Morgan Stanley
INVESTMENT MANAGEMENT

# Engage

**ENGAGEMENT REPORT** | AUTUMN 2025

**INTERNATIONAL EQUITY TEAM**

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## Scope of Report

This report covers the engagement activities of the International Equity Team, acting on behalf of its clients in the strategies set out below. The engagement case studies and/or proxy voting activities included in this document are examples of the type of engagements and proxy voting the team carries out with companies on matters it believes are potentially financially material risks or opportunities.

This report relates to activities carried out in the period 1 January 2024 to 31 December 2024, unless otherwise stated. As at the date of publication, the International Equity Team manages the following strategies: Global Franchise, Global Franchise Equity Income, Global Franchise ex Tobacco, Global Quality, Global Quality ex Tobacco, Global Sustain, International Equity, International Equity Plus, American Resilience, and International Resilience. These strategies are made available through different vehicles globally as well as segregated mandates. The activities in this document may not be applicable to all strategies or vehicles.

# Sixty second snapshot

**Capitalising on opportunities**
With evolving stakeholder and regulatory requirements around ESG reporting, demand for technological solutions has grown. This presents opportunities for companies who can help corporate clients measure, manage and report their environmental footprint, particularly when it comes to issues such as carbon, deforestation and water. We engaged with two technology companies held across our portfolios for which we have identified sustainability solutions as a potentially financially material long-term growth driver.

**An eye on supply**
Companies may face nature-related risks that can pose a material threat to their bottom line. For instance, companies might depend on natural resources and the ecosystem services provided by nature, such as water, clean air and pollination which are likely to see an increase in price over time due to regulation and resource scarcity. Having identified nature-related risks as potentially financially material for a consumer goods company held across portfolios, we engaged to understand how it is managing these risks.

**Getting (carbon) physical**
Physical risks linked to climate change may pose financially material risks for companies either directly or indirectly, depending on their operational setup. Companies may face direct damage to owned physical assets, or have to grapple with indirect supply chain and logistical disruption. We sought to analyse which companies may be exposed to physical climate risk, and identify the potentially material opportunities that may exist for other companies offering commercial solutions.

**Climate targets in 2024**
We believe accurate measurement and transparent reporting of carbon emissions is fundamental in enabling companies and investors to understand the size and sources of companies' emissions, and therefore their potential financially material exposure to climate transition risks, such as carbon taxes. We engaged with two of our companies we had previously engaged with on the subject to see how they were progressing.

AUTHOR

**BRUNO PAULSON**
*Managing Director*

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# Capitalising on opportunities

With evolving stakeholder and regulatory requirements around ESG reporting, demand for technological solutions has grown. This presents opportunities for companies who can help corporate clients measure, manage and report their environmental footprint, particularly when it comes to issues such as carbon, deforestation and water. We engaged with two technology companies held across our portfolios for which we have identified sustainability solutions as a potentially financially material long-term growth driver.

## Case Study One

We met with a German multinational software company in the first quarter of 2024 as part of the carbon strand of our thematic engagement programme. The goal was to better understand the company's ESG solutions business, which the company is touting as a potential growth driver and better evaluate the size of the revenue opportunity. During the meeting, the company's Global Head of Circular Economy Solutions explained how the company is developing its suite of circular economy solutions. The company works with its corporate clients to design and produce smarter products that help meet regulatory requirements and monitor progress toward sustainability objectives, as well as optimising for other financial goals such as cost and diversification. It is embedding its solutions within its enterprise resource planning (ERP) and supply chain products with a focus on carbon emissions and plastic use. While these product development efforts stem from sustainability-related regulations and its clients' sustainability ambitions, we encouraged the company to be clear on the size of the revenue opportunity and to disclose this to investors. We believe it is important to enable investors to understand the company's priorities, including any investments made into a new growth area, as well as mitigating against greenwashing risks. Companies are increasingly under scrutiny to ensure they do not overstate their ESG credentials, including by over-emphasising their ESG-related products and services.

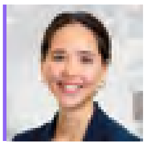
We followed up with the CEO in the second quarter of 2024, who emphasised that while the incremental revenue is a positive, the main benefit is that the embedded sustainability solutions help to sell the core ERP and supply chain products. The company also disclosed to us the estimated revenue contribution of this opportunity, which we welcomed.

## Case Study Two

A multinational professional services firm we own had identified sustainability and carbon-management solutions as a potential growth driver. We met with the company in the first quarter 2024 to better understand their approach and the revenue opportunity. During the engagement, the company's Global Sustainability Services Lead noted that regulation has the potential to be a meaningful catalyst driving demand for sustainability solutions, with this area of business growing twice as fast compared to non-sustainability-related work in the same industry. The company estimates an addressable market of $100 billion for its sustainability solutions by 2027.

During the engagement, we learned that the company is prioritising four areas of opportunity believed to be significant to its business. These are consultancy and technology solutions related to: companies' carbon commitments, including net zero, regulation-driven measurement/analytics, supply chains (e.g. Scope 3 carbon emissions management), and green software (which means writing and deploying code that consumes less energy, runs on more sustainable infrastructure, and considers the carbon intensity of the electricity used). We asked if and how its sustainability services are contributing to its competitive edge. As an example, the company shared a case study from its advisory services to a London-based pharmaceutical client, whose business it won after giving advice on embedding a sustainability model in a contract upgrade, and who the company is now working with to identify ESG metrics for reporting purposes and establish new processes. They also noted the distinct benefits from their partnership with a German multinational software company, with whom they are co-developing products and solutions. Going forward, we encouraged greater disclosure of sustainability revenues in order to monitor the company's ability to realise this revenue opportunity.

AUTHOR



**SORA UTZINGER**
*Vice President*
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# An eye on supply

Companies may face nature-related risks that can pose a material threat to their bottom line. For instance, companies might depend on natural resources and the ecosystem services provided by nature, such as water, clean air and pollination – "free common goods" which are likely to see an increase in cost over time due to regulation and resource scarcity. Companies might also have a negative impact on nature, which can bring significant legal and reputational risks, particularly given regulatory developments.

The team identified nature-related issues as potentially financially material for a consumer goods company we hold across our portfolios, including the risk of water scarcity and the responsible sourcing of commodities, such as palm kernel oil, a crucial ingredient in surfactants and which the company has disclosed 51-60% of its sales are dependent on. This is potentially financially material given regulations such as the EU deforestation regulation (EUDR)[1] – the implementation of which has been delayed to the end of 2025 for large companies – which require companies to implement improved traceability and compliance systems. Further information on assessing the exposure of companies we own to EUDR can be found in our earlier piece, "Seeing the Wood for the Trees: EUDR 101 (Autumn 2024).

In the fourth quarter of 2024, we met with the company to better understand how it is managing potentially financially material risks relating to its impact and dependencies on nature.

To manage the risk of water scarcity, the company is seeking to reduce its water use in its operations and has set itself several goals by 2030, including to increase water efficiency at its facilities by 35% per unit of production. In 2020, the company assessed more than 130 facilities and identified 33 located in areas exposed to high water risk and is focusing its efforts there. Such facilities are required to understand their local watersheds and create action plans in the event of water scarcity. The team encouraged the company to quantify sales dependent on water which the team believes will provide investors with greater transparency on the magnitude of the risk. The company is also seeking to reduce the water footprint associated with consumer use of its products, for example through product innovation. This aims to provide customers with superior products in terms of quality and usability but with a smaller resource footprint, enabling cost savings for the end user in terms of less water and energy use. We believe the company's focus on the consumer experience is an important component of its success.

While we believe the company is taking appropriate steps towards managing these risks, we made specific asks of the company. This included quantifying sales dependent on water, which we believe will provide investors with greater transparency on the magnitude of the risk, and reporting the percentage of palm oil sourced from key geographies (e.g. Indonesia).

[1] The EU Deforestation-free Regulation (EUDR) is a policy framework to address and mitigate the environmental impacts of deforestation. For details on the regulation referenced, refer to https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32023R1115&qid=1687867231461.

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# Getting (carbon) physical

Physical risks linked to climate change may pose financially material risks for companies either directly or indirectly, depending on their operational setup. Companies may face direct damage to owned physical assets and infrastructure. Equally, they may have to grapple with indirect supply chain and logistical disruption, for example, due to higher and more volatile input prices, shortfalls in inventory, or higher insurance costs.

We started our thematic engagement on carbon in 2021 and it continues to this day. Over time, we have looked at three key areas:

1. Measurement, reporting, target setting and transition planning.
2. Opportunities linked to the low carbon transition.
3. Physical climate risks and opportunities.

## Physical Climate Risk: An Overview

For some companies, physical risks are already beginning to materialise. As we covered in "Testing the Water" (Engage Winter 2023), water scarcity is partly a physical climate risk; as temperatures increase, the risk of water shortages and droughts is also likely to increase, presenting a risk to companies dependent on limited local water supplies for their operations, such as breweries.

To better understand the risk and resilience of companies in our portfolios, we sought to analyse which companies may be exposed to physical climate risks, assess the potential impacts of such risks and the actions they are taking to manage and/or mitigate disruption. We also identified the financially material opportunities which might exist for those companies offering commercial solutions to identify, assess and manage physical climate risk.

## Understanding Climate-Related Risks

Climate-related risks may be broken down into two broad categories[2]:

- **Transition risk:** the financial impact a company may face as economies transition and adapt to a lower-carbon economy. These risks might be related to policy changes, the regulatory environment, technology trends, market demand and supply shifts, and a company's reputation. Inevitably, accelerated decarbonisation is likely to disrupt certain sectors – e.g., coal production and power generation, carbon-heavy metal producers, and in the long term, oil and industries dependent on it, such as aviation – and boost others e.g., renewable energy and electric vehicles.
- **Physical risk:** planetary changes resulting from climate change. Physical risk can be broken down further into acute and chronic risks. Acute risks are event-driven, e.g., extreme weather events such as hurricanes, floods, extreme heat and resulting wildfires, while chronic risks refer to longer-term shifts in climate patterns, e.g., rising sea levels and increasing temperatures.

## Climate-related risks and our portfolios

Previously, the focus of our climate assessments and engagement efforts was largely on transition risk, given the likely nearer-term impact of policy and regulation already in motion in certain jurisdictions. With extreme weather events becoming more frequent and severe,  companies are facing more significant physical climate-related risks, especially those with complex, global supply chains that operate in regions that are more vulnerable to unpredictable weather patterns such as droughts, wildfires, heatwaves, floods and storms. Given this, we turned our attention to assessing the potential financial materiality of physical climate risks facing the companies we own.

**TABLE 1**
### Acute and chronic physical risks

**ACUTE**
- Increased severity of extreme weather events such us cyclones and floods

**CHRONIC**
- Changes in precipitation patterns and extreme variability in weather patterns
- Rising mean temperatures
- Rising sea levels
- Reduced revenue from decreased production capacity (e.g. transport difficulties, supply chain interruptions)
- Reduced revenue and higher costs from negative impacts on workforce (e.g. health, safety, absenteeism)
- Write-offs and early retirement of existing assets (e.g. damage to property and assets in 'high-risk' locations)
- Increased operating costs (e.g. inadequate water supply for hydroelectric plants or to cool nuclear and fossil fuel plants)
- Increased capital costs (e.g. damage to facilities)
- Reduced revenues from lower sales/output
- Increased insurance premiums and potential for reduced avai

Source: TCFD final status report

[2] As identified by the Task Force for Climate Related Disclosures (TCFD).

[3] Source: Intergovernmental Panel on Climate Change (IPCC). (2021). *Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* (Chapter 11: Weather and Climate Extreme Events). Cambridge University Press. Retrieved from https://www.ipcc.ch/report/ar6/wg1/chapter/chapter-11/.

NASA. (2025, June 17). *NASA data reveals dramatic rise in intensity of weather events. The Guardian.* Retrieved from https://www.theguardian.com/world/2025/jun/17/nasa-data-reveals-dramatic-rise-in-intensity-of-weather-events.

We started by considering data on physical climate risks from third-party data vendors, but quickly identified that the top-down data available did not provide us with sufficient insights given the lack of integration of companies' supply chains and particular business models that may give rise to specific risks. We next used a proprietary framework to review and assess companies' physical climate risks, taking into account companies' value chains including both upstream and downstream risks.

Having conducted a qualitative review of companies in the portfolio, we were able to identify which were more exposed to physical climate risks as well as the category of disruption. Where physical climate risks were identified as potentially financially material, we sought to engage with these companies to better understand the risk and how the relevant company is seeking to manage and mitigate against it.

## Case study one

In our engagement with an information technology company we hold, amongst other climate-related topics, we probed on physical climate risks that we had identified to be potentially financially material. The company operates facilities in storm-prone Texas, has a water-heavy production process (both direct risks), and a complex supply chain (an indirect risk). During our conversation, we learned that the company has dedicated personnel considering water-related risks over the long term, and that it has taken a number of steps to manage both weather- and water- related risks. For instance, new facilities are being built to the highest storm resistance standards, and water usage is also being closely scrutinised at new facilities, which are built to be less water intensive. In terms of the supply chain, the company is ensuring that alternative suppliers, buffer stocks, and energy sources are in place in an attempt to minimise risk of single point failure. For example, facilities now have back-up energy sources on a separate grid, rather than relying on generators. Overall, while we think the approach to managing physical risks is sensible, we asked that the company set long-term water use reduction targets given the approach includes risk mitigants rather than solutions.

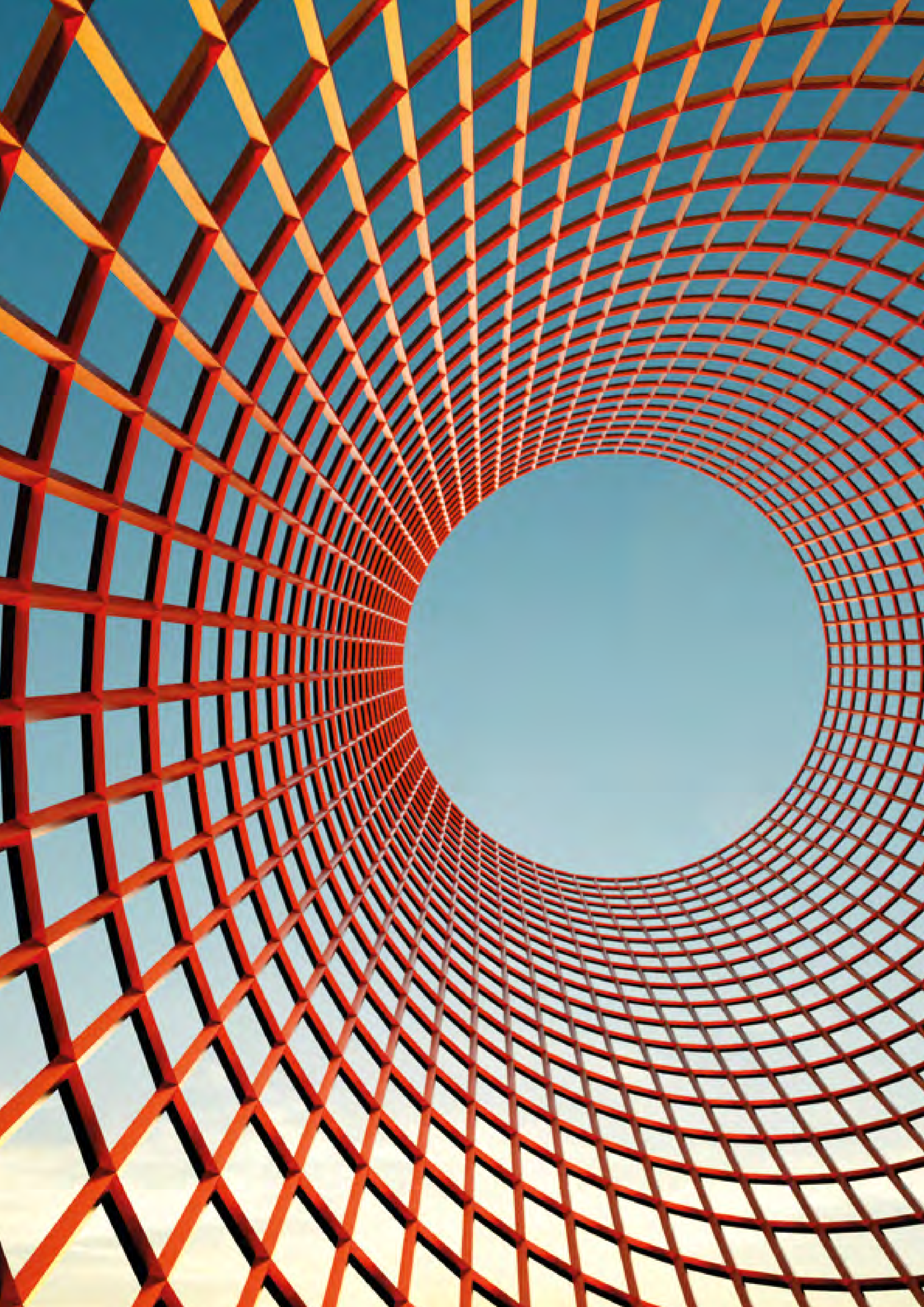
## Case study two

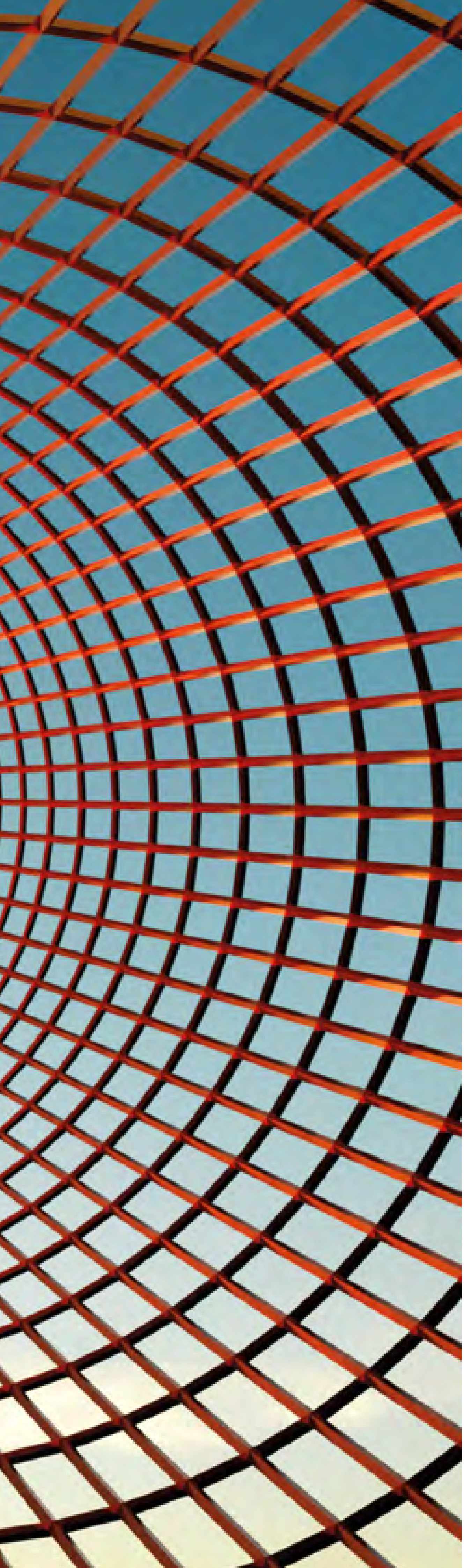
While physical climate risks might cause financially material disruption to some companies' direct operations and supply

chains, for others they may present a financially material opportunity. For example, companies able to aid their clients in understanding these potential risks, and which can provide products and solutions to manage and mitigate them. We engaged with a leading insurance broker and risk consultant held in our global portfolios on potentially financial material opportunities linked to physical climate risk. During our engagement, we learned that the company is well positioned to benefit from increasing client interest in analysing and mitigating physical climate risk. The company believes its climate data and consulting capabilities represent an advantage over competitors. These new services are likely to be bundled with existing products to help the company grow or maintain market share.

### Case study three

Our bottom-up, fundamental analysis identified climate-related risks to be potentially financially material for a large derivatives exchange, given its role as custodian of critical futures markets and its exposure to physical assets, such as offices and data centres. During our engagement, we were encouraged to hear that the company has stress-tested its operations against potential disruptions and implemented robust risk management practices to safeguard its physical assets from climate-induced disruptions. On Scope 3 emissions, management has engaged a third-party consultant to establish a baseline for category 11 emissions (processing of sold goods) and committed to providing regular updates. We asked the company to strengthen its climate disclosures by including detailed findings from its risk assessments and mitigation strategies. On the opportunity side, the company is positioned to benefit from growing demand for carbon markets and transition metals driven by renewable energy and decarbonisation efforts. Enhanced disclosures on climate risk assessments and progress on Scope 3 emissions tracking will provide critical information on the company's preparedness to address both physical and market-related climate risks. In addition, by capitalising on tailwinds from COP29 negotiations and increasing demand for transition metals, we believe the company is well-positioned to drive value while supporting the energy transition.





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**GREG HEYWOOD**
*Vice President*

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# Climate targets in 2024

As covered in "Spotlight on Carbon Emissions" (Engage Winter 2023), we believe accurate measurement and transparent reporting of carbon emissions is fundamental in enabling companies and investors to understand the size and sources of companies' emissions, and therefore their potential financially material exposure to climate transition risks, such as carbon taxes.

## Case study one

We first engaged with this information technology company on greenhouse gas emissions in 2021. At the time, the company did not measure or report on its emissions, nor did it have a formal carbon reduction target.

We encouraged the company to both measure and report on its emissions, and to set emissions reduction targets validated by SBTi. We were later invited by the company to participate in a consultation with a leading sustainability integration firm it had hired, exploring emission reduction targets.

We followed up again in 2022, when the company had published its first ESG report, which included reporting on Scope 1 and 2 emissions for the first time. 2024 marked the company's first time reporting on Scope 3 emissions. The company has also committed to set near-term SBTi-validated emissions reduction targets, in line with our suggestion.

## Case study two

As reported in "Rising to the Challenge" (Engage 2022), we first engaged with this industrials company on decarbonisation in May 2022. At the time, the company already had a Scope 1 and 2 emissions reduction target and was working on improving its measurement of Scope 3 – its most material source of emissions. We enquired whether the company would consider a science-based approach to target setting (which would include Scope 3) but did not expect to see progress given the company's focus on its existing target. We had a follow up engagement in November 2023 where we learnt the company had just made a commitment to setting near-term emissions reduction targets validated by the SBTi; we saw these validated in April 2024 and include a Scope 3 reduction target.

# Proxy voting reflections from 2024

We believe that proxy voting is an important part of the dialogue between companies and their shareholders. This means we do not outsource proxy voting and never have. Our investment team seeks to vote in a prudent and diligent manner and in the best interest of our clients, consistent with the objective of maximising long-term investment returns.

Our proxy voting is predominantly related to governance issues such as management incentives and director appointments. We also consider how to vote on proposals related to social and environmental issues on a case-by-case basis by determining the relevance of the issues identified in the proposal and their likely financial impact. We generally support proposals that, if implemented, would enhance useful disclosure or improve management practices.

However, the act of voting alone can often fall on deaf ears, particularly if majority support on important proposals is lacklustre, either due to a lack of information or insufficient understanding of the issue, or diffused ownership implicating outcomes. That's why we believe in the twin roles of engagement and voting. As fundamental managers running concentrated portfolios and representing meaningful client assets, we are fortunate to have better-than-average access to company management. We typically have the opportunity to explore the proxy agenda with the company ahead of the annual general meeting (AGM) — sometimes at their invitation – which also provides the opportunity to make our voice heard. We do not share our voting intentions with companies prior to casting our vote.

### A look back at our team's 2024 voting season

During 2024, our team voted on 1708 proposals at 96 AGMs. Our disciplined investment philosophy means our voting record has remained consistent when compared to previous years; we voted against management 8% of the time (140 proposals) and against management at least once at 70% of our portfolio companies' AGMs (67 companies). Most votes against management were related to compensation (43% of all votes against management), director elections (26%) and shareholder proposals (15%).

## Executive pay

As covered previously (Engage Winter 2023), we consider executive pay to be a particularly important topic. As long-term investors, we want the companies our clients own to have pay plans in place that encourage longer-term thinking over short-term opportunism and agree with renowned investor Charlie Munger's claim that incentives drive outcomes. We take the process very seriously, using our proprietary Pay X-Ray scoring framework to evaluate pay schemes where possible, engaging with companies to encourage improvements and voting against them where we are unhappy with the structures. In total, we voted on 221 compensation-related proposals and against management 27% of the time (60 proposals).

## Proxy voting case studies

### CASE STUDY ONE

As we had in 2023, in 2024 we voted against the pay plan of an American multinational consumer credit reporting agency we own. This was primarily because of the heavy weighting towards earnings per share (EPS) in the annual bonus and relative total shareholder return (TSR) in the long-term incentive plan (LTIP), as well as the "pay to stay"[4] component. We would like to see a pay plan entirely based on performance with metrics linked to company fundamentals such as return on capital and organic revenue as well as a longer vesting period.

### CASE STUDY TWO

Our detailed analysis on an American medical devices and health care company's compensation scheme, using our proprietary Pay X-Ray scoring framework, yielded a negative Pay X-Ray score, due to overly complex incentive structures and targets that we believed were too easily attainable. Having voted against the company's pay plan in prior years, we voted against the company's pay plan again at its 2024 AGM and took the opportunity to articulate our concerns to the company through engagement. We explained our key concerns, which included (i) the sizeable "pay to stay" component in the LTIP, and (ii) the use of relative TSR as a performance metric, which we believed to be sub-optimal. Instead, we encouraged the use of performance share units in place of non-performance-linked options and asked that the company reduce the weight of TSR in favour of metrics linked to company fundamentals.

[4] As described in "Show me the incentive and I will show you the outcome" (Engage Winter 2023), "pay to stay": where management merely has to avoid being fired to benefit.

**CASE STUDY THREE**

We voted against executive pay at a global semiconductor company we own primarily because the company's equity awards are not based on performance; we would like to see a performance-based LTIP with metrics linked to company fundamentals such as return on capital and organic revenue. As we voted against the company's executive pay for several years and have not seen progress, we also signalled our view by voting against the re-election of the chair of the remuneration committee.

**CASE STUDY FOUR**

We voted against a British-American professional services company's pay plan primarily because the LTIP is entirely based on EPS. We believe EPS is a suboptimal metric that can be easily manipulated and can encourage management to take decisions that boost profits in the short run at the expense of their companies' ability to compound over the long run. We would prefer to see metrics linked to company fundamentals such as return on capital and organic revenue. In addition, we noted the Remuneration Committee's decision to increase the bonus cap from 200% to 250% without a clear rationale.

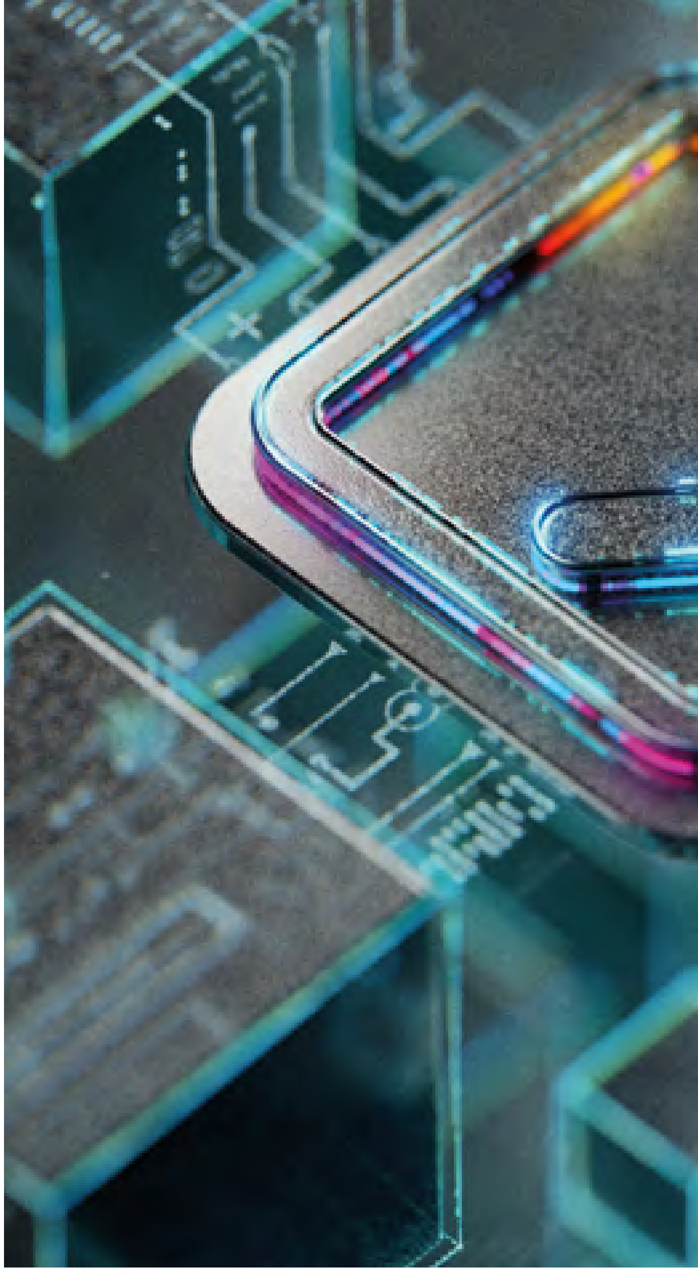
We also saw a number of instances where management put forward proposals to authorise the company to call a general meeting with two weeks' notice. We voted against all of these as we believe a shortened notice period could disenfranchise shareholders by not giving them sufficient time to prepare/be aware of the meeting and vote.

## Shareholder proposals

Within the period there were 52 shareholder proposals, we voted against management on 22 of them (42%). Here are some examples of our voting activity on shareholder proposals.

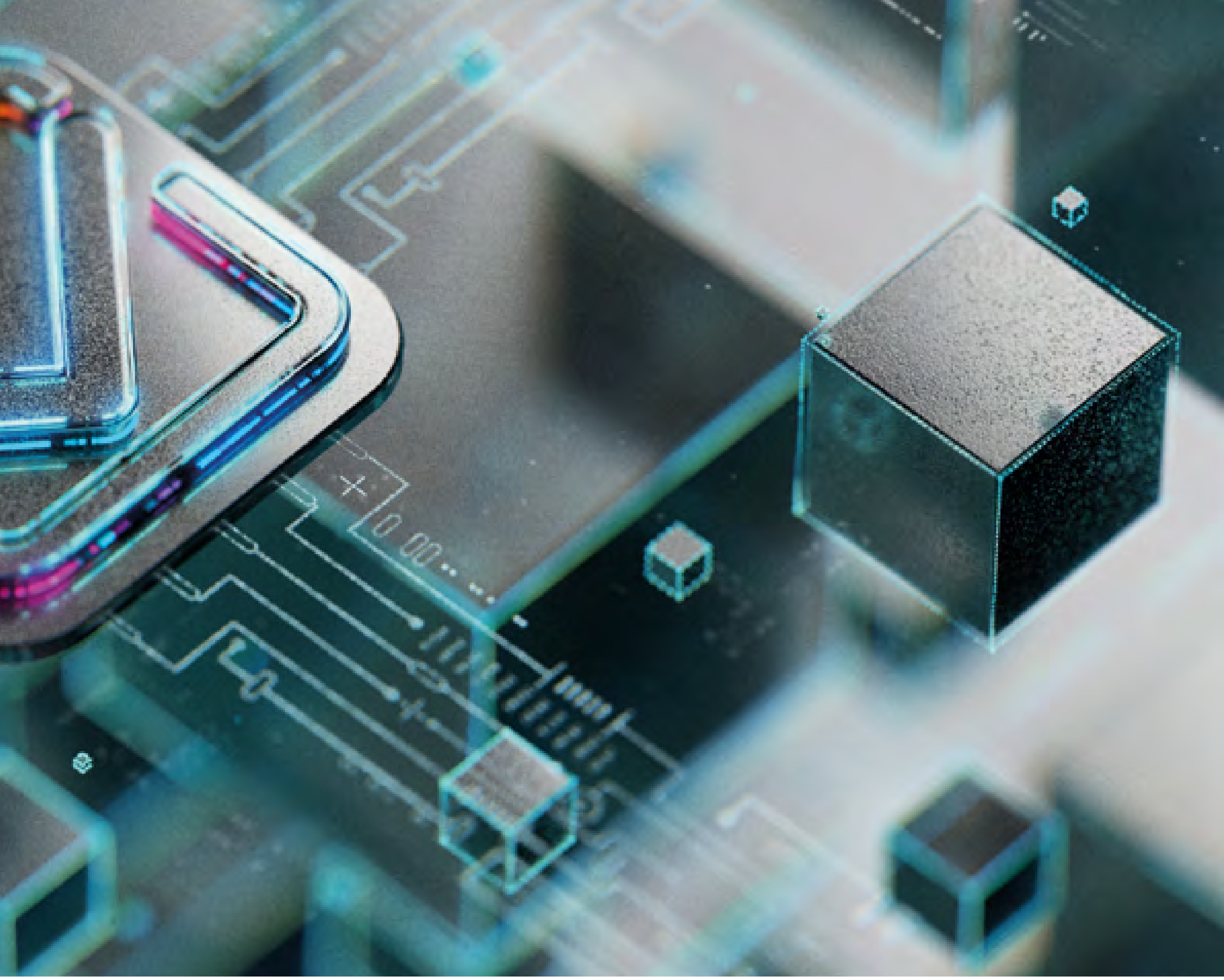
**CASE STUDY ONE**

We voted against management and in favour of a shareholder proposal which asked a global semiconductor company we own to report on due diligence efforts to trace end-user misuse of company products as there is a potential risk for the company that chips end up being used in conflicts through illicit diversion. We have engaged with the company and believe the risk is partially mitigated through thorough control over "weapon specific" chips and close collaboration with relevant authorities. We also recognise that it is difficult to stop general purpose chips from entering markets illicitly. However, we would welcome greater transparency over the exposure and actions taken and believe a report, so long as it's not prohibitively costly or disruptive, could help keep investors informed of the company's actions and mitigate future reputational risk.



**CASE STUDY TWO**

We voted in favour of two shareholder proposals relating to Artificial Intelligence (AI) at an American technology conglomerate. One of the proposals asked the company to report on misinformation and disinformation risks, both generated and disseminated via its generative



AI platform, as well as its plans to mitigate such risks.[5] The World Economic Forum has ranked mis- and dis-information as a top global risk over the next two years, as groundbreaking technology charges ahead of a fragmented regulatory environment left struggling to catch up.[6] We voted in favour of the shareholder proposal given the evolving threat landscape[7] and the potential risks facing the company. We also believe it could improve disclosure to enable investors to assess whether its risk mitigation measures are adequate.

The second proposal requested that the company report on AI data sourcing accountability. We voted in favour given our view that the company faces a variety of legal, regulatory and reputational risks due to the use of external data in the development and training of its AI offerings, especially those relating to copyright infringement. We acknowledge the company's planned disclosures on the matter but believed a vote in favour of the proposal was warranted to signal to management the significance of this issue given the potentially financial materiality of the associated risks.

The proposal relating to AI misinformation and disinformation risks received 18.7% dissidence, while the proposal relating to AI data sourcing accountability received 36.2%, reflecting a significant level of shareholder concern on these topics.

[5] Disinformation: the deliberate creation and spread of false or misleading content. Misinformation: the accidental spread of such content. Source: https://post.parliament.uk/ai-disinformation-and-cyber-security/.

[6] Source: https://www.weforum.org/publications/global-risks-report-2025/in-full/.

[7] The threat landscape is the entire scope of potential and recognised cybersecurity threats affecting user groups, organisations, or specific industries.

# International Equity Team

## INVESTMENT TEAM

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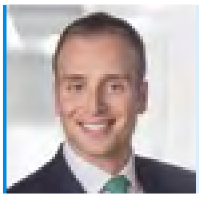

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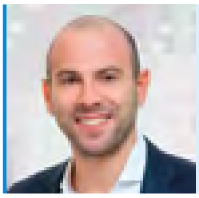

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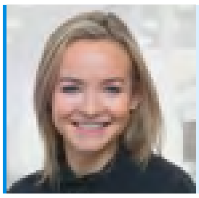

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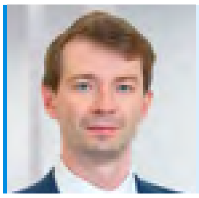

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**SCOTT ADAM**
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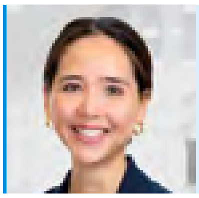

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*Vice President*

## ESG

**GREG HEYWOOD**
*Vice President*

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