

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Socially Responsible Investing



BROTHER MICHAEL O'HERN, since joining Christian Brothers Investment Services in 1987 as Executive Vice President, has significantly contributed to its growth and success. As President and CEO, he is responsible for the mission, services and organizational development of CBIS. Throughout his years at CBIS, his leadership skills, his strategic insights and vision have enhanced CBIS' effectiveness and greatly contributed to its success as a unique provider of superior, socially responsible investment programs to the Catholic institutional market. His experience as a school system administrator in the Archdiocese of Chicago provided him with an understanding of the investment needs and unique challenges facing Catholic religious organizations. He graduated from Lewis University with a BA in 1969. He also holds an MBA from the University of Chicago, an MA in Administration from Northwestern University and an MA in History from Michigan State University.

TWST: Would you start with an overview of Christian Brothers Investment Services?

Br. O'Hern: Christian Brothers Investment Services was founded in 1981 by two De la Salle Christian Brothers to provide socially responsible investment advice and management services to Roman Catholic organizations in the United States. We did this as an extension of some other services that we were offering at that point to Catholic Church organizations. In the early 1980s, it seemed appropriate to bring that model that we had been using by providing other services into the investment arena.

More and more Catholic organizations at that time were looking to invest funds, particularly religious institutes who were beginning to take a look ahead at the funding needs for retired members. The Brothers brought to bear professional level services in investment management initially for that audience.

Since then, we have expanded our services to dioceses and parishes, healthcare systems, educational institutions and all kinds of Catholic organizations.

TWST: Do you have individual investors?

Br. O'Hern: No, we don't have any individual investors. All of our investors, whom we call participants, are Roman Catholic institutions.

TWST: What is the investment philosophy? Would you tell us about socially responsible investing?

Br. O'Hern: The investment philosophy is to integrate the principles of Catholic ethical and social teaching into the investment process — to enable an investor to bring their values into the investment process so that the investment of Catholic organizations remains consonant with their mission.

For example, a fundamental Catholic belief is the value of each person and in the right to life. There are things that we can do in the investment process that are consistent with that belief in terms of our working with companies or in terms of making choices about whether to invest in some companies or not. There is a consonance, if you will, with the investment program and the mission and that's really what the socially responsible investment

philosophy, as applied by us, is meant to achieve. To do that, we work with investment managers with whom there is a compatibility of their investment process, philosophy and style where our socially responsible investment program can work. That's a key piece of the process.

The social responsibility part in itself has several principal aspects. The first is what we call principled purchasing, which some people call screening. The second is active ownership or shareholder advocacy, which entails several active strategies. The third is community development investing. Let me comment on the first two, most particularly the principled purchasing program for CBIS which is what most people think of when they think of socially responsible investing. For us, principled purchasing is choosing not to own companies whose core business activity would contradict some of the principal messages of the Church. For example, we certainly wouldn't want to be investors in producers of pornography or companies that are major contributors to the global arms race.

Part of the message of the Church, and particularly recent statements from the Pope, have been about peace in the world. Owning major arms manufacturers and exporters would be contradictory to that. What we are looking to do is to say whether the activities of these companies are such that we don't think it's appropriate for Catholic organizations to make money from these companies. However that's really not the key piece of the program for us.

The key piece of the program for us is corporate advocacy work. As Church investors, we have particular beliefs and values that are important to us. Where appropriate, we would like to see those values reflected in the companies that we own. For example, we work with companies on issues of employment practices, employment conditions and the rights of workers. We also would work with companies on issues of diversity both internally as well as on the Board level. We attempt to implement the key beliefs and values of Catholic organizations. It's important for us, as owners of a company, to see if that company is behaving in ways that are consonant with those beliefs. We also believe they are good business practices.

TWST: Is this a profit-making investment process?

Br. O'Hern: Absolutely. Clearly, the first reason all these institutions invest is to make money to support their mission, their work. In order to do that, they are looking for investment management approaches that will achieve those objectives. Our experience over time is that investing in this way is profitable and competitive in the investment arena.

For example, in our program, we offer a series of diversified investment programs both through pooled funds and separate accounts. We have a manager-of-managers' approach for our institutional funds and separate accounts. Our lineup of asset managers includes some very fine institutional asset managers in the United States and now also globally. A key piece of this, obviously, is suc-

cessful and competitive investing and competitive investment returns. We look for managers who are competitive and we utilize a search evaluation and retention process that looks at both qualitative and quantitative factors for the managers, as well as managers who are able to implement our socially responsible investment program. We find that our returns in this process are very competitive and we are competitive with the returns that these same managers are earning for their other clients.

TWST: Would you provide us with some examples of your active ownership and how the advocacy has altered some company policies?

Br. O'Hern: We have an extensive report on this on our Website but here are a couple of highlights. We have engaged with companies in the extraction business — **Newmont Mining (NEM)**, for example. In those cases, we work with them on the social and environmental impact of their activity on local communities. In some cases, we've seen examples where companies had a lot of problems moving into certain geographic areas in their business and we've worked with them to talk about how to work more successfully locally in a way that enables them to conduct their business and be more confident with the local community.

In the case of **Newmont Mining**, a member of our staff now serves on an Advisory Board with their company that is reviewing its procedures for working in local communities and starting new facilities in those communities.

There are other examples where we've asked companies to look at employment practices and where they source. Particularly in the apparel industry, we look at the kinds of practices that are used by vendors where they have their clothing and shoes manufactured, the working conditions there and so on. We've seen some progress and that's been well reported in the press, too. We often see examples of companies that see that implementing some of these values is very sound, very good business practice and enables them to conduct their business more smoothly and therefore more profitably.

TWST: Do most of the corporations you are dealing with welcome this type of shareholder advocacy?

Br. O'Hern: I have been working here for 22 years. My observation is that, over time, there is a much different climate in terms of corporate advocacy work. Today, I think most larger corporations — multinationals in particular — are very sensitive to shareholder concerns in these matters and there is a receptivity to working with shareholders on these things. I would say 20 years ago, far fewer thought this was necessary and perhaps the strategies used by all parties weren't as developed as they are today. The companies today are much more amenable to this than they were at one time.

My general answer to that question would be, yes, of course. There are some that are less so, but I think the trend has been for companies to be much more engaging in terms of working with shareholders.

TWST: What about pharmaceutical and biotechnology companies that do terrific research for people, and yet at the same time, might be involved in stem cell and abortion medicine?

Br. O'Hern: We have a very developed and carefully articulated policy in this area. As you know, this is a matter of great sensitivity for Catholic institutional investors. There are some activities from which we believe it's very inappropriate to make money, given the public stances of the Church on these things. The manufacturers of abortifacients being one example, or a facility that provides elective abortion services being another sort of example, where clearly we just don't think this is an appropriate place for us, as Church investors, to make money.

Stem cell research also presents some challenges in this. There are some areas where the answer would be the same. If the research involves the destruction of human life, even at its earliest stages, then we'd be uncomfortable with the activities of that company. As investors, the source of the stem cells matters greatly to us. In some cases, we might be comfortable with a company's activity in that area, while in other cases, we would not be. Our approach here is more nuanced, and is consistent with solid Catholic ethics.

TWST: Do you have an ethical committee that looks into all these different aspects of the corporations' business?

Br. O'Hern: We have a unit within the company that is responsible for this in terms of looking at the activities of companies, engaging them in active ownership and corporate dialogue and also responsible for voting our proxies. All these policies are subject to the Investment Boards of the trusts through which this money is all invested. Those Trustees are representatives of the investors. We're fortunate to always have several of them who are well trained in the areas of ethics and theology.

In addition to that, we do go to other sources. For example, we have consulted with, and used extensively the National Catholic Bioethics Center, particularly for life ethics issues in developing our recommendations to the Trustees for strategies in this area. We have both internal resources and we periodically, of course, do turn to external resources.

In terms of company research, we do some of our own research and we rely on some other external research firms and our own asset managers to provide us a good deal of information about corporate activity in these areas.

TWST: Another field that's been in the news recently and frequently is environmentalism and ecology. Is that an area of interest for you?

Br. O'Hern: Yes. Greatly. It is an area where, again, our principal methodology or approach to this is that of corporate advocacy. We believe very much in engaging companies about environmental practices and have done so — whether we are dealing with issues of green house gas emissions or development of alternative energy sources.

In some cases, it even has to do with financial services companies in terms of the sorts of projects they're lending for and

their awareness of the environmental impact of lending activity. We talk to companies of different stripes about not only the primary activity or primary sorts of environmental issues, but also, if you will, the funding of some of those issues, through bank lending and so on. Yes, the environment is a very important issue to our investors.

TWST: Are there other areas where you have achieved some success, perhaps the corporate policies with employees?

Br. O'Hern: We have seen some companies, over time, open up senior management and Board positions to women and people of color, sometimes through our activities, or ours and many others' activities, and that's the reason we participated. Attentiveness to working conditions in overseas plants is something we have seen companies become more sensitive to and responsive to in terms of shareholder efficacy.

TWST: Is CBIS the only investment service that the Catholic Church has or are there other companies that work with the Catholic Church in portfolio management?

Br. O'Hern: The Catholic Church is, in terms of its investments, very diversified. That is, local dioceses, religious groups, educational institutions and other Catholic entities all make their own choices in terms of selection of investment services.

We believe Christian Brothers Investment Services is the only investment service firm owned by Catholic Church entities. We are owned by the Brothers of the Christian Schools. We know of no other investment company that is owned by Roman Catholic Church entities. At the same time, almost every secular investment company, and a great variety of banks, is providing some kind of investment service to Catholic organizations. However, we are the only one that is owned by Church entities and also the only one that is focused exclusively on socially responsible investments from a Catholic perspective.

Our whole perspective in terms of implementing a socially responsible investment program is from a Catholic point of view. That puts us, we think, in something of a unique position. If you look at the *Pensions & Investments* annual report on asset managers, we are in the top half of all asset managers in their survey and I believe we are one of the largest, if not the largest, that is exclusively focused on socially responsible institutional investing.

One of our new ventures is that we are expanding from the US into the European Union this fall. We are introducing CBIS Global Funds, a group of funds based in Dublin, Ireland. The Funds utilize the UCITS structure, the Undertaking for Collective Investment in Transferable Securities. We are certainly not the first to use this, but we are the first with a Catholic ethical focus managing funds in the European Union.

Previously, European Catholic institutions could only invest with us if they wanted to invest in US dollars. This new structure, CBIS Global Funds, will enable European Catholic organizations to invest directly both in dollar-denominated funds and in euro-denominated funds. That is a real change for us and a step beyond where we have been operating since our first 26 years.

TWST: You are a manager of managers. Would you tell us about the process by which you select and evaluate and retain these money managers?

Br. O'Hern: We are long-term investors and so we are looking here to identify asset management firms that will optimize the risk/reward trade-off across a variety of asset classes and within a variety of asset management styles. Our job here is to go into the institutional manager marketplace to identify managers who can do this.

We obviously look first at style, metrics, past performance, portfolio characteristics, sector allocations, performance in up and down markets — the sorts of things one would look for in any asset management search. We employ a variety of styles, including active and passive strategies and both domestic and international managers. Our job is to identify sound, successful institutional asset managers in those areas.

We also look at a variety of qualitative characteristics — who are the key players and how long have they been in place, how are the decisions made in the firm, what is the participation of ownership of key people in the firm, how stable is it, etc. We sift through those quantitative and qualitative criteria to identify our prospective firms. Those firms then go through interviews both onsite in their offices and here at CBIS. From there, our management committee makes a determination as to whether or not they will be a manager for CBIS.

Obviously the evaluation process includes how well they implement the strategy that we have hired them for, their success relative to their peers, relative to the market benchmark that has been selected for them and also relative to the market environment. There are obviously some times when one style or another or one particular asset class or another is not doing very well, so we look at all of that when evaluating potential managers. From there we decide whether to retain them or to change the assignment or alter it in some way going forward.

We are also looking to build complementary teams of managers. In all of our active strategies we like to have several managers working on a pool of funds because we think complementarity tends to dampen volatility and enhance return over time. Part of our assessment of any manager is how their style would work with the successful managers that we are already working with.

TWST: Is changing managers an expensive proposition? If a money manager is underperforming, do you make changes?

Br. O'Hern: Yes, we do and you are absolutely right, it is an expensive proposition and so we like to give a manager three to five years to make sure that the manager has had an opportunity to

perform in several market environments. We evaluate their management in a variety of circumstances because to change is expensive — it is expensive for the investors in the fund and for investors with separate accounts as well. But that said, sometimes it's important or necessary to make a change. It might be that quantitatively the firm just hasn't been able to achieve the kind of investor results that we expected them to or it may be that some serious qualitative piece for them has changed.

We had firms where teams of people have left the firm for whatever reasons, and that changes the character of the firm, or there has been a lack of planning for the departure of key people and that's changed the way the firm has operated. It could be any of several circumstances that would cause a change. Presuming stability in the firm, we want to be sure that they have the opportunity to perform in several market environments before we would come to a conclusion that they are unsuccessful. It's a balance of looking at their work and considering the cost for the investors in making a change.

TWST: Brother Michael, is there anything that you would like to add?

Br. O'Hern: I suppose just one thing, going back to the social responsibility program. As we are focused exclusively on the Catholic institutional market, we are very careful to be sure that our advice and programs in that area are consistent with guidelines that are established by the US Conference of Catholic Bishops. They are the clearest national voice we have in articulating these matters and so therefore we want a Catholic organization that comes to us seeking our services and/or advice to know that our advice and services will be consistent with the Catholic voice of the Bishops in this regard.

TWST: Thank you.

Note: Opinions and recommendations are as of 9/2/08.

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