

Catholic Values Investing

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Background and Context

1 What is the connection between faith and investing?

Faith-based institutions and individuals have, for centuries, considered the social and environmental impact of their investments. This stems from the importance of mission including to protect and promote the worth of every person, a pillar of the Catholic mission.¹

Today, stakeholders — including staff, trustees and donors, as well as those served by faith-based institutions such as parishioners, students and patients — call for a holistic approach to embracing their faith. This can include integrating mission and values into the financial objectives and investment guidelines of the institution in-line with their fiduciary responsibility.

High net worth individuals and families interested in aligning their faith with their investments generally seek to integrate guidelines specific to their faith's mission and values into their financial objectives. Faith-based investment guidelines vary by person, family, investment strategy and by the mission and teachings of the faith the individual, family, or institution follows.

Faith-based investors are credited with inspiring the larger Investing with Impact movement at different times in history including Methodists and Quakers divesting from alcohol, tobacco, and gambling in the 19th century as well as Protestant and Roman Catholic organizations demanding divestment from South Africa during Apartheid.

2 Historical context for faith-based investing

In the 19th century, both Quakers and Methodists adopted investment guidelines grounded in religious mission and values. Methodists were firmly

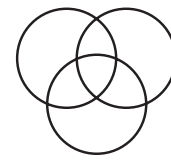
opposed to the slave trade, smuggling and conspicuous consumption. In accordance with these values, Methodist religious entities avoided investments in companies that manufacture alcohol, tobacco or promote gambling. Around this same time, guided by Quaker testimonies and values such as peace, simplicity, integrity and justice, the Friends Fiduciary Corporation established guidelines that avoided investments in companies that manufacture alcohol, tobacco and weapons. These guidelines established centuries ago have carried forward, alongside other evolving approaches, to Quaker and Methodist institutional and individual investment preferences today.²

Catholic Values investors have a notable legacy as well. Beginning in the late 1960s, Roman Catholic organizations alongside Protestant organizations, spoke out publicly against Apartheid in South Africa. Catholic nuns are credited with success in the 1970s advocating that corporations withdraw any direct exposure to South Africa. Further, the nuns used their pooled retirement assets as leverage to file shareholder resolutions to confront corporations that had not yet adopted the Sullivan Principles. The Sullivan Principles are broad reaching in their commitment to promoting equality and inclusivity at corporations. As an example, the Sullivan Principles require a corporation to ensure that all employees are treated equally, and in an integrated environment, regardless of race.

Starting with a few dozen religious investors representing the inter-denominational landscape of investors in the 1970s, today the [Interfaith Center on Corporate Responsibility \(ICCR\)](#) — a coalition of faith and values driven organizations that view the management of their investments as a powerful catalyst for social change — is comprised of over 300 religious organiza-



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Background and Context

tions including faith-based institutions, pension funds, colleges, universities, and asset management companies. Together, these organizations represent over \$100 billion in invested capital.

Built on a strong foundation, faith based investors continue to be leaders in the integration of financial and impact objectives by adopting investment guidelines that represent their values and mission.

3 What are Catholic Values?

Catholic Values are a set of guidelines designed to help stakeholders of Catholic institutions and individual investors integrate the mission of the Church into the financial objectives of their investment portfolio.

The Principles for the United States Conference of Catholic Bishops (“USCCB”) Investment Guidelines established in 2003 are a comprehensive, though equivocal, set of guidelines for Catholic Values oriented investors. The guidelines delineate specific areas for Catholic Values investors to consider as part of their investment selection process. The guidelines do not provide guidance on implementation and leave room for interpretation depending upon the teachings and preferences of specific organizations and individuals.

The Principles are rooted in a fiscally prudent approach to investing; the USCCB guidelines state explicitly that Catholic organizations, in order to function and effectively carry out their mission, depend on a reasonable return on investments and are required to operate in a fiscally sound, responsible and accountable manner.

An example of one of the basic themes is the USCCB pastoral letter (Economic Justice for All) that reflects the Catholic Values stance towards investing:

- **Church as Shareholder and Investor:** “Individual Christians who are shareholders and those responsible within church institutions that own stocks in U.S. corporations must see to it that the invested funds are used responsibly. Although it is a moral and legal fiduciary responsibility of the trustees to ensure an adequate return on investment for the support of the work of the church, their stewardship embraces broader moral concerns. As part owners, they must cooperate in shaping the policies of those companies through dialogue with management, through votes at corporate meetings, through the introduction of resolutions and through participation in investment decisions. We praise the efforts of dioceses and other religious and ecumenical bodies that work together toward these goals. We also praise efforts to develop alternative investment policies, especially those which support enterprises that promote economic development in depressed communities and which

“We are not faced with two separate crises, one environmental and the other social, but rather one complex crisis which is both social and environmental.”
—Pope Francis, 2015 Encyclical

help the church respond to local and regional needs. When the decision to divest seems unavoidable, it should be done after prudent examination and with a clear explanation of the motives.” (Economic Justice for All, 354)³

Interpretation of USCCB Catholic Values Guidelines⁴

The USCCB guidelines include negative (exclusionary) screening as well as targeted positive environmental and social impact.

Negative Catholic Values screens can include restricting investment in companies that derive significant revenue from the following areas:

- Life ethics; abortifacients; contraception, and embryonic stem cell research
- Pornography/Adult Entertainment
- Weapons including conventional and nuclear, weapons of mass destruction, firearms and landmines
- Tobacco
- Predatory Lending
- Human rights deficiencies
- Racial discrimination
- Gender discrimination

Positive or inclusionary screens can include investment in companies that derive revenue from or promote;

- Access to affordable housing
- High labor standards
- High environmental standards
- High corporate social responsibility

Investor Engagement

4 What investors are uniquely interested in Catholic Values?

- Catholic and Jesuit educational institutions — lower, middle and high schools, colleges and universities
- Catholic health care and service organizations
- Catholic Arch/Diocese — regional grouping of parishes
- Catholic non profits/charitable organizations
- Families and Family Offices
- High Net Worth Individuals

5 Laying the foundation for a Catholic Values investment approach

Differences by Investor Type

INDIVIDUALS

- Investors can work with their Morgan Stanley Financial Advisor to develop a tailored investment approach based on their preferences with regard to integrating Catholic Values. This process is part of the development of a lasting investment plan that seeks to achieve the desired financial and faith-based impact objectives. This process can be driven by, or informed by, the USCCB guidelines and may include additional impact criteria not outlined in the USCCB guidelines.
- This process may take one or more meetings with the individual or family.

INSTITUTIONS

- Institutions typically explore the full range of faith-based and Catholic Values approaches including but not limited to, negative screening, positive integration of ESG, shareholder engagement and proxy voting at multiple board meetings and, as a decision-making body, determine which approach is most suitable given the organization's financial goals, stakeholders, and impact objectives.
- For institutional investors it may be appropriate to work with a third party to help lead the discovery process alongside their Financial Advisor. Third parties can include investment managers with relevant experience, or a overlay restriction screening data provider such as IW Financial. The third party can effectively assist in walking the board and/or committee through the appropriate questions related to developing organization-specific Catholic Values guidelines.
- **Moving the Conversation Forward:** Institutional investors may be interested in participating in the broader conversation regarding faith-based investing, including faith-based membership organizations and networks, which can be a way to maintain awareness of best practices amidst like-minded peers. Some examples include: [ICCR \(Interfaith Center on Corporate Responsibility\)](#), [The Forum for Sustainable and Responsible Investment \(US SIF\)](#) and [International Interfaith Investment Group \(3iG\)](#).⁵

INTEGRATING CATHOLIC VALUES INTO AN INVESTMENT PLAN

Once an individual or institutional investor has decided to integrate Catholic Values into their investment portfolio, the next logical step is to build an investment plan or Investment Policy Statement. This can help to set investor expectations as well as build in enough flexibility to allow the Catholic Values investment strategy to evolve over time as the investment opportunity set grows and adapts to market demand.

In order to gain consensus on an investment plan and/or policy statement, an extended meeting with a Financial Advisor can be a helpful exercise, especially with institutional boards. This allows the Financial Advisor to direct the conversation with several key discussion questions that will help form the investment plan/policy statement.

The landscape of Catholic Values investments is a very broad and diverse set of approaches and criteria interpreting the USCCB guidelines. Thus, beyond establishing Catholic Values as an important part of the investment plan/policy statement — the Financial Advisor can help an investor to determine which strategy may be suitable for their needs.

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6 Overview of different approaches

It is important to keep in mind that there is no one-size fits all approach to Catholic Values investing. It is a very personal process for individuals, families and institutions; however, there are several approaches outlined below to consider. The process of discovering the appropriate approach to Catholic Values investing can take some time and will likely involve personal and/or institutional education around central tenets and implications of the different approaches.

Here at Morgan Stanley, through our investment advisory program platform, we see a growing landscape of investment choices and opportunities in the Catholic Values space and expect this to accelerate in the near-term. Some third-party investment managers have developed an in-house approach to interpreting the Catholic Values guidelines set by the USCCB resulting in a proprietary approach to integrating the guidelines into their disciplined investment process. This largely consists of two approaches – negative screening, or avoiding objectionable companies as outlined in the guidelines, and positive or inclusionary screening to identify companies that are focusing on Catholic Values mandates. Positive criteria outlined in the USCCB guidelines include investing in companies that are environmental leaders, provide access for low income populations to affordable housing, medicine, education and financial services and more. Third-party managers rely on both proprietary sources of data, including conversations with company management, as well as external sources including

environmental, social and governance (“ESG”) data provided by third parties to determine a company’s adherence to Catholic Values guidelines.

There are certain managers that have “standard” or off-the-shelf Catholic Values investment portfolios, as well as managers that can implement custom Catholic Values mandates. Custom investment opportunities are typically executed using Morgan Stanley’s investment advisory programs; whereby managers seek to integrate an investor’s unique Catholic Values preferences into their existing investment discipline. Certain managers are able to implement negative screens only; others include both negative and positive approaches to integrating Catholic Values.

Further, investors may be able to apply overlay restriction screening in line with their Catholic Values over separately managed accounts in Morgan Stanley’s advisory programs to avoid certain objectionable industries not already covered by the investment process. It is not possible to apply overlay restriction screens on mutual funds or exchange-traded funds. In order to better enable Financial Advisors to serve the needs of their Catholic Values investors through custom restriction screening, Morgan Stanley has retained the services of IW Financial,⁶ a leading independent provider of objective research and technology solutions to evaluate corporate ESG criteria – environmental, social, and governance from both an exclusionary screening as well as positive or proactive Best-in-Class⁷ perspective.

Regarding Catholic screens, below is what is currently available to Morgan Stanley as a result of our arrangement with IW Financial:

CATHOLIC EXCLUSIONS ONLY

- Exclusions include: Abortion, Adult Entertainment, Contraceptives, Firearms, Stem Cells, and Weapons
- All Exclusion Screens at 1% revenue thresholds (e.g., excludes companies that derive greater than 1% revenue from the screens outlined above)

CATHOLIC VALUES (EXCLUSIONS AND POSITIVE CRITERIA)

- Restriction screens as defined in the Catholic Exclusions theme in Section 3 above.
- Best-in-class ESG criteria includes Environmental Ratings and Human Rights Ratings.
- Best-in-class ESG criteria allows investors to avoid companies whose performance in regard to select ESG practices is in the bottom 5% of all rated companies.

Custom enhancements are available through IW Financial directly – Financial Advisors can refer to the [third party IW Financial piece in the Tool Kit](#) for more information.



There is no one-size fits all approach to Catholic Values investing. It is a very personal process for individuals, families and institutions.

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7 Asset Allocation approach to Catholic Values

The goal of this primer is to provide a framework for Catholic Values investors to understand the specific opportunity set that can be pursued across virtually every asset class in their portfolio. It is important to note there are more robust investment opportunities in certain asset classes; further, investors are unique and not every asset class will be appropriate or relevant.

Following are brief summaries from two asset managers investing in the equity and fixed income asset classes, in their own words, about how they can integrate Catholic Values into their investment process.⁸

FIXED INCOME

- Breckinridge Capital Advisors has developed a proprietary analytical framework to incorporate ESG factors into their credit research process. Breckinridge has found that this integrated approach provides a more comprehensive and forward-looking evaluation of a borrower's ability to repay. It is also a factor in investment valuation, as ESG integration helps the investment team to identify and price risk. Catholic Values portfolios will be managed consistent with the USCCB Socially Responsible Investment Guidelines. The USCCB investment strategies and the corresponding Breckinridge approach would include:

Do No Harm Customizations: To help Catholic investors avoid participation in harmful activities, Breckinridge would exclude corporations that violate the USCCB life ethics guidelines, as well as those that derive over 5% of their revenue from such sectors as adult entertainment and weapons. Additional customizations could exclude those companies involved with gaming, tobacco, alcohol, prisons and lending institutions with a history of poor CRA ratings.

Active Corporate Participation:

We engage in active dialogue with corporations and municipalities on the management of ESG risks.

Positive Strategies: Breckinridge invests in companies we believe have superior ESG characteristics and essential public purpose municipal bonds to help fulfill USCCB's investment strategy of promoting common good.

EQUITY

- In Trillium Asset Management's Catholic Strategy, based on the Large Cap Core approach, Trillium includes positive and negative environmental, social, and governance criteria consistent with the USCCB as well as the spirit of the 1986 US Catholic Bishops Letter on the Economy. Trillium's negative criteria are implemented at the beginning of the investment process to reduce the investable universe using strict revenue-based exclusionary thresholds, for example a 5% revenue threshold for tobacco, alcohol, gambling, nuclear power, weapons, and pornography and any revenues related to abortion, contraception, embryonic stem cell research, and human fetal tissue research. Trillium also excludes companies with major recent or ongoing controversies in areas such as environment, workplace, governance, human rights, and product safety.

- During a secondary stage of the investment process conducting fundamental equity analysis, industry analysts work to identify companies with industry leading policies and performance in the ESG areas that are most material to each industry.

ALTERNATE INVESTMENTS⁹

Options are currently quite limited for alternative investments¹⁰ (including hedge funds and private equity) that integrate both the negative screening and positive impact aspect of Catholic Values guidelines. To be eligible to invest

in alternative investments, you would need to be a sophisticated investor who is able to understand the complex investment strategies sometimes employed, and tolerate the risks and liquidity constraints of alternative investments.

8 Portfolio construction and manager selection

PORTFOLIO CONSTRUCTION

There are at least three different ways to think about integrating Catholic Values into a portfolio:

- **Total Portfolio Solution:** An investor can activate their entire portfolio based on your financial and Catholic Values objectives. This could involve utilizing only mutual funds, exchange-traded funds and separately managed accounts that, to one extent or another, utilize a proprietary process to integrate both positive and/or negative Catholic Values into their investment discipline, depending upon the investors preferences. One limitation to be aware of is that the universe of available opportunities may limit the diversification of a portfolio.

To consider: Many Catholic Values oriented investors resonate with our Morgan Stanley Investing with Impact Platform broadly (see Exhibit 1) and may be interested in pursuing opportunities that include the positive aspects of Catholic Values (investing in environmental leaders and good corporate citizens).

Further, there may be certain Thematic Exposure managers that achieve Catholic Values guidelines as well. It is important to note that this approach does not necessarily include all of the negative or restriction screens relevant to the USCCB guidelines.

- **Partial Portfolio Solution:** Where options exist that meet the financial and Catholic Values objectives of the investor these investments can be integrated

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into the context of a fully diversified portfolio that may include non-Catholic Values integrated investments.

- **Carve-Out:** An investor may choose to have a portion of their assets aligned with their version of Catholic Values – either the public equity/public fixed income, alternatives (where suitable) or both.

Link financial goals and impact goals: Morgan Stanley Financial Advisors work with investors to truly integrate their faith-based impact goals into the context of their risk and return objectives. Currently, all available investments across the spectrum of faith-based approaches, i.e. negative screening, positive screening, ESG-Integration and Shareholder Engagement seek to achieve risk-adjusted market rate returns, as compared to traditional benchmarks.

Conclusion

When choosing investment managers that are experienced and capable of integrating Catholic Values, it is important to understand there are many different approaches.

As described earlier, managers may utilize negative screening, positive

screening or ESG-Integration, or a combination of all. To give context to the approach that managers take, Morgan Stanley’s proprietary framework for Investing with Impact can help investors of all sizes navigate the different approaches to align their portfolio with their impact objectives – including adhering to Catholic Values guidelines.

At Morgan Stanley, we see both individual and institutional investors are motivated to invest their portfolios in accordance with their personal and faith-based mission and values. We believe it is important for investors to partner with a Financial Advisor to help them navigate the complexity of this approach to investing. The Financial Advisor can be critical in helping investors to identify what approach suits their motivations and unique investment goals.

In our view, success around integrating Catholic Values requires investors to recognize current challenges, to think several steps ahead of the current investment landscape and to shape the marketplace to benefit future growth in Catholic Values integration. ■

Exhibit 1– Morgan Stanley’s Investing with Impact Framework

Minimize Objectionable Impact ▶ Targeted Impact

VALUES ALIGNMENT	ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INTEGRATION	THEMATIC EXPOSURE	IMPACT INVESTING
Managing exposures by intentionally avoiding investments based on specific criteria	Proactively considering ESG criteria alongside financial analysis to identify opportunities and risks during investment process	Focusing on themes and sectors dedicated to solving sustainability-related domestic and global challenges	Allocating to investment funds focused on private enterprises structured to deliver specific positive social and/or environmental impacts
Public Markets		Private Markets	

SOURCES/RESOURCES

<https://www.afsc.org/testimonies/introduction>
<http://www.friendsfiduciary.org/socially-responsible-investing/>
<http://www.investingforthepeople.org/>
http://www.ussif.org/files/Publications/FaithBased_Toolkit.pdf
<http://www.morningstar.com/advisor/t/65920341/getting-religion-with-faith-based-mutual-funds.htm?&ps=9>
<http://www.iccr.org/reports-and-publications?&page=3>
<http://sustainability.thomsonreuters.com/2013/08/09/history-of-socially-responsible-investing-in-the-u-s/>
<http://www.usccb.org/about/financial-reporting/socially-responsible-investment-guidelines.cfm>

¹ "Life and Dignity of the Human Person." *United States Conference of Catholic Bishops*, accessed June 3, 2015, <http://www.usccb.org/beliefs-and-teachings/what-we-believe/catholic-social-teaching/life-and-dignity-of-the-human-person.cfm>

² "Community Investing: Toolkit for Faith-based Community," *US SIF: The Forum for Sustainable and Responsible Investment*, 2009, http://www.ussif.org/files/Publications/FaithBased_Toolkit.pdf

³ "Economic Justice for All: Pastoral Letter on Catholic Social Teaching and the U.S. Economy," *United States Conference of Catholic Bishops*, 1986, http://www.usccb.org/upload/economic_justice_for_all.pdf

⁴ "USCCB Socially Responsible Investing Guidelines," *United States Conference of Catholic Bishops*, November 12, 2003, <http://www.usccb.org/about/financial-reporting/socially-responsible-investment-guidelines.cfm>

⁵ The third party web site links are provided for your convenience and information only. The inclusion of these links is not and does not imply an affiliation, sponsorship, endorsement, approval, investigation, verification or monitoring by Morgan Stanley of any information contained on these web sites.

⁶ IW Financial is not affiliated with Morgan Stanley and acts as an independent contractor, subject to Morgan Stanley's on-going due diligence.

⁷ Best-in-class refers to IW Financial's ratings on selected ESG criteria relative to all companies in the Russell 3000 index for the same criteria. These ratings can be used for either negative (exclusionary) purposes to eliminate the worst performers or positively (inclusion or over-weighting), dependent on how the client wishes to approach the topics.

⁸ The investment manager examples are for illustrative purposes only and should not be deemed a recommendation to purchase, hold or sell any securities or investment products. They are intended to demonstrate the types of approaches taken by managers who focus on Catholic Values in their investment strategy. There can be no guarantee that a client's account will be managed as described herein.

⁹ Alternative investments may only be offered to clients by AI-qualified FAs/PWAs. Before AI-qualified FAs/PWAs may discuss a particular private fund with a prospective investor, they must confirm that the prospective investor meets the offering's minimum qualification requirements by submitting the appropriate client information into the firm's Reg D system. Only firm-approved offering materials (generally, the offering memorandum, pitchbook, and related materials) may be used to offer or sell interests in a particular fund.

¹⁰ Most alternative investments on the AIG platform are sold on a private placement basis to eligible clients who must be Accredited Investors and/or Qualified Purchasers depending on the requirements of the specific investment.

IMPORTANT INFORMATION

This publication is based on information from multiple sources and Morgan Stanley makes no representation as to the accuracy or completeness of information from sources outside of Morgan Stanley.

Investing in the market entails the risk of market volatility. The value of all types of investments may increase or decrease over varying time periods. The returns on a portfolio consisting primarily of faith-based investments may be lower or higher than a portfolio that is more diversified or where decisions are based solely on investment considerations.

Alternative investments often are speculative and include a high degree of risk. Investors could lose all of a substantial amount of their investment. Alternative investments are suitable only for eligible, long-term investors who are willing to forgo liquidity and put capital at risk for an indefinite period of time. They may be highly illiquid and can engage in leverage and other speculative practices that may increase the volatility and risk of loss. Funds of funds typically have higher fees than single manager vehicles as they are subject to an additional layer of fees charged by the fund of funds manager. Alternative investments involve complex tax structures, tax inefficient investing and delays in distributing important tax information.