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403(b) Retirement Plans and Socially Responsible Investments

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HR Management Forum

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It started with what seemed to be a fairly innocent phone call from a faculty member to the Human Resources director at St. Anywhere Catholic College. The professor explained that she recently attended a meeting where some faculty had inquired whether the college's endowments were invested in socially responsible funds. This aroused her curiosity about the college's 403(b) retirement plan - she wanted to know whether the college's 403(b) plan used socially responsible criteria in banning inappropriate mutual funds from its core investment options. The director, fresh from his most recent meeting with the Board of Trustees Finance Committee, explained that only highly rated funds were made available in the plan and that participants could choose from among a number of excellent funds to direct their retirement plan contributions. Moreover, there were at least two available funds in every major asset class. He pointed out that the Board of Director's Investment Committee had taken great strides over the past few years to satisfy its fiduciary responsibilities and that each of the funds in the core investment menu met the college's stringent investment policy criteria. For a mutual fund to be considered for the retirement plan investment platform, it had to have a proven track record of high performance relative to its asset class benchmark, a history of consistent management, and low fees. Not only that, even the funds that were available through the retirement plan were reviewed quarterly by the investment committee. Funds that dropped below the college's investment quality standards were replaced by better-performing funds.

The professor replied that she wasn't referring to investment performance. Rather, she was concerned that some of the key holdings of some of the mutual funds were companies with highly questionable business practices seemingly contrary to the college's mission and Catholic Social Teaching.

He responded that the law is the law and because the college's retirement plan could not be considered a church plan, the plan was subject to the Employee Retirement Income Security Act (ERISA). As such, he explained that the college has a fiduciary responsibility to act in the sole interest of plan participants rather than in the interest of any particular sub-group in the college community with particular political or moral leanings. He further explained that this fiduciary responsibility included the requirement that the investment committee follow prudent investment practices in selecting and retaining funds in order to best protect the participants' retirement accounts. She pointed out that, in terms of pension investments, the law has been gradually recognizing that fiduciary duty may include recognizing that socially responsible screens might increase investment returns. She called his attention to a recent report from the Social Investment Forum that two-thirds of socially responsible mutual funds outperformed their 2009 benchmarks despite last year's economic tailspin. If that was the case, she wondered, would the college's fiduciary role suggest an affirmative duty to offer such socially responsible funds?

The director noted the college does in fact offer employees a socially responsible fund option. He recalled that, among the faculty, this fund was one of the most popular options in terms of the amount of money invested in it. She thanked him for that option, but narrowed her question to whether a Catholic college should have an even higher standard than a generic social investment fund. She noted that Pope John Paul II had written that investment choices were always moral decisions and with the employer matching part of the employee's contribution, did that not impose a moral responsibility on the college? She wanted to know why the college would allow employees to exercise immoral choices or would even invest its matching contributions into such immoral choices. Initially rebuffed by what he took to be a personal critique of his integrity, the director responded that "immoral" is a highly subjective term and that all of the mutual funds were highly reputable. She replied that the United States Conference of Catholic Bishops issued guidelines for socially responsible investing.

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In addition, their pastoral letter, Economic Justice for All, stated, "The ways these resources are invested and managed must be scrutinized in light of their effects on non-monetary values. Investment and management decisions have crucial moral dimensions: they create jobs or eliminate them; they can push vulnerable families over the edge into poverty or give them new hope for the future; they help or hinder the building of a more equitable society." (Par. 92. c.) Although expressing a need to exercise both prudence and justice in developing investment strategies, the guidelines explicitly excluded some investments, called for divestment in others and challenged Catholic investors to actively encourage companies to become involved in certain social justice policies. She saw none of these recommendations incorporated in the 403(b) plan's Investment Policy Statement regarding fund selection, although she acknowledged that the one social investment fund did have a list of screens and did encourage some shareholder activity to change corporate policy.

Although he was aware of the bishop's guidelines, the director countered that first of all, the bishop's guidelines were intended only for the conference's direct investments. The director also argued that investing in a mutual fund is fundamentally different than directly investing in a company. A participant who directs retirement plan contributions into a mutual fund doesn't actually buy direct ownership in the companies whose stock is owned by that fund. Practically speaking, given that a mutual fund's portfolio could consist of shares representing scores of different companies with the mix of stocks constantly in flux, it would be impossible to monitor any fund's underlying investments for nebulous moral criteria. Finally, the director noted that any attempt to screen investments along moral or political lines would run afoul of the college's emphasis on diversity. The institution's faculty and staff held a multitude of political views and religious affiliations on a correspondingly wide range of moral and social justice issues. He feared that it would be impossible to navigate all those choices.

The professor would not relent. She insisted that the fact that the college was utilizing prudent investment practices in selecting and monitoring the funds available to participants in the 403(b) retirement plan did not make these practices sufficient. She went on to argue that the investment options in the 403(b) plan should be additionally evaluated against the college's mission statement that emphasizes the God-given dignity of every human being and education for all to enhance the common good. She noted that the principles in the college's mission statement represented basic values that all the faculty and staff accept simply by virtue of working for the institution. She raised the question of whether the college had a fiduciary duty to act in a manner consistent with its mission.

The director responded that the mission statement provided guidance to the university's academic activities rather than specifically regulating its internal business practices which must follow civil law. "There's the rub," the professor countered, asking whether mission should be pigeonholed in a way that made the university's operational business decisions irrelevant to their impact on society. Would not the director's response fly directly counter to the bishop's concern that investments should further a more equitable society?

She went on to argue that, even beyond the role of mission, the common good must be a primary consideration in all investment decisions. To this comment the director exclaimed that providing excellent investment options to help ensure that employees can retire with dignity promoted the common good most effectively.

Realizing that she was not making any progress, she asked the director if there could at least be some way to let employees know of the business practices they were supporting with their investment dollars. When the director indicated that employees are provided with a prospectus for each of the available funds, the professor replied that this was insufficient. In addition to knowing the major holdings of a mutual fund, plan participants had a right to know how these companies whose stocks comprised those holdings operate in regard to moral and ecological factors: Do the companies manufacture and/or distribute harmful products? Do they operate sweatshops oversees?

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Are they green? Do they manufacture land mines or chemical weapons? Her argument was that if the college's investment committee was going to continue to select and monitor the plan's investment options primarily on the basis of fund performance, then employees should be empowered with information to make morally prudent investment choices based on their own standards. Further, she thought that the college's senior administrators and the board should also be provided with this information because they too were making investment decisions with the college's funds through the plan's matching contributions. The director thought that even this watered-down request was not administratively feasible; however, he was much more comfortable with this informational approach from a fiduciary perspective than he was with a special moral/ecological screening approach. He contemplated whether the professor's reference to the bishop's guidelines might illuminate a course of action using the virtues of prudence and justice to regulate all the competing concerns raised by institutional investment decisions. He ended the conversation by informing the professor that although he very much enjoyed their discussion and appreciated her insights, the plan's investment choices were not HR's responsibility and that she would have to take up this issue directly with the chair of the investment committee who happened to be a faculty member.

In the days following their conversation, the HR director decided to get an opinion from St. Anywhere's Mission and Values vice president on this issue. Should the mutual fund investments available through the retirement plan be screened with regard to fundamental Catholic teachings? If not, is there a moral obligation on the part of Catholic institutions to help employees be informed investors when making individual retirement plan fund choices, such as issuing a human dignity and ecological report card for each of the funds' top five stock holdings? The fundamental question the HR director now had was this: even if the investment committee meets its fiduciary responsibility by ensuring that only quality funds are available to its faculty and staff in its 403(b) retirement plan, is there a yet higher obligation for an institution that professes to be Catholic? Is there?

The opinions expressed in this column are ours alone and do not represent DePaul University's.
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As always, we invite our readers to enter into this dialogue by sharing their thoughts and experiences, as well as their practical and effective solutions, on any of the topics we address in our columns. To facilitate this, we have a blog - http://hr-forum-ccu.blogspot.com/ - where readers can comment on this column or any of our past columns. We encourage your feedback to begin our collective attention to these issues.

We would also like to post links to your mission statements as well as HR and compensation philosophy documents if you would like to share them with our readers. This will permit a fuller discussion of how mission and CST enters into the employment process. Please let us know if you would like us to link to any of your institution's documents.

Among the resources used for this column you may find additional information at the following cites:

Pope John Paul II's commentary on investment as a moral issue was taken from "Centesimus Annus," paragraph 36 (1991): http://www.vatican.va/holy_father/john_paul_ii/encyclicals/documents/hf_jp-ii_enc_01051991_centesimus-annus_en.html (last visited on 2/24/10).

U.S. Catholic Conference of Catholic Bishops: Socially Responsible Investment Guidelines November 12, 2003, at: http://www.usccb.org/finance/srig.shtml (last visited on 2/10/10).

Economic Justice For All, Pastoral Letter on Catholic Social Teaching and the U.S. Economy (1986) can be found at: http://www.usccb.org/jphd/economiclife/pdf/economic_justice_for_all.pdf (last visited on 2/24/10).

A report on developing understandings of fiduciary duty was prepared by the Social Investment Forum in "Investment Consultants and Responsible Investing, Current Practice and Outlook in the United States," December 2009, and can be found at: http://www.socialinvest.org/documents/Investment_consultant.pdf (last visited on 2/10/10).

The report on the 2009 Mutual Funds outperforming their benchmarks came from the Social Investment Forum's Press Release: "Social Investment Forum: Two Thirds of Socially Responsible Mutual Funds Outperformed Benchmarks During 2009 Economic Downturn," January 21, 2009, https://www.socialinvest.org/news/releases/presselease.cfm?id=151 (last visited on February 9, 2010).

For an additional resource on Mission and Socially Responsible Investing, see: Charles Strain, "In Service of Whom? The Impact of Vincentian Universities' Institutional Investment Practices on Global Poverty," Vincentian Heritage, Vol. 28, No. 2 (2008), p.167.