The Evolution of Sinful Investing

by Lisa Smith (Contact Author | Biography)

Like beauty, the decision regarding whether something is sinful seems to be in the eye of the beholder. This is a key concern in socially responsible investing, or the avoidance of sin stocks. In addition to earning good returns on their portfolios, socially responsible investors want their money to support companies and industries that operate in a responsible manner. Let's take a closer look at the history of sin and how its definition as pertains to investment strategies has changed over the years. (To keep reading about social responsibility on Wall Street, see *Change The World One Investment At A Time*.)

The History of Sin

While Jewish law had ethical investing mandates in biblical times, the Quakers forbade ownership of slaves in early American history, and anti-war protesters chose not to invest in businesses that supported the Vietnam War, modern socially responsible investing (SRI) screens largely have their roots in the religious traditions that frowned upon activities such as gambling, alcohol consumption, tobacco use and the ownership of weapons. As a result, firms engaged in these businesses were dubbed sin stocks.

The launch of the Pax World Fund in 1971 marked the entrance to the market of the first mutual fund dedicated to socially responsible investing. Others soon followed. The rising popularity of socially responsible investing mandates also gave birth to indexes that set benchmarks for the SRI category. The launch of the Domini 400 Social Index in 1990 was the first of many to come. (To learn more about this fund, see *Socially Responsible Investing Vs. Sin Stocks* and *Socially Responsible Mutual Funds*.)

Initially, funds and indexes in the SRI category generally operated with zero-tolerance policies toward sin stocks. Any company engaged in activities that failed to pass the sin screen was excluded from the portfolio. In 2005, that zero tolerance policy caused SRI funds to sell their holdings of Starbucks (Nasdaq:SBUX), as the famously socially conscious coffee maker had licensed its name to a coffee liqueur featuring Jim Beam alcohol. A similar challenge for SRI mandates arose with the internet portal Yahoo! (Nasdaq:YHOO), which provides access to gambling sites.

The Screens Change

While the primary business at Starbucks was not alcohol production and the primary business at Yahoo! was not gambling, zero-tolerance policies were crystal clear on what was and was not appropriate for a portfolio. The only way to include firms with minor interests in sinful businesses was to change the screens to permit companies that engage in alcohol or gambling enterprises as long this was not their primary business. In 2006, Pax did just that, and the definition of sin (as mandated by mainstream SRI screens) began to change. (Learn how screens work in *Getting To Know Stock Screeners*.)

In March 2008, Calvert Funds, another well-known SRI firm, lifted its prohibition on owning firms that make weapons. Under the new screening criteria, Calvert's socially screened equity funds came to avoid investing in companies that:

- "manufacture, design, or sell weapons, or the critical components of weapons, that violate international humanitarian law (IHL), or
- manufacture, design, or sell inherently offensive weapons, as defined by the Treaty on Conventional Armed Forces in Europe and the U.N. Register on Conventional Arms, or the munitions designed for use in such inherently offensive weapons."

These new screening criteria forbid the purchase of firms that engage in the manufacture of offensive weapons, which include battle tanks, armored combat vehicles, artillery, combat aircraft, and combat helicopters, warships and missiles. Interestingly, firms that produce pistols, rifles, bullets and similar implements of war can be included in Calvert portfolios, on the grounds that these items can be used in a defensive manner.

In 2008, Calvert also began to permit its funds to hold energy firms with minor holdings in nuclear power, despite the fact that nuclear waste disposal remains an unaddressed challenge for the industry.

The New Face of Sin

If alcohol, tobacco, weapons and nuclear power are no longer strictly categorized as sin, what is? The new face of sin belongs to companies that engage in unethical business practices such as child labor, environmental negligence, or the support of oppressive regimes. In 2008, corporate governance and the environment are both hot topics in the SRI realm, with SRI firms and concerned shareholders pressuring major corporations to institute recycling programs, release records of their stances on environmental issues and put in place independent boards of directors that look out for shareholder interests. (Read on to learn about corporate governance and the environment in *Go Green With Socially Responsible Investing* and *Green Investors Get Heard*.)

When screening for these issues, SRI investment managers may, for example, exclude firms that do business in Sudan, on the grounds that the government of that nation supports genocide and doing business there helps to support the government. Other screens could forbid investing in firms that engage in unsustainable logging practices such as the clear cutting of rainforests, or industries that produce significant amounts of greenhouse gases. (To learn more about investing and environmental issues, read our Green Investing Feature.)

Human rights issues, such as the treatment of indigenous peoples and workplace safety, are also part of the latest evolution of SRI screens, as are product safety issues. These concerns are particularly relevant when investing in emerging markets, where low pay scales, poor treatment of employees and tainted products are more common than in developed nations.

Pick Your Poison

Like beauty, the decision regarding whether something is sinful now seems to be in the eye of the beholder. Investors seeking an old-fashioned, pure play mandate that avoids alcohol, tobacco and firearms can still find it, but SRI advocates now need to take a long, hard look at their investments before they buy based simply on the name of the fund.

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