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# Guideline for Ethically Sustainable Financial Investment in the German Protestant Church

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Evangelische Kirche  
in Deutschland

# **Guideline for Ethically Sustainable Financial Investment in the German Protestant Church**

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\* In the second and updated version the former chapter "Commodities" has been replaced by the rather comprehensive chapter on "Commodity Investing".

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## Foreword

People entrust their money to the Church to facilitate church work. The Protestant Church thus considers its management of church funds as a responsibility before God and the people. This applies to church work, to financial transactions, and to financial investments in particular. Placed funds and invested money remain the property of the investor who is responsible for what happens to this money. This issue is not simply a current topic: the Church has traditionally addressed the consequences and impact of financial investments.

When making financial investments, church organisation takes security and economic efficiency into consideration above all else, the more so since these investments serve predominantly to honour payment obligations. This economic principle is always valid. Yet, at the same time, it is stipulated that financial investments must not be contrary to the Church's mission. It is characteristic for the Protestant Church that in this respect broad and sometimes even diverging notions exist.

Commissioned by the Council of the Evangelical Church in Germany (EKD), the Working Group Church Investments in the German Protestant Church has thus elaborated this guideline, which has now been issued in a second and updated edition. It may be regarded as a compendium of standards. First and foremost, the guideline addresses church and institutional investors, but is also meant to help private individuals to channel their actions specifically towards their own mission. This guideline is not a statute, but a tool from which it may be necessary to deviate: the given references may be framed too restrictively for some, yet too broadly for others. Likewise, they are subject to constant revision as people and companies change their behaviour over time.

The Working Group will maintain and continually update this guideline. For references and new developments, please visit our website: [www.aki-ekd.de](http://www.aki-ekd.de). Suggestions are welcome—we aim to create a knowledge cycle for ethically sustainable investments.

*Heinz Thomas Striegler*  
Chair of the Working Group





## Church investment expectations – where do we stand?

"And whatever you do in word or deed, do all in the name of the Lord Jesus, giving thanks to God the Father through Him."

Colossians 3,17

In his Small Catechism, Martin Luther admonishes us to love and trust in God and to do good according to his commandments. In his explanation of the Seventh Commandment, Luther elaborates: "We should fear and love God that we may not take our neighbour's money or property, nor get them by false ware or dealing, but help him to improve and protect his property and business [that his means are preserved and his condition is improved]."

In the Leuenberg Agreement (II.1.d), it specifically says: "They [the Christians] stand up for justice and peace on earth between individuals and nations. In consequence, they must join with other people in seeking appropriate rational criteria and play their part in applying these criteria."

In line with this agreement, church activities in the field of investments should accord with God's Commandments and the Church's Mission rather than contradict them. The Church Mission consists in the proclamation of the Gospel, taking socially responsible actions (in terms of Diaconia), and in the commitment to peace, justice, and the responsibility for the integrity of creation for this world. Being a Protestant Christian also includes the freedom of conscious choice in view of one's responsibility before God and man.

## I. What does ethically sustainable investment mean?

Handling funds responsibly means investing them in an economically oriented manner and an adherence to the so-called 'Magic Triangle' which comprises three criteria: security, profitability, and liquidity. At the same time, the impact the investment may have on others must also be considered, thus supplementing the Magic Triangle with the criterion ethics/sustainability. The following therefore applies:

- Investments must be made according to **economic principles**
- At the same time it is vital to **address the investment's impact** on the environment, on the social world, and on posterity.

Hence, in consideration of our Christian values, investments should therefore be made which are

- socially compatible,
- ecological and,
- include intergenerational justice.

**"Socially compatible"** means the recognition of the inviolability of human dignity and worldwide respect for the civil, political, economic, social, and cultural rights and obligations of every human being.

**"Ecological"** means responsibility for the integrity of creation, and not merely protection of the environment and natural resources.

**"Intergenerational justice"** refers to the responsibility for the coexistence of the current generation in peace and justice as well as the conservation of development potentialities for future generations. ("Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.")<sup>1</sup>

Adhering to these criteria meets the requirements for **ethically sustainable financial investment**.

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1 Report of the World Commission on Environment and Development: Our Common Future 1987, page 41.

## II. How to invest money ethically

### 1. Investment Goals

In choosing a suitable investment, the criteria security, liquidity, and profitability are balanced so that, depending on the available total investment and other framework conditions, the aspired investment goals are attained with the best possible returns. In considering ethically sustainable principles, this so-called "Magic Triangle for Financial Investment" is extended to include the fourth dimension ethics/sustainability and becomes a "Magic Square."

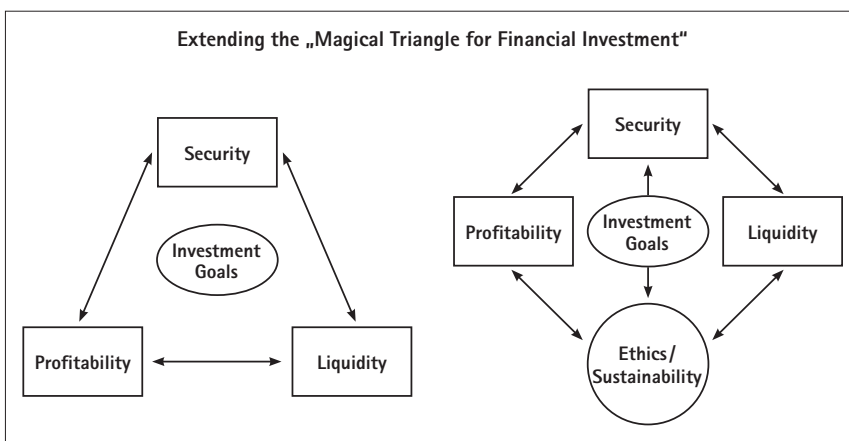


Fig. 1: For each investment, the criteria of security, liquidity, and profitability are balanced in the so-called Magic Triangle for Financial Investment. This enables the goal associated with the investment to be attained in the best possible way. In considering ethically sustainable principles, this is extended to include the criterion ethics/sustainability which then becomes a "Magic Square" without affecting the other goals in any way.

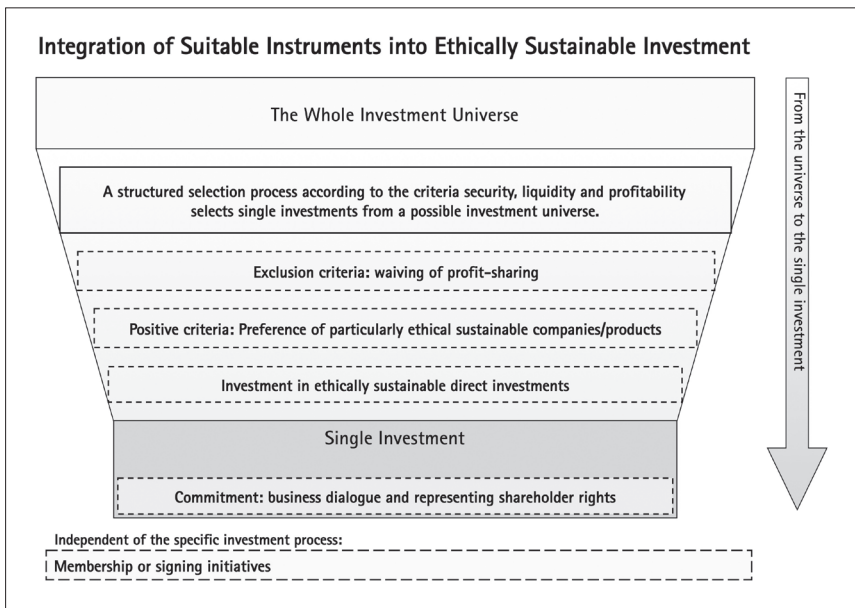
### 2. Implementation

Under the motto "promote, design, avoid", several instruments have been established in the money and capital markets regarding how investors can contribute ethically sustainable aspects to an investment. These instruments are

- laying down exclusion criteria
- inclusion of positive criteria
- ethically sustainable themed and direct investments

- active shareholder engagement (business dialogue and/or exercise of voting rights)
- membership in or signing of initiatives that correspond to the intentions of this guideline.

Based upon individual framework conditions and diverse objectives regarding the investment, each investor must decide which of the mentioned instruments is resorted to within the scope of the "magic square" so as to implement their general sustainability strategy ("modular system").



*Fig. 2: Investors make their decisions in consideration of the Magic Square components (security, liquidity, profitability, and ethics/sustainability).*

## III. Description of instruments

### 1. Exclusion Criteria (Negative Screening)

Exclusion criteria<sup>2</sup> are the standards used to determine which assets should be excluded from investment.

However, in defining or rather establishing exclusion criteria, a too narrow limitation of the available investment universe should be avoided so that the criteria security, profitability, and liquidity can still be adequately considered. Moreover, exclusion criteria should be defined in a way that allows for an unbiased review process (re-search process), which then generates an exclusion list.

#### 1.1 Excluding businesses

Excluding a company from the investment universe is **not** a basic rejection of the whole company. Instead, exclusion makes evident that, due to ethically sustainable motivation, investors do not wish to benefit from the **profit made** in form of dividends, interest, or capital gains.

Companies listed on the stock exchange are usually broadly diversified. This implies that within a company there may indeed exist individual business divisions which an investor rejects for certain reasons. As long as the share of this business division in the total company turnover does not amount to more than ten per cent maximum, exclusion should be discouraged on the basis of proportionality. In such a case, a direct business dialogue (see → 4. Active Shareholder Engagement) would be preferable to exclusion. However, companies involved, for instance, in the development or manufacturing of banned weapons should be excluded from investments regardless of the attributable share of turnover.

A further aspect is important in the exclusion of corporate bonds from certain issuers: by purchasing a bond the investor makes money available to the respective issuer to finance his company. The exclusion of certain companies can prevent the money from being invested in business ventures that the investor, for specific reasons, does not wish to fund. Here, too, the matter of proportionality should be likewise considered.

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2 In common parlance, the terms "negative list" and "negative criteria" are also often used.

### Exclusion criteria<sup>3</sup> for companies

1. Companies involved in the development or manufacture of **armaments** (in terms of the appendix to the War Weapons Control Act) as well as companies involved in the development or manufacture of **banned weapons**, regardless of their turnover share.
2. Companies producing **liquors** (minimum alcohol content 15 percentage by volume)
3. Companies manufacturing **tobacco** products
4. Companies conducting controversial forms of **gambling**
5. Companies manufacturing products that violate human dignity with **denigrating and degrading portrayals of persons**
6. Companies producing **genetically modified crops**
7. Companies manufacturing products that are produced in support or toleration of inhumane **labour conditions and child labour** (in terms of violating one of the fundamental ILO core labour standards) – including the supply chain.

Investors can lay down further exclusion criteria, for instance, for companies conducting unnecessary/non-statutory animal testing or embryonic stem cell research.

## 1.2 Excluding countries

Other than is the case with corporate bonds, no specific business purpose is financed in purchasing government bonds. The money invested is generally used to fund the state budget. Hence, the application of exclusion criteria for countries should ensure that the invested money only goes to countries that fulfil certain criteria.

### Exclusion criteria for countries:

1. Countries practising the **death penalty**
2. Countries classified as "**not free**" (in the terms of the organisation and research institution Freedom House)
3. Countries that did not ratify the **Kyoto Protocol** (or any of the follow-up protocols)
4. Countries that did not ratify the **Convention on Biological Diversity of the UNEP**
5. Countries perceived as **highly corrupt** (in terms of the CPI rating from Transparency International: Rating < 40; CPI = Corruption Perceptions Index)

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<sup>3</sup> More detailed information on the individual criteria is given in the appendix.

## 2. Positive Criteria

Among investment options of the same kind, it is the objective of positive criteria to identify and favour those that have a better rating in terms of ethics/sustainability. This is achieved by assessing companies, countries, and branches according to specific systematics by means of ethically sustainable criteria. The results of such analyses are lists that rate companies and industries according to the degree they fulfil given criteria.

The so-called **best-of-class approach** compares different industries with each other. An investor will then invest in assets that belong to the corresponding ethically sustainable best industries. However, this approach may lead to accumulated individual investments in only a few sectors, which does not seem reasonable considering the risk aspects.

A cluster risk of this kind avoids the so-called **best-in-class approach**. Here, all sector assets are compared to each other according to ethically sustainable aspects and brought into a rank order. Investors will then invest their money in the respectively best ethically sustainable assets from several industries, thus allowing a broad diversification of the investment.

The elaboration of such ranking lists requires a comprehensive research process conducted by specialised sustainability research agencies and banks. In a next step, the acquired knowledge is supplemented with economic data and then implemented into specific individual investments within a structured investment process. In practice, hybrids of the best-of-class and best-in-class approach have often evolved.

### Examples for Positive Criteria

In consideration of our Christian values, investment should be made socially compatible, ecologically, and with intergenerational justice.

#### **Socially compatible**

- Preference for companies that assume shared responsibility for the labour conditions in subsidiaries and suppliers worldwide, or have issued anti-discrimination programmes
- Preference for companies promoting further training for its entire staff
- Preference for companies that have formulated directives on the employees' right to assemble, reasonable working hours, or in favour of minimum wages

#### **Ecological**

- Preference for companies campaigning specifically for the reduction of pollutants emissions as well as a decreased consumption of commodities, water, and energy
- Preference for companies which further develop and promote the use of regenerative energies
- Preference for companies that have formulated their own environmental policies, or have implemented an individual environmental management system

#### **Intergenerational justice**

- Preference for companies allowing for an improved reconciliation of family and working life
- Preference for companies promoting actively in all regions measures for infrastructure development and the construction of schools or expansion of water and power supply systems
- Preference for companies developing or manufacturing products with a sustainable life cycle for instance by using sustainably produced commodities, or through organically degradable ingredients etc.
- Preference for companies guaranteeing health care within a community/society, or that engage in research in thus far neglected diseases
- Preference for companies, whose activities cause minimal impact on climate change

### **3. Themed and direct investments**

Direct investments are direct equity holding<sup>4</sup> or investments in material assets (real estate, infrastructure, commodities, agricultural investments). In this regard, direct investment is the investment strategy that is most likely to enable investors to realise their individual concepts of ethics and sustainability. At the same time, however, direct investments demand an extensive amount of work and controlling as well as intensive consideration of the underlying products.

Themed investments are investments focused on specific subjects.

Microfinance investments are a particular way of providing money to support people in developing and emerging countries.

Hedge funds and commodity investments in form of derivatives, funds, and certificates are not themed investments in the above-described terms, but also require special attention due to their manifold strategic options.

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4 The bargaining and sale of exchange-traded securities (e.g. shares) has already been described in chapter III, 1. and 2, and thus will not be repeated here.



### 3.1 Equity participation

Direct participation in a company is usually acquired via shares or so-called silent participation contributions. For rather long-term and experienced investors in particular, there is the option to make their money available as equity capital to finance start-up or fast-growing companies. These companies are usually not (yet) listed on the stock market (Private Equity).

Private equity participations usually have a rather long-term investment horizon. Another feature is the interim lack of fungibility. Due to the long-term investment phase of these participations, investors will receive no or only small payouts during the first years. At times, and especially during the investment stage, the investment value can sink below the cost value.

To date, ethically sustainable orientation of private equity securities is rather seldom and requires a thorough review—including if necessary the intervention of additional experts. Statements regarding exclusion and positive criteria apply correspondingly.

### 3.2 Real Estate

Real estate investing can be made directly (project development, purchase) as well as indirectly (fund investment). It is possible to involve ethically sustainable aspects into the whole life cycle of a realty property. This applies both for new buildings as well as for maintenance measures of portfolio properties.

#### Examples for considering ethically sustainable aspects at the different stages of a realty property cycle:

##### Planning stage

- Sustainable architecture of buildings (a large number of south-facing windows to collect direct sun, and a severe restriction of the number of north-facing windows)
- Harmonious co-existence of commercial and residential properties (noise pollution, social culture)
- Reconciliation of family and working life due to accessible child care
- Good connections to public transport
- Use of regionally available commodities
- Accessibility
- Environmental management (e.g. recyclable and compostable building materials)
- Quality of work place (acoustic, light, and climate quality, ceiling height, communication/com-munal rooms)

**Commissioning the (sub) contractors**

- Relation of temporary/leased staff vs. permanently employed staff
- Standard and/or agreed wages
- Prevention of undeclared work and corruption
- Promotion of small and medium-sized regional or local companies

**Construction stage**

- Prevention of unnecessary ecological damage
- Reduction of construction noise
- Use of modern energy-efficient and eco-friendly machines and vehicles
- Separation of construction waste and use of return systems/recycling
- Support for builders and residents

**Building management**

- Conservation of resources (e.g. waste management, use of drinking water)
- Energy efficiency
- Creation of safety aspects (e.g. by avoiding unlit car parks and alleys)
- Use of recyclable means of production
- Frequent restoration and maintenance

**Use**

- Consideration of exclusion and positive criteria in selection of tenants
- Creating communication/communal rooms
- Fair balance of interests between landlords and tenants

Today, a variety of rating systems exists to measure the sustainability of real estate such as BREEAM, LEED, or the *Deutsche Gütesiegel Nachhaltiges Bauen* of the German Sustainable Building Council (DGNB). So far, however, the rating system of certification is inconsistent and not really comparable.

The Evangelical Church in Germany offers several environmental management systems for real estate such as, for instance, *Der Grüne Gockel* or *Der Grüne Hahn*.

### 3.3 Infrastructure

"Infrastructure" refers to the economic and organisational basics required for the operation and development of a national economy. Infrastructure projects ensure the general public's supply of basic services and allow goods and information to be transferred to the consumer.

Investors with a long-term investment horizon can also become involved with such infrastructure projects as ports, toll roads, and airports as well as schools, hospitals,

communication systems, and energy supply. Frequently, the payout of dividends will not begin until termination of projects, often after several years. Political and economic risks cannot be excluded. Hence, new requirements regarding the management or security of a project, or higher environmental standards, often make additional investments necessary. Here, as in the case of private equity investment, the money invested is fixed for many years.

Participation in infrastructure projects that would be reasonable from an ethically sustainable point of view requires a high degree of expertise. Ethically sustainable assessment (e.g. ecological compatibility, societal benefits, etc.) must be made individually for every single project. The involvement of further experts is recommended.

### 3.4 Commodity Investing

From an ethically sustainable point of view, commodity investing often proves to be problematic.

Commodities are natural resources that are either consumed directly or used as primary material for further processing stages in production. The extraction of raw materials always involves an impact on nature. Moreover, recourse is often made to environmentally harmful chemical and physical methods. Likewise, labour conditions and their social impact in the production of raw materials are time and again subject to criticism.

If the investment takes place in form of stocks and corporate bonds or in terms of direct shares in the production of raw materials, the aforementioned instruments, exclusion and positive criteria, as well as active shareholder engagement, are used. Thus, in line with the criteria applying to companies manufacturing tobacco or radioactive materials used for nuclear weapons, these are excluded in the same manner as companies violating the ILO core labour standards or companies that, owing to corrupt structures, maintain monopolies at the expense of the local population. Hence, neither shares, corporate bonds, nor agricultural investments are subject of this passage.

For commodity investing, acquisition can be differentiated into three categories: direct acquisition, acquisition via future markets, and indirect acquisition via funds and certificates. They all have in common that inherent returns accrued from the investments are minimal; the intended added value is usually attained with the correct assessment of a price trend.

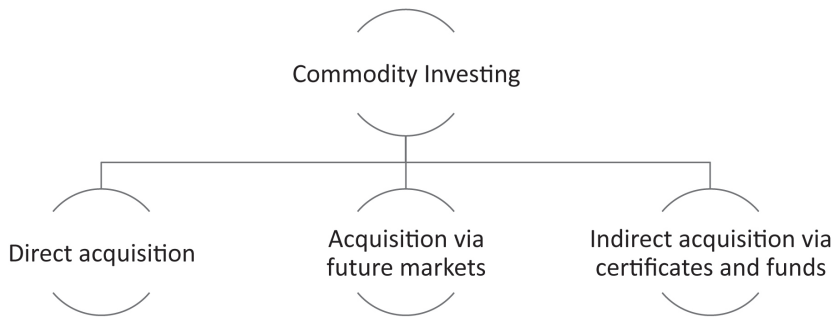


Fig. 3: Categories of commodity investing.

**Direct acquisition of commodities:** Since delivery and storage of commodities involves considerable efforts, the purchase of physical goods concerns primarily noble metals. One motive for investments in noble metals is protection against the depreciation of money.

The consideration of ethically sustainable aspects is difficult given that, for commodities, documentary evidence of origin is the exception rather than the rule. Where this does exist, the procedures of fair trade can be applied, for example, buying "Fairtrade and Fairmined" gold. In general, it is desirable when purchasing commodities that the processing industry pays attention to proof of origin and labour conditions of suppliers.

**Acquisition via future markets:** Corresponding financial instruments belong to the group of derivatives, which refer to an underlying asset. The decisions that sellers and buyers of derivatives make are guided by the assumed future value development of this underlying asset, for instance, the spot price of an individual commodity or commodity index.

Based on their motives, two main groups of market players can be distinguished here: producers, purchasers, and traders on the one hand, and financial investors on the other. The former seek a hedge against undesired changes in prices as well as a gain in certainty when planning, while the latter aim at profits through the correct assessment of price trends.

Future markets are trading centres for expected market prices and not for a trade volume, which will actually take effect in the future. Yet, it cannot be excluded that

future market activities affect commodity prices, namely in terms of boosting existing trends and by contributing to inflated prices.

From the ethically sustainable standpoint, it would be problematic if financial investors distorted food prices, thus leading to a worldwide aggravation of famine. Excessive price increases make the purchase of food more expensive for the consumer; excessive price cuts lead to declining profits for smallholder farming. In science, the debate on the effects of financial speculation with food is controversial. Unless doubts regarding a negative effect cannot be removed, from an ethically sustainable point of view, investment in food future markets should be excluded.

**Indirect acquisition through commodity certificates and funds:** Both for commodity funds as well as for commodity certificates, so-called Exchange Traded Funds (ETFs) or Exchange Traded Commodities (ETCs) respectively, products are traded on the stock exchange. As purely passive investments, their goal is to represent the value development of an underlying asset as precisely as possible. Corresponding underlying assets in the commodity sector are usually prices for individual commodities and indices on the future markets. Since the future markets are only open to investors who specialise in them, this product line creates indirect access for all investors.

If the underlying commodity certificate or fund is a basket of different commodities or an index, it is recommended to perform an analysis of the single values contained prior to the investment decision to ensure that the financial product fulfils the expectations of the investor. Moreover, care should be taken to make investment strategies and research processes adequately transparent. Should the analysis reveal that the single values include food, the concerns regarding food investments put forth in the section "acquisition via future markets" apply for those products as well: as long as it cannot be ruled out that trading with the corresponding commodity certificates and funds will impact food prices, they are out of question for an ethically sustainable investment.

### 3.5 Agricultural Investments

Agricultural investment refers to the purchase of arable land or forestry (timber). With this investment form, the investor benefits from rising land prices and the returns from annual crops or forest management (sale of timber). Hence, the risks are high due to possible price erosion for land or crops as well as crop losses due to weather events (high winds, hail, dry periods) or pest infestations.

From an ethically sustainable point of view, such an investment is problematic if it encourages exploitation, monocultures, deforestation, and uncontrolled logging, or

if it generates (in the short term) higher yields owing to the use of fertilisers. Since many of these investments are made in emerging or developing countries, they can carry considerable risks of different types, including displacement of local populations, undermining or negating of existing rights, increased corruption, reduced food security, environmental damage in the project area and beyond, loss of livelihoods or opportunity for land access by the vulnerable, nutritional deprivation, social polarization, and political instability. Moreover, large-scale irrigation systems may cause problems in the drinking water supply or groundwater depletion.

On the other hand, investment in the agricultural sector offers significant potential to complement public resources by creating necessary and useful infrastructure for the general public (such as, for instance, improved drinking water supply, irrigation systems, or agricultural technology for smallholders). Or it may help in halting deforestation and conserving forest areas.

Generally, the holding period of an agricultural investment is rather long. Forest areas in particular need between ten and 30 years in growth before generating notable returns.

Assessing the ethically sustainable aspects of agricultural investments requires a high degree of expertise, and the involvement of additional specialists is recommended.

### 3.6 Themed Investments

Themed investing offers the investor the opportunity to invest in the successful trend of a specific industry or technology, selected according to ethically sustainable aspects.

Examples for themed investing are shares in companies or projects

- promoting or developing energy from renewable sources (solar, wind power, hydro power)
- with a sustainable approach to the resource water (supply and waste disposal, water treatment, water consumption)
- developing and producing emission reducing technologies
- committed to the principles of fair trade
- supporting circular economy /recycling

It should be noted, however, that due to the limitation of the available investment horizon there might be an increased risk owing to the lack of diversification opportunities. Statements regarding exclusion and positive criteria apply accordingly.

### 3.7 Microfinance

Microfinance refers to provision of basic financial services such as loans, investments, or insurance for clients in developing and emerging countries, who for different reasons lack access to traditional banks.

Microfinance is understood to entail the granting of very small loans (microloans) by Microfinance Institutions (MFI) to impoverished population groups with a low income, who traditionally lack a verifiable credit history. Typically, it provides borrowers with the option to improve their individual income situation, for instance, by founding or expanding microbusinesses. The frequent criticism of microfinance investments concerns the often very high level of interest rates that end buyers must pay. Though interest rates are lower than those of local money traders, this aspect must be reviewed before investing in microfinance products.

In the past, the appeal of microfinance products has been explained with the repayment rate of microcredits, which has often been higher than the repayment rate in the conventional credit transactions of domestic banks. Given that these constellations can change at any time, this aspect should not serve as the single argument for an investment decision in microfinance.

MFI likewise offer local populations the opportunity to save assets. These investments earn interest and can be provided by MFIs as credits. Often, the savers do not qualify as clients for traditional commercial banks since they do not have a regular income or lack the necessary documentation. The market for micro-insurance as protection, for instance, against the loss of crops or health risks, is just about to emerge.

The investor does not usually directly invest in MFIs, but instead uses an intermediary. This may be, for example, a bank, a cooperative, or a limited liable company, which then transfers the invested funds to the local MFIs which grant the actual microcredits.

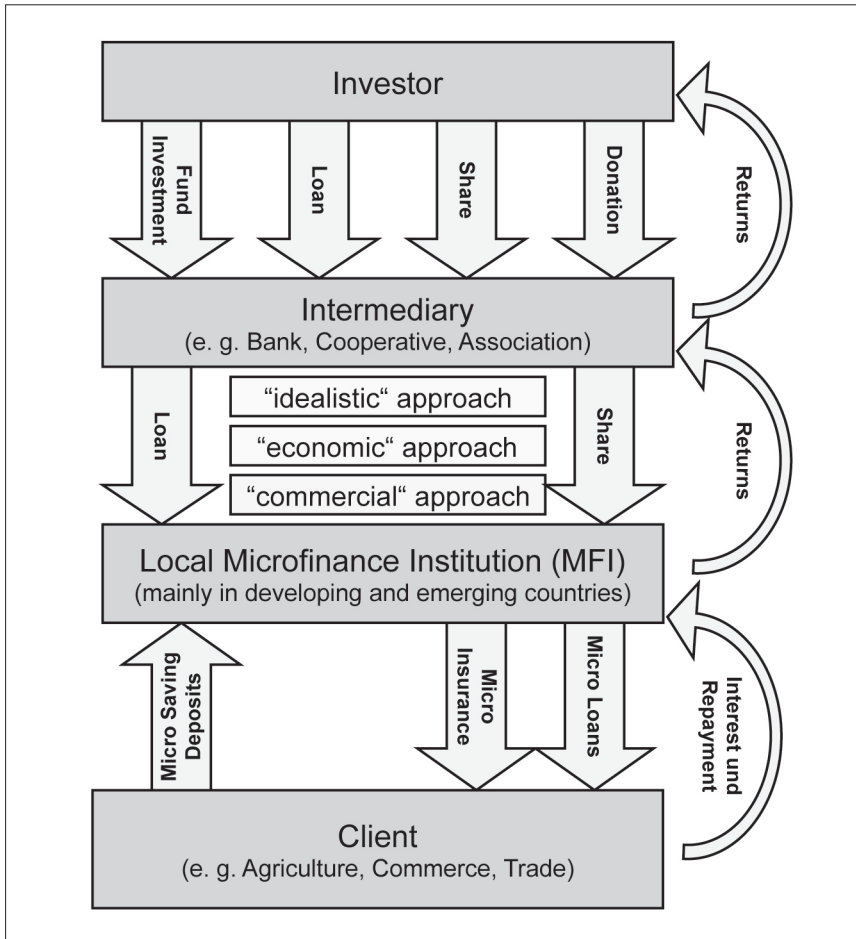


Fig. 4: Diagram of microfinance parties.

Therefore, the intermediary (and likewise implicitly the local MFI) must be chosen with great care since this selection decides on the intention of the microcredit transaction. Hence, it is of importance for the investor if the intermediary or the MFI takes a rather "idealistic" approach when providing the money without or for low interest (subvention of MFI and microcredit interest rates), or if the goal of "economic" benefits for everyone involved is pursued (return in line with market conditions of the invested funds, cost-covering organisation of the MFI, but also higher microcredit interest rates). The granting of "commercial" microcredits for consumption purposes must be refused since this often marks the beginnings of the debt trap.



### 3.8 Hedge Funds

From an ethically sustainable point of view, investments in hedge funds are often problematic.

According to § 112 of German Investment Law, hedge funds are special assets with additional risks.

They use flexible investment methods in different market phases with the goal of generating high returns. Hedge funds basically possess great freedom of investment. Due to the variety of hedge fund strategies in the market, ranging from rather conservative to highly speculative, a general statement regarding possible investment is not appropriate. The assessment of a possible investment (including consideration of ethically sustainable aspects) in hedge funds requires a high degree of expertise and the involvement of additional specialists is recommended.

**The following aspects must be reviewed before making an investment decision:**

- Transparency of the investment process
- Traceability of investment decisions
- Appropriate leverage
- Taxation and domiciliation of hedge funds
- Consideration of ethically sustainable aspects

## 4. Active Shareholder Engagement

Another key instrument for ethically responsible investors is taking an active approach to the company, since they actually account for the use of their capital, for instance, as a share or bond. Suited for this approach is, for example, dialogue with companies, the exercise of voting rights as well as the participation in committees (advisory boards, etc.).

So far, many engagement processes focus on meeting corporate governance criteria. The active shareholder engagement of church investors, however, is beyond that, basically geared toward the criteria social compatibility, ecology, and intergenerational equity. Respecting those criteria often serves the improvement and long-term

sustainability of the company's added value, and assists it in doing justice to its social responsibility.

Hence the following forms of active engagement should accompany church investments:

#### **4.1 Business dialogue**

The main reason for entering into a constructive dialogue with companies is to achieve the necessary improvements in ethically sustainable corporate governance.

The first stage of this dialogue should be an exchange of ideas and information either in written form or in a personal interview—taking place in private.

The non-public business dialogue is the best way to achieve the engagement goals – assuming the sincerity of everyone involved is provided. A public debate may prove counter-productive for both the company as well as the investor, and thus for the whole venture.

Yet, this does not preclude the possibility of supplementing this dialogue with a public exchange of views, if necessary.

#### **4.2 Exertion of voting rights**

Investors are not entitled to vote on company issues until they have purchased voting shares (for instance, equities, cooperative certificates, etc.). The previously held business dialogue gives added weight to this right. However, the mere exertion of the voting right does not reveal to the company why a proposal in the general meeting does not meet with approval and what the needs are for amendment. Therefore, it is advantageous to explain to the respective company, within the scope of active engagement, why and with what objective the voting right is exercised.

The voting right can be exercised

- a) with regard to existing applications as well as to obtain information,
- b) to submit applications of one's own (e.g. new item on the agenda).

Depending on the legal framework in each country, this may be difficult to implement since there are diverse barriers for filing an application in the general meeting.

## 5. Memberships and Initiatives

Another option—independent of specific investment decisions—for pursuing ethically sustainable goals is the support of initiatives and associations that emerge at regional, national, and international level to promote ethical and sustainable objectives. Thus, investors can publicly demonstrate that they also support the goals of the particular initiatives. Furthermore, this benefits networking as well as the exchange of experience and information.

### 5.1 Memberships

Every investor has the opportunity to support the objectives of associations advocating ethically sustainable investment. Memberships usually involve membership contributions.

Examples for such associations are the Berlin-based "Forum for Sustainable Money Investment" (*Forum Nachhaltige Geldanlagen e. V.*) which has about 150 corporate members promoting sustainable investment; the *Südwind Institute* which helps church and non-religious private and institutional investors with the implementation of socially responsible investments, and the *Corporate Responsibility Interface Center* (CRIC), an association for ethically guided investors which pursues the goal to add more weight to ecological and socio-cultural aspects in companies.

### 5.2 Initiatives

Worldwide initiatives have emerged campaigning for ethically sustainable goals. In some cases, being a signatory or supporter of an initiative may entail additional input in terms of money or working time/power.

Examples for those initiatives are the United Nations-supported *Principles for Responsible Investment* (PRI) Initiative<sup>5</sup> which so far counts more than 250 asset owner and over 700 investment manager signatories committed to considering environmental, social, and governance (ESG) criteria in their investment processes and decision-making; or the *Carbon Disclosure Project*, which on behalf of more than 700 institutional investors tackles climate change and helps companies to understand and manage their proper greenhouse gas emissions.

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5 Cf. the entire document in the appendix.

## IV. Practical Implementation

The guidance given in the following section is meant to help implement ethically sustainable aspects in the decision-making process of an investment. Since implementation of the instruments described above is not always easy, it may be useful to resort to the advisory service of others. Church banks in particular can provide the relevant expertise. Likewise, numerous research possibilities already exist around the Internet.

### 1. Exclusion criteria

Once investors have decided to apply certain exclusion criteria, a systematic research process is planned and conducted. The companies or countries contained in their investment universe will be analysed with regard to the exclusion criteria they have laid down. The outcome of this analysis should be a specific list of assets to be excluded, which the investor will no longer fund. Given that such a research process is time-consuming and comprehensive, it is mainly conducted by sustainability research analysts and appropriate banks.

Taking such a negative list into consideration is unproblematic for the **direct purchase** and deposit of government bonds or corporate bonds and shares. Yet, the magic square criteria must always be considered. This also includes adequate risk diversification through the distribution of amounts invested among sufficient assets within an asset class (principle of diversification).

Due to the lack of diversification opportunities, the direct purchase of bonds and shares is not always recommended for smaller investors. For them, a great number of ethically sustainable oriented **mutual funds** is available, which already consider exclusion criteria in their investment policy. These criteria, however, must not necessarily be consistent with one's own carefully formulated exclusion criteria. Hence, prior to the purchase of fund shares, an analysis should be performed to determine the funds whose foci best correspond with the investor's goals. Moreover, it should be considered whether the investment strategies and research processes are sufficiently transparent. The same applies for **index products** (e.g. ETFs or index certificates).

For investments in **special funds/asset management**, it is usually no problem to pass on the negative list to the corresponding fund manager.

## 2. Positive criteria

The decision to include positive criteria in the investment likewise requires conducting a research process.

For the investment of smaller amounts of money, a variety of ethically sustainable oriented **mutual funds** does already exist, which conduct the research process; in most cases using the best-in-class-approach, sometimes supplemented with exclusion criteria. Hence, prior to purchasing fund shares, an analysis should also be performed here in order to select those funds whose foci best correspond with the investor's goals. The same applies for **index products**.

Obviously, investors may decide not to purchase such ready-made products and define instead individual positive criteria; they would then conduct the research process and give the resulting positive list to their bank as a guideline to be considered in the systematic investment process in **special funds / asset management**. By deliberately limiting the available investment horizon, the investor strengthens the ethically sustainable orientation of the fund.

## 3. Themed and direct investments

Direct investments are the most immediate option to invest money according to ethically sustainable aspects. Nonetheless, risks may also be notably higher here than in other investment forms.

Investors may invest their money either via the purchase of shares in open-end investment funds, through the direct purchase of the negotiated stocks, or through investment in holding companies—mostly in form of close-ended funds.

### 3.1 Open-end funds/Themed funds

**Open-ended investment funds** collect predominantly smaller sums from many investors which are then invested with a target-oriented approach and bundled in major sums. If the investment strategy of open-ended investment funds consists in emphasizing selected industries, technologies, or issues regarded as particularly promising or worthy of support, they are also called **themed funds**. This includes, for instance, ethical, water, solar, or forestry funds, but also real estate and infrastructure funds.

In themed funds, the principle of diversified investments often becomes less important for the benefit of the thematic focus. This may indeed induce a higher risk than a widely diversified equity or pension fund. The same applies for **index products**.

### 3.2 Direct participation

**Direct participation** is often restricted to specific (regional) projects, such as for instance, erecting a wind turbine, building a local residential complex for senior citizens, or a biomass / solar power station. The nature of the investment turns into a direct partnership in the funding of the project. Comprehensive knowledge about project handling as well as legal reviews and (tax) audits are indispensable for direct participation. Early availability of the sums invested is seldom possible. Moreover, participation of that type is not subject to the rules of financial supervision.

A special form of direct participation is the purchase of subordinated capital (e.g. profit sharing rights). Profit-shares are often higher than for stocks, but are acquired by waiving voting rights. Moreover, in the case of insolvency, other terms apply than for shareholders. That is, the particular terms of contract must be closely examined in the purchase of subordinated capital.

### 3.3 Closed-end funds (Private Equity Fund)

For investment in **closed-ended funds**, a number of a priori limited shareholders participate with fixed sums and for a fixed, long-term period in specific projects (like for instance, offshore wind farms, forests, real estate projects, or incorporated/ stock companies not listed on the stock markets). Owing to the legal form (a limited company in most cases), the investor assumes as shareholder the entire rewards and risks of a company, which in the worst case may lead to a total loss of the investment. Reviewing this type of investment is quite complex and refers in addition to investment likewise to legal, tax, and economic components. Premature availability of the sums invested is seldom possible.

## 4. Active Shareholder Engagement

Active Engagement is an important instrument of ethically sustainable investment. Investors can become engaged by

1. entering into dialogue with the company themselves and actively exercise their voting rights,
2. entrusting specialised external service providers or church banks with the exercise.

Companies listed on the stock exchange usually show such high capitalisation that individual church investors can only include their own particular interests with little effect. Hence, the coordination and merging of engagements is recommended.

## 5. Matrix of Instruments

Ethically sustainable instruments can be included into almost any type of financial investment, albeit not simultaneously. The following table may provide assistance in reviewing which instruments tailored to the specific conditions of each asset class make sense for which investment:

	Exclusion Criteria	Positive Criteria	Theme / Direct Investment	Active Shareholder Engagement	
				Exercise of Voting Rights	Business Dialogue
				III.1	III.2
Shares	✓	✓	✓	✓	✓
Government Bonds	✓	✓	✓ conditional		
Corporate Bonds	✓	✓	✓		✓

	Exclusion Criteria	Positive Criteria	Theme / Direct Investment	Active Shareholder Engagement	
				Exercise of Voting Rights	Business Dialogue
				III.1	III.2
Subordinated Capital	✓	✓	✓		✓
Private Equity	✓	✓	✓	✓ conditional	✓
Real Estate	✓	✓ conditional	✓		
Infrastructure	✓		✓		
Raw Materials	✓		✓		
Agricultural Investment	✓		✓		
Micro Finance	✓		✓		
Hedgefonds	✓ conditional	✓ conditional			

Tab. 1: Tool Matrix.

## 6. Banking Services

Not only in choosing the right financial investment should the investor consider ethically sustainable aspects. Likewise, the decision-making process for the right bank as a business partner for the required banking services enables the endorsement of ethically sustainable concerns.



**The following questions, for example, could be discussed in a consultation with the bank before establishing a business relationship:**

- Does the bank have a Mission Statement or a Code of Conduct in accordance with ethically sustainable objectives (e.g. compliance with the standards governing the relationship with clients or regarding the granting of loans)?
- Does the bank receive ethically sustainable guidance from, for instance, an advisory board or ethics council?
- Does the bank frequently publish sustainability reports?
- Are the bank's own investments made according to ethically sustainable issues?
- Does the bank have guidelines in place to prevent business from being made with companies or countries violating universally acknowledged conventions such as, for instance, ILO standards?

Church banks are particularly well qualified to meet these standards.

# Appendix

## 1. Explanatory notes on exclusion criteria

### Armament

Weapons and armaments cannot only be used for defence but also for aggression. This runs counter to the churches' mission of peace. A comprehensible list as to which weapons and military equipment are regarded as armaments, is provided in the appendix to the War Weapons Control Act. According to this list weapons of war include for example:

- Weapons of mass destruction (biological, chemical, nuclear and radiological)
- Fighter aircrafts, attack helicopters, warships, submarines, and tanks
- Missile weapons including the corresponding launchers
- Small arms (except for hunting and sporting weapons)
- Howitzers, land mines, naval mines, anti-personnel mines, explosive bombs (booby traps)
- Ammunition

Companies producing cluster munition or land mines and other controversial and banned weapons (that is, weapons whose use has been prohibited by conventions) should generally be excluded, even if the turnover is below 10 per cent. The *Convention on Prohibitions or Restrictions on the Use of Certain Conventional Weapons Which May Be Deemed to Be Excessively Injurious or to Have Indiscriminate Effects (with Protocols I, II and III)* is for example such an agreement.

### Liquors

The consumption of alcoholic spirit beverages lies in the personal responsibility of every individual; however, excessive or permanent use of spirits holds an increased risk of addiction.

The limit mentioned in the criterion approximately marks the transition from alcoholic beverages such as wine and beer (about 3–14 per cent) to liquors (15–80 per cent). This also includes the manufacturers of so-called alcopops, if they are based on spirits.

## **Tobacco products**

The consumption of tobacco products lies in the personal responsibility of every individual, but excessive or permanent use of these substances is associated with the considerable risk of addiction.

## **Gambling**

Gambling is problematic not least because it can lead to or foster gambling addiction or ludomania. This is especially the case where there is only short time left between stake and result to reflect one's own actions and become promptly aware of the losses. In terms of this exclusion criterion the following types of gambling are considered as "controversial": certain sports bets, electronic gaming like slot machines, virtual casinos etc. Not included, however, are state lotteries or the like.

Besides the above-mentioned "classic" gambles certain computer games must be considered as potentially addictive media. However, so far research results in this regard are not sufficient enough to include that sector into this exclusion criterion.

## **Violation of human dignity/Pornography**

The belief that women and men are created in God's image also includes human dignity, and thus the mission to protect this dignity against derogatory, denigrating or degrading portrayals. The analysis of this criterion should not only consider pornographic products, but also the producers of videos depicting violence and likewise computer games glamorizing violence.

## **Genetically modified crops**

Due to different application possibilities (like for instance DNA sequencing, marker assisted selection, generation of genetically modified crops) the use of genetic engineering techniques in plant breeding is not excluded as a rule. Hence this exclusion criterion refers to companies significantly producing genetically modified crops. What can be discerned here are above all socio-economic risks (the issue of extreme market concentration, increasing clustering of the value-added chain with just a few companies and the granting of biological patents), ecologic risks (the hazard of contaminating "conventional" plants) and health hazards (resistances). That also includes the production of genetically modified woody plants (for example, wood

for paper manufacturing, fruit trees). Green genetic engineering entails major risks.

Since the application possibilities of genetic engineering are rather dynamic, continuous review and adjustment of the criterion is required.

### **Violation of ILO Standards**

The International Labour Organization (ILO) is a special agency of the UN and has four fundamental principles which have been specified with several core labour standards and a variety of additional conventions and recommendations. The ILO Declaration covers four fundamental principles and rights

- Freedom of association and the effective recognition of the right to collective bargaining
- Elimination of all forms of forced or compulsory labour
- Effective abolition of child labour
- Elimination of discrimination in respect of employment and occupation

A company should not be considered in the investment universe, if it knowingly violates the ILO core labour standards, or does not take measures to stop violations that have become known – including its suppliers. The exclusion of a company based on this criterion requires intensive and meticulous research.

### **Death Penalty**

Executing the death penalty is incompatible with the protection of human dignity. Thus the death penalty should be opposed on principle.

### **Classification "Not-Free"**

The research institute *Freedom House* issues an annual *Freedom in the World* report that seeks to assess the degree of political freedoms and civil liberties in countries all over the world on a scale from 1 (most free) to 7 (least free). The scope "not free" ranges from 5.5 to 7.0.

## Kyoto Protocol

The absorptive capacities of the environmental media – water, soil, and air – must not be exceeded from the sustainable point of view. An obvious sign for the wish to protect the environment is the ratification of the Kyoto Protocol, which is the first international treaty to set international legally binding target values on the emissions of greenhouse gases.

Many countries and organisations seek the ratification of a follow-up agreement to the Kyoto Protocol after the completion of the first commitment term (2008-2012). The protocol was amended in 2012 to accommodate the second commitment period, but this amendment has not yet entered into legal force.

## Biodiversity Convention

The conservation of biodiversity (biological diversity) is a crucial responsibility for the integrity of creation. A clear statement in favour of this goal is the fact that the Convention on Biological Diversity (CBD) is an international legally binding treaty.

## Corruption

*Transparency International* annually publishes a *Corruption Perceptions Index* (CPI), which describes the degree of public sector corruption in a country as perceived by business people and experts. The scale ranges from 0 (highly corrupt) to 100 (very clean). All countries with a rating below 40 should be excluded.

## 2. The Six Principles of Responsible Investment (UN PRI)

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

### **3. List of links (selection – in alphabetical order)**

#### **General Information and Publications:**

- |  |  |
|--|--|
| AKI – Working Group Church Investments   | - <a href="http://www.aki-ekd.de">www.aki-ekd.de</a>                               |
| Brot für die Welt – Development Criteria | - <a href="http://www.brot-fuer-die-welt.de">www.brot-fuer-die-welt.de</a>         |
| Church finances                          | - <a href="http://www.kirchenfinanzen.de">www.kirchenfinanzen.de</a>               |
| Projekt „Zukunft einkaufen“              | - <a href="http://www.zukunft-einkaufen.de">www.zukunft-einkaufen.de</a>           |
| Publications and statements              | - <a href="http://www.ekd.de/english/index.html">www.ekd.de/english/index.html</a> |
| Südwind e.V.                             | - <a href="http://www.suedwind-institut.de">www.suedwind-institut.de</a>           |

### **Banks of the Church:**

- Bank for Church and Diaconia, Dortmund - [www.kd-bank.de](http://www.kd-bank.de)
- Evangelische Darlehnsgenossenschaft eG, Kiel - [www.edg-kiel.de](http://www.edg-kiel.de)
- Evangelische Kreditgenossenschaft eG, Kassel - [www.ekk.de](http://www.ekk.de)

### **Research Agencies:**

- Imug - [www.imug.de](http://www.imug.de)
- Oekom research - [www.oekom-research.de](http://www.oekom-research.de)
- Sustainalytics - [www.sustainalytics.com](http://www.sustainalytics.com)

### **Provider Database:**

- Sustainable Business Institute - [www.nachhaltiges-investment.org](http://www.nachhaltiges-investment.org)

### **Initiatives:**

- Corporate Responsibility Interface Center - [www.cric-online.org](http://www.cric-online.org)
- European Sustainable Investment Forum - [www.eurosif.org](http://www.eurosif.org)
- Forum Sustainable Money Investment - [www.forum-ng.de](http://www.forum-ng.de)
- Principles for Responsible Investment - [www.unpri.org](http://www.unpri.org)

### **Real Estate Certification:**

- BREEAM - [www.breeam.org](http://www.breeam.org)
- German Sustainable Building Council - [www.dgnb.de/en/](http://www.dgnb.de/en/)
- Grüner Gockel/Grüner Hahn - [www.gruener-gockel.de](http://www.gruener-gockel.de)
- LEED - [www.usgbc.org](http://www.usgbc.org)

### **Microfinance Organisations:**

- Oikocredit - [www.oikocredit.org](http://www.oikocredit.org)
- Procredit - [www.procredit-holding.com](http://www.procredit-holding.com)
- Responsability - [www.responsability.com](http://www.responsability.com)

### **Other Organisations:**

- Freedom House - [www.freedomhouse.org](http://www.freedomhouse.org)
- ILO - [www.ilo.org](http://www.ilo.org)
- Transparency International - [www.transparency.de](http://www.transparency.de)
- UNEP - [www.unep.org](http://www.unep.org)

## 4. Glossary

**BREEAM** – Building Research Establishment Environmental Assessment Method is a certification method for buildings and entails numerous environmental and sustainability aspects. It was established in 1990 in Great Britain and underwent a significant facelift in 2008.

**Brundtland Report** – The report of the World Commission on Environment and Development, *Our Common Future*, was published in 1987. The former Prime Minister of Norway Gro Harlem Brundtland was chairwoman of the commission.

**Corporate Governance** – Responsible business management and control

**ETF** – An Exchange-Traded Fund is an investment fund traded on stock exchanges. ETFs are largely passively managed portfolios and track an index in the process.

**Genome Analysis** – DNA sequencing is the process of determining the predisposition of an individual human being, in which his genetic make-up is checked for possible disease-triggering dispositions or other liabilities.

**Intermediary** – A mediator who goes between various actors

**Small Catechism** – Written and published by Martin Luther the Small Catechism wants to be understood as an introduction into Christian faith.

**War Weapons Control Act** – Implementing law to Article 26 of the Basic Law, which regulates the manufacture, transfer, placing, purchase and transport of war weapons.

**Land grabbing** – Appropriation of land; large-scale land acquisitions: the buying or leasing of large pieces of land in developing countries by private and government investors. The target is food security in the *investing* countries wishing to secure their *own* supply. Another goal is to secure water rights. Hence the local population can no longer use the corresponding agricultural areas, subsequently destroying smallholder livelihoods. It entails the danger of increasing local food prices, deteriorating food situation with increased necessary food imports as well as damages to environment and biodiversity.



**LEED** – Leadership in Energy and Environment Design is an US system developed by the U.S. Green Building Council for the classification of green buildings. It was developed in 1998 based upon the BREEAM system and rates buildings by awarding points for individual criteria.

**Leuenberg Concord** – Constitutive document of the Community of Protestant Churches in Europe. In 1973 the member churches agreed in Leuenberg near Basel on pulpit and table fellowship as well as communion in witness and service.

**Marker assisted selection** – A process used in plant and animal breeding whereby a marker is used for the selection of a genetic determinant or determinants of a trait of interest.

**Open-end/closed-end funds** – An open-end fund is a collective investment scheme that allows investors to acquire shares in bigger investments even for relatively modest amounts of money. In general, shares can be issued and redeemed at any time. Closed-end funds provide investors with the opportunity to purchase shares for specific projects, whose number is fixed. The shares can only be purchased and sold in the market.

**Offshore wind power** – A group of wind turbines in the same location in a body of water to generate electricity from wind.

**Mutual/Specialist funds** – Mutual funds are investment funds that are open to the general public. Institutional investors, however, may only acquire shares of specialist funds.

**Private Equity** – Equity capital, where the participation to which the capital provider agreed is not traded on the stock markets. If the capital is made available to young and innovative businesses or if there is a high risk (with a correspondingly high growth prospect) involved one also refers to venture capital.

**[Securities] Research** – Research analysts perform financial analyses of companies and capital investments regarding specific aspects, the result of which serve as a basis for an investment decision.

**Timber** – aka lumber; used in investments as a direct investment in woods, plantations or other forestry projects.

**Genetically modified crops** are plants into which genes foreign to the species have been introduced. In natural conditions the hereditary disposition would not happen due to crossing or natural breeding. If bacteria transfer certain genes to plant hosts, these plants can independently develop toxins to resist pests.

## **5. Members of the Working Group Church Investments**

For a current member list of the Working Group Church Investments (*Arbeitskreis Kirchliche Investments*, AKI) please go to:

[www.aki-ekd.de/arbeitskreis-kirchliche-investments/mitglieder/](http://www.aki-ekd.de/arbeitskreis-kirchliche-investments/mitglieder/)



