

Exclusion: The First Boundary of Capital

Newsletter

- Exclusion criteria translate ethical principles into portfolio decisions by excluding activities deemed incompatible.
 - It represents a primary level of implementation of moral principles, defining the boundaries of the investable universe.
 - The doctrine provides general criteria for the use of capital; documents such as *Mensuram Bonam* set out guiding principles without prescribing operational lists.
 - Their definition takes place at the institutional level, where Episcopal Conferences, Catholic institutions and foundations develop practical guidelines.
 - These frameworks identify activities incompatible with the Christian values, forming the foundations for exclusion criteria in portfolio construction.
- In the previous issue, capital was examined from an intentionally essential perspective: not merely as a financial instrument, but as a form of participation in the economic dynamics it helps sustain over time.
 - Adopting this perspective has an immediate implication. Every investment decision concerns not only what is financed, but also what is deliberately excluded.
 - In responsible investing, this approach typically takes the form of exclusion criteria. Certain activities, sectors or business models are deemed incompatible with specific principles and are therefore removed from the investable universe.
 - Within investments aligned with the Social Doctrine of the Church, this represents the first level of practical application of moral principles. It does not yet define a comprehensive investment strategy, but it establishes an initial constraint: a boundary beyond which capital does not participate.
 - This issue examines how that boundary is defined, which criteria enable its practical application, and what implications this has for portfolio construction.

The Principle of Exclusion in
Catholic Investing

Exclusion: The First Boundary of Capital

Newsletter

The Principle of Exclusion

- In translating moral principles into investment policies, Catholic institutions typically organise exclusion criteria around a set of core thematic areas.
- This structure reflects the framework of the Social Doctrine of the Church, which, over time, has developed a coherent body of principles intended to guide moral judgement on economic activity and the use of capital. Beginning with the major social encyclicals — from *Rerum Novarum* to more recent developments in the magisterium — this body of reflection has progressively identified areas where economic dynamics may come into tension with fundamental principles of the Christian understanding of the person and society.
- When expressed in the operational language of investment policies, these principles are generally grouped into a limited number of broad moral categories, within which the economic activities subject to exclusion are identified.
- An analysis of guidelines developed across different ecclesial contexts — including Episcopal Conferences, foundations and Catholic institutions — shows a high degree of convergence around a number of recurring areas, despite the absence of a single, universally binding codification.

In summary, these areas can be grouped into the following domains:

Protection of Human Life	Economic activities incompatible with the protection of life at every stage
Dignity of the Person	Activities involving exploitation, commodification or serious harm to human dignity
Common Good	Economic activities that produce social effects that are gravely harmful or incompatible with the good of the community
Social Justice	Activities or business practices associated with serious violations of human rights and fundamental labour conditions
Care for Creation	Economic activities incompatible with the protection of the environment and ecosystems

Exclusion: The First Boundary of Capital

Newsletter

The explicit emergence of the environmental dimension reflects more recent developments in the Church's social teaching, particularly through the call to integral ecology set out in *Laudato Si'*. The operational application of these categories, however, is not uniform across different ecclesial contexts.

While there is broad convergence on the underlying moral principles, guidelines developed by Catholic institutions may differ both in the selection of activities to be excluded and in the level of detail with which such criteria are defined. Some areas — such as the protection of human life or controversial weapons — show a high degree of convergence. Others, such as gambling or certain activities with indirect social impact, are subject to more differentiated assessments, depending on cultural context and pastoral priorities.

These differences reflect the nature of the Social Doctrine of the Church itself, which sets out guiding principles while leaving their operational translation to institutions. Exclusion criteria should therefore be understood not as a uniform and universally codified set of rules, but as the outcome of a coherent, albeit contextualised, process of applying moral principles. The way in which these exclusions are subsequently defined and applied — through sector criteria, revenue thresholds or screening methodologies — represents the operational level of this process and is addressed in the following section.

If exclusion criteria represent the first level of operational translation of moral principles, the next step is to give those principles a form that is stable, coherent and governable over time. In this context, the investment policy emerges not as a purely technical document, but as the reference framework that explicitly defines objectives, constraints, selection criteria and decision-making processes guiding capital allocation.

The investment policy is the point of convergence between a values-based vision and financial discipline. It makes principles actionable, verifiable and replicable. Through it, investors can ensure consistency over time, alignment across decision-making levels, and the ability to translate ethical orientations into a structured investment process.

The relevance of exclusion criteria lies in the extent to which they are embedded within the investment process.

Exclusion: The First Boundary of Capital

Newsletter

Structuring the Investment Policy

For exclusion criteria to be applied consistently and sustainably over time, their integration into the investment policy requires a sufficient level of formalisation and methodological clarity. This involves defining an explicit values-based perimeter within which the activities to be excluded are identified, together with any acceptable level of tolerance.

Governance is a key element. Best practice requires a clear allocation of responsibilities among the parties involved — typically the investment committee, the advisor and the managers — as well as structured review processes. It is equally essential to ensure that the policy is operationally implementable.

On this basis, criteria are articulated in operational terms through the classification of relevant activities and the introduction of quantitative thresholds. The investable universe is then determined through the exclusion of non-compliant exposures, with implementation carried out through screening methodologies embedded in the selection process.

Maintaining policy coherence ultimately requires ongoing review:

Exclusion criteria defined in explicit, measurable and verifiable terms

Clear distinction between absolute exclusions and exclusions based on quantitative thresholds or materiality criteria

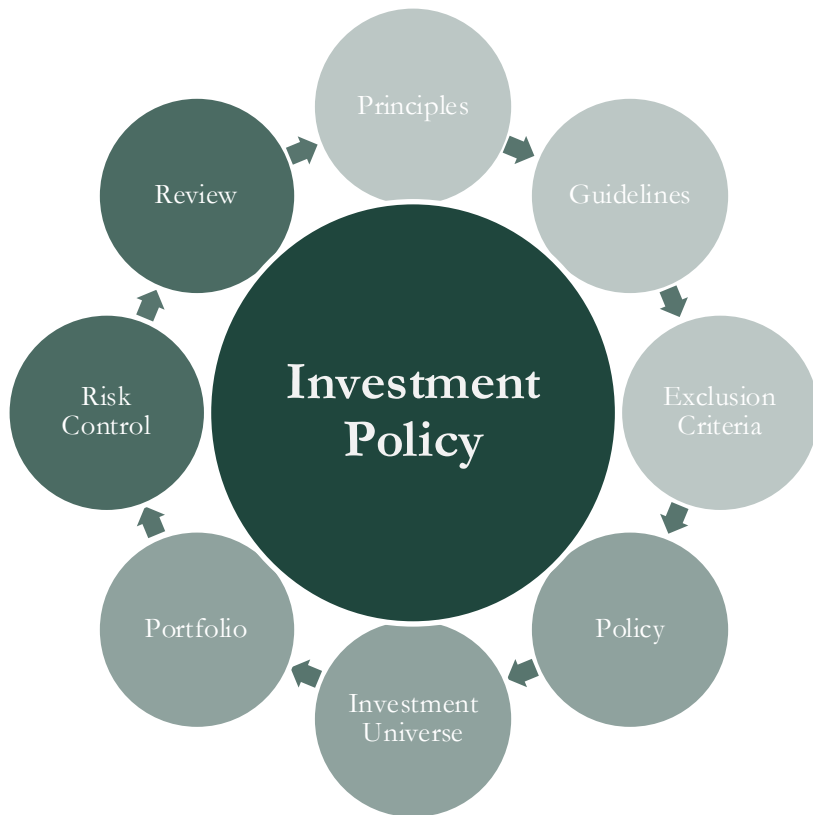
Level of granularity aligned with available tools

Information sources and classification methodologies clearly defined and documented

Integration of criteria into existing decision-making processes

Exclusion: The First Boundary of Capital

Newsletter



Reading the Process

The process represents the transition from principles to investment decisions.

Governing bodies define the values framework. The **investment committee**, supported by the **advisor**, translates it into guidelines and exclusion criteria.

These criteria are formalised in the investment policy and approved at the institutional level. On this basis, **portfolio managers** define the investable universe and construct the portfolio.

Consistency between criteria and investments is ensured through ongoing oversight, supported by **control functions and the advisor**. The process is completed through periodic review of both the policy and the criteria, under the direction of the relevant governing bodies.

Exclusion: The First Boundary of Capital

Newsletter

Criteria and Market Instruments

Over time, the application of exclusion criteria has become progressively formalised at both institutional and market levels.

Within the ecclesial context, several Episcopal Conferences have developed guiding documents. Among these, the document issued by the **Italian Episcopal Conference** (2022) represents a significant reference point.

At the same time, market instruments aimed at constructing coherent investable universes have been developed. The **IOR–Morningstar** initiative led to the launch of the *Morningstar® IOR Catholic Principles Eurozone Index* and the *Morningstar® IOR Catholic Principles US Index*. These indices select issuers using methodologies consistent with Catholic doctrine.

A further example is provided by **Franklin Templeton**, which launched ETFs based on indices such as the *MSCI World Select Catholic Principles Index*.

Alongside these initiatives, there has been a growing expansion of ESG instruments with partially overlapping criteria.

Protection of Human Life

- Abortion and related pharmaceuticals
- Research involving embryos and stem cells
- Cloning

Dignity of the Person

- Pornography and exploitation
- Human trafficking
- Discrimination

Common Good

- Controversial or prohibited weapons
- Gambling
- Tobacco

Fundamental Rights

- Child labour
- Rights violations
- Human rights

Care for Creation

- Environmental harm
- Protection of ecosystems
- Unsustainable economic practices

Exclusion: The First Boundary of Capital

Newsletter

Beyond the Boundary: Towards Intentional Capital Allocation

The framework developed in this issue outlines the first level of practical application of the principles guiding a responsible use of capital. Through the analysis of exclusion criteria, it becomes clear how the values dimension can be translated into an operational constraint capable of shaping the investable universe and introducing an initial level of alignment between stated principles and financial decisions. Exclusion, in this sense, is a necessary step, but not a sufficient one. Defining what capital avoids establishes the boundary, but it does not yet fully determine the direction in which it is deployed.

While exclusion defines the investable perimeter, it leaves open a broader question: how capital can be deployed coherently not only through avoidance, but through intentional allocation. In this perspective, robust governance tools become essential. Among them, the investment policy provides a first concrete point of reference, linking principles, criteria and decisions within a coherent and verifiable framework.

This is where the next step lies: moving from defining what cannot be supported to constructing a portfolio that expresses, in a deliberate, measurable and effective way, the principles that guide it. The shift is from avoidance to active choice — from excluding to deliberately allocating capital in line with defined priorities. This requires a corresponding shift in capabilities. They must become more analytical, more structured and more deliberate: deeper analysis, clear accountability in allocation decisions, and the ability to translate principles not only into constraints, but into active investment directions with measurable impact.

This more complex and less immediate development represents the natural continuation of the path outlined here and will be the focus of the next issue.

Author's notes and Disclaimer



Andrea Favalaro is an executive manager with over thirty years of international experience in financial services and strategic advisory. Over the course of his career, he has held leadership roles in leading global financial institutions, operating in European and international contexts. His professional path combines a deep knowledge of financial markets with solid experience in governance and strategic development. In recent years, he led the European transformation and strategic repositioning of CBIS Global, contributing to the strengthening of its positioning in the field of ethical and Catholic investing.

Today he is primarily engaged in Non-Executive Director and Strategic Advisor roles, supporting investors, companies, and institutions in complex contexts, with a focus on long-term growth strategies, governance, sustainability, and ethical and values-based coherence in economic and financial decision-making.

Agave Advice is the strategic advisory firm founded by Andrea Favalaro, with an international positioning and an approach oriented towards the integration of strategy, governance, and responsibility in economic and financial choices. The firm operates as an independent space for advisory and thought leadership, within which a commitment to education and high-quality dissemination also finds expression through this newsletter.

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