QUESTIONNAIRE ON REVIEW OF THE ENVIRONMENTAL, SOCIAL AND GOVERNANCE REPORTING GUIDE

We invite interested parties to respond to the Consultation Paper on Review of the Environmental, Social and Governance Reporting Guide (**Consultation Paper**), which can be downloaded from the HKEx website at:
http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201507.pdf

This Questionnaire contains the Privacy Policy Statement; Part A: General Information of Respondents; and Part B: Consultation Questions.

All responses should be made in writing by completing and returning to HKEx both Part A and Part B of this Questionnaire no later than **18 September 2015** by one of the following methods:

By mail or hand delivery to:	Corporate Communications Department Hong Kong Exchanges and Clearing Limited 12th Floor, One International Finance Centre 1 Harbour View Street Central Hong Kong **Re: Consultation Paper on Review of the ESG Reporting Guide**
By fax to:	(852) 2524-0149
By e-mail to:	response@hkex.com.hk Please mark in the subject line: **Re: CP on Review of the ESG Reporting Guide**

Our submission enquiry number is (852) 2840-3844.

The names of persons who submit comments together with the whole or part of their submissions may be disclosed to members of the public. If you do not wish your name to be published please indicate so in Part A.

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Purpose

From time to time we may collect your personal data such as your name, mailing address, telephone number, email address and login name for the following purposes:

1. to process your applications, subscriptions and registration for our products and services;
2. to perform or discharge the functions of HKEx and any company of which HKEx is the recognised exchange controller (as defined in the Securities and Futures Ordinance (Cap. 571));
3. to provide you with our products and services and administer your account in relation to such products and services;
4. to conduct research and statistical analysis; and
5. other purposes directly relating to any of the above.

Direct marketing

Except to the extent you have already opted out or in future opt out, we may also use your name, mailing address, telephone number and email address to send promotional materials to you and conduct direct marketing activities in relation to our financial services and information services, and related financial services and information services offered by our affiliates.

If you do not wish to receive any promotional and direct marketing materials from HKEx or do not wish to receive particular types of promotional and direct marketing materials or do not wish to receive such materials through any particular means of communication, please contact us through one of the communication channels below.

Identity Card Number

We may also collect your identity card number and process this as required under applicable law or regulation, as required by any regulator having authority over us and, subject to the PDPO, for the purpose of identifying you where it is reasonable for your identity card number to be used for this purpose.

Transfers of personal data for direct marketing purposes

Except to the extent you have already opted out or in future opt out, we may transfer your name, mailing address, telephone number and email address to our affiliates for the purpose of enabling our affiliates to send promotional materials to you and conduct direct marketing activities in relation to their financial services and information services.

Other transfers of personal data

For one or more of the purposes specified above, the personal data may be:

1. transferred to our affiliates and made available to appropriate persons in our affiliates, in Hong Kong or elsewhere and in this regard you consent to the transfer of your data outside of Hong Kong; and
2. supplied to any agent, contractor or third party who provides administrative or other services to HKEx and/or any of our affiliates in Hong Kong or elsewhere.

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Session Cookies: temporary cookies that only remain in your browser until the time you leave the HKEx website, which are used to obtain and store configuration information and administer the HKEx website, including carrying information from one page to another as you browse the site so as to, for example, avoid you having to re-enter information on each page that you visit. Session cookies are also used to compile anonymous statistics about the use of the HKEx website.

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The cookies used in connection with the HKEx website do not contain personal data. You may refuse to accept cookies on your browser by modifying the settings in your browser or internet security software. However, if you do so you may not be able to utilise or activate certain functions available on the HKEx website.

Compliance with laws and regulations

You agree that HKEx and its affiliates may be required to retain, process and/or disclose your personal data in order to comply with applicable laws and regulations, or in order to comply with a court order, subpoena or other legal process, or to comply with a request by a government authority, law enforcement agency or similar body (whether situated in Hong Kong or elsewhere). You also agree that HKEx and its affiliates may need to disclose your personal data in order to enforce any agreement with you, protect our rights, property or safety, or the rights, property or safety of our affiliates and employees.

Corporate reorganisation

As HKEx continues to develop its business, we may reorganise our group structure, undergo a change of control or business combination. In these circumstances it may be the case that your personal data is transferred to a third party who will continue to operate our business or a similar service under either this Privacy Policy Statement or a different privacy policy statement which will be notified to you. Such a third party may be located, and use of your personal data may be made, outside of Hong Kong in connection with such acquisition or reorganisation.

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Under the PDPO, you have the right to ascertain whether HKEx holds your personal data, to obtain a copy of the data, and to correct any data that is inaccurate. You may also request HKEx to inform you of the type of personal data held by it. All data access requests shall be made using the form prescribed by the Privacy Commissioner for Personal Data ("**Privacy Commissioner**") which may be found on the official website of the Office of the Privacy Commissioner.

Requests for access and correction or for information regarding policies and practices and kinds of data held by HKEx should be addressed in writing and sent by post to us (see contact details below).

A reasonable fee may be charged to offset HKEx's administrative and actual costs incurred in complying with your data access requests.

Termination or cancellation

Should your account with us be cancelled or terminated at any time, we shall cease processing your personal data as soon as reasonably practicable following such cancellation or termination, provided that we may keep copies of your data as is reasonably required for archival purposes, for use in relation to any actual or potential dispute, for the purpose of compliance with applicable laws and regulations and for the purpose of enforcing any agreement we have with you, for protecting our rights, property or safety, or the rights, property or safety of our affiliates and employees.

Contact us

By Post:
Personal Data Privacy Officer
Hong Kong Exchanges and Clearing Limited
12/F., One International Finance Centre
1 Harbour View Street
Central
Hong Kong

By Email:
pdpo@hkex.com.hk

Part A General Information of the Respondent

(1) Please state whether your response represents your personal or your company/entity's view by checking (☑) the boxes below and filling in the information as appropriate:

☑ Company/Entity view

Company/Entity name*:	Creative Investment Research
Company/Entity type*:	*HKEx Participant:-* ☐ SEHK ☐ HKFE ☐ HKSCC ☐ SEOCH ☐ HKCC ☐ Listed company ☐ Professional body / Industry association ☑ Market practitioner (Type: ESG Research and Development) ☐ None of the above
Contact person*:	Mr/Ms/Mrs William Michael Cunningham
Title:	Social Investing Advisor
Phone no.*:	202-455-0430 Email address: info@creativeinvest.com

☐ Personal view

Respondent's full name*:	Mr / Ms / Mrs William Michael Cunningham
Phone no.*:	202-455-0430 Email address: info@creativeinvest.com

Among the following, please select the one best describing your position*:

☐ Listed company staff ☐ HKEx participant staff ☐ Retail investor
☐ Institutional investor staff ☐ None of the above

<u>Important note</u>: All fields marked with an asterisk (*) are mandatory. HKEx may use the contact information above to verify the identity of the respondent. Responses without valid contact details may be treated as invalid.

(2) Disclosure of identity

HKEx may publish the identity of the respondent together with Part B of this response to the members of public. Respondents who do not wish their identities to be published should check the box below:

☐ I/We do not wish to disclose my/our identity to the members of the public.

Signature (with Company/Entity Chop if the response represents company/entity view)

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEx website at: http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201507.pdf

Where there is insufficient space provided for your comments, please attach additional pages.

1. Do you agree with our proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the "comply or explain" provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports?

☒ Yes

☐ No

Please give reasons for your views.

Background

William Michael Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services.

Creative Investment Research, Incorporated is an independent investment research and management firm, founded in 1989. For clients, our services save millions, if not billions: on December 22, 2003 and February 6, 2006, we warned the S.E.C. and other regulators that statistical models using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure (see below). Clients who heeded our warning adjusted their investment portfolios in a manner that allowed them to escape much of the damage caused by the crisis. The firm was formerly in the pool of Corporate Governance Advisors and Diversity Investing Advisors to CalPERS.

Mr. Cunningham is a Global Member of the Internet Society (ISOC), a Public Member of the World Wide Web Consortium (W3C), and an Invited Expert Member in the eGovernment Group of the W3C.

On November 16, 1995, he launched one of the first investment advisor websites at www.ari.net/cirm (now www.creativeinvest.com).

Track Record

On July 3, 1993, Mr. Cunningham wrote to US Securities and Exchange Commissioner (SEC) Mary Schapiro to notify the Commission about a specific investing scam, the "Nigerian letter scam." A timely warning was not issued to the investing public, members of the public were damaged, and the SEC launched retaliatory regulatory actions against Mr. Cunningham.

He designed the first mortgage security backed by home mortgage loans to low and moderate income persons and originated by minority-owned institutions. (See: *Security Backed Exclusively by Minority Loans,* The American Banker Newspaper. Friday, December 2, 1994.)

Mr. Cunningham opposed the application, approved by the Federal Reserve Board on September 23, 1998, by Travelers Group Inc., New York, New York, to become a bank holding company. In October 1998, in a petition to the United States Court of Appeals (Case Number 98-1459) concerning the Travelers Group Inc./Citicorp merger, Mr. Cunningham cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions.

From October 1999 to March 2002, Mr. Cunningham was responsible for proxy voting activity for the Board of Pensions of the Evangelical Lutheran Church in America. In 2001, he voted on 1395 issues impacting 401 companies. In 2000, he voted on 1903 issues impacting 422 companies. We managed fund efforts and corporate governance matters related to Talisman Energy and its' operations in the Sudan. We researched the issue, contacting various groups involved in the process. For the fund, our efforts also included researching fund policies and procedures. Our collaborative, risk controlled strategy helped lead the firm out of the Sudan. On February 1, 2000, Mr. Cunningham wrote to the office of U.S. Senator Samuel Brownback (R-KS) urging him to encourage pension funds to divest from the Sudan.

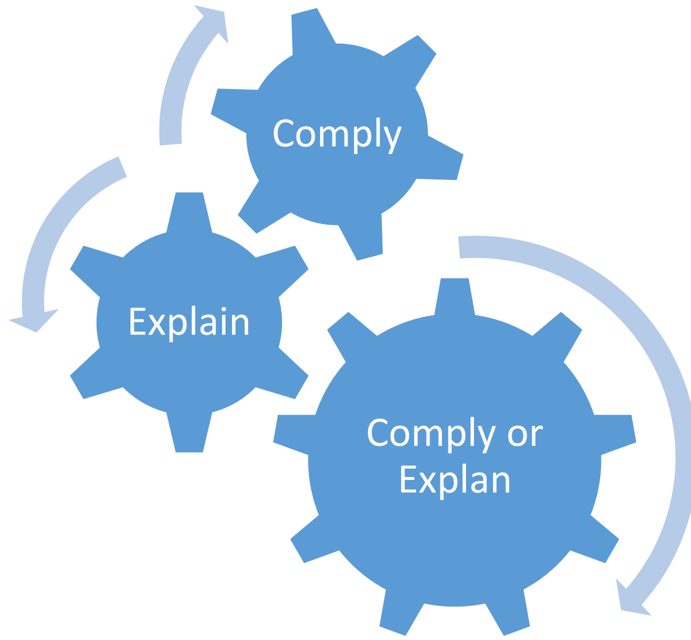
On June 15, 2000, Mr. Cunningham testified before the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE's) of the U.S. House of Representatives and suggested that GSEs Fannie Mae and Freddie Mac be subject to a Social Audit. A social audit is an examination of the performance of an enterprise relative to certain social return objectives. It includes a review of ethical practices. Had the GSE's been subject to this audit, certain flaws in their operation, including ethical shortcomings, would have been revealed earlier, in a better market in which to make corrections.

In 2001, Mr. Cunningham participated in the first wide scale home mortgage loan modification project. The Minneapolis-based effort helped 50 families victimized by predatory lending practices. See: Property Flipping Remediation Yields Investment-grade Security.

Given this background and track record, it is safe to say that Mr. Cunningham has a great deal of experience in this subject matter.

We agree with your proposal to amend Rule 13.91 to require issuers to disclose in their annual reports or ESG reports whether they have complied with the "comply or explain" provisions in the ESG Guide and if they have not, they must give considered reasons in the ESG reports. We believe this gives a convenient go/no starting point for analysis. Our analysis flowchart might look as follows:

CIR ESG Analysis Process



If Comply:

- Move to data review and analysis.

If Explain

- Review and score reasons for non-compliance.

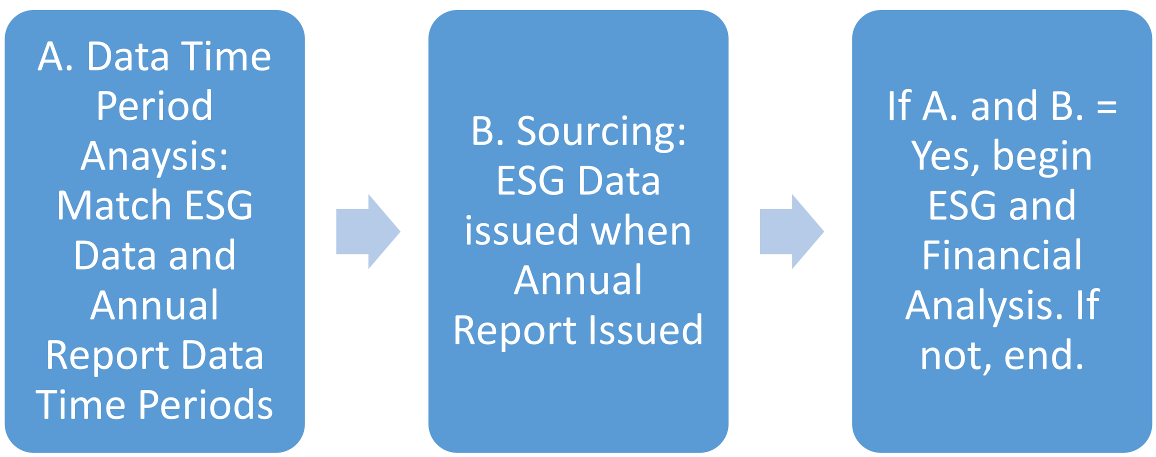
2. Do you agree with our proposal to amend Rule 13.91 to require the issuer to report on ESG annually and regarding the same period covered in its annual report?

☒ Yes

☐ No

Please give reasons for your views.

It is important to align financial and social data time periods when conducting ESG analysis. Knowing an entity is sensitive to this matter is one factor in our review. We have shown that sensitivity to this factor has predictive value with respect to the "cleanliness" of the ESG data.



3. Do you agree with our proposal to include a Note under Rule 13.91 to clarify that:

    (i) an ESG report may be presented as information in its annual report, in a separate report, or on the issuer's website; and

    (ii) the issuer should publish the ESG report as close as possible to, and in any event no later than three months after, the publication of the issuer's annual report?

☒ Yes

☐ No

Please give reasons for your views.

Please see our responses to:

Definition of Nationally Recognized Statistical Rating Organization
Other Release Nos.: 34-51572; IC-26834
File No.: S7-04-05
http://www.sec.gov/rules/proposed/s70405/wcunningham9442.pdf

Securities Offering Reform
Other Release Nos.: 34-50624; IC-26649; International Series Release No. 1282
File No.: S7-38-04
http://www.sec.gov/rules/proposed/s73804/cunningham013105.pdf

Internet Availability of Proxy Materials
Other Release No.: IC-27182
File No.: S7-10-05
http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf

For example, in File No. S7-10-05, the U.S. Securities and Exchange Commission (the Commission) "proposed amendments to the proxy rules under the Securities Exchange Act of 1934 that would provide an alternative method for issuers and other persons to furnish proxy materials to shareholders by posting them on an Internet Web site and providing shareholders with notice of the availability of the proxy materials."

In our response, we noted that: "We do not believe the Securities and Exchange Commission should require issuers and other soliciting persons to make their proxy materials available in a format that can be readily downloaded by shareholders over dial-up connections. We believe developments in the portable document field will lead to the creation of new formats that will allow shareholders to download large documents over dial-up connections." So it is here. We believe new standards and technologies will be developed to help deliver ESG data to interested parties. As we said in 2006, "We believe management should be given maximum flexibility to use the new delivery medium in the most appropriate manner given the specific circumstances at hand."

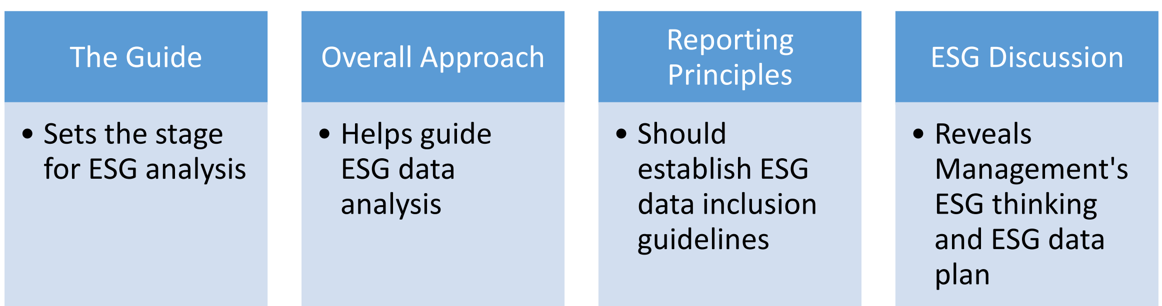
4. Do you agree with our proposal to revise the introductory section of the Guide into four areas (i.e. "The Guide", "Overall Approach", "Reporting Principles" and "Complementing ESG Discussions in the Business Review Section of the Directors' Report"), and with the wording set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

We believe organizational structure revisions should be adopted that will enhance ESG data analysis. These revisions move in that direction.



5. Do you agree with the proposed wording of the Reporting Principles (i.e. "Materiality", "Quantitative", "Balance" and "Consistency") in the introductory section of the Guide, as set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

Yes. See our response to SEC File No. S7-10-05. We believe new standards and technologies will be developed to help deliver ESG data to interested parties. As we said in 2006, "We believe management should be given maximum flexibility to use the new delivery medium in the most appropriate manner given the specific circumstances at hand." We believe developments will lead to the creation of new ESG data analysis technologies.

6. Do you agree with the proposed wording in the Guide linking it to Appendix 16 to the Main Board Listing Rules (in relation to the requirement for ESG discussions in the business review section of the directors' report), as set out in Appendix II to the Consultation Paper?

☒ Yes

☐ No

Please give reasons for your views.

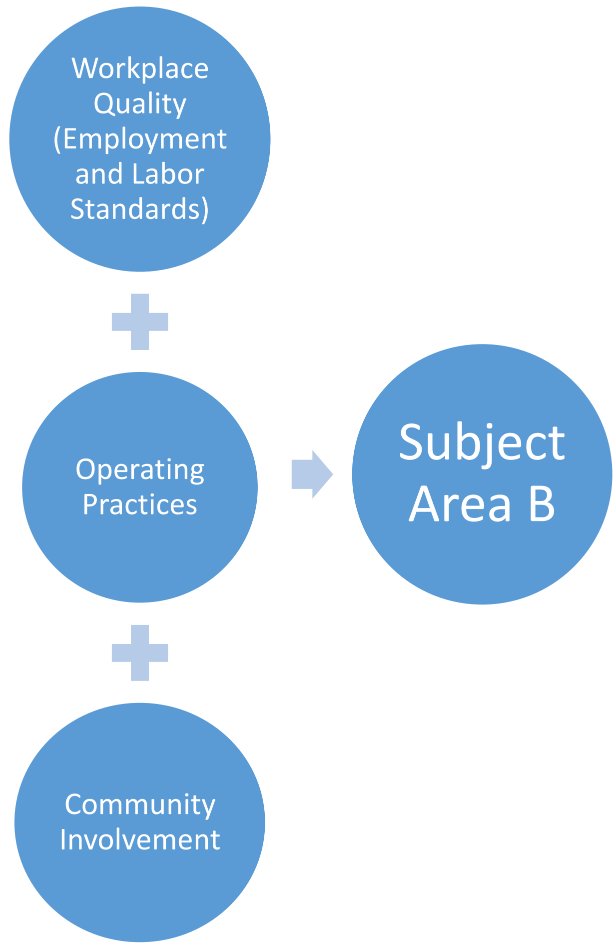
This may be useful as a "Roadmap" to ESG data for a particular issuer.

7. Do you agree with the proposal to re-arrange the Guide into two Subject Areas (A. Environmental and B. Social) and re-categorise "Workplace Quality", "Operating Practices" and "Community Involvement" under Subject Area B?

☒ Yes

☐ No

We see the consolidation as follows:



As long as ESG data in each of the three areas at left above continue to be reported and this consolidation is not used to hide relevant data, we believe it is appropriate.

8. Do you agree with the proposal to change the heading “Workplace Quality” to “Employment and Labour Standards”?

☒ Yes

☐ No

This is consistent with international guidelines.

9. Do you agree with our proposal to upgrade the General Disclosures for each Aspect of the ESG Guide to “comply or explain”?

☒ Yes

☐ No

Please give reasons for your views.

This is consistent with international guidelines.

10. Do you agree with our proposal to amend the wording of paragraph (b) under current Aspects A1, A2, A4, B1, C2 and C3, re-numbered Aspects A1, B1, B2, B4, B6 and B7, to “compliance with relevant laws and regulations that have a significant impact on the issuer…” in order to align it with the language of the relevant provisions of the Companies Ordinance?

☒ Yes

☐ No

Please give reasons for your views.

This is consistent with international guidelines.

11. Do you agree with our proposal to revise proposed Aspect A1 (“Emissions”) by upgrading to “comply or explain” the current KPIs B1.1, B1.2, B1.4 and B1.5, re-numbered KPIs A1.1, A1.2, A1.4 and A1.5, concerning disclosure of emissions and non-hazardous waste?

☒ Yes

☐ No

As ESG reporting initiatives have matured, more data is available, since there is greater demand for this information. This is entirely appropriate to use whatever leverage and laws exist to support the ESG data reporting and analysis effort. We believe it makes sense to use these additional data reporting requirements efficiently, to enhance ESG Data analysis. This change does so.

12. Do you agree with our proposal to upgrade to “comply or explain” the current KPIs B1.3 and B1.6, re-numbered KPIs A1.3 and A1.6, concerning disclosure of hazardous waste?

☒ Yes

☐ No

Please give reasons for your views.

As ESG reporting initiatives have matured, more data is available, since there is greater demand for this information. This is entirely appropriate to use whatever leverage and laws exist to support the ESG data reporting and analysis effort. We believe it makes sense to use these additional data reporting requirements efficiently, to enhance ESG Data analysis. This change does so.

13. Do you agree with our proposal to upgrade to “comply or explain” the KPIs under the current Aspect B2, re-numbered Aspect A2, “Use of Resources”?

☒ Yes

☐ No

Please give reasons for your views.

As ESG reporting initiatives have matured, more data is available, since there is greater demand for this information. This is entirely appropriate to use whatever leverage and laws exist to support the ESG data reporting and analysis effort. We believe it makes sense to use these additional data reporting requirements efficiently, to enhance ESG Data analysis. This change does so.

14. Do you agree with our proposal to upgrade to "comply or explain" the current KPI B3.1, re-numbered KPI A3.1, concerning disclosure of the significant impacts of activities on the environment and natural resources?

☒ Yes

☐ No

Please give reasons for your views.

Our research supports the contention that "there is no contradiction between the financial goals of the fund and an objective of influencing climate policy." Using data from both old and new sources, Creative Investment Research, Inc. explored and quantified the impact environmental factors have on stock prices using several statistical techniques. Our research is structured into two parts. In the first, we specify three standard market models and test the hypothesis that environmental factors do, in fact, impact equity prices. In the second part, we examine the impact of a major environmental incident on stock prices, using new data sources and with the assistance of the equity market models specified in phase one. We created three portfolios based on a ranking of environmental impact forecasts and preparations, as outlined below. The first portfolio returned -21.974% from March 10, 2011 to August 10, 2011. This portfolio consisted of firms with an environmental impact forecast who were well prepared for an environmental incident. The second portfolio consisted of firms with an environmental impact forecast who were marginally prepared for an environmental incident. Returns were +30.686% from March 10, 2011 to August 10, 2011. The final portfolio consisted of firms without an environmental impact forecast who were not prepared for an environmental incident. Returns were -24.036% from March 10, 2011 to August 10, 2011. Our analysis strongly suggests that investors and publicly traded companies must recognize the impact environmental incidents and issues have on a given firm's ability to use company assets and therefore generate revenue and profits.

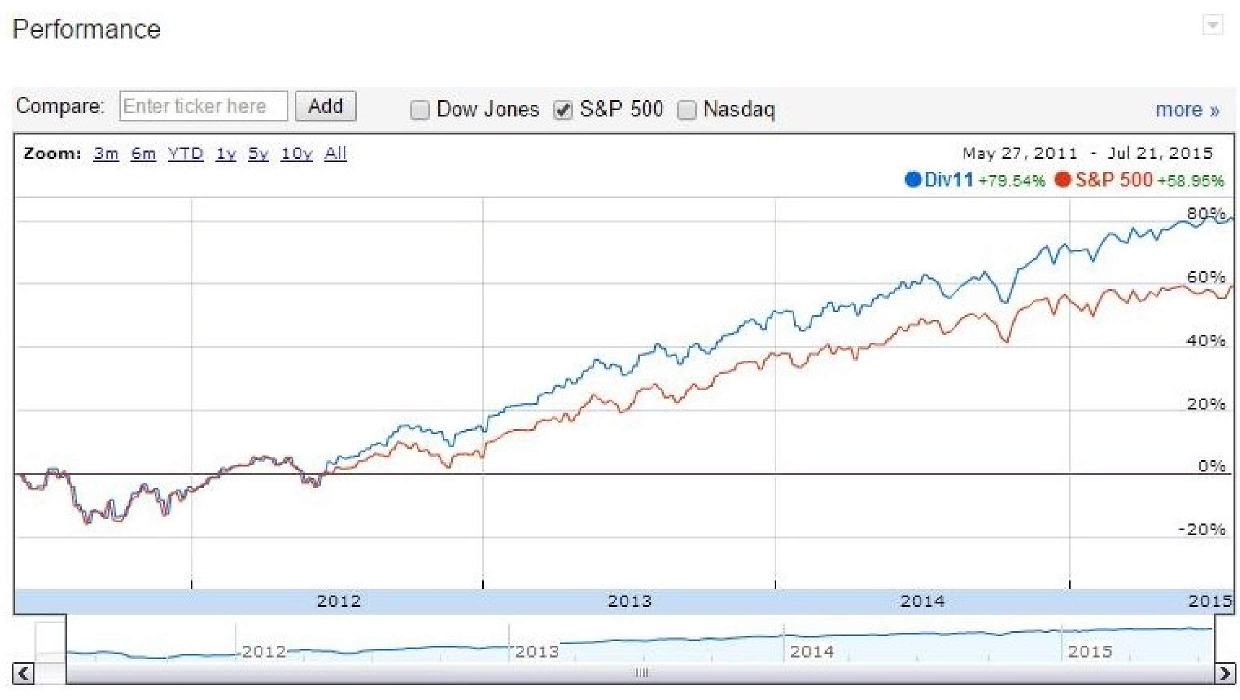
15. Do you agree with our proposal to incorporate gender disclosure in proposed Subject Area B. Social, under the sub-heading "Employment and Labour Standards"?

☒ Yes

☐ No

Please give reasons for your views.

Diversity has proven to be a leading indicator of management's ability to enhance shareholder value. The chart below shows the performance of our Diversity Index Fund relative to the S&P 500 from 5/27/11 to 7/21/15:



(Returns calculated before fees deducted. Past performance is no guarantee of future returns. See our disclaimer page at www.diversityfund.net.)

See the news stories below on the Creative Investment Research Diversity Fund (www.diversityfund.net.)

First Socially Responsible Investing Portfolio Devoted to Diversity Launched by Bill Baue. SocialFunds.com July 31, 2006. Online at: http://www.socialfunds.com/news/print.cgi?sfArticleId=2071

Minority-owned Creative Investment Research conceived of the portfolio to promote corporate diversity while targeting women and minority investors for economic empowerment.

SocialFunds.com -- Socially responsible investing (SRI) has a long history of promoting corporate diversity through positive screens and shareowner advocacy--for example by filing resolutions for more race and gender diversity on the board or a commitment to sexual orientation non-discrimination. However, there has not been an SRI portfolio exclusively focusing on diversity until last week's launch of the Diversity Index Portfolio by Creative Investment Research, a Minneapolis-based minority owned social investment advisory firm. The portfolio consists of between 40 to 60 large-cap US companies with strong diversity performance.

"While other socially responsible funds may consider workforce diversity as one factor among many, the Creative Investment Research Diversity Index Portfolio makes it the top selection criterion," explains Bill Cunningham, CEO of Creative Investment Research and the fund's investment advisor. "Companies in the Portfolio all have a proven track record in four key measures of diversity: human capital, CEO commitment, corporate communications, and supplier diversity. We research hundreds of companies each year, using data from multiple public sources including NAACP, Urban League, Operation PUSH, and others, and rank them on financial and diversity-related performance," Mr. Cunningham told SocialFunds.com.

Mr. Cunningham contends that strong diversity performance can correlate with strong financial performance. For example, back-testing of a model of the Diversity Portfolio resulted in significant outperformance, generating 11.35 percent returns over the one-year period ending July 25, 2006, compared to 5.02 percent for the S&P 500.

Bolstering this contention is the strong performance of the 2006 DiversityInc Top 50 Companies for Diversity Index, which measures the financial performance of this year's lists of the strongest corporate diversity performers as determined by DiversityInc, the field's foremost publication. Over a ten-year period, this index outperformed the S&P 500 by 24.8 percent and the Nasdaq by 28.2 percent.

The portfolio's top five holdings include Harris (ticker: HRS), BellSouth (BLS), Ikon Office Solutions (IKN), AT&T (T), and Embarq (EQ). Other holdings include Bank of America (BAC), Citigroup (C), Coca-Cola (KO), Ford (F), Procter & Gamble (PG), and Sprint (FON). The portfolio's exclusive focus on diversity (it applies no other SRI criteria) means it may contain companies screened by other SRI funds. For example, the CREF Social Choice Account, the largest SRI retail fund in the US with $8 billion in assets, recently dumped Coke when it was deleted for environmental, social, and governance reasons from the index upon which it is based, the KLD Broad Market Social Index (BMSI).

"While better than average on the diversity front, these firms are not perfect," admits Mr. Cunningham. "Creative Investment Research monitors the portfolio to maximize social return through advocacy, education, and consultation. I am a Quaker, so I believe in being proactive and collaborative," he adds. "We think selecting these companies based on diversity may allow for advocacy concerning other SRI issues--hopefully, we can make these firms better."

The very structure of the portfolio may help facilitate this engagement. The portfolio is essentially a basket of companies chosen by Creative Investment Research for investment through FOLIOfn, an electronic investing platform.

"One of the great things about Folio is that it allows you to vote proxies, since shareholders are actually holding shares of stock in the individual companies directly, and not through a mutual fund company," says Mr. Cunningham. "We hope to educate shareholders about diversity issues and get them to advocate, too."

With an expense ratio ranging from 0.6 to 0.8 percent, the portfolio specifically seeks to attract women and minority investors, who typically have less investing experience and less money, according to Mr. Cunningham. In this way, it supports the economic empowerment of classes of people who have been historically disenfranchised. This dynamic at the individual investor level coincides with the goal of the portfolio at the corporate level of promoting social justice.

"Almost everyone agrees that equal opportunity is a laudable goal, and it has been codified in many laws in the U.S. Consequently, many people think the best way to achieve equal opportunity is a merit-based system that is completely colorblind," says Mr. Cunningham. "This is certainly the ideal, and one that we hope will be a viable solution in America someday. However, it makes one fatal assumption: that the history of injustice is no longer relevant to today's society," he adds. "Sadly, this is not true. Consequently, a colorblind outlook strikes us as hopelessly out of touch with the reality of life in the United States and the world," Mr. Cunningham concludes. "Fortunately, there are solutions, and we believe The Creative Investment Research Diversity Portfolio can be a positive force for social change."

The Wall Street Journal - FUND TRACK
Pax May Bless Some 'Sin' Stocks
By DIYA GULLAPALLI, September 1, 2006; Page C1

Maybe sin isn't quite as bad as it sounds.

That is what Pax World Funds, one of the biggest of the "socially responsible" mutual-fund families, has decided. In a few weeks, the company will hold a shareholder meeting where it will take action on the most significant change to its investment practices since it was launched about 35 years ago.
[track]

Socially responsible investing, or SRI, generally involves avoiding so-called sin stocks -- for instance, breweries, casinos and weapons makers. Pax was one of the first to give this strategy a try, and has maintained its approach since its founding by two Methodist ministers in Portsmouth, N.H.

Now, Pax wants to tone down that objective. Shareholders in August were sent a proxy statement to vote on whether to eliminate a zero-tolerance policy specifically against alcohol and gambling. The change would enable Pax to selectively invest in these industries based on a company's "entire social-responsibility profile."

But in other areas, the fund is trying to add new ways to screen out companies it might disapprove of. Shareholders will also vote on whether fund managers should consider a company's record on environmental issues, for instance.

These shifts illustrate how SRI funds are trying to tweak their strategies amid sagging returns. SRI investors are sometimes willing to exchange a few points of returns for socially conscious stock picking.

But many SRI funds have faltered because they tend to focus on "large growth" stocks, or big companies that offer fast-climbing earnings, an area that has done poorly in recent years. Large-growth funds have returned about 1% in the past year, but large-growth SRI funds have returned just 0.21% for the 12 months through July. Pax World Balanced Fund has returned only 4% in the 12 months through July, trailing more than half its peers.

By contrast, funds like Vice Fund -- which actively seeks out sin stocks -- have handily beaten most SRI funds recently. In the past three years, Vice Fund has posted a 20% average annual return.

A host of other SRI funds are also fiddling with their approaches. In December, Domini Social Investments LLC will abandon its traditional approach of passively tracking an index of socially responsible companies in its Domini Social Equity Fund, and instead will become an actively managed fund, picking its own stocks to invest in. Last year, it launched a new fund, Domini European Social Equity Fund, which was actively managed from the start. In May TIAA-CREF, the teacher's-pension giant, announced the formation of a new social and community investing department, and Ariel Capital Management LLC started Ariel Focus Fund last year.

In recent months, a slew of new SRI funds have cropped up that reflect this changing landscape. Parnassus Workplace Fund started last year to focus on companies that treat employees well, and **minority-owned Creative Investment Research in Minneapolis launched the Diversity Index Portfolio this summer that uses employee diversity as a selection criterion.**

Even exchange-traded funds, which trade on exchanges like stocks, are getting in on the do-gooder action. Barclays Global Investors has an SRI ETF and filed with regulators in August to launch another, iShares KLD 400 Social Index Fund, which would track a popular SRI index.

For Pax, the move comes after it had to sell a lucrative stake in Starbucks Corp. last year when the company set up a deal to launch a coffee liqueur with whiskey maker Jim Beam. The funds' 375,000 shares were valued at $23.4 million at the time, and had to be relinquished even though some SRI researchers estimate liquor-related sales contributed less than 1% to Starbucks's revenue. Similarly, Pax sold its stake in Yahoo Inc. last year after discovering that company had business ties to Internet gambling.

"I thought these were absurd results," says Joe Keefe, Pax's chief executive, who took that job last year. Mr. Keefe says he voiced this opinion during his interview for the job, and has been reading competitors' prospectuses to decide the best way to change the wording of Pax's own mandate.

SRI experts think dropping the ban on alcohol and gambling makes sense for Pax, because it will still try to avoid companies that derive substantial revenue from these areas. The company saw its biggest inflows in its history last year, roughly doubling its assets to more than $2 billion across its funds, and it is continuing to expand.

On Tuesday, Citizens Funds, another SRI fund company in Portsmouth, disclosed in a filing that it has signed a nonbinding letter of intent for Pax to buy its funds, which have about $800 million in assets. Terms weren't disclosed.

"I think it makes sense what they're doing," says Bill Rocco, an analyst who helps cover SRI funds for Morningstar Inc., the fund-research company. Some of his family members own Pax World Balanced Fund, he says, but "I also drink beer in moderation."

Jay Falk, president of SRI World Group Inc., a research company, agrees. "A screen on alcohol is a bit puritanical," he says.

The Pax funds are also taking steps to focus more on the corporate governance of the companies they invest in, such as whether the board of a company is sufficiently independent from management.

Separately, the Securities and Exchange Commission has been inquiring into issues related to the financial reporting at Pax's high-yield funds for more than a year. The SEC is also looking at potential conflicts of interest, given that the family of Pax's chairman owns Pax World Management Corp. and part of Pax's distribution company. Mr. Keefe declined to comment about the SEC inquiry.

Other SRI funds say they won't change their own sin-stock mandates just yet, with each varying slightly in guidelines like numerical cutoffs. Domini generally doesn't invest in companies that derive more than 1% of sales from alcohol production or more than 15% from alcohol retailing. Sometimes it can be even stricter than that. Domini decided not to buy toy maker Hasbro Inc. a few years ago despite the fact it made less than 1% of its money from licensing its Monopoly brand name to casino slot machines. Domini concluded it was inappropriate to use a children's game for gambling purposes.

For now, alcohol and gambling is "a place where Domini is not going to change," says Jeffrey MacDonagh, an SRI portfolio manager at Domini.

Ariel Capital Management, another large SRI fund company, doesn't screen for alcohol or gambling but does avoid tobacco and weapons companies. Unlike Domini, this has allowed the Ariel Fund to hold Hasbro among its 40 or so stock positions. Another SRI fund group, the Calvert Funds, won't invest in companies that derive more than 20% of revenue from selling or distributing alcohol, or 10% from weapons sales.

Still, such funds have changed other screens in recent years. Ariel added a screen against handguns in 2003, and Calvert added one about preserving the rights of indigenous people in 1999. Others have added more contemporary factors like nondiscrimination based on sexual orientation.

How Will SRI Screens Evolve?
Article published on Aug 18, 2006
By Lisa Lacy

There's a new fund in the socially responsible universe that is homing in on diversity as its No. 1 selection criterion. While the extremely focused strategy and its future effectiveness are being met with mixed reviews, its very existence may speak to screens in the future.

The fund, the Diversity Index Portfolio from Creative Investment Research, intends to promote diversity and target women and minority investors.

There aren't many socially responsible funds that use a similarly narrow focus, observers say, but the Diversity Index Portfolio isn't entirely alone. The Women's Equity Fund, which launched in 1993, invests in companies that "advance the social and economic status of women in the workplace."

"The reason we started in the first place was to use the power of shareholders and their right to have a dialogue with the company to break the glass ceiling," says Linda Pei, president of Women's Equity.

The fund screens company stocks to make sure there is an adequate number of women on the board and in senior management. It also screens to make sure women are paid equally and that the employer offers benefits such as child care.

After 13 years, the fund has more than $35 million under management without doing much in the way of advertising.

But Pei had to start from the ground up, using the fund to attract clients one at a time rather than starting out with an existing client base. An overwhelming 90% of the shareholders today are women.

And Pei sees big potential. "If all working women understood why we have this fund and how powerful our message is, the fund could easily be $1 billion or more," she says. "I also know from listening to those who finally find us and invest in the fund. Their passion confirms my belief."

Passion is certainly a core element in socially responsible investing and has been since the beginning. But as the number of SRI funds grows, there is also a greater opportunity to diversify, along with more screens that have entered the mix, says Steve Schueth, president of First Affirmative Financial Network, an RIA that specializes in managing portfolios for socially conscious clients.

He speaks of a "palate" that has changed based upon "things people care about." Those concerns range from events that took place in South Africa in the mid- to late 1980s to environmental concerns in the early 1990s and, most recently, corporate governance.

But not everyone agrees that the screens have seen major changes. For his part, Lipper senior research analyst Jeff Tjornehoj feels screens have largely remained the same over the years.

Anita Green, vice president of social research at the $2.2 billion Pax World Funds, says both diversity and the environment have been important screens for the firm's SRI funds from the very beginning. Interestingly enough, Green says Pax has found advocacy, or trying to invoke change at a company it invests in, more effective than trying to find firms that are socially conscious from the beginning.

But if what Schueth says is true, what happens next?

Bill Cunningham, CEO of Creative Investment Research, expects to see more fully developed screens and funds in the future. "The market sees the need for additional investing styles and screens," he adds.

While not exactly advocating Cunningham's strategy per se, Schueth says part of the reason for growth in the SRI industry is investor demand. And growth is also an important factor in the launching of new funds. Because it is an industry that has reached a certain level of maturity, there are new providers that are trying to carve out their own niche where they can dominate, such as the Women's Equity Fund.

The question is whether there are enough investors for these focused funds. Many, including Schueth, argue that most socially conscious investors care about more than one issue and might not be attracted to a fund that stakes its claim solely on diversity.

However, pointing to Pei, Social Investment Forum president Tim Smith says the very fact that the Women's Equity Fund has existed for so many years using similar criteria bodes well for Cunningham, and that he can have "a profitable fund as well as a fund that's responsive to social issues."

Not everyone is so optimistic. Lipper's Tjornehoj says the Women's Equity Fund "hasn't developed into a name brand."

Furthermore, he says sometimes it's an uphill battle to convince people that a particular brand of socially conscious investing is better than another because they're essentially cannibalizing other socially responsible funds.

Detractors also say most socially responsible funds already use diversity as one of many screens.

Tjornehoj expects the Diversity Index Portfolio to have some trouble attracting assets unless there's initial backing for an expensive marketing campaign or it has been tied in with a sponsorship deal with a progressive group.

The problem is that "diversity is not necessarily an investment strategy — it's a value," Tjornehoj says.

Perhaps these funds are just a bit before their time.

Schueth says, "[The fact that] there are no other funds that take this very focused approach is telling in that maybe the market is not quite ready."

He mentions a gay and lesbian fund that was eventually absorbed into a fund with a broader set of criteria.

Investors who are attracted to these very specific funds — and socially responsible investors as a whole, for that matter — tend to be very loyal as their investments are tied to beliefs, and so their "money tends to be sticky," Tjornehoj says.

Smith notes that such funds market to a very specific clientele and have the added bonus of finding companies that are innately good rather than merely weeding out the bad ones.

In the early days, Schueth says, "it was all about avoiding the bad guys. Today it's far more about finding the best companies because the avoidance stuff is really easy."

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Index opens new front in ethical investing -A portfolio of stocks based on a company's diversity was created last month in Minneapolis. No Minnesota firm is in it.

Kara McGuire, Star Tribune

There are investment portfolios that shun tobacco and alcohol companies and portfolios that appeal to different religious groups.

Why not one that makes choices based on a company's diversity practices, thought Bill Cunningham, an investment adviser and CEO of Creative Investment Research Inc. So he created the Diversity Index Portfolio last month from his office in Minneapolis' Uptown.

The portfolio, for which he will make buy, sell and rebalancing decisions only once a year, consists of 40 to 50 stocks, including the likes of Coca-Cola, Wells Fargo, Federated Department Stores, Time Warner, even Ford. Not a single Minnesota company is on the list.

Cunningham, the sole adviser, picks companies based on the number of racially diverse, gay, lesbian, transgendered, female or disabled employees and board members; senior management's commitment to diversity through policies such as domestic partner benefits and whether they communicate those policies to the public, and the volume of business a company does with diverse suppliers.

He also factors in basic financial fundamentals so a company with great diversity practices and awful performance won't make the cut.

Part of the reason for a lack of Minnesota companies in the portfolio is size. The portfolio tracks large-cap companies, defined as those with more than $10 billion in market value. Except for companies in the league of Target and UnitedHealth Group, the majority of Minnesota-based companies are too small.

But the omission also speaks to the need for the state to attract a more diverse population and to reduce the income and education gap between the racial groups that live here today, Cunningham said.

"If there's one company that's likely to be in future portfolios it's probably Target," he said, although to date he feels it has underperformed compared with others in its industry. He omitted UnitedHealth Group largely because of its corporate governance practices. And General Mills, an award-winner for its diversity efforts, lost to Kraft Foods. "[Kraft] just does a better job getting the message [about diversity] out there," he said.

For Minnesota companies to make the grade, Cunningham wants to see more diversity awareness training, mentoring and multicultural marketing.

Investing with heart

The number of socially responsible investment choices almost quadrupled in the past decade, from 55 mutual funds in 1995 to 201 last year, according to the Social Investment Forum's 2005 Trends Report.

Values-guided investment doesn't mean sacrificing return. Cunningham's index would have beaten the Standard & Poor's 500 index of large-company stocks over the one-year period ended Sept. 13, returning 17.63 percent vs. the S&P 500's 9.46 percent. Cunningham believes that companies sensitive to diversity will outperform competitors that are less so, because employees will be less likely to leave and more likely to be innovative in an environment where they feel included.

Cunningham hopes the portfolio will grow to $1 billion in five years and will attract pension plans, 401(k) providers and individual investors. But while the portfolio is ready to accept money, no one has invested, not even Cunningham.

He blames inertia, not a lack of confidence, and plans to transfer money from other assets in the next couple of months. Personally, I prefer investments with a manager who has some skin in the game.

An Ohio-based supermarket company and two Illinois-based pension funds are considering the portfolio, he said.

The hesitation may stem from Cunningham's nonexistent track record managing a stock portfolio. His background is in financial research, consulting and managing mortgage backed securities for pension funds.

Can go it alone, with time

Individuals could substitute the Diversity Index Portfolio for a broader index of large-company stocks such as the S&P 500, although it's heavier on financial, automotive, consumer discretionary and utility stocks and lighter on technology and oil companies. It also wouldn't be too difficult to create a diversity portfolio of one's own using diversity stock lists published by magazines such as Diversity Inc. and Hispanic Business, although you'd have to have a lot of time for analysis and a lot of money lying around to buy shares of 50 stocks.

Unlike investors in mutual funds, investors in Cunningham's portfolio, which he manages online using a service called Foliofn (www.foliofn.com), own shares of stocks directly. The platform costs a fraction of a traditional brokerage, keeping the portfolio's expenses to 0.80 percent of the fund's assets plus a $25 annual account fee.

Direct shareholders can voice their opinions about company practices at shareholder meetings or through proxy voting. Mutual fund investors can vote on fund matters but not on matters of the companies held in the fund.

He thinks a portfolio that allows investors to get more involved and incite change within corporate America will appeal to Minnesotans, who he said have a history of "community sensitivity and social responsibility." Cunningham also hopes the portfolio will do well with women, people of color and others who are likely to have experienced insensitivity and discrimination at work and would want to invest in companies committed to preventing such experiences from happening within their walls.

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