



Faithful Investing vs. ESG Investing

Christian investors call for consistency

Investors, increasingly concerned about the ethical dimension of investment, are not satisfied with simply meeting environmental, social and governance criteria.

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A new direction for investment

ESG investing has notable weaknesses, stemming from its lack of consistency, which do not convince many investors.

Socially responsible investing has gained prominence in the world of finance. ESG (Environmental, Social and Governance) criteria are now offered as investment guidelines for those who seek to bring their decision in line with certain principles commonly accepted by society.

In principle, ESG Ratings arise due to the greater social awareness among investors today. The misuse and abuse of natural resources, the injustices suffered by workers in past decades, especially in the 20th century, or the social problems caused by certain business activities (such as those derived from pornography or gambling) have highlighted the need to invest according to criteria that fall under the umbrella of so-called Socially Responsible Investment. However, investment according to these criteria presents notable weaknesses, derived from its lack of consistency, which do not convince many investors.

It is precisely for the latter that Faithful Investing is born. This type of investment introduces Christian thinking into the investment universe and allows the construction of portfolios that are consistent with the Christian faith by respecting and promoting human life and the family, the dignity of the human being, and the value of creation. The acceptance of this type of investment could lead the financial sector to undergo a substantial change that would affect both investors and markets. **Objectivity, transparency, and clarity are just some of the attributes that accompany Faithful Investing and make it a perfect alternative to what until now has been presented as the only option available to investors.**



Weaknesses of the **ESG** criteria

01

Different combinations, different ratings

To develop an "ESG filter" agencies use three parameters:

Scope

One agency might consider in its analysis the labor policies developed by the company, carbon emissions or other forms of pollution. Another, however, might decide to evaluate one of these areas (labor policies), abandoning others (carbon emissions) and even introducing a new one (gender equality policies).

Measurement

In assessing the same area – for example, labor policies – one agency will look at actual working time while another will look at the company's pending labor law litigation.



If each agency uses different valuation criteria for the same area, then there will be situations in which, for the same company and in the same area, the valuations are radically different.

Weight

Each rating agency gives a different weight to each of the areas of evaluation with respect to the overall score. For example, an agency may give more weight to the environmental category, so that a company's poor performance in this area will result in a lower overall score than if the failure was in another area such as labor equality or community engagement.

02

"Rater Effect" or subjectivity of the analyst

Another problem that should not be overlooked is what is known in psychology as the "rater effect". This disadvantage accompanies any analysis of a company's performance, since a certain degree of subjective judgment on the part of the analyst is always necessary to be able to make an assessment of this type.

The analyst's overall view of a company determines the analyst's assessment of each of the specific categories (E-S-G) in which the company operates. Thus, given that "ESG rating agencies usually divide analysts' work by company rather than by category"^[1], the rater effect becomes an important factor that could contribute to the lack of objectivity of the ratings. For example, if the analyst rates the company's human rights performance positively, he or she will already be predisposed to an equally positive rating in relation to the company's social or labor policies. For this reason, a rating with a low rater effect will be one in which the correlation between the different areas of analysis is small (i.e., some aspects can be rated very positively and others not so positively, or even negatively).

[1] MIT Sloan School of Management, 2019. *Aggregate confusion: The Divergence of ESG ratings*. [online] Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533 [Accessed 15 August 2021].

03

Correlation among rating agencies

According to data provided by a recent MIT Sloan School Of Management study² the correlation between the different ESG rating agencies is lower than might be expected. The MIT analysis examines six rating agencies that cover a substantial part of the global ESG ratings industry.

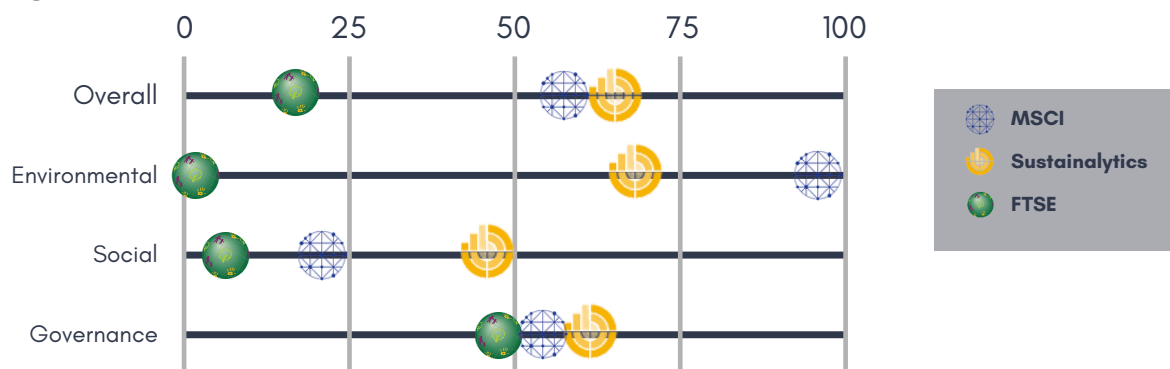


For the environmental dimension (E) there is an average degree of coincidence of 0.54, this being the area in which the correlation is highest. For the social (S) and governance (G) dimensions, the average coincidence drops to 0.53 and 0.42, respectively.

A weak correlation between two rating agencies may be due either to a generalized disagreement in the way companies are evaluated as a whole, or to a significant disagreement in the way a few companies are rated. **This means that there are not only divergences in the way the evaluation parameters are combined in general (scope, measurement, weight) but also in the way they are combined for each individual company.**

A report by London-based asset manager SCM Direct³ gives an example of this by looking at the case of the famous car company Tesla. In 2019, MSCI rated the company as a leader in its sector in terms of environmental protection, as it viewed the benefits of the clean technologies installed in the company's products very positively. However, in the same year, FTSE gave it the lowest rating for its environmental performance, because it took into account the gas emissions from Tesla's factories, while Sustainalytics opted for a medium score. The rating scheme was as follows:

TESLA



Source: SCM Direct

[2] MIT Sloan School of Management, 2019. *Aggregate confusion: The Divergence of ESG ratings*. [online] Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533 [Accessed 15 August 2021].

[3] SCM Direct. (2019). *Greenwashing: Misclassification and mis-selling of ethical investments*. Available at: <https://scmdirect.com/wp-content/uploads/2019/11/SCM-Direct-Greenwashing-Report.pdf>

04

Verification of the content of sustainability reports

Unlike other types of company analysis, which are based on public, objective and audited (or verified) data, **the main source of analysis for ESG valuation is the companies' sustainability reports.**

As noted in a recent report by Anna Hirai ⁴, of the Harvard Law School Forum on Corporate Governance, around 10,000 companies in more than 100 countries around the world have signed up to the Global Reporting Initiative (GRI). This initiative encourages companies to produce a sustainability report that follows clear standards. In turn, these reports are used each year by rating agencies to assess a company's ESG performance. However, despite the commitment that companies may have to publish standardized information on their sustainability activities, there are still significant problems that affect these documents and, therefore, the subsequent evaluation by rating agencies.

The main drawback is the lack of verification of the data in the reports. **Only a very small number of companies have their sustainability reports externally audited.** Therefore, in most cases there is no third-party verification of the data contained in the ESG documentation.

05

Scientific evidences or corporate aspirations?

Another problem that threatens the reliability of ESG criteria is the lack of scientific backing for companies' sustainability strategies. Kenneth P. Pucker, former COO of Timberland, offers a clear explanation in this regard in his article *Overselling Sustainability Reporting*⁵.

According to Pucker, less than 5% of companies base their environmental protection objectives on scientific data about the planet's ecological limits. Environmental strategies are often based on corporate subjectivity, with companies designing a plan according to their aspirations or capabilities. This shows that sustainability is sometimes not seen as a response to a real need, but as a vehicle used by companies to improve their image.

[4] Hirai, A., & Brady, A. (2021). *Managing ESG Data and Rating Risk*. Harvard Law School Forum on Corporate Governance. Available at: <https://corpgov.law.harvard.edu/2021/07/28/managing-esg-data-and-rating-risk/>

[5] P.Pucker, K. (2021). *Overselling Sustainability Reporting*. Harvard Business Review. Available at: <https://hbr.org/2021/05/overselling-sustainability-reporting>.



06 Supply chains: an obstacle to data collection

The complexity of obtaining certain data makes it difficult for companies to accurately assess their environmental impact. For example, **the geographical diversification of the supply chain makes it very difficult to have reliable information on the individual impact of each of the processes that make up this chain.**

In addition, as Kenneth P. Pucker notes in the article above, contractors are increasingly turning to subcontractors, making traceability difficult and preventing companies from investigating and detecting social and environmental abuses.

07 Metrics leading to confusing interpretations

Companies' achievements in terms of sustainability are often expressed through metrics that are difficult for investors to understand. For example, when a company claims that a certain amount of CO₂ has been emitted (or not emitted) in the production of a certain product, the investor may ask: what measurement system has been used to obtain this data? Normally, this data is not supported by a detailed explanation from the company.

08 ESG funds under the scrutiny of supervisory bodies

Since most companies say to comply with a sustainable growth program, it is becoming increasingly difficult to find the differences between a conventional investment fund and one that claims to be sustainable in relation to the holdings that make up each of them.

A recent article published in Cinco Días [5] raises the issue of the rating of sustainable funds. As explained in the newspaper, the US and German supervisory authorities are investigating Deutsche Bank's fund manager DWS for a lax rating of ESG funds in order to rate a larger number of assets in this way.

Investors should be alert to the phenomenon known as greenwashing and ask whether the companies or funds in which they invest really care about environmental or sustainable issues or whether, on the contrary, they use the ESG label to attract more investment and stay afloat in the market.

[5] Salobral, N. (2021). La SEC y el regulador alemán investigan a DWS por falsear fondos sostenibles. Cinco Días. Retrieved 26 August 2021, from https://cincodias.elpais.com/cincodias/2021/08/26/mercados/1629978503_801299.html.

To sum up...

The **disparity of combinations** that can be created with the evaluation parameters (scope, measurement and weight) makes the correlation between rating agencies significantly low.



The analyst's **subjectivity**, which manifests itself in the so-called rater effect, also contributes to the lack of consistency of ESG valuations and, therefore, is a variable to be taken into account when approaching such valuations.

The fact that there is no consensus on what requirements a company or fund has to meet to be qualified as "sustainable" may encourage the practice known as **greenwashing**.



The source of data from which the rating agencies draw their ratings (the companies' sustainability reports) has many drawbacks that have not yet been addressed and which cast doubt on the effectiveness of ESG valuation. These drawbacks include:

- ✗ lack of verification of the content of reports
- ✗ difficulty in obtaining reliable information
- ✗ the lack of scientific basis for sustainability strategies
- ✗ complexity in interpreting the metrics



Faithful

Investing:
the consistent
alternative

Today's investors are increasingly concerned about the ethics underlying their investments.

Today's investors are concerned about the ethics underlying their investments. There are studies that state that tolerance for unethical companies is decreasing.⁶ There is a growing tendency to exclude from the investment universe those assets that have any relation to arms production, human rights violations, addictions or labor precariousness.⁷ Thus, both listed companies and wealth management companies have jumped on the bandwagon of socially responsible investment, which seems to be booming.

However, **it can be argued that ESG investing offers inconsistent results**, either because of the rating agencies' methodologies, the fact that many companies use these criteria for greenwashing, or any of the other reasons mentioned above. So, if investors are determined to guide their decision-making through ethical criteria, and ESG criteria are not presented as a reliable alternative, is there any other truly consistent alternative? The answer is yes. Faithful Investing presents itself as a consistent alternative for those who want to invest with integrity.

Faithful Investing: the consistent alternative

Faithful Investing is based on investing in assets or companies whose activity and practices do not conflict with certain moral principles or values. The criteria for valuing different companies come from the Social Doctrine of the Church (SDC), which encompasses a set of social teachings that the Catholic Church calls to practice, from which specific principles can be established. Principles that companies may or may not respect. These teachings can be grouped into four fundamental pillars:

- Respect for human life
- Promotion of the family
- Promotion of human dignity
- Care and respect for creation

[6] Stobierski, T. (2021). *15 Eye-Opening Corporate Social Responsibility Statistics*. Business Insights - Blog. Available at: <https://online.hbs.edu/blog/post/corporate-social-responsibility-statistics>.

[7] Spainsif. (2020). *La inversión sostenible y responsable en España*. Available at: <https://www.spainsif.es/estudio-spainsif-2020/>

In contrast to ESG ratings, company ratings based on the DSI overcome the problem of disparity of criteria, since the areas being evaluated are directly related to guidelines and principles that do not change over time, but have remained unchanged throughout history. The permanent ethical principles proposed by the Magisterium are valid for the entire mankind, in all times and cultures. **The reason is that the source of morality - or moral authority - is only one, and its legitimacy does not depend on man's assent or on temporary and variable fashions, but on the fact that it is an expression of the truth in its various aspects, according to what the Church teaches (the truth of man's being, the truth about creation, the truth about the family or the truth about human dignity).**

Investment according to ESG criteria is not able to offer a completely objective evaluation, since the assessment will depend on each rating agency's own, and sometimes disparate, methodology. This means that the investor has to make a discernment effort to overcome the heterogeneity of the ratings given by the different agencies in the sector. However, the application of criteria related to Faithful Investing makes it possible to clearly and unequivocally recognize which practices and activities carried out by companies really conflict with human dignity and, by extension, with their social, economic and environmental surroundings.

The Church's social approach offers the investor an alternative summarized in two key points:

- 1 The person must be the center of economic-social life⁸
- 2 Investment decisions should be made according to permanent criteria and principles (e.g. common good, justice or dignity).

Respecting these premises, Faithful Investing is a methodology capable of providing the investor with reliable advice. The criteria it follows are clear and allow investment portfolios to be oriented towards companies and assets that perform ethically.

Going the extra mile: generating Christian culture

Man's concern to do good, to contribute to making this world a better and more beautiful place, is nothing new. A human life lived with authenticity brings these desires to the surface and, as history has taught us, in every age there have been individuals, families, or groups who have put themselves on the line to help bring about the ideals of justice and goodness that every good person longs for. This era, and the finance sector, are no excluded from these aspirations.

[8] Pablo VI (26 de marzo de 1967) *Populorum Progressio*. Retrieved from: https://www.vatican.va/content/paul-vi/es/encyclicals/documents/hf_p-vi_enc_26031967_populorum.html

The investor who is sensitive to these issues goes through a two-way path: on the one hand, he notices the needs that arise in society and, on the other, he seeks to satisfy these needs from his position, from his place of work, doing his best to commit himself to this.

In the financial world, there are different realities that want to be a way to respond to these needs. The main one, or the one that is on the rise, is the ESG investment movement, which seeks to add certain objectives of justice, equal opportunity or care for the environment to financial analysis. The aspirations of this type of investment are necessary and legitimate. However, if what is sought is the flourishing of the family, the creation of strong and prosperous economic relationships and the integral development of the human being, then it seems that this option becomes insufficient. Faced with this situation, a new alternative appears within the framework of possibilities: Faithful Investing.

Faithful Investing does not reject what is authentic in the goals of sustainable investment. The magisterium of the Catholic Church teaches that concern for human affairs, each and every one of them, is a Christian attitude. However, the horizon open to the investor who chooses to invest in a manner consistent with Catholic faith is much broader and deeper than mere solidarity with certain social causes.

The exceptional value that the Church's Social Doctrine can make society aware of the fact that it is not sufficient to take into account just material, political or environmental problems, but it is necessary to consider the human being as a whole. The Church is convinced that, when it comes to the human being, solutions must embrace all dimensions of his existence and, for this reason, issues such as the promotion of the family, the protection of human life and respect for the dignity of each person become indispensable causes, which must also find a place in the financial decision-making process.

In short, Faithful Investing is undoubtedly a way of investing that favors sustainability. But, above all, it is a way for the investor, through his testimony and commitment, to actively contribute to protecting those realities that are indispensable for the good of man and society. The starting point is to decide on a coherent life. The point of arrival is the generation of Christian culture. Or, in other words, the generation of a dynamic of thought and action that leads man towards goodness, goodness and beauty.

[8] Pablo VI (26 de marzo de 1967) *Populorum Progressio*. Retrieved from: https://www.vatican.va/content/paul-vi/es/encyclicals/documents/hf_p-vi_enc_26031967_populorum.html

Without sacrificing profitability

Finally, this type of investment is by no means at odds with good market performance. Just as the number of ESG assets is growing, new initiatives that offer market returns are also emerging in the branch of investment that follows faith-related criteria. Here are three examples: the first focuses on the criteria in the light of the Catholic Magisterium (which has been the focus of attention so far). The last two are related to American entities close to the Protestant religion.

Altum Catholic Values European Index (EUCATH)



[click here](#)

Stock index that provides exposure to the European equity market following the principles of the Social Doctrine of the Church based on four pillars: the promotion of human dignity, life, the family and the care and protection of Creation.

Inspire 100 ETF (BIBL)



[click here](#)

ETF that invests in the 100 largest U.S. companies with the largest market capitalization, basing its investment decisions on the Bible.

2ndVote Life Neutral Plus ETF (LYFE)



[click here](#)

ETF that invests in U.S. companies with a high pro-life social rating system (taking into account, among others, corporate donations or sponsorships).

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