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Don't Expect These ETFs to Spark a Price War

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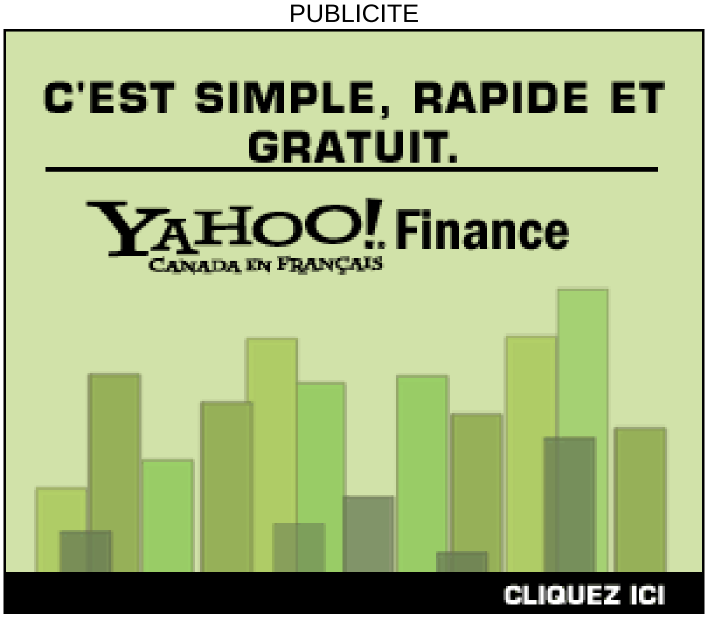
By Dan Culloton

Competition from low-cost exchange-traded funds helped spur Fidelity Investments to slash prices on its in-house index funds earlier this month. Will the advent of socially responsible ETFs have the same effect on SRI index funds? Not in the near future.



The deals that most SRI index funds offer aren't horrendous, but they could be better. The average expense ratio for a passively managed SRI equity offering is under 1%. Still, funds such as Citizens 300 (Nasdaq:CFCDX - News), Domini Social Equity (Nasdaq:DIEQX - News), and MMA Praxis Value Index (Nasdaq:MVIAX - News) are much more expensive than mainstream stock index funds. Those offerings could use a run for their money, but there currently are no SRI ETFs on the market to do so. That could change soon, but it's not yet clear whether the SRI ETFs seeking regulatory approval will put any pressure on SRI firms to cut their funds' expenses.

There are now scads of ETFs, such as iShares, StreetTracks, Spiders, and Vipers, offering investors a cheaper way to get exactly what Fidelity offered. This threat is what prompted Fidelity to respond with lower costs. The SRI ETFs proposed so far (at least two have registered with the SEC this summer) don't present the same challenge, however. They won't offer investors the same exposure as existing open-ended funds and they won't offer it for rock-bottom prices either. Furthermore, it's far from certain that these new SRI ETFs, PowerShares Wilder Alternative Power Technologies Portfolio and the iShares KLD Select Social Index Fund, will prove to be compelling alternatives.

The PowerShares ETF will track the WilderHill Clean Energy Index, which is made up of publicly traded companies seeking to tap the wind, sun, water, waste, hydrogen fuel cells, and other technologies for environmentally friendly sources of energy. It's likely to include a lot of

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small speculative companies with products that may or may not prove to be commercially viable, so it could be pretty risky.

The iShares fund will track the KLD Select Social Index which, unlike most socially responsible benchmarks, doesn't rule out any industry--except tobacco--on social grounds. Instead it picks and ranks about 350 stocks from the S&P 500 and Russell 1000 based on their "social and environmental performance," according to bogy's creator, KLD Research & Analytics. The fund could resemble the Domini Social Index, whose Domini 400 benchmark is also assembled by KLD. About half of the top-10 holdings of the Domini 400 and the KLD Select Social overlap. Still, the new fund won't be an exact duplicate because KLD Select Social weights its constituents according to their social and environmental ratings, rather than their market caps.

Even if these new funds provided some head-to-head competition, they would not be the cheapest SRI index funds. PowerShares' July filing didn't include an expense ratio but says it plans to collect a 2% sales charge on shares bought during the funds subscription period. Also, if the 0.6% annual cost of two other PowerShares ETFs already on the market is any guide, the new fund's expense ratio won't be a screaming bargain.

Meanwhile, iShares KLD Select plans to charge a 0.5% expense ratio, according to its regulatory filing. That's cheaper than the average socially responsible index fund by about 0.20 percentage points, and is less expensive than the biggest socially responsible fund, Domini Social Equity (Nasdaq:DSEFX - News). However, it's about double the cost of peer Vanguard Calvert Social Index (Nasdaq:VCSIX - News).

When you factor in commission costs, these ETFs will be far from the low-cost leaders in the SRI realm. Furthermore, considering that the existence of four-year-old Vanguard Calvert Social Index has yet to incite an SRI price war, it may be too much to expect that the arrival of a couple of untested ETFs would convince higher-cost SRI index funds to budge on expenses anytime soon.

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