

Making a difference

Gary Hawton left a lucrative job with a discount brokerage firm to become the founding CEO of Meritas Financial, a Cambridge-based mutual fund company that makes investments based on socially responsible guidelines.

Photography | Rainer Leipscher

Investing in a better world

Socially responsible investing is gaining momentum as pension funds, individuals take ethical perspective

By Rose Simone
CAMBRIDGE

Nine years ago, Gary Hawton had what anyone in the financial industry would consider a successful career. The Wilfrid Laurier University graduate was working in the Toronto area, selling investments to high net-worth clients, had become part of the executive management team at a full-service discount brokerage firm and helped start up two discount brokerage houses.

But something was missing. Hawton felt a deep disconnect between the world of finance and his values.

Then, one day, he happened upon an intriguing job ad. Three Mennonite-based organizations — the Mennonite Foundation of Canada, the Mennonite Savings and Credit Union and Mennonite Mutual Aid — were setting up a mutual fund company that would provide products for financial advisers who had clients, regardless of faith, who wanted to invest in companies that behave in a socially responsible way.

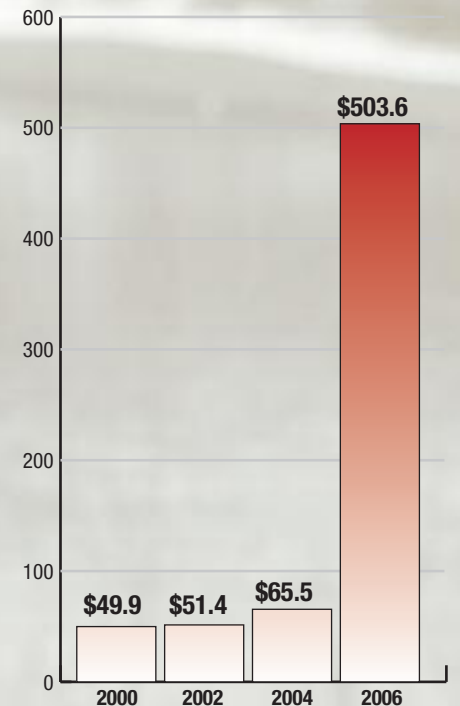
They needed a chief executive officer and although Hawton is not Mennonite, he applied. "I wasn't even looking for a job, but something drew me to the ad and then windows and doors opened up for me," he says.

Soon after, in 2000, with all his office belongings packed in two cardboard boxes, he was leading the launch of Meritas Financial Inc. in Cambridge.

Hawton, a native of Collingwood who now lives in Carlisle, 30 kilometres east of Cambridge, says even at the beginning there were people from many different faiths or no religious affiliation who were

SOCIALLY RESPONSIBLE INVESTMENT ASSETS IN CANADA

In billions of dollars



Source: Social Investment Organization

interested in the Meritas funds.

"The majority of the financial planners who sell our funds are not Mennonite," says the 43-year-old. Their interest was driven by clients who did not want to invest in companies that profit from war, child labour or the destruction of human health or the planet's ecosystem. "This is not about theology, this is about the compassionate side of humanity."

Still, at the time Meritas was formed, socially responsible investing was a niche in the market. Few people knew about »

» it and there wasn't much available to sell to financial advisers and planners.

Since then, the landscape has changed dramatically and socially responsible investing is rapidly becoming mainstream.

Meritas, housed in offices in a non-descript plaza on Hespeler Road, ended 2007 with about \$270 million in assets, more than double the \$138 million it managed a year earlier.

Across Canada, the amount of money invested according to socially responsible guidelines grew steadily but modestly, from \$49.9 billion in 2000 to \$51.4 billion in 2002 and \$65.4 billion in 2004. Then, in the next two years, socially responsible investing exploded, reaching \$503.6 billion in 2006, according to the Social Investment Organization, a Toronto-based association that represents companies and advisers selling these funds.

The entry of large pension funds in socially responsible investing goes a long way toward explaining the explosive growth, says Eugene Ellmen, the organization's executive director. The Canada Pension Plan and Ontario Municipal Employees Retirement System pension plan, for example, have adopted socially responsible investing guidelines in the past two years and are now voting their share proxies accordingly, he says.

It also became easier for individual investors to jump on board after the big banks started offering socially responsible investment products. For example, RBC Royal Bank rolled out three funds based on screening guidelines developed by Jantzi Research Inc., a Canadian leader in socially responsible investment screening. The funds are comprised of companies that are deemed to be the best in their sectors according to environmental, social and governance criteria.

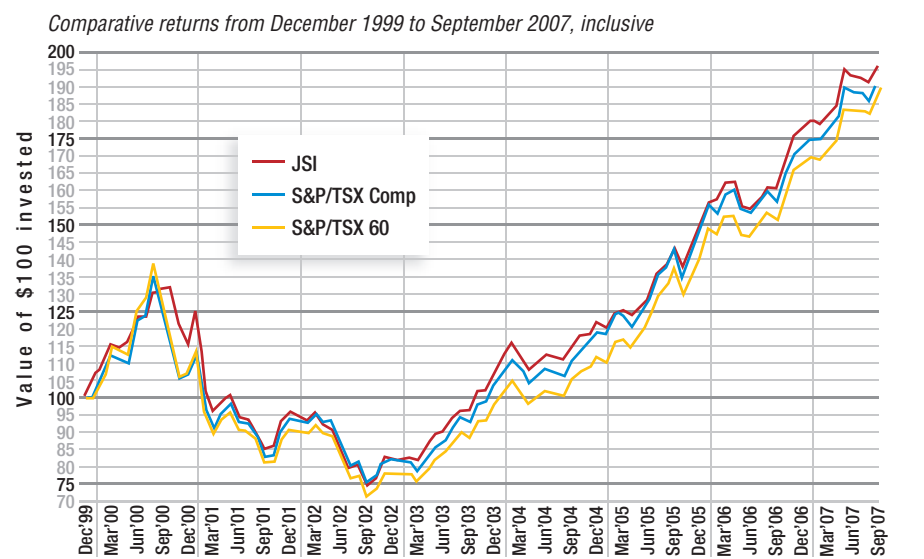
That doesn't mean companies in socially responsible funds are perfect, says Paula Glick, director of sales and marketing at Jantzi Research.

Oil and gas companies, for example, are part of the Jantzi Social Index, a stock index modelled on the Toronto Stock Exchange Standard & Poor 60. To create the index, Jantzi screened out companies on the TSX S&P 60 that didn't meet its environmental, social and governance criteria, and added companies from the TSE Composite Index that met the criteria.

"Yes, oil and gas is damaging to the environment, yet we are still dependent on it and it is a prominent part of the economy," says Glick. "So we don't exclude that sector, but we look for companies that are the best at managing their greenhouse gas

THE JANTZI SOCIAL INDEX PERFORMS WELL COMPARED TO OTHER STOCK INDEXES

The Jantzi Social Index (JSI) is modelled on the S&P/TSX 60 and consists of 60 Canadian companies that pass a set of broadly based environmental, social and governance rating criteria. This chart shows its performance in comparison to the S&P/TSX 60 and the S&P/TSX Composite index.



Source: Jantzi Research Inc.

Chart | Carolyn McLeod-McCarthy

emissions, invest in alternative energy, and are managing their relationships in the communities in which they operate."

There are sectors of the economy that are excluded because of what they do. In the Meritas funds, there is zero tolerance for companies involved in military and weapons contracting, tobacco and alcohol manufacturing, pornography, gambling and the nuclear industry.

Beyond that, socially responsible investment funds are built around companies that are leaders in their industry in areas such as internal governance, labour practices, and social, economic and environmental sustainability.

"Included in that are things like the gender and cultural diversity of the workforce, community relations, product safety, animal testing, executive compensation and a lot of things that most people never think about," Hawton says.

It's not easy to decide which companies are the best in their sectors from a socially responsible point of view, he says. "Some companies will score really high in some areas and frustratingly low in other areas."

Screening companies also is difficult because of the complexity of the economy. It's easy enough to exclude obvious military contractors. But what about companies that sell seemingly benign products and services, such as telephone or computer services, to defence industries?

"If they are selling a generic item to an excluded industry, there is not much we can do, but if we find out that more than

10 per cent of a company's income is coming from contracts with those excluded industries, then we become concerned and consider whether they are vertically integrated in that industry," Hawton says.

"Most companies either have a diverse client base or they don't divulge who their clients are, so we haven't run into that yet, but it is something that we are mindful of."

It's also difficult to determine whether companies in certain sectors are socially responsible. For example, in the electronics sector manufacturing of particular brands is likely outsourced to overseas manufacturers that might have questionable labour and environmental practices.

"We have conversations with those companies about their vendor standards and say to them that just because you have outsourced does not mean you can wash your hands of what those other companies are doing," Hawton says.

Although socially responsible funds are not composed of perfect companies, "we try to own the leaders, and work with them to raise the bar for everyone else in the industry," he says.

Meritas does ongoing reviews and an annual portfolio audit of the companies in its funds. If a company no longer meets its standards, it is dropped and replaced with a different company. For example, Meritas divested its holdings in Magna International because of concerns over a dual-class share structure that allowed Frank Stronach, founder of the auto parts giant, to maintain control over the

company even though he owned less than four per cent of its shares.

There's another way — one unique in the mutual fund industry — that Meritas makes a difference. It invests one to two per cent of its assets in microfinance institutions that make small loans to community development initiatives and businesses started by individuals in developing nations.

Even though it is a tiny amount of money, the impact on communities and the lives of people is beyond anything that can be measured by financial tools, Hawton says. "We have never, to this point, ever had a default on any of those investments. For an individual who has an entrepreneurial mind but no access to capital, to be able to get off a factory line and start a business or perhaps go back to school, it gives them hope."

Socially responsible investing is also changing the larger business world by shattering what Hawton calls the "performance myth" that you can't make money on investments by caring about people and the environment.

Most academic studies show that in the short term, social investment funds can have a bigger variance in performance, for the better or worse, than funds that are not screened. That's because in the short term an excluded company, such as a tobacco manufacturer, might perform well or poorly so eliminating the company affects the comparable performance of the socially responsible portfolio. But in the long term, socially responsible funds do as well if not slightly better than other funds, says Hawton.

Since the Jantzi Social Index was launched in 2000, it "has outperformed both the TSX Composite and the TSX S&P 60, which it was modeled after," Glick points out.

From a longer term perspective, companies that are screened for their environmental and social practices are less likely to become tomorrow morning's headlines for abuses related to child labour, the environment or governance, adds Hawton. "These are companies that are trying to stay ahead of their industry on those issues."

Glick says socially responsible investing is booming because investors are more aware that the social, governance and environmental behaviour of a company can pose a huge risk to the bottom line. For example, there is a risk of lawsuits if a company causes an environmental catastrophe; or it could be hit with fines or extra regulation due to poor safety or labour standards.

Ellmen of the Social Investment Organization says the main challenge for social investment funds is getting companies to report on the factors that socially responsible investors would like to screen for. His organization argues that Canadian publicly traded companies should be required to file to the Global Reporting Initiative, which has established sustainability reporting guidelines. Right now, reporting under those guidelines is voluntary and only a minority of companies are doing it.

"There are leaders among companies that are producing good reports and disclosing more than they are required to. But we strongly believe that the level of corporate reporting is not nearly enough to satisfy what our industry needs," Ellmen says.

With the rise in socially responsible investing, publicly traded companies are being pushed in this direction by shareholders themselves. Meritas will act as shareholder advocate, not only engaging companies in discussions about how they can improve their performance on environmental, social or governance issues, but also taking an active role in submitting and voting on proxies. Resolutions it submits at annual shareholder meetings may call on a company to improve disclosure practices or take more responsibility for an issue. "We will sponsor the resolution and explain, in person, why it is important to us and to all shareholders, and why it should be important to the management of the company," Hawton says.

It's hard to measure the impact of socially responsible investing on companies, but he believes this type of investing is a way individuals can make a difference in the world. "An individual raindrop in a rainstorm may just be a single raindrop," he says. "But when there are millions joining with you, it makes a difference. We don't have millions joining with us yet, but I think that is coming."

Hawton's passion for what he does becomes evident as he speaks. "Halfway around the world, our lives would be so different. To say that you just want to maximize profit and you don't care . . . that is not humanity. That is not justice. That is not how things should be."

Hawton certainly doesn't regret the career change he made nine years ago.

"I have a great feeling at the end of the day that I have accomplished something bigger at Meritas than I could have accomplished anywhere else," he says. "There is a real personal connection here to who I am and how I lead my life that I don't know if I could experience anywhere else." □

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