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## **Socially Responsible Investment: Mutual Funds. Global and Local Trends**

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**Abstract:** This study aims to provide a wide perspective of socially responsible investment, especially regarding mutual funds. We show the growing interest on screened funds that justifies further research. After a general view of the trends in the most important collective investment industries, attention is focused on the Spanish market. In doing that, we can compare mature mutual fund industries with a recent developed country in this aspect. Socially responsible mutual funds have shown an increase both in total net assets and in number of investors; but the sector is by far behind the United States regarding the share of the mutual fund industry devoted to screened funds.

**Key words:** Mutual funds, screening, social and environmental concerns, Spain

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### **INTRODUCTION**

Growing concerns over environmental and social issues are making socially responsible investment taking an outstanding place in financial markets. Socially Responsible Investment (SRI) is an investment process that considers social, environmental and ethical issues jointly with rigorous financial analysis. Social investment managers often give priority to qualitative analysis with positive or negative ethical screening of the potential targets instead to the traditional quantitative analysis of profits. It is a process of identifying a wide number of extra-financial criteria to find companies that meet certain standards of Corporate Social Responsibility (CSR). According to the European Social Investment Forum, CSR includes issues such as Corporate Governance, Environmental and Social Management, Human Resources Management, Socio-Economic impacts in developing countries, Community involvement, Social-ethical or moral issues and Sustainability and related reporting.

We may encounter the origins of socially responsible investing long back; religious investors from Jewish, Christian and Islamic faiths and many indigenous cultures have long related morals with money. Investments encompassing slave trade, alcohol, tobacco or gambling were often refused by Quakers in the American colonies and Methodists in the UK. This is the remaining idea of SRI and the beginnings of its development. The Pioneer Fund, opened in US in 1928 screens since 1950 its portfolio investments to meet the needs of Christian investors and still excludes these industries.

However, the great rise for SRI dated from the 1960s with different social movements such as civil-rights, feminism, environmentalism and protests against the Vietnam War. Some time later, two funds were promoted to meet this desire of social and environmental investment; the Pax World Fund, launched in 1971 and the Dreyfus Third Century, one year later, both in the US. Since then, several issues have motivated the ongoing development of SRI, e.g., the human rights in developing countries, the climate change, nuclear power, genetically modified organisms and so on. As result, corporate governance even though included into conventional financial analysis is becoming a criterion for evaluation companies, with an inherent idea of greater competitiveness when they adopt sustainable business practices.

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We define in detail what it is understood by Socially Responsible Investment. According to the criteria of the Social Investment Forum, there are three main socially responsible investment strategies: screening, shareholder advocacy and community investing. The first one is related the selection of assets based on social or environmental criteria either as pooled products such as mutual funds or as socially screened separate accounts managed for individual and institutional clients. There are negative and positive screens, the former are used to identify companies whose activities or policies do not fit the ethical, social or environmental values of the investors. Positive criteria mean the investment selection in companies that show an active concern and commitment with the society.

Shareholder advocacy refers to shareholder resolutions on social issues and corporate governance that at the same time revert to the long-term shareholder value and financial performance. Finally, community investment has the aim of redirecting capital from investors and lenders to undeserved communities. Local financial service organizations can, in this way, provide access to credit of basic banking products and vital community services.

### **Socially Responsible Investment in Figures**

The social concern mentioned in previous section is easily identifiable when providing statistics on investment. For instance, in the United States, SRI, including the three core strategies defined by the Social Investment Forum (screening, shareholder advocacy and community investing), stands at \$2.3 trillion in 2005 what means a substantial increase from \$40 billion in assets involved in social investing in 1984. Focusing on screening investment and especially on collective investment, the number of socially screened pooled products available at the end of 2005 is 201 that hold \$179 billion (this figure includes mostly mutual funds, but it also considers variable annuities). Among these funds, 80% use tobacco as screening criteria; alcohol, gambling and military contracting, defense or weapons are the next commonly used applied social screens, though tobacco and alcohol are by far in the two top positions.

Table 1 shows the evolution of collective investment in detail. Despite the great growth of the mutual fund industry during the last decade, with a compound annual growth rate of 12.22%, the socially screened investment industry beats by far this percentage up to a 31.03% annual increase of the total net assets. However, socially responsible investment still has a 2.01% share of the mutual fund industry (Table 1).

We provide also information about some countries with a well developed SRI asset management industry. For instance, in Canada, the first SRI mutual fund opened in 1986 (Ethical Growth Fund); in June 2004, 41 national funds manage a total of C\$4.26 billion according to the Canadian Social Investment Review 2004 published by the Social Investment Organization. The Australian Ethical Investment Association estimates the retail segment of the SRI mutual funds in A\$2.75 billion at the end of June 2005 in the Sustainable Responsible Investment in Australia survey.

Regarding Europe, SRI investment is classified as retail and institutional investments. The total net assets amount €1.03 trillion according to European Social Investment Forum (2006). This figure comprises a broad number of strategies such as ethical exclusions, positive screening, among others. The above cited study includes the survey to nine European countries: Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Switzerland and United Kingdom.

Table 1: Mutual funds and socially screened funds in the United States

Years	1995	1997	1999	2001	2003	2005
Mutual fund assets (\$ billions)	2,811.29	4,468.20	6,546.34	6,974.95	7,414.40	8,904.80
Total net assets SRI funds (\$ billions)	12.00	96.00	154.00	136.00	151.00	179.00
No. of socially screened funds	55.00	144.00	168.00	181.00	200.00	201.00

Source: Investment Company Institute (ICI: [www.ici.org](http://www.ici.org)) and Social Investment Forum (2006) Foundation

Similarly to the study of the US, we focus on the collective investment assets under management. According to the report of Avanzi SRI Research (2006), assets under management in funds domiciled in Europe stand at € 34 billion as of the end June 2006 distributed in 388 funds, this means 0.62% of the assets over the total UCITS (Undertakings for Collective Investment in Transferable Securities) in operation at that date. Avanzi's report covers the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Orway, Poland, Spain, Sweden, Switzerland, the Netherlands and the United Kingdom. A fund to be included in the statistics has to meet the three following conditions: 1-to use ethical, social or environmental screens for portfolio selection; 2-to be marketed as socially responsible investment products and 3-to be available to the public (retail funds). Therefore, funds that simply donate a part of commissions or profit to charitable or other 'good' causes or specialized only in environmental technologies are not included.

Table 2 provides information of the evolution of the sector from the end 1999 to the end of June 2006. It shows the steady growth of socially responsible funds in the investment panorama, both in the number of funds domiciled in Europe and in the total assets under management. Just as happened in the United States market, the annual growth of socially responsible investment is higher than the growth of the total collective investment industry, 18.74 and 8.52%, respectively.

The situation is diverse throughout the different European countries as shown in Table 3. The UK and France are by far at the top of European countries with respect to SRI retail assets, they manage €9,483 and €6,539 million, respectively. The three main countries in socially responsible investment, UK, France and Belgium represent 58.18% of the total industry.

### **The Specific Analysis of the Spanish Sector**

After the description of the overall situation attention is focused on the Spanish market. From Table 4, it is clear that the socially responsible investment in mutual funds is much less developed in Spain than in other European countries. According to the quoted study, its share of the total net assets

**Table 2: Mutual funds and socially screened funds in Europe**

Years	1999	2001	2003	2004	2005	2006
Mutual fund assets (EUR millions)	3,223,000	3,444,338	3,763,217	4,192,053	5,182,694	5,484,978
Total net assets SRI funds (EUR millions)	11,136	14,482	12,150	19,034	24,127	34,009
No. of socially screened funds	159	280	313	354	375	388

Source: European Fund and Asset Management Association (EFAMA: [www.efama.org](http://www.efama.org)) and Avanzi SRI Research (2006)

**Table 3: Total net assets in Europe per country in June 2006 (EUR millions)**

Country	Total net assets
Austria	1,355
Belgium	3,764
France	6,539
Germany	1,497
Italy	2,582
Netherlands	2,218
Spain	165
Sweden	3,085
Switzerland	3,121
United Kingdom	9,483

Source: Avanzi SRI Research (2006)

**Table 4: Mutual funds and socially screened funds in Spain**

Years	1999	2000	2001	2002	2003	2004	2005	2006
Mutual fund assets (EUR millions)	205,524.0	183,391.0	179,510.0	170,810.0	197,980.0	219,572.0	245,855.0	254,306.0
Total net assets SRI funds (EUR millions)	58.3	77.3	58.4	47.6	824.6	994.2	1,013.3	1,094.2
No. of socially screened funds	5.0	8.0	8.0	9.0	10.0	10.0	13.0	15.0

Source: Collective Investment and Pension Fund Association (INVERCO: [www.inverco.es](http://www.inverco.es))

in Europe is 0.49%. However, in the survey of the European Fund and Asset Management Association, (EFAMA) that gathers information about 23 European countries, Spain is placed in the sixth position of the ranking of total net assets, with a 5.06% share as of June 2006.

The sector is auto regulated by a circular on the use of collective investment undertakings of the denomination of ethical, ecological or any other that stresses on socially responsibility aspects published on 15 November 1999 by Inverco (Collective Investment and Pension Funds Association) under the demand of the Spanish Exchange Commission (CNMV) to the financial sector to clarify what was being called ethical, environmental and social. Inverco constituted then an Ethics Committee.

Without any further official regulation on SRI collective investment schemes, the main points of the circular of 1999 are the following:

- There are negative and positive criteria for screening. Both criteria admit graduations when evaluating companies.
- Collective Investment Schemes must detail in the prospectus their ethical investment aim.
- An Ethics Committee must be regulated in the prospectus to determine the range of potential securities according to the ethical conviction.
- When advertising the scheme, the following message must be included: For ethical criteria of the scheme, please consult the prospectus.
- The quarterly report must include the relevant information about the ethical ideology and the composition and decisions of the Ethic Committee.

Socially responsible collective investment amounts €1,110.8 million, though most of it corresponds to mutual funds. There is only one investment society (Urquijo Cooperación, SICAV, S.A.) that uses social and environmental screening. Therefore, the size of the socially responsible mutual fund industry is €1.09 billion, what represents 0.43% of the whole sector (this percentage is calculated on the size of equity and money market funds). Table 4 show the evolution of the assets under management for both, the mutual fund industry and the socially responsible mutual funds.

As of the end of 2006, there are in Spain 15 domestic SRI funds and 46,334 investors. If we analyze in depth Table 4 we show an impressive growth in 2003, which is due to the opening of the fund BBVA Extra 5 II Garantizado with the particularity of being a guaranteed fund. This fund represents 71.76% of the total net assets of SRI funds.

Further information about the screening mutual funds in Spain is shown in Table 5 that incorporates the information of the listed investment society.

Based on the prospectuses of the funds obtained in the register of the Spanish Securities Exchange Commission ([www.cnmv.es](http://www.cnmv.es)) for the entire universe of 15 socially screened funds in Spain, we can obtain interesting information about the screening criteria of these funds. Both in number of funds and in total net assets the most commonly applied social screens related to military contacting, defense, or weapons. A total of 11 funds with € 208 million in total net assets incorporate this criterion. Table 6 details the types of screens in Spanish socially screened funds, it shows the total net assets and the number of funds affected by their application. Table 6 does not include BBVA Extra 5 II Garantizado, because its classification of ethical fund is consequence of the reference index it applies. On the other hand, BBVA Desarrollo Sostenible only employs positive criteria in the management of the portfolio. That means a total of 13 socially screened funds analysed. Note that funds usually apply more than one screening criterion.

According to the results shown in Table 6, the screening criteria of Spanish funds differ from those applied in the United States. Tobacco fails to the fourth position regarding the total net assets, besides alcohol and gambling highlighted in the United States are scarcely employed. Other criteria not included specifically are offensive advertising, the Social Doctrine of the Catholic Church, nuclear energy, alcohol, pornography and gambling.

Table 5: Socially responsible pooled products registered with CNMV

Pooled products	Investment objective	TNA EUR thousands	No. of investors	Annual return and ranking
Ahorro Corporación Responsable 30, FI	International Mixed Fixed Return	6,391	989	2.23%50(70)
BBK Solidaria, FI	Mixed Fixed Return	5,125	424	3.86%101(140)
BBVA Desarrollo Sostenible, FI	International Equity	52,001	10,377	6.95% 77(157)
BBVA Extra 5 II Garantizado, FI	Equity Guaranteed	785,205	29,244	0.67%442(481)
BNP Paribas Fondo de Solidaridad, FI	Mixed Fixed Return	4,810	97	4.94% 75(140)
Caixa Catalunya Europa Valor, FI	International Equity, Europe	3,448	420	6.19% 62(64)
CAM Fondo Solidaridad, FI	Global	7,196	247	14.99% 35(292)
Compromiso fondo ético, FI	Global	8,421	136	-
Foncaixa 133 Socialmente Responsable, FI	International Equity, Europe	6,626	378	9.68% 58(64)
Foncaixa Cooperación, FI	International Mixed Equity	8,909	442	4.80% 42(75)
Fondo Solidario Pro Unicef, FI	International Mixed Fixed Return	3,947	460	4.84% 16(70)
Morgan Stanley, Fondo activo ético, FI	International Mixed Equity	15,925	193	2.20% 51(75)
Santander Responsabilidad, FI	Mixed Fixed Return	42,016	227	2.51%131(140)
Santander Dividendo Solidario, FI	International Equity, Europe	60,505	1,518	21.86% 14(64)
Urquijo Cooperación, SICAV, S.A.	Global investment society	16,648	113	1.68%
Urquijo Inversión Solidaria, FI	Global	83,665	1,182	9.46% 69(292)
Total		1,110,838	46,447	

First column indicates the type of mutual fund according to the investment objective described in the prospectus; following, there are statistics of the total net assets and the number of investors as of December 2006 and, finally, the annual return of 2006. This last column also shows the ranking and the total number of funds in the category the fund belongs to. *Compromiso fondo ético* has no data available on the last column because it was launched during 2006

Table 6: Total net assets and number of socially responsible funds domiciled in Spain by screen types

Screening criterion	No. of funds	Total net assets (EUR millions)
Defense/Weapons	2	90,861
Contrary to Public Health	3	97,952
Environment	4	100,796
Tobacco	5	116,721
Human Rights	9	143,262
Justice/Peace	5	166,310
Child Exploitation	6	173,506
Genetic Engineering	11	208,577

Another particularity of the screening mutual funds in Spain is that most of the funds offered to Spanish investors came from foreign management companies, up to 17 funds in 2005 as shown in Albareda and Balagner (2006). They also indicate that despite of the number of funds not domiciled in Spain, they have a residual importance in terms of assets invested, though it is not possible to obtain individual data for each country they operate in.

Among mutual funds that use social and environmental screening criteria, many of them are also classified as sharing funds. In other words, funds that donate part of their management fees to various social bodies. Additionally, there are four funds that are exclusively sharing funds and do not use any screening for inclusion of companies in their portfolios. These funds also show, to some extent, the concern over the social problems because donations are usually dedicated to NGOs. In total these four funds manage €31.18 million and have 1,927 investors.

### Final Reflections

This study shows the situation of the socially responsible investment around the world. Mutual funds provide an additional service to their investors, additionally to the diversification or the professional management. This service consists on investment products specially addressed to investors concerned with the environmental and social problems of the society. Through investing in socially responsible mutual funds, individuals have more facilities to screening the target companies within professional management.

We have shown the current state of the socially responsible investment in mutual funds worldwide giving a broad perspective of the global trends. From the most developed collective industry in the United States, we conclude that the screening mutual funds have a 2.01% share of the total net assets despite the intense growth of the last years. Even though the United States is by far a leading country in the socially responsible investment, thus in Europe, this share decreases up to 0.62%.

Focusing on local trends, we have investigated in depth the Spanish case. There are great differences with the service provided in the United States. In Spain, only 0.43% of the total net assets of the mutual fund industry are managed by screening funds. Despite being much lower than the share of the United States, it reflects a great concern given that the first screening fund was launched in 1997.

The growing interest on social and environmental issues makes necessary a complete development of the pooled vehicles that facilitate the individuals investment. In this sense, further research is also essential to compare traditional collective investment products with mutual funds applying screening criteria.

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