Italian Episcopal Conference

Episcopal Commission for Charity and Healthcare Services
Episcopal Commission for Social Issues and Work, Justice and Peace

THE CATHOLIC CHURCH AND MANAGING FINANCIAL RESOURCES USING THE ETHICAL CRITERIA OF SOCIAL AND ENVIRONMENTAL RESPONSIBILITY AND GOOD GOVERNANCE

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INTRODUCTION

In addition to being a duty, today it is actually possible to manage economic and financial activities ethically.

For religious entities, this is a challenge and an opportunity.

In this light, this document is intended to serve as an invitation for the Italian Church to continue its courageous progress towards transparency and disclosure in its economic activities.

This is not only consistent with evangelical teachings but is a "necessary action" for those who operate thanks to charity or public funding, becoming an even more compelling responsibility in terms of preventing harmful management of economic assets and the scandals that would result.

We hope this document will serve both as a compass and a guide for religious organisations and their administrators called upon to manage economic assets in the best way possible, in accordance with ethically sustainable purposes, focussed on the principles of the Gospel.

Rome, 25 February 2020

Episcopal Commission for Charity and Healthcare Services.

(H.E. Mons. Carlo Roberto Maria Redaelli, Archbishop of Gorizia, Chairman)

Episcopal Commission for Social Issues and Work, Justice and Peace.

(H.E. Mons. Filippo Santoro, Archbishop of Taranto, Chairman)

1. *Economic and financial activities in accordance with the teachings of the Catholic Church*

1.1 Overview

The Holy See's approach to finance and economy was recently expressed in the document "*Oeconomicae et pecuniariae quaestiones*" (OPQ). Prepared by the Congregation for the Doctrine of the Faith and the Dicastery for Promoting Integral Human Development, it was approved by Pope Francis on 6 January 2018, with the goal of offering certain "considerations for an ethical discernment on some aspects of the current economic-financial system". Developing the theme of the relationship between ethics based on Social Doctrine (SD) documents, "to liberate every realm of human activity from the moral disorder that so often afflicts it, the Church recognizes among her primary duties the responsibility to call everyone, with humble certainty, to clear ethical principles"[1]. "Therefore, the proper orientation of reason can never be absent from any area of human activity...or impermeable to ethical principles based on liberty, truth, justice and solidarity"[2]. The text continues, "The recent financial crisis might have provided the occasion to develop a new economy, more attentive to ethical principles, and a new regulation of financial activities that would neutralise predatory and speculative tendencies and acknowledge the value of the actual economy"[3]. The document expresses an invitation to "develop new forms of economy and of finance, with rules and regulations directed towards the enlargement of the common good and respect for human dignity along the lines indicated by the social teachings of the Church".

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1 *OPQ 3:* In order to liberate every realm of human activity from the moral disorder that so often afflicts it, the Church recognizes among her primary duties the responsibility to call everyone, with humble certainty, to clear ethical principles. The shared human reason, that ineffaceably characterizes every person, demands an enlightened discernment in this regard. Moreover, human rationality searches, in truth and justice, for the solid foundation that sustains its operation and maintains its sense of direction.

2 *OPQ 4*

3 *OPQ 5*

At the same time, it urges “ethical reflection on certain aspects of financial transactions which, when operating without the necessary anthropological and moral foundations, have not only produced manifest abuses and injustice, but also demonstrated a capacity to create systemic and worldwide economic crisis”[4]. These words put down in black and white, as the saying goes, a tragic situation that also impacts our Italian Church. In sharing this issue and worry, we take on the entire ethical and value structure in the Holy See document, with the guidelines it contains, as a shared foundation of principles to use as the starting point for identifying concrete actions able to guide any investment. These activities do not need to be aimed solely at achieving profit, but must necessarily and simultaneously work towards ethical and socially responsible purposes.

Already in the past, the Italian Episcopal Conference (IEC) took action on this issue, publishing three documents, prepared by the National Office for Social Issues and Work: ““Etica e Finanza” [Ethics and Finance] (2000), “Finanza internazionale e agire morale” [International Finance and Moral Action] (2004), and “Etica, Sviluppo e Finanza” [Ethics, Development and Finance] (2006), where, in part due to globalisation and digital technologies, finance takes on a new role, within other human activities. The various contributions initiate reflection on the main economic and social questions, taking the financial aspect as the reference point. These documents offer an approach which aims to teach responsibility, inspired by faith and the Church's Social Doctrine, identifying general criteria that can help in evaluating attitudes and actions. Already in these documents, it can be seen that the real economy, to which finance is theoretically secondary and subservient, is often disregarded and, therefore, also undervalued, especially its social aspects, by financial activities which are self-referential and focussed on mere speculative profit.

[4] *OPQ 6*

The rapid acceleration driven by globalisation has unequivocally driven the access of new "emerging" countries to economic growth, thereby increasing the distribution of wealth produced by the world's population.

On the other hand, it has granted full freedom of action to the "spirit animals" of the markets, supporting morally unacceptable actions and generating further imbalance between the Global North and South. The consequences of this "deregulated" situation was the outbreak in 2007 and 2008 of the most significant economic and financial crisis in history in terms of the number of countries involved, asset values compromised and jobs lost.

Taken from a multidisciplinary analysis, we offer a comment on the causes of this immense depression, much larger than the one known as the Great Depression of 1929:

"The present financial emergency was reached after a long period where reason nodded off, during which, driven by the immediate objective of pursuing short-term financial results, the actual dimensions of finance were neglected. Its true nature was forgotten—to guide the use of saved assets where they can support the real economy, the well-being and development of all humans and all humankind. Both facets of the current crisis, the emergency generated in the developed markets and the chronic inadequacy of resources going to support real development, raise an unavoidable moral question. To avoid moralism, which tends to focus on the behaviour of others while the speaker absolves themselves, it is enough to honestly remember that the current crisis occurred after a decade which saw the blossoming of conversations about ethical business and the practical adoption of ethical codes. This tells us that the ethical side of economics and finance is not just an accessory, but is essential. It is born within these environments. In fact, ethics is always an expression of an anthropology and a culture."[5]

[5] *Various Authors. Lezioni per il futuro: le idee per battere la crisi [Lessons for the Future: Ideas for Combating the Crisis], pg. 106, pub. Il Sole 24 Ore*

1.2 Good works through finance: What are the perspectives?

The theme of financial investments can be examined through three perspectives:

1) the first is one which claims a clear distinction and a consequent relationship between “ethics and finance”. In this view, ethics represents a combination of limits to “humanise finance”. This expression, frequently used at conferences and seminars, has the obvious merit of highlighting the distinction which exists between the two areas, but is only able to express their connection in a negative manner, in the form of a juxtaposition.

2) The second perspective is that of “ethical finance”, according to which there is an “ethical” approach, placed in opposition to a “non-ethical” approach. In this case, “ethical finance” would indicate a virtuous sector of finance, in opposition to a “non-ethical” sector. This view is reductive, because all finance must be ethical, otherwise it is simply speculation.

3) The most appropriate expression, which adheres to the expectations expressed by the teachings and, more generally, the Social Doctrine of the Church, is “the ethics of finance”. The preposition “of” is very important in that it indicates that ethics belongs to finance, is something that it possesses and that comes from inside of it. It is not added after the fact, but comes from an inner need within finance to pursue its objectives, given that in the end finance is also a human activity. The same preposition also outlines an area of ethics, finance, making it clear that the field of ethics is wider than the field of finance. The task set for our document—to define ethical and socially responsible criteria to apply in the field of investments—cannot disregard the taking of responsibility by all believers involved in this area. This is a responsibility that becomes clear in the face of the actions of an individual who obtains or grants loans with excessive ease, for example; of one who does not adequately

inform investors; one who sells opaque derivatives, hiding one inside another and concealing the risk. And what can we say about the shadow banking system, which works to render ineffective the international regulations introduced by specific and various supranational authorities, not yet sufficiently organised and empowered? The Compendium of the Social Doctrine of the Church refers to this problem when asking to identify “institutional solutions” and a “regulatory framework” to ensure people operating in the financial system take on adequate responsibility. Consequently, to identify a foundation of ethical principles to be adopted by those using financial instruments, it must be remembered that, in finance, when things do not go as planned, the causes frequently are not to be found in the investment instruments, but in the system which guides them, using the predominant cultural models. This occurs when the objective of maximum profit is pursued, entirely in contrast with any other ethical motivation which centres the common good and the enhancement of humans.

We are therefore speaking of a cultural challenge, a push towards utopia, for those who want to continue to believe, as active citizens, in a better world. In effect, going beyond rhetoric, moral responsibility and the need for virtue involve every person, with the awareness of their ability to influence reality in order to improve it. To that end, there are no exceptions which can relieve us from responsibility.

1.3 The recipients

Through history, there has been much reflection on the relationship between the Church and its assets, with discussions that have often been controversial. However, a non-negotiable principle continues to be the universal allocation of these assets. The Church requires funds to stably support its services, from liturgy and catechism to charity. It therefore must be able to acquire, hold, manage and sell assets, in order to guarantee financial coverage for its activities. Ecclesiastical assets, not existing as a goal unto themselves, require financial managers to face the challenge of diligently carrying out their tasks while, at the same time, being particularly aware of the elevated ethical requirements of the Church. In other words, they must be aware of their financial decisions and demonstrate that the Church carries out its tasks with care and responsibility, including in financial aspects. In fact, contradictions between teachings and actions are also to be avoided in financial investments.

Naturally, in an ever more globalised world, the Church may need to make use of investment options within the international financial markets. However, to protect its credibility, it cannot worry solely about how to make use of profit, but must also raise questions about how its investments create that profit. Investing ethically and sustainably is a choice dictated not only by financial aspects, but also by the ethical, social and environmental effects and consequences. Numerous administrators, appointed to manage the Church's assets, already invest the resources entrusted to them in this way, with the intent of applying Christian values in investment decisions as well.

This document illustrates the current status of socially responsible investing at the international level, generally known as ESG - SRI (Environmental Social Governance - Socially Responsible Investing), from the initial experiences through to the current phase of rapid growth. It aims to serve as a tool to guide and educate, to be used by the financial managers working for dioceses, parishes, religious and charitable foundations, congregations, associations and other religious entities. It should be seen as a combination of guidelines with regard to the most common investment tools and choices on the market. The institutional nature of the entities at which it is aimed is not limited to the ecclesiastical field, as it can also serve as a tool for private individuals who desire to use the principles of the Catholic Church as guidelines for how to operate in finance in a manner consistent with evangelical values.

Identifying “good practices” for investing, the principles that inspire them, investment management objectives based on ESG - SRI purposes and supporting their spread in and outside of the Catholic world becomes an incredible opportunity for testimony in and for the Church, based on the fundamental values of truth, freedom, justice and solidarity.

2. Investing responsibly: a choice and a duty

2.1 General investment criteria and current situation for ESG - SRI instruments

In the face of a new frontier for finance, we ask how we can restructure our investments as a function of social needs and requirements. It is easy for anyone to see that we live in an era of significant change, which in turn may lead to environmental and climate problems, scarcity of natural resources, social inequality and difficulties in accessing essential goods and products for a large part of the population.

The economic development and cultural models we want to work with are those of the free market and of business freedom, exercised under the rule of a law, with real competition and fair profits, which all economic activities must generate. This economic system must protect the natural and socio-cultural environmental eco-systems and respect fundamental human rights, so as to place value on the existence and contribution provided by every human being. Adopting shared governance systems, politically expressed in a democratic manner, thereby respecting minorities and their diversity, all economic/financial activities must pursue sustainable development based on the principle of subsidiarity, focussing not just on profit, but mainly on the common good.

This leads to the identification of practices which revise the concept of responsible investing, starting from figures that indicate the current status and research offers, to integrate the principles already shared and applied by companies with our own. In reality, companies follow various strategies, including those with specific value-related criteria. These may include quality and safety of products, CO_2 emissions, anti-corruption systems, how employees are paid and how diversity in the workforce is treated. In practice, companies make different choices which depend on the context in which they operate, and this is very important for investors. This is information which goes beyond financial figures. It is very important and must be considered when making investment decisions so as to understand a continually changing dynamic. Many investors, both private individuals and institutions, make use of the international ESG principles issued by the United Nations (PRI - United Nations Principles for Responsible Investment). This means that when investment decisions are made, securities are favoured, whether equity or debt-based, and whether issued by public or private entities, which promote actions that work to protect the environment, respect human, social and labour rights in their economic activities and make use of shared good governance management systems. It also means having the possibility to serve as active shareholders, participating in Shareholders' Meeting and voting, making contributions to ensure that company policies are increasingly ESG compatible.

The amount of assets under management for companies supporting socially responsible investments is increasing exponentially. In 2010, around 500 companies throughout the world subscribed to the international ESG principles, for global capitalisation of $ 20 trillion. At the end of 2018, there were nearly 2000 companies and over 81.7 trillion in assets managed.

The most common practice for investors, above all in Italy but also in Europe, is the use of black lists, which identify securities that should not be invested in. Frequently, these lists identify entire sectors, e.g. fossil-fuel based energy producers or gambling companies. A much more sophisticated selection method, which identifies the merit associated with an individual issuer, could potentially be obtained by integrating economic and financial data with a company's behavioural data in terms of ESG criteria. The qualitative analysis deriving from this is must more significant in terms of determining investor decisions. In fact, mere exclusion does not lead to efficient management of investments, in that a black list serves only as passive self-limitation. However, an incredible opportunity is created when the investment process is supported by the addition of information associated with the environment, social issues and good governance. If financial reporting is analysed, a practice which was fairly recently adopted and generalised among investors (in the 1980s and 90s), we find that we are working in an environment bombarded with financial information. Econometric data is made available by all financial operators, and the amount and quality has improved significantly from 2000 on thanks to developments in the IT and communications technology now available. Consequently, with such vast informational resources available, the markets are able to be quite efficient in determining the prices of individual securities and in foreseeing their ability to generate better or worse returns over time. The more this information is shared and strengthened, the more difficult it is to identify arbitrage positions on the markets (possible sales/purchases of securities with margins) or diversification between one security and another, necessary conditions for generating a financial differential for the transaction.

2.2 ESG investments: content and issues

The development of socially responsible investing has only recently begun a similar process, in which the gathering of information about the ESG actions of companies, even when rapidly expanding, is still organised in a “pioneering” manner, not always in a structurally homogeneous and orderly manner, as it involves amounts of data which are quantitatively much greater than those associated with mere financial reporting. In an environment where there are no general accounting standards and where the publications regarding this information are still somewhat incomplete, these objective difficulties lead to notable market inefficiencies.

This change is essential for investors in that the ethical and socially responsible actions of businesses are not yet evaluated in a precise manner by the markets, meaning that stock market prices underestimate this value, making them ideally placed for future arbitrage and with a good probability of producing greater value.

The growing availability of ESG data will, over time, strengthen the position of a greater number of issuers sensitive to it (at present, they represent 65% of global capitalisation for listed companies). From this last figure, it can be seen that ESG analysis derived from and has mainly developed as a means for selecting equity-based securities and/or bonds issued by corporate issuers. Only later did it expand to also include debt securities issued by governments.

Following the ever greater availability of information, standards to assess ESG aspects are becoming stronger. Sector by sector, business by business, the most important characteristics for generating value are being identified. For example, in the mining sector, it is important to have data about water consumption and availability, while in the technology and financial sectors, data security is decisive. The Sustainability Accounting Standards Board (SASB) has created a chart identifying the most important factors to be considered for each sector. Sizeable resources have been invested to create this infrastructure. Now, through processing large information archives, investors receive, sector by sector, value drivers and figures to be monitored and taken into consideration when making investment decisions.

The ever greater availability of ESG screening leads to “engagement”, which translates to investors having the ability to affect the operating decisions of a business. This may occur directly, through active participation in Shareholders' Meeting and strategic and operating proposals, or indirectly, by increasing or decreasing the stock market price achieved by the issuer by buying or selling shares.

One additional consideration: in general, we tend to underestimate the role of listed companies, considering them as something small with respect to the population of their respective countries. In some ways this is an unfounded prejudice, in that, on the contrary, these companies are more significant than is thought. The 500 largest companies in the world account for almost 50% of total market value, 40% of the workforce, 60% of investments in research and development and more than 50% of income produced. Therefore, if we do not develop our ability to track value growth also in terms of social impacts, integrating this information into investment decisions, it is difficult to imagine any type of permanent progress.

Lastly, it should be emphasised that ESG analysis mainly derived from a means to select equities and bonds issued by companies. Recently, this same tool has been extended to government debt securities which, in relation to certain important ESG principles in the social and governance areas, may have aspects which are more or less in line with these principles. This means it is increasingly possible to rate the public debt securities issued by national governments, subjecting the decisions and actions of these governments to the same ESG principles.

2.3 Investing in an ethically and socially responsible manner

To appropriately define an ESG - SRI investment, we must first ask ourselves: what is the primary task an asset manager must accomplish? James Tobin, a Noble Prize winner for economics, effectively summarises the answer by responding, “They are the guardians of the future, against the claims of the present”. For the Church, this means managing assets, received over the years through charity, respecting the intentions of the donors, who provided these goods for the needs of the Christian community, in particular for the poor.

Ensuring the continuity of these assets over time, while also using some of them to meet the needs of the present: meeting these two needs defines the quality of a good manager over time and, consequently, their goal, which is no longer merely creating economic value, but also includes an ethical component.

The objective of an ESG - SRI investment cannot be solely expressed as a quantitative economic result (the return), but must simultaneously express a qualitative relationship (represented by risk)[6].

So, how can we improve the quality of our investments while also ensuring the risks in the portfolio are monitored, excluding none of them?

2.4 ESG analysis and market risks

When selecting an investment, an individual shareholder and an institutional investor both need to properly consider the risk/return ratio of the financial instruments, to be combined with an ethical assessment, the social responsibility of the individual issuer.

As ESG analysis has developed, it has become clear that investments—in order to generate development and lasting returns over time—must first of all respect the conditions of equilibrium relative to the environment, social aspects and governance. When compared with other types of financial instruments, the most recent data demonstrates that ESG instruments perform better than less socially responsible instruments. The former, given that they focus on the common good and are more consistent with the rules of good governance, are less likely to be involved in legal disputes or to suffer severe economic fines.

6 Cross reference: risk means all factors which could potentially negatively impact assets, either from a qualitative or quantitative point of view. This includes issuer risk, interest rate risk, foreign exchange risk, country/geographic area risk and liquidity risk. Last but not least is reputation risk relative to the investor, who may find themselves in difficulty, including economic, if their portfolio contains securities not compatible with their values, as expressed in the Code of Ethics.

Therefore, the selection of financial instruments for investment cannot skip over a comprehensive assessment of the instruments in question, including fundamental risk analysis and other information that is not strictly economic, such as that offered by ESG benchmarks. Institutional investors, above all, having the task of best preserving and managing the assets merely entrusted to them, must provide themselves with appropriate controls for their portfolios relative to all points of view.

In fact, evaluation of financial instruments is not done merely by examining economic returns. It must always include an assessment of the risk/return ratio. Every investor is called upon to select financial instruments that are compatible with their risk profile and, therefore, make their own allocation decisions, taking into account the intended use and end goals for the assets.

Evaluating the risk/return ratio is essential for protecting future profit levels as well as average variability in returns over time, a factor which is closely correlated with the risks affecting the portfolio. Therefore, in order to invest well, it is always necessary to carefully assess the transparency, prudence and consistency in results, as well as the care with which assets are preserved, above all during market corrections.

Careful monitoring of the risk/return level of the portfolio is also an essential factor in ethical and socially responsible investing. It would be inconsistent to desire to make ESG-compatible investments without being able to depend upon proper management.

2.5 How to invest in ESG instruments

What tools do investors have available to make socially responsible investments?

In recent years, the financial industry has seen significant growth in the range of products offered (mainly mutual funds and Exchange Traded Funds - ETFs), as well as in specific strategies (e.g. renewable energy, greenhouse gas reduction, water savings) and in amounts managed. In fact, an Assogestioni survey found that assets invested in ESG - SRI funds in Italy have risen from € 1 billion in 2008 to € 8.5 billion at the end of 2017. Every investor is also able to invest in individual securities. However, the information necessary for in-depth analysis of ESG behaviour within individual companies is not always easily obtained. For this reason, collective investment tools are preferred, such as ethically and socially responsible mutual funds and ETFs.

To further analyse financial instruments available, ETFs passively replicate a market index, ensuring wide risk diversification and low management fees. On the other hand, active funds offer a basket of selected securities with good historic performance, but have higher management fees.

Many investment agencies offer both types of instruments.

The ETFs currently found on the market are mainly equity-based and offer a great deal of variety in terms of selection criteria, ranging from issues linked solely to the environment (low carbon ETFs, renewable energy ETFs, water consumption ETFs, etc.) to social aspects (number of women in the company, respect for workers' rights, combating gender discrimination, etc.), as well as more generic themes, which screen out individual sectors or activities in which a company is involved (excluding securities of companies which produce alcohol, tobacco, non-conventional arms, gambling, etc.).

This means an investor is theoretically able to select investments from a wide and differentiated range of possibilities. However, in practice, it is difficult to identify which instrument best meets their own ethical requirements, as there are no standard methods of applying ESG principles. There are a number of application platforms, using various methods but based on the same principles, proposed and developed by notable and qualified ESG providers on the basis of experience, created by investing resources to collect information and keep it up to date. However, it is still difficult to compare these various systems, which analyse enormous amounts of data that only continues to grow. Additionally, it is very difficult to find instruments that apply the specific ESG principles proposed by the Church's Social Doctrine relative to those which apply more generic ESG principles.

For these reasons, despite the fact that the market for ESG instruments is healthy and constantly growing, there appears to be a need for an authoritative indication of the criteria to be adopted to allow all investors (private and institutional) to invest in accordance with the teachings of the Church.

Hence, the objective of this document is to create the conditions and technical tools required to support investment using ESG criteria which are consistent with evangelical values. Constant monitoring and updating will be summarised and certified over time through the creation of a listed ETF index, made available to the markets and all investors, whether professional or not.

3. Managing Church assets ethically, based on ESG criteria

3.1 The Church is also an economic and financial entity

The Church's mission is to spread the Word, consistent with the values of truth, freedom, justice and solidarity. Actions which are in contrast with the teachings and testimony create severe discomfort for the faithful, with possible negative consequences, including economic, which are difficult to quantify. This is what is referred to as reputation risk which, like all other types of financial risk, must be carefully managed.

All economic activities cannot aim merely to produce income and earnings but, as we have seen, must also comply with the principles of sustainability based on ESG analysis: sustainability in terms of the environment, social aspects and governance (ecological, fair and sustainable). For the Church, the inclusion of a fourth aspect is of fundamental importance: ethical, in line with its principles.

"Ecological" means the responsibility of taking care of creation, not only by protecting the environment and natural resources, but also protecting the socio-cultural and religious context. "Equitable" means the responsibility of living together with justice and peace, offering development and prospects for both current and future generations. "Sustainable" refers to the inviolability of human dignity and respect for the civil, social, cultural and religious rights of every individual, which are compatible with meeting the needs of the present without compromising the possibilities for future generations. "Ethical" means the desire to pursue all three ESG aspects, working to achieve the ultimate goal of integral human development with an eye to the common good.

For believers, it is essential that investment choices meet all four of these requirements. This is the prospect for an integral ecology proposed by Pope Francis in his encyclical "Laudato si".

3.2 Models of responsible management

To manage and promote ESG investments on financial markets, various methodologies have been proposed, which an investor may adopt to match the objectives of instruments with their own ethical standards. Recently, a large number of investors and/or market operators have chosen to adhere to the list of ESG principles proposed by the UN (PRI - United Nations Principles for Responsible Investment). This document defines 17 objectives for ESG investments:

- no poverty;
- zero hunger;
- good health and well-being;
- quality education;
- gender equality;
- clean water and sanitation;
- affordable and clean energy;
- decent work and economic growth;
- industry, innovation and infrastructure;
- reduced inequality;
- sustainable cities and communities;
- responsible consumption and production;
- climate action;
- life below water;
- life on land;
- peace and justice strong institutions;
- partnerships to achieve the goal.

More traditional methods used in the past included:

- the indication of criteria used to exclude sectors or individual economic operators, with behaviour in contrast with ESG principles. This precludes investment in companies which engage in controversial activities (black lists);

- the application of basic principles in line with ESG issues and commonly accepted by public opinion, *de facto* identifying a standard practice, even if not officially established or imposed by a higher authority recognised by the markets.
- Best in class method: this means creating a list which selects the best companies, either by sector or in general, at the top of the list with regards to ESG classifications, achieving constant and progressive improvements in the investment portfolio.
- Identifying single issue investment themes and/or strategies can support the growth of instruments more consistent with ESG principles. For example, the issue of water consumption, CO_2 production caused by industrial activities, energy consumption and savings or fighting against market approaches of consumerism. Experience has taught that this method is mainly applied to environmental sustainability issues.
- Engagement: investors work to create dialogue within a company in which they hold a minority stake by exercising their voting rights at the Shareholders' Meeting, to achieve improvements in the actions of directors with regards to social, environmental and governance issues.

4. *Guidelines for investing responsibly.*

4.1 *How Catholic inspiration promotes ethical sustainability in ESG investments*

Beyond environmentally sustainable investment strategies, there are other areas that the Church can include under ESG objectives, including protecting life and human dignity in all its forms, supporting the emancipation of female workers, supporting families with children and associated welfare policies, reducing the production of weapons, pursuing economic justice and encouraging corporate responsibility. To establish a level of needed authority relative to these sectors, believers must find significant support from:

- the Teachings and/or Social Doctrine of the Church;
- a policy document approved by the Bishops and distributed through the Italian Episcopal Conference.

4.2 *Inclusive criteria*

Careful identification of ESG criteria is also and especially accomplished through a process of continuous updating, also necessary to create best practices and to identify, among varied investment choices, those most consistent in terms of ethics and sustainability (best in class). The availability of increasingly in-depth analysis and information about companies, sectors and, recently, also for governments and laws, have assisted the spread of ethically shared ESG criteria and initiated a debate around the welfare policies of sovereign states. This creates an opportunity for the Church as well to apply ESG principles not just to investments, but also by including them in its institutional functions: pastoral ministry, catechism and education and charitable work. Additionally, it is important to carefully examine the possibility that the Church's actions carried out through its various institutional structures—IEC, dioceses, parishes, etc.—could more actively be involved in development projects within the country. For example, this could include infrastructure, the creation of welfare services or new technology research, thereby assisting in the creation of new jobs or investing in infrastructure projects in developing countries. Recent studies, carried out in cooperation between the Universities of Venice and Vienna, societal progress, to be qualitatively measured and quantified, must satisfy the following fundamental needs and rights: housing, work, education, public service, waste disposal and the circular economy, community, personal and social rights, mobility and free time. Offering concrete responses and solutions in these areas means applying ESG principles, working for the good of both individuals and communities.

4.2.1 Social compatibility criteria

This involves:

- supporting companies which take responsibility for their own working conditions and those of third-party companies within the client/supplier system, working against discriminatory practices;
- supporting fair wage and assistance policies, accompanied by precise guidelines with reference to worker safety;
- offering active support for shareholder resolutions aimed at protecting and promoting human rights;
- choosing companies that provide continuous training to their employees;
- selecting companies that support pregnant women and parents, offering direct support to workers and families and indirect support through infrastructural projects (housing, nurseries, etc.);
- preferring companies which have established guidelines regarding employees' right to assemble, working hours and minimum wages;
- encouraging companies to report economic/financial results in a transparent manner, including social benefits directly and

indirectly obtained (Social Responsibility Report) and the environmental impacts of their activities;

• developing direct control by stakeholders over the social responsibility guidelines adopted by companies;

• supporting the development of local economic activities which meet the basic needs of communities without waste or redundant consumption, with a willingness to make use of cooperative business systems to better challenge international markets.

4.2.2 Ecological criteria

In this area, both public and private entities can be evaluated, by:

• selecting companies that work to reduce the consumption of raw materials, water, energy and to reduce emissions of pollutants;

• selecting companies that develop and promote the use of renewable energy sources, supporting and undertaking reasonable and effective initiatives for energy savings and to develop alternative renewable and clean energy sources;

• committing to apply policies that offer incentives to companies that reduce harmful emissions and assistance to workers affected by harmful past practices;

• supporting shareholder resolutions that encourage MNCs to work to protect the planet's environmental assets, to reduce poverty in the poorest countries, focussing development in terms of quality rather than quantity in the industrial sector, and creating technology which is sensitive to environmental needs;

• rewarding companies that have created their own environmental directives or have implemented a specific environmental management system;

• following the indications provided in "Laudato si" with regard to climate change, supporting companies which, working in the fossil fuel sector, have a business plan to reorganise and transform towards renewable energy sources, or which are investing in research and development to reduce CO_2 emissions. On the other hand, excluding companies involved in serious environmental disputes which have not planned any conversion projects or initiatives to reduce harmful emissions.

4.2.3 Equity criteria

- Supporting companies which provide better work/family balance.
- Implementing company policies regarding wage parity, promotion opportunities for women and adjustments for legitimate family needs; supporting the active participation of women in corporate life, in particular in terms of policies and decision making, and inclusion in leadership positions.
- Supporting companies that promote measures for development of infrastructure, construction of schools or the construction of water and electricity systems in all regions.
- Rewarding companies that develop or produce products with a sustainable life cycle (e.g., using sustainably extracted raw materials, selecting biodegradable ingredients, etc.).
- Promoting companies that guarantee medical assistance for workers or which research diseases not yet fully understood.
- Supporting investments in companies with programmes intended to make life-saving medicines available to those living in low-income communities and countries.
- Promoting positive stories in the communications world which communicate the importance and beauty of the human experience in all its aspects: personal, social, cultural and religious.
- With regard to weapons, it is absolutely necessary to decrease the production of arms to what is strictly necessary (e.g. those provided to police or regular infantry) and to replace the concept of "weapons as an offensive tool towards someone or something" with a new paradigm of "a system of personal and collective defence". This type of formulation makes it necessary to identify processes to convert weapons production capacity to other non-military production so as to not penalise the employment sectors involved.

4.3 Exclusion criteria

In general, the exclusion of a company from the possibility of investment does not occur due to a basic rejection of the entire business, but indicates that the investor does not intend to invest based on an ethical/sustainable motivation for one of its activities. Companies listed on stock markets have corporate structures which differ greatly from each other. This means that, within a given corporation, there may be individual fields of business that an investor rejects for a particular reason. Widespread practice in the financial industry establishes a limit of ten percent of total company turnover as the cut-off for not directly excluding the company from the possibility of investment. In these cases, it is preferable to use engagement as a tool for direct dialogue with the company, with the aim of limiting or eliminating the ethically non-compatible activity.

4.3.1 Protection of life

Below are certain sectors in which investments should not be made:

1. Abortion: the investment policy establishes the absolute exclusion of investments in companies whose activities include direct involvement or support for abortion. For example, this includes companies which produce abortifacients or public healthcare companies which provide abortions.
2. Contraceptives: investments cannot be made in companies which produce or sell contraceptives with abortifacient effects.
3. Stem cell research: investments cannot be made in companies which carry out scientific research using human foetuses or embryos which:

- determine the end of prenatal human life;
- make use of tissues deriving from abortions or other activities which determine the end of human life;
- violate the dignity of a developing life.

The specific activities covered by the policy will include:

a) embryonic stem cell research (ESCR);
b) foetal tissue research;
c) human cloning.

4. Arms production and sale: the Church's Social Doctrine condemns any use of arms, whether conventional or not, and works to fight against the serious distortions deriving from excessive and disproportionate military spending. On the other hand, weapons in and of themselves are recognised as a tool of defence, for example those used by the police to guarantee public order. For this reason, investment in companies which produce non-conventional weapons will be prohibited, such as biological and chemical weapons, nuclear weapons and weapons of mass destruction, as well as landmines. However, an exception for special examples with defence purposes will be possible.

5. In general, with reference to research, new experiments or new research and services developed will be assessed on a case-by-case basis.

4.3.2 Supporting human dignity.

- Discriminatory stances: investments shall not be made in companies or countries with discriminatory policies in terms of race, culture, religion, gender and/or in companies involved in serious disputes with regard to discriminatory stances.
- Pornography: investments will not be made in companies directly or indirectly involved in the production or distribution of pornographic material, even if it does not exceed the limit of 10% of turnover.

- Corruption: one of the greatest hindrances to sustainable development is corruption. Condemned by the Church, it is one of the biggest causes of underdevelopment and poverty. Corruption leads to growing disparity because it harms the collective good by favouring individuals. It is an issue seen not only in all sectors of society, but also in many countries. There are benchmarks for the level of corruption within countries that can be taken into consideration to combat it, starting from evaluating the appropriateness of investing in the securities issued by the same. Companies involved in disputes with regards to corruption will be excluded from possible investment.
- Death penalty: no investments will be made in countries which apply the death penalty.
- Totalitarian regimes: totalitarian regimes and military dictatorships destroy the individual character of citizens within a society. Human life is not able to develop freely and the division of power is suppressed. Additionally, the concentration of power within individuals or small groups of people also suppress the necessary development of civil obligations. Therefore, investment in government bonds issued by countries which international bodies identify as totalitarian and/or dictatorships will be excluded.

There are also other issues which merit differential assessment but do not always lead to exclusion, rather an evaluation of the possible negative social effects caused by instrumental use, personal responsibility and behaviour in these contexts.

Among these sectors, we note:

- Gambling, which can create addiction and is to be excluded in the following forms: bets, on sporting events and otherwise, slot machines, casinos and online casinos[7].

7 National lotteries and similar games are not considered to be gambling.

- The addictions caused by tobacco and alcohol represent a danger for human life, often create social marginalisation and, based on the level of consumption, can create a threat to life. The Church sees addiction as a disease which destroys lives and involves heavy social costs for the collective. Despite this, responsible and limited use of tobacco and alcohol can be acceptable, and therefore these sectors will not be excluded. It is not the product in and of itself that creates the problem, but improper use.

4.3.3 Support for economic justice

- Work standards and work organisation: it is not appropriate to invest in products or companies involved in disputes or with negative responsibilities relative to work and/or all individuals involved in managing the company (stakeholders).
- Fraudulent and non-transparent banking practices: credit institutions and financial institutions involved in serious disputes due to non-transparent practices and/or involvement in fraudulent practices must be excluded.

4.3.4 Environmental protection

- In the context of classic economic activities (agriculture, industry, services), a strategic role is played by the care taken with agricultural/industrial processes, with special attention paid to the role of farmers and fair wages.
- Coal: investment in companies involved in the extraction, use and production of energy based on coal is excluded.
- Pollution: investment in companies involved in significant disputes regarding pollution is excluded.

4.3.5 Protection of animals

Animals are part of creation and therefore fall under the protective responsibilities of humans. Experiments on animals classified as useful and necessary are those which substantially fall within the field of medicine and the pharmaceutical industry, contributing to healing and saving human lives and, therefore, governed under the law. Therefore, investments which directly or indirectly support experiments on animals for other reasons are not allowed, for example those carried out as general practice in the cosmetic sector, or genetic experiments.

4.3.6 Sustainability of investments.

Investment in companies with a low sustainability rating is prohibited. Among other reasons, these may possibly lead to losses, as they are potentially subject to court cases involving liability, to fines or other legal actions.

4.4 Engagement

Already introduced above, engagement is another important tool available to investors to support ESG principles. This refers to active influence exercised on the company by shareholders, representing either the equity stake held or, in the case of bondholders, the loans subscribed. This influence is exercised through voting rights and, frequently, by participating in the company through its statutory bodies (Board of Directors, committees, Shareholders' Meetings).

The effectiveness of engagement mainly depends on the quality of the company’s corporate governance system. The more transparent and sophisticated it is, the greater the degree of influence stakeholders can exercise. Fully taking advantage of this type of control and guidance requires investors to have specific skills, with actual experience not particularly widespread among religious entities.

Engagement by religious institutions must substantially be based

on criteria of social, environmental, ethical and equity compatibility. Respecting these means long-term improvement of the company's ability to create added value while, at the same time, allowing it to better comply with its social responsibilities.
Good corporate governance, therefore, is not only required for investee companies, but is a fundamental objective for religious entities, called upon to support transparency and disclosure, publishing their own economic results (financial statements, accounts, certifications) and documenting the ways the resources entrusted to them are used.

Glossary

Arbitrage

This is a transaction that involves acquiring a commodity or financial asset on a market and selling it on another market, taking advantage of price differences to obtain profit.

Active shareholding or hard engagement

Refers to active participation by shareholders, individually or in a coalition, relative to the companies in which they invest, with regards to social, environmental or governance issues. This generally involves making speeches, presenting resolutions and exercising voting rights at Shareholders' Meetings.

Asset Allocation

Asset Allocation is the process which determines an investment strategy in reference to the expected risk/return ratio in order to best satisfy one's objectives. Once the benchmarks to be used as parameters are established, financial instruments (money market instruments, government securities, bonds, shares, funds, etc.) and individual securities are selected which make the investment decision concrete.

Central Bank

A Central Bank is an institution which, by order of the government, manages the circulation of money and supervises technical regulations for the banking system.

Custodian Bank

A Custodian Bank is a bank in which the sums invested by investors are physically deposited. When any securities investment is made, the money is deposited in a current account held by the management company with a Custodian Bank. The Custodian Bank is also responsible for monitoring the transactions carried out by the management company, verifying the congruence of transactions with investment regulations.

Basis points

A Basis Point is 0.01%. For example, if rates rise from 5.75% to 6%, this translates to an increase of 25 basis points.

Benchmark

A Benchmark is an objective parameter, frequently an index, which mirrors the investment profile in terms of objectives and risk, used as a reference to assess the performance of one's investment choices.

Best-in-class

An approach which selects or weighs issuers in a given portfolio based on environmental, social or governance criteria, favouring the best issuers generically, within a category, or within an asset class.

Bid-Ask Spread

The Bid-Ask Spread indicates the difference between the best sales and purchase prices present in negotiations for a security. The difference between the bid and ask cannot exceed certain levels, set by the market authority.

Big Data

The term big data refers to a collection of data so large in terms of volume, speed and variety so as to necessitate specific technology and analytical methods to extract value. The term is used in reference to the ability to extrapolate from, analyse and identify relationships within an enormous quantity of heterogeneous data, structured and otherwise, with the intention of identifying links between various phenomenon and foresee future ones.

Social Responsibility Report or Sustainability Report

The document through which a company provides information about the activities, performance and strategies associated with the social and environmental impacts of its business.

Securitisation

Securitisation refers to the conversion of similar and non-negotiable transferable securities, such as mortgages or bonds, to transferable securities which can be traded on the market.

Cash Flow

Cash generated (revenues and contingent assets) from an investment or activity for a given period of time, from which cash outflows are subtracted (costs and expenses).

Stem Cells

Stem cells are primitive unspecialised cells with the ability to transform into various other types of cells in the body through a process known as cellular differentiation. They are studied by researchers working to cure certain diseases, taking advantage of their ductility. Stem cells can be obtained from various sources, such as the umbilical cord, the amniotic sac, blood, bone marrow, the placenta, adipose tissue and dental pulp.

Embryonic and Foetal Stem Cells

Stem cells can be divided into 2 types: embryonic and foetal stem cells and adult stem cells (also known as somatic). Embryonic stem cells are those found in the embryo. Current science holds these to be of great interest, but usage poses serious ethical questions, in that extraction involves destruction of the embryo. Foetal stem cells are extracted from foetuses resulting from miscarriages or abortion. Ethical problems derive from abortion. On the other hand, adult stem cells can be found in many tissues and organs in the human body. They can be extracted from an adult human and reimplanted in the same person, avoiding issues of incompatibility.

Management Fee

The Management Fee is a cost applied as payment for managing the transferable securities held in a portfolio and represents the percentage of total assets which the management company retains. In the case of asset management, while management fees still have the same meaning, they are generally calculated on a quarterly basis and clearly expressed, increasing clarity for the investor.

Performance Fee

The Performance Fee is the commission retained by the management company exclusively based upon the results achieved by the portfolio. The percentage is generally commensurate with the increase in the value of assets with respect to the increase recorded in a reference parameter. This reference parameter may be a benchmark or another parameter, such as inflation.

CSR

An acronym for Corporate Social Responsibility. Indicates the combination of strategies, policies, practices, actions and initiatives that a company may implement to improve management of the social and environmental aspects of its business, and therefore improve its social and environmental performance. The term sustainability is frequently used as a synonym for CSR.

Default

An inability to comply with payment due dates for debt or to comply with a given condition established in an agreement.

Derivative

A Derivative is a financial instrument whose value depends on the value of another asset known as the Underlying Asset. Future and forward contracts, options and swaps are all types of derivatives.

Diversification

Subdivision of an investment into various securities, funds and bonds from different industries in order to reduce total risk.

Downgrade

Downgrade is a term which indicates the worsening of an opinion issued by a merchant bank regarding a given security or worsening of the credit rating issued by a ratings company for a company or government.

Duration

Measures the residual duration of a bond, assessed solely for financial purposes. It is obtained by calculated the weighted average of the due dates on which coupons will be received and the capital will be repaid. The benchmark decreases as the real maturity of the loan draws closer, while it increases as coupons decrease. Referred to as *Durata Media Finanziaria* in Italian.

Engagement

Indicates dialogue with investee companies, carried out by sustainable and responsible investors, intended to influence the actions of companies and improve their social, environmental and governance performance. It is referred to as “soft” when speaking of conversation and meetings, even repeated, between investors and companies. It is referred to as “hard” when speaking of investor participation at annual general meetings (AGMs) to make speeches, present resolutions and exercise voting rights.

ESG

An acronym for Environmental, Social and Governance. Indicates the three dimensions considered in sustainable and responsible finance. At times used as a synonym for SRI.

ETF

ETF is the acronym for Exchange Traded Fund. These are indexed funds listed on the market. The objective of an ETF is to faithfully replicate the risks and returns of a financial index, the reference benchmark.

Extra-financial (or Non-financial)

Term often used as a synonym for ESG. Indicates all aspects and associated information which in relation to business activities, for example, go beyond purely economic and financial aspects, therefore involving social, environmental and governance issues.

Financial Reporting

This refers to the annual financial statements, as well as all those accounting documents which a company must periodically prepare, under the law, in order to pursue the principle of accuracy and to allow ascertainment, in a clear, true and correct manner, their equity and financial situation, at the end of the reference period, as well as the economic results achieved during the same financial year.

Harmonised Fund/SICAV

A Harmonised Fund is a fund operating under foreign law, authorised for placement in Italy. The offer must be made through intermediaries authorised to act in Italy and CONSOB must approve the informational prospectus. The same applies to Harmonised SICAVs.

Forward

A contract with which two counterparties undertake to exchange at an established future date a given quantity of commodities or financial assets for a pre-established price is known as a Forward contract. The price is the Forward Price. In contrast to a Futures Contract, a Forward contract is not standardised and not traded on the stock market.

Future

A Futures contract is a standardised contract, traded on regulated markets, through which one party acquires or sells a given quantity of commodities or financial assets at a pre-established price, with delivery at a future date. In contrast to Forward Contracts, a Futures Contract is traded on regulated markets and is a contract with pre-established features which cannot be independently determined by the investor.

Financial Management

This is the process through which financial resources are administered. It necessarily involves 4 stages: obtaining the available resources; identifying objectives; managing resources; monitoring the resources.

Hedge Fund

In practice, these are funds which do not respond to laws or constraints involving guarantees and have the sole purpose of allowing subscribers to derive profit from any market (foreign exchange, stock, futures, options, etc.) and on any type of market (bull, bear, oscillating). The results are often significantly higher than those achieved by mutual funds, but at the price of risk which is proportionately higher and generally associated with opaque management models. This makes them unwilling and likely unable to be certified on the basis of ESG criteria.

Impact Investing

Investing with the goal of achieving positive social impacts, pre-established and measurable, in addition to financial returns.

Financial Brokering

The combination of services intended to connect supply and demand for financial services, or the transfer of capital from entities which have excess to those with a deficit, through buying and selling own financial securities and instruments or those of others. These activities are reserved exclusively for banks, investment companies, SICAVs, asset management companies and financial brokers registered with the specific registry, for EU and non-EU investment companies with branches in Italy, and harmonised management companies. Securities brokerages (*società di investimento mobiliare* or *SIM* in Italy) can also be considered as financial brokers, in a wider sense.

Ethical and Socially Responsible Investing

Implementing an appropriate socially responsible investment strategy means, over the medium-long term, integrating economic and financial analysis with analysis relative to social, ethical and environmental aspects. The investment is intended to optimise not merely the financial return, but aims to create positive and beneficial externalities for the entire social collective.

Black List

A list of companies in which financial resources cannot be invested.

Option

This is a type of contract which grants the holder the right, but not the requirement (hence the term option), to acquire or sell a security for which the option is established, known as the underlying instrument, at a given pre-established price (strike price), by a given date, against the payment of a non-recoverable premium. Options may refer to various types of underlying instruments: equities, commodities, interest rates, etc.

OTC

OTC is an acronym for Over the Counter, used to indicate trading which occurs outside of the regulated market. The instrument is traded between the seller and purchaser without using a regulated market.

Emerging Countries

The term “emerging country” is generally used to describe an economy with per-capita income that is lower than the average for developed countries and with a potential GDP growth rate higher than the global average. The World Bank, for example, sets the level of per capita income at around $ 9,000. There are very different situations within the category of “emerging country”, in terms of political and economic institutions, infrastructure, size and political regimes.

Developed Countries

Developed countries in general refer to countries with advanced economies (although not all developed countries have advanced economies), high per capita income and a high human development index.

PRI

An acronym for Principles for Responsible Investment. These are the principles issued by the United Nations in 2006 to support the growth of sustainable and responsible investing in the international financial community.

Quantitative Easing

Quantitative Easing (QE) is an unconventional expansive monetary policy tool used by central banks. It involves purchasing debt securities from member states or those issued by private entities.

By expanding the monetary base, economic growth is indirectly stimulated, as well as production, employment, inflation and, last but not least, support for states with higher debt.

Rating

A rating is an assessment made of an issuer, of equity securities or bonds, by an agency tasked with evaluating solidity, credibility and attractiveness. The most well-known ratings agencies (for debt) are S&P, Fitch and Moody's.

ESG rating

Also known as a sustainability rating. Similar to traditional ratings, which evaluate the creditworthiness of an issuer, an ESG rating analyses and assesses the performance of an issuer in relation to social, environmental and governance aspects, together with its ability to manage risks linked to these aspects.

ESG Screening

A process through which a portfolio is analysed in terms of ESG ratings.

Shadow Banking

A collateral or "shadow" banking system. This refers to all trades that allow alternative forms of financing (and, more generally, circulation of capital) in contrast to those carried out through credit entities.

A Shadow Banking System exists outside the scope of regulatory authorities and in the absence of the monetary channels which can be activated by Central Banks.

Short Selling

The term Short Selling refers to a financial transaction in which securities not directly owned are sold. Short Selling involves taking a bearish position on a given instrument.

Spread

The term Spread normally indicates the difference between the best sales and purchase prices present in trading a security. It is also used to indicate the price differential between two financial instruments, with the first considered to be the reference price, e.g. the Bund-BTP spread.

SRI

Acronym for Socially Responsible Investment. Indicates financial investments which include not just classic economic/financial considerations (e.g. optimising the risk/return ratio over a given time frame) but also include considerations associated with social, environmental and governance aspects.

TER

The Total Expense Ratio is the ratio between the charges applying to the fund and average assets. This figure represents in a simple and brief manner the percentage of assets taken from the fund in a calendar year to pay for management services. The TER includes management and performance fees, auditing expenses, fees paid to the depositary bank and other charges. However, it does not include brokering fees paid to brokers to buy and sell securities.

Taxes are also excluded from the TER, as are subscription, redemption and switch fees paid directly by the subscriber. The costs that subscribers of mutual funds must pay are divided into two categories: those paid directly by the client and those paid by the fund (and indirectly paid by the client).

VaR

VaR stands for Value at Risk, a benchmark used to estimate the probability that loss from a portfolio exceeds a pre-established amount. This is a technical statistic based on analysis of historic price and volatility trends.

Average Volatility or Variability of Returns Over Time

Volatility is a statistical measurement of the price fluctuations of an underlying asset. The greater the fluctuations around a certain average price of the underlying asset, the greater the volatility. Volatility is a measure of portfolio risk.

Ethics and finance. Contributo alla riflessione [Food for thought] (2000) IEC National Office for Social Issues and Work

Summary[7]

In the context of globalisation and with the introduction of new technologies, the new role and new weight taken on by finance at various levels leads to scenarios in which returns and profit work to make investment more enticing and risk more acceptable.

In the face of this, Christians must work carefully to understand and examine the reality of the situation, helping to develop mature actions and life choices in line with their Christian faith, not only personally, but also professionally, publicly and institutionally. The document is intended to help believers and communities to distinguish the true situation and guide them in terms of the Christian view of life.

The text (completed in May of 2000, following the financial crisis of 1997-1999, in the context of the Great Jubilee) was the start of research and reflection on the main economic and social questions, using finance as a reference point[8]. It offers a method of approach which aims to provide information about responsibilities, inspired by the faith and Social Doctrine of the Church (SDC), based on which the three sections of the document identify general principles and criteria (Part I) which make it possible to evaluate behaviours and actions in the financial sector, while taking into account the current situation of finance (Part II), illuminated by certain fundamentals of SDC.

Part I: Moral assessment of behaviours and actions in the financial sector (pg. 6-11[9])

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7 Edited by Don Domenico Santangelo, research assistant for the National Office for Social Issues and Work (= UNPSL).

8 The text was prepared by a research group established within the UNPSL, and for the most part remained the same during the preparation of two subsequent additions.

9 The page numbers refer to the numbering in the text, as found on the Office's website. This is important because the numbering in the paper copy is different.

- Understanding the relationship between morally good and technically effective/systemic: these are not identified, but both moral and technical are important, to protect the sense of humans and the truth of their self-realisation in all activities, including technical ones;
- Understanding the relationship between morally good and legally permitted: both of these are important, but they are not identified; it asks what moral values can and must be legally protected for all individuals in all situations;
- Understanding the relationship between morally good and established with consent: these are not identified, but are both important: to create consent it is necessary to allow all to participate in debates (investors, national communities, businesses, brokers, authorities, etc.), examining the plausibility of the arguments made, in view of the common good. To establish the moral value of behaviours, mere consent is not sufficient. Criteria which are good and just in and of themselves are also required. This raises questions about the rules that govern the functioning of financial markets: What are their purposes? What practical reasoning governs their operations?
- Understanding the relationship between morally good and historically possible: one is a moral value to be promoted, the other is the historical possibility of its occurrence, but it is necessary to create a relationship between the two aspects (ideal and real).

What is the moral good involved in financial activities and how can we define it? The criteria of the common good is the decider, containing both qualitative aspects (relational) and quantitative aspects (the concrete goods which are available). Common good is “the good of the people in the opinion of those people, in their existence in relationship to each other” (pg. 9). Profit is not the same as but is linked to good. The vice of avarice (“unlimited desire for unlimited possessions” - pg. 9) violates the rights of others to that needed for their own existence, resulting in identifying a person with the things the own, personal with quantity and spiritual with material. Together with avarice, the vice of avidity is also identified, which drives people to accumulate goods and not share them.

This lead to idolatry of money (consider that most recently referenced by Pope Francis in the second chapter of his *Evangelii gaudium*). On the contrary, it is necessary to develop stances and actions to ensure virtue: justice, temperance (sobriety/moderation), generosity and solidarity. In this way, with reference to the individual, it is possible to assist them from abstaining from "actions which in and of themselves harm the moral good, in particular morally reprehensible speculative forms" (pg. 11), and with reference to the economic/financial system, a commitment to reform and change can be promoted. "The moral duty to inform oneself and quickly remove funds from institutions that do not guarantee certainty" with regards to goals acceptable from a moral point of view, "to instead direct them towards brokerages which guarantee the maximum social utility"[10] (pg. 11).

<u>Part II.</u> The current situation of finance (pg. 12-17)

What value premises does economic theory include? "Only by making reference to an open theory of economics, not self-sufficient and not self-referential, not closed off to any external contribution, is it possible for moral value judgements or premises to specifically guide economic conclusions and actions" (pg. 12). An economy which serves humanity is needed - a "social economy" (pg. 12). Catholic social morals, with objective and universal value, can provide the value premises able to focus economic discourse in a manner which enriches it. Based on this anthropologically based concept, finance is "an integral part, as a tool, of the economy" (pg. 12). It is a tool to make use of real resources, but also carries the risk of absorbing more and more of economic discourse and in a misleading manner (rereading the document, we do so through the lens of the crisis which occurred not that many years later), with actions that are "unpredictably frenetic, foreign and unjust" (pg. 16).

10 It becomes clear that the meaning of the terms used needs to be rendered explicit: what does "social utility" mean? Making reference to morality is not automatic, if we structure everything with an eye to social utility.

Ethical justifications and moral presuppositions must go hand in hand with identification of regulatory and control measures for financial markets, above at the international level, taking into account the difficulties associated with concrete implementation. In particular, the issue which must be acknowledged is that financial developments "have a life of their own" (pg. 13), far from the phenomena of the real economy. Due to this, a pathology is identified (money laundering and usury), as well as a grey area of finance (speculation and an increasing shift towards short-term returns, accompanied by a consumeristic neo-liberal ideology), with both internal and international aspects: the former (which in this document is of particular interest), consists of all those operations able to make the functioning of the real economy more fluid, effective and efficient (see pg. 13). In this sense, the phenomena which is expanding is the development of derivatives and synthetic securities.

To properly interpret the financial reality and intercept changes, codes of ethics or conduct are not seen as sufficient, as these limit themselves to establishing transparency, honesty, fairness, impartiality and professionalism as rules (see pg. 16). Beyond formal fairness, it is necessary to give "personal actions a general value, within a universal and ontologically based order" (pg. 16). Note again that general ethical social criteria are needed, such as those developed in Catholic morality, which identify pre-existing and objective criteria for moral judgements. Beyond an "ethics of finance", it is necessary to properly structure the question in terms of "ethics and finance", not limiting the discourse to certain actions by operators, but "introducing moral requirements within the deepest structures of the market, such as those, for example, expressed through the criteria of the common good" (pg. 16). These are the needs which are highlighted when examining the main negative financial effects on economic and political realities (see, pg. 17): *a)* the impossibility of a fair division of power and wealth internationally; social justice and equal opportunity for people, social groups, populations and nations is at play here; *b)* the utilitarian use of finance which has created a push towards unnecessary and unproductive investments and a debt economy; *c)* positions with excess returns, harming widespread entrepreneurship, economic efficiency and public debt; *d)* the unscrupulous and excessive use of speculation through the abusive use of confidential information or investments in wars or in countries where workers are exploited, or leading to financial bubbles in entire markets; *e*) an excessive climate of competition between financial companies, including increased usury and impotent authorities.

<u>Part III.</u> SDC and certain guidelines for application of morals (pg. 18-31).

The historic/doctrinal reference points are clear regarding the value as well as the danger of wealth in the light of biblical sources. Social teachings do not offer a systematic ethical treatment of money, savings, investment, banks and financial markets. Certain themes are dealt with through an eye to social justice, and these make it possible to ask the question of all those who invest, in larger or smaller amounts (or those who in any case are involved in the financial market). These individuals must answer if and how much, in terms of the ethical criteria in question, financial management of resources (by each and all) tends to support and in what way: wealth and concentration of power or, on the contrary, the requirement of solidarity, prioritising labour in the face of power and the universal division of goods.
The result is that the doctrinal tradition of the Church, over the course of history, has developed and continues to develop principles and norms, together with moral aspects regarding certain specific issues (e.g. the poor), evaluating complex and cultural changes in the economy and in finance (e.g. changes in mentalities and customs), so as to understand economic and financial facts, going beyond a procedural prospective which reduces ethics to social rules. Certain affirmations are central, which state that: 1)

moral good cannot be reduced to legal fairness; 2) the individual always takes precedence (every individual: me and others), my and your needs before my and your rights; 3) affirmation of a lack of difference between people is not enough, i.e. equality, necessary to affirm closeness and solidarity between people and social groupings.
These highlighted criteria should allow financial institutions to create a political vision (which refers to the entire social corpus) which supports the possibility of having reference parameters to assess the expediency of individual economic/financial investments and transactions. In order to render economic/sociological/political aspects of finance significant for the purposes of human action, it is necessary that morality is achieved in finance, that is it must "justify itself" and the qualitative measure of the justification will depend on the contribution that finance makes to promoting the human in the economic: How and to what extent does finance promote the human in the economic, starting with individual investment decisions?

Another two aspects reflected upon in the document involve the ethics of the lending market and the ethics of equity markets. With regards to the first area, the bank, as an intermediary between creditors and debtors, must find a balance between duty and virtue, mediating savings and investments, deciding how to apply the criteria of efficiency and justice, treating similar situations in a similar way and different situations in a different way. In this way the principle of equality in rules is applied, as well as the principles of objectivity and universality, balancing benevolence and rigour. With regards to the second area, it asks what is the appropriate conduct for trading securities and identifies areas of significance in this context, relative to: 1) ethics in selecting equity for investment; 2) ethics of the investor (i.e. the individual focussed on the value of capital and returns from transferable securities and ethics of the speculator (i.e. the individual focussed on differentials in changes in transferable security values over time); 3) ethics of listed companies and actions relative to shareholders and the market; 4) ethics of brokerage companies. A specification: speculation is ethically allowable, if and when it reduces uncertainty with regards to whether shares can be traded on the market. However, this is in contrast to the speculative attitudes which predominate when connections with the real economy do not exist.

This leads to the need for control mechanisms at the international level. Already in medieval times Duns Scoto wrote that the same profit is ethically allowable when the intermediary achieving it has rendered some service to the community, in terms of real value to the economy. This is the question which the investor must ask themselves, when determining whether their choices are ethically based: “what projects will we finance?” “In what places will we invest?” In this sense, to answer these fundamental questions, justice and the common good must lead investment decisions and, more generally, all economic and financial transactions. Lower profit with justice, instead of more profit without justice. Ethical investors (returning to *Caritas in veritate*, it should be said that all investors should act ethically[11]) must pay attention not only to the degree of profit and associated risk, but also evaluate the nature of the goods and services in question, the placement of the business and the way in which it is carried out, in order to make assessments in accordance with justice and common good. In other words, this also indicates that more responsibility and conscience relative to the ethical dimension of their actions is needed, starting with the intentions with which they consider and act.

Regarding profit, the text states, “We need it (pg. 28). It is the measure of the objective efficiency of a company. The greater the profit, the more efficient the company, but this—and it falls within the structure of justice and common good to which I have referred—is not the only nor the most important end of business, efficiency in and of itself can be an absolute".

11 “It is necessary to act—the observation here is essential—not only for 'ethical' sectors or segments of economy or finance to develop, but for the entire economy and all of finance to be ethical, and this will occur not just because of an external label, but based on the respect for the intrinsic requirements of their nature. The Church’s social doctrine speaks clearly on the subject when it recalls that the economy, in all of its aspects, is a sector of human activity”. (Benedict XVI, Enc. *Caritas in veritate*, no. 45)

This means that the purpose of a financial company is to continuously satisfy requirements while also contributing to the development of all the people who make up the company and those living outside of it (*Caritas in veritate* speaks of "stakeholders")[12]. But how? Through the efficient production and distribution of useful goods and services.

These comments apply both within countries and internationally, a need ever more important and urgent in times of "progressive and pervasive globalisation"[13]. As both papal and Holy See teachings state, together with episcopal and ecclesiastical teachings, if a financial system is needed, further integrated at the global level, it is necessary to achieve global markets, organised around efficiency, transparency and justice, appropriately developing a culture of globalisation of responsibility among all entities, operators, populations and institutions.

In conclusion, finance raises various challenges for ethics, at the end of which the focus must lie in taking into account the abstract, fungible and impersonal character of financial goods, through the importance of the fiduciary relationship between service suppliers and clients. This establishes the centrality of ethical education for people and necessary training for individuals in the use of money.

The text is accompanied by a number of examples regarding the use and features of certain financial instruments and systems (pg. 32-42).

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12 *Ibid.*, no. 40.
13 *Ibid.*, no. 9.

International finance and acting morally. Contributo alla riflessione [Food for thought] (2004)
IEC National Office for Social Issues and Work
Summary of the text[14]

The initial part of the text (pg. 5-19[15]) references the first part of the first addition, adding certain historic/conceptual notes with the objective of better understanding and learning about the tradition in which we live, often those matured in Christian through over the centuries, until reaching those closest to us. From this point, the next portion of the text offers an analysis of the problems which international finance poses for our times from a moral point of view (part two: pg. 20-32). This method makes it possible to examine the financial realities, first examining the principles (part three: pg. 33-37) and then the methods of action (part four: pg. 38-42) that can give sense to its ventures.

Working to further examine the aspects dealt within the first addition, focussing on certain conceptual questions (evolution of money, the function of money, securities and transferable securities, the subjects of financial activity), the text makes it possible to identify, especially at the international level, what distinguishes "good" finance from "black" or "grey" finance. The fundamental features of finance, those which in other words define "good" finance, consist of all those transactions which, aiming at an economic return, play a fundamental role in rendering more efficient the transfer of funds between sectors with a surplus and those with a deficit. The document specifies that if this does not occur, the financial activity is not ethically good—leading to the creation of a "grey" or "black" zone. In other words, these are actions which cannot find any ethical justification.

14 Edited by Don Domenico Santangelo, research assistant for the National Office for Social Issues and Work (= UNPSL).

15 The page numbers refer to the numbering in the text, as found on the Office's website. This is important because the numbering in the paper copy is different.

The real underlying information on which the treatment of the subsidium is based starts with the presupposition that the current financial market is heavily internationalised, global and of dimensions that make it independent of the real economy, such that it influences the latter. To understand the functioning of the international system, various types of instruments and transactions are outlined, together with the technical opportunities granted by each one: payments for commercial transactions, remittances to countries of origin, foreign currency transactions (arbitrage and speculation), portfolio investments, direct foreign investments, bank loans, issues of government loans through public securities, both external and internal, loans and donations made by foreign countries and international financial institutions, development loans. This discussion, to identify an ethical judgement regarding international finance, makes it possible to delineate which of the aspects of finance are inherent, which are pathological and which fall halfway between. If all the subjects involved obtain a benefit from the transactions in question and at an aggregate level the economic system as a whole can produce a larger amount of goods and services to make available to consumers, the overall benefit is clear, meaning that the ethical judgement for international financial transactions will be entirely positive. For more appropriate judgements, it is obviously necessary to take into account the specific circumstances surrounding individual transactions. However, international finance can also be used for illicit purposes and illegal activities: e.g. money laundering, human trafficking or tax havens, but this “black” zone (for which the ethical and legal judgement is morally negative) also includes activities and capital movements linked to a desire to escape legal obligations and solidarity duties relative to the country from which the funds derive. For example, think of financial transactions carried out with the aim not of finding more productive and therefore more remunerative use, but simply to find a more profitable taxation system. These are transactions which at the ethical level fall within the area of tax evasion.

Halfway between good and bad finance is a vast middle zone consisting of a whole series of speculative transactions made possible by current IT technology.

In order to issue an adequate moral judgement, it is necessary to examine all the various effects of these transactions, some of which are positive (e.g. greater liquidity on the financial market) and some of which negative (e.g. taking into account those who actually benefit from the transactions in terms of justice and common good). To make an ethical, clear and definitive judgement regarding financial transactions in this "grey" area, we should remember aspects which would require the judgement to be necessarily negative: 1) when financial investors are "unduly" enriched, especially those involving large sums of money; 2) when they systematically enrich those who are already very rich, with the risk of reducing entire countries to poverty; 3) when they produce massive flows of money, removing them from productive use in the real economy.

Based on knowledge about international finance and the ethical judgement made relative to the same, in the light of the principles of inspiration and the Christian ethical tradition, to move forward to action, absolute definitive rules cannot be identified (these would be impossible to determine given that these are complex, controversial questions, subject to continuous and rapid change), but stimulating consciences so that, in constructing each day the good deemed concretely possible, we can re-examine past steps and discover new and ever greater spaces for action, through personal and collective actions that allow us to "humanise" international finance (see the third subsidium on this subject). This may include voting (even the purchase or investment in a financial product rather than another is a clear choice which creates an influence), or lobbying, or awareness campaigns, some of which accompany the conclusion to the addition, giving a nod to the activities of the IEC's Justice and Solidarity Foundation and the campaign of Volunteers in the World - FOCSIV, in favour of taxing international foreign currency transactions.

Ethics, development and finance.
40 years of the 'Populorum progressio' encyclical.
Contributo alla riflessione [Food for thought] (2006)
IEC National Office for Social Issues and Work

<u>Summary of the text</u>[16]

The third subsidium further investigates and specific an additional approach to the discussion, combining a reflection on the words ethics and finance with the area of development to be promoted and supported. The text moves into reality, offering a description of the world in which we live. In particular, it asks us to acknowledge the intolerable inequality within the human family and the inequality between various groups, populations and countries. In anticipation of the 40th anniversary of the encyclical *Populorum progressio* which states that, "Development of the individual necessarily entails a joint effort for the development of the human race as a whole", (no. 43) and of the 20th anniversary of *Sollicitudo rei socialis*, the subsidium was issued in 2006 with the aim of translating to the concrete situation in which we find ourselves the principles for reflection, judgement criteria and directives for action which are found within the Church's social teachings, specifically on the question of development applied to finance. In fact, the tool in question, understood as a stimulus for the Christian communities of our question, raises the question of what discernments to implement and, more specifically, through what concrete choices and commitments to base finance on, in service to the development of the human race as a whole. What is the interpretive key used in the text? Looking at the relationship between ethics and finance through the lens of development, the moral judgement is more an invitation to carry out good, rather than a suggestion to focus on the evil to be avoided.

16 Edited by Don Domenico Santangelo, research assistant for the National Office for Social Issues and Work (= UNPSL).

For this reason, the discussion of a chapter begins (see, pg. 4-7[17]) intended to reflect on ethical assessment criteria relative to economic development. Specifically, it asks about the sense of the economy exemplified in the question: "Towards goods or towards the good?" (p. 4); continuing with the examination and research into the issues, the second chapter (pg. 8-17) interrogates the meaning of development, referencing the need to "affirm life" (pg. 8) as the focus for the entire conversation. Given that the general theme of the subsidium focuses on the relationship between ethics and finance for the purposes of development, the third chapter (pg. 18-30) examines concrete examples of the main finance instruments for development, with the main options available (continuing forward with that discussed in the first and second subsidia). The fourth section (pg. 31-43) takes into consideration the responsibilities of the various entities involved and with an eye to responsible citizenship identifies and outlines the various types of concrete commitments: for investors and banks, for entrepreneurs and shareholders, for consumers, for politicians and, more generally, for the entire civil group of Christians in Italy, both personally and in organisations. The conclusions (pg. 44-46) outline certain concrete steps that fall under the possible actions of the various entities outlined in the fourth chapter.

The first chapter begins the discussions, analysing the two "moments" around which economic analysis is structured: the positive moment and the regulatory moment. The importance of the first is clear—that is the study of the functioning of the economic system. The second one, the regulatory moment, is more delicate, which asks what is right to do and the right way to intervene in financial transactions.

17 The page numbers refer to the numbering in the text, as found on the Office's website, in the PDF version. This is important because the numbering in the paper copy is different.

From this point, the question regarding the purpose of the economic question takes priority, to be oriented within the prospective in question, referring to SDC, that of an economy which serves the individual, towards the objective of socially and environmentally sustainable development or, in other words, that which is at the service of life. In this way, finance itself is understood as a tool for the healthy functioning of the economy, at the service of human life.

The second chapter calls attention to the issue of development, starting with the ecclesiastical attention that the Church has given this area of interest, specifically with the encyclicals on development (*Populorum progressio* and *Sollicitudo rei socialis*), highlighting ethical choices as the viewpoint for examining the issue, given that the question of development is part of the sense of human existence, with a multitude of dimensions that must be taken into account if the goal is to protect integrity and integrality. These perspectives move towards a conception of development that does not take into account only the economic dimension (although this is necessary), but establishes a wider more human view, which includes social, institutional and environmental aspects. In this way, by removing the structural causes of injustice and poverty, peace can be promoted, by extending the condition of full citizenship to all women and men on the planet, protecting the dignity of human life.

The third chapter focussing on analysing the various instruments and methods available to finance development in low-income countries. This includes public development aid, loans or foreign debt associated with foreign lenders, international commerce in terms of exports, foreign direct investment in manufacturing by foreign operators (individuals and business), remittances sent to countries of origin by immigrants, microlending and microfinance and, finally, innovative finance tools for development (e.g. tax incentive mechanisms for the distribution of contributions to finance development).

The tools and forms of finance outlined in this chapter are assessed in terms of ethics mainly in terms of the direct and indirect effects they generate: do they genuinely promote development? Do they provide concrete support for the poorest countries in the world? Essentially, it is necessary to determine whether, outside of generating new resources, they also contribute to decreasing situations of imbalance, injustice and poverty, starting with discouraging negative practices in terms of sustainable development. It is obvious that before making a definitive judgement about any of the forms analysed it is necessary to specifically examine not just the purposes intended to be achieved through the financial instrument, but also the technical methods and circumstances surrounding its use.

The financial instruments and methods outlined in chapter III do not operate automatically, but "are entrusted to the responsibility of those with the power to activate and guide them towards an established end" (pg. 31). A more general duty of solidarity is in play, which involves multiple levels and cases of social responsibility, to be carried out in all the various roles that each of us plays and holds, in proportion to the effective power we have. The following are examined: 1) the relationship between an investor and banks which finance ethically, e.g. cooperatives, companies operating in the field of environmental protection, cultural training activities or those with social goals, or which involve the use of capital in the Global South for development projects; 2) the relationship between the entrepreneur and shareholder, through financial investment in the shareholding structure of businesses operating in developing countries; 3) the relationship between a citizen and their consumption choices, to be made with responsibility (e.g. favouring fair trade products); 4) the relationship between the citizen and politics, given that in this area the most important decisions are made with regards to financing development (e.g. the amount of public aid dedicated to development, the rules of international commerce, global financial architecture, etc.); 5) the relationship between Christians in Italy and the fraternal sharing generated through the actions of numerous civic organisations (e.g. NGOs working for development and to combat poverty, the role of Caritas, the actions of the Italian Church through the 8‰ collected through Italian citizens' income tax declarations).

In this vein, the conclusions strongly emphasise the principle that states the prospects for fruitful action towards authentic development exist if each and every citizen of the planet, in all the various roles and positions they hold in their social lives, exercise the duties possible and executable as part of their co-responsibility, by exercising the citizenship that lies at the foundation of all their economic and financial actions, to promote each human and the whole human (see, *Populorum progressio*, no. 14).

“‘Oeconomicae et pecuniariae quaestiones’.
Considerations for an ethical discernment regarding some aspects of the current economic-financial system”, Congregation for the Doctrine of the Faith and the Dicastery for Promoting Integral Human Development, 17/05/2018

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