

Restriction Screening and ESG Policy

GLOBAL FIXED INCOME TEAM | NOVEMBER 2021

Overview

SFDR Classification

The Restriction Screening and ESG Policy (“the Policy”) described below refers specifically to the Morgan Stanley Investment Funds (**MS INVF**) **Global Asset Backed Securities Fund** (“the Fund”).

The Fund promotes environmental and social characteristics within the meaning of **Article 8** of Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial sector (“**SFDR**”).

The MSIM Fixed Income Sustainable Investing team in collaboration with the Credit Analysts and Portfolio Managers (“the Investment Team”), are responsible for establishing the screening and Environmental, Social and Governance (ESG) criteria of this Policy, which will be reviewed and updated on at least an annual basis to ensure that it remains consistent with our view on best practice in the context of the goals of the Fund.

Restriction Screening Rationale

Restriction screening refers to intentionally avoiding investments in certain sectors or issuers. In designing the restriction screening policy as part of our investment strategies, we consider the following aspects:

- **Reducing exposure to risks related to ESG factors.** *These risks may be reputational, regulatory or financial, stemming from the business activities or practices of the issuer. We aim to remove some of the most material of these risks through restriction screening at the sector level.*
- **Values alignment.** *We may decide to exclude certain sectors from the portfolio based on our assessment that they have an overall negative impact on society or the environment which is not aligned to the objectives of the fund.*
- **Consideration as to whether there is an opportunity for engagement on ESG issues** *and whether an issuer may be able to transition its business activities or practices to a more sustainable model. We therefore may apply thresholds or carve-outs as part of the sector-level exclusions with an aim to engage with certain issuers to help drive positive change and long-term value.*
- **Adherence to core basic standards, minimum safeguards and ethical norms.** *We expect issuers to adhere to minimum standards as defined by local regulators and international ESG norms.*
- **Implications for portfolio construction.** *We aim to consider whether restrictions may have an effect on the risk/return profile of the fund, or narrow the investable universe to an extent which may be detrimental to that profile.*

Our restriction screening process is intended to avoid investment in issuers of securitisations that are not aligned with our core investment principles or our sustainable investing philosophy, or that are found to be in breach of minimum standards of responsible lending and business practice based on local regulation and/or international norms, where relevant.

Our current list of restrictions applicable to the Fund is presented below.

I. Predatory Lending

Responsible lending practices represent, in our view, the most material ESG factor when investing in securitized transactions. We believe predatory lending causes social harm by imposing unfair and/or abusive financing terms on borrowers, and restricting access to affordable capital. In addition, loans usually have a higher risk of default when there are instances of predatory lending.

We shall not knowingly invest in securities of issuers that the Investment Team evaluates as being applying **any form of predatory lending**.

II. Severe Malpractice in Payment Collection & Foreclosure Practices

We take the view that aggressive payment collection processes and foreclosure practices, from property owners or in the context of on-going loan servicing, may result in economic and moral damage to the borrower, and can lead to higher risk of defaults and pre-payments.

We shall not knowingly invest in securities of issuers that the Investment Team evaluates as displaying **severe malpractice in payment collection** or being applying **unjustifiably aggressive foreclosure practices**.

III. Breaches of Consumer Protection Standards

We expect the issuers we invest in to comply with minimum standards at the local and/or international level, as applicable. One of the key questions in our securitised investment due diligence process asks about the current status of each lender and servicer with the Consumer Financial Protection Bureau (CFPB) in the United States and any relevant regulatory and supervisory agencies in other jurisdictions, to help us ensure fair lending and servicing practices are being applied.

We shall not knowingly invest in securities of issuers that have **any ongoing breaches of the relevant local or international consumer protection standards**.

IV. Fraudulent Behaviour

We monitor securitization issuers' business practices on an ongoing basis, to mitigate potential litigation risk associated with controversies on business ethics and fraud allegations.

A "Very Severe" controversy case is defined as an instance or ongoing situation in which company operations and/or products allegedly have an environmental, social, and/or governance impact that is serious or very serious in its nature, and extensive or extremely widespread in its scale.

We shall not knowingly invest in securities of issuers with **controversy cases related to business ethics and fraud that we view as being "Very Severe"** based on data by relevant ESG data providers, and where we believe appropriate remedial action has not been taken.

ESG Methodology

The Investment Team integrates the consideration of sustainability issues in its investment decision-making based on bespoke methodologies developed by MSIM Fixed Income to evaluate the ESG characteristics of issuers and transactions across sub-asset classes including corporates, securitised and sustainable bonds (as defined below). Details of the methodologies are available on the web links below:

- **[ESG Securitised model](#)**
- **[ESG Credit model](#)**
- **[Sustainable Bond evaluation](#)**

We may include the evaluation of **positive and negative alignment with the UN Sustainable Development Goals ("UN SDGs")** and may **engage company management** around corporate governance practices as well as what we deem to be materially important environmental and/or social issues facing a company, in particular in relation to MSIM's priority sustainability themes of Decarbonisation & Climate Risk, Circular Economy & Waste Reduction, Diverse & Inclusive Business, and Decent Work & Resilient Jobs. Details on our engagement approach and thematic priorities are outlined in our **[MSIM Fixed Income Engagement Strategy](#)**.

The Fund may also invest in Sustainable Bonds from securitisation issuers, defined as labelled bonds where the issuer has committed to financing or attaining specific environmental and/or social objectives, including but not limited to the below based on the main labels of bonds issued to date, including those recognised by the International Capital Market Association (ICMA):

- Green Bonds
- Social Bonds
- Sustainability Bonds

Sustainability Indicators

The Investment Team measures and monitors the relevant environmental and social characteristics for the Fund with the use of certain sustainability indicators. The table below specifies some sustainability indicators used in the security selection process and data sources.

Sustainability indicator	Metric	Methodology	Data sources
Securitised Deal's ESG score	ESG scores at deal-level developed by MSIM	The MSIM Securitized ESG score ranges from 1-5, where 5 is best. Securitized deals with an ESG score equal to 1 do not qualify for investment for the Fund.	MSIM proprietary Securitized Sustainability Framework
Business Ethics & Fraud	We monitor two third-party metrics: <ul style="list-style-type: none"> • Business Ethics and Fraud Score • Business Ethics & Fraud Number of Very Severe Controversies 	The first metric evaluates industry-specific business ethics issues, including but not limited to anti-competitive practices, pricing fraud, controversial customer practices, and insider trading. Companies that have faced severe controversies over the past three years score lower (Score: 0-10). We only invest in issuers with a score greater than 1. The second metric represents the number of business ethics-related controversies in which the company has been involved in the past three years (if any) for which the severity assessment is 'Very Severe'. We only invest in issuers that have 0 'Very Severe' controversies.	MSCI

ESG Data

In undertaking the ESG assessment and restrictions screening process described above, the Investment Team supplements its own analysis and due diligence with data from third parties such as MSCI, where available. The Investment Team will bear the costs in relation to the use of third-party data. Third-party data is subject to change, which can result in delays in reflecting such changes in the portfolios. Where this is the case, we will resolve such instances as soon as possible.

Policy Compliance

This Policy applies to the physical investments held directly in the Fund. Investments that are held by the Fund but become restricted after they are acquired for the Fund will be sold. Such sales will take place over a time period to be determined by the Investment Team, taking into account the best interests of the Investors in the Fund.

Representatives from several areas of MSIM are responsible for monitoring the portfolio for compliance as outlined below:

Portfolio Managers and the Fixed Income Sustainable Investing team are primarily responsible for ensuring compliance with the Policy.

Traders are responsible for executing trades that are consistent with Policy and subject to best execution. They also must enter trades into the portfolio trading system, which enables traders to monitor individual portfolios for guideline conformity.

The Portfolio Surveillance team is responsible for coding ESG-related rules into our trade compliance system which uses an automated process to monitor the Policy and ensure adequate surveillance of the portfolio.

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This document supplements the information provided in the Prospectus. Investors should read the Key Investor Information Document and Prospectus before investing. There is no assurance that a Fund will achieve its investment objective.

Funds are subject to market risk, which is the possibility that the market values of securities owned by the Fund will decline. Accordingly, you can lose money investing in this Fund.