Investment Strategy

The Scottish National Investment Bank

2021

Summary

The Scottish National Investment Bank (the Bank) has been established to be Scotland’s development investment bank. The Bank was launched on 23 November 2020 to provide patient capital to businesses and projects connected to Scotland to build a fairer, more sustainable economy.

The Scottish Government committed to establishing the Bank in its 2018 Programme for Government. An implementation plan outlined the Government’s intention to establish a new cornerstone institution in Scotland’s economic landscape. Following the recommendations within ‘A Mission-Oriented Framework for the Scottish National Investment Bank’ developed by the UCL Institute for Innovation and Public Purpose (IIPP) (available at www.gov.scot), it was decided that the Bank would be a mission impact development investment bank, the first of its kind.

The Bank’s Missions

Place Mission
Extending equality of opportunity through improving places by 2040

Net Zero Mission
Achieving a just transition to net zero by 2045

Innovation Mission
Harnessing innovation to enable our people to flourish by 2040

Core Principles of the Scottish National Investment Bank's Investment Strategy:

- The Bank is a mission impact investor, seeking to use its investments to deliver the missions set for it by the Scottish Government.
- As a development investment bank, the Bank will seek to invest where the private market is failing to invest. It will also to act as a cornerstone investor, crowding in private sector investment alongside its public capital, to support the development of a sustainable and fairer economy.
- The Bank will develop its Impact Assessment and Reporting Framework to capture the mission impacts of its investments.
- The Bank will invest on commercial terms with appropriate covenants and protections for its capital in line with market precedent and the risk profile of each investment it makes.
- The Bank will be a patient investor, investing patient (long term) capital in businesses and projects across Scotland.
- The Bank will be an ethical investor, setting ethical standards for its investments via its Ethical Investment Policy.
- The Bank will seek the regulatory authorisations it requires in its first full year of operation to enable it to conduct the full range of investment activities included within this Investment Strategy. From launch, the Bank will act as if it is regulated by the Financial Conduct Authority (FCA).
- The Bank aims to be financially self-sustaining within the medium term, by generating sufficient income from its investments and investment related activity, including investment advisory and investment management, to cover its operating costs.
- The Bank will reinvest repaid capital investment and any profits it makes back into mission impact investments over the long term, creating a perpetual investment fund for Scotland.
- Response to the Pandemic: it was a key priority of the Scottish Government to continue with the launch of the Bank during the COVID-19 pandemic to support Scotland's economic recovery. The Bank will support this economic recovery by investing in businesses and projects impacted by the current pandemic to support their recovery. It will do this where the business or project presents a viable path to recovery from the pandemic which qualifies for investment from the Bank and requires patient capital support that cannot be sourced elsewhere.

How will the Bank Deliver its Investment?

What the Bank Does

Commercial
We will invest on commercial terms to provide a commercial return to our shareholder, the people of Scotland

Impact Investor
Our investments will be guided by our missions to have positive social, environmental and economic impacts on the well being of the people of Scotland

Ethical Investor
We will invest ethically as guided by our missions and governance

Unlock Markets
We will invest where banks and other private financial investors are not currently investing or need support to invest

Funds
We will invest in external funds that support the delivery of our missions and we will establish our own managed funds to invest in our missions

Partnering Private Capital
We will seek to bring in private capital to invest alongside us in every investment we make

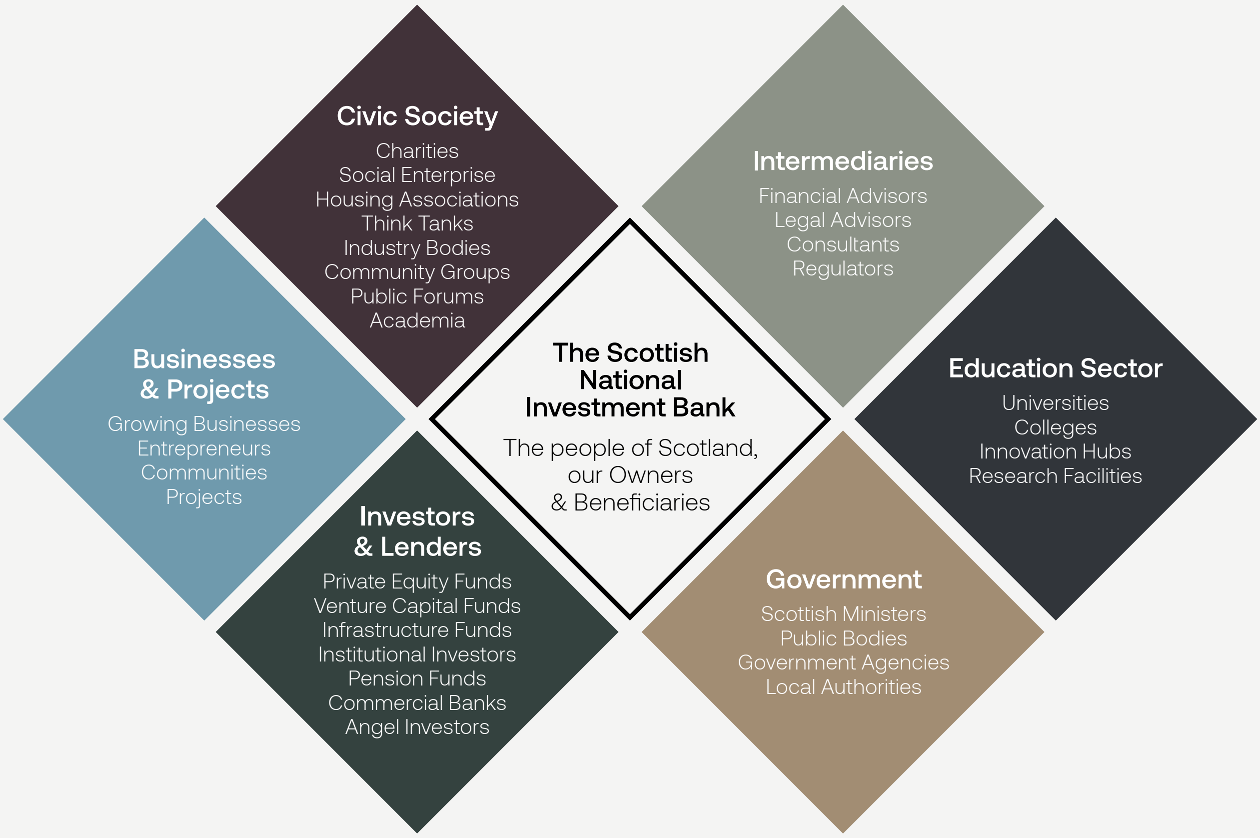
What the Bank will not do:

- The Bank will not provide grant or sub-commercial funding, this will continue to be delivered by the enterprise agencies and central Scottish Government.
- The Bank has not been established to provide short term working capital, bridging finance or revolving capital facilities to businesses or projects. It will provide long term fixed rate term debt and equity.
- The Bank has not been established to provide retail banking, short term finance, bridge financing, working capital or deposits to individuals or micro businesses.
- The Bank has not been established to provide government guarantees or 'first loss' investments.
- The Bank will not invest in distressed businesses in crisis, or in need of emergency immediate or short term financial support. The enterprise agencies and central government will continue to provide this support to Scottish businesses and projects where appropriate.

An Introduction to the Bank

The Bank's Ecosystem

The Bank is a new entrant to an existing private and public sector investment and financial ecosystem and will work closely with the pre-existing ecosystem to develop its role over time. The Bank is expected to be a positive disruptor to the existing ecosystem.



The Bank's Missions

The Bank is a mission impact investor. It will focus on ensuring that it not only delivers a commercial return on its investments but that its investments will deliver positive social, environmental and economic impacts that support the delivery of the Bank's missions.

Grand Challenges

Climate Emergency	Place Based Opportunity	Demographic Change

Bank's Missions

Net Zero Mission	Place Mission	Innovation Mission
Achieving a Just Transition to net zero carbon emissions by 2045.	Extending equality of opportunity through improving places by 2040.	Harnessing innovation to enable our people to flourish by 2040.
Invest in rebalancing our economy towards leadership in sustainable technology, services and industries	Invest in places and regeneration to reduce inequality, and improve opportunities and outcomes for people and communities	Invest in innovation and industries of the future for a healthier, more resilient and productive population

Ethical Investment Policy

The Bank will set minimum ethical investment standards by way of its ethical investments policy. The Bank will consider compliance with its ethical investment policy throughout its investment assessment process with final investment approval contingent on compliance with this policy.

The Bank's Ethical Investment Policy can be found on the Bank's website.

Equality and Diversity Strategy

Following its launch, the Bank is required to develop a Gender Equality Strategy in consultation with relevant expertise in the market. The Bank intends to expand this strategy to include wider equality and diversity considerations. It will carry out this consultation during its first full year of operations and will publish its Equality and Diversity Strategy on its website.

This strategy will outline the Bank's commitments to equality and diversity both at an operational level in its own employment decisions and at an investment level, where the Bank will seek to encourage the recipients of its investment to support the improvement of equality and diversity in Scotland.

How will the Bank Invest?

The Bank will identify, develop and assess investment opportunities in the following way:

- Originate investment opportunities proactively through the Bank's networks and wider ecosystem.
- Assess and appraise investment opportunities idenitified following a robust investment appraisal process in line with market best practice.
- Make investments with appropriate terms and conditions and expected returns in line with the risk profile of each investment and market.
- Manage its individual investments and investment portfolio to both protect its invested capital and maximise its financial and impact returns.

Direct Investment

The Bank will invest in equity and debt depending on the requirements of each investment opportunity. It is expected that every investment the Bank makes will be unique and structured to fit the specific needs of an individual business or project.

Wherever possible the Bank will seek to crowd-in capital to invest alongside the public funds the Bank has been allocated.

Indirect Investment

The Bank will also be able to leverage its public sector capital by investing in private sector funds which align with its missions.

In committing some of its public sector capital to private sector funds, as well as making its own direct investments from launch, the Bank will maximise its impact in the Scottish economy and accelerate the delivery of its missions.

Crowding In

The Bank will seek to crowd-in private sector capital to co-invest in its investment activity from its launch on an investment by investment basis.

Funds Management
As the Bank grows and develops its reputation as a trusted investor with an established track record of successfully delivering commercial mission impact investments to the Scottish economy, it will establish an investment management business. This will enable the Bank to further increase private sector co-investment by raising and managing private sector capital to invest alongside the Bank via the investment management of segregated accounts or specialised funds.

The Bank is also expected to manage some of the existing funds established or procured by the Scottish Government prior to the Bank's launch.

Debt Capital Markets
Over the medium term, in line with other international development banks (and subject to Parliamentary approval), the Bank may also directly leverage its balance sheet by raising funds in the debt capital markets. Any funds raised via the debt capital markets would again be invested alongside the Bank's public capital to enhance and accelerate the delivery of the Bank's missions through mission impact investment.

Patient Capital Investor

The Bank will be a patient investor. It will invest for the medium to long term to support the sustainable growth of businesses and projects that are connected to Scotland or provide a direct benefit to the Scottish economy.

Regulated Investor

The Bank will comply with all relevant financial services regulatory requirements, applicable laws and industry best practice standards. The Bank will seek appropriate regulatory approvals in a timely manner following its launch to ensure complete compliance. The Bank will seek to follow industry best practice and seek to operate as if it is regulated by the FCA from its launch.

Financial Self-Sustainability

The Bank will invest its public capital on commercial terms. The income generated will support the Bank in becoming financially self-sustaining.

The Bank will earn 'coupons' or interest payments for its debt investment, which will typically be fixed rate debt investments. The Bank will also earn fees in the ordinary course of its debt investment activity in line with market norms.

In its equity investments the Bank will be seeking to earn dividends or exit capital gains. Dividends will typically be paid over the longer term and it will not be uncommon for the Bank to have to wait for a significant number of years before it sees a return on its equity investments given the early stage of the businesses it will invest in.

The Bank will receive a commercial return, in line with that of other commercial investors within the same fund, for the fund investments it makes. Fund investments are realised over the longer term and often not significantly realised until such time as the fund exits its equity investments.

It is expected that the Bank will primarily invest in equity funds, however it will consider investing in debt funds to the extent they are aligned with the Bank's missions. In investing in debt funds, the Bank can expect an earlier return on its investments in line with that noted above for direct debt investments.

The Bank will also charge fees for managing private capital either via segregated accounts or establishing funds. These investment management or funds management fees will be a key component of the Bank's financial self-sustainability in the medium to long term.

The Bank will also charge appropriate fees for financial advice and funds management activity it undertakes on behalf of the government, or its bodies and agencies.

Creating a Perpetual Investment Fund for Scotland

As the Bank grows and its investments mature, the Bank will receive repayments of its initial capital investments (debt, equity and fund investment). It has been agreed with the Scottish Government that this repaid initial capital will be reinvested by the Bank. In addition, any investment income the Bank makes in excess of its operating costs, will be reinvested creating a perpetual investment fund for Scotland.

Target Rate of Return

The Bank will seek to deliver a positive return on its investment over the longer term. The target rate of return will be set by the Scottish Ministers, following consultation with the Bank and its Board in the Bank's first few years of operation.

Direct Investment Strategy

The Bank will seek to invest widely and diversely, and each investment it makes will likely be bespoke. Wherever possible the Bank will be seeking to invest in opportunities that deliver positive impacts supporting the delivery of the Bank's missions.

The Bank will be able to invest up to £50m in equity or debt, or a combination of both, in an individual business or project subject to the Bank's investment approval process. The Bank may invest both equity and debt within a single business or project, however the Bank will not make majority equity investments. The Bank may make follow-on investments. The Bank's minimum investment size will be £1m. Occassionally, the Bank may consider investing smaller amounts of £500,000 or more where an investment opportunity has a particularly strong mission alignment, or potential for follow on investment.

Direct Investment in Businesses

The Bank will be able to invest in all stages and sizes of business with a focus on businesses supporting the delivery of the Bank's missions.

The Bank expects to focus its business investment activity on those businesses that are in their scale-up phase, demonstrating commercial progress, and seeking debt or equity investment in excess of £1m to support their growth. Typically, the Bank will invest in Series A or later funding rounds, however the Bank may invest in earlier funding rounds at the discretion of its investment committee. It is expected that these businesses will be targeting strong financial returns, have ambitions for growth and demonstrate a clear alignment to the Bank's missions.

It is expected that the vast majority of the Bank's investment in businesses will be focussed on investing in small and medium sized Enterprises (SMEs).
An SME is typically identified based on its employee headcount, turnover, or balance sheet.

The Bank will reference the European Union's definition of an SME in categorising its investments in businesses:

Business Category	Employee Headcount	Turnover	Balance Sheet
Medium-Sized	< 250	≤ £45m	≤ £45m
Small	< 50	≤ £10m	≤ £10m
Micro	< 10	≤ £2m	≤ £2m

The Bank will focus its direct investment activity on small and medium-sized businesses as defined above.

Direct Investment in Projects

Project investment is distinct from business investment as it typically involves investment in a structure that brings together a number of parties to deliver a 'project'. Project finance is typically associated with infrastructure and energy investment but can also involve the delivery of a wide variety of outcomes, including real estate developments.

The Bank will seek to invest in commercially viable projects that support the Bank's missions. It is expected that the Bank will invest in viable projects requiring debt or equity investment in excess of £1m and up to £50m. The Bank will invest in the development stage (development projects) as well as the operational stage of projects (operational projects) depending on the need of the specific projects.

Investment in Communities and the Third Sector

The Bank will seek to support the ambitions of local communities and the third sector to create local sustainable economies through investing in commercially viable local or charitable:

- Businesses
- Clean energy projects
- Circular economy waste reduction and recycling initiatives
- Local affordable or social housing developments
- Local housing sustainability projects
- Local regeneration projects

It is expected that the Bank will invest in commercially viable mission impact community and charitable investment opportunities requiring debt or equity investment in excess of £1m. This threshold will be considered carefully when considering opportunities to invest in smaller and more remote communities in Scotland, with the potential for the Bank to make smaller investments where this is appropriate given the individual project circumstances.

Investment in Tertiary Education

Scotland has a strong and enduring reputation as a leading provider of tertiary education. It is expected that the Bank will be able to support the Scottish tertiary education sector with investment in specific capital projects in Scottish universities and colleges to ensure they maintain their reputations as internationally leading tertiary education and research providers; and, in supporting the development of university developed and incubated innovative businesses and projects.

Equity Investments

The Bank will invest in equity and equity-like instruments including: ordinary shares; preference shares; debentures; income notes; redeemable preference shares; unlisted securities; and, subordinated loan notes.

The nature of the equity investment the Bank makes will depend on the type of business or project it is investing in and the most suitable investment instrument, taking into account the existing or expected capital structure of the business or project.

As a patient capital investor, the Bank will view its equity investments for the longer term. This is expected to be up to 15 years for businesses and up to 35 years for projects.

It is expected that the Bank could invest equity in:

- Growing businesses.
- Businesses seeking capital investment to scale up operations.
- Businesses seeking capital to support a permanent relocation to Scotland.
- Business seeking capital to support continued research and development where sufficient market diligence underpins the value of this investment.
- Businesses or projects seeking capital investment to support the transition to net zero.
- Equity stake acquisitions from other investors, where doing so supports the Bank's missions and supports continued connection to Scotland of a particular business or project.
- Asset financing including asset leasing.
- Project finance as sponsor (equity).

The Bank will seek to crowd-in equity investment alongside its own investments from private sector investors. To enable this crowding-in, the Bank will only take a minority non-controlling equity stake in a business or project.

The Bank will seek to actively manage its equity investments in businesses and projects to ensure it effectively stewards the public capital it is investing. In making its equity investments, investment protection and supervision arrangements will be put in place, typically in the form of various financial and non-financial covenants. The Bank may require an 'Investor Director' board position on the investee business or project. The Bank may additionally require an 'Investor Observer' board attendee.

Project Finance Equity Investment

In investing equity in projects or asset finance vehicles, the Bank may be investing for a long period of time, in line with the expected underlying life of the assets being financed via the project or asset finance vehicle. It is expected that equity investments in projects will be up to 35 years in duration. It is noted that in investing equity in a project or asset finance, equity returns tend to be paid out by dividend gradually over the period of the project rather than as a capital gain at the end of the investment period. In some instances, where the underlying assets have a remaining residual value or project life, an additional capital gain may be made on disposal of the assets at the end of the life of project or asset finance vehicle.

Responsible Exit Strategy

In making its equity investments the Bank will consider its investment exit strategy at the outset of its investment and review these assumptions annually. When an opportunity to exit arises, the Bank will work with the management of the business or project to ascertain whether it is the right time, the right value, or the logical point within a business's life for the shareholders to exit.

The Bank will seek to responsibly exit its investments and ensure that in exiting, the positive societal or environmental mission impacts delivered by the investment will continue.

It is noted that the Bank is being established to be a patient investor and embedded within each of its missions, is the support of the Scottish economy for the long term. As such it is expected that the Bank will seek to build bigger businesses over a longer period.

Equity Valuations

The Bank will typically seek an independent verification of its valuation of a business or project equity investment opportunity as part of its full investment due diligence during its investment appraisal process.

The Bank's Chief Financial Officer will be responsible for the ongoing monitoring of the valuations of its equity investments. The performance of the Bank's equity investments will be closely monitored and regularly revalued on an individual investment basis and portfolio basis by the Bank's Investment Committee, the Board Valuation Committee and where relevant the Bank's full Board.

Distressed Investments

The Bank will not be responsible for the management of government equity investment stakes in distressed businesses or projects. The Bank will only invest in financially sustainable businesses or projects approved by the Bank's Investment Committee. It is anticipated that the Bank's Investment Committee would only approve investment in distressed businesses or projects based on a clear and well diligenced turnaround plan.

Debt Investments

The Bank will invest in debt across the capital structure including:

- senior debt
- subordinated debt
- mezzanine debt
- junior debt
- convertible loan notes

Where possible and appropriate given the capital structure in place within the business or project in which the Bank is investing, the Bank will always seek to take the appropriate security for the type of debt instrument it is providing.

The Bank will be a patient capital investor and expects to invest in debt with tenures of up to 35 years in project finance and up to 15 years in businesses depending on the nature of the business. The Bank will consider the refinance risk and/or amortisation profiles of its debt investments as part of its investment assessment and approval process.

Debt Fees and Margins/Coupons

The Bank will invest on commercial terms in line with the rest of the market and the prevailing market pricing at the time the Bank makes any debt investments.

The Bank will seek to make its debt investment on the same fees and margins as other lenders or investors in the same type of debt instrument within a capital structure, when investing contemporaneously. Where the Bank is investing in a different type of instrument, at a different time, or is the sole investor or lender, the Bank will benchmark its debt fees and margins with the market in line with common market practices and the Bank's subsidy control requirements.

The performance of the Bank's debt investments will be closely monitored and regularly reviewed on an individual investment basis and portfolio basis by the Bank's Investment Committee, the Bank's Board Valuations Committee, and where relevant the Bank's full Board. The Bank's Chief Financial Officer will periodically review the value of the Bank's debt investments.

Project Finance Drawdown and Repayment

- Development project finance debt will have a delayed draw profile over a construction period, typically around 2 years but can be up to five years.
- Operational periods are typical between 20-35 years, depending on: the expected life of the assets being financed; an underlying subsidy or revenue guarantee (for example, fixed term operating contract, contract for difference, power purchase agreement); or, the term of an underlying concession for the operation of the assets.
- During the operational period, project finance debt typical amortises in full, however in some circumstances it is appropriate for the structure of the financing to have a portion of the debt that does not fully amortise, but is refinanced at the end of the debt term. This is generally appropriate when the asset itself is expected to have a life beyond that of the operational period of the project finance. This portion of unpaid debt is commonly referred to as a 'balloon repayment'.

Business Finance / Lending Repayment

Business finance can: fully amortise; partially amortise; or, be interest only with a full repayment of debt only occurring at the end of the term of the debt investment (commonly referred to as a 'bullet maturity').

Investment Terms and Conditions

The Bank will seek to ensure that the terms and conditions of its debt and equity investments are in line with market standards, and are commercial and appropriate for the level of risk identified in the underlying business or project.

Mission Covenants

The Bank will also seek to embed mission covenants into its investments both to ensure that the businesses and projects in which it invests not only deliver mission impacts but report on these in a regular and timely manner to the Bank for inclusion in the Bank's regular non-financial investment portfolio performance reporting (mission impact reporting).

The Bank will also seek to ensure that its investments continue to comply with its ethical investment policy and where possible build in an exit mechanism from its investments should the business or project breach the Bank's ethical policy and be unable or unwilling to work with the Bank to remedy the situation.

Geographical Investment Focus

As a national investment development bank, the Bank will seek to ensure that any investment it makes benefits the Scottish economy, focussing on businesses or projects located within Scotland or with a strong connection to Scotland.

Investment Due Diligence

The Bank will undertake full due diligence on all of its investments in line with market norms in making its direct debt and equity investments. This will typically cover Legal, Technical, Financial, Commercial, Insurance and Taxation. The Bank will apply its own stringent investment assessment standards to all investment opportunities it considers and will make its investment decisions independently of the Scottish Government or any other investor.

Fund Investment

The Bank will conduct thorough due diligence on any funds it seeks to invest in. This will ensure the fund's proposed investment activities are in line with the Bank's missions, comply with the Bank's ethical investment policy, and provide sufficient reporting of the mission related impacts as well as the financial performance of the fund. In line with market, the Bank may be offered co-investment opportunities to invest alongside the fund in a specific project or business. The Bank will monitor the performance of any fund investment it makes in line with the Bank's investment portfolio reporting and monitoring policies. Any fund investment will be subject to the Bank's investment approval process.

Investment Origination

The Bank will continually develop a pipeline of potential investment opportunities. It will identify and develop direct investment opportunities and indirect fund investment opportunities by building its relationships with both the private and public sector and recruiting experienced investment professionals.

The Bank's investment origination team will have the primary responsibility for the development of its investment pipeline. In its recruitment the Bank seeks to ensure that its people are aligned with the Bank's missions and committed to making a positive contribution to Scotland's economy, society and environment. The Bank aspires to create a diverse and inclusive team of people to deliver its missions.

The following quadrants reflect some of the opportunities the Bank expects to invest in but are not exclusive:

Sustainable Places

- Affordable & Social Housing
- Regeneration & Community Creation
- Technology Parks, Innovation Hubs & Eco Parks
- Tertiary Education Facilities
- Clean Industrial Projects & Offset
- Nature Based Investment & Offset
- Community Wellbeing & Leisure Projects
- Associated Supply Chains

Sustainable Energy

- Renewable Energy (generation, transmission & distribution)
- Renewable & Sustainable Heat (generation, transmission & distribution)
- Recycling, Waste & Circular Economy
- Energy Efficiency
- Energy Transition
- Net Zero Energy / Offset Solutions
- Associated Supply Chains

Sustainable Technology

- Digital Infrastructure
- Digital Connectivity
- Innovation & Technology SMEs
- Sustainable Agriculture
- Sustainable Food Supply
- Space & Satellite Infrastructure
- MediTech & Life Sciences
- Associated Supply Chains

Sustainable Transport

- Clean Transport & Supporting Infrastructure
- Net Zero Transport Solutions
- Ports Infrastructure
- Road Infrastructure
- Rail Infrastructure
- Associated Supply Chains

Investment Confidentiality and Disclosure of Investment Activity

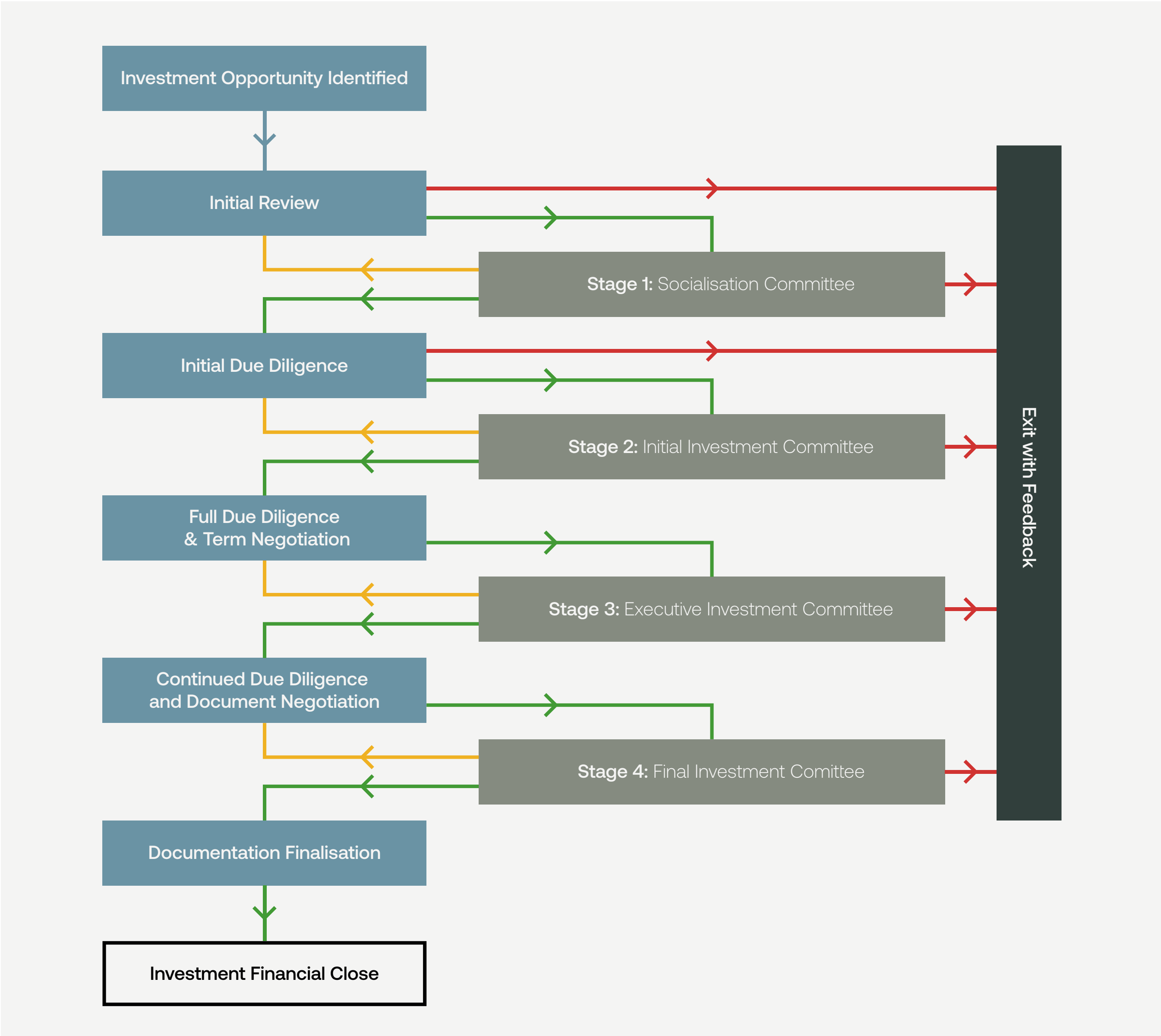
The investment pipeline and investment opportunities under consideration by the Bank will be subject to a high level of confidentiality in line with investment banking industry standards; applicable laws; and, financial prudential regulation. Once an investment has been made, a package of disclosable information will be agreed with counterparties to the investment for release to the general public and details of the investment made included on the Bank's website's investment portfolio page.

Any financial investor has many reasons for declining a transaction. It is industry best practice not to disclose details to ensure the affected business or project is not prevented from raising investment from another investor or lender. Therefore, where the Bank declines an investment opportunity it will endeavour to maintain an appropriate level of confidentiality with exceptions made only with the agreement of the counterparty affected and information being released on a limited basis where this is required.

Investment Committee Approval Process

All individual investments the Bank makes will be considered over a four stage committee process. An investment can only be sanctioned by the Bank's fourth and final stage investment committee, the Final Investment Committee. All other committees are progressive with permission to proceed only. The Bank's four stage investment approval process is illustrated below:

The time an investment takes to consider in the illustrated process is heavily dependent on the flow of information to the Bank's investment team to support the appraisal and documentation of the opportunity. Where a complete set of due diligence information is available, the Bank can deliver its investment quickly. Less developed investment opportunities will of course develop over a longer time period. The Bank will work closely with its potential clients to ensure they understand both the Bank's investment process at the outset and an individual investment opportunity's stage of development through this process.



Investment Portfolio

As a new Bank, the Bank will be building its investment portfolio over time. From its outset the Bank will seek to develop a balanced and diverse portfolio of investments that delivers commercial financial returns combined with positive impacts across all three of its missions. However in its initial years the impact of each new investment could result in variable diversity across the investment portfolio.

Investment Management

The Bank's Investment Management team manages the Bank's investments after they have been made. It provides the Investment Origination team with support in designing and finalising any mission or ethical investment covenants and relevant reporting requirement within the investment documentation, and manages the collection and collation of mission impact investment data on an ongoing basis.

Investment Portfolio Management & Reporting

The Bank will actively manage the financial and mission impact performance and relevant other aspects of its investments' performance. It will establish an Investment Portfolio Management team within its Investment Management team to do this.

The Bank is required to report on the financial performance of its portfolio annually, and will do this by way of its annual statutory accounts. The Bank is also required to report annually to its shareholder on the non-financial performance of its investment portfolio. This will focus on the portfolio's performance on delivering the Bank's missions (mission impact reporting).

Portfolio Concentration

The Bank will seek to actively manage its investment portfolio concentration risk across its missions.

Given the Bank's purpose to only invest in businesses and projects with a connection to Scotland, it will not have traditional georgraphical portfolio limits as are commonly found in other Banks and investment firms. However, the Bank expects to monitor and report on the geographic dispersion of its investment across Scotland as a whole, to ensure that it is investing fairly and broadly across the whole of Scotland.

The Bank is required to report regularly via the following:

- **Audited Accounts**
  As a public limited company, the Bank is required to produce audited financial accounts annually, within 6 months of its financial year end. The Bank's financial year end is 31 March.
- **Annual Investment Performance Report**
  In addition to its statutory financial reporting requirements the Bank is required to report to Scottish Ministers annually on its investments performance, both financial and mission related. The Act requires that the Bank use a balanced scorecard to support its performance reporting.
- **Mission Report**
  The Bank must issue a Mission Report to the Scottish Ministers outlining how it intends to respond to the strategic missions that the Scottish Ministers have set for it. This report is to be delivered on or before the first working day of the financial year.
- **Equality & Diversity Report**
  Every 2 years, following the publication of the Bank's Equality Strategy, the Bank will prepare and lay before Parliament a report evaluating:
  - the extent to which the Bank has fulfilled the commitments in its equality strategy;
  - the extent to which the fulfillment of each commitment has made a contribution towards advancing equality in Scotland.

Risk

The Bank is subjected to many risks and has developed a Risk Management Framework and employed appropriately skilled individuals to manage its risks. The Bank has identified seven high level risks (outlined below) with multiple risks identified and managed below these top tier risks.

Risk	Definition
Mission Risk	The risk that stakeholders type, kind, or number of investments made by the Bank are not sufficiently aligned to our missions or fail to deliver the desired benefits.
Investment Risk	The risk of losses due to failed loans, investments or inadequate portfolio management creating volatility that could result in losses.
Financial Risk	The risk of unstable capital or liquidity arising from fluctuations in funding streams, investment returns, financial performance or external factors.
Operational Risk	The risk of direct or indirect losses resulting from inadequate or failed internal processes, people and systems or from external events.
Governance Risk	The risk that the Bank's frameworks and processes for decision-making are ineffective or are not supported by a culture of transparency and high standards of conduct.
Culture Risk	The risk that the Bank's culture fails to encourage respect, collaboration, collective and personal responsibility or to marry a public service ethos with financial sector acumen.
Reputation Risk	The risk that the stakeholders form a negative view of the Bank due to actions by its staff, partners, third parties or invested companies.

Investment Risk Assessment & Reporting

Whilst the provision of finance in the form of equity and debt investments is the method by which the Bank will deliver its missions, by its nature, any investment carries the risk of financial loss arising from failure of the business or project or, the borrower or investment vehicle's inability to repay the Bank's equity or principal/interest as it falls due.

As a development bank the Bank seeks out underinvested risk and it accepts that there may be losses from its investments. The Bank will quantify, monitor and manage investment risk so that it obtains adequate compensation for risks taken.

There will be some risk of financial volatility as the Bank grows but it remains committed to achieving financial self-sustainability in the medium term. Potential losses arising from the mismanagement of investment risk may be substantial and Bank personnel involved in the investment process must therefore exercise due diligence and sound judgement in the initial evaluation and assessment of counterparty and other risks as well as in the ongoing portfolio management of approved debt and equity facilities.

Risk Appetite Statements

As the Bank recognises it is exposed to significant financial performance related risks through its normal course of business and by pursuing its missions it will control its overall exposures by reference to Risk Appetite Statements (RAS). Further detail on the Bank's Risk Management Framework is available at The Bank's website address.

The RAS for Investment Risk is divided into 3 key sub-risks as follows:

- Equity Investment Risk: The Bank is exposed to losses in value to either the Bank's investment portfolio and/or individual investments, due to businesses and projects experiencing difficulties where the Bank has an investment.
- Debt Investment Risk: The Bank is exposed to credit losses in its loan portfolio due to the Bank's clients experiencing difficulties as a result of internal or external events meaning it is unable to service the debt.
- Concentration Risk: The Bank is exposed to a range of risks in a particular sector or counterparty due to a lack of portfolio diversification or significant concentration which can result in credit losses or loss in value of an investment(s).

Three Lines of Defence

The effective execution of the investment risk management roles and responsibilities is enabled through the adoption of the 'Three Lines of Defence' risk governance model.

Risk Assessment Process

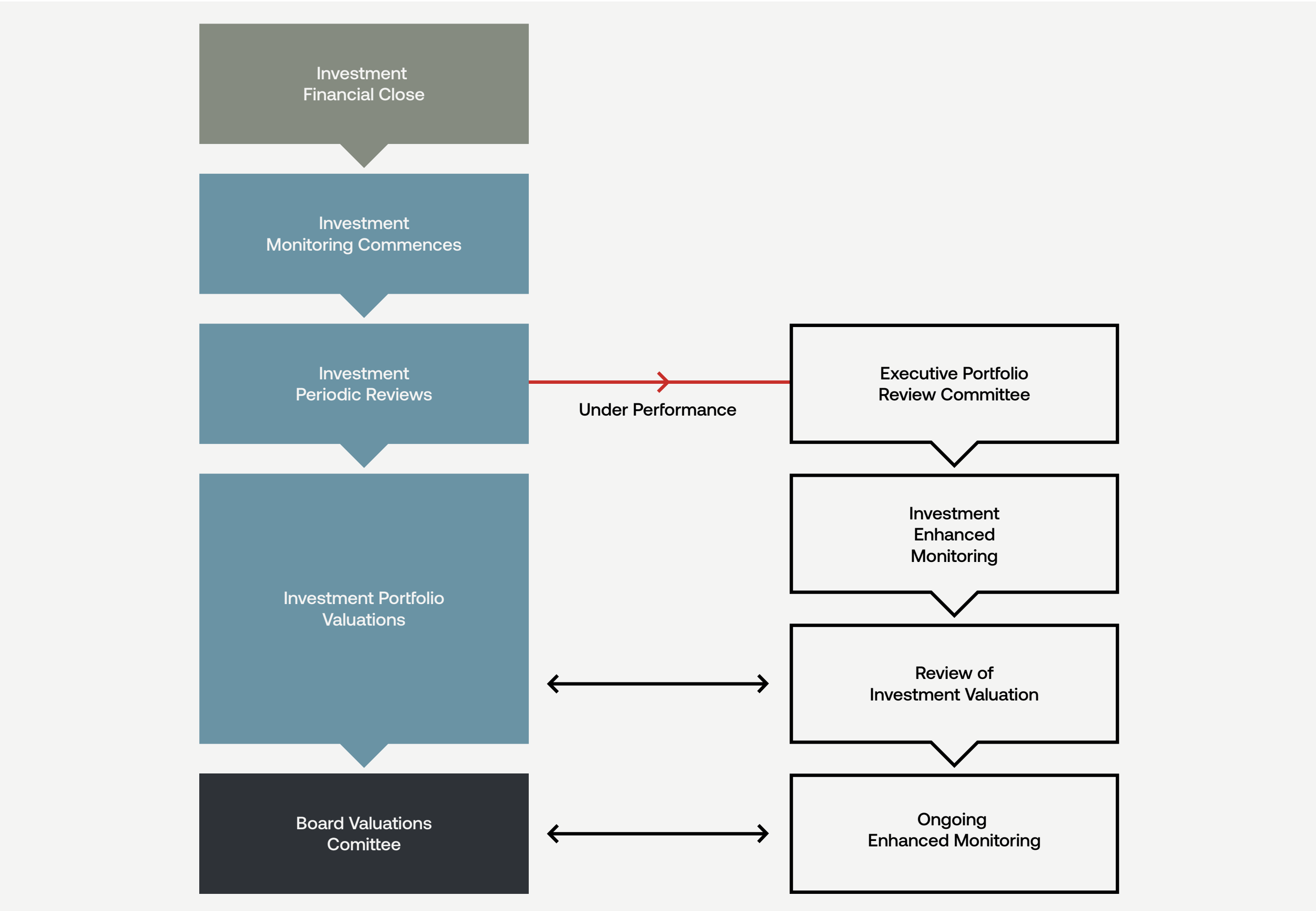
Once a potential opportunity has been deemed to be compatible with the Bank's missions and also aligned with the Bank's Ethical Investment Policy, a written proposal will be developed by the Bank's investment origination team (in its role as the first line of defence) to provide sufficient detail and analysis so as to allow a full assessment of the business or project's risk position by the Bank's Investment Risk team and the Bank's investment committees.

Portfolio Risk Management

The primary purpose of monitoring investments is to maintain the quality of the Bank's investments and to safeguard the assets of the Bank with a view to avoiding potential losses. This can be achieved by ensuring the effective implementation of sanctioned terms and the satisfactory conduct of an investment during its life.

Portfolio Review Committee and Troubled Investment Process

The Bank's internal Portfolio Review Committee can be convened at any time to consider an underperforming asset and regular reports on the performance of the Bank's investments will be given to the Bank's Board Valuations Committee. Further detail on the management of underperforming investments is noted in the following section on investment risk assessment and reporting.



Investment Impact Assessment & Reporting

It is a core objective of the Bank to develop a best in class investment impact assessment and reporting capability to ensure it can demonstrate the delivery of its missions over time and to underpin its annual and longer term reporting of its mission impacts. The Bank firmly believes its investment activity can deliver both mission impacts and commercial financial returns.

The development of the assessment and reporting of the Bank's mission impacts will by necessity be iterative as the Bank's portfolio grows. However, the Bank will anchor its mission impact assessment and reporting on the International Finance Corporation (IFC) Operating Principles for Impact Management and the IRIS+ system of impact measurement.

In addition, the Bank will seek to report the impacts of its missions in line with the Scottish National Performance Framework. These frameworks are all closely aligned with the United Nations Sustainable Development Goals and are complementary in nature.

Further details of how the Bank will seek to monitor, assess and report on the delivery of its missions through its investments can be found in the Bank's first Mission Report, available on the Bank's website.

Subsidy Control & State Aid

The Scottish National Investment Bank Act 2020 required European Union State Aid approval from the European Commission to be obtained before the Bank could be established. Following extensive pre-notification discussions with the Commission, the Scottish Government submitted its final notification in October 2020 and the Commission issued its decision on 7 November 2020, granting approval for the Bank to be established. Full details of this permission can be found TBC.

Under the terms of the Bank's State Aid Decision Letter from the European Commission, the key compliance considerations for the Bank are:

- **Market Failure Framework** - the existing Market Failure Framework set out by the Commission, read alongside the terms of the Bank's Decision Letter, offers a solid basis for the Bank to invest, with the flexibility to deliver its missions with impact;
- **Crowding In** – the Bank will deploy a series of measures to ensure that it does not 'crowd-out' private sector investment, but instead actively seeks to 'crowd-in' other investors to help catalyse critical economic activity in pursuit of its missions; and
- **Pricing** – the Bank will invest on a commercial basis (in line with the Market Economy Operator Principle) in all cases, pricing its provision of finance in a way which fully reflects the commercial risk and anticipated return that the Bank is taking within the capital structure of any given transaction.

Each prospective investment will be subject to a risk based assessment of each of factors listed above. This assessment will take place at the outset, and will be continually reviewed as the investment moves towards the Bank's Final Investment Committee.

Post Brexit State Aid Landscape

The EU-UK Trade and Cooperation Agreement (TCA) committed the UK to developing its own regime based on a set of principles similar to those which continue to apply across the EU.

The UK Government issued a consultation on the detailed design of the new regime early in 2021, to which the Bank responded. Building on that consultation process, primary legislation has now been laid before the UK Parliament alongside updated UK Government Department for Business, Energy and Industrial Strategy (BEIS) Guidance.

The guidance highlights that existing Decisions/ Approved Schemes under the EU State Aid regime will be assumed to comply with the terms of the TCA, and accordingly comply with the new UK regime. On that basis, and as an interim measure, the Bank will seek to continue to comply with the terms of the Commission's Decision in the first instance.