IR/PS CSR Case #07-14

Domini Social Investments:

A CSR Case Study

By: Jennifer F. Cheng

GRADUATE SCHOOL OF INTERNATIONAL RELATIONS AND PACIFIC STUDIES
UNIVERSITY OF CALIFORNIA, SAN DIEGO
Prepared for Professor Peter Gourevitch
Corporate Social Responsibility
Fall 2007

***Abstract*:**
Do Socially-Responsible Investment (SRI) mutual funds actually invest their clients' dollars in socially-responsible companies? This paper will evaluate this CSR problem by examining Domini Social Investments and how it determines and implements SRI strategies with regards to its flagship mutual fund, Domini Social Equity Fund (DSEFX).

Table of Contents

I. Socially Responsible Investment Industry

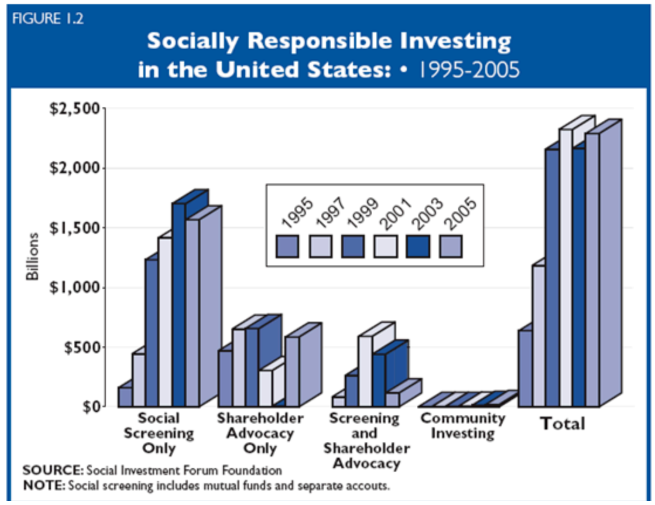

Figure 1 SRI Trends in the United States: 1995 - 2005

A. Introduction

Consumers and private firms are increasingly paying heed to responsible business practices, and the area of investments is no exception. While socially responsible investing (SRI) still play a small role in overall investments, SRI has established itself as a major player in corporate social responsibility (CSR) discourse over the last two decades.

According to Social Investment Forum's 2005 Report on Socially Responsible Investing Trends in the United States, mutual funds have been the fastest growing segment of SRI. In 2005, \$2.29 trillion in assets were under management (up from \$2.16 trillion in 2003) using one or more of the three socially responsible investing strategies: (1) screening, (2) community investing, or (3) shareholder advocacy. It is estimated that "one out of every ten dollars under professional management in the US being involved in some form of SRI (see Figure 1)."[1]

B. Screening

Screening is the process of evaluating and selecting companies based on the degree of CSR compliance. Negative screening wholly or partially excludes companies that are engaged in certain industries, practices, or services. The most common negative screening processes excludes businesses that are engaged in tobacco, alcohol, weapons, nuclear power, though depending on the type of fund, negative screens may extend to other issues such as contraception,

[1] Larissa Redins, "The Evolution of Socially Responsible Investing," *Environmental News Network*, September 11, 2006, http://www.enn.com/top_stories/article/4540 (accessed October 27, 2007).

animal welfare, firearms, human rights, biotechnology, gambling and pornography. Some companies are only excluded if the revenue derived from a negative screen reaches a certain threshold while other funds extend these screens to the company's suppliers and customers[2]. Positive screening is a process by which a company is selected to be in fund based on the degree of its compliance to a positive CSR goal. Positive screens too vary from fund to fund, but typically include a company' work in corporate governance, environmental sustainability, human rights, and labor issues.

C. Community Investing

An investment firm may also employ community investing as an SRI strategy. This entails using investor capital to finance or guarantee loans to individuals and organizations that improve local communities in a socially positive and environmentally sustainable way. According to the Social Investment Forum, such loans are generally used for affordable housing, small business creation, development of community facilities, and the empowerment of women and minorities in the United States.[3] Loans may also be available to local financial institutions abroad to finance international community development. The community investing institution typically provides training, support and expertise to facilitate the loan's success and ensure returns to its investors. According to the Social Investment Forum, community investing grew 388 percent, from $4 billion to nearly $20 billion in assets from 1995 to 2005, making community investing the fastest growing area of SRI (see Figure B).

---

[2] Paul Hawkin, "Socially Responsibly Investing," *The Natural Capitalism Institute*, October 2004.
[3] "Community Investing," The Social Investment Forum, http://www.socialinvest.org/projects/communityinvesting.cfm, (accessed December 4, 2007).

D. Shareholder Advocacy

Shareholder advocacy is a tool favored by many SRI firms in which the investment firm, on behalf of the SRI shareholder, engages with management of portfolio companies to further CSR issues. Tools include initiating dialogue with management, voting on company issues via the proxy voting process, or filing and co-filing shareholder resolutions.

FIGURE B

Socially Responsible Investing in the US • 1995-2005

(in Billions)	1995	1997	1999	2001	2003	2005
Social Screening[1]	$162	$529	$1,497	$2,010	$2,143	$1,685
Shareholder Advocacy	$473	$736	$922	$897	$448	$703
Screening and Shareholder[2]	N/A	($84)	($265)	($592)	($441)	($117)
Community Investing	$4	$4	$5	$8	$14	$20
Total	**$639**	**$1,185**	**$2,159**	**$2,323**	**$2,164**	**$2,290**

SOURCE: Social Investment Forum Foundation

1. Social Screening includes mutual funds and separate accounts. Since 2003, SRI mutual fund assets have increased (see Section II) while separate account assets have declined (see Section III) as single issue screening has waned and shareholder advocacy increased on the part of institutional investors.
2. Assets involved in Screening and Shareholder Advocacy are subtracted to avoid double counting. Tracking Screening and Shareholder Advocacy only began in 1997, so there is no datum for 1995.

Figure 1: SRI Portfolio Strategy Trends in the U.S., 1995 - 2005

According to the Social Investment Forum, shareholder advocacy activities are adopted in the hopes that they will generate investor pressure on company management to exercise good corporate citizenship while promoting financial performance. Of the 2.29 trillion reportedly invested in SRI funds, $703 billion (just over 30%) is engaged in some form of shareholder advocacy (Figure 2).

On July 25, 2007, the Securities and Exchange Commission (SEC) presented for comment potential changes that would limit investors' ability to issue advisory resolutions, which are the most common form of shareholder resolutions adopted by SRI firms. The proposal calls for increasing the votes required for resubmitting resolutions to 10% after the first year, 15% after year two and 20% thereafter, compared to current respective thresholds of 3%, 6% and 10%.[4] This proposal was similar to one put forth in 1997 by the SEC, which caused many SRI firms to engage in a collective campaign that successfully dissuaded the SEC from adopting the

[4] Tim Smith, "Shareholder Resolutions Challenged By SEC", Accountability-Central.com, September 6, 2007, http://www.accountability-central.com/single-view-default/browse/3/article/shareholder-resolutions-challenged-by-sec/?tx_ttnews%5BbackPid%5D=13&cHash=e38ad24eea (accessed December 4, 2007).

change. A similar campaign was launched by SRI firms: the SEC received 34,000 comments opposing the proposal. On November 28, 2007, the SEC announced it would not pursue the proposal. [5]

E. No Universal Standard

There are no set universal screening criteria that determine whether a company's business practices are eligible to be included in a SRI fund. SRI screening, community investing and shareholder advocacy is determined by the sole discretion of each individual investment firm. Thus, investors are forced to shop around and research each fund's unique screening criteria in order to ascertain whether a fund matches their personal values.

By one estimate, there are currently 221 SRI funds[6] available in the United States, each purportedly offering a unique fund that is comprised of specially selected firms that meet some specified CSR criteria. Funds can be secular or religious, broad or as specific as to only screen companies on one CSR issue, such as women's rights. The Social Investment Forum, a membership association devoted to the promotion and practice of socially-responsible investing, offers a list of 106 SRI funds and identifies whether a fund screens for the following twelve issues: 1) alcohol, 2) tobacco 3) gambling, 4) defense/weapons, 5) animal testing, 6) products/services, 7)environment, 8) human rights 9)labor relations 10)employment/equality 11)community investment and 12) proxy voting. Paul Hawkin's "Socially Responsible Investing" research paper provides 24 different screening categories for 602 American and international SRI mutual funds (**Appendix A**).

[5] "Press Release: Socially Responsible Investors Applaud SEC Decision Not to Curtail Shareholder Resolutions, But Strongly Oppose Curbs on Director Nomination Process," The Social Investment Forum, http://www.socialinvest.org/news/releases/pressrelease.cfm?id=101 (accessed December 4, 2007).
[6] Shaheen Pasha, "Five funds to ease your conscience," *Money*, July 4, 2006, http://money.cnn.com/2006/07/03/pf/funds/socially_responsible_funds/index.htm (accessed October 27th, 2007).

II. The CSR Problem

Social responsibly-screened mutual funds have become the fastest growing segment of the socially responsible investing industry. SRI mutual funds have increased nearly 15-fold between 1995 and 2005, and assets have increased 18.5% between 2003 and 2005 (see Figure 3).

FIGURE A

Socially Screened Mutual Funds • 1995-2005

Figure 2 SRI Mutual Fund Growth, 1995 - 2005

					3	2005
Number of Funds	55	144	168	181	200	201
Total Net Assets *(In Billions)*	**$12**	**$96**	**$154**	**$136**	**$151**	**$179**

SOURCE: Social Investment Forum Foundation

While the popularity of SRI mutual funds among investors is clearly evident, it gives rise to a whole host of CSR considerations. The growing popularity of socially screened financial portfolios begs the question*: Can an investor be really assured that their money is really being invested in a manner that supports and furthers CSR practices?*

To answer this question, the following subset of questions must first be investigated with relation to the SRI investment firm:

Who sets the CSR standard?

- What is the CSR standard?
- Who implements the CSR standard?
- What are the incentives to implement or “cheat”?
- Are the achievements of CSR objectives clear?

This case study shall provide tentative answers to these questions by examining Domini Social Investments and its flagship fund, the Domini Social Equity Fund (DSEFX). The goal of this study is to shed light on the degree to which to which an investment firm’s SRI mutual funds can be regarded as an effective monitoring mechanism to the private sector’s CSR initiatives.

III. Domini Social Investments

A. Introduction

Domini Investments describes itself as an investment firm exclusively specializing in socially responsible investing. It manages $1.8 billion "for individual and institutional investors who wish to integrate social and environmental standards into their investment decisions."

B. History

Domini Social Investments is the brainchild of Amy Domini. While working as a stockbroker in 1980, Domini noticed that some of her clients objected to investing in companies whose policies they did not agree with. Gradually, Domini became a strong proponent of a new type of investing, where a connection is made between an individual's investments and personal beliefs. At the time, SRI mutual funds and shareholder activists affiliated with the Interfaith Center on Corporate Responsibility were emerging, but the community was small and efforts were isolated.

Amy Domini believed that the primary obstacle to the growth of SRI was investors' uncertainty of how investments in CSR-friendly firms would compare to traditional investments. She decided that social investors required a social benchmark to serve as a point of comparison to traditional benchmarks such as the S&P 500 or Dow Jones Industrial Average.

In 1989, Amy Domini and her partners Peter Kinder and Steve Lydenberg founded KLD Research & Analytics, Inc. and launched the Domini 400 Social Index in 1990, the first socially-responsible index of its kind. The index was primarily made up of 400 primarily large-cap U.S. corporations, selected based on a wide range of social and environmental standards, roughly comparable to the S&P 500. The Domini Social Equity Fund was then launched in 1991, with

Amy Domini serving as President, providing investors with a fund that tracks the Index. The Domini Social Equity Fund was the first index fund to track socially and environmentally responsible companies.

The Domini Social Equity Fund achieved $10 million in assets in 1993 and $100 million in assets in 1996. On October 1997, Domini's mutual fund management and administrative operations were centralized in New York City with formation of Domini Social Investments LLC.

It is not clear whether Domini Social Equity Fund operated as a separate entity from KLD Research & Analytics before its incorporation in 1997. It is known that KLD determined and owned the Domini 400 Social Index, to whom Domini Social Investments paid a licensing fee for exclusive fund management[7], but it is uncertain whether this arrangement was established from the fund's inception. Amy Domini was involved with KLD Research & Analytics from 1989 through 2000 but is no longer associated with the firm.[8] **Appendix B & C** shows Domini Social Investment's reported milestones and Amy Domini's website biography.

In 2006, Domini's website reports that the company received shareholders' approval to change from a strategy of passive index investing to active management, an issue this case will explore further.

---

[7] "Amy Domini Honored by Time Magazine," Interfaith Center on Corporate Responsibility, http://www.iccr.org/news/press_releases/2005/pr_domini041405.htm, (accessed December 4, 2007).

[8] Amy Domini Biography, http://amydomini.com/cv.html, (accessed December 4, 2007).

C. Personnel

Domini Social Investments currently employs about 35 to 40 employees.[9] About 10 people are employed as part of Domini's research team. Currently, five executives serve as principals and 6 others are identified as key personnel of Domini's organization structure. They include a former SEC attorney, litigator, auditor, and former mutual fund analysts. Please refer to **Appendix D** for complete biographies of principals and key personnel as listed on the company website.

Of note, a few key personnel distinctly trace their roots back to KLD Research & Analytics, namely:

Amy Domini: Founder and CEO of Domini. Domini is a former board member of the Church Pension Fund of the Episcopal Church in America; the National Association of Community Development Loan Funds, an organization whose members work to create funds for grassroots economic development loans; and the Interfaith Center on Corporate Responsibility, a coalition group of faith-based investors. She is a member of the Boston Security Analysts Society. Amy Domini's biography (**see Appendix C**) reveals that she also serves as a private trustee/portfolio manager with the Boston-based firm of Loring, Wolcott & Coolidge, where she manages the assets of high net-worth individuals. She has been associated with the firm since November 1987.

[9] Jennifer Cheng, Phone Interview with Christina Gastelum, Marketing Associate, Domini Social Investments, November 27, 2007.

Steven D. Lynderberg, Chief Investment Officer of Domini Social Investments & VP of the Domini Funds: Lynderberg was Amy Domini's co-founder of KLD Analytics and Research is the and served as KLD's research director from 1990 to 2001.

Jeff MacDonagh, Domini's SRI Porfolio Manager: MacDonagh, worked as a social investment researcher at KLD Research & Analytics, Inc. from 2000 to 2003.

D. Board of Trustees

Domini Social Investments is governed by seven Board of Trustees members. A complete list is provided at the end of Domini's annual report, although it is not available on its website. The Board is made up of Domini personnel, divided into "interested" and "disinterested" parties, though their exact definitions are not given. The Board is not elected for fixed terms and shareholder meetings are not held for the purpose of election. Amy Domini is list the only "interested" trustee. Please **see Appendix E** for a complete listing.

IV. Domini Product Mix

Domini offers SRI products to both intuitional and private investors. Intuitional investors are essentially offered the same product mix as individual investors but in the "A share" format. Institutional funds are renamed Domini Social Equity Portfolio Class A, Domini European Social Equity Portfolio Class A, Domini PacAsia Social Equity Portfolio Class A, and Domini European PacAsia Social Equity Portfolio Class A. Figure 4 shows Domini's product mix for individual investors:

	Products	Sub-Managers	CSR Priorities	SRI Strategies
Stocks	Domini Social Equity Fund	Wellington Management	Social & Environment	Screening & Shareholder Advocacy
	Domini European Social Equity Fund	Wellington Management	Social & Environment	Screening & Shareholder Advocacy
	Domini PacAsia Social Equity Fund	Wellington Management	Social & Environment	Screening & Shareholder Advocacy
	Domini EuroPacific Social Equity Fund	Wellington Management	Social & Environment	Screening & Shareholder Advocacy
Bonds	Domini Social Bond Fund	Seix Advisors	Community Economic Development	Screening & Community Investing
Cash	Domini Money Market Account	Shorebank	Community Economic Development	Community Investing

Figure 3 Domini Social Investments' Product Line

Domini offers products in 3 major asset classes: stocks, bonds and cash and its portfolio construction and financial performance are all actively managed by three different sub-managers.

A. Stocks

The Domini Social Equity Fund invests in socially and environmentally sustainable U.S. companies screened by Domini. In 2005, Domini began offering international portfolios to "allow investors to diversify their portfolios, take advantage of overseas economic growth, and promote human dignity and environmental performance." The Domini European Social Fund benchmarks against the MSCI All Country Europe Index, while the Domini PacAsia Social Equity Fund benchmarks against the MSCI All Country Asia Pacific Index. The EuroPacific Social Equity Fund's portfolio consists of both European and Asian companies.

B. Bonds

The Domini Social Bond Fund seeks to provide its shareholders with a high level of current income and total return. The Fund invests 85% of its portfolio in assets bonds that meet the it's social and environmental standards and least 10% in debt instruments that "provide a high level of community impact".

C. Cash

Domini transfers the assets of its Domini Money Market Account (DMMA) investors to ShoreBank, a Chicago-based community developmental bank. ShoreBank converts DMMA investors' federally insured bank deposits into development loans that are used to help communities rebuild neighborhoods, create jobs, secure decent homes, and finance small businesses. Founded in 1973 on the objective of not sanctioning loans on the basis of race and income, Shorebank is known as the nation's oldest and largest community development bank. In 2000, the bank widened its screening criteria to include environmental issues. Its banks and nonprofits collectively make Shorebank a $2.1 billion company.[10]

V. Domini Social Equity Fund (DSEFX)

This case study's focus will remain with Domini's Social Equity Fund (DSEFX), the company's oldest. It is this fund's performance that allowed Amy Domini to garner significant media attention and honorary awards (**Appendix C & D**).

A. DSEFX Overview

The fund's stated investment objective is to "provide its shareholders with long-term total return."[11] The fund invests in mid-cap companies (market capitalization at the time of purchase between $2and $10 billion) and large-cap companies (market capitalization with greater than $10 billion). Currently, net assets are $1.5 billion.

[10] *About Shorebank: Corporate Information*, February 16, 2007, http://www.shorebankcorp.com/bins/site/templates/child.asp?area_4=pages/nav/about/right_side.dat&area_2=pages/about/corp_info.dat&area_7=pages/titles/about_title.dat, (accessed December 5, 2007).
[11] "Domini Social Equity Fund: Overview," Domini Social Investments, http://www.domini.com/domini-funds/Domini-Social-Equity-Fund/index.htm#, (accessed December 6, 2007).

B. History: Domini 400 Index (DS 400)

Domini Social Equity Fund got its start in 1991 as the nation's first socially responsibly screened index fund portfolio, which followed the Domini 400 Social Index (DS 400). An index fund is a form of a mutual fund that replicates the stock composition of a specific financial market index. It is considered a form of passive management because the rules of ownership are set regardless of market conditions; investment managers cannot to buy and unload stocks easily. Fund managers cannot change the composition of the stocks in an index fund unless the composition of the index changes.

The DS 400, while developed in part by Domini CEO Amy Domini and Domini CIO Steven D. Lynderberg at KLD Analytics, was owned by KLD. The Domini Social Equity fund paid a licensing fee to KLD for the exclusive use of the Domini 400 Index. DSFEX ceased tracking the index in August 2006 when it switched to an actively managed strategy. The fund is no longer affiliated with the Domini 400 Index, and KLD now licenses the Index to Barclay's Global Investors' iShares and Green Century Capital Management's Green Century Equity Fund.[12]

C. History: Domini 400 Index (DS 400) Screening Process

Though the Domini Social Equity Fund no longer tracks the Domini 400 Index, it is still worthwhile to briefly examine how KLD Analytics screened and determined the composition of the Index. While there is no information on how KLD determined the composite index while it was licensed exclusively to DSFEX, a brief examination of current practices serves as an adequate barometer.

[12] *FAQ: Domini Social Index*, KLD Indexes, http://www.kld.com/indexes/ds400index/faq.html, (accessed December 5, 2007).

Currently, the Domini 400 Index is determined by the KLD Indexes, which obtains exclusive research information from its parent, KLD Research & Analytics. The majority of companies selected by KLD are S&P 500 companies. KLD identifies eligible companies by screening them for the avoidance of alcohol, tobacco, gambling, nuclear power, firearms and weapons-related defense contracting. Positive screens include community relations, diversity, employee relations, environmental stewardship, human rights, product safety and quality, and corporate governance. In 2000, Time magazine reported that companies in the index "must pass muster on 140 issues, ranging from toxic-waste fines to diversity in top management."[13] KLD states that half of S&P 500 companies qualified for the DS400. KLD also selects about 100 mid cap companies and 50 small cap companies to bring the total holdings to 400.

KLD does not publicize changes in holdings nor does it publicly offer a complete list of companies in its index, though it makes it available for purchase or subscription. However, it does publish a list of its top ten holdings (Figure 5 &6).

Top 10 Holdings
Microsoft Corp.
AT&T Inc.
Procter & Gamble Co.
Cisco Systems Inc.
Johnson & Johnson
Apple Inc.
JPMorgan Chase & Co.
Intel Corp.
Coca-Cola Co.
Verizon Communications Inc.

Figure 5 Domini 400 Index Top 100 Holdings as of October 31, 2007

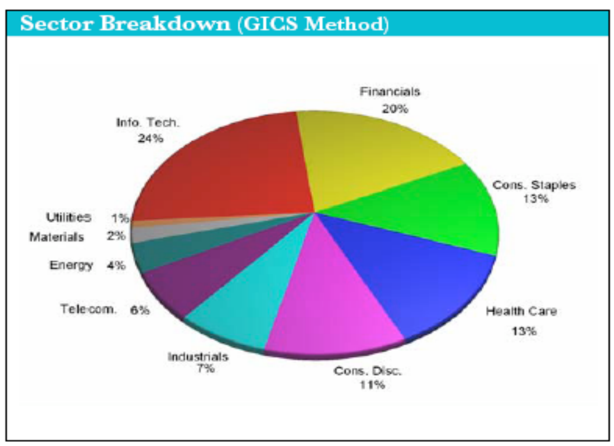

Figure 6 Domini 400 Index Holdings' Sector Breakdown as of October 31, 2007

KLD's current DS400 prospectus states that "companies may be removed from the DS400 due to corporate actions, violation of exclusionary screens or concerns related to

[13] Margot Roosevelt, "How Green Is Your Money?," Time Magazine, October 16, 2000, http://www.time.com/time/magazine/article/0,9171,998249,00.html, (accessed December 6, 2007).

performance," and that '"index turnover ranges from 6%-8% in a typical year ,"[14] but other sources note that KLD '"is reluctant to remove companies from the index for qualitative concerns, unless it is clear that these concerns will be long-term and of major proportions.'"[15]

Under the Index, Domini Social Equity Fund performed reasonably well in the 1990's, against its benchmark, the Standard & Poor 500. BusinessWeek reports that strong growth during this period can be attributed to the socially responsible profile of the technology sector in which the Fund was heavily invested in. However, fund performance has been middling since the internet bubble burst in the early 2000's, particularly since the fund's screens out high-performing energy, utility, and industrial sectors for their negative environmental records. [16] Refer to Figure 7 for Domini Social Equity Fund's performance against the SP&500. Refer to **Appendix E** for figures.

Figure 7: Domini Social Equity Fund's performance against the SP&500.

[14] *FAQ: Domini Social Index*, KLD Indexes.
[15] Paul Hawken, "Socially Responsible Investing," pg. 19-20.
[16] Lauren Young, "A Social Fund's Strategic Shift," *BusinessWeek,* May 26, 2005, http://www.businessweek.com/investor/content/may2006/pi20060526_159620.htm?chan=investing_investing+funds, (accessed December 5, 2007).

D. The Switch from Active to Passive Management

On May 25, 2006, Domini Social Investments filed with the Security and Exchange Commission to switch from index strategy to an actively managed strategy, instating Wellington Management as sub-manager to all of Domini's stock funds. While the exact reason for the switch is unclear[17], BusinessWeek reports:"With her name on the door at both firms, it's been a tough decision for Amy Domini, founder and CEO of Domini Social Investments. 'Emotionally, this is difficult,' Domini says. 'But I can't ask my shareholders to be patient forever.'"[18]
At the time, Domini Social Equity's indexed strategy underperformed compared to mutual funds. With an expense ratio of 0.95%, it was also considered one of the most expensive index funds on the market.[19]

In October 2006, Karin Chamberlain, manager of indexes at KLD, and Eric Fernald, director of research, said the aim of the DS400 was to socially responsible while providing a broadly diversified portfolio with low turnover.[20] Nevertheless, the Domini index strategy garnered critics because its low turnover strategy rendered it difficult for a CSR transgressor to be divested from the index.

For example, while the Domini 400 index was underweighted in the health care sector in 2006 '"in large part because of price and safety controversies in the pharmaceutical industry,'" the portfolio included McDonald's, PepsiCo, and Coca-Cola- companies whose products have been blamed for the nation's growing obesity problems. Peter Kinder, president of KLD

---

[17] Jennifer Cheng, Phone Interview with Christina Gastelum, Marketing Associate, Domini Social Investments, November 27, 2007.
[18] Young, "A Social Fund's Strategic Shift".
[19] Ibid, Young.
[20] Daniel Askt, "The Give and Take of 'Socially Responsible,' *New York Times,* October 8, 2006, http://www.nytimes.com/2006/10/08/business/mutfund/08social.html?_r=1&fta=y&oref=slogin, (accessed December 6, 2007).

defended the portfolio, saying '"There's no such thing as a perfect company. Socially responsible investors are willing to deal in grays." [21]

Though Domini's own website and various news articles attributes financial reasons for the change to active management, Domini's proxy statement to its investors for their vote on the switch to active management takes a decidedly CSR approach. In the proxy statement overview, it states:

> "Q. Will this proposed change affect the Fund's commitment to socially responsible investing?
>
> A. No. Domini has no intention of changing its steadfast commitment to socially responsible investing. The proposed new investment strategy reflects Domini's strong belief that the use of social and environmental standards to select investments leads to better stock picking (as well as more responsible corporate behavior). The new strategy that Domini is proposing is designed to strengthen the use of social and environmental standards. The new strategy is also designed to allow the Fund to maintain its strong commitment to shareholder activism."[22]

E. Wellington Management LLC

Domini reports that on August 2006, its shareholders approved a new active investment strategy for the Domini Social Equity Fund and Domini Institutional Social Equity Fund, selecting Wellington Management LLC as the funds' submanager. Wellington Management is an

---

[21] Ibid, Askt.
[22] Domini Social Investment: DEF 14A: Overview of Proxy Statement", *Edgar Online*, Filing Date: June 15, 2006.

investment management firm with over US$550 billion in client assets under management and serves an investment advisor to approximately 1,400 institutions located in 43 countries.

Wellington reportedly acts as a mutual fund subadvisor to approximately 130 institutions, including banks, insurance companies and asset management firms around the world.[23] The firm's Subadvisory Relationship Management team has extensive experience in helping mutual fund and other clients solve business and investment problems. BusinessWeek reports that Wellington is a notoriously press-shy firm, though one of its known clients is Vanguard. [24] On November 30, 2006, the fund officially transitioned to the actively managed strategy[25] and the stock composition of Domini's funds was no longer tied to the index. An interview with Domini reveals that the company believes the switch was a beneficial one because they lacked flexibility under an indexed strategy; Domini could not make decisions as fast as it would like. They cited the fact that the index strategy led the fund to be heavily weighted in the banking sector but were lightweight in the utilities and energy sector into which they would further diversify. [26] Using a Domini pre-approved list of companies, Wellington Management "re-optimizes" the list by using a quantitative method that neutralizes market risk and benchmarks it against the S&P 500.[27] Wellington, is ultimately responsible for the funds' final portfolio construction, day-to-day management, and financial performance.

F. Fund Performance Under Wellington's Management

Having only actively managed DSEFX since November 30, 2006, Wellington's managerial performance can only be judged according to the last four quarterly returns at the

[23] "Overview", Wellington Management,
[24] Young, "A Social Fund's Strategic Shift".
[25] "Annual Report 2007," Domini Social Investments, pg. 14.
[26] [26] Jennifer Cheng, Phone Interview with Christina Gastelum, Marketing Associate, Domini Social Investments, November 27, 2007.
[27] ibid

time of writing (Figure 8). While the fund still underperforms the S&P 500, the difference in performance has generally become smaller under Wellington's management when compared to the fund's annual performance as an index fund (see **Appendix E** for comparison)

DSEFX Quarterly Returns

		DSEF	S&P 500	Difference
3rd	Qtr 2007	-1.91%	2.03%	-3.94%
2nd	Qtr 2007	6.18%	6.28%	-0.10%
1st	Qtr 2007	0.72%	0.64%	0.08%
4th	Qtr 2006	6.41%	6.70%	-0.29%

Figure 8: DSEFQ Most Recent Quarterly Returns

G. *Expense Ratios*

With the switch to Wellington, Domini increased the fund's expense ratio to 1.15% , a figure that is considered reasonable for an actively managed fund.[28] DSEFX, as a no-load fund, makes it free for investors to invest provided that put forth the $2,500 minimum required investment (the minimum is $1,500 for IRAs and $1,500 for an automatic investment plan). The firm charges a 2.00% redemption fee if the investor decides to withdraw from the fund after only 60 days.

Domini's reported total operational expenses are 1.24% of DSEFX Investor class shares. Management fees constitute 0.30%, distribution fees constitute 0.25%, administration and other expenses constitute 0.69%, and after deducting a fee waiver of 0.09%, the expense ratio to the investor is 1.15%. Please see **Appendix F** for details on the cost structure of Domini's other funds.

According to the Domini Fund Prospectus, Domini "has contractually agreed to waive certain fees and/or reimburse certain expenses, including management fees" for all its funds, "so that each Fund's expenses, net of waivers and reimbursements, will not exceed, on a per annum basis, 1.15%,1.60%, 1.60%, 1.60% and 0.95%, respectively, of the average daily net assets

---

[28] Young, "A Social Fund's Strategic Shift".

representing Investor shares." It does not state with whom Domini has signed this contractual agreement. At the time of writing, Domini has not yet issued out a new expense ratio for the Domini Equity fund. [29]

Figure 9 shows Domini Social Equity Fund's ten largest holdings and portfolio construction as of September 30, 2007. A complete list of DSFEX's current portfolio holdings can be found in **Appendix G.**

SECTORS *(as of 9/30/07)*

	% of Portfolio
Financials	24.34%
Information Technology	17.64%
Health Care	11.25%
Consumer Discretionary	10.62%
Consumer Staples	10.26%
Telecommunication Services	7.22%
Industrials	6.66%
Energy	6.10%
Utilities	3.16%
Materials	2.30%
Cash Equivalents	0.45%
Total	100.00%

TEN LARGEST HOLDINGS *(as of 9/30/07)*

	% of Portfolio
IBM	3.77%
JP Morgan Chase	3.57%
Verizon Communications	3.49%
Hewlett-Packard	3.23%
Citigroup	3.21%
Bank of America	3.14%
Goldman Sachs Group	3.04%
Johnson & Johnson	2.88%
Microsoft	2.47%
AT&T	2.46%
Total	31.26%

Figure 9: DSEFX Portfolio Sector Holdings & Top 10 Holdings as of September 30, 2007

VI. Screening

Potential investors interested in learning about Domini's portfolio screening process are led to a company webpage that assures investors that companies that derive

Exclusionary Screens	Positive Screens
Tobacco	Community
Alcohol	Customers
Gambling	Eco-Systems
Military Weapons	Employees
Nuclear Power Plants	Investors
	Suppliers

Figure 10: Domini's Screens

[29] "Domini Social Investments Prospectus", November 30, 2007, *Domini Social Investments*, pg. 22.

"a significant portion of its revenues" in tobacco, alcohol, gambling, military weapons, and nuclear energy are immediately omitted from consideration. Current and potential holdings are then positively screened for whether or not they "1) Contribute to the local **communities** in which they are located; 2) Produce high-quality, safe, and useful products for **consumers;** 3) Enrich the **ecosystems** on which they depend; 4) Invest in the health and development of their **employees;** 4) Treat their **investors** and lenders openly and transparently; 5) Strengthen the capabilities of their **suppliers**." No further elaborations are given on these definitions or how screens are implemented.

Domini's June 15, 2006 Proxy Statement overview provides little more insight into the screening process:

> "Domini's in-house research department will analyze a universe of approximately 1,000 of the largest U.S. companies using Domini's social and environmental standards. These standards are maintained by a Standards Committee that includes Amy Domini, Domini's Founder and CEO, and Steven Lydenberg, Domini's Chief Investment Officer. Domini will provide Wellington Management with a list of securities that it determines are consistent with these standards. Domini will periodically review and update this list of approved stocks based on its ongoing social and environmental analysis."[30]

An interview with Domini Marketing Associate, Christina Gastelum provides more insight into the process. Using a proprietary internal-ranking system, Domini's 10 in-house researchers are responsible for the development and application of the Funds' social and

[30] Domini Social Investment: DEF 14A: Overview of Proxy Statement", *Edgar Online*, Filing Date: June 15, 2006.

environmental standards. The system utilizes "top-down" and "bottom-up" strategies. A top-down strategy is employed by identifying the industry and sub-industry a company belongs to and then employing applicable CSR measures specific to the area. A "bottom-up" strategy involves identifying and evaluating the company's relations with its stakeholders.

Wellington and Domini investors are not privy to the mechanics of the internal ranking system. A list of companies qualified by Domini is submitted to Wellington who in turns "re-optimizes" the portfolio using quantitative methods and weights them against the S&P 500 to generate the best financial returns. In short, Domini sets the social standards of the portfolio, while Wellington constructs the most financially-optimal portfolio and oversees its day-to-day management. Ms. Gastelum says she is not aware of any cases in which Wellington divests companies without Domini's instructions as Wellington acts according to Domini's direction.

VII. Shareholder Advocacy

The other half of Domini Social Equity Fund's SRI strategy is engagement in shareholder activities. It's stated objected is to "use our shareholders' investments to encourage greater corporate responsibility, both by using social and

Annual Advocacy Statistics				
Action	**2003**	**2004**	**2005**	**2006**
Resolutions Filed*	26	20	20	16
Additional Dialogues	N/A	N/A	22	35
Additional Companies Contacted	35	55	2	211
% of Domini Social Portfolio	36%	43%	N/A	N/A
TOTAL**	61	75	44	262

Figure 10: Domini's Annual Advocacy Statistics

environmental standards to select our holdings and by directly engaging corporate management through proxy voting and shareholder dialogues."

A. Direct Dialogue

Domini states that when it has concerns with a company over its CSR practices, it will engage in direct dialogue with the company to articulate them, either by phone, face-to-face meetings, or letter-writing. Domini de-briefs its shareholders on its direct dialogue activities by summarizing its activities a quarterly Social Impact Update newsletter to investors, and by updating its online list of "History of Successes" (**Exhibits H & I).** There are no full reports detailing the progress and trajectory of its efforts.

A sample passage of its direct dialogue activities from its Third Quarter 2007 Social Impact Update newsletter:

> "During the third quarter, we met with 16 companies in person or by phone, including **Hershey's** to discuss labor standards in the company's supply chain, **McDonald's** and **Disney** to continue work on a multi-year project on factory working conditions, and **Timberland** to discuss the company's efforts to reduce its carbon footprint.
>
> We wrote to an additional 212 companies, including 196 companies in North America, Europe, and Asia that did not respond to the Carbon Disclosure Project, an annual survey of greenhouse emissions data that is sent to the world's largest companies on behalf of institutional investors with $41 trillion under management. "[31]

[31] "Shareholder Activism: Your Dollar For Change, Third Quarter 2007," Domini Social Investments, http://www.domini.com/shareholder-advocacy/index.htm, (accessed December 7, 2007).

Domini indicates that if its direct dialogue efforts do not product results, filing shareholder resolutions may then be considered.

B. Shareholder Resolutions

Domini first engaged in filing shareholder resolutions when it co-filed its first shareholder proposal asking Wal-Mart to public disclose its diversity data. From 1994 through 2006, Domini claims to have filed more than 140 shareholder resolutions at more than 60 companies.

Domini frequently works with the Interfaith Council for Corporate Responsibility (ICCR), a membership coalition of faith-based investors, to file and co-file shareholder resolutions. Amy Domini has previously served as a board member for ICCR.

Like its direct dialogue activities, Domini does not provide any detailed reports of Domini's shareholder resolutions except for the list of its History of Successes and brief descriptions in its Social Impact Quarterly Updates (**Exhibits I &H)**. It is uncertain whether a withdrawn resolution indicates a successfully conclusion to the resolution, or whether Domini gave up on the issue. It does state:

> "If we achieve our goal before the annual meeting, we may choose to withdraw the resolution. Should negotiations fail to produce a satisfactory result, our objective becomes to achieve sufficient votes to keep the resolution on the proxy the following year….
>
> If possible, we refile the resolution each year until the issue is resolved. According to the rules of the Securities and Exchange Commission (SEC), a resolution must receive 3% of

the vote the first year it is filed, 6% in year two, and 10% thereafter to be included on the proxy the following year. "[32]

ICCR's Ethvest Database promises detailed reports of its resolutions but requires a subscription for access. In an e-mail correspondence with the author on December 7, 2007, Kenneth Cynar , Executive VP, General Manager of the Governance Accountability Institute which manages the website writes, **"**EthVest is a subscription site and focused on supplying information to non-profits and for profit fund managers, money managers, investors, pension plans etc....it is not designed or priced specifically for individual use...for profits are charged $2,500 per year for example with a discount for non-profits."[33]

A sample passage of its direct dialogue activities from its Third Quarter 2007 Social Impact Update newsletter:

> "Domini refiled a resolution with **Becton Dickinson**, asking the company to report on the use of brominated flame retardants in the healthcare supplies that it sells. The most common brominated flame retardants disrupt the endocrine systems of rats and mice and may pose a risk to human health. The resolution was first filed in 2005, but withdrawn in 2006 when the company appeared to be making progress on the issue. We refiled the resolution after progress stalled." [34]

C. Proxy Voting

Domini claims it was the first mutual fund to public make available its manager's proxy votes in 1996 "so that our investors could hold us accountable for the positions we are taking.

[32] "Shareholder Advocacy: How the Process Works," Domini Social Investments, http://shareholder-advocacy/Proxy-Voting/index.htm, (accessed December 7, 2007).
[33] Jennifer Cheng, e-mail correspondence with Ken Cynar, December 7, 2007.
[34] "Shareholder Activism: Your Dollar For Change, Third Quarter 2007," Domini Social Investments.

We petitioned the Securities and Exchange Commission for the rule that now requires all mutual funds to disclose their votes, and their voting guidelines." Domini provides its historical proxy voting record proxy votes on its website, though records only date back to July 1, 2003. [35]

It reports it was one of four mutual fund families to be rated "most activist" by The Corporate Library, an information resource on corporate governance. Having voted in favor of management-sponsored resolutions 66% of the time and shareholder-sponsored resolutions 63%of the time at the end of fiscal year June 30, 2007 [36], Domini claims this meant it was "least likely to support management, and most likely to support shareholder resolutions on corporate governance and social and environmental issues in our proxy voting" since the other 54 fund groups surveyed supported 97.7% of management proposals and 35.2 of shareholder proposals.[37]

D. Sanctions

Domini's website does not cite any examples of companies that have been divested for its CSR transgressions. Where there are issues, Domini will engage in dialogue, resolutions or proxy voting. As an actively managed fund, it is clear that the composition of the fund's portfolio will occasionally change, but changes are made unilaterally and without announcement. While it can be speculated that a change in the portfolio may either be due to a company's poor financial performance or poor CSR compliance, exact reason are never explicitly cited.

VIII: Evaluation and Assessment

An examination into Domini's internal screening and shareholder advocacy mechanism indicates that the organization is severely lacking in the transparency demanded by the very CSR

---

[35] "Domini Proxy Votes," Domini Social Investments, http://www.domini.com/shareholder-advocacy/Proxy-Voting/index.htm, (accessed December 7, 2007).
[36] "Fund Votes," http://www.fundvotes.com/, (accessed December 7, 2007).
[37] "Shareholder Activism: Your Dollar For Change, Third Quarter 2007," Domini Social Investments

movement it purports to support. Domini acts as the sole issue setter. Its screening standards are kept private and its work in shareholder activism is only sporadically and briefly reported.

Asides from offering its investors the opportunity to e-mail Domini about their individual CSR concerns and preferences, there is no meaningful mechanism for channeling, tallying, and incorporating its investor's preferences into its SRI company selection process. [38]

The switch from passive to active management presented an opportunity for Domini to claim that such a switch could allow them to easily divest from CSR-incompliant and invest in CSR-compliant companies ones, which would allow Domini to be a better CSR advocate in the world of socially-responsible investing. While Domini does cite this as its reason for the switch in its proxy statement to investors, all current Domini and outside literature indicate that the sole reason to the switch to active management was to due to the financial underperformance using the indexed strategy.

In fact, the switch to active management may create some dangerous pressures for Domini. Domini may be more inclined to pick profitable companies that are not CSR-friendly and then initiate shareholder activism to justify its choice. While the switch can easily let it divest CSR transgressors, it may also create an unwillingness to divest companies, especially if companies are performing well financially.

Ultimately, it is uncertain who has the incentive to blow the whistle on CSR non-compliant firms. It is clear Domini does not have a set internal mechanisms to incorporate its investor's CSR interests, but it seems that if media exposure on a particular issue is large enough, Domini will join pressure groups to coax companies into compliance. Indeed, one of its more recent issue areas is lobbying companies not to engage in Sudan due to the Darfur crisis.

[38] Christina Gastelum, Domini Social Investments, Interview.

On the whole, Domini enjoys great freedom and flexibility in the way it purports to "monitor" corporations' CSR behaviors and actions on behalf of shareholders. Domini does not make any of its monitoring tools transparent and is not subjected to the monitoring of any other organization, which should be a cause of concern for potential SRI investors. A potential investor's criteria in evaluating an SRI organization should, then, be based on whether that particular SRI firm makes it screening criteria known and provides in-depth updates and reports on its shareholder advocacy activities.

IX. Further Questions

An evaluation of Domini's known activities indicates that the firm's SRI strategy is heavily weighted in shareholder activism and less so on screening mechanisms. For some potential investors, it may be enough to know that Domini is lobbying companies to be more socially compliant on their behalf since it is better than the alternative of not doing anything at all. More research would have to be conducted into Domini's Shareholder Advocacy program to determine how Domini really measures up in this area. The following is a list of questions sent to Domini by the author in November, 2007 regarding this matter, but has hitherto been unanswered:

A. Further Questions on Shareholder Activism:

1. What is the nature of your relationship with Interfaith Center on Corporate Responsibility? Is Domini a faith-based organization? Would you say ICCR or Domini sets the CSR activism issues?

2. What does it mean to be a lead or co-filer? Are you the point of contact with the company? Can you take me through a typical process?

3. You seem to file a lot of resolutions, initiate dialogues, and contact companies-do you have statistics on how your actions actually lead to real change?

4. Do you only initiate dialogue with companies you are already invested in? Do you initiate dialogue with companies you are thinking about investing in? How big if your research staff? And how are they funded?

5. What happens when you withdraw a resolution? Do you only withdraw when a solution has been reached or do you withdraw even if no agreement has been made?

6. How often do you lead coalitions? Or just join a coalition? Who do you normally team up with? How often do you team up with them?

7. How effective would you consider your proposals and resolutions? Do you feel companies hear your proposals sufficiently?

8. Can you give some concrete examples of how you have resolved conflict of interest issues in the past? Either within or among Domini, Wellington and ICCR?

7. What else can you tell me that would give me confidence that my money is being investing in a socially responsible manner?

B. Further General Questions on Domini Social Investments:
1. Is Domini a faith-based organization?

2. What instigated the change from passive to active management? Was it a push from shareholders or Domini management?

X. Conclusion

In the case of Domini Social Investments, we cannot safely say that this SRI firm is investing its clients' money in socially-responsible companies. While Domini certainly expresses its SRI intent and expends time and resources in screening and shareholder advocacy, it is unclear the extent and the degree to which its efforts are effective. Indeed, even if its efforts were genuine and persistent, it is uncertain how strong of a sway Domini actually holds over large corporations, given that it is significantly smaller than major traditional mutual fund players. After all, its current largest holding is only 3.79% of net assets. Profit maximization seems to be Domini's primary concern. The lack of transparency in its SRI strategies enhances this suspicion.

XI. Monitoring Organization Matrix

MONITORING ORGANIZATION MATRIX: Domini Social Investments
Fall 2007

Monitoring organizations: Name of the GROUP On each dimension, let imagine a scale of 1-5, where1 is ideal for strong monitoring and 5 is the weakest. Try to write down a figure for each place you have information. If you have no information, leave it blank. You can't get ALL of this in One quarter here in San Diego. Show what you can: Make notes on WHAT you would like to know. Where do you look to get this information? Imagine, that research on this Group will be continuing, or that you will come Back to it: what would you like to have if You come back, or someone else continues the work..

DIMENSIONS	SCORE	COMMENTS
1) Autonomy from Target of Monitoring		
how autonomous from either target or the Pro standards group:		
Do they fit third party concept ?	4	Domini screens companies, but lack transparency
•in money source: do they take money from the Target	1	
•in control: governance structure: who sits on the boar	2	One "interested" trustee out of 7 board members.
are they connected to the Target?		
• Do they charge fees for inspection?	1	No fees charged to corporations
• Who pays the fees?		Domini Investors
2) Organizational Strength		
Capacity to carry out monitoring:	3	
•size of staff		35-40 FT 10 Reserachers
• training of staff: what kind of		unknown
• educational level of staff		Principles have college and professional degrees
• amount of back up: accounting, finance, law?		In house counsel, staff attorney. Auditor is KPMG
3) Monitoring Practice		
How do they carry it out?	4	Unknown screening process. Frequently works with ICCR for shareholder activism issues.
•How often in the field?	N/A	
•Unannounced?		
• how do they select inspection sites?		
• How do they interact with the Target?:		
Do they need permission?		
4) Sources of Information		
How do they get information:	N/A	Unavailable
• visits to the field?		
• do they collect complaints from		
• employees and others?		
• are they free of the target?		
• in information gathering?		

5) Standards vs. Monitoring		
•How sets the standard? How is that related to monitory act	5	Domini sets standards
•Is the Monitor separate from the standard setter?	5	No.
6) Evaluations		
•Do they ever find violations? How many?	5	No known violations
•What do they do with the violations information?		N/A
• How do they measure compliance with the standard ?		N/A
• How do they follow up deviation from standard?		N/A
7) Sanctions		
•Are there any sanction on the target?	3	Dialouge, shareholder resoultions
•Who administers a sanction : what other organization		Domini
(It is not likely that the Monitor is the Sanctionner		
That would be the Standard setter, or the lobby group?		
7) Transparency of Monitoring Organization		
•Does it provide the information for the above?	5	
•Can you learn about 1-6 from their Website, How? Calling?		All information cannot be obtained by website. Screening information obtained through calls. Conversation ended before shareholder actvism questions could be asked. Sent follow-up questions, but they were left unanswered.
•Does it tell you about		
• Money,		Tells you amount of assets managed & expense ratios of portfolios.
• Board control		
• Process,		Some
• Staff, etc. ?		Some staff biographies (see appendix)
8. Shadow of the State		
• does the organization rely on Government info		Unknown, but probably not.
• on Government rules of information provision?		Relies on SEC maintaining rules for shareholder activism
• does it need government support to get target to give information?		Unknown, but probably not.

XII. Discussion Questions

1. Given its history, how do we evaluate the relationship between Domini Social Investments and KLD Research & Analytics? Is this relationship problematic? Domini also manages the assets of high-net individuals at another firm- is there a potential conflict of interest?

2. Domini's case for active management is that it makes for better financial performance. However, when the switch was being put up to a vote, its proxy statement to its shareholders cited the switch would allow them to institute better CSR practices. Why does Domini emphasize one over the other? Which is reason has more validity? Do you believe passive management is better addresses the CSR problem or active management?

3. Look at the lists of Domini and KLD's holdings by company and sector. Are there significant differences between the indexed list and the actively managed lists? What do you know of these companies that would allow it to be qualified as a socially responsible? In your opinion, what are some known transgressions that should lead them to be divested?

4. Evaluate Domini Social Fund's SRI strategies. Do you think they are effective tools in persuading firms to adopt CSR policies?

4. How do we evaluate Domini's refusal to publicize its screening criteria?

5. Would you invest in the Domini Social Equity fund? Why or why not? If not, what would Domini have to do to convince you that your money is invested according to CSR standards?