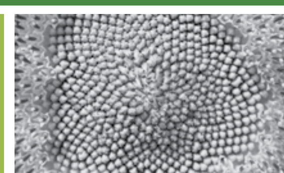
CBIS
Christian Brothers Investment Services

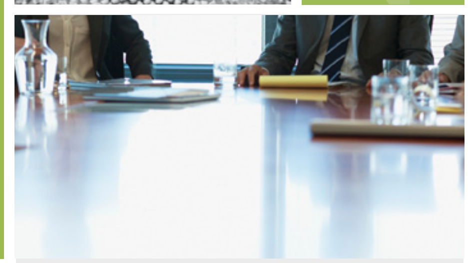
CATHOLIC RESPONSIBLE INVESTING

Being a Catholic Fiduciary

How to Better Integrate Faith & Finance and Advance Your Mission

The rapid growth of the socially responsible investment movement in the 1980s and 1990s produced an expanded notion of fiduciary responsibility. Today, many religious and lay fiduciaries integrate social and religious beliefs into investment strategy in order to support positive social change while seeking to achieve superior long-term portfolio returns.





- Recognizing the potential for abuse, exploitation and violation of human rights when economic life is lived separately from spiritual life, the Catholic Church offers a rich tradition of ethical and social teaching that seeks to unify the demands of faith and finance in a spiritually engaged capitalism. Throughout its writings, the Church makes clear that justice is an essential aspect of our economic activities.
- A Catholic view of fiduciary duty draws on the potential for wealth creation offered by contemporary capitalism, modern portfolio theory and global capital markets, but goes beyond to integrate into the investment process the core beliefs that all Catholics share.

Summary

How Catholic fiduciaries can integrate faith and finance to enhance their institution's mission, promote human dignity, economic justice and environmental stewardship, while supporting long-term portfolio return.

In the Pastoral Letter *"Economic Justice for All"* and its ten-year update *"A Catholic Framework for Economic Life"* the U.S. Conference of Catholic Bishops(USCCB) writes:

"All economic life should be shaped by moral principles. Economic choices and institutions must be judged by how they protect or undermine the life and dignity of the human person, support the family and serve the common good. Workers, owners, managers, stockholders and consumers are moral agents in economic life. By our choices, initiative, creativity and investment, we enhance or diminish economic opportunity, community life and social justice."

Through these and other writings, the Bishops give voice to a powerful idealized vision of a humane capitalism, one that offers broad-based appeal to individuals of conscience around the world. They call for Catholics to be advocates for a just and sustainable economy, one in which economic benefits and costs are shared broadly and fairly, and one that meets the needs of the current generation without compromising the ability of future generations to meet their own needs. However, financial fiduciaries at Catholic institutions face a more immediate and pragmatic mandate. They must invest an institution's assets in a manner that targets the risk-adjusted return necessary to achieve its financial goals and fund its unique mission, an equally important and complementary aspect of the larger global mission of the Catholic Church.

For some fiduciaries, the Bishops' vision may appear to conflict with the demands of institutional finance. But the reality is just the opposite. Indeed, the legal framework that governs the interpretation of fiduciary responsibility has evolved in recent years to acknowledge that ethical principles can play a constructive role in investment strategy. Fiduciaries at religious and secular institutions are now integrating environmental, social and corporate governance (ESG) considerations into portfolio management in order to align their institution's beliefs with the management of its assets while harnessing the influence they possess as shareholders to promote corporate policies that advance economic justice. And they are achieving investment performance that is competitive with recognized benchmarks and peer group returns.

Moreover, many prominent secular institutional fiduciaries now advocate for a vision of portfolio stewardship similar to that described by the Bishops, but one founded primarily on economic necessity. As stewards of institutions whose life spans are measured in decades, these investors recognize that economic justice is a crucial underpinning of healthy and growing markets, vibrant global trade, and the strong, sustainable profit growth that drives superior investment returns. This is especially true as globalization creates promising long-term investment opportunities in emerging market nations that often lack Western traditions of human rights, environmental laws and shareholder rights. And a growing number of institutions are incorporating the analysis of ESG factors directly into the stock selection process, firmly believing that this improves their ability to identify companies who will outperform competitors over the long term.

While some fiduciaries concern themselves primarily with short-term portfolio return, a Catholic fiduciary takes a broader and perhaps a more rewarding view. Becoming a Catholic fiduciary is not a difficult process. It requires only thought and guidance. We hope this publication inspires the former and offers the latter.

Section One Summary

THE ROLE OF THE FIDUCIARY

- A fiduciary is someone tasked to oversee the prudent management of another's assets. The interpretation of this mandate has evolved over time.
- During the 1960s and 1970s, religious and lay fiduciaries began to include ethical considerations in portfolio management — divestment from South Africa was one well-known example — as a matter of principle and as a means for effecting social change.
- The rapid growth of the socially responsible investment movement in the 1980s and 1990s produced an expanded notion of fiduciary responsibility. The legal framework that governed fiduciary duty affirmed that ethical considerations can play an important role in portfolio stewardship.
- Today, many religious and lay fiduciaries integrate social and religious beliefs into investment strategy in order to support positive social change and achieve superior long-term portfolio returns.

Merriam-Webster's Dictionary of Law defines fiduciary as "one often in a position of authority who obligates himself or herself to act on behalf of another (as in managing money or property) and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation." Fiduciary duty is defined as "a duty obligating a fiduciary (as an agent or trustee) to act with loyalty and honesty and in a manner consistent with the best interests of the beneficiary of the fiduciary relationship (as a principal or trust beneficiary)."

A HISTORICAL PERSPECTIVE

An important formal articulation of fiduciary responsibility was coined fairly early in American history. In 1830, the Massachusetts Supreme Court defined the "prudent man rule," which instructed the stewards of institutional and family assets "to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." Even today, the standard of a prudent man, as articulated in 1830, remains a widely used benchmark for evaluating fiduciary performance.

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A contemporary description of fiduciary duty for institutional investors comes from the U.S. Department of Labor, which says that the primary responsibility of retirement plan fiduciaries is "to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. . . They also must avoid conflicts of interest. In other words, they may not engage in transactions on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, service providers or the plan sponsor."

These definitions, and their interpretation over time, established a conceptual framework for the role of the fiduciary that discouraged speculation with assets and prohibited self-enrichment at the expense of beneficiaries, but one that did not specify whether or how ethical considerations might be incorporated into the stewardship of the plan's investments.

THE GROWTH OF ETHICAL STEWARDSHIP

Beginning in the 1960s and 1970s, fiduciaries at many religious organizations adopted an approach to investing that sought to reconcile the teachings of their faith with the management of their assets. They began to use the power of their pooled capital to bring ethical concerns to the board rooms of corporate America, and they began to selectively avoid investment in companies whose business activities conflicted with their core institutional beliefs.

In the 1980s, for example, many religious and public institutional investors divested from their portfolios the stocks of companies with business ties to South Africa as a statement against apartheid. Many people believe that apartheid's collapse was in no small measure a result of the influence wielded by these institutions, who felt a social responsibility to stand up and demand that American corporations not support such an assault on human dignity.

While religious investors initiated the socially responsible investing movement in the United States, its broad appeal to individuals of conscience and its success at effecting change drove it far beyond its religious roots to become one of the fastest-growing segments of the investment management business over the past two decades.

Clearly, SRI could not have achieved success of this magnitude were it incompatible with the structuring of prudent, diversified investment portfolios and the achievement of competitive market returns. And the considerable body of academic research that analyzed and compared the performance of SRI programs with their non-SRI equivalents confirmed this. But the legal interpretation of fiduciary responsibility took some time to catch up with the growth of SRI.

AN EVOLVING CONCEPT

A watershed moment came in 1998, when in response to a query from SRI investment manager The Calvert Group about the inclusion of SRI funds in private retirement plans, the Department of Labor wrote:

". . . it is the view of the Department that the same standards set forth in sections 403 and 404 of ERISA governing a fiduciary's investment decisions . . . apply to a fiduciary's selection of a "socially-responsible" mutual fund as a plan investment or, in the case of an ERISA section 404(c) plan, a designated investment alternative under the plan. Accordingly, if the above requirements are met, the selection of a "socially responsible" mutual fund as either a plan investment or a designated investment alternative for an ERISA section 404(c) plan would not, in itself, be inconsistent with the fiduciary standards set forth in sections 403(c)and 404(a)(1) of ERISA."

With this interpretation, the consideration of non-financial criteria in the investing process was deemed to be consistent with fiduciary responsibility as applied to retirement plans, as long as it did not conflict with the institution's overall investment strategy.

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In 2001, a group of leading business academics and institutional fiduciaries working under an initiative called The Global Academy sought to evolve an expanded concept of fiduciary responsibility, one that could better promote the interests of both institutional investors and society as a whole. The Global Academy recognized that institutions, by virtue of the scale of their collective investments, have enormous influence over financial markets and global business practices. According to the Global Academy:

" . . . the integration of prudent financial management practices with principles of environmental stewardship, concern for community, labor and human rights, and corporate accountability to shareholders and stakeholders — which until recently have not been considered relevant to the financial decision-making process — constitute in fact a single bottom line. In order to guarantee long-term sustainability, to minimize long- and short-term financial risk, and to identify investment opportunities, and thereby increase shareholder value, the definition of fiduciary responsibility has to evolve."

This perspective clearly repositioned the relationship between ethics and investing. Ethical considerations were no longer suspect as potential impediments to investment success, nor were they merely tolerated as neutral counterparts to investing. Instead, they were viewed as essential elements in the search for superior risk-adjusted, long-term performance.

THE BUSINESS CASE FOR ETHICAL STEWARDSHIP

Many institutions have adopted the notion of fiduciary duty articulated by The Global Academy and frame SRI primarily through the lens of finance. In the U.S., large institutional investors such as the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTERS), the State of Connecticut and the New York City Employees' Retirement System (NYCERS) were some of SRI's early adopters. And the movement has gone global. Public pension plans in the U.K., France, Germany and Canada now incorporate analysis of environmental, social and governance (ESG) factors in the investment process. Even some traditional asset managers, such as Morgan Stanley, Hermes Asset Management and Goldman Sachs, integrate varying degrees of ethical criteria into their investment activities.

These investors strongly believe that companies who hold themselves to high social and environmental standards are often better-managed than those that do not, and generally make better investments. They also believe that these standards,if applied across the economy and around the globe, will help cultivate the strong and sustainable economic growth that, in turn, will produce the highest possible long-term profit growth for portfolio companies and the optimal risk-adjusted returns for institutional portfolios.

Many religious investors share this point of view. An important goal for both faith-based and secular socially responsible investors is the promotion of a just and sustainable economy, one that shares the benefits of capitalism broadly and fairly, and that meets its needs without compromising the ability of future generations to meet their needs. Religious investors believe that this serves fiduciary duty for two primary reasons.

The first is that help from corporations can decrease the burden on religious organizations that serve unmet social needs and that function as safety nets for individuals and families in need. A Catholic hospital, for example, serves as a provider of last resort for those who cannot otherwise afford healthcare.

Globally, Catholic charities care for victims of economic injustice, human rights abuse, civil conflict and environmental degradation, problems that are often concentrated in low-income communities and low-wage nations which struggle to benefit from economic globalization. Promoting justice and sustainability at portfolio companies may influence the very nature of global economic development, and reduce the burden placed on charitable institutions over the long-term, if indirectly.

The second is that, in the long run, irresponsible corporate conduct can reduce portfolio returns for diversified investors. Most institutional portfolios include holdings across a broad cross-section of the economy. And long-term portfolio returns depend primarily on the strength of the economy as a whole, not on the performance of individual companies. A company that increases profits by imposing costs on society does not serve shareholder interests as understood by socially responsible investors. Irresponsible business practices simply move those costs from one area of the portfolio to another. Therefore, the scope of fiduciary oversight of institutional portfolios should include holding managements accountable for a responsible disposition of these costs.

As we are all stewards of God's creation, it is our responsibility to nurture, respect, preserve, and protect the planet as a resource for all, including future generations. The Investor Network on Climate Risk (INCR), for example, is a network of more than 110 institutional investors representing more than $13 trillion in assets committed to addressing the risks and seizing the opportunities resulting from climate change and other sustainability challenges. The mission of these investors is to mobilize other investor leaders to address climate and sustainability risks, while building low-carbon investment opportunities.

For years, social and faith-based investors have called upon companies to better monitor production processes at overseas factories to ensure product quality, health and safety, and labor rights.

The toy company Mattel once discovered many of its products that had been imported from China were highly defective — including some children's toys colored with lead paint. It subsequently issued massive recalls of many of its products at great cost, and too late to prevent long-lasting damage to its reputation.

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The oil giant BP had experienced a series of health and safety problems that led many investors to shun the company. The explosion at BP's Deepwater Horizon drilling rig killed 11 workers and leaked 200 million gallons of oil into the Gulf of Mexico is considered the worst environmental disaster in the U.S. and impacted the residents and economies of five states. BP is estimated to have paid more than $50 billion in claims, fines, and clean up costs, and the disaster had a significant impact on the company's market cap.

Newmont Mining publicly recognized the need to improve how it interacts with local communities around its mining sites, acknowledging a pattern of local opposition that impacted its ability to operate efficiently. However, insufficient progress engaging local communities and addressing their concerns resulted in strong opposition to Newmont's Conga mine in Peru, and subsequent clashes between local community members and the police resulted in the deaths of five protesters. Work on the $4.8 billion mine, one of Newmont's largest, was suspended.

In each of these cases, companies made decisions that served short-term financial interests — by reducing costs or increasing revenue — while elevating longer-term risks. Investors with long-term time horizons, such as most religious institutions, want companies to be mindful of the longer-term view as well.

It should be clear that the definition of fiduciary has always been somewhat fluid. Neither the courts nor the legislature have defined it with a precision beyond the mandate to invest prudently and avoid self-enrichment. Otherwise, the concept has evolved and expanded considerably since the 1830 Prudent Man rule, and it will likely continue to evolve over time.

Section Two Summary

A CATHOLIC APPROACH TO FIDUCIARY DUTY

- Recognizing the potential for abuse, exploitation and violation of human rights when economic life is lived separately from spiritual life, the Church offers a rich tradition of social teaching that seeks to unify the demands of faith and finance in a spiritually engaged capitalism.
- Throughout its writings, the Church makes clear that justice is an essential aspect of economic activities. By employing the principles and strategies of ethical stewardship, institutional investing becomes a tool of the Church's mission, not merely a supporter of it.
- The Church gives shape to the relationship between its larger mission and economic life through the foundational principles of her social doctrine: the common good, the purpose of material goods, participation in society, solidarity, the dignity of work and subsidiarity (decentralized or localized responsibility).
- The guiding principles articulated by the larger SRI community — which consists of both lay and other religious institutional investors — often compliments our own CRI principles.

The Catholic Church has been a consistent supporter of investment in a market economy and praises the market based-system for allowing people to make choices and fulfill their human potential, yet it also recognizes the potential for abuse, exploitation and the violation of basic human rights when economic life is lived separately from spiritual life. The economy exists for the human person, not the other way around. As such, in order to establish the essential unity of these facets of life, the Church offers a rich tradition of social teaching that begins with the Apostles. Pope Leo XIII 's "Rerum Novarum" includes subsequent papal teaching, the documents of Vatican II (particularly the four constitutions that are the hermeneutical key to the other documents) and the contemporary writings of the Bishops of the United States have developed and further articulate the social doctrines of the Church. Noting this heritage, the United States Conference of Catholic Bishops (USCCB) in its statement "A Century of Social Teaching" remind us that:

"Our faith calls for us to work for justice; to serve those in need; to pursue peace; and to defend the life, dignity, and rights of all our sisters and brothers. This is the call of Jesus, the challenge of the prophets, and the living tradition of the Church."

As Catholics, we approach this work mindful of the Incarnation — that God is present in the world, and it is good — and we are comfortable with the Gospel taking us into the world of investing because it is a part of that Creation that God makes Holy. As Catholic fiduciaries, we have the opportunity not only to use our assets to support the mission of the Church but to invest them in ways that further promote that mission. By employing the principles and strategies of ethical stewardship, we make our investment activity itself a tool of mission, not merely a supporter of it. Pope Paul VI explored this theme in "Ecclesiam Suam":

"All things human are our concern. We share with the whole of the human race a common nature, a common life, with all its gifts and all its problems. We are ready to play our part in this primary, universal society, to acknowledge the insistent demands of its fundamental needs, and to applaud the new and often sublime expressions of its genius. But there are moral values of the utmost importance that we have to offer it. These are of advantage to everyone. We root them firmly in the consciences of men. Wherever men are striving to understand themselves and the world, we are able to communicate with them."

In "Sollicitudo Rei Socialis," Pope John Paul II further tells us:

"The teaching and spreading of her social doctrine are part of the Church's evangelizing mission. Since it is a doctrine aimed at guiding people's behavior,it consequently gives rise to a commitment to justice, according to each individual's role, vocation and circumstances."

And in "Centesimus Annus" the Popereminds us that:

"The new evangelization which the modern world urgently needs, and which I have emphasized many times, must include among its essential elements a proclamation of the Church's social doctrine."

The "Pastoral Constitution on the Church in the Modern World," Gaudium Et Spes, provides an ecclesiological foundation for the Church's social ministry. The vision that emerges from that pivotal document, and indeed from the Second Vatican Council, is a socially engaged one. The Church's defense of the human person, advocacy for the poor and calls for justice are central to a community of faith properly engaging society in a discussion based beliefs. An important passage in that Pastoral Constitution states:

"And so the Council, as witness and guide to the faith of the whole people of God, gathered together by Christ, can find no more eloquent expression of its solidarity and respectful affection for the whole human family, to which it belongs, than to enter into dialogue with it about all these different problems."

Throughout its writings, the Church makes clear that justice is an essential aspect of all our economic activities, including stewardship of Church resources. As stewards, we invest resources to achieve a return that supports the ministries of the Church. But we must also do this in ways that are consonant with the other dimensions of the Church's mission.

Section Four

CONCLUSION

A Catholic view of fiduciary duty draws on the potential for wealth creation offered by contemporary capitalism, modern portfolio theory and global capital markets, but goes beyond to integrate into the investment process the core beliefs that all Catholics share. Catholic fiduciaries adjust their thinking and their investment strategies to the true projected life-span of their institution. They make a commitment to learn about the long-term risks associated with ignoring environmental, social and governance factors when selecting portfolio investments, and they recognize the long-term economic case for applying the power of their pooled capital to promote human dignity, economic justice and environmentally sustainable global economic growth.

They use the techniques of ethical stewardship to speak their beliefs in the marketplace. They not only incorporate these beliefs into investment decisions, but participate in the life of companies they own by actively engaging management on issues of concern to Catholics. They remain mindful of the impact, and potential impact, of their investments on human beings around the world.

Catholic fiduciaries believe that integrating Catholic teachings into the investment process is not contrary to fiduciary responsibility but supportive of it. We have the opportunity to participate in the market and to utilize it to carry out our fundamental mission: to preach the Gospel. We have the capital to bring the mission of the Church to the world of investing and the tools to give voice to the Gospel in the way corporations conduct business around the world.