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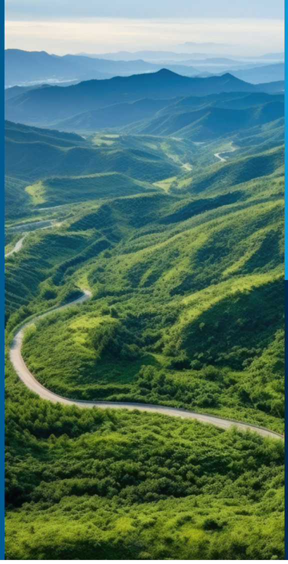

Morgan Stanley's 2024 Annual Sustainable Finance Summit Overview

INSIGHTS | June 2024

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Perspectives from Morgan Stanley Investment Management (MSIM):

Technology Meets Sustainability – Problem or Solution?

"You either have to be part of the solution, or you're going to be part of the problem"

— Eldridge Cleaver *(American writer and political activist)*

KATUGAMPOLA: The technological revolution that we are living through has presented a range of opportunities and risks to investors. When it comes to sustainability, the progress of technology has the potential to accelerate sustainable development, especially when it comes to addressing environmental and climate challenges. However, at the same time, there may be challenges around social implications, especially where costs can be elevated, and there, may be a danger that certain regions or segments of society get left behind in this transformation. Layered over all of this are ongoing questions and concerns around governance in an age of new technology and big data issues. To highlight how we at Morgan Stanley Investment Management are evaluating these potential opportunities and risks, we brought together some of our sustainability experts from a range of asset classes, spanning private and public markets for a wide-ranging discussion on the intersection of sustainability and technology.

Navindu Katugampola, Global Head of Sustainability for MSIM, moderated a panel of Sustainability and Research Leads from MSIM investment teams at Morgan Stanley's recent Annual Sustainable Finance Summit, who offered insight into the implications of technology for sustainable investing. **Mona Benisi,** Head of Sustainability for Global Real Assets; **Barbara Calvi,** EMEA Head of Fixed Income ESG Strategy & Research; **Eric Carlson,** Head of Sustainability, Emerging Markets Equity; and **Helen Mbugua-Kahuki,** Director of Research, Calvert Research & Management, shared their unique perspectives on this timely and critical topic.

Here are 4 key takeaways from the discussion:

1 Calvert's approach to Responsible Investing acknowledges that Technology is essential to navigate a world facing limited resources, although there may be serious implications for the workforce.

MBUGUA-KAHUKI: Evaluating companies based on the Calvert Principles for Responsible Investment (Calvert Principles), in addition to traditional financial metrics, provides a broader and deeper insight into the risk and reward potential of each investment. Responsible investing is not just about managing risks, but also evaluating investment opportunities, as well. We are constructive on technology in general, we believe that in a world of limited resources, decarbonization, creating an optimal workplace for employee, better data management systems, to name a few, without technology is unlikely.

The application of the Calvert Principles and a rigorous research process built around a financial materiality framework enables us to decipher the material risks and rewards to best inform forward-looking view and valuation of a sector, and consequently the companies within that industry. In the past, the fear following the introduction of automation in manufacturing facilities and warehouses was that workers may lose their jobs. However, the story was not about job loss, but more so about changes in job quality, job losses may only happen if productivity peaked. Technology and automation were generally meant to help workers by reducing monotonous and physically strenuous activities. However, these technological systems were in many cases putting more pressure on workers to work harder and faster, and under more scrutiny – we saw this come to head during the pandemic when injury rates in warehouses increased. Fast forward, people fear job losses due to artificial intelligence (AI), before making any assumptions about consequences of AI, we take a step back and ask ourselves - How should we define responsible governance for AI? And what should our framework for the principles for responsible AI be? The framework is going to be crucial in helping us, as responsible investors more accurately work out the true implications of AI and other future technologies.

2 In Fixed Income, technologies such as nuclear power and carbon capture / sequestration are appearing in the labelled green bond market. These pose challenges in evaluation, as not all projects are equally successful.

CALVI: The green bond market has continued to grow, with now over $4 trillion in outstanding market value.[1] It has evolved and matured in terms of what investors deem eligible projects and technology within issuers' green financing frameworks, although each case deserves a thorough analysis. For example, with nuclear power, we scrutinize every investment and generally look positively at those that strive to extend the life and enhance the safe operations of existing assets. We have seen some well-established companies using some of their nuclear capacity to plug intermittency gaps of renewable power generation and begin investing in pink hydrogen production. We believe that with the right safeguards in place, health and safety risks from nuclear energy can be contained. On the other hand, we tend to be more skeptical on new nuclear capacity development and would likely not finance it through green instruments. There are going to be long lead times and a risk of potential cannibalization with renewable investments, which can undermine their potential contribution towards short- and medium-term emissions reduction efforts. For example, a significant nuclear development project in the UK has been delayed several times, it is significantly over budget at around 10 times the cost per kilowatt compared to alternative renewable sources.

When evaluating the carbon capture, storage and utilization (CCUS) market in the context of green bonds, we aim to ensure that it doesn't divert attention from efficiency around emissions reduction, and that it creates some tailwind for investments in new CCUS infrastructure, which is still lagging. Instead of greenfield developments, which could also give rise to tensions with local communities, the conversion of gas assets for carbon transport and storage appears more palatable . Overall, we believe it is important to approach this market and new technologies with an open mindset and ad hoc evaluations, and really look at the pros and cons of each individual green bond issuance in terms of an issuer's business model, energy transition pathways, and how these investments can contribute to the trajectory of decarbonization.

[1] Climate Bonds Initiative

3 Deployment of new technologies, often perceived as an integral proponent of helping to promote sustainable development, presents unique opportunities for emerging markets.

CARLSON: The renewables market is an example of technology making a material difference at a scale in emerging markets. With the exception of a few North Asian economies, emerging markets are often very low per capita electricity consumption. Further, there are favorable weather conditions in many emerging markets which are embracing solar and wind power, such as India, Brazil, Chile, and Mexico and South Africa. Renewables also offer a lower capital cost and distributed architecture, likely driving affordability and flexibility for deployment. All of these factors combined have really accelerated the ability to meet the growing electricity demand in emerging markets with renewables. As a result, we believe there is investment potential in companies benefitting from this trend, and that many markets are growing with renewables earlier in electricity evolution than developed markets so they don't have to backfill a lot of legacy technology, with the exception of a few North Asian economies.

We believe that, from a macro perspective, how renewables could ultimately help is a huge development that will underpin more sustainable development in emerging markets. It is relatively affordable and environmentally friendly, and from a macro perspective helps the balance of payments and energy security for a lot of countries that have been big oil importers.

There are also many examples with digitalization, with mobile phones and high speed data allowing for tech-enabled business models to improve market access, increase formalization, and drive inclusion, which are very important for sustainable growth and development in emerging markets. Digitalization helps to lower the cost of service and to lower barriers to entry, breaking down existing oligopolies in many markets which are more predatory and based on legacy way of doing business in many EMs.

4 Data and measurements, and AI software are building the foundation for sustainability through technology in the real estate sector.

BENISI: The real estate industry has a prominent role when we think about sustainability and climate change, given that approximately 40% of global greenhouse gas emissions are attributed or associated to real estate construction and operations of buildings.[2] Sustainability related technology is a fast-growing part of Real Estate tech budgets, so the industry's embrace of technology is encouraging.

Data and measurement may come across as tedious, but it all starts with this. Companies need to quantify the problem before thinking about solving it. Technology is transforming how companies measure sustainability in buildings. As an example, smart meters and sensors enable automatic collection of real-time data on energy use, water consumption, and indoor air quality, etc., this eliminates manual meter reading and ensures accuracy of data. Building Management Systems can take things a step further by centralizing data from various systems, providing a holistic view of resource use. Thanks to AI and advanced data analytics companies may be able to unlock even greater insights by analyzing vast amounts of data to identify potential sustainability risks and opportunities within a property and across real estate investment lifecycle.

[2] "Buildings generate 39% of annual global GHG emissions, with 28% coming from operations of buildings and 11% coming from building materials and construction processes (i.e., embodied carbon)." (GRESB, 2023/03/01, What is embodied carbon in the real estate sector and why does it matter? - GRESB)

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