

MORGAN STANLEY INVESTMENT FUNDS (MS INVF)

## Emerging Leaders Equity Fund

# Restriction Screening Policy

ACTIVE FUNDAMENTAL EQUITY | GLOBAL EMERGING MARKETS TEAM | NOVEMBER 2021

In relation to the MS INVF Emerging Leaders Equity Fund (the “Fund”), the Investment Team, in its discretion, integrates information about sustainable themes and ESG issues in its investment decision-making. The Investment Team will also apply restriction screening, which refers to intentionally excluding investments in certain sectors or issuers. The Investment Team may engage with company management around corporate governance practices as well as what it deems to be materially important environment and/or social issues facing a company. The Fund references third party ESG data when narrowing the investible universe for the Fund and for specific data points not disclosed by all companies during the security research process, but does not rely on third party ESG data for the purposes of constructing the portfolio.

In designing the restriction screening as part of our investment strategy we consider the following aspects:

1. **Reducing exposure to risks related to Environmental, Social and Governance (ESG) factors**

These risks may be reputational, regulatory or financial, stemming from the business activities or practices of the issuer. We aim to avoid many of these risks through restriction screening at a sector level.

2. **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.

3. **Adherence to core basic standards, minimum safeguards and ethical norms**

We expect issuers to adhere to minimum standards as defined by international ESG norms, such as the UN Guiding Principle, UN Global Compact, OECD Guidelines for Multinational Enterprises and the International Labour Organization’s (ILO) fundamental principles, and we aim to not invest in issuers that violate, or are at high risk of violating, these international norms.

4. **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 investible universe to an extent to which it may be detrimental.

Investments shall not knowingly include any company whose **business activity** involves the manufacturing or production of:

## I. Tobacco

We believe tobacco has significant negative social and economic impacts and is considered the single greatest preventable cause of death. We estimate that, as a result, tobacco companies are increasingly exposed to significant ongoing financial, reputational and regulatory risk.

We exclude companies that directly manufacture tobacco products, or generate 5% or more of their revenues from the supply of key products necessary for the production of tobacco products, such as filters.

## II. Adult Entertainment

We exclude companies that directly produce or own a majority stake (over 50%) in adult entertainment companies.

## III. Civilian Firearms

We take the view that although firearms can in some cases support rightful and peacekeeping activities, their use by civilians, particularly in the case of automatic and semi-automatic firearms, poses a threat to society as there is a high risk that they might end up being used illegally or indiscriminately against other people, causing mass wounding or death. We exclude companies that manufacture automatic firearms or semi-automatic firearms for the civilian market.

## IV. Controversial Weapons

In our view, controversial weapons are indiscriminate and excessively injurious, often resulting in civilian casualties and causing a disproportionate level of pain and suffering. We exclude companies that manufacture whole weapons systems, intended use components, or are a majority owner, or majority-owned by, a controversial weapons company, including cluster munitions.

Our approach to controversial weapons is consistent with the following treaties:

- The Ottawa Convention, 1999: banning the use, stockpiling, production and transfer of anti-personnel landmines.
- The Oslo Convention 2010: banning the use, stockpiling, production and transfer of cluster munitions.
- Weapons banned under the Biological Weapons Convention, 1975 and the Chemical Weapons Convention, 1997.

## V. Fossil Fuels

We recognize that climate change poses significant risks to the global economy and therefore look to exclude the most exposed carbon-intensive sectors from the Fund to mitigate our climate related financial risks and where we estimate that we are unable to drive positive impact through engagement towards the low carbon transition.

### Coal

We recognize that coal is the most carbon-intensive fuel source compared to other fossil fuels and it is exposed to significant stranded asset risk from climate policy. We will not invest in securities of issuer *that generate any revenue from the mining and extraction of thermal coal, or in securities of issuers that generate 10% or more of their revenue from coal-fired power.*

### Oil Sands

We estimate that oil sands have the highest Green House Gas (GHG) potency (kg per GJ) compared to conventional fossil fuels and have significant negative environmental and social impacts related to their extraction/refining methods, which can in turn generate complex legal regulatory and social risks to shareholder value.

We exclude companies that derive 5 percent or more of their revenues from the extraction or production of oil sands.

### [Arctic Oil](#)

Since 2011 Arctic sea ice has been declining at a rate of 12.85 percent per decade, relative to the 1981 to 2010 average. This represents a serious threat to ecosystems and wildlife, as well as to local communities and indigenous people living in the region. Arctic oil exploration and production not only capitalizes on the effects of global warming, but also contributes to worsening it through further emissions, and can lead to serious environmental damage in case of spills.

We will not invest in securities of issuers that generate 5 percent or more of their revenue from oil extraction or production in the Arctic region, including in the Arctic National Wildlife Refuge (ANWR).-

## **VI. Gambling**

Gambling activities embed a high risk of generating direct negative social impacts, in particular addiction and over-indebtedness, as well as indirect impacts especially for more vulnerable groups, including reduced familial stability and household income and increased propensity to crime.

We will not invest in securities of issuers that derive 5 percent or more of their revenue from gambling activities.

## **VII. ESG Controversies and International ESG Norms**

We expect the issuers we invest in to comply with minimum standards and safeguards around human rights, labour rights, the environment, business ethics and corruption as defined by international norms, such as the UN Guiding Principles, UN Global Compact, the OECD Guidelines for Multinational Enterprises and the International Labour Organization's (ILO) fundamental principles, and we aim to not invest in issuers that violate these international ESG norms.

We monitor business practices on an ongoing basis, through data on ESG controversies and standards screening that we source from third party providers.

A "Severe" ESG controversy is defined as an instance or ongoing situation in which company operations and/or products allegedly have a significant negative environmental, social, and/or governance impact.

We seek to exclude securities of issuers with controversy cases that we view as being "Severe" based on ratings by relevant ESG data providers (currently MSCI) and where we believe appropriate remedial action has not been taken. We will also not invest in securities of issuers that fail to adhere to the above listed international ESG norms.

## **VIII. ESG METHODOLOGIES**

The Investment team considers that the Fund promotes environmental and social characteristics.

The Fund will invest in companies in emerging markets, with positive and/or improving alignment to one or more sustainability themes including but not limited to climate change, natural capital, human capital and innovation/infrastructure.

The Investment Adviser believes companies with forward-looking management teams that establish proactive strategies on these sustainability and ESG issues will be better positioned from a business and financial perspective over the long term than companies that do not consider them. A security will be considered aligned to one or more of these themes if the company shows evidence of product revenues, policies, initiatives, industry leadership, and/or established targets to proactively address one or more of these themes. Alignment will be determined by the Investment Adviser's research and analysis, supported by direct company engagements and third party sources.

## Sustainability indicators

The Investment Adviser measures and monitors the relevant environmental and social characteristics for the Fund with the use of certain sustainability indicators (as indicated below).

The table below specifies some sustainability indicators used in the security selection process and data sources:

Environmental and Social Characteristic	Sustainability indicator	Metrics (Including without limitation)	Methodology	Data sources
<b>Environmental</b>	Climate Change	<ul style="list-style-type: none"> <li>Climate change revenue as measure by the percentage of issuer revenue from products/services aligned to the promotion of renewable and affordable energy, as well as addressing climate change and its impacts.</li> <li>Carbon Emissions intensity as measured by Total greenhouse gas emissions and intensity of company sales as measured by scope 1 and scope 2 emissions normalized by revenue. Scope 1 carbon emissions: emissions generated from sources that are controlled by the company that issues the underlying securities Scope 2 carbon emissions: emissions from the consumption of purchased electricity, steam, or other sources of energy generated upstream from the company that issues the underlying securities</li> <li>Energy intensity calculated as megawatt hours of energy consumed per million of sales revenue in the company's reporting currency.</li> </ul>	The Investment Adviser incorporates (available) information regarding company performance on these climate change metrics to make investment decisions. The result of this process is a portfolio which is tilted toward issuers that are implementing best-in-class practices and taking initiative in managing climate risk within their respective industries.	Bloomberg, company reports, MSCI ESG, RobecoSAM
<b>Social Characteristics</b>	Diversity & Inclusion Metrics	<ul style="list-style-type: none"> <li>% of revenues derived from products and services that promote gender equality and reduced inequalities</li> <li>Assessment of company diversity and inclusion taking into consideration, without limitation, factors such as gender diversity of staff and company leadership and remuneration policies.</li> </ul>	The investment adviser incorporates (available) information about Company performance on diversity and inclusion metrics as part of the investment decision making process. The result of this process is a portfolio which is tilted towards companies that the investment adviser believes to be best-in-	Bloomberg, company reports, MSCI ESG, , RobecoSAM

			class in managing human capital within their respective industries.	
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## DATA SOURCES

In undertaking the above analysis and restrictions screening, the Investment Team supplements its own analysis with data from third parties such as MSCI and RobecoSAM. The Investment Team will bear the costs in relation to the use of third party data.

### Restriction Policy Compliance

This restriction screening 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 shareholders of the Fund.

We review this policy periodically and any changes will be reflected in this document. In addition to ongoing monitoring by the investment team, portfolio managers, Morgan Stanley Investment Management's Portfolio Surveillance team will conduct quarterly reviews to ensure the compliance of restriction policy.

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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.