



Social Investment Forum

MERCER

Investment Consulting

Defined contribution plans and socially responsible investing in the United States

A survey of plan sponsors, administrators and consultants

June 2007



Contents

- Executive summary 2
- Background..... 4
- Characteristics of respondents 6
- Current state of SRI in DC plans 8
- Evaluation of SRI options 15
- Looking ahead 17
- Conclusion..... 20

Appendix A

List of organizations that responded to the survey and agreed to public disclosure of survey participation

Appendix B

PLANSPONSOR magazine – 2006 Socially Responsible Investment Survey: Consultant and adviser practices

Appendix C

Resource guide for plan sponsors: Adding a socially responsible investment option to your defined contribution plan





Executive summary

This survey was commissioned by the Social Investment Forum (SIF) to document the state of socially responsible investment (SRI) options within defined contribution (DC) plans in the United States. It provides a look at the current status and future outlook for SRI options in DC plans from the perspective of plan sponsors, plan administrators, and consultants¹. Overall, the survey results indicate a strong demand for SRI options – with 60% of the respondents either currently offering or intending to offer an SRI option within 3 years. At the same time, plan sponsor respondents indicate that they have a general lack of knowledge of SRI fund options and the variety of SRI products available.

Select key findings from plan sponsors include:

- Nineteen percent of DC plan sponsor respondents currently offer one or more SRI fund options.
- An additional 41% of respondents plan to add an SRI option to their DC plan within 3 years.
- Alignment with organizational mission was the primary driver for adding an SRI option followed by recommendations from pension-related staff and management.

Among the range of plan sponsors surveyed, healthcare organizations and government funds are most likely to offer SRI fund options. Given the religious

affiliation and mission of many healthcare organizations and the public responsibility of governments, this does not come as a surprise.

For most organizations, it appears that staff recommendations and participant requests can be a determining factor for whether or not SRI options are available. While these efforts by participants and staff are leading drivers for the addition of an SRI option, over 70% of survey respondents where SRI options are not available believe that this type of investment has never been requested or suggested.

The outlook for SRI fund options in DC plans appears strong; more than 70% of consultant/adviser respondents* and about 48% of plan sponsor respondents predict that the demand for SRI options will increase or remain steady over the next five years. Over 40% of consultants/advisers* also believe that an increase in the number of DC plans will increase demand for SRI funds. These consultant opinions in all likelihood result from an increase in SRI fund search activity; the number of consultants performing five or more SRI searches in the first three quarters of 2006 increased 50% from all of 2005*.

Despite an overall positive outlook for increased SRI fund demand, an admitted lack of knowledge of SRI by plan sponsors provides an opportunity for trustees, consultants and the SRI industry to educate plan sponsors and participants on SRI.

¹The plan sponsor and plan administrator surveys were undertaken by Mercer Investment Consulting, Inc. and are the focus of this report. The consultant and adviser survey was completed by *PLANSPONSOR* magazine, and full findings are available in Appendix B.

*Results of survey completed by *PLANSPONSOR* magazine.



Educational efforts around SRI should focus on those issues most important to plan sponsor respondents, which include SRI funds' performance track record relative to non-SRI funds, participant demand for SRI options, and concerns over fiduciary duty.

Surveying plan participants was beyond the scope of this project; however, two recent studies conducted by organizations sponsoring the current survey have addressed individual participant interest in SRI. A 2006 TIAA-CREF report entitled "SRI: An Understanding of How SRI Is Viewed by TIAA-CREF Participants" found that TIAA-CREF participants want their social values reflected in their investments and have a deep need for more information about SRI strategies and accounts. Also in 2006, Calvert sponsored a survey by Yankelovich entitled "Attitudes Toward Socially Responsible Investment," which found that 65% of employees without an SRI option would like one added.

The current survey confirms an opportunity for education around SRI in the DC arena. There is a strong interest in SRI by plan sponsor respondents, but a lack of knowledge concerning the availability and specific characteristics of SRI fund options. This survey and its associated resource guide (Appendix C) attempt to close the gap between interest and knowledge, and facilitate plan sponsors' consideration of SRI options for DC plans.

Respondent profiles are outlined in section 3, Characteristics of respondents.



Background

Socially responsible investing (SRI) is an approach to investing that seeks social benefits in conjunction with financial returns. In order to achieve these goals, investors typically utilize one or more of the following approaches:

- Screening or applying environmental, social, and corporate governance (ESG) criteria to portfolio constituents;
- Shareholder advocacy, which may include proxy voting, dialogue with portfolio companies and/or filing of resolutions; or
- Community investing, in which capital is directed towards individuals, businesses and organizations in underserved communities.

The roots of SRI lie in the investment practices of faith-based groups whose beliefs prohibited the support of certain business activities, such as the production and distribution of alcohol and weapons (a negative screening approach). In recent years, however, there has been a marked shift to encompass a broader spectrum of social concerns. In fact, more investors are using SRI to identify companies seeking to enhance financial performance, through environmental and social policies and programs, such as firms that create or use environmentally friendly energy alternatives or multinationals that apply fair labor practices wherever they operate. Not only can such actions contribute to

perceptions of good corporate citizenship, but ESG factors like these may also help determine which companies are best poised to deliver long-term value. This approach may be called positive screening or a best in class approach to SRI.

A number of investment firms, research groups and service providers have emerged offering ESG analysis as SRI has become more important among institutional investors. In the US, as of 2005, overall SRI assets have grown to over \$2.29 trillion*. Included in these assets are 200 SRI mutual funds with assets of \$179 billion, up from 55 funds with \$12 billion in assets in 1995*.

As SRI continues to grow, corporations have found that participating in collaborative and independent initiatives can help to improve their ESG practices and disclosure.

Large corporations further their commitment by dedicating staff resources and in some cases appointing a corporate social responsibility (CSR) manager. These managers serve as a resource to their pension plans and have helped to educate their pension and benefit committee members about SRI. Additional examples of CSR initiatives are noted in the accompanying resource guide in Appendix C, section 2, Compilation of resources.

* Social Investment Forum. 2005 Report on Socially Responsible Investing Trends in the United States: 10-Year Review. Washington, DC. January 24, 2006.



About this report

Today, more and more Americans are relying on DC plans for their retirement. Retirement assets reached an all-time high of \$14.5 trillion in 2005, a 7% increase over 2004*. DC plans and Individual Retirement Accounts (IRAs) rose almost 9% in 2005 and constitute 51% of retirement assets*. The investment composition of these assets is regularly analyzed; however, little concrete information is available to plan sponsors and participants about the availability of SRI in DC plans.

Thus, the Social Investment Forum (SIF) engaged Mercer Investment Consulting, Inc. (Mercer IC) to undertake a survey of plan sponsors and administrators, which has resulted in this report that presents the results of the survey, and identifies key observations and conclusions. SIF also engaged *PLANSPONSOR* magazine to conduct a survey of consultants. This summary report is available in its entirety in Appendix B and is referenced in this report, as appropriate.

The following Project Partners made this survey possible by providing input and funding to SIF:

- AltruShare Securities
- Calvert
- FTSE Group
- Neuberger Berman
- Northern Trust
- TIAA-CREF

Overall, the objectives for this project were to gather market intelligence on the “state of play” of SRI in the DC market, through surveying DC plan sponsors, plan administrators and consultants about their experiences with SRI. A number of questions are addressed in this report, which should be of interest to DC practitioners and participants, as well as to the SRI industry:

- What is the percentage of DC plans with SRI options? Is this number likely to grow? And if so, why?
- What is the demand for SRI options from plan sponsors?
- What are some of the drivers and barriers for adding an SRI option to a DC plan?
- What strategies can be utilized by the SRI industry to gain entrance into DC plans?
- What does the shift to DC plans in the US mean for SRI options?

In addition to the survey results, this document contains a resource guide for plan sponsors in Appendix C. The guide will assist plan sponsors in considering, assessing and choosing SRI options. The guide is also available as a separate electronic document. Please contact the Social Investment Forum (www.socialinvest.org), Mercer IC (www.merceric.com/ri), or one of the Project Partners listed to receive an electronic copy.

* The US Retirement Market, 2005, Research Fundamentals, Investment Company Institute, July 2006.

Characteristics of respondents

Profile of plan sponsors

The plan sponsor survey was sent to more than 5,000 potential respondents representing public, corporate, faith-based, healthcare and other plan types. The survey universe was based on an internal Mercer IC list of plan sponsor contacts, as well as listings from the Money Market Directory. In total, 129 plan sponsors responded. The respondents are mainly corporations offering 401(k) plans with fewer than 25,000 plan members and less than \$5 billion in assets.

Number of respondents		129
By total plan assets (US dollars)		
≥ \$250 million		12%
> \$250 million ≤ \$500 million		18%
> \$500 million ≤ \$1 billion		11%
> \$1 billion ≤ \$5 billion		18%
\$5 billion +		12%
By number of plan members		
> 1,000 ≤ 10,000		53%
> 10,000 ≤ 25,000		23%
> 25,000 ≤ 50,000		11%
> 50,000 ≤ 100,000		4%
100,000 +		9%
By nature of organization		
Corporate (public)		50%
Corporate (private)		23%
Government		7%
Healthcare		10%
Other		10%
By type of DC plan offered		
401(k)		85%
403(b)		9%
457		11%
Other		17%

Profile of plan administrators

Sixteen plan administrators from a universe of the 25 largest responded to a separate survey instrument. Overall, these respondents are among the largest providers in the business in terms of size of assets and number of accounts.

Number of respondents		16
By total plan assets administered (US dollars)		
> \$500 million ≥ \$1 billion		6%
\$10 billion +		94%
By number of plans administered		
> 1,000		81%
> 500 ≥ 1,000		13%
> 250 ≥ 500		6%
By total plan assets by nature of organization (US dollars)		
Corporate		62%
Government/public		20%
Non-profit		10%
Other		8%
By number of plans		
Corporate		66%
Government/public		15%
Non-profit		17%
Other		2%

A list of organizations that responded to the survey and agreed to public disclosure of survey participation is available in Appendix A.



Profile of consultants/advisers

Thirty-eight consultants and advisers responded to the survey conducted by *PLANSPONSOR* magazine. The survey was sent to a list of consultants/advisers derived from *PLANSPONSOR* magazine's own database. Respondents included a cross-section of larger and smaller organizations, institutional consulting firms and financial advisers.

The following characterizes the consultant/adviser respondents:

- More than two-thirds categorized themselves as traditional institutional consultants.
- Half oversee assets worth between \$500 million and \$1 billion, while nearly 45% oversee assets of between \$1 billion and \$100 billion.
- Nearly two-thirds of respondents advise on 50 or fewer plans and almost 8% consult to more than 1,000 plans.
- More than one-third of respondents said their DC business has increased sharply, whereas nearly half say their business has increased only somewhat.
- Over half of respondents' business is corporate; government and non-profit organizations account for another third.

Additional details and the full results of *PLANSPONSOR* magazine's survey are available in Appendix B.

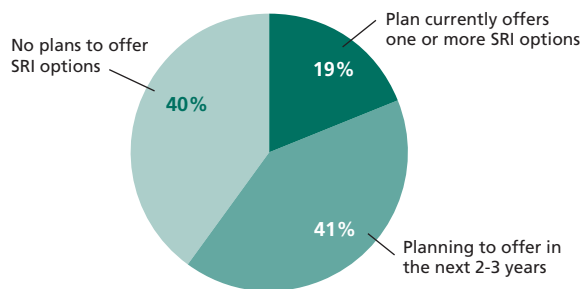
Current state of SRI in DC plans

Plan sponsors' viewpoint

Question: Does your DC plan currently offer one or more SRI fund options?

Question: If your organization does not currently offer SRI options, please indicate when you might in the future.

Exhibit 1



As can be seen in Exhibit 1:

- Nineteen percent of the respondents currently offer one or more SRI fund options to plan participants.
- Forty-one percent plan to offer these options within two to three years.
- Forty percent indicate that at present they have no plans to offer SRI options to plan participants.

Mission-based organizations, specifically faith-based and healthcare plans, are more likely to offer an SRI option to plan participants. Over 45% of healthcare respondents, about one-third of government respondents and almost 15% of corporate respondents offer SRI options in their plans.

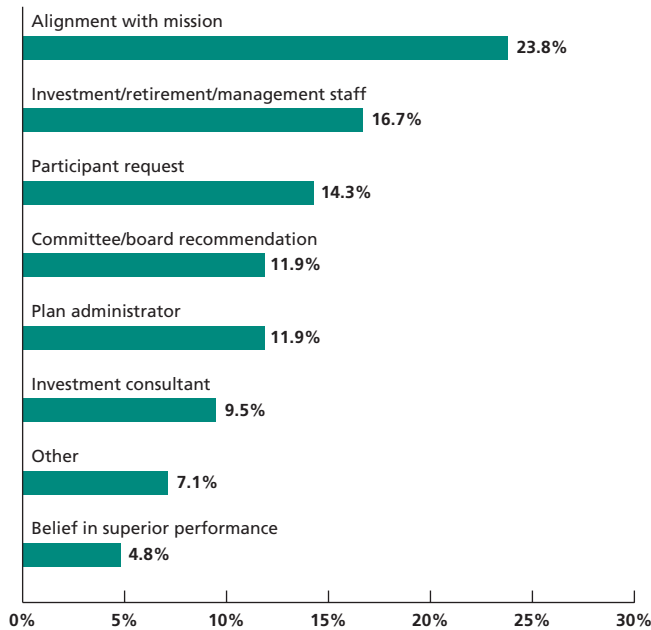
Organizations that make SRI options available tend to be somewhat larger in both number of participants (between 1,000 and 25,000 participants) and size of assets (greater than \$250 million) than other respondents. More than three-quarters of these organizations use an investment consultant regularly.

The fact that 40% of respondents have no current plans to offer SRI options may be because of plan sponsors' recognized lack of knowledge about SRI coupled with low participant demand. These issues are discussed later in this report.



Question: What drove the decision to add an SRI option/s to the plan?

Exhibit 2



As can be seen in Exhibit 2, the primary motivations for the addition of SRI options are to:

- Offer an investment option that aligns with the organization’s mission
- Respond to recommendations from investment, retirement and management staff, as well as participant requests

In determining if there is a correlation between the types of organizations offering SRI options and their missions or alignment with certain values, the survey asked corporate plans if their companies produce a corporate responsibility report. Of the corporate plan respondents, almost 14% produce an environmental, corporate citizenship or similar report. About 22% of these organizations also offer SRI options in their plans, whereas the other corporate respondents that produce these reports are evenly split between those that plan to offer an SRI option within the next three years and those that currently do not have plans to make this addition.

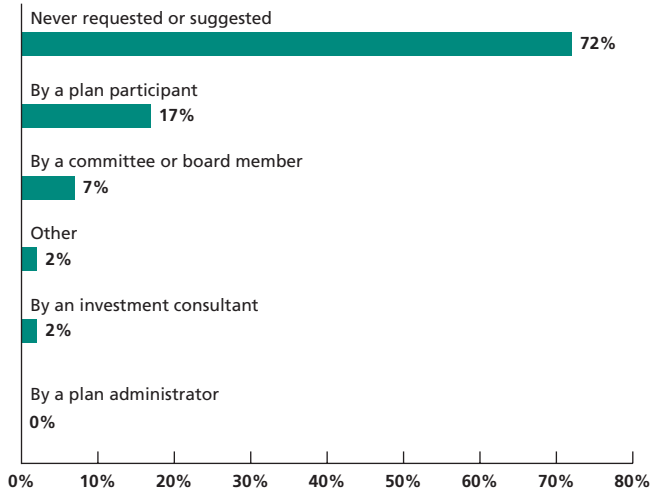
Though producing a report is only one indicator of what could constitute a socially responsible firm, there appears to be a strong correlation between producers of these reports and SRI funds appearing in the DC plans of these firms. Corporations producing a citizenship report are more than twice as likely to offer an SRI option. In aggregate, 61% of the organizations producing these reports are already offering (22%) or plan to offer (39%) an SRI option within the next three years. In aggregate, half of corporations not preparing these reports are already offering (10%) or plan to add (40%) an SRI option within the next three years.

It may be inferred that increased uptake of corporate responsibility initiatives could lead to more corporate DC plans offering SRI options.



Question: If you don't have an SRI option, has this ever been recommended or suggested?

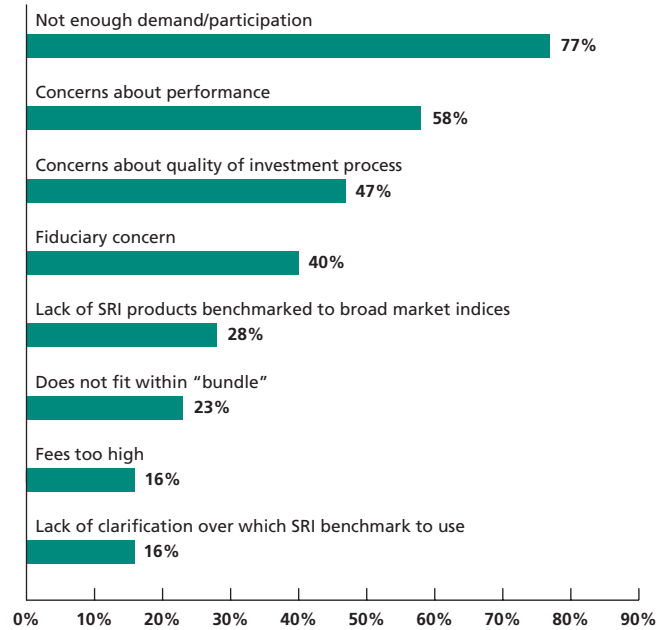
Exhibit 3



As can be seen, where SRI options are not offered, 72% of the respondents indicate that this type of investment has never been requested or suggested. In some instances, plan participants and committee/board members appear to have suggested including SRI options, but without success.

Question: If an SRI option has been either requested by a participant or offered by a provider for your plan and is not included in your fund line-up, please indicate the reason(s) why.

Exhibit 4

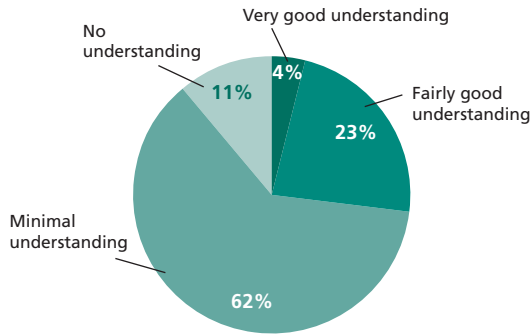


Plan sponsors were asked to rank the top three reasons for not acting on a request or suggestion to add an SRI option. As noted in Exhibit 4, the reasons given centered primarily on the lack of requests received from participants, concerns about performance and the quality of the investment process, and fiduciary concerns. Education for plan sponsors and participants on SRI may mitigate these issues in the future.



Question: How good of an understanding would you say you have of the SRI investment products and indices that exist?

Exhibit 5

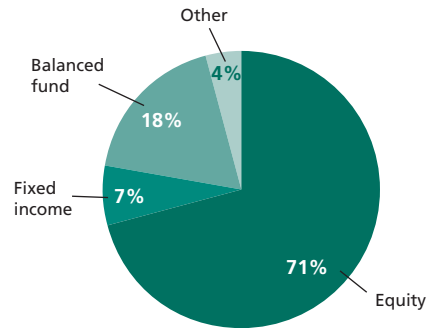


Of the total plan sponsor respondents, over 73% indicate they have minimal or no understanding of SRI investment products and indices. For those plan sponsors that currently offer SRI options, only 36% felt they have minimal understanding, whereas 64% indicate that they have a fairly good or very good understanding of SRI products and indices.

Plan sponsor – SRI options

Question: If your plan does offer an SRI fund options, please provide information regarding that option.

Exhibit 6



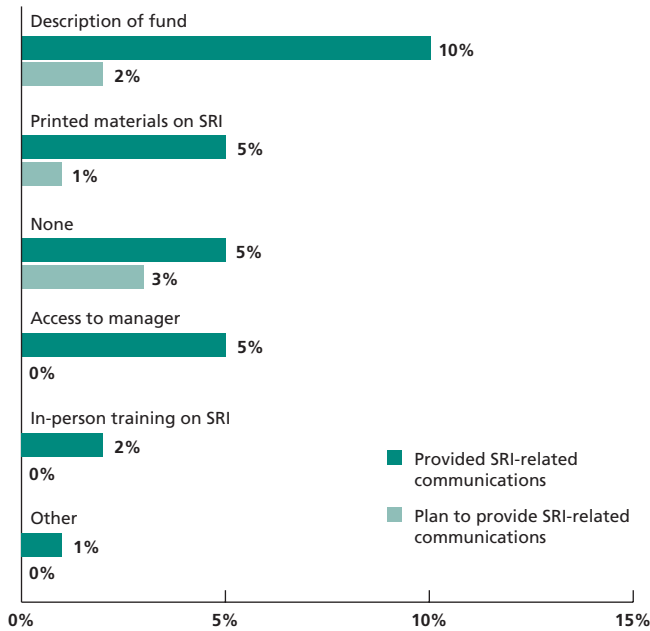
Of the 19% of plan sponsors currently offering SRI options:

- Eighty-four percent offer only one SRI option, whereas 16% offer two or more options
- Seventy-two percent of the options listed are actively managed, while 28% are passively managed
- Over 95% of the options are offered in a mutual fund vehicle and the remaining 5% in other vehicles
- Seventy-one percent of the options are equity based, 7% are fixed income, and 18% are in balanced funds
- The median aggregate SRI fund balance was below \$5 million. That is, 50% of the respondents have an aggregate balance below \$5 million, whereas the other 50% have an aggregate balance greater than \$5 million



Question: Please indicate any SRI-related communications you have provided (or plan to provide) to participants beyond legal requirements.

Exhibit 7



As can be seen, the majority of the respondents indicate that they only provide fund descriptions and other print material on the SRI options, which is consistent with material they provide on non-SRI funds.

Question: If your plan does offer an SRI fund option, please provide information regarding that option.

The respondents noted 11 fund managers that they use for SRI options; those mentioned most often are:

- Calvert (24%)
- Domini (20%)
- Vanguard (12%)

Other fund managers mentioned are Ariel, Diversified, Neuberger Berman, American Funds, TIAA-CREF, One America, Pax World and PIMCO.

The respondent organizations indicate that they primarily use standard broad market benchmarks to measure performance. Only 17% of the respondents indicated that they use SRI indices.

The two SRI indices noted are:

- KLD Domini 400 Social IndexSM
- FTSE4Good US Select IndexTM

Some respondents also indicate that they utilize an SRI benchmark in addition to a non-SRI benchmark or a composite of the two.



Plan administrators' viewpoint

Background

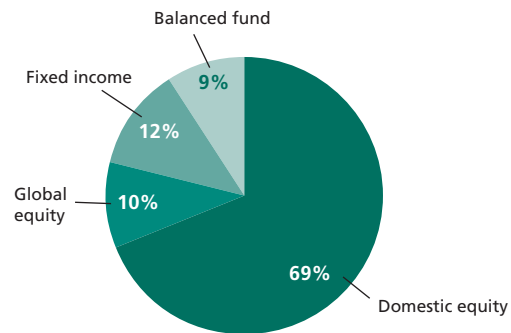
As plan sponsor needs have evolved, the plan administrator business has seen significant changes. With increased competition in this industry and lower margins, this business has become a commodity-based service with fewer providers and increased consolidation among those that remain. Only a few years ago it was not uncommon to see plan administrators offering only proprietary investment funds on their DC investment platforms. Today, this type of structure is the exception. Now, administrators typically offer fully open platforms where sponsors can request almost any fund and may pay a recordkeeping fee depending on the fund added. This type of open structure provides the most flexibility for plan sponsors seeking SRI options. Consequently, for the most part, plan administrators are able to offer any SRI fund to sponsors.

Plan administrator – SRI options

The majority of plan administrator respondents are able to accommodate most plan sponsors' SRI fund requests. The survey asked respondents to provide details on their more popular SRI options. The majority of the funds listed are actively managed domestic large cap equity mutual funds. As noted in Exhibit 8, 79% of the options are equity based, 12% are fixed income funds, and 9% are balanced funds. These statistics are consistent with the types of options offered, as reported by plan sponsors.

Question: Please complete the following information on the SRI options that exist.

Exhibit 8



The respondents listed 14 fund managers that their clients use for SRI options; those mentioned most often are:

- Calvert (25%)
- Domini (17%)
- Vanguard, Neuberger Berman, Ariel, and Citizens (8% each)

Other named fund managers include Pax World, American Century, DWS Scudder, Forward Green, TIAA-CREF, VALIC, Winslow Funds and Women's Equity.



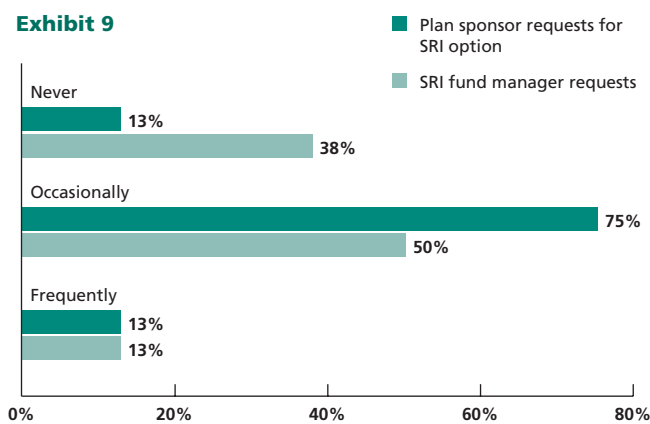
Question: How often have you been asked by a plan sponsor to provide an SRI option for clients?

Question: How often have you been approached by an SRI fund manager to provide an SRI fund option for your platform?

Consultants/advisers' viewpoint*

SRI option searches

Question: How many SRI searches did you undertake for clients in 2004, 2005 and 2006 (Q1-Q3)?



As can be seen:

- Three-quarters of the plan administrators note that plan sponsors occasionally requested SRI fund options.
- Half the respondents note that they are approached occasionally by SRI fund managers requesting that their SRI fund be added to the administrator's platform.

The number of consultant/adviser respondents that conducted at least one SRI search increased 13% between 2004 and 2005, with 74% of all respondents conducting at least one SRI search in 2005. The number of consultants reporting five or more SRI fund searches for the first three quarters of 2006 increased more than 50% from 2005. It is also interesting to note that more respondents conducted no SRI searches in the first three quarters of 2006 (32%) than in 2005 (26%), though the 2006 numbers do not include the full year.

Consultants/advisers indicate that actively managed domestic large cap equity SRI mutual funds are the most requested product category in client searches.

Question: What is your total full-time staff equivalent dedicated to SRI consulting and research?

Nearly 40% of respondents have one or more full-time staff equivalents dedicated to SRI consulting and research; however, 23% do not have any SRI-dedicated staff.

Question: Have you offered any SRI-specific educational or other materials?

Although consultants/advisers are mostly lightly staffed in this area, 64% of respondents indicate that they have offered their clients SRI fund product comparisons, and nearly 50% say they offer manager research and on-demand reports on SRI funds. Further details from this survey can be found in Appendix B.

* Results of survey completed by *PLANSPONSOR* magazine.

Evaluation of SRI options

Plan sponsors' viewpoint

Question: Did you apply the same criteria for evaluating SRI products vs. non-SRI products for your plan?

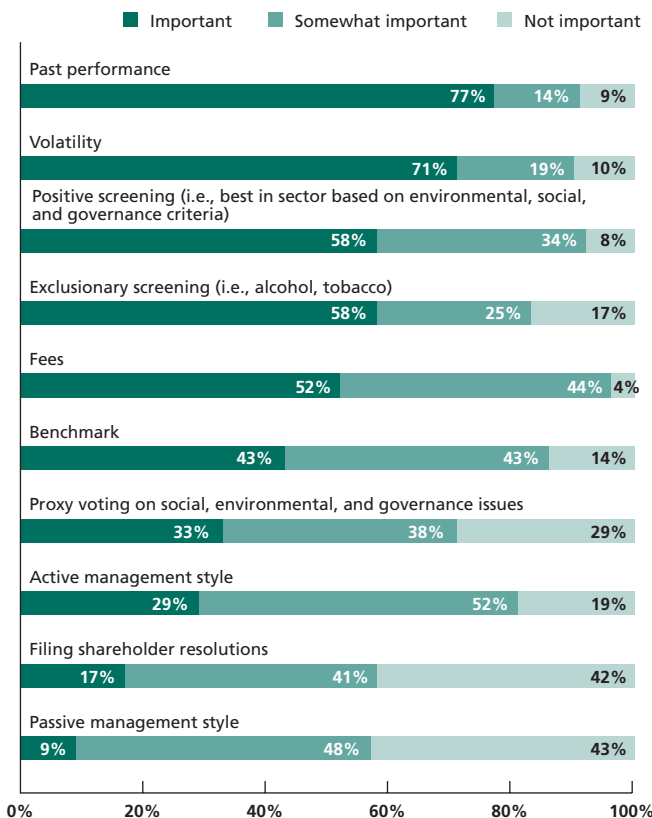
Over 92% of plan sponsor respondents indicate that they use the same evaluation criteria for SRI funds as for non-SRI funds. The remaining 8% used customized evaluation criteria.

Question: How important were the traditional characteristics in selecting the SRI option(s)?

Question: How important were the SRI-specific characteristics in selecting the SRI option(s)?

The traditional and SRI-specific characteristics noted in the survey from which a respondent could choose are combined in Exhibit 10 below.

Exhibit 10

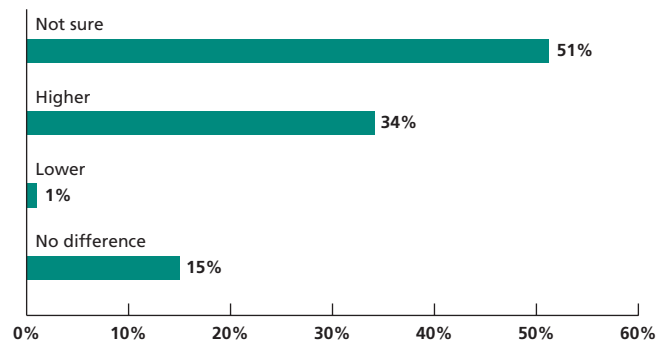


As can be seen, plan sponsors view past performance as the most important factor for fund evaluation, with volatility following closely behind. The approaches of positive screening and exclusionary screening are viewed as being equally important by the sponsors.

Fees

Question: What is your understanding of how fees for SRI funds compare to fees for non-SRI funds?

Exhibit 11



Over 50% of the plan sponsors surveyed indicate that they have no understanding of how fees for SRI funds compare to non-SRI funds.

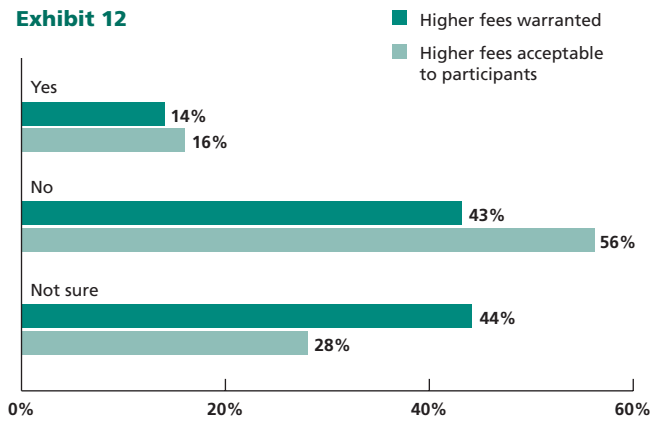


Question: Certain SRI funds charge higher fees to support social research and shareholder engagement. In your opinion as a plan sponsor, are higher fees warranted for SRI funds?

Question: Do you believe higher fees are acceptable to participants?

While fees are not a primary consideration for plan sponsors in selecting SRI options, they are a consideration. Exhibit 11 indicates that 51% of respondents are unsure of fee levels of SRI funds compared to non-SRI funds. This contrasts with Exhibit 12, where respondents indicated opinions on how participants would react to higher fee levels of SRI funds.

- Over 40% of plan sponsors are not sure if higher fees are warranted for SRI funds, while an equal number feel they are not.
- Over 55% believe that higher fees are not acceptable to participants.



Consultants/advisers' viewpoint

Further details can be found in Appendix B.

Looking ahead

Future demand for SRI

Question: What do you believe the trend will be over the next five years among DC plan participants regarding their demand for SRI options?

Exhibit 13

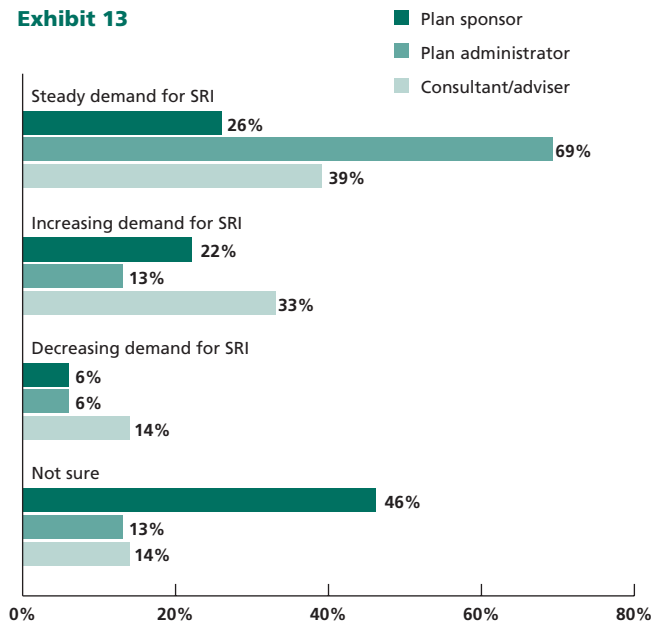


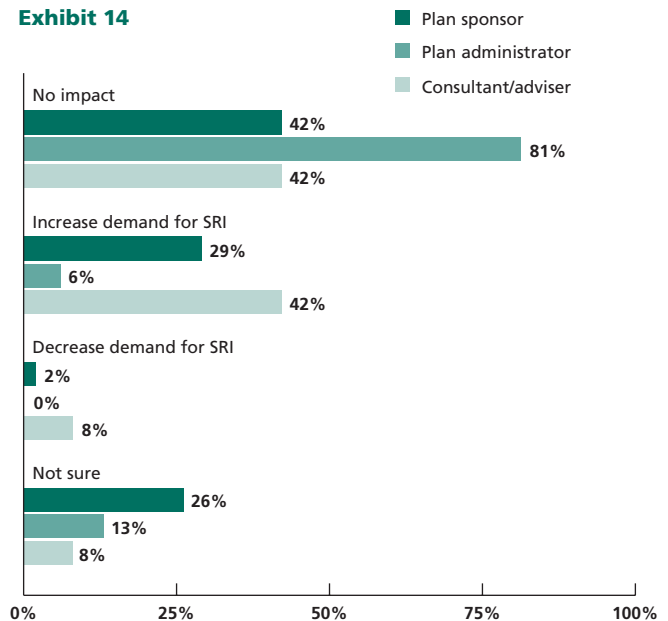
Exhibit 13 illustrates plan sponsor, administrator and consultant* predictions for future demand for SRI in the DC context. The predictions of plan sponsors were evenly mixed: 48% predicted increasing or steady demand, whereas 46% indicated that they are not sure.

The majority of plan administrator respondents (69%) believe the demand for SRI options will continue at its current pace.

More than 70% of consultant/adviser* respondents predict that the demand for SRI options will increase or remain steady; about one-third believe that there will be an increase in demand.

Question: Do you believe that the increase in DC plans in the US will disproportionately increase, decrease or have no effect on the offering of SRI options in these plans?

Exhibit 14



As can be seen:

- Only 28% of plan sponsor respondents felt that the increase in the number of DC plans in the US would increase demand for SRI options, whereas a much larger number of respondents (42%) felt it would have no impact.
- Over 80% of the plan administrator respondents believe that the increase in the number of DC plans will have no impact on SRI fund demand.
- Consultants/advisers* are split between whether or not an increase in DC plans will have any effect on demand for SRI options (42% predict that demand will increase; 42% predict no effect). The remaining respondents are equally split on having no prediction or predicting a decrease in demand, as a result of an increase in DC plans (8% each).

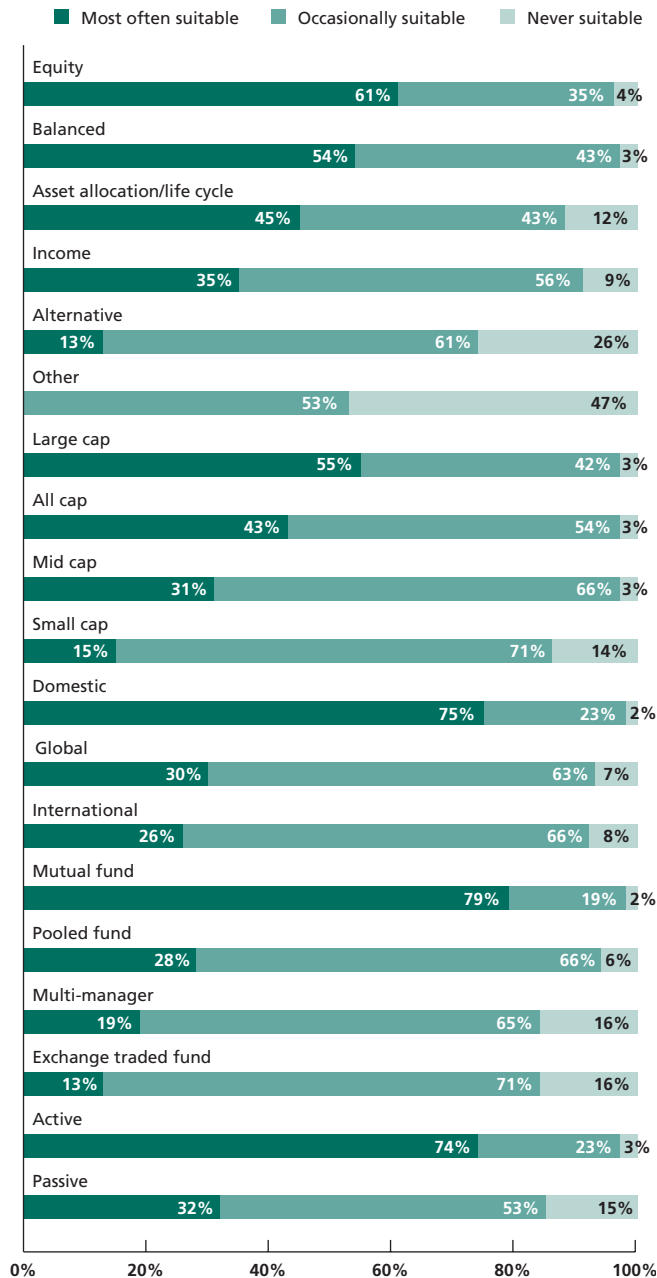
* Results of survey completed by *PLANSPONSOR* magazine.



Most suitable product types for SRI options

Question: What types of SRI options do you think would be most suitable to DC plans?

Exhibit 15



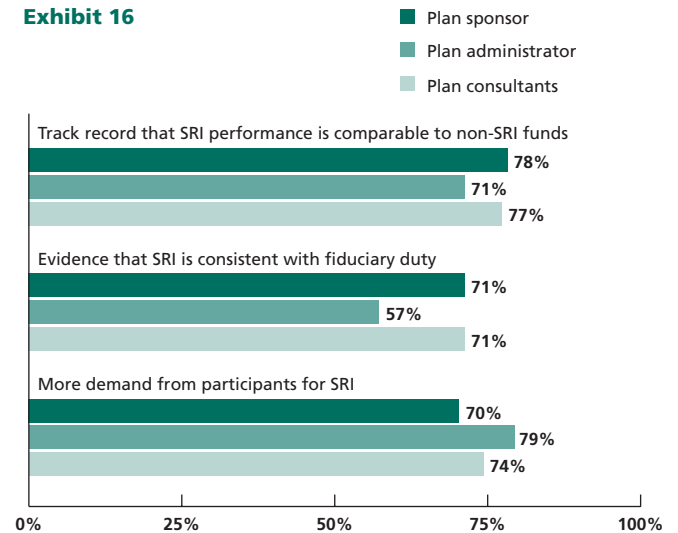
Plan sponsor respondents indicate that either actively managed mutual funds with a domestic large or all cap equity mandate, balanced funds or asset allocation/life cycle funds are the most suitable SRI options for retirement plans.

Plan administrators and consultants/advisers* mostly concurred with the plan sponsor responses as to the most suitable asset classes for SRI options.

Primary catalysts for increasing SRI options

Question: What steps might increase the offering of SRI options in DC plans?

Exhibit 16



Plan sponsor respondents indicate three factors as critical to increasing the number of SRI options in DC plans: a track record that demonstrates comparable performance between SRI and non-SRI funds, evidence that SRI is consistent with fiduciary duty, and more participant demand (see Exhibit 16).

* Results of survey completed by *PLANSPONSOR* magazine.



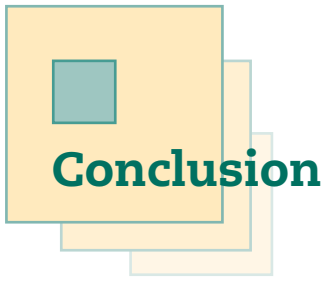
Plan administrators and consultants/advisers* concur with plan sponsors in their belief that performance, participant demand and fiduciary certainty are the most important factors to drive future demand for SRI funds in DC plans.

Availability of SRI products benchmarked to broad indices, lower expenses associated with SRI, and adoption of SRI options by larger prominent US DC plans are viewed as the next three most important factors.

Other choices offered to the respondents that rate below those noted above include:

- Availability of custom SRI benchmarks to assist with monitoring
- More SRI options to choose from
- Lower expenses associated with adding funds or changing plan options
- More SRI education for participants
- More SRI education for trustees
- Inclusion of SRI options in bundle line-up

* Results of survey completed by *PLANSPONSOR* magazine.

A graphic consisting of three overlapping squares. The top square is light blue and contains a smaller, solid blue square in its top-left corner. Below it are two overlapping light orange squares. The word "Conclusion" is written in a bold, teal font across the middle of the squares.

Conclusion

As institutional investors continue to consider ESG issues within their investments and as these issues continue to be prevalent in the news, Mercer IC believes that overall demand for SRI options by DC participants will grow. In addition, certain types of organizations may see growth in SRI because of their mission, commitment to sustainability, or because they employ a workforce with beliefs aligned with the tenets of SRI.

If survey respondents constitute a representative sample of DC plan sponsors, then 60% of plans should have an SRI option within three years. In addition, increased or steady demand is predicted by a significant number of respondents across all three groups surveyed (plan sponsors, plan administrators, consultants/advisers*). Many respondents believe that an increase in DC plans will not have an impact on demand for SRI, which implies that demand will be driven by other factors and may include the increasing visibility of ESG issues in the media and public debate. Plan administrators with open platforms will also play a role in the future of SRI fund offerings. Although

this type of platform in and of itself will not increase the number of plans offering SRI, the open structure eliminates a potential barrier to addition. It is unlikely plan sponsors would change their administrator for the opportunity to add a specific SRI option.

To realize expected increases in demand for SRI options in DC plans, further education on SRI will be necessary. Survey responses by plan sponsors demonstrate a general lack of knowledge of SRI and the availability of SRI options, as well as concerns over performance, investment processes and fiduciary duty. There is a substantial amount of literature and expertise available to address these issues with DC plan sponsors that only needs to reach the audience.

The resource guide in Appendix C (also available as a separate document from SIF, Mercer IC and any of the Project Partners) provides a framework to assist plan sponsors in considering, assessing and choosing SRI options for their plans. It also contains electronic links to additional information sources.

* Results of survey completed by *PLANSPONSOR* magazine.



Appendix A

List of organizations that responded to the survey and agreed to public disclosure of survey participation

Plan sponsors

ACLU
Aker Kvaerner
AmerUs Group
Archdiocese of Indianapolis
Arnett HealthSystem
Ascension Health
The Associated Press
Autodesk
Bendix Commercial Vehicle Systems
Bimbo Bakeries USA
Boral Industries Inc.
Bull Information Systems
Catalina Marketing Corporation
CH2M-WG Idaho, LLC
Children's Mercy Hospitals & Clinics
City of Little Rock
Compass Group
CONSOL Energy
Corning Incorporated
Credence Systems Corporation
CSA
Davis Wright Tremaine LLP
Del Mar Thoroughbred Club
E.ON US
Electronic Arts
Federal Reserve Employee Benefits System
Frederick Memorial Hospital
Genlyte Group
Getty Images
Greatbatch, Inc.
HIP Health Plan of New York
IBM Retirement Funds

Intel Corporation
Kaiser Permanente
Limbach Facility Services LLC
Maritz, Inc.
Marsh & McLennan Companies, Inc.
Mayo Clinic Arizona
Metropolitan Gov't Nashville/Davidson Co., TN
Miami County
Mirant Corporation
Mitsubishi Electric & Electronics USA
NCCI Holdings, Inc.
Ogilvy
OMI Corporation
Organic Trade Association
Pacific Life
PotashCorp
Principal Financial Group
QVC, Inc
Rotary International
SKF USA Inc.
Spansion
Starbucks Corporation
Symcor Inc.
Tomkins
United Water
Univar USA Inc.
URS Corporation
US Foodservice
VNU
Wachovia Bank
Waggener Edstrom Worldwide
YRC Worldwide
Zale Corporation



Plan administrators

Advised Asset Group (sub of Great-West life annuity)
AIG VALIC
Charles Schwab
Diversified Investment Advisors
Hartford Insurance
JPMorgan Retirement Plan Services
Mercer Human Resource Services
Nationwide Investment Advisors, LLC
The Newport Group
PMFM/401(k) Toolbox
Principal Financial Group
TIAA-CREF
Wachovia

Consultants/Advisers

Details for the consultant/adviser survey completed by
PLANSPONSOR magazine can be found in Appendix B.

Appendix B

PLANSPONSOR magazine – 2006 Socially responsible investment survey: Insight into consultant and adviser practices

2006 Socially Responsible Investment Survey

Insight into consultant and adviser practices

December 2006

PLANSPONSOR

Methodology

The Social Investments Forum partnered with PLANSPONSOR in conducting a survey of financial consultants in the defined contribution market concerning their use of socially responsible investments.

The online survey was sent out in September of 2006 and was closed on October 5, 2006. It consisted of 30 questions concerning socially responsible investments and how consultants weighed them in making their investment decisions. There were 70 responses to the survey, with 38 deemed complete enough to be used in the database.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

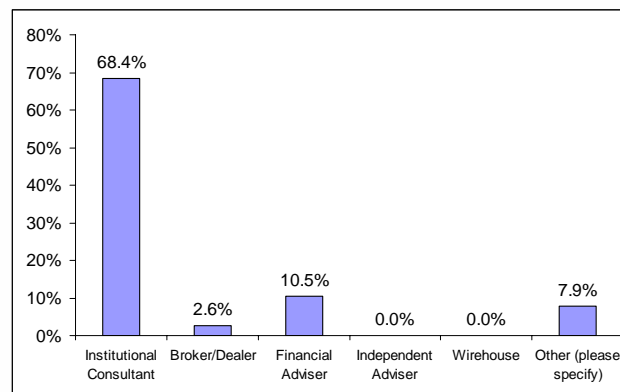
Findings overview

- ▶ The SRI funds in greatest demand are:
 - ▶ *by asset class*: Equity
 - ▶ *by size*: Large Cap
 - ▶ *by region*: Domestic
 - ▶ *by vehicle*: Mutual Fund
 - ▶ *by style*: Actively Managed
- ▶ 85% of consultants indicate their DC business is *increasing*.
- ▶ 75% of consultants report having staff dedicated to SRI investments.
- ▶ Two-thirds of consultants believe that fees are higher for SRI funds than for other funds.
- ▶ Nearly 75% project steady or increasing demand for SRI funds over the next five years.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Respondent types

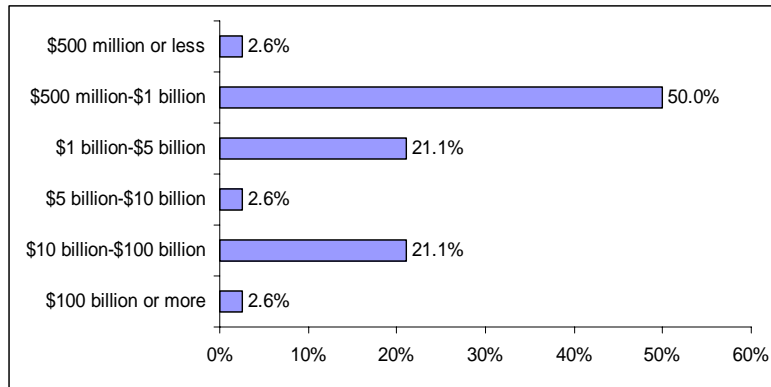


- ▶ More than two-thirds of respondents categorize themselves as Institutional Consultants.
- ▶ Another 13% of respondents say they are Advisers or Broker/Dealers.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Assets under advisement

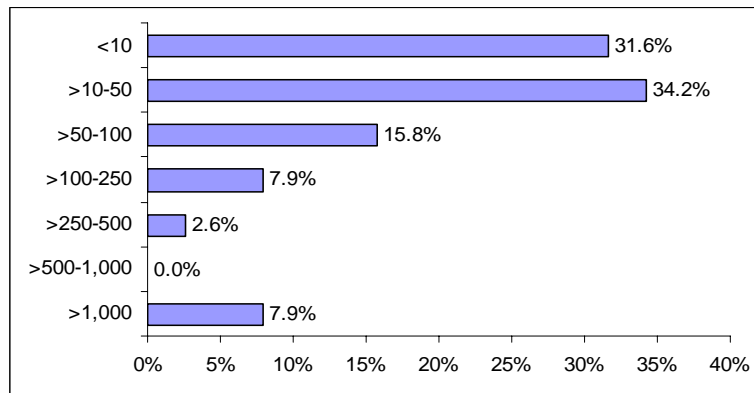


- ▶ Half of respondents oversee assets worth between \$500 million and \$1 billion.
- ▶ Nearly 45% of respondents oversee assets of between \$1 billion and \$100 billion.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Number of plans managed

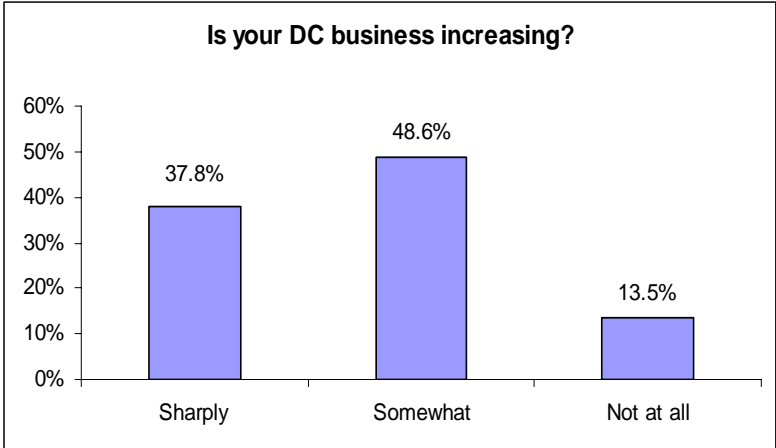


- ▶ Nearly two-thirds of respondents manage fifty or fewer plans.
- ▶ 7.9% of respondents manage more than 1,000 plans.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Growth of DC business

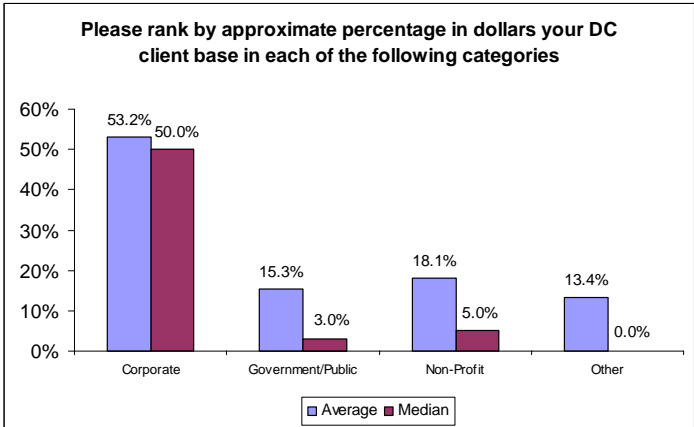


- ▶ More than one-third of respondents say their DC business has increased sharply.
- ▶ Over 85% of respondents say their business has increased at least somewhat.

PLANSponsor

Source: 2006 PLANSponsor/Social Investment Forum SRI Survey

DC client base in dollars

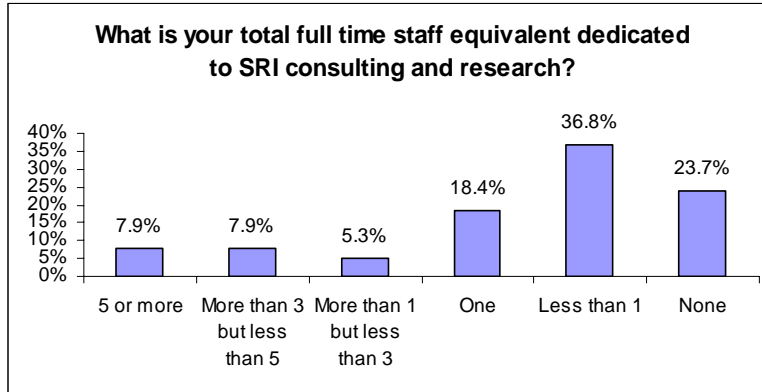


- ▶ Over half of respondents' business is Corporate.
- ▶ One-third of respondents' business is Government and Non-Profit combined.

PLANSponsor

Source: 2006 PLANSponsor/Social Investment Forum SRI Survey

SRI staffing

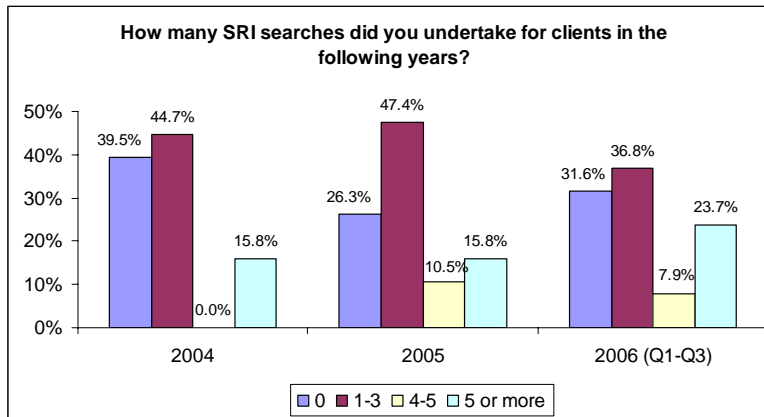


- ▶ More than three quarters of respondents have staff dedicated to SRI investments.
- ▶ Nearly 40% of respondents have one or more full time staff dedicated to SRI investments.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

SRI searches per year

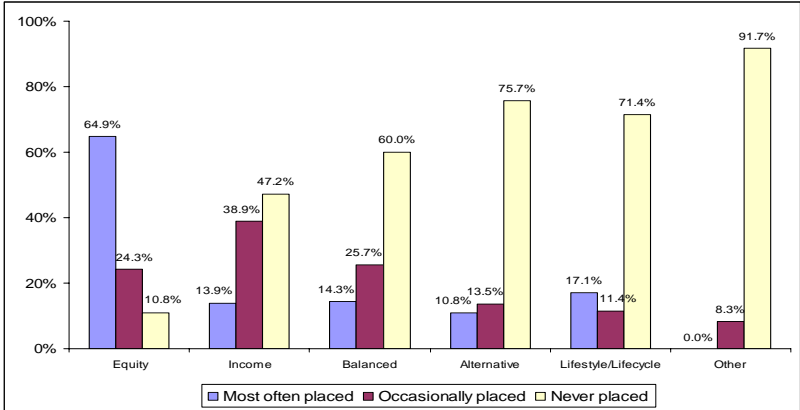


- ▶ Nearly one-quarter of respondents say they undertook five or more SRI searches in the first three quarters of 2006.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Demand for SRI funds by asset class

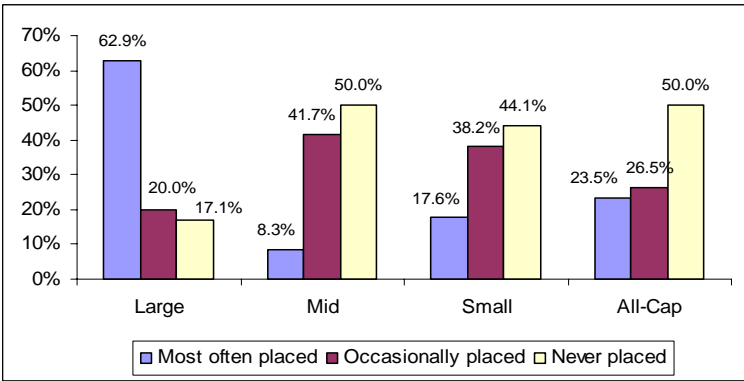


- ▶ Nearly 65% of funds placed are equity funds.
- ▶ Lifestyle/Lifecycle SRI funds are now in greater demand than those in Income, Balanced and Alternative funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Demand for SRI funds by size

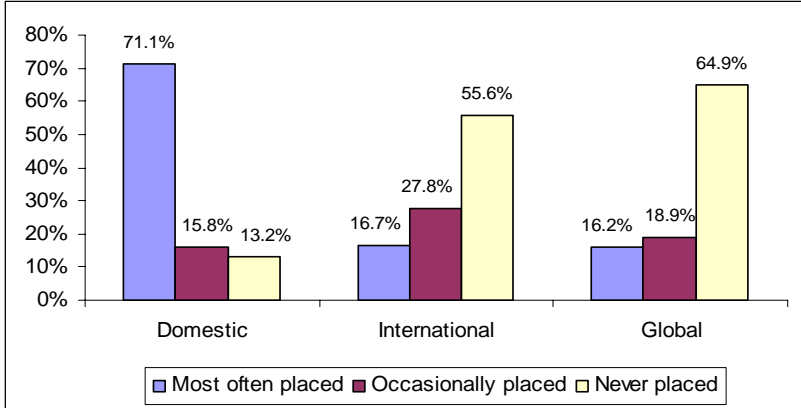


- ▶ Large Cap SRI funds are the most frequently placed by consultants. Nearly 63% of respondents say they choose them first.
- ▶ All-Cap funds are second in terms of popularity.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Demand for SRI funds by region

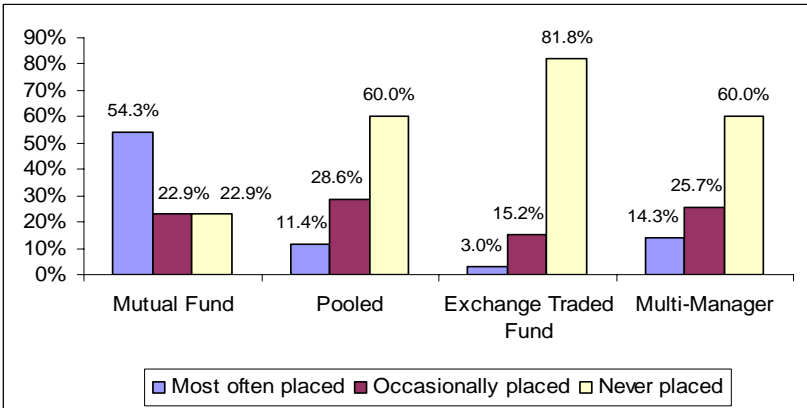


- ▶ 71% of respondent consultants say they most often place Domestic SRI funds.
- ▶ International and Global SRI funds are quite even in terms of popularity.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Demand for SRI funds by vehicle

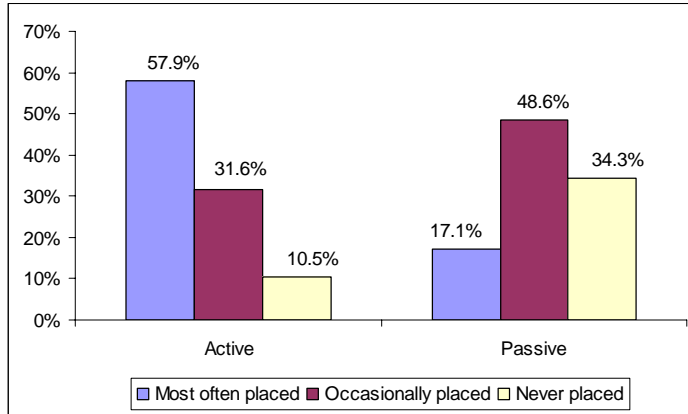


- ▶ Over half (54.3%) of respondent consultants say they place Mutual Funds offering SRI options.
- ▶ Exchange Traded SRI funds are rarely placed.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Demand for SRI funds by style

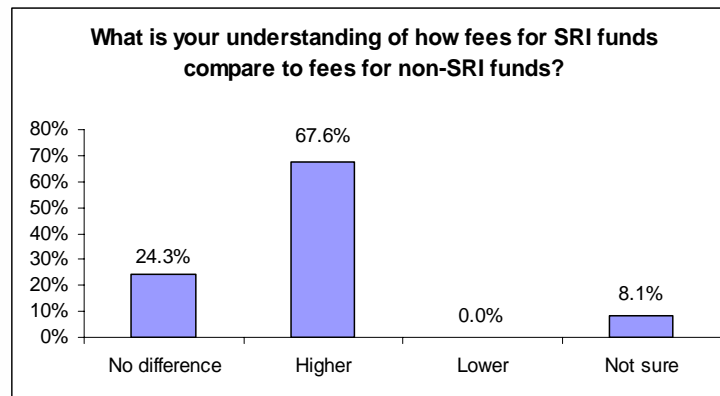


- ▶ Nearly 60% of respondent consultants place actively managed SRI funds.
- ▶ Still, nearly half of respondents (48.6%) say they occasionally place passively managed SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR Social Investment Forum SRI Survey

SRI fund fees

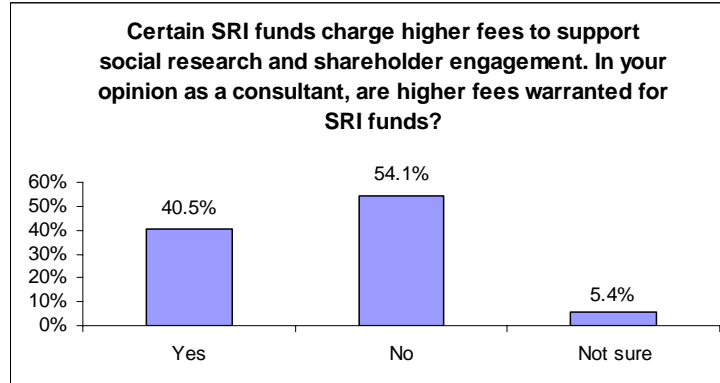


- ▶ Two-thirds of respondents believe fees on SRI funds are higher than those of non-SRI funds.
- ▶ Roughly one-quarter of respondents believe there is no difference between SRI and non-SRI fund fees.

PLANSPONSOR

Source: 2006 PLANSPONSOR Social Investment Forum SRI Survey

Are higher fees warranted?

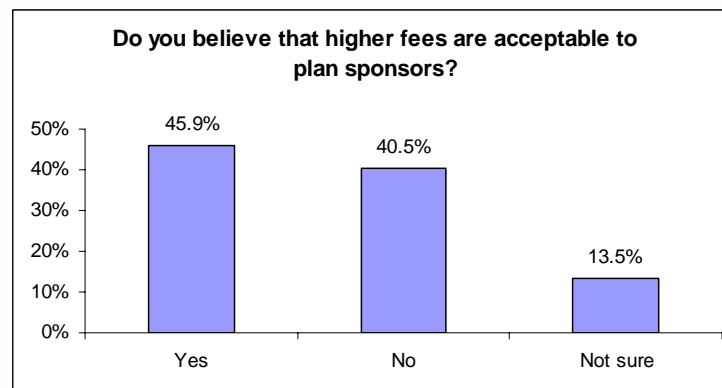


- ▶ Over 40% of respondents feel that higher fees are warranted for SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Fee impact on plan sponsors

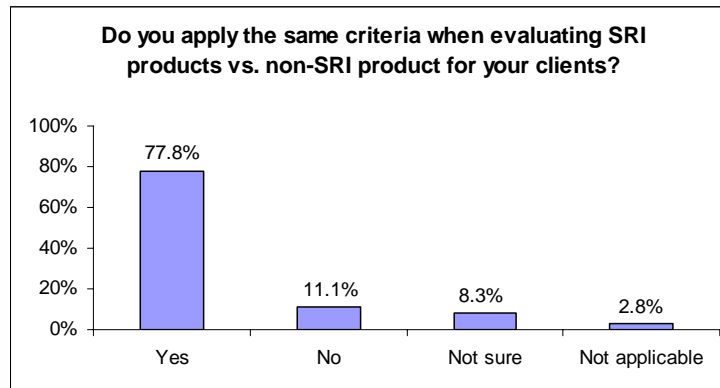


- ▶ A majority of respondents believe that higher fees for SRI funds are acceptable to plan sponsors.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Criteria for evaluating SRI products

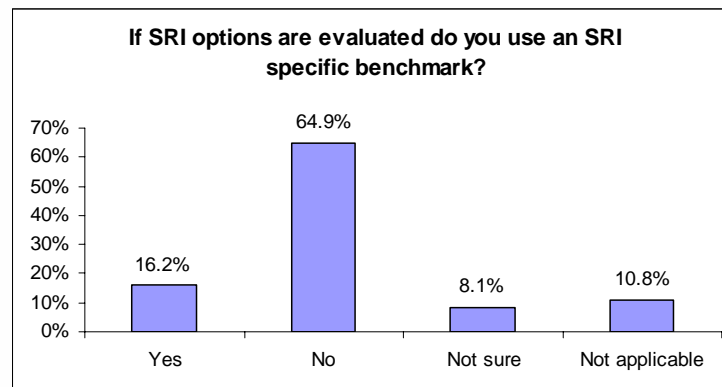


- ▶ Over three-quarters of respondents say they evaluate SRI funds by the same criteria as non-SRI funds.
- ▶ Only 11% say they use different criteria.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Use of SRI benchmarks



- ▶ Only 16.2% of respondents use SRI-specific benchmarks when evaluating SRI funds.
- ▶ Nearly 65% say they do not utilize SRI-specific benchmarks when evaluating SRI funds.
- ▶ These results are consistent with the percentage of consultants that evaluate SRI funds on the same criteria as non-SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Verbatim comments

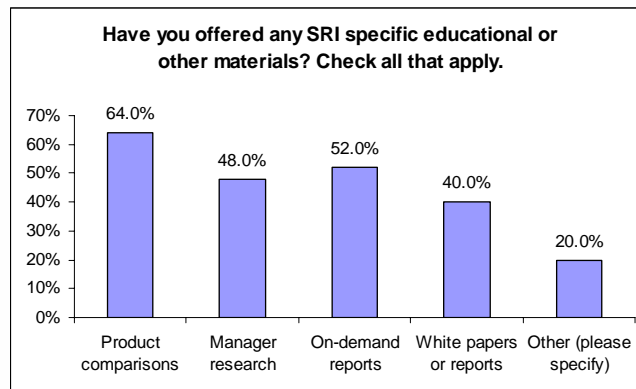
Please describe other differences, if applicable, in the way SRI options are evaluated compared to other options.

- We are assuming that emerging manager mandates are included in your definition of SRI. We consult on Real Estate only.
- Only compare SRI options.
- We look at exclusion/inclusion criteria. What does the client want? What are the objectives if any?
- SRI is a secondary investment criteria so we apply the same screens that we would in the non-SRI universe.
- On some previous questions, it implied the use of funds. I rarely use mutual funds, only managed accounts.
- If the client has a specific values orientation, that may be taken into consideration when evaluating any SRI product.
- Sometimes, plan sponsors are willing to live with a margin of underperformance as the investment universe of SRI products is limited and performance is not the sole objective of having the strategy on the DC menu.
- Style.
- We look at the specific types of SRI. One client may want 'morality' screens, while another may want a focus on environmental issues.
- Beta, Sharpe Ratios, category rankings.
- We also use non-SRI benchmarks and always use a benchmark tied to the plan goals.
- [We] can evaluate the degree and quality of SRI implementation for a manager or specific product using a methodology developed in-house.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

SRI educational materials

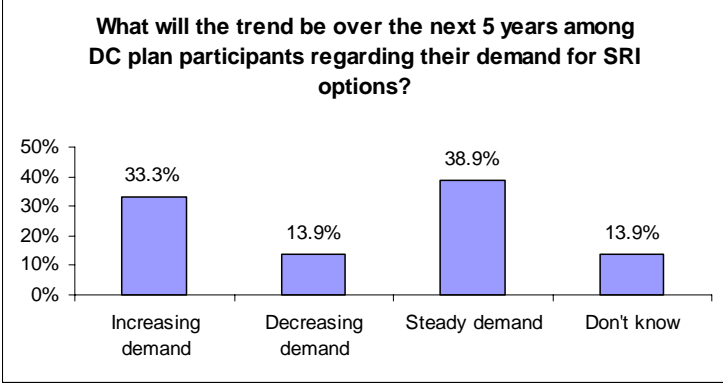


- ▶ 64% of respondents offer SRI fund product comparisons to their clients.
- ▶ Nearly 50% say they offer manager research and on-demand reports on SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Trends among DC participants

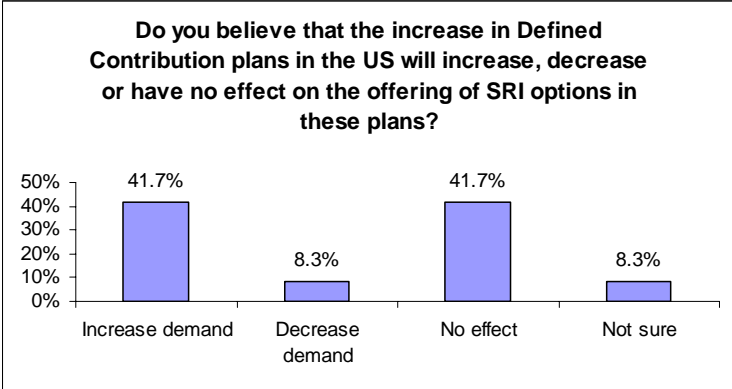


- ▶ One-third of respondents believe that SRI funds will see increasing demand over the next five years.
- ▶ Nearly 75% project steady or increasing demand for SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR Social Investment Forum SRI Survey

DC impact on SRI demand

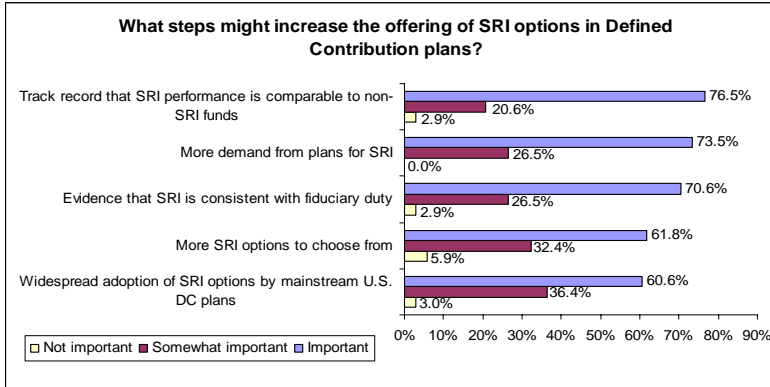


- ▶ The same number of respondents say that the increase in DC plans would increase demand for SRI funds as those that say it would have no effect on SRI fund demand.
- ▶ Only 8.3% feel that the increase in DC plans would lower demand for SRI funds.

PLANSPONSOR

Source: 2006 PLANSPONSOR Social Investment Forum SRI Survey

Stepping up SRI demand



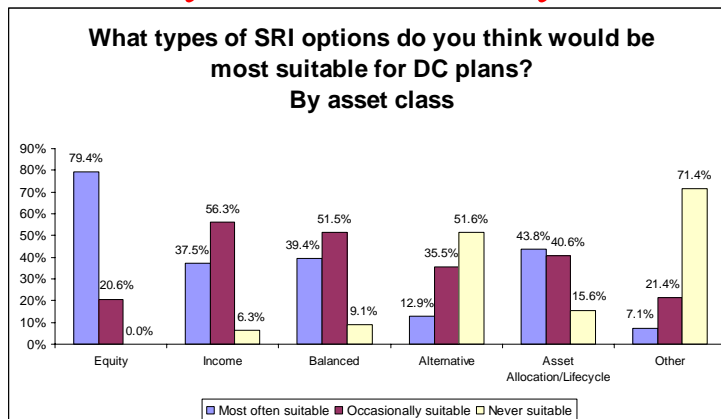
According to consultants, the most important steps in increasing the offering of SRI options in DC plans are:

- ▶ Demonstrate that SRI performance is comparable to non-SRI funds.
- ▶ See more demand from plans for SRI.
- ▶ Show evidence that SRI funds do not compromise fiduciary standards.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Suitability of SRI funds by asset class

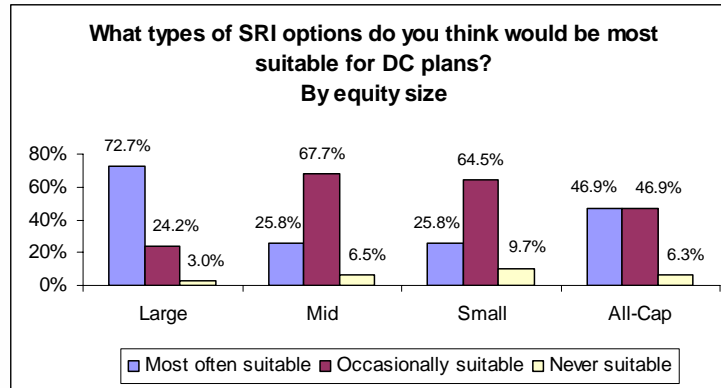


- ▶ Nearly 80% of respondents think that Equity SRI options are the most suitable for DC plans.
- ▶ Income, Balanced and Asset Allocation/Lifestyle/lifecycle funds were all deemed most suitable about half as often.
- ▶ Just 12.9% of respondents think Alternative SRI funds are suitable for DC plans.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Suitability of SRI funds by size

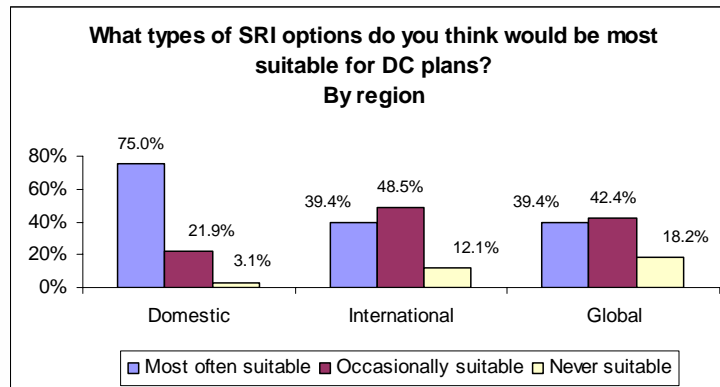


- ▶ A preponderance (72.7%) of respondents think Large Cap SRI funds are most suitable for DC plans.
- ▶ Nearly half of respondents think that All-Cap SRI funds are most often suitable for DC plans.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Suitability of SRI funds by region

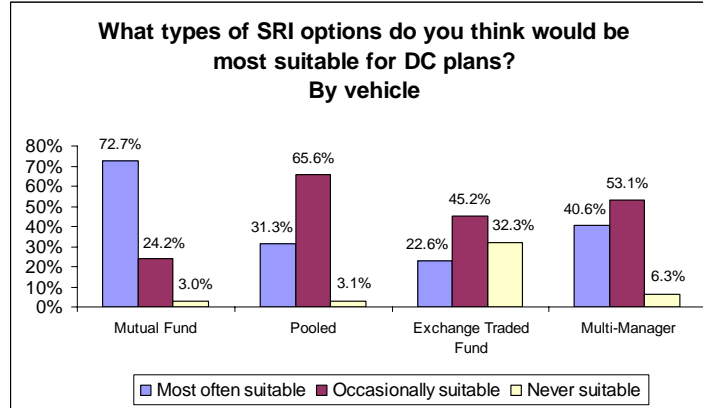


- ▶ 75% of respondents find Domestic SRI funds the most suitable for DC plans.
- ▶ The same number of respondents (39.4%) said that International and Global SRI funds were most often suitable for DC plans.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Suitability of SRI funds by vehicle

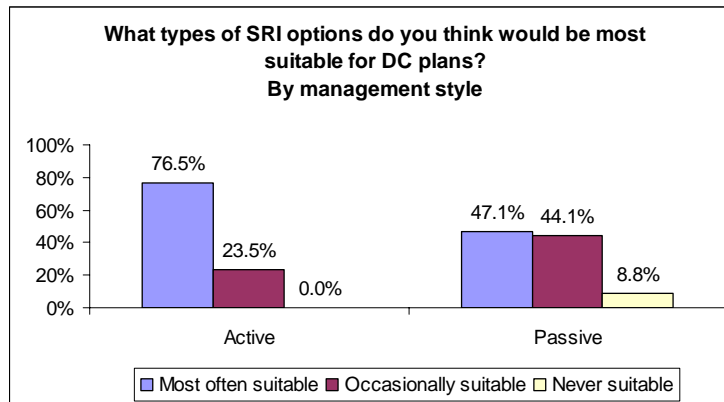


- ▶ Nearly three-quarters of respondents think Mutual Funds are the most suitable vehicle for SRI funds.
- ▶ Exchange Traded Funds were deemed least suitable: nearly 33% found them never suitable.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Suitability of SRI funds by style



- ▶ According to 76.5% of respondents, actively managed SRI funds are the most suitable for DC plans.
- ▶ No respondents found actively managed funds never suitable.

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

Respondent names made public

The following respondents indicated that they are comfortable being named as respondents to this SRI Survey:

- Aon Investment Consultants
- Bridgebay
- CapTrust
- Clark Strategic Advisors, Inc.
- CRA RogersCasey
- Ellwood Associates
- Hallett & Associates, P.S.
- Innovest Portfolio Solutions LLC
- IPEX
- JF Beasley & Company, Inc.
- JFK Consultancy
- Kravitz Davis Sansone
- MBO Cleary Advisors Inc.
- Mercer Investment Consulting
- Meridian Trust & Investment Co.
- Merrill Lynch
- NEPC
- Pension Consulting Alliance, Inc.
- Ponder Financial Group
- RBC Dain Rauscher
- Russell Investment Group
- Smith Barney
- Stephane Hpay Financial Services
- The Townsend Group
- UBS Financial Services, Inc.
- WHA Financial Solutions, Inc.
- White Oak Advisors
- WSP Group

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey

This study was funded and informed by the following groups:

- Calvert
- Northern Trust
- Neuberger Berman
- FTSE
- TIAA-CREF
- Altrushare

PLANSPONSOR

Source: 2006 PLANSPONSOR/Social Investment Forum SRI Survey



Resource guide for plan sponsors: Adding a socially responsible investment option to your DC plan

Contents

Adding a socially responsible investing (SRI) option to your DC plan: Six steps	27
■ Step #1: Gauge interest in adding an SRI option	27
■ Step #2: Increase your knowledge of SRI	29
■ Step #3: Check with your consultant and/or plan administrator	30
■ Step #4: Make the case: Addressing performance and fiduciary concerns	31
■ Step #5: Choose a fund (and monitor performance)	32
■ Step #6: Educate participants	35
■ One company's experience with SRI: A conversation with Dave Stangis, Intel's director of corporate responsibility	36
Compilation of resources	37
■ Corporate initiatives and codes of conduct	37
■ DC plan administrator platforms specializing in SRI	37
■ Investor initiatives and organizations	37
■ SRI and fiduciary standards	37
■ SRI educational sources	37
■ SRI indices	37
■ SRI performance sources	37



Adding a socially responsible investing option to your DC plan: Six steps

This step-by-step guide assists plan sponsors considering the addition of a socially responsible investment (SRI) option to their defined contribution (DC) retirement plan. The Social Investment Forum (SIF) engaged Mercer Investment Consulting, Inc. (Mercer IC) to prepare this guide in response to results from a recent survey¹ that shows that although plan sponsor interest in SRI is increasing, many plan participants still do not have access to or sufficient knowledge of SRI options. The survey indicates that many plans (41 percent) are considering adding an option within the next three years² in addition to the 19% already offering an SRI option.

The steps outlined will help sponsors demonstrate the feasibility of SRI as an investment option and address their situation-specific concerns about SRI. The described framework assists in the review, consideration and addition of an SRI option.

Steps to adding an SRI option to your DC plan

- Step #1: Gauge interest in adding an SRI option
- Step #2: Increase your knowledge of SRI
- Step #3: Check with your consultant and/or plan administrator
- Step #4: Make the case: Addressing performance and fiduciary concerns
- Step #5: Choose a fund (and monitor performance)
- Step #6: Educate participants

Step #1: Gauge interest in adding an SRI option

With recent media coverage of corporate governance, climate change and other issues, public interest in SRI is on the rise. As a result, sponsors may increasingly field requests to add an SRI option to their DC plans. In fact, recommendations from board members, and pension, investment and management staff, as well as requests from participants are leading drivers for adding an SRI option.³ However, the most significant driver cited by sponsor survey respondents for adding this option is to demonstrate an alignment with the mission or values of the sponsor. The inclusion of an SRI option is often viewed as an element of a company's commitment to corporate responsibility. For this reason, boards and investment and pension committees receive requests from their own executives, such as managers of corporate social responsibility (CSR), to consider adding an SRI option to the organization's retirement plan.

¹ Defined Contribution Plans and Socially Responsible Investing in the United States. June 2007. The SIF commissioned Mercer Investment Consulting, Inc. to complete a survey of plan sponsors and administrators on SRI options in DC plans. SIF's project partners made this survey possible by providing input and funding to SIF: AltruShare Securities, Calvert, FTSE Group, Neuberger Berman, Northern Trust, and TIAA-CREF. This survey report is available at www.socialinvest.org, www.mercerIC.com/ri, or any of the project partners' websites.

^{2,3} Defined Contribution Plans and Socially Responsible Investing in the United States. June 2007. Social Investment Forum, Report prepared by Mercer Investment Consulting.



Surveying participants

Some sponsors have found that surveying plan participants is an excellent way to gauge demand for an SRI fund and to uncover specific social issues of concern (for example, the environment, corporate governance or diversity). Surveys need not focus solely on interest in SRI but can also be broad enough to determine interest in adding other investment options to plans and satisfaction with the current line-up. It would be helpful to include explanatory information about SRI at the beginning of such a survey to ensure a level of understanding. A number of sample survey questions follow:

1. Would you like your retirement fund options to include an SRI option (one that uses social and environmental criteria to help choose its holdings)?
2. How familiar are you with SRI?
3. Please rate the following in terms of importance in your retirement plan options:
 - A. Good financial returns
 - B. Investing with your values
 - C. Low risk
 - D. High risk
 - E. Risk that adjusts downwards as I get closer to retirement
 - F. Low fees
4. SRI funds utilize a variety of approaches, sometimes in combination. Which aspect of SRI is most important to you to achieve financial and social objectives?
 - A. Screening and analysis. Applying environmental, social and corporate governance (ESG) criteria to portfolio constituents
 - B. Shareholder advocacy. This may include proxy voting, dialogue with portfolio companies and/or filing of resolutions
 - C. Community investing. Capital is directed toward individuals, businesses and organizations in underserved communities
5. What specific social issues are you most concerned about?
 - A. Environment/climate change
 - B. Corporate governance
 - C. Diversity
 - D. Employee safety
 - E. Other
6. What type of SRI investment would you prefer as an option in your plan?
 - A. Multiple funds
 - B. Core investment fund
 - C. Asset allocation fund
 - D. Other
7. If you had an SRI option available, would you use it? If yes, approximately what percentage of your assets would you place in such a fund?
 - A. Less than 5 percent
 - B. Between 5 and 10 percent
 - C. Between 10 and 20 percent
 - D. Greater than 20 percent
8. Do you believe your company is committed to social responsibility?
9. Do you believe adding an SRI option would help demonstrate your company's commitment to corporate responsibility?



Connecting with CSR managers

Many companies have dedicated staff managing CSR or sustainability issues. Often they are already networked with SRI research and investment firms and can relay their experience with various SRI investment strategies available. You should identify early on if such a position exists in your company. As you'll read later, Intel's Director of Corporate Responsibility Dave Stangis provided this type of support in the company's decision to add SRI options to its DC plan.

Step #2:

Increase your knowledge of SRI

Once you assess a high level of participant interest and wish to proceed, it's time to turn your attention to learning more about SRI and the various investment options available. The SIF (www.socialinvest.org) is the membership association for SRI practitioners; it offers comprehensive information, contacts and resources on SRI.

There is also a growing number of media outlets covering or dedicated to issues related to CSR and SRI. The following links provide easy access to information on a range of SRI issues including SRI fund performance, shareholder activities and the implications of environmental, social and governance (ESG) issues for investors:

- www.greenmoneyjournal.com: A newsletter that provides resources and contacts for SRI
- www.socialfunds.com: Website featuring information on SRI mutual funds, community investments, corporate research, shareowner actions and daily social investment news

- www.sristudies.org: Resources for investment professionals, academics and other people interested in the quantitative aspects of SRI

Investor initiatives

In addition to SRI-specific sources, there are a number of initiatives for investors that focus on deriving long-term enhanced returns from the analysis of ESG factors. The signatories to these initiatives are primarily investment managers, public pension funds and mission-based organizations seeking to align investments and ownership activities with their fiduciary mandate to minimize risk and provide long-term returns. The secretariats of these initiatives often serve as clearinghouses for information on SRI issues such as climate change.

The United Nations' Principles for Responsible Investment (PRI) (www.unpri.org) offer a framework enabling investors to address ESG considerations within their investment strategies. The six principles, each associated with several possible actions, were developed by an international group of institutional investors reflecting the increasing relevance of ESG issues to investment practices and fiduciary duty. Since April 2006, over 50 asset owners and 50 asset managers from around the world representing assets of over US\$8 trillion have committed to the PRI.⁴ United States funds that are signatories include Connecticut Retirement Plans and Trust Funds (CRPTF), CalPERS, Illinois State Board of Investment, New York City Employees Retirement System (NYCERS), New York State and Local Retirement System, The General Board of Pensions and Health Benefits of the United Methodist Church, and the Nathan Cummings Foundation.

⁴ Mercer Investment Consulting was the original consultant to the PRI and continues to support the UN as a signatory and the consultant in developing the PRI reporting and assessment framework.



Sponsors can also delve into issues of ESG risk management through the following collaborative engagement initiatives:

- **Carbon Disclosure Project (CDP)** (www.cdproject.net): The CDP is the largest registry of corporate greenhouse gas emissions in the world. This initiative combines the efforts of many institutional investors by collectively signing a single global request for disclosure of information on greenhouse gas emissions.
- **Investor Network on Climate Risk (INCR)** (www.incr.com): This network of institutional investors and financial institutions is dedicated to promoting better understanding of the financial risks and investment opportunities associated with climate change.
- **Investor Environmental Health Network** (www.iehn.org): Inspired by INCR and CDP, this network of institutional investors and financial institutions encourages companies to address the environmental health questions raised by their products.

There are also industry groups that work with investors in different arenas to improve corporate governance, investor rights and the integration of ESG risks into financial analysis:

- **Council of Institutional Investors** (www.cii.org): A not-for-profit association of 130 pension funds with assets exceeding US\$3 trillion, the CII works to educate members and the public about corporate governance and advocates strong governance standards on issues ranging from executive compensation to the election of corporate directors.
- **Enhanced Analytics Initiative** (www.enhancedanalytics.com): This international collaboration between

asset owners and asset managers is aimed at encouraging better investment research that takes into account the impact of extra-financial issues on long-term investment.

- **United Nations Environment Program Finance Initiative, Asset Management Working Group** (www.unepfi.org/work_streams/investment/amwg): This global platform of asset managers representing US\$2 trillion is focused on understanding the various ways ESG issues affect investment value and the evolving techniques for the inclusion of such extra-financial criteria and metrics.

Step #3: **Check with your consultant and/or plan administrator**

It is prudent early on to research your existing plan administrator platform and external advisers. They may well already have information about SRI and investment options.

Plan administrator platforms

Many major plan administrator platforms provide access to at least one SRI option or have an open structure – that is, they are able to include any fund option on their platform. You may be surprised to learn that it already offers an SRI option. If so, find out which fund(s) is available, and inquire as to how the fund(s) was chosen. If your plan administrator does not currently provide an SRI option, see if it is able to add one for your account.

Be sure to also inquire if there are significant fees and/or administrative issues associated with adding a new fund to your investment line-up. If that's the case, external advisers may be able to assist with negotiating lower fees.



External advisers

More consultants are developing expertise in SRI and offer opinions or information on SRI strategies. If you are currently working with a consulting firm, you might ask them the following questions:

1. What is your level of knowledge and experience with SRI?
2. What is your view of SRI as part of a DC line-up?
3. Have you conducted successful SRI searches for DC plans?
4. Do you have off-the-shelf research on SRI managers and strategies?
5. Do you have dedicated SRI staff?
6. How do you evaluate an SRI fund?
7. What is the universe of SRI funds that you consider for a DC plan?

Step #4:

Make the case: Addressing performance and fiduciary concerns

There has been a perception that SRI investing means giving up returns, either because you are limiting the investment universe or because the correlation between ESG factors and financial performance has not been adequately demonstrated. Numerous academic studies have challenged this assertion and shown that there need not be a performance cost to SRI on a risk-adjusted basis.⁵

In fact, certain factors, such as environmental management and workplace health and safety, show positive correlations to valuation and financial performance metrics. Reputational risk associated with environmental and social issues has also been found to play a significant role in long-term financial performance.⁶

Issues such as climate change, corporate governance and community relations are seen to have material impacts on some companies and sectors. Increasingly, financial analysts are incorporating a company's management of these issues into their analysis.⁷

But other studies show that there can be a performance cost to SRI.⁸ For more information about SRI performance research, the Haas School of Business at Berkeley and Lloyd Kurtz of Nelson Capital Management have developed an annotated bibliography of studies (www.sristudies.org).

Fiduciary duty

There has been a long-running debate on whether or not pursuing SRI is consistent with fiduciary duty. Recent survey results underscore fiduciary responsibility as a major concern of plan sponsors.⁹ Over the past several years, private and public sector experts have supported SRI funds and the consideration of ESG factors within investment management practices. These experts were supportive of SRI, provided that the investor expected competitive returns and completed and documented its due diligence process.

For example, in *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment*, a major law firm examined fiduciary law in seven developed markets including the US and found that "The links between ESG factors and financial performance are increasingly being recognized. On that basis, integrating ESG considerations into an investment analysis is clearly permissible and is arguably required in all jurisdictions."¹⁰

⁵ Kurtz, Lloyd. "Answers to Four Questions." *The Journal of Investing*. Fall 2005. Number 20461.

⁶ Orlitzky, Marc, Schmidt, Frank L., and Sara L. Rynes. "Corporate Social and Financial Performance: A Meta-analysis. 2003." This is a meta-analysis of 52 previous studies and 33,878 observations that demonstrates a positive correlation between corporate social and financial performance.

⁷ Barnett, Michael L. and Richard Salomon. "Beyond Dichotomy: The Curvilinear Relationship Between Social Responsibility and Financial Performance." *Journal of Strategic Management*. Volume 27; Issue 11. November 2006.

⁸ For example, Lehman Brothers, UBS and Goldman Sachs have all published recent reports on the risks and opportunities associated with climate change.

⁹ "Defined Contribution Plans and Socially Responsible Investing in the United States." June 2007. Social Investment Forum, report prepared by Mercer Investment Consulting.

¹⁰ Freshfields Bruckhaus Deringer, *A legal framework for the integration of environmental, social and governance issues into institutional investment* (New York/Nairobi: UNEP FI, Oct. 2005). Pg 13.



Other sources have dealt more explicitly with the negative screening of certain sectors that is often a part of SRI funds. In a paper for the California County Retirement System, the law firm of Baker & McKenzie issued the following statement: “If the social investment’s rate of return is similar to the return on a similar type of investment sought, then it appears that public system retirement boards can make the social investment.”¹¹

Regulators have also weighed in on the implications of the Employment Retirement Income Security Act (ERISA) regarding SRI. In 1998, Calvert sought an opinion on the application of ERISA to an SRI option as part of a retirement plan. The response from the Office of Regulations and Interpretations reads, in part:

“ . . . The fiduciary standards of sections 403 and 404 do not preclude consideration of collateral benefits, such as those offered by a ‘socially responsible’ fund in a fiduciary’s evaluation of a particular investment opportunity . . . The same standards set forth in sections 403 and 404 of ERISA governing a fiduciary’s investment decision, discussed above, apply to a fiduciary’s selection of a ‘socially responsible’ mutual fund as a plan investment or, in the case of an ERISA section 404(c) plan, a designated investment alternative under the plan. Accordingly, if the above requirements are met, the selection of a ‘socially responsible’ mutual fund as either a plan investment or a designated investment alternative for an ERISA 404(c) plan, would not, in itself, be inconsistent with the fiduciary standards set forth in sections 403(c) and 404(a)(1) of ERISA.”¹²

The citations above agree on two main points relevant to adding an SRI option to your plan:

- SRI options are acceptable within ERISA plans.
- The same requirements for due diligence apply to SRI and non-SRI funds.

These comments do not apply to any particular fund or family of funds; they are interpretations of fiduciary standards by private and government experts. Actions around SRI, as with other decisions, should be taken with a comfort level appropriate for a fiduciary. Showing a clearly articulated plan and method for adding an SRI option with appropriate due diligence is key to supporting the plan’s fiduciary duty. Legal counsel, committees and external consultants/advisers can assist with procedural and reporting aspects of this process.

Step #5: Choose a fund (and monitor performance)

SRI funds as a group exhibit similar characteristics to non-SRI funds. There is an ever-expanding range of asset classes, styles and vehicles. In addition, SRI funds, like other types of funds, have varied in performance and tracking error.

There are many options available to plans looking for SRI investment vehicles; domestic equity funds are the most popular. However, different types of funds (such as asset allocation, income, style-based and geographically focused) are also offered by SRI management firms and increasingly by larger financial institutions entering the SRI space. SRI fund vehicles have

¹¹ Gibson, Virginia, Levitt, Bonnie and Karine Cargo. Paper for California County Retirement System. Baker & McKenzie. November 2000. Quoted from Baue, William. “Baker & McKenzie Paper Concludes Social Investing Consistent with Fiduciary Duty.” www.socialfunds.com, May 21, 2004.

¹² Office of Regulations and Interpretations Advisory Opinion (The “Calvert Letter”). Robert J. Doyle, Director, Office of Regulations and Interpretations. May 28, 1998.



also expanded in recent years to include exchange-traded funds and passively managed, commingled and separate account vehicles. SRI hedge funds and lifestyle funds are also emerging.

In terms of choosing the right type of fund, your company should explore the following questions with your committee and/or consultant:

1. Will the SRI fund fill a gap for an asset class not represented in your plan or will it be an additional option within an existing asset class?
2. What is the appropriate asset class, style and vehicle for an SRI option in your plan?
3. What performance benchmark is appropriate for an SRI option in your plan line-up?

In addition to where the SRI option might fit within your existing line-up, the specific SRI tools utilized by the fund should be considered. Stringency on negative screens for sectors such as tobacco, alcohol and weapons differ by fund manager. The same is true for screens on issues such as the environment, labor and human rights. Some funds utilize positive or best-in-class screening to seek out the leaders on an issue or within an industry (and avoid screening out sectors completely).

Specialized SRI funds are also an option. Investments focusing on treatment of women, protecting the environment and religious beliefs are available.

As you consider the types of screens, ownership activities and commitment to community investing most

appropriate for your plan, the following questions will help lead you toward a decision and allow you to narrow the list of SRI fund candidates:

1. Do your plan participants have specific values or beliefs that will affect your choice of an SRI fund?
2. Do your participants or trustees prefer a negative screening or positive screening approach to SRI?
3. Do you or your participants have an interest in community investment as part of the offered SRI option?

SRI funds offer additional characteristics that may be of interest to plan sponsors and participants, such as how proxies are voted and whether portfolio companies are challenged on ESG issues. Questions that will help you to determine the importance of commitments to active ownership (including proxy voting, shareholder engagement and advocacy) include:

1. Is a proactive proxy voting policy an important part of SRI for you or your participants?
2. Is shareholder advocacy an important part of SRI for you or your participants?
3. Is shareholder dialogue an important part of SRI for you or your participants?

Consultants are seeing more requests for proposals (RFPs) issued by clients searching for SRI funds with specific characteristics. RFPs that include the preferred characteristics for the SRI fund help focus the search on the most applicable funds and managers.



Monitoring SRI options

As with any investment decision, once you have selected a fund option, the next step is to set up a system for monitoring its performance. A monitoring program implemented internally or through a consultant should regularly assess that the SRI fund is meeting its objectives.

Questions to pose to your SRI fund manager or to your consultant to evaluate your SRI fund's performance include:

1. Is your fund meeting return expectations, net of fees, on an absolute basis?
2. Is your fund meeting return expectations, net of fees, in relation to its SRI benchmark or peers?
3. Is your fund meeting return expectations, net of fees, according to its non-SRI benchmark or peers?
4. Is your fund maintaining its stated investment style?

The plan should also monitor the other traditional data points typically reviewed for non-SRI funds, such as investment staff turnover, capitalization, etc.

Additionally, an SRI fund should also maintain its stated mandate regarding screening, active ownership and community investing. There may be several ways to assess whether the quality of a fund's social investing approach has been maintained. Communications from the managers to shareholders and clients should

announce any major changes to screens or other SRI activities. In addition, consultants, research providers or internal staff can review the holdings of the fund to determine if the portfolios continue to meet expectations in terms of the SRI mandate.

Communications regarding proxy votes, engagement and community investing are often provided by SRI funds utilizing those tools as part of their SRI strategy. These may be reviewed as part of the monitoring program to ensure that the fund's social concerns are aligned with those of the plan and its participants.

Additional questions to pose to your SRI fund manager or your consultant to assist with evaluating your SRI fund's performance could include:

1. Have there been changes in the screens applied to the fund (for example, changes in criteria, research providers or focus of the fund)?
2. Have proxy voting policies been maintained and executed as expected? Are policies reviewed periodically to address new issues?
3. Were any shareholder resolutions filed by the manager over the last year? Are there other efforts to effect change in corporate performance and behavior that the manager can share?
4. Does community investing remain a part of the SRI strategy? Are the investments appropriate for the overall fund and for your plan?



Step #6: Educate participants

This is a critical step. When an SRI option is added to your plan, plan participants should be alerted to it with appropriate educational materials. A 2006 TIAA-CREF report found that TIAA-CREF participants had wanted their social values reflected in their investments but had a need for more information about SRI strategies and accounts.¹³ Educational information may be provided as part of regular communications on plan options, or specific efforts can be made to educate participants on SRI, such as through presentations by SRI investment firms, consultants or industry experts.

Your plan administrator, SRI fund manager or consultant can provide specific materials about your SRI fund options. They should be able to provide information with additional context about the SRI options within your line-up, such as differences between SRI and non-SRI funds and differences among SRI strategies.

If the plan (or the sponsoring company) is involved in promoting ESG issues, communicating these activities may have numerous ancillary benefits. For instance, it may reinforce and enhance the brand of the employer among employees and participants. This may translate to improved attraction and retention of key staff. For example, a company that adheres to the guidelines of

the Global Reporting Initiative for disclosing corporate social, environmental, economic and ethical information (www.globalreporting.org) or is a constituent in an SRI index may wish to share this information with participants. As a consequence, such positive impressions may actually boost participation in the SRI option itself.

Specific considerations for introducing SRI and your SRI option to participants include:

1. Does the information provided to participants enable them to compare an SRI with a non-SRI investment based on financial performance and fees?
2. Does the information provided to participants explain the specific ESG criteria utilized by the SRI fund manager?
3. Does the information provided to participants explain the active ownership and community investing aspects of the fund?
4. Are additional sources of information or education available to participants who want to learn more about the investment or SRI in general?

¹³ "SRI: An Understanding of How SRI is Viewed by TIAA-CREF Participants." TIAA-CREF, 2006, and "Attitudes Toward Socially Responsible Investment," Calvert, 2006.

**One company's experience with SRI:
A conversation with Dave Stangis, Intel's director
of corporate responsibility**

(March 9, 2007)

Participants of Intel's DC plan have had an option to invest in an SRI equity or fixed income fund since 2000. Dave Stangis, Intel's director of corporate responsibility, played an integral role in the decision-making process, and, in the following discussion, he explains some of the challenges, obstacles and opportunities SRI presented to Intel. Note that Intel's inclusion of SRI options predates this guide and therefore the process is not completely aligned with the recommendations presented. However, Dave's experience may assist you in your consideration of the potential role for SRI in your DC plan.

Question: Can you walk us through the process that led to Intel's addition of two SRI options?

Dave Stangis: As part of Intel's program to continuously improve its corporate responsibility, the company began speaking with SRI researchers and fund managers on a regular basis several years ago. As director of corporate responsibility, I took part in many of these conversations and developed these relationships. Some SRI researchers and investors wanted to know if Intel's 401(k) plan experienced the same drive toward corporate responsibility as the company. To participate more fully in the discussions, I began experimenting with SRI in my personal investments. At the same time, I heard of other major corporations adding SRI options to their plans.

As Intel was striving to improve its corporate responsibility and environmental management, the idea of an SRI option for the DC plan was introduced to the pension committee. It took a few years to get onto the agenda of the regular investment committee meetings. Eventually, Intel approved the addition of two SRI funds (one equity,

one fixed income) at the same time that it changed plan administrators and increased the number of investment options from 14 to 70.

Question: How were the funds chosen? Were they already a part of the platform or was a search conducted?

DS: After the plan administrator was chosen, the funds were selected by the Investment Policy Committee.

Intel's Investment Policy Committee was focused on core holding – type funds for the equity and fixed income options. The new plan administrator already offered two SRI funds that met the committee's criteria, so these were the funds chosen.

Question: What kind of communication was provided to participants about the SRI options? Were there any SRI-specific materials?

DS: The SRI options were announced as part of the roll-out of additional options in the plan. No additional communication was issued by Intel.

Question: What has the reaction been?

DS: Coincidentally just after the two SRI funds were added, Intel began receiving inquiries from participants requesting SRI options. The requests mostly arrived through Intel's Employee Sustainability Network, a virtual community of Intel employees interested in sustainability issues, but not necessarily working on them day to day. The Employee Sustainability Network was very interested in this investment option for the 401(k) plan and communicated this change across its membership. Intel was and continues to be pleased to be able to tell its employees that fixed income and equity investment SRI options are already available that consider environmental, social and governance issues.



Compilation of resources

For your reference, we have compiled in this section the website links mentioned in this guide, as well as other sites, some of which address the role of SRI and ESG in DC plan management.

Corporate initiatives and codes of conduct

Business for Social Responsibility (www.bsr.org)
Carbon Disclosure Project (www.cdproject.net)
CERES (www.ceres.org)
Global Reporting Initiative (www.globalreporting.org)
United Nations Global Compact (www.unglobalcompact.org)

DC plan administrator platforms specializing in SRI

Social(k) (www.socialk.com)

Investor initiatives and organizations

Carbon Disclosure Project (www.cdproject.net)
Council of Institutional Investors (www.cii.org)
Enhanced Analytics Initiative (www.enhancedanalytics.com)
Investor Environmental Health Network (www.iehn.org)
Investor Network on Climate Risk (www.incr.com)
United Nations' Principles for Responsible Investment (PRI) (www.unpri.org)

SRI and fiduciary standards

The Avon Letter (www.lens-library.com/info/dolavon.html)¹⁴
The Calvert Letter (www.calvert.com/pdf/sri_DOL_Letter.pdf)
The Freshfields Report (www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf)

SRI educational sources

Green Money Journal (www.greenmoneyjournal.com)
Socialfunds.com (www.socialfunds.com)
The Social Investment Forum (www.socialinvest.org)

SRI indices

Dow Jones Sustainability Indices (www.sustainability-index.com)
FTSE4Good Indices (www.ftse4good.com)
KLD Indices (www.kld.com)

SRI performance sources

SRISTudies.org (www.sristudies.org)
United Nations Environment Program Finance Initiative Asset Management Working Group (www.unepfi.org/amwg)

¹⁴ The Lens-Library is hosted by the Corporate Library, a leading resource of research and analysis on corporate governance issues (www.thecorporatelibrary.com).

MERCER

Investment Consulting



Social Investment Forum
1612 K Street NW, Suite 650
Washington, DC 20006
+1 202 872 5319
www.socialinvest.org

Mercer Investment Consulting
1166 Avenue of the Americas
New York, NY 10036
+1 212 345 7000
www.mercerIC.com

© 2007 Mercer Investment Consulting, Inc.