations involved in tobacco, alcohol, gambling, and the production of weapons of destruction and violence.

In the 1980s, the primary emphasis started shifting from simple avoidance of "sin" to the use of "positive" criteria in an effort to encourage positive changes in the policies and practices of corporations. The theory is a simple one: the clout of the marketplace can be harnessed to motivate recalcitrant firms, and even whole countries, into reforming irresponsible practices.

Unlike avoidance, in which clients seek to keep their funds out of certain types of stocks, positive screens are often used to identify and reward emerging companies applying progressive policies. Additionally, through shareholder activism, some investment companies and others involved in responsible investing use their stake in "problem" companies as a means to encourage the abandonment of irresponsible policies and products.

According to the new SIF research, positive screens are now much more widely used in responsible investing than even industry leaders had assumed. Of those money managers using screens in making responsible investment decisions:

- ***More than two out five (42 percent) screen for human rights.*** Northern Ireland and Burma are the leading areas of focus in the "positive" human rights screens in the post-South Africa divestment period.

- *Over a third (38 percent) screen for environmental concerns.*
- *One in four (24 percent) screen for animal rights.*
- *More than one in five (22 percent) screen for employee relations.* This category includes such issues as unions, and the advancement of women and minorities in the workplace. Though a relative latecomer outside of union pension funds, employee relations issues appear to be the fastest-growing of the new "positive" investment criteria.

As expected, the traditional "sin" categories in responsible investing were found to be almost universal today. Of those money managers using screens in making responsible investments:

- *Almost nine out of 10 (86 percent) avoid tobacco stocks.*
- *Roughly three out of four (73 percent) avoid alcohol stocks.*
- *Two out of three (64 percent) avoid weapons stocks.*

The SIF research data includes nothing to suggest that the traditional "avoidance" core of responsible investing will either shrink or expand in the coming years. However, it does appear that the new generation of positive screens will continue to gain ground during the 1990s and beyond. It may be here that responsible investing has its greatest potential for major growth in the post-apartheid era.

SECTION IV

THE EXTENT OF RESPONSIBLE INVESTING IN THE UNITED STATES

The overall level of socially responsible investing in the United States has always been a subject of much guesswork. Spread across literally thousands of institutions and individual money managers, funds and fund managers engaged in responsible investing had never been subjected to a detailed review prior to the year-long study undertaken by the Social Investment Forum. The new SIF findings paint a picture of responsible investing as a diverse movement that continues to thrive two years after the end of the apartheid-related divestment issue.

A total of 182 major institutions (including pension funds, unions, colleges and universities, and foundations) with \$639 billion in assets under management were found to engage in responsible investments. On this basis, it can be concluded that one in every 10 dollars under management in the United States is invested in a fashion that embraces some aspect of responsible investing. The \$639 billion in assets involved in responsible investing account for about 9 percent of the total \$7 trillion in managed funds, according to Nelson's 1994 Directory of Money Managers.

In an effort to identify the smaller pool of money managers who only make responsible investments on the basis of specific, written screens also was undertaken by SIF researchers. This more rigorous review of the practices of the investment world resulted in the firm estimate that 674 money managers

in the U.S. handle a total of \$162 billion in screened portfolios. The pools of client funds handled by individual managers ranged from a high of \$33 billion to a low of \$700,000, with an average of roughly \$50 million. On average, about 5 percent of the total assets managed by the 674 money managers are in responsibly invested portfolios.

The \$639 billion total figure for the U.S. is broad enough to take into account investment *activities* (e.g., shareholder activism) and *categories* (e.g., community development funds) not typically associated with the stereotypical view of socially responsible investing. However, the reality is that the practice of responsible investing is much more broadly based than a few dozen mutual funds that garner most of the media attention devoted to “socially responsible investing.”

The total universe of \$639 in socially responsible investments includes:

- ***\$473 billion in shareholder activism.***
- ***\$162 billion in socially screened investment portfolios.***
- ***\$4.0 billion in community-targeted investments, including community development banks and loan funds, program-related investments, and economically targeted investments.***

It bears emphasizing that most, if not all, portfolio managers most develop responsibly invested portfolios that are “customized” to reflect the primary concerns of individual clients with social concerns. The result is a striking level of diversity in the approaches and criteria used to make ... and avoid ... investments. The world of responsible investments is divided almost equally among the major categories of assets handled by money managers. The SIF data indicate that:

- ***30 percent comes from religious concerns.***
- ***24 percent comes from institutions other than government pension funds.*** This category includes unions, universities, and foundations.
- ***23 percent comes from individuals.***
- ***23 percent comes from government pension funds.***

The emphasis shifts somewhat when money managers are looked at in terms of those who engage in responsible investing on the basis of client demands:

- ***68 percent of the money managers have religious clients who want responsible investments.***
- ***47 percent of the money managers have individual clients who want responsible investments.***
- ***36 percent of the money managers have institutional clients who want responsible investments.***
- ***13 percent of the money managers have government pension funds who want responsible investments.***

The balanced distribution of responsible investing clients points to another reason for the continuing strength of responsible investing in the post-apartheid era. The prevalence of multiply screened

portfolios and the strong demand on the part of religious and individual clients left the socially responsible investment world well positioned to minimize and even offset any post-apartheid drop in demand on the part of government and non-government institutional investors.

SECTION V

METHODOLOGY

For the purposes of the SIF analysis, an institution was considered to engage in socially responsible investing if it did one or more of the following:

- ***Employs one or more social screens, which are part of a formal institutional policy.*** Only that portion of an institution's funds that are actually invested in a socially responsible fashion are credited as such.
- ***Sponsors shareholder resolutions on social issues.***
- ***Has an active social investment committee that determines proxy-voting policy on social issues before the issues come up for a vote.***
- ***Is a Community Development Financial Institution (CDFI), has Program Related Investments (PRI), economically targeted investments (ETI), targeted venture capital, or targeted state investment funds.*** Only that portion of the funds in question that are actually invested in a socially responsible fashion are credited as such.

An institution was not considered to engage in responsible investing if it only did the following:

- ***Says it takes into account social criteria in its investment decisions, but has no formal policy and/or no screens.***
- ***Says it "votes proxies" but lacks any formal policy determining votes, and/or votes with management in a clear majority of cases.***

A wide variety of information sources were used to pull together the SIF picture of the responsible investment practices of institutions. Key information centers included: literature sources; Investor Responsibility Research Center (IRRC) data; Interfaith Center on Corporate Responsibility (ICCR) data; Investing For Good Directory; Investing From the Heart; The Social Investment Almanac; the 1993 Money Management Directory; the 1994 Pension Funds Directory; Pension and Investment's January 23, 1995 list of the top 200 pension funds; and interviews with leading experts on responsible investing. Combined with extensive one-on-one phone and mail contact by researchers, an exhaustive review of the above sources resulted in documentation of conclusive information for 182 investing institutions with a cumulative \$639 billion in responsible investments.

The second major phase involved a narrower focus on money managers handling responsibly invested portfolios. For the purposes of this research, SIF used two standards:

- ***Identification of assets handled by portfolio managers where “avoidance” and/or “positive” screens are used.***
- ***Exclusion of other funds handled by the same investment managers where responsible investment screens are not used.***

A wide variety of information sources were used to pull together the SIF picture of the responsible investment habits of U.S. investment managers. These sources included: the Nelson’s 1994 Directory of Money Managers; a Nelson-generated list of money managers that have indicated they manage money with responsible investment screens; and the membership list of the Social Investment Forum itself.

With the help of The Melman Group, a Washington, D.C.-based polling firm, SIF developed a questionnaire and statistical sampling procedure for survey outreach to targeted investment managers. Based on an initial pool of more than 800 investment advisors believed to make socially responsible investments, SIF researchers set out to collect a minimum 75-100 definitive responses. Using the polling firm’s techniques, SIF ended up with 100 responses representing a representative sample (including geographic distribution) of the larger list of money managers. Respondents were asked about: amount of responsibly invested funds; screens used; type of clients requesting responsible investments; and types of investments made.

Of the 100 portfolio managers contacted, 22 percent were found to be miscategorized. The other 78 percent did satisfy SIF’s test standards for a responsible investment firm. When this representative sample was projected out to the entire universe, SIF ended up with a firm estimate of 674 money managers handling \$162 billion in screened responsible investment portfolios.

At least two major factors could account for serious *under*reporting here of the extent of responsible investing in the U.S. According to SIF researchers, the following should be considered:

- ***Reticence about divulging specifics on the handling of assets under management.*** This was true of private fund managers and even government-related institutions. In the end, it is likely that such discomfort at the prospect of public disclosure had the effect of depressing somewhat the reporting of responsibly invested assets. Also, given that this was an initial effort for SIF, there was some concern about how the results would be used from the standpoint of confidentiality.
- ***Tight research standards may have resulted in the inadvertent screening out of some time-pressed money managers.*** Few of those contacted had a great deal of time to devote to the SIF survey. Given that proof of formal, written screen use was required for the study, it is likely that some institutions and money managers declined to take the time to comply, thereby further depressing the tally.

It is hoped that these concerns and other potential improvements to the research methodology will be addressed in a future SIF update report on the extent of socially responsible investment in the U.S. Comments are invited in anticipation of that follow-up effort.

SECTION V

ABOUT THE SOCIAL INVESTMENT FORUM

The Social Investment Forum is a national nonprofit membership association dedicated to promoting the concept, practice and growth of socially and environmentally responsible investing. The Forum's membership includes over four hundred social investment practitioners and institutions, including financial advisers, analysts, portfolio managers, banks, mutual funds, researchers, foundations, community development organizations and public educators. Membership is open to any organization or practitioner involved in the social investment field. The Forum provides cutting-edge research on trends in social investing, publishes the nation's most comprehensive annual directory of practitioners in the field, and distributes a Mutual Fund Performance Chart which provides monthly performance data on socially screened funds.

Socially aware investors are sensitive to the idea of achieving personal financial goals while putting their money where their hearts are. Screening allows socially aware investors to match their personal values to their investment decisions. Shareholder advocacy allows concerned investors to communicate directly with corporate management and boards of directors about desired changes in policy and practice. Community-based investing works in local communities where capital is not readily available to create jobs, affordable housing and environmentally friendly products and services.

Socially aware investors are a fast growing segment of investors who applaud and reward management for responsible corporate practices and put pressure on firms not taking responsibility for their impact on society. As dollars are pooled around social investment strategies, these progressive individual and institutional investors encourage more responsible corporate citizenship through traditional marketplace mechanisms.

FOR MORE INFORMATION ON THIS REPORT

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