Morgan Stanley
INVESTMENT MANAGEMENT

MSIM's Securitized Sustainability Framework

MS INVF Global Asset Backed Securities Focused Fund: Encouraging Positive Sustainability Alignment in the Securitized Market

MARKETING COMMUNICATION | MORTGAGE & SECURITIZED TEAM | October 2024

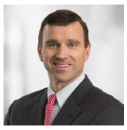
Key Features

- MS INVF Global Asset Backed Securities Focused Fund promotes positive contributions to the UN Sustainable Development Goals (SDGs)
- Rigorous screening to increase investments in securitizations promoting ESG characteristics, and exclude those that don't
- Integrating ESG factors in multiple stages of the transaction
- Leveraging proprietary ESG scoring methodology to tackle securitized ESG data gaps

Our team believes that Environmental, Social and Governance (ESG) considerations are an essential component to investing in securitized markets, and that a thoughtful ESG integration approach can result in better performance and encourage positive outcomes for the environment and society. Recognizing the securitized market's lack of high quality and consistent ESG data, such as carbon emissions data, that may be more prevalent in other asset classes, in 2018 we became one of the first asset managers to develop a proprietary sustainability ESG rating framework. Given the success we have had with our global approach to securitized investing and our ESG rating framework, we recently launched a more ESG-targeted Global Asset Backed Securities Focused Fund ('the Fund') in January 2024 that leverages this framework to implement its three primary aspects of ESG integration, depicted in *Display 1*.

While many existing ESG-oriented securitized investment funds focus on just one ESG characteristic (i.e. environmental or social), the Fund invests across all sectors and geographies and considers environmental, social and governance implications for each deal. As an Article 8 Fund, it is recognized by the EU Sustainable Finance Disclosure Regulation "SFDR" (please see the Fund's website disclosure) as a product that promotes environmental or social characteristics and is bound to integrate sustainability into its investment process.

AUTHORS



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MS INVF Global Asset Backed Securities Focused Fund

FAST FACTS

Inception Date	18/1/2024
Yield	5.90%
Duration	3.6 yrs
Bloomberg	MSGABSA LX
ISIN	LU2724484691
Return Since Inception	7.33% (USD, net)

As of 30/9/2024

DISPLAY 1

Three Pillars of ESG Integration

EXCLUSIONS	BEST-IN-CLASS ESG SCREENING	SUSTAINABLE INVESTMENT ALLOCATION
▪ The Fund will avoid investments in securitisations that **violate responsible business or lending practices** ▪ Excluded activities include, but are not limited to: predatory lending, severe breaches of consumer protection standards, and very severe controversies related to business ethics and fraud	▪ The Fund will **only invest in securitisations which are rated 3, 4, 5** in an ESG score range of 1-5, where 5 is best ▪ A rating of 3 or greater than 3 signifies that the underlying assets of the securitisation demonstrate responsible lending practices	▪ The Fund will make a minimum of **10% sustainable investments** in labelled Sustainable Securitisations, which make a positive contribution through their use of proceeds

Source: Morgan Stanley Investment Management, October 2024

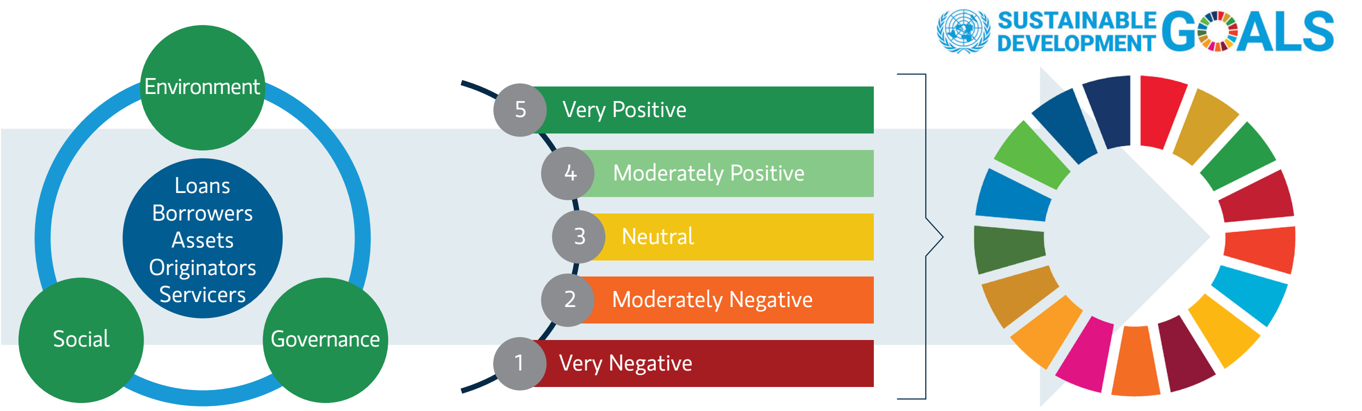
Our "Best-in-Class" ESG screening, a core aspect in the Fund's security selection process, is based on three key steps, as presented in *Display 2*:

1. In-depth analysis of the specific E, S, G characteristics of each deal and the issuer;
2. Scoring of the deal on a 1-5 scale, with 5 being best, based on its overall ESG profile; and
3. Mapping of the positively and negatively scored deals to the applicable United Nations Sustainable Development Goals ("SDGs"), for consistent tracking and reporting of a portfolio's overall sustainability alignment.

DISPLAY 2

MSIM Securitized Sustainability Framework

Key characteristics of the transactions are assessed for **positive and negative ESG characteristics**	Deals are assigned a **proprietary MSIM score on the overall ESG profile**	Positively- and negatively-scored deals are **mapped to the UN SDGs**



Score	Examples
5	Green buildings, solar panel or hydro-electric power
4	Govt sponsored lending for disadvantaged borrowers
3	Fannie Mae/Freddie Mac, Credit cards
2	High carbon footprint or potentially negative social externalities
1	Industrial plant, predatory lending business

This represents how the portfolio management team generally implements its investment process under normal market conditions. 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. Individual funds and client accounts operating within the strategy may have specific ESG-related goals and restrictions. Please refer to governing documents of individual vehicles to understand their binding ESG criteria.

DISPLAY 3

Key ESG Factors In Securtized Analysis

DEAL TYPE	RMBS	CMBS	ABS
ENVIRONMENT	▪ Exposure to climate risk (physical, e.g. weather events, and transition, e.g. energy performance regulation) ▪ Environmental impact of the underlying properties (e.g. industrial plants waste & pollution) ▪ LEED or other energy performance certification of the buildings		▪ Environmental impact of the collateral (e.g. carbon footprint of autos or aircrafts) ▪ Green or energy-efficient benefits related to the collateral
SOCIAL	▪ Affordable lending to disadvantaged borrowers (e.g. first-time home buyers, minorities) ▪ Reverse mortgages to provide retirement income for senior citizens	▪ Community benefits and public space provision	▪ Affordable lending to small business ▪ Affordable lending to underserved demographics ▪ Loans that allow increased access to higher education
GOVERNANCE	**Lenders:** ▪ Underwriting standards ▪ Status with regulators (CFPB, OCC, FDIC, DFS), and state attorneys general in US; FSA, FCA and PRA in UK; EBA and ESMA in Europe[2] **Servicers:** ▪ Status with regulators ▪ Payment collection processes and foreclosure practices **Property Owners:** ▪ Risk from business practices and legal standing		

- **ENVIRONMENTAL FACTORS** are emphasized in our analysis of commercial mortgage-backed securities (CMBS) and asset-backed securities (abs), especially when underlying assets are exposed to environmental risks or opportunities.
- **SOCIAL FACTORS** are most relevant when assessing residential mortgage-backed securities (RMBS) and consumer loan asset-backed securities where predatory lending concerns are most acute
- **GOVERNANCE** is an essential component of our assessment and we may change our exposure to an issuer based on direct engagement meetings with related parties.

Example of governance due diligence in the Fund:

We divested our exposure to Credit Acceptance Corporation (CAC), one of U.S.'s largest sub-prime auto lenders, based on concerns around their roll-out of high-interest car loans to low-income consumers in New York. The investment team engaged with the lender's Chief Treasury Officer to discuss the allegations in Q1 2023, however the explanations were not sufficient to mitigate the team's concerns, which led to divesting to avoid downside risks from further escalation of the controversy. The New York Attorney General and the CFPB ultimately sued the lender for deceptive and predatory lending practices in January 2023.

1. ESG Analysis at the Deal-level

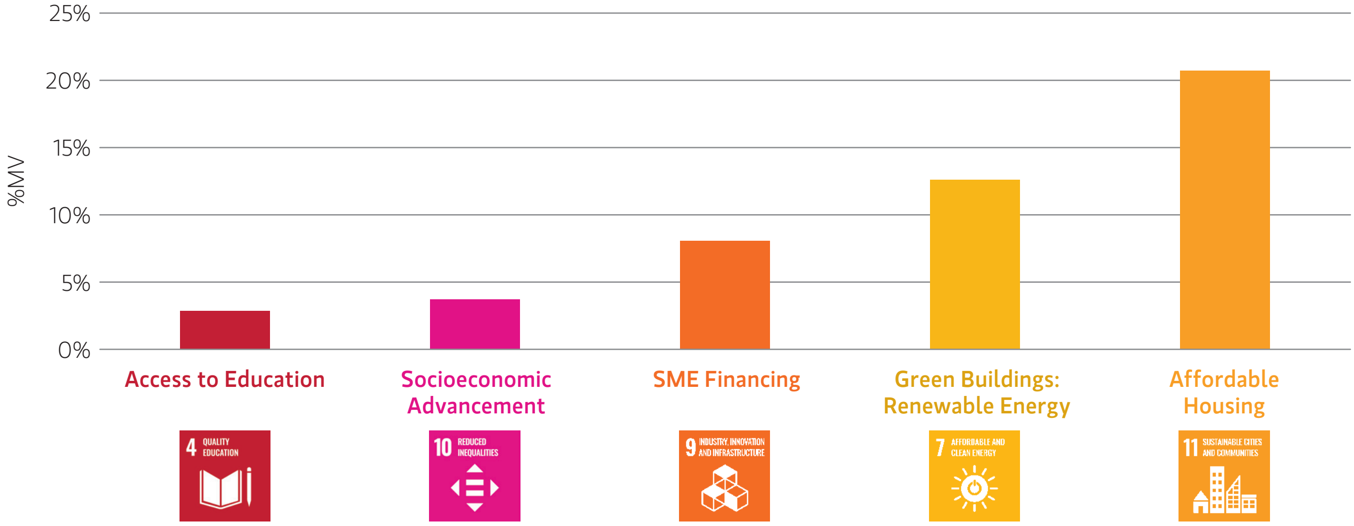
Our analysis begins by identifying the key E, S or G risks and opportunities across all levels of the securitization structure for every deal we assess. This involves taking into account the nature of the underlying loans, borrowers, properties or assets, as well as the ESG profile of loan originators, servicers and issuers. Due to wide variations in the structures of mortgage- and asset-backed securities, ESG considerations can take different forms, as presented in *Display 3*, and we believe they can be directly linked to credit performance, potentially impacting risk-adjusted returns both positively and negatively.

2. Our Securitized ESG Scoring

Based on the analysis presented above, MSIM assigns an ESG score ranging from 1-5, 5 being best, to each deal. ESG scores are then applied to all tranches in a deal, based on the rationale that ESG factors are consistent throughout the entire debt structure. Some exceptions could apply.

DISPLAY 4

Portfolio's Positive Alignment with the UN SDGs



Source: Morgan Stanley Investment Management. Represents the percentage of the Fund holdings aligned against the UN SDGs. As of 8/23/2024

We view most residential, commercial and consumer lending to have a neutral ESG profile, which translates to average ESG scores of 3 across our investment universe. We take a conservative approach in this regard, by assigning a score of 3 to standard responsible lending practices, with the thesis that responsible lending should be interpreted as a baseline, while scores of 4 or 5 are reserved for lending practices and/or assets and loans with outsized positive environmental or social characteristics. This is the case, for example, with buildings that have particularly robust LEED certifications (e.g. Gold or above, or equivalent), which would be associated with a score of 4.

The Fund only invests in securitizations that it considers to be best-in-class on ESG matters, which translates to ESG scores of 3, 4, or 5 within our Framework. By doing so, the Fund maintains a tilt towards positive sustainability-aligned investments, and excludes any securitizations linked to negative factors such as severe breaches of consumer protection standards and fraud.

3. Mapping SDG Alignment

The third and final step of our framework involves mapping the securitized portfolio to the SDGs as an indication of its positive or negative sustainability alignment. This is done by linking positively and negatively scored deals to the respective SDG Target, and then aggregating the total contribution at the SDG Goal level.[1] For example, CMBS backed by certified green buildings contribute to SDG Target 7.3 – "Double the global rate of improvement in energy efficiency", while solar panel ABS have a positive association with SDG Target 7.2 – "Increase substantially the rate of renewable energy in the global energy mix". Together, these investments count towards overall portfolio alignment with SDG Goal 7 – "Affordable and Clean Energy".

Given the nature of underlying loans and assets, we find that most of our securitized portfolio's positive environmental contributions align with SDGs 7, 9 and 13 on clean energy, sustainable industry and infrastructure, and climate action (specifically in terms of reducing carbon emissions). Our positive social contributions tend to align with SDGs 3, 4, 10 and 11 on social wellbeing, and access & affordability of essential services. *Display 4* presents the mapping of the Fund's holdings to the UN SDGs.

[1] There are 17 Sustainable Development Goals that are supported by 169 Targets in aggregate. The Targets help determine whether the Goals are met by defining measurable milestones under each Goal.

DISPLAY 5

Putting it all together: Example of an ABS Security Deal

Positive and negative environmental contributions assessed	Proprietary sustainability score assigned	UN SDG mapping
sunnova Solar Loan Backed Notes ✓ Projected avoidance of **38.8 million MT CO_2e** from total set of installed systems[2] ✓ Reporting in line with TCFD, with **comprehensive assessment of Scope 3 inventory**	Very Positive ESG Impact Solar securitisation, aiming to both avoid emissions and increase residential solar access for disadvantaged homeowners and communities Property ESG Score 5	7 AFFORDABLE AND CLEAN ENERGY **Target 7.2** By 2030, increase substantially the share of renewable energy in the global energy mix

Conclusion

Putting these steps all together, our ESG evaluation of each of the Fund's investments is robust and comprehensive, as exemplified by the ABS deal presented in *Display 5*.

Overall, we believe the Fund presents a compelling investment opportunity given its unique ESG-focused securitized offering, attractive risk-adjusted yields and strong total return potential. Our research-driven approach provides a flexible architecture to the integration of ESG factors into the investment process which we continue to evolve and enhance with the aim of maximizing financial returns for our clients while contributing to positive sustainability outcomes.

Risk and Reward Profile

The fund may be impacted by movements in the exchange rates between the Fund's currency and the currencies of the fund's investments. The value of bonds are likely to decrease if interest rates rise and vice versa. The value of financial derivative instruments are highly sensitive and may result in losses in excess of the amount invested by the Sub-Fund. Issuers may not be able to repay their debts, if this happens the value of your investment will decrease. This risk is higher where the fund invests in a bond with a lower credit rating. The fund relies on other parties to fulfill certain services, investments or transactions. If these parties become insolvent, it may expose the fund to financial loss. Sustainability factors can pose risks to investments, for example: impact asset values, increased operational costs. There may be an insufficient number of buyers or sellers which may affect the funds ability to buy or sell securities. There are increased risks of investing in emerging markets as political, legal and operational systems may be less developed than in developed markets. Past performance is not a reliable indicator of future results. Returns may increase or decrease as a result of currency fluctuations. The value of investments and the income from them can go down as well as up and investors may lose all or a substantial portion of his or her investment. The value of the investments and the income from them will vary and there can be no assurance that the Fund will achieve its investment objectives. Investments may be in a variety of currencies and therefore changes in rates of exchange between currencies may cause the value of investments to decrease or increase. Furthermore, the value of investments may be adversely affected by fluctuations in exchange rates between the investor's reference currency and the base currency of the investments.

[2] As of December 2022

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INDEX INFORMATION

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