



Morgan Stanley

INVESTMENT MANAGEMENT

An Emerging Markets Approach to ESG: Our Progress

ACTIVE FUNDAMENTAL EQUITY | GLOBAL EMERGING MARKETS TEAM | 2019

Our Portfolio Managers believe ESG factors matter for company results and will exclude a company based on our assessment of material ESG risks and how the company is handling them. Our ESG process is truly integrated—and the final decision makers, the portfolio managers, lead the engagements.

We provide a high level of transparency into our ESG process with detailed tracking of our engagements. We believe integrating information about ESG issues into our investment process makes us better investors and is consistent with our approach as long term, growth managers in the emerging markets.



ESG Integration into Our Investment Process

As fundamental investors we seek out areas of growth and opportunity which we believe will last for the next 3 to 5 years and sustainable, well-run businesses which can capitalize on these trends. Our research process considers environmental, social and governance issues that confront policymakers and company management, because they matter for sustainable growth. Information we gather about the environmental, social and governance issues faced by both country policymakers and company management teams helps us build a more complete picture of these investment opportunities and the potential risks involved. ESG is integrated throughout our investment process at both the company engagement level as well as in our top-down country analysis.

Our investment process integrates ESG analysis in a simple and repeatable way: identifying and assessing material issues and engaging company management on these issues.

AUTHORS

GLOBAL EMERGING MARKETS TEAM

“ESG is integrated in our investment process in a simple and repeatable way.”

Our Active Ownership Approach

Identify and Assess
Material ESG Issues

Engage Company on
Key ESG Issues

Actively Vote
Proxies

- MITIGATE RISKS, RECOGNIZE OPPORTUNITIES
- IDENTIFY QUALITY COMPANIES
- ENGAGE MANAGEMENT FOR BETTER CORPORATE BEHAVIOR

IDENTIFY AND ASSESS MATERIAL ESG ISSUES: We identify the issues that are most material to the health of the business we are analyzing. We look by industry at the issues most directly linked to key business drivers for each company—for example resource efficiency in heavy industries, working conditions in labor intensive sectors, and talent attraction and retention in intellectual property based industries.

We have access to several different ESG resources, which help our understanding of the key ESG issues, including the Morgan Stanley Institute for Sustainable Investing, MSCI ESG ratings and research and sell-side ESG research, and the company's own disclosure on corporate social responsibility. While we draw on these external resources, rather than simply relying on a third-party rating, we focus on understanding the issues raised by these providers

and conducting our own analysis on these issues and the companies' accompanying strategy. We ultimately form our own independent judgment based on our analysis and engagement with management.

ENGAGE WITH COMPANIES: Our portfolio managers travel widely meeting with company management as part of our due diligence process. During these meetings we engage management with questions on the most pressing ESG issues facing their business. These conversations often give us information we need to focus on and dig deeper in later meetings. Over time, we have found increasing management interest in ESG issues, especially when ESG can be tied directly to the company's financial outlook. We also support good corporate governance through proxy voting and will vote against board recommendations we do not perceive to be in the best interests of shareholders.

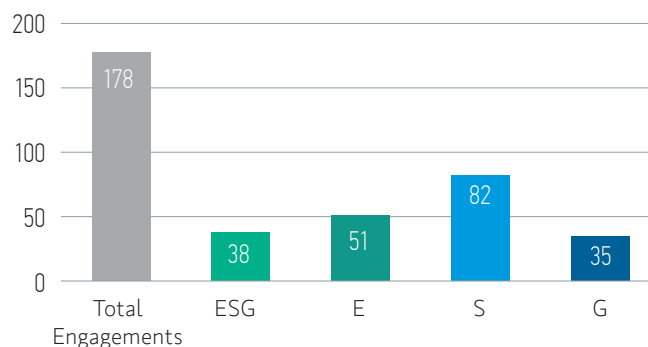
TOP-DOWN COUNTRY ANALYSIS: ESG factors are deeply embedded in Our Rules of the Road framework for identifying economies with a promising growth trajectory. The rules assist in measuring balance across the cycles—from politics to credit, investment and market sentiment—that shape economic growth. ESG factors can and do play an important role in tipping these balances.

As long-term investors, we firmly believe that a strong system for monitoring ESG in emerging markets helps us stay alert to the risks and opportunities of our company holdings for the long haul.

In an effort to increase transparency on our ESG integration progress, below are the engagement statistics for our team over the past year.

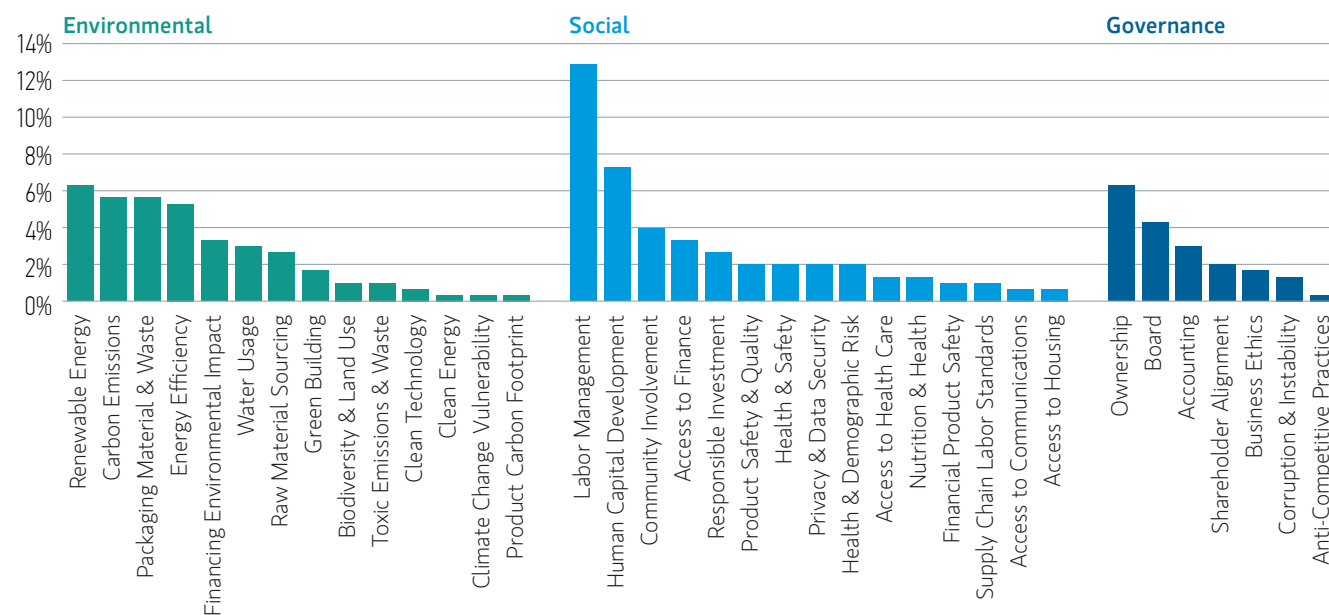
Engagements Statistics and Breakdown (January 1, 2018 – December 31, 2018)

Of the total 424 documented meetings during this time period, the Emerging Markets Equity team engaged with companies on ESG issues in 178 meetings. This represents 42% of the total.



There were a total of 178 engagements. The above includes overlap if one or more topics were discussed in the same company engagement. Documented meetings are defined as meetings in which the portfolio manager or analyst wrote a note.

Engagements by Key Issue*



*Engagements by key issue are represented as a percentage of total engagements and may include two or more topics discussed in one meeting.

Engagement Examples

Below are examples of our engagements with management on E, S and G issues. In each case, we have asked about the key issue we feel most affects the company and taken note of their responses. Our ESG analysis helps us mainly to understand company risks and business model sustainability. It can also help us understand the opportunities for companies in terms of branding, product segmentation and customer perception.

COMPANY	ISSUE	ENGAGEMENT DETAILS
ENVIRONMENT		
Largest brewer in Latin America <i>August 2018</i>	Packaging Material & Waste	We discussed recycling of bottles with the company, asking if could lead to potential cost savings and opportunities. Management stated one of their main initiatives is to improve its returnable glass bottle penetration. Currently roughly 50% of its global volumes are in returnable glass bottles, and it believes it can increase this number specifically in Brazil. Management believes this not only has obvious environmental benefits, but is very positive for the business.
Multi-format retailer in Mexico with presence across Central America <i>August 2018</i>	Carbon Emissions, Renewable Energy	A key issue for this retailer is carbon emissions, which we engaged the company on. We discussed the company's goals of reducing greenhouse gases by 18% by 2025. They are a leader in renewable energy; currently 91% of their units in Mexico are supplied with renewable energy. There were recent electricity tariff increases in Mexico, but since the company has already been moving toward renewables, the company now has a competitive advantage on costs. This is an example where good ESG management can actually lead to opportunity. We will continue to engage with them on their progress toward greenhouse gas reduction in future meetings.
SOCIAL		
Integrated state-owned Brazilian oil company <i>May 2018</i>	Health & Safety	A main concern remains safety. We continue to engage with them on their safety record each time we meet with management. Safety continues to be a top priority and the company has reached its target of 1 accident per 1 million work hours, two years ahead of target. We also engaged on corporate governance and renewable energy.
Leading bank in Hungary with presence across Eastern Europe <i>September 2018</i>	Privacy and Data Security	We asked management about privacy and data security as there was a recent cybersecurity breach that hit the bottom line. The bank has spent significant capex to ensure data security, recently employing a third party to provide secure digital payments and risk management solutions. Management is trying to deliver increased openness while ensuring the highest levels of privacy and data protection for their clients.
Non-Banking Financial Company in India with exposure to infrastructure, housing and rural <i>June 2018</i>	Labor Management, Financing Environmental Impact	Attrition is critical to a company highly dependent on the work force. We engaged with management on the company's labor practices including company culture and morale, leadership programs, talent pipelines and board diversity and composition, salary and incentive structures. We also asked about whether they are looking for impact financing projects. The bank is funding two big projects on water management and rain water harvesting, and are focusing on providing long-term innovative solutions benefitting the water-deprived communities in rural India.
GOVERNANCE		
Chilean bank <i>September 2018</i>	Corruption and Instability	Cybersecurity, fraud and money laundering is addressed at the board level. The bank has a dedicated unit within their commercial areas to monitor cybersecurity and fraud, and these are overseen by the risk and auditing units. The bank's money laundering controls have received recognition from U.S. authorities.
Philippines bank <i>January 2018</i>	Corruption and Instability	A main issue for banks is corruption and instability. In order to help alleviate this, management rotates relationship managers across customer accounts to prevent fraud. They are also implementing tighter controls and have hired a third party to conduct a full review of operational risk framework and processes. They have a strong whistleblower policy that requires the CEO to receive reports.
Convenience store operator in Thailand <i>September 2018</i>	Accounting	The company has set up a corporate governance committee headed by an independent director. Management has shown that despite concerns on their high debt levels, they consistently pay down debt and have lowered their net debt/equity ratio.



Proxy Voting

During the time period January 1, 2018 – December 31, 2018 we voted against management on 271 agenda items, representing 11% of the total 2448 agenda items, in our Global Emerging Markets Equity portfolio.

Proxy Voting Examples

1. **COMMERCIAL BANK IN INDONESIA:** Voted against approving remuneration and tantien of directors and commissioners because disclosure was limited and, in our view, needs to improve.
2. **LARGEST BANK IN HUNGARY:** Voted against authorizing a share repurchase program because the repurchase limit of 25% of the company's share capital is excessive. We prefer a dividend issuance instead of a share buyback.
3. **PROPERTY DEVELOPER IN THE PHILIPPINES:** Voted against director nominees that served on multiple boards and were considered over-boarded.
4. **PRIVATE BANK IN MALAYSIA:** Voted against the approval of director remuneration as the average director fee in 2017 was already a 27% increase from the previous year. The proposed director fees were considered significantly higher than those of its peers.
5. **DAIRY MANUFACTURER IN CHINA:** Voted against the issuance of equity or equity-linked securities without preemptive rights because the issue price discount was not disclosed.
6. **FOOD RETAILER IN RUSSIA:** Voted against the approval of remuneration for the supervisory board because based on 2017 practices and amount granted, the proposed non-executive remuneration appears excessive in relation to both Dutch and Russian market practices.
7. **LEADING PHARMACEUTICAL COMPANY IN CHINA:** Voted against the approval of issuance of equity or equity-linked securities without preemptive rights because of excessive issuance and the failure to disclose the price discount. Voted against grant of options under their share option scheme because it included a 9% dilution and a provision that provides for accelerated vesting if the company changes control.
8. **INTEGRATED OIL AND GAS COMPANY IN CHINA:** Voted against a provision of guarantee and relevant authorizations because the company would be taking in a disproportionate amount of risk relative to its ownership stake without compelling justification.
9. **TRAVEL LUGGAGE COMPANY:** Voted against the approval of restricted share units pursuant to the share award scheme as we believe stock options are a better way to reward management. The administrators of the scheme have to be different from the directors or the terms of the scheme should be approved by shareholders and tied to targets on revenue, ROI, profit and cash flow productivity.
10. **SOUTH AFRICAN HOLDING COMPANY:** Voted against director nominees considered over-boarded and against re-electing audit committee members who attended less than 75% of meetings held by the board and committees in the fiscal year.

Exhibit

Examples of key issues we consider and questions we ask when engaging with companies

INDUSTRY	KEY ISSUES	KEY QUESTIONS
Retail, Textiles & Luxury Goods	Labor Management Supply Chain Standards	What employee management programs are in place to incentivize loyalty and to encourage professional development?
Banks & Insurance	Access to Finance Privacy & Data Security Responsible Lending	What are your efforts toward expanding financial inclusion measures in the markets you operate? What steps are taken to improve access to finance? What are practices in place to mitigate risks related to data privacy and security? What is your greatest exposure to regulatory risk? What are the controls and practices to prevent ethical breaches? Do you lend to carbon intensive industries? How do you price risk in loans that have high environmental, social or governance risk?
Oil & Gas	Toxic Emissions & Waste Employee Safety	How do you ensure your chemical usage is keeping in compliance with changes in regulatory and reformulation costs? How does the company aim to reduce the environmental footprint (emissions) of its products? How do you manage labor relations and what are your practices to engage with labor including employee health and safety? What safety goals have been put in place? How does the board value employee safety? Do they receive regular updates and reports on safety targets? What steps are taken to protect existing biodiversity of the land/environment that the company's operations take place on?
Internet, Mobile & Social Media	Privacy & Data Security	Are employees trained on cybersecurity and how to handle privacy and data issues? How well is the company prepared to handle a breach of customer data? What data protections and oversight practices are in place at your subsidiaries and third-party service providers? What is the company's strategy to avoid anticompetitive behavior?

RISK CONSIDERATIONS

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline. Accordingly, you can lose money investing. ESG Strategies that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. Please be aware that this portfolio may be subject to certain additional risks. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in

foreign markets entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries. **Stocks of small- and medium-capitalization companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the Portfolio's performance. **Illiquid securities** may be more difficult to sell and value than public traded securities (liquidity risk). **Non-diversified portfolios** often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility.

DEFINITIONS

"ESG" investment: Environmental Social and Governance based investment is an investment approach which takes explicit account of the environmental, social and corporate governance aspects of all proposed investments. The **MSCI Emerging Markets Index (MSCI EM)** is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance of emerging markets.

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