Morgan Stanley

INVESTMENT MANAGEMENT

Fixed Income

2022
ENGAGEMENT REPORT

Fixed Income Team

Executive Summary

Engagement and sustainability advocacy are increasingly important tools for driving positive change and capturing potential alpha opportunities. As active bond investors, we believe we have a duty to leverage our access to a variety of debt-issuing organisations and to express our expectations around how these organisations should improve their processes and practices, as we deploy capital toward positive environmental and social outcomes.

Our Fixed Income team continues to engage on an ongoing basis with issuers across the various asset classes that we cover. Over the past 12 months,[1] we conducted **145 ESG-focused engagement** meetings, with three-in-four targeting **carbon-intensive industries and financiers**. We also translated words into action: almost one-third of the engagements **influenced our investment strategy**, leading us to invest in a new transaction, pass on a new issuance or reduce existing exposure.

A Year of Engagement in Numbers

DISPLAY 1

Thematic focus: Decarbonisation & climate action remains most common topic[2]

Corporate Governance – 15%

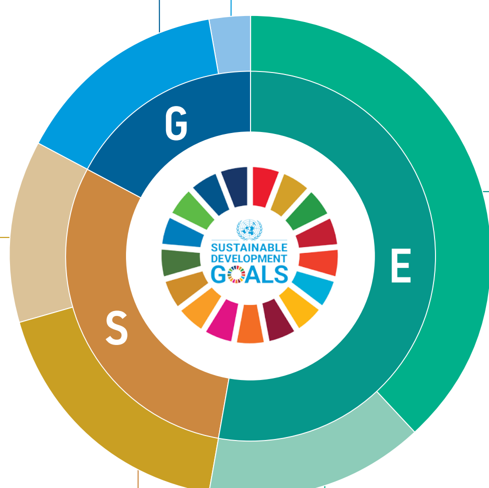
- Sustainability-linked executive pay
- Remediation of sustainability controversies

Decent Work & Resilient Jobs – 12%

- Human rights monitoring
- Employee satisfaction
- Supply chain management

Diverse & Inclusive Business – 18%

- Board diversity
- Community engagement & inclusion
- SME financing



Reporting & Disclosure – 2%

- Enhanced disclosure in line with market standards
- Sustainable bond impact reporting

Decarbonisation & Climate Action – 38%

- Science-based emissions reduction targets
- Carbon emissions measurement & reporting
- Fossil-fuel phaseout

Circular Economy & Waste Reduction – 15%

- Plastic-free packaging
- Recycling across the value chain
- Biodiversity commitments

[1] Refers to engagements conducted in the 12-month period from July 1, 2021, to June 30, 2022. The term "MSIM" generally includes each registered investment advisor owned by Morgan Stanley. However, unless otherwise noted, references to MSIM and to the "Fixed Income team" in this document do not include Eaton Vance Management, Calvert Research and Management, Atlanta Capital Management Company, or Parametric Portfolio Associates who were acquired by Morgan Stanley on March 1, 2021.

[2] We usually address multiple themes across the environmental, social and governance pillars within our engagements.

In 2020, our Morgan Stanley Investment Management (MSIM) Fixed Income team ("we", the "Team") established an ESG Engagement Strategy, outlining the structure for our engagement activities, as well as priority sustainability themes, as follows:

- Decarbonisation & Climate Action
- Circular Economy & Waste Reduction
- Diverse & Inclusive Business
- Decent Work & Resilient Jobs
- Corporate Governance & Reporting Practices (cross-cutting theme)

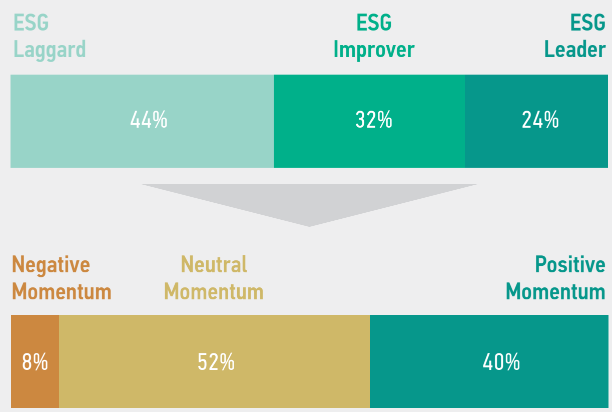
Over the reporting year, the Intergovernmental Panel on Climate Change (IPCC)[3] published three Working Group contributions for its Sixth Assessment Report,[4] with the latest one taking stock of current progress on climate change mitigation, evaluating the adequacy of national climate pledges, and reiterating the urgency of setting the global economy on a pathway aligned with a 1.5°C scenario (i.e., 1.5°C climate warming above pre-industrial era global temperatures).

In line with these developments, this year we maintained a similar thematic breakdown to last year, with **over one-half of our engagements** focused on **environmental risks and opportunities**. The majority of our meetings focused on the setting of corporate science-based emission reduction targets and on investments in more energy efficient technologies. However, we also increased our strategic focus on promoting business models that effectively manage natural capital within a circular economy. In the first half of 2022, we started to address the topic of biodiversity in greater depth, particularly with companies in the Agribusiness and Food & Beverage sectors, focusing on topics including deforestation, upstream supply chain auditing, and land conflict management, among others. Following the launch of the Taskforce on Nature-related Financial Disclosures (TNFD)[5] in June 2021, we also began to encourage companies to include time-bound biodiversity commitments into their sustainability strategies and green financing frameworks, where relevant.

Assessing good governance practices continues to play a key role in our engagement strategy. As Fixed Income investors, we do not have the shareholder proxy voting rights of our Equity colleagues. However, we get direct access to companies and other organisations' senior management through their primary market debt issuance, which tends to be more frequent than in equities. This allows us to advocate for what we perceive to be best practice in corporate behavior, business ethics, and sustainability-related disclosure. It also enables us to assess the extent to which a debt issuer displays good governance practices, which informs both our regular credit analysis and sustainability evaluation to the extent that such practices influence the management and oversight of environmental and social issues.

DISPLAY 2

Targeted approach: Over three-quarters of our engagements were with ESG Laggards or Improvers,[6] to identify their momentum[7]



[3] IPCC is an intergovernmental body of the United Nations based in Geneva responsible for advancing knowledge on human-induced climate change.

[4] Sixth Assessment Report — IPCC, 2022.

[5] The Taskforce on Nature-related Financial Disclosures (TNFD) consists of 34 senior executives representing financial services, the corporate sector and market services companies. https://tnfd.global/

[6] Leaders, Laggards, and Improvers are determined through MSIM's proprietary ESG scoring system. ESG Leaders include issuers in the top-30% ESG scores; ESG Improvers include issuers between the 30th and 70th percentile ESG scores; ESG Laggards include issuers in the bottom-30% ESG scores as well as ESG-unscored. ESG ratings are relative and subjective and are not absolute standards of quality. Ratings apply only to portfolio holdings and do not remove the risk of loss.

[7] Momentum refers to the extent to which an issuer is able to provide evidence of near-term planned or initiated actions to improve its overall sustainability performance, or it has set targets on specific environmental or social matters of concern. Please refer to the "Outcomes Focus" section in this document for more details.

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Alongside our thematic priorities, we also target issuers based on their idiosyncratic ESG-related issues, such as company-specific governance concerns or sustainability-related litigation, as well as sectors that we deem to be associated with significant sustainability risks.

The Team identifies, on an annual basis, an "engagement pipeline" of issuers that we intend to meet or follow up with. The list spans our holdings in investment grade, high-yield and emerging market debt and is determined by a clear set of criteria, as described in the table below.

Most of our meetings take place with ESG "laggards," ESG-unrated companies or ESG "improvers" (over **three-quarters of our engagements** combined). We aim to facilitate and accelerate the resolution of serious gaps in sustainability standards or litigation, gather information to complement our research, and identify organisations whose recent improvements on environmental or social factors might not yet be appreciated in the market, offering opportunities for alpha generation where such factors are material.[8] We also continue to engage with ESG "leaders," such as pure-play companies or frequent green or sustainable bond issuers, to advance our knowledge on best practices, which we can ultimately share with other players to help raise market standards.

DISPLAY 3

Engagement pipeline criteria

TARGET AREA	RATIONALE
Size of our bond holdings across portfolios	When holding significant asset value in bond holdings or multiple bonds from the same issuer, we aim to leverage our position to push for better sustainability outcomes. While we are unable to vote as fixed income investors, focusing on the issuers to which we allocate more capital can increase the possibility of positive change.
Laggard ESG scores	Issuers that score poorly in our proprietary ESG Scoring models raise red flags for their sustainability procedures and may not qualify for certain funds. Here, we seek to provide recommendations on best practices such that low scorers may improve through our broader sustainability expertise. This may enable potential investment in the name as the score improves (thereby rewarding positive sustainability momentum).
High carbon emissions	We target issuers with high carbon emissions across Scopes 1, 2 and 3[9] to encourage them to encompass the totality of those emissions under their decarbonisation targets. By doing this, we aim to differentiate between issuers that are taking credible steps to improve versus laggards, instead of applying an investment exclusion approach based only on today's emissions.
Strong operational misalignment with the SDGs associated with MSIM's thematic focus areas	MSIM's priority themes guide our engagements. Significant misalignment with the themes, and the United Nations Sustainable Development Goals ("SDGs")[10] they are associated with, suggests a failure to appropriately address some of the bottlenecks to sustainable development.
Severe controversies, such as violations of the UN Global Compact, or broader governance issues	Controversies, such as breaches of human rights standards, or business ethics issues, serve as indicators of poor governance practices. We aim to engage to assess remediation strategies, in order to promote adherence with international principles for sustainable business.

[8] PRI: https://www.unpri.org/showcasing-leadership/esg-improvers-an-alpha-enhancing-factor/8867.article

[9] Scope 1 refers to direct emissions from company-owned or controlled sources. Scope 2 refers to emissions from purchased or acquired electricity, steam, heat, and cooling. Scope 3 includes all other indirect emissions that occur in a company's value chain. Source: GHG Protocol.

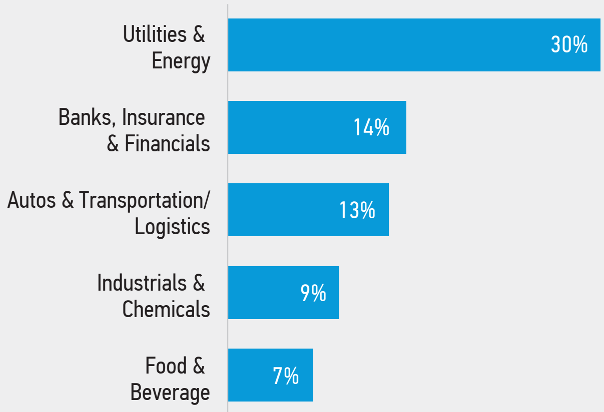
[10] The content of this publication has not been approved by the United Nations and does not reflect the views of the United Nations or its officials or Member States. See https://www.un.org/sustainabledevelopment/sustainable-development-goals for more details on the Sustainable Development Goals.

2021-2022 Highlights

Sector Focus

DISPLAY 4

Key sectors engaged: Prioritisation of climate-intensive sectors and their financers



Utilities, Energy & Financials. As part of our efforts to promote a just transition, we seek to engage with sectors that have a distinct role to play in mitigating their climate impact or in promoting climate adaptation and action. We believe that sectors such as Utilities & Energy, where nearly one-third of our engagements were concentrated over the reporting period, are core facilitators to promote the shift toward net zero. Utilities, alongside Financials, also represent over one-half of green bond issuers.[11] Therefore, as we look to position some of our sustainable fixed income portfolios on a net zero pathway, we are increasingly engaging with these sectors to promote sustainable financing frameworks that can fast-track the implementation of the issuer's overarching sustainability strategy.

Autos & Transportation. In our previous Fixed Income Engagement Report, we highlighted our focus on decarbonising the Automotive industry and regulatory advances relevant to the sector through the EU's 'Fit for 55 Package.' An expansion in decarbonisation-related regulation beyond the EU (e.g., the recent move to ban new petrol vehicles in California by 2035)[12] has continued to place sustainability at the forefront of auto companies' strategic agendas.

We continued our Automotive engagement series in the wake of the United Nations Climate Change Conference (COP26) in November 2021, particularly given the absence of large automakers from signing the pledge to only sell zero-emissions vehicles by 2035.[13] While we continued our thematic focus across decarbonisation processes and diversity & inclusion practices, we further developed our approach toward engaging on supply-chain management, understanding that for these resource-intensive sectors, the impact goes beyond climate. The shift towards electric vehicles has placed greater impetus on transparency across the supply chain of (often conflict) minerals, and, as such, we have requested greater disclosure in relation to the sustainability of the value chain, both upstream and downstream.

While regulation has pushed some high impact sectors to quickly develop more sustainable technologies and to pivot toward lower carbon alternatives, our engagements indicate that for other sectors a regulatory impetus is still needed. Over the past 12 months, for instance, the Team has furthered engagements with aircraft lessors and airlines to address barriers to decarbonisation. In our view, the International Energy Agency's recent Net Zero by 2050 report highlights a credible pathway for the aviation industry to align with a 1.5°C scenario that underlines the importance of Sustainable Aviation Fuel (SAF) to reduce emissions.[14] As such, we have continued to promote active dialogue between aviation issuers and their suppliers, in light of company feedback that government policy support for a fast transition toward SAFs is lacking.

Metals & Mining. Our engagements mirrored this consideration for the value chain across sectors, such that we have advanced our engagement approach with Metals & Mining companies that act as the first stage in minerals extraction for the electric vehicle transition. In particular, we have focused our efforts on companies that have been flagged by the UN Global Compact for human rights-related controversies. Our engagements encourage the development of processes for remediation and addressing the risk of forced and child labor. Here, we have incorporated our focus on governance, such as supporting mitigation strategies for a mining company that had contributed toward a humanitarian crisis through poor tailings dam infrastructure. We have also encouraged the development of human rights assessment tools to support legislation surrounding conflict minerals.

Food & Beverage. We also intensified our engagement with Food & Beverage companies, linked to the rise in our thematic focus on the circular economy and waste reduction. For this sector, we structured many of our engagements around deforestation and supply chain management, particularly since the majority of Food & Beverage emissions are derived from supply chains (sector emissions account for about one-third of greenhouse gas emissions globally).[15] Our aim is to promote enhanced transparency—we believe that better disclosure practices are a key stepping-stone toward the mitigation and resolution of both environmental and social issues within this sector.

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[11] How Green are Green Debt Issuers? IMF, 2021.

[12] Source: State of California Air Resources Board, Advanced Clean Cars II Regulations, Resolution 22-12, August 25, 2022.

[13] Source: COP26 declaration: zero emission cars and vans, November 2021.

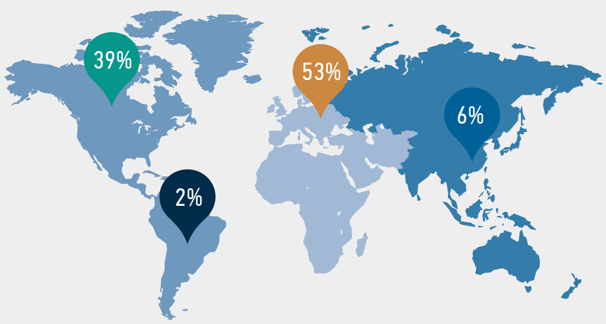
[14] Source: Climate Action 100+ and UN PRI, March 2022.

[15] Source: UN PRI, 2021.

Regional Focus

DISPLAY 5

Regional breakdown of engagement meetings: Continued dialogues in Europe, with an increasing proportion focused on North America



Europe continues to lead, globally, in terms of the sustainability focus of policy makers, regulators, and asset owners. This is reflected, for example, in the implementation of the EU Sustainable Finance Disclosure Regulation (SFDR), which has led to greater attention from investors into how ESG criteria are integrated in the portfolio management process, including through the use of stewardship and engagement. Specifically, in relation to the decarbonisation theme, 54 out of the 74 current members of the Net Zero Asset Owners Alliance are European institutions.[16] Pressure on asset managers—across Equity and Fixed Income—has therefore increased from this client base, in terms of their expectations around the implementation and reporting on how engagement activities linked to their portfolio holdings contribute to advancing a low carbon transition.

Nevertheless, other regions are learning from the European experience and accelerating their regulatory work as it relates to climate and sustainability-related disclosure. The signing of the United States' Inflation Reduction Act[17] into legislation, which supports investment to aid a 40% reduction in emissions by 2030 (compared to 2005 levels), is one such example.

These developments are reflected in the geographical breakdown of our engagements: more than half of the dialogues have been with organisations based in Europe, which also tend to be more active in the sustainable financing market. However, over the last reporting period, we increased the proportion of engagements with Northern American issuers from **26% to 39%,** largely in the Energy and Utility sectors, to assess whether their business strategies and capital investment plans could position them competitively to benefit from these tailwinds.

Outcomes Focus

DISPLAY 6

Assessment of sustainability momentum: 44% of the issuers' responses were satisfactory, and 32% influenced our investment decision[18]

44% Satisfactory Issuer Response

32% Engagements Impacted the Investment Strategy

We believe engagement not only helps to promote better sustainability outcomes, but also feeds into our views of individual credits and ultimately informs our overall investment strategy. During the reporting period, we updated our definition of "satisfactory" engagement, incorporating more of an explicit consideration for the positive sustainability momentum of an issuer. We define an issuer as exhibiting positive momentum where they provide evidence of initiated or near-term planned action to address our concerns, such as taking tangible steps toward the resolution of past controversies. The assessment of the relevance and expected effectiveness of such actions is done by the Team on a case-by-case basis, taking into consideration the sectoral and national or regional context in which an issuer operates.

We may then choose to reward this progress by investing in a new transaction, or to penalize any deterioration by passing on a new issuance or reducing existing exposure. Such positive or negative impact on the investment strategy occurred in **almost one-third of cases**. Other meetings resulted in our analysts reflecting the insights into their ESG research and issuer-level analysis for ongoing reference.

Elsewhere, we leveraged sustainable bond roadshows to assess in-depth the green or social eligibility criteria set by issuers and to gain an understanding into how the transactions could

[16] UN Environment Programme Finance Initiative, 2022.

[17] Source: Inflation Reduction Act of 2022, Public Law 117-169, United States Congress.

[18] A *positive impact* on the investment refers to a decision to participate in a new debt issuance, or to an overweight recommendation from the credit analyst, which may or may not eventually lead to an investment action. A *negative impact* on the investment refers to a decision to pass on new debt issuance, an underweight recommendation from the credit analyst, or a decision to sell bonds.

act as catalysts to accelerate the achievement of sustainability objectives at the organisational level.

In most cases where an engagement influenced our investment strategy, we made the decision to invest in a labelled sustainable bond for our portfolios.

Beyond Corporates

As investors in the Sovereign, Supranational and Agency (SSA) debt market, we seek to leverage our voice beyond engagement with corporates. Given that the size of the sovereign bond market is over double that of corporates,[19] we believe there is significant opportunity to help shape sustainable financing agendas toward achieving the targets set out in the United Nation's 2030 Sustainable Development Goals. The latest COP26 conference also highlighted the need for governments to work on raising the bar on their Nationally Determined Contributions (NDCs) to support a global decarbonisation pathway aligned with the objectives of the Paris Agreement.

As a result, our engagement with SSA issuers has been structured around:

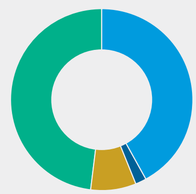
- Emissions reduction commitments for countries through their NDCs;
- How sustainable bond issuances can catalyze additional financing toward environmental and social projects at the national and local level, in particular for emerging countries; and
- How development institutions and local agencies can help set best practice on impact measurement and reporting, using the SDGs as the main outcome reporting framework.

Sustainable Bonds: A Window for Targeted Engagement

ESG-labelled debt exceeded the $500bn mark in July. However, increasing concerns over greenwashing are dampening the pace of supply, as issuers face a growing number of requirements to achieve best practice in their sustainable bond frameworks.[20] We believe that engagement provides an avenue for investors to capture alpha in the labelled sustainable bond market,[21] and to shape sustainable financing more broadly, such as through our sovereign engagements. Over the past 12 months, **more than one-quarter of our engagements** have specifically focused on new labelled sustainable bond issuances, through MSIM Fixed Income's participation in sustainable bond roadshows, or through one-to-one meetings with issuers.

DISPLAY 7

Labelled sustainable issuances: Almost half of sustainable bond engagements target sustainability-linked bonds



Green	42%
Social	2%
Sustainability	8%
Sustainability linked	48%

Our engagements regarding sustainable financing frameworks have focused on the robustness of the selected use of proceeds categories or key performance indicators, alongside external verification and quality of reporting, in line with our proprietary Sustainable Bond Evaluation Framework. However, we are increasingly assessing the fit of the issuer's sustainable financing framework with their overall strategy: firstly, to mitigate the risk of greenwashing, and secondly, because almost half of our engagements have been related to Sustainability-Linked Bonds (SLB) where proceeds are for general corporate purposes.

Following the publication of additional SLB guidance[22] from the International Capital Markets Association (ICMA), we developed our engagement process for issuers choosing this type of instrument. We aim to encourage more ambitious sustainability performance targets, including emissions reduction targets which are set in alignment with science-based guidelines, and to evaluate how extensively key performance indicators are supported by an issuer's overall strategy. We also seek to ensure that the call dates, observation dates for targets and maturities for these instruments occur within a suitable period of time for the coupon step-up to have a material effect, alongside encouraging the selection of sustainability indicators that are core to the business.

[19] Source: ICMA, as of August 2020.

[20] Morgan Stanley Research – ESG Bond Intel: Downward Revision to Issuance Forecasts, August 2022.

[21] Morgan Stanley Research – Greeniums: Verify, Then Trust, July 2022.

[22] https://www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/SLB-QA-CLEAN-and-FINAL-for-publication-2022-06-24v2-050822.pdf

Collaboration: A Stronger Voice

We believe that collaborative, active ownership improves the level of influence we may have on issuers as investors, which can consequently result in tangible improvements to issuers' sustainability strategies.

PRI Principles for Responsible Investment

UN PRI

Our membership in the Principles for Responsible Investment's (PRI) ESG in Credit Risk and Ratings Initiative was strengthened over the course of 2022, following our participation in two collaborative workshops with issuers in the Banking and Insurance sectors. Within these workshops, the MSIM Fixed Income team covered topics including the integration of environmental and social considerations in financial institutions' governance structures, climate risk horizons for scenario analysis and the societal cost of the energy transition.

The PRI has published summary notes outlining the best practices we shared, aiming to enhance awareness of the importance of standardization of sustainability disclosures in the Fixed Income space. We have since aimed to continue growing collaboration efforts, placing our credit analysts at the center of dialogues, with the Fixed Income Sustainable Investing team as a support mechanism.

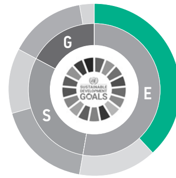
European Leveraged Finance Association

European Leveraged Finance Association

As part of our continued efforts to increase engagement with high-yield debt issuers, we continue to participate in several of the European Leveraged Finance Association's (ELFA) committees, including the ESG Committee and the Diversity and Inclusion Committee, in order to promote sustainability awareness and reporting best practices.

We have provided inputs to a number of ELFA publications, such as an ESG Fact Sheet for the Automotive sector and an ESG Fact Sheet for Building Materials companies, to help standardise the disclosure of material E, S and G considerations for the sector. In addition, the Team contributed toward an insight report ("SFDR's Disclosure Challenges: How credit investors and corporate borrowers can prepare") to help high yield issuers and smaller investors understand the implications of the EU Sustainable Finance Disclosure Regulation (SFDR) and to prepare for its implementation.

Case Studies[23]



DECARBONISATION & CLIMATE ACTION – 38% of engagements

Accelerating Sustainable Aviation Fuels Use to Help Decarbonise Airlines

Background

- **Case:** A major airline which has one of the most extensive fleets and operational footprints in the sector. The company is a poor performer in our proprietary ESG model as well as in some third-party ESG ratings.
- **Engagement purpose:** Discuss the company's emissions reduction and transition strategy, as well as its initiatives to improve its diversity & inclusion practices.

Company Response

- The company was the first airline to have its emissions reduction targets approved by the SBTi.[24] These included:
  - A commitment to reducing, across the value chain, emissions related to jet fuel by 45% per revenue ton kilometer from both owned and subcontracted operations by 2035 (vs 2019).
  - The objective to reduce absolute Scope 2 GHG emissions by 40% in the same timeframe.
- While there are constraints currently preventing the scaling up of Sustainable Aviation Fuels (SAFs), the airline is actively working with suppliers to increase the output of SAFs and has also signed long-term procurement contracts with leading SAF producers, adding further protection to commodity supply shocks.
- On the social side, almost 9 out of 10 of its employees are represented through labor unions, up to four times greater than some peers, and the company received a fair-pay certification in 2022. It has also developed a software to better pinpoint and rectify structural gender pay discrepancies, and recently tied senior management compensation to ESG targets.

Outcome

- The company's momentum is deemed as positive despite the industry headwinds. Following our engagement, the company published its ESG Report in which they detailed they were the only airline in the U.S. to use over one million gallons of SAF over 2021. We plan to continue engaging further on the company's labor unions relations.

Lack of Climate Action in the Energy Sector Impacting Bond Performance

Background

- **Case:** A midstream energy company, which we had already engaged with twice in 2021.
- **Engagement purpose:** While previous interactions looked to improve the company's ESG rating, this engagement sought to encourage the company to be more proactive and forward-looking with regards to emissions reduction and diversity.

Company Response

- The company is being more proactive via "action-based" initiatives aimed at emissions reduction. However, it continues to refuse to set concrete emissions reduction or alternative energy-related targets.
- In terms of disclosures, the company published an inaugural corporate sustainability report, however, emissions disclosures were limited to Scope 1 GHG emissions and made no reference to setting a target.
- The company showed unwillingness to address their lagging position relative to peers when it comes to diversity and inclusion. The company stated they had no intention to bring in diversity targets, attributing any shortcomings to their location and industry.

Outcome

- Our team assessed the engagement to be unsatisfactory because of the negative momentum. The company's bonds were trading at the wider end of midstream companies, which in part could be attributed to the lack of ESG progress. We therefore reduced our exposure and plan to monitor the company's sustainability-related actions closely.

These examples are provided for illustrative purposes only. There is no assurance that the engagements will be successful and/or result in positive investment outcomes.

[23] Note: Any statements in the following case studies pertaining to portfolio holdings refer to the period as of June 30, 2022.

[24] The Science Based Targets initiative is a market-leading external verification provider of GHG emissions standards.

Constructive Dialogue on Impact Reporting in the Chemicals Sector

Background

- **Case:** A market leader in chemical production, including ethylene. Ethylene is a significant contributor to carbon emissions, with production responsible for generating an estimated 0.8% of the world's carbon emissions alone.[25]
- **Engagement purpose:** Encourage the company to set a clear environmental strategy focused on emissions reduction and a more sustainable use of plastics.

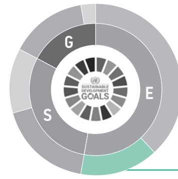
  The company approached our team in early 2022 for recommendations on how to improve sustainability-related disclosures and align with best practices. We recommended the publication of regular impact reporting on their circular economy projects and the development of granular emissions reporting, in particular on Scope 3 GHG emissions.

Company Response

- The company highlighted some of the circular economy initiatives recently launched, including:
  - Revitalising certain upstream process plants to replace synthetic with bio-based feedstocks.
  - Engaging with customers on repurposing and recycling plastics and using alternative packaging.
- The company also demonstrated a strong track record of cutting absolute emissions despite growing their production volume, through process efficiency, innovative carbon capture and natural gas-to-hydrogen conversion technology.

Outcome

- A positive ESG outlook in terms of delivering on sustainability targets, which could also benefit the company's business strategy. The company's high standards in sustainability disclosure may act as a signal for sector peers. Our synergistic relationship contributed to the company adopting even more comprehensive and investor-friendly reporting, while allowing us to learn more about effective measures to promote a circular economy in the chemicals sector.



CIRCULAR ECONOMY AND WASTE REDUCTION – 15% of engagements

Setting Targets for Operational Waste Recycling in Utilities

Background

- **Case:** Newly initiated ESG-focused engagement with a transmission and distribution electric utility company.
- **Engagement purpose:** Previous initiatives to repurpose or recycle certain forms of operational waste had an unambitious target compared to sector peers. Therefore, the team sought to encourage further development of circular economy initiatives and gain a better understanding of the company's efforts.

Company Response

- The company stated that its recycling target of 50% was an ongoing aim and they were reviewing ways to increase it. They highlighted their forthcoming sustainability report in which they planned to announce their progress.

Outcome

- A few weeks after our engagement, the company's new sustainability report stated that the percentage of recycled operational waste had increased to over 60%, underlining that the company was looking to advance their circular economy initiatives with conviction. We believed the engagement to be satisfactory, with company management providing clear answers and being receptive to the concerns we raised.

[25] "The Search for Greener Ethylene", C&EN, March 2021.

Assessing Digital Inclusion Opportunities in Mobile Services

Background

- **Case:** A privately-owned mobile operator, which is not currently rated by the main third-party ESG agencies.
- **Engagement purpose:** We aimed to better understand the company's ESG strategy, to benchmark it against some of the listed sector peers, to encourage the company to put in place measures to ensure an inclusive culture in the context of recent acquisitions and to take action to reduce the gender pay gap.

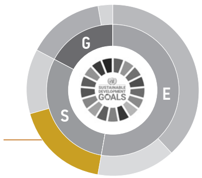
Company Response

- A diversity plan was approved in 2021. It includes a series of initiatives focusing on gender equality and digital inclusion. The company needs to improve gender representation in management roles and, as such, has focused on this in recent executive hires. They have yet, however, to set specific diversity targets—which we urged them to do.
- The company's existing digital inclusion projects have already benefited rural and marginalized communities through stable access to the internet. It is also accelerating the buildout of its 5G network via joint ventures with other telecoms players.
- Finally, the company is offering a more generous and sustainability-orientated employee benefits package across healthcare, parental leave, flexible working and company transportation. It is ranked the third-best employer in their headquarter country.

Outcome

- We were pleased with the overall level of granularity provided by the company on their sustainability initiatives and perceived the engagement to be satisfactory. Sustainability is seen as a business priority and the engagement highlighted strong management buy-in and a positive outlook, reinforcing our analyst's constructive view on the credit. We expect the company to show more progress going forward.

DIVERSE AND INCLUSIVE BUSINESS – 18% of engagements



Leveraging Social Bonds to Expand Access to Medicines

Background

- **Case:** A biopharmaceutical company that is planning to issue an inaugural Social Bond.
- **Engagement purpose:** We looked to assess the additionality of the company's social financing framework to its business-as-usual approach. We sought to address our main concern around the geographical dispersion of proceeds, to ensure that positive impact through expanded access to medicines for orphan diseases would also benefit communities in developing countries, not only in developed ones.

Company Response

- The company confirmed that the proceeds could be used for patients worldwide, not just in the developed markets, and that they were planning to report both on qualitative and quantitative data, providing case studies on the impact of previous trials and innovation initiatives.

Outcome

- The team decided to invest in the social bond as we were pleased with the level of additionality provided by the framework. The proceeds were clearly intended for diseases that are lacking in research and treatment options across a range of geographies and underserved populations.
- Recently, the company published the Impact Report for the social bond, which, while granular from a qualitative case study perspective, could have benefited from additional quantitative insight into impact, beyond allocation. Our team intends to follow up with the company to recommend specific improvements that we would like to see in future years' reporting.

Promoting Robust Human Rights Standards in Metals & Mining

Background

- **Case:** A metals & mining company with which we had previously engaged following the creation of a bespoke ESG team. The company was flagged by the UN Global Compact for its negative impact on local communities as a result of a tailings dam collapse.
- **Engagement purpose:** We sought to encourage the company to progress on their remediation processes and develop their human rights policy further.

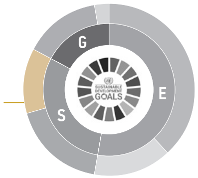
Company Response

- The newly formed ESG team pointed out that the company did not have the correct internal audit systems in place. Structural engineers had previously flagged issues with the dam prior to the disaster.
- A Foundation was created to manage reparations with local communities. Significant progress has been made with one of the communities, with c.80% of the families approved for resettlement.
- The tailings dam assessment framework has been overhauled. The new framework features more frequent dam assessments and forward-looking risk assessments. As a result, some existing tailings dams were closed and relocated—underpinning the company's commitment to resolve the controversies.
- Following our engagement on relationship management with Indigenous groups, the company presented an extensive two-pronged process which included a Land Use Agreement and a Reconciliation Action Plan. The initiative went further than local legislation requirements, via proactive actions such as investment into Indigenous enterprises and voluntary social investment.

Outcome

- The meeting helped shed more light on the actions the company was taking to remediate past controversies. A few months after our engagement, the company was upgraded to an ESG rating of A by a reputable third-party rating agency.

DECENT WORK AND RESILIENT JOBS – 12% of engagements



Promoting Job Creation Through Sovereign Green Investments

Background

- **Case:** A sovereign looking to issue their inaugural Green Bond, additionally integrating social factors in the framework. The country has already set an ambitious Nationally Determined Contribution and developed mandatory climate-related disclosure requirements for companies operating within it.
- **Engagement purpose:** We engaged with the government to recommend that the integration of social factors—particularly job creation—into their green financing framework be done at the project selection stage, rather than reporting stage only. We later met with the Debt Management Office (DMO) team, closer to the transaction date, to discuss the details of their final bond structure.

Country Response

- The DMO provided useful insights into how the framework formed part of the country's wider aim to develop an independent taxonomy assessment of environmental and social activities. The majority of eligible green projects are to be directed towards clean transportation, including eligible projects such as R&D for SAFs, which is robust given the country is home to some of the largest volumes of airline traffic globally.[26]
- The country seeks to report on the added social benefits of the framework. Given some controversies related to the development of transportation infrastructure within the country, our team engaged to ensure that the framework would help mitigate those risks. The country had also included a pre-issuance impact assessment carried out by a renowned publicly funded sustainability organisation, which added credibility to their process.

Outcome

- Our team was impressed with the level of transparency and disclosure outlined in the green financing framework. We participated in the issuance and continue to hold the bond. However, we recommended the government to consider integrating social factors into green project selection, instead of only reporting on those benefits on an ex-post basis. We aim to reassess the need for further engagement in the future based on the progress made by the country and on their impact reporting once published.

[26] Civil Aviation Authority UK, 2019.

Tackling Board Entrenchment and Executive Overcompensation in Family-Owned Businesses

Background

- **Case:** A family-owned construction company which was attracting concerns for their contract bidding practices and board structure. In particular, our credit analyst had identified significant issues relating to the Board's plurality voting method, resulting in entrenchments and CEO overpayment.
- **Engagement purpose:** We sought to assess the willingness of the company to change their voting process into a majority-based one, and encourage them to do so.

Company Response

- The company, whose founder is CEO and Chairman of the Board, has been facing long-standing allegations of making unrealistically low bids to win government construction contracts, and subsequently raising costs at the expense of taxpayers. As certain U.S. states' legislation requires local governments to award the contract to the lowest bidder, it allowed the company to repeat this process multiple times. The company responded that this was a 'misconception' in the construction industry, and that they closely tracked costs and subsequent changes in order to stringently manage this risk.
- They informed us that no changes to the plurality voting process were planned, and that all members of the Board are legally independent. However, our analyst noted that, according to external assessments, one Board member is not deemed independent.

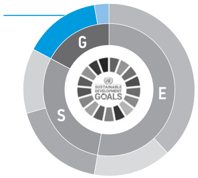
Outcome

- Since the company did not respond proactively to our suggested changes, the situation would remain the same. Our team therefore considered the engagement unsatisfactory, and the entrenchment of board members a persistent issue negatively impacting the use of additional cash.

  Given the CEO's material ownership of the company's shares and with no succession plan in sight, our team perceived this to represent a risk to the credit and decided to sell the company's bonds.

  Following our divestment, the company reported a -175% change in EBITDA in their Q2 earnings, pushing the metric into negative territory. Moreover, they withdrew their full year 2022 guidance due to pending litigation, which included a reversal of previously awarded litigation damages.

CORPORATE GOVERNANCE AND REPORTING – 17% of engagements



Driving Transparent Climate Disclosure Through Sustainability-Linked Bonds

Background

- **Case:** We engaged with a global investment company, focused on consumer goods and services, ahead of their inaugural Sustainability-Linked Bond issuance. The company was rated poorly by third parties, largely due to its private ownership and resulting lack of governance transparency.
- **Engagement purpose:** The company had set three key performance indicators (KPIs) in their SLB framework. The KPIs covered emissions reduction and gender diversity across their value chain. The objective of our engagement was to assess the materiality of the KPIs, develop a better understanding of the company's sustainability governance and their efforts to improve ESG disclosure across their portfolio companies.

Company Response

- One of the company's Sustainability-Linked Bond KPIs focused on increasing the percentage of portfolio companies with emissions reduction targets approved by the SBTi. The company highlighted that private portfolio companies, representing 45% of their portfolio, would also be included in this SBTi target and therefore the target would cover 99% of their portfolio as well as future investments.
- The company had recently started to publish climate reporting in line with the Taskforce on Climate-Related Financial Disclosures, and to progress toward their target, had engaged with over 80% of their portfolio companies to help them develop their own sustainability strategies, emissions measurement and reporting processes.

Outcome

- This forward-looking approach, supported by an active engagement with portfolio companies on at least 30% female representation in non-executive boards (to achieve the third KPI in the framework), exhibited strong positive momentum toward a just transition. The company's response was particularly impressive, given the percentage of private companies within their portfolio.

  As a result, we decided to participate in the transaction and continue to hold the name. We plan to re-engage with the company as it issues new SLBs, to ensure they remain on track to meet their targets.

Morgan Stanley Investment Management (MSIM) is a signatory of the PRI since October 2013. The Fixed Income Team is also a supporter of the PRI-led "ESG in Credit Risk and Ratings Initiative".

As part of the 2021 PRI assessment, MSIM Fixed Income received 5/5 stars and scored well above the median scores in the following modules:[27]

MODULE NAME	MSIM AND MEDIAN SCORES (/100)	MSIM STAR SCORE (1 TO 5)
Direct - Fixed Income - Sovereign, Supranational, Agency	98 / 50	★★★★★
Direct - Fixed Income - Corporate	98 / 62	★★★★★
Direct - Fixed Income - Securitised	98 / 55	★★★★★

Source: PRI Assessment Report for Morgan Stanley Investment Management, 2021. Signatories report on their responsible investment activities by responding to asset-specific modules in the Reporting Framework. Each module houses a variety of indicators that address specific topics of responsible investment. Signatories' answers are then assessed and results are compiled into an Assessment Report. The Assessment Report includes: indicator scores–summarizing the individual scores achieved; module scores grouping similar indicator scores together into modules (e.g. policy, assurance, governance) and comparing them to the median scores; and an aggregation of all the indicator scores within a module to assign a rating of 1 to 5 stars. PRI Score Methodology: do not do ESG/scored 0 to 25%: 1 star; > 25 ≥ 40%: 2 stars; > 40 ≥ 65%: 3 stars; > 65 ≥ 90%: 4 stars; > 90 ≥ 100%: 5 stars; More information is available on PRIwebsite at https://www.unpri.org/reporting-and-assessment/how-investors-are-assessed-on-their-reporting/3066.article

These ratings apply to the firm and not that of any specific investment.

For MSIM's 2021 Transparency and Assessment Reports please follow the corresponding link.

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For more information on MSIM sustainable investing activities, please visit: Sustainable Investing (morganstanley.com).

[27] The term MSIM generally includes each registered investment advisor owned by Morgan Stanley. However, unless otherwise noted, references to MSIM do not include Eaton Vance Management, Calvert Research and Management, Atlanta Capital Management Company, or Parametric Portfolio Associates which were acquired by Morgan Stanley on March 1, 2021.

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