How to Make Your Retirement Investments Reflect Your Values

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First Published: Jun 12, 2020, 9:00am

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If you could take a deeper look at the investments being purchased with your retirement funds, do you think you'd be comfortable with what you found?

For many people, saving for retirement means little more than contributing to a 401(k) or an individual retirement account (IRA) on autopilot. Many of us choose target-date mutual funds and call it a day.

But there's more to investing than just dollars and rates of return. If you'd like to ensure that your retirement investments aren't supporting activities that are counter to your values, you need to do your due diligence and research your investment choices.

Let’s take a look at the steps you can take right now to ensure your retirement investments are aligned with your values, providing value to your communities.

Understanding Socially Responsible Investing

First of all, take a moment to think about what causes and values you would want your money to support. This includes understanding the connection between your values—for example, environmental activism, social justice or religious beliefs—and what sort of companies your retirement funds are being invested in.

After that, learn about socially responsible investing (SRI) and how it can help you ensure your dollars aren’t supporting companies that don’t align with your values. Depending on their profile, SRI mutual funds would avoid investing in tobacco companies, gun manufacturers or the fossil fuel industry. Ave Maria mutual funds use criteria to screen out companies that promote or support activities contrary to the teachings of the Catholic Church.

SRI has secured a prominent place in investing. Over $12 trillion is invested in SRI assets in the United States, according to the U.S. SIF Foundation’s 2018 biennial report “U.S. Sustainable, Responsible and Impact Investing Trends.” SRI assets have grown at nearly 40% year-over-year since 2016.

And SRI means not only avoiding investments in certain companies, but also actively seeking to invest in companies that actively promote certain values. That’s where ESG ratings come in.

Environmental, Social and Governance (ESG) Standards

ESG stands for environmental, social and governance, a set of socially conscious criteria that a company can choose to apply to its operations. ESG standards rate how a company supports environmental sustainability, how it promotes ethical management practices, leadership, executive pay, audits, internal controls and shareholder rights. Investors can use ESG criteria to screen potential investments.

Gary Matthews, CEO and founder of SRI Investing, a financial advisory firm dedicated to socially responsible investing, explains how SRI and ESG are related.

“ESG is an aspect of, or a way of approaching the construction and management of SRI portfolios,” Matthews says. “It’s a newer, more recent methodology to approach SRI.”

Companies are given ESG ratings by third-party agencies that assess the company's performance and how it compares to others.

The Pros and Cons of ESG Criteria

It's important to note that some investing experts push back on ESG rating companies due to inconsistent metrics and methodologies that can result in widely different outcomes agency by agency. There can be scoring bias depending on what industry the scoring agency specializes in.

"While deficiencies in the process don't render ESG investment meaningless, they do indicate that the agencies' influential findings must be viewed through a critical lens," writes Timothy Doyle for Investor's Business Daily. "It is imperative that investors understand what these ratings are: largely subjective and prone to serious methodological problems. They are not infallible, scientific measures of companies 'doing good.'"

Matthews agrees "to a certain extent" with the concerns that ESG-ratings don't have set standards across the industry. But he argues that investors can do their own due diligence in finding ESG-ratings that are appropriate and fair for their values and goals.

"The investor, I think, wants to know who's behind the ESG ratings," Matthews says. "What is the methodology there? Can I trust the people that are publishing that? Those are legit questions for investors who want to implement SRI for themselves."

Investors should also be aware that while companies can be designed to be inherently "good" by promoting diversity and employee rights, it's important to take a deeper look and analyze any controversial practices it may be employing, like exploiting labor workers in foreign countries or paying women less after childbirth.

Though ESG investing comes with its own flaws, even the big investment platforms are embracing the concept; rightfully so, considering net flows to ESG funds in the U.S. topped $20 billion in 2019, a 300% increase from the year prior, according to MorningStar.

Vanguard, Pimco and Fidelity now offer their own ESG versions of funds, including the Vanguard Global ESG Select Stock (VESGX), which was introduced in 2018. There's also an exchange-traded fund (ETF) that explicitly addresses issues of racial inequality and is backed by the NAACP, the Impact Shares NAACP Minority Empowerment ETF.

https://www.forbes.com/advisor/retirement/values-sri-investing-retirement/

You can find a list of ESG mutual funds via the Forum for Sustainable and Responsible Investment.

How to Responsibly Balance Your 401(k)

If you make contributions to an employer-sponsored 401(k) retirement plan, your contributions are generally invested in mutual funds, index funds or target-date funds. These funds may buy securities issued by hundreds or even thousands of different companies.

The funds available to you in your 401(k) are limited by the plan's administrator. Only 2.9% of all 401(k) plans have ESG funds, according to the Plan Sponsor Council of America's most recent study. That means your money could very well be parked in companies that don't align with your values.

If you find that your 401(k) does not offer any ESG-rated funds, you can opt to customize your investments through a brokerage window, also known as "self-directed brokerage option." This DIY-approach allows participants more investment options than the mutual funds offered by the retirement plan directly. After opening a brokerage window, investors can focus their money in companies that support their values.

If you choose to opt for a self-directed brokerage option with your 401(k) plan, be aware that it comes with challenges. A plan sponsor can limit choices offered through brokerage windows, and these windows can come with maintenance fees and higher than average trading costs.

Investors interested in exploring a brokerage window option should work with a financial advisor to determine a strategy that will be both cost effective and efficient for their investing goals.

How to Advocate for More ESG-Rated Options in Employer-Sponsored Plans

There's another approach you can take if your company's 401(k) doesn't offer any ESG-rated options. You can initiate change by advocating for better, more socially conscious investment options in your retirement plan.

Start by enlisting colleagues who share the same desire for more ESG-rated options, and then bring your case to human resources. Be ready for pushback; many employers don't want to include funds that don't have proven track records.

Be ready to counter any arguments with evidence that ESG-focused funds have few to no financial trade-offs compared to traditional funds. There's strong statistical evidence that ESG funds are actually more stable, according to this 2019 analysis by Morgan Stanley.

Initiating a conversation with your employer about why ESG-rated funds are an important option, and then maintaining the dialogue can pave the way for including these investment options for you and your coworkers.

How to Responsibly Balance Your IRA

Individual retirement accounts are tax-advantaged retirement accounts. Unlike 401(k)s, individuals can open IRAs on their own and make contributions whether or not they have a separate workplace retirement plan available to them.

In most cases, there are broader investing options available for IRAs than with 401(k)s. If you open an IRA with an online brokerage account, you can seek out socially responsible ETFs or mutual funds with ESG ratings that help verify they fit your values.

Fidelity, for example, has an ETF screener with filters to help investors find and compare SRI funds. Schwab also has a Socially Conscious Funds List that includes companies that meet MorningStar's socially conscious criteria.

The Pros and Cons of Robo-advisors for IRA Values Investing

Investors who don't want to sort through compiled lists can open an IRA account through a robo-advisor, which handles fund selection for you. Wealthfront and Betterment, two popular robo-advisors, offer dedicated SRI portfolios. Wealthfront's SRI portfolio, for example, includes ETFs that pledge low carbon exposure and support for human rights around the world.

Sam Adams, CEO of Vert Asset Management, says most SRI offerings from robo-advisors are a great way to get the word out about SRI and help investors understand how it works and how they can get involved in it.

"I think the number of people who need an individually attuned portfolio is smaller than a lot of people assume," Adams says.

There's also the issue of how often robo-advisor SRI portfolios are evaluated. Jill Fopiano, president and CEO of O'Brien Wealth Partners, warns that robo-advisors that offer more limited SRI portfolios risk including companies that aren't closely watched to ensure they're actually living up to responsible and ethical standards.

"My concern with a robo-advisor in the ESG world is that a company that's claiming to be ESG has to be monitored for it's 'ESG-ness' on a frequent basis to make sure it doesn't deviate from that," Fopiano says.

Bottom Line

Saving for retirement is a necessary step in your financial journey, but many people might not be aware of what their retirement portfolios are investing in. The current options for socially responsible investing are ambitious, but not perfect. For now, SRI investors should remain skeptical of ESG ratings while also working to make sure their investments align with their values and make a difference in the world.