

Restriction Screening and ESG Policy

FIXED INCOME TEAM | NOVEMBER 2022

Overview

SFDR Classification

The Restriction Screening and ESG Policy (“the Policy”) described below refers specifically to the range of fixed income Morgan Stanley Investment Funds (MS INVF) listed in footnote 1 (“the Funds”).¹

The Funds promote 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 Funds.

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.*

¹ This Policy applies to the following funds:

- MS INVF Emerging Markets Corporate Debt Fund
- MS INVF Emerging Markets Fixed Income Opportunities Fund
- MS INVF Euro Bond Fund
- MS INVF Euro Corporate Bond Fund
- MS INVF Euro Strategic Bond Fund
- MS INVF European Fixed Income Opportunities Fund
- MS INVF European High Yield Bond Fund
- MS INVF Euro Corporate Bond - Duration Hedged Fund
- MS INVF Global Fixed Income Opportunities Fund
- MS INVF Global High Yield Bond Fund
- MS INVF Global Bond Fund
- MS INVF Global Convertible Bond Fund
- MS INVF Short Maturity Euro Bond Fund
- MS INVF US Dollar Corporate Bond Fund
- MS INVF US Dollar High Yield Bond Fund
- MS INVF US Dollar Short Duration Bond Fund
- MS INVF US Dollar Short Duration High Yield Bond
- MS INVF Global Credit Fund

- **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 international ESG norm.*
- **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 combines sector-level exclusions, which are intended to avoid investment in sectors that are not aligned with our core investment principles or our sustainable investing philosophy, and norms-based exclusions, through which we screen out securities of issuers that are found to be in breach of minimum standards of responsible business practice based on international norms. Our current list of restrictions applicable to the Funds is presented below.

I. Controversial Weapons

MSIM Fixed Income views controversial weapons as indiscriminate and excessively injurious, often resulting in civilian casualties and causing a disproportionate level of pain and suffering. These weapons may also pose a long term risk to civilian populations from unexploded ordnance which can detonate long after their initial use.

We shall not knowingly invest in securities of issuers that generate **any revenue** from the manufacturing or production of controversial weapons or intended use components, or are a **majority owner of, or majority owned by,** controversial weapons companies. Controversial weapons are defined as including anti-personnel landmines, cluster munitions, biological/chemical weapons and nuclear weapons.

Our approach to controversial weapons is consistent with the Ottawa Convention 1999, the Oslo Convention 2010, the Biological Weapons Convention 1975, and the Chemical Weapons Convention 1997.

II. 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 shall not knowingly invest in securities of issuers that generate **any revenue** from the manufacturing or production of civilian firearm systems.

III. Tobacco

We believe tobacco has significant negative social and economic impacts and is considered the single greatest preventable cause of death. As a result, tobacco companies are exposed to significant ongoing financial and reputational risk from increased regulation. Moreover, in our view, there is no reasonable level of tobacco consumption and we believe engagement with the tobacco industry will not lead to significant change.

We shall not knowingly invest in securities of issuers that generate **any revenue** from the manufacturing or production of tobacco products.

IV. Thermal Coal

We estimate that coal is the most carbon-intensive of the fossil fuels and it is exposed to significant stranded asset risk from climate-related policy, and we therefore look to exclude it from the Funds to mitigate our climate-related financial risks.

We shall not knowingly invest in securities of issuers that generate **5 percent or more of their revenue** from the mining and extraction of thermal coal.

The exception to this is that the Funds may invest in labelled Green and Sustainability Bonds, as defined further below in this Policy, which are issued to raise capital specifically for climate-related or environmental projects, so long as we have determined that the objectives of such instruments are consistent with a reduction by the issuer in its carbon emissions. Investment in such instruments will be subject to diligence by the Sustainable Investing team, with the support of our MSIM Credit Analysts.

We may also engage issuers' management more broadly around the topics of decarbonisation and climate risk (as well as corporate governance practices and what it deems to be materially important other environmental and/or social issues facing an issuer) including those issuers involved in coal-fired power generation and those that generate less than 5 percent of their revenue from the mining and extraction of thermal coal. As part of such engagements, we will endeavor to encourage issuers to develop decarbonisation strategies and specify science-based targets to transition their business models to more sustainable ones.

V. Monitoring of ESG Controversies and International Norms

We expect the issuers we invest in to comply with minimum standards and safeguards around human rights, labour rights, environment, business ethics and corruption as defined by international norms such as the United Nations Global Compact, the International Labour Organization's (ILO) fundamental principles and the Organisation for Economic Co-operation and Development's (OECD) Guidelines for Multinational Enterprises. We monitor business practices on an ongoing basis, through data on ESG controversies and standards screening that we source from third party providers. Although failure to comply with such standards will **not automatically result in exclusion from the Funds**, it may cause us to pursue a more cautious stance to the company, conduct further research and due diligence, and engage with company management to try to ensure that our understanding of the issue is as comprehensive as possible, and that any action we take is fully informed.

ESG Methodology

Environmental & Social Characteristics

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, sovereigns, securitised and sustainable bonds (as defined below). Details of the methodologies are available on the web links below:

- [ESG Credit model](#).
- [ESG Sovereign model](#).
- [ESG Securitised 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 Funds may also invest in Sustainable Bonds, 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 Funds 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
Issuer's ESG score	ESG scores at issuer-level developed by MSIM, with data inputs from third-party providers.	Information regarding an issuer's ESG score is incorporated in the investment process.	MSIM proprietary methodologies, with third-party inputs, where relevant, from MSCI, World Bank, United Nations, Emission Database for Global Atmospheric Research (EDGAR), University of Notre Dame
Carbon footprint for scope 1 and 2 emissions	Weighted Average Carbon Intensity (WACI), defined as tons of CO2 equivalent per \$1 million revenue. Note: Scope 1 carbon emissions: direct emissions generated from sources that are controlled by the company that issues the underlying assets; Scope 2 carbon emissions: indirect emissions from the consumption of purchased electricity, steam, or other sources of energy generated upstream from the company that issues the underlying assets.	Information regarding WACI is incorporated in the investment process.	MSCI

ESG Data

In undertaking the ESG Assessment and restriction screening process described above, the Investment Team supplements its own analysis with data from third parties such as MSCI, Sustainalytics, S&P Trucost, ISS ESG and others. 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 Funds. Investments that are held by the Funds but become restricted after they are acquired for the Funds 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 Funds.

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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