Ethical Investment Policy

The Scottish National Investment Bank

The Scottish National Investment Bank Plc (the "Bank") is Scotland's development bank. We were established in 2020 and tasked with enabling investment that supports the delivery of missions designed to address the grand challenges facing Scotland. These challenges and the missions to address them require long term patient investment.

As an impact investor we invest to achieve specific positive environmental, social and economic benefits against these missions (outlined in our Impact Report and Investment Strategy, both of which are on our website). Additionally, as a responsible investor we also aim to "do no harm" in our investments and this Ethical Investment Policy (the "Policy") sets out how we integrate Environmental, Social and Governance ("ESG") requirements in our investments to underpin our commitments as a responsible investor. It also outlines how we integrate these requirements to influence and enhance ESG outcomes in our investment and portfolio management processes.

This Policy applies across the Bank as set out in Section 6 below and provides guidance on how we ensure the investments we make reflect international good practice in ethical and responsible investing. This Policy is in addition to our compliance with applicable law and regulation including but not limited to financial crime, anti-money laundering and Modern Slavery.

The Policy:

1. Provides overarching context on what it aims to achieve
2. Describes our ESG requirements
3. Summarises how we promote and support better ESG and impact practices
4. Provides a description of how the Policy is applied over the life cycle of an investment
5. Outlines a set of excluded activities for which our capital cannot be used
6. Provides an overview of Policy Governance and Oversight

1. Policy Context

As a responsible investor, we place significant value on the role we play as an enabler of better ESG (including human rights) outcomes through the investments we make.

We believe that by applying good ESG practices, our investees can achieve the outcomes we value, whether that is protecting workers and the environment or creating new economic opportunities for local communities. Applying these ESG standards can also produce material financial benefits and opportunities for businesses, including:

- improved access to markets and capital
- increased productivity
- better relations with employees
- increased customer trust and brand value
- cost efficiencies
- better stakeholder relations.

2. Bank Requirements

Standards that underpin this Policy

This Policy defines the ESG standards we will require in our investments, as well as ways in which we can support the evolution of good ESG practices through our investments. Enabling better ESG practices within our investee businesses is an important part of our “value add”. The Policy also identifies a range of activities which we will not invest in (Excluded Activities – see Section 5).

We will focus on the following, in line with best practice:

- Scottish Investments Limited (“SIL”), and the businesses and projects in which we invest, will comply with all applicable laws, including environmental, planning, regulation and permits, labour and employment, health and safety and human rights;
- SIL will invest in businesses or projects that already have good governance arrangements in place, or require the adoption of, or improvement in good governance, as part of our investment conditions;
- SIL will review the commitment, capacity, and track record of investee to manage ESG risks associated with its operations, as well as its ability to deliver potential positive impacts;
- SIL will assess risks associated with international supply chains (including human rights, and geopolitical risks and issues);
- SIL will act as a responsible lender and where required in line with our commercial remit. We will carefully manage our debt recovery practices to ensure they are fair and in line with best practice in the market.

SIL recognises that some of our investees are at an early stage in the growth of their business and will apply a proportionate and measured approach in relation to ESG requirements (including the use of an Action Plan[1] and investment measures that allow for the development of capacity and processes over an agreed time).

SIL also recognises the requirements we have will vary depending on the structure of the investment. Where we invest our capital directly in a company or a business, we place requirements on the investee in relation to its own operations. Where we invest in an investee such as a financial institution or private equity fund (an “intermediated investment”) that will in turn make investments, we place our requirements on our investee, not on its portfolio companies, because our contractual relationship is with our investee.

For intermediated investments, in addition to the requirements we place on the investees in relation to their own activities, we also require them to develop their own processes, capacity and governance systems to enable them in turn to implement appropriate standards and impacts in their portfolios. We provide guidance and support to these investees on how to do this, where necessary, including training and capacity building. But ultimately, we do not control the relationship between investees and their portfolio companies.

Similarly, in terms of scope, concerns over environmental and social (“E&S”) impacts in supply chains are rising rapidly, and therefore in some cases, we will specifically consider the E&S impacts and risks in investee supply chains (in relation to labour and working conditions, greenhouse gas emissions and climate impact, human rights, and biodiversity). Where appropriate, we will assess the scope and adequacy of management and control systems an investee has in place to address supply chain risks and may require the development of such systems as part of an agreed Action Plan.

1. An Action Plan is developed jointly between the Bank and an investee and describes activities that will be undertaken subsequent to an investment that will help deliver impact and appropriate ESG performance. An Action Plan forms part of the investment agreement with an investee.

3. Promoting and supporting better ESG and impact practices

As a responsible investor, we seek to encourage and enable better ESG outcomes across our portfolio, especially where we believe these practices confer business benefits now and in the future. These opportunities include (but are not limited to) the following:

The changing nature of work: The need to plan for, and deliver, a just transition as part of the response to climate change, the impacts of automation, the rights of workers involved in the 'gig' economy, and ways in which workers can communicate and engage with management. We support the adoption of Fair Work practices and will require the adoption by investees of Fair Work criteria in a proportionate and relevant manner.

Promoting Equality, Diversity and Inclusivity (EDI): We will encourage the businesses and projects we invest in to improve and report on EDI practices and performance within their workforce, Board and potentially wider beneficiaries (e.g. via goods or services). This can include commitments to improve the lives and opportunities of under-represented groups and those with protected characteristics. The application of EDI covenants will be proportionate and relevant, whilst providing directional guidance and support to agree standards that will positively influence change.

Good Corporate Governance: We will consider the corporate governance standards of a business or project we invest in ahead of our investment as part of our due diligence. We will continue to monitor (and influence as appropriate and possible) an investment's governance standards throughout the duration of our investment. Enhancing governance practices over the course of an investment is an important element of our value add. The Bank will consider 'Good Practice' guidance and recommendations[1] in promoting better governance practices across our portfolio. As part of this, we will specifically consider the role that corporate governance can play in guiding companies in assessing and managing systemic business challenges, including climate change, EDI and supply chain risks.

Good governance is not only associated with sound and commercially successful companies, but also with companies committed to high standards of business integrity. We have a separate Policy (Financial Crime Policy) that we use to assess business integrity risks and issues (including potential money laundering and terrorist financing, bribery and corruption, fraud, sanctions and asset freeze requirements). This is in line with various legislative and regulatory requirements in relation to financial crime mitigation.

Human Rights: There is growing recognition of the role that private sector businesses can play in managing human rights risks (including modern slavery) and promoting human rights. We view human rights risks and issues through the lens of the UN Guiding Principles on Business and Human Rights and will assess the salience of human rights risks and issues in all our investments. Where salient risks are identified, we will undertake appropriate human rights due diligence and require actions to reduce and manage human rights risks.

Supply Chains: SIL will specifically consider whether and how our investments are affected by geopolitical risks and issues (including through sanctions[2] and human rights and other risks that may be represented in investee supply chains) and will work with investees to manage these risks to our satisfaction.

Scotland's Net Zero Journey: We recognise the urgent need to address climate change risks, including adaptation and resilience for communities and economic activities that are subject to near-term climate risks and impacts, and the role that businesses can play in enabling action to address climate change. We will invest in businesses and projects that have committed to Net Zero or that develop Net Zero plans as a result of our investment and where these plans are consistent with Scotland's ambitions for Net Zero.

1. Including that provided by the BVCA Corporate Governance, reporting and audit (bvca.co.uk) and FRC 2018-Guidance-on-Board-Effectiveness-FINAL.PDF (frc.org.uk). 2. Including but not limited to The Global Human Rights Sanctions Regulations 2020 (legislation.gov.uk) and Financial sanctions targets: list of all asset freeze targets - GOV.UK (www.gov.uk).

3. Promoting and supporting better ESG and impact practices
continued

We also recognise the need to promote circular economy models of production and use, and as appropriate we will work with business and projects that we invest in to promote and scale the delivery of the circular economy in Scotland.

Biodiversity and Natural Capital: We recognise the urgent need to address threats to biodiversity and ecosystem services (including the role ecosystem services play in regulating and mitigating climate change) and the role Scotland can play in promoting Natural Capital-based solutions to the climate and biodiversity crises. We support the need to preserve, and where needed, renew Scotland's natural environment and promote the development of nature-based solutions to achieve a net improvement in biodiversity and environmental wellbeing as a result of the investments we make. As appropriate this expectation will be considered in the Company's supply chains where biodiversity impacts may be present.

The Built Environment: We will invest in construction activities that deliver reduced carbon emissions through energy efficient practices, decarbonising the built environment and other measures, and which are compliant with the Scottish Government's targets for renewable and low carbon heating system usage at a minimum. We will prefer to invest in brownfield redevelopment and regeneration rather than green field development.

The Health and Wellbeing of Scotland's People: We recognise the important role that Scottish businesses can play in addressing health and wellbeing challenges in Scotland (and globally) and we will support technologies and other measures that address global health care needs.

4. Implementation of the Policy

Pre-investment

SIL applies the Policy to all proposed investments, and considers the following criteria as part of the investment process:

- ESG risks and opportunities for each potential investment, including human rights risk assessment where salient risks are possible;
- The potential scale and scope of impact that an investment might enable over time (based on the Bank's missions and impact assessment processes).[1] The Bank's missions will be the initial filter it applies when considering an investment;
- The corporate governance standards and practices of a business or project it invests in, and will continue to monitor and influence (as appropriate) an investment's approach to governance throughout the duration of its investment;
- Commitments to the Fair Work economy and the development of a diverse and inclusive workforce that recognises the benefits of equality of opportunity;
- The commitment, capacity and the track record of potential investees to manage and deliver both impacts and appropriate ESG measures.

SIL undertakes an assessment of the above through the investment process (see Figure 1 on page 9) for each potential investment. The outcome of this review will inform the terms and covenants included in an investment agreement, the potential need for an Action Plan and assumptions about the contribution and value add that our investment might generate. It is recognised that the outcome of the review will be different for each investee company and therefore what is included (or not) in terms and covenants in the investment agreement and any Action Plan will differ from investee company to investee company. This Policy does not mandate the content of those but instead seeks to ensure consistency of approach when considering potential investments.

A key element of this work is to identify and assess ESG risks pre-investment, to ensure appropriate resources and support are provided to investments that are deemed to have higher risks, and to agree reporting needs and requirements as well as Action Plans with proposed investees as needed.

1. The Bank has adopted the internationally recognised **Principles for Impact Management** as the basis for demonstrating how it integrates impact into investment decisions.

4. Implementation of the Policy continued

Post investment

The Bank aims to be a practical and engaged investor and sees an important role in working with our portfolio companies to enable impact and to manage ESG risks and opportunities. This is part of the value add that we want to bring to our investments so that our portfolio companies deliver the impacts we have assumed as part of our investment case. It is also important that we enable catalytic effects on the market more broadly by showcasing how ESG principles can be applied, and the benefits that they deliver.

We want to work with like-minded companies. We recognise that ESG requirements may be new to some of our investees, and that support in the implementation of our requirements may be needed. In the above, we aim to apply the Policy in a proportionate manner, recognising the scale and stage of development of each investee and that compliance with requirements (but not Excluded Activities as set out in Section 5) may take time and might be addressed through Action Plans and Conditions Subsequent[1].

Following the assessment as set out above, when drafting the investment agreement, SIL will consider whether an investee's non-compliance with any part of the Action Plan and/or a Condition Subsequent is so material in and of itself that SIL would have the ability to trigger an option to exit that investment.

For all investments, SIL will also seek an ability to trigger an option to exit in the event that insufficient progress has been made on an Action Plan by the longstop date. It is recognised that the specific triggers for the option to exit may vary on a deal-by-deal basis.

In situations where an investee consistently fails to meet our ESG requirements, or where there is a serious breach of our requirements, we can engage in a variety of ways to increase attention to these deficiencies or breaches. Our overwhelming preference is to work with investees to agree and implement corrective actions, but in the final event, a serious breach which cannot be resolved, or persistent delays in meeting requirements, may trigger options for us to cease funding, take remedial action or exit an investment. The availability and nature of these options will depend on the nature and structure of the investment and consequences of the breach.

The Bank is a signatory to the Principles for Impact Management and assesses the impact achieved at exit through a Responsible Exit review. This review will assess the extent to which impact assumptions (including ESG performance) were met, and ways in which we can enable continuing commitments to good international ESG and broader impact practices after an investment is complete.

1. A Condition Subsequent takes effect after an investment is made but is controlled and enabled through legal conditions and obligations.

5. Excluded Activities

SIL excludes investments, whether direct or indirect, in the activities and sectors set out below (the "Excluded Activities"). The investment agreement will contain a covenant under which the investee company agrees not to carry out any Excluded Activities by reference to this Section 5 as updated by SIL from time to time via publication on its website. SIL will ensure that investment agreements with investee companies contain a right for SIL to trigger an option to exit its investment in the event of a breach of this covenant by an investee company that has not been or is not capable of being remedied.

i. Fossil Fuel Extraction

That promote the exploration or extraction of fossil fuels. Noting that we may make investments in businesses or projects:

- Which operate in energy intensive or fossil fuels industries, where that investment supports a planned transition or diversification of activities, or a significant reduction in its emissions consistent with Scotland's ambitions for Net Zero;
- Where that investment supports an organisation to transition or diversify its activities, or to make a significant reduction in its emissions consistent with Scotland's ambitions for Net Zero, and that organisation produces or retails energy or heat from fossil fuel (coal, oil, and gas) power plants (utilities).

ii. Construction that is inconsistent with the Scottish Government Energy Efficiency programme

Construction of new residential or commercial property and refurbishment projects where these are not consistent with the energy efficiency standards set in the Scottish Government's Energy Efficient Scotland programme.

iii. Tobacco and Tobacco Products

Involved in the production of tobacco or tobacco products, or to companies who sell such products under their own name. Tobacco products include, but are not limited to, finished products such as combustible cigarettes and cigars, and key materials necessary for their production such as cigarette papers.

iv. Gambling

Involved in the development, production or sale of gambling products, or for the provision of financial services related to gambling.

v. Animal Testing

That use animal testing for cosmetic, personal care, household goods or industrial manufacturing purposes.

vi. Munitions

Production of, or trade in, arms (i.e., weapons, munitions or nuclear products) primarily designed for military purposes.

vii. Brothels, Pornography and Adult Entertainment

Involved with unregulated/illegal sex trade, or in businesses or projects that produce or design pornographic or adult entertainment products or services.

The Bank will also exclude investments which cannot meet the following standards and criteria:

viii. Natural Environment and Biodiversity

Whose activities would negatively impact Scotland's natural environment and biodiversity without appropriate mitigation. These expectations will also apply to biodiversity impacts in supply chains internationally.

ix. Equality

That do not have in place, or are not willing to put in place in a proportionate and relevant manner, policies and practices that are aligned with the Bank's equalities objectives as laid out in the Bank's Equality Strategy.

x. Fair Work

That do not already have Fair Work practices in place, or are unwilling to commit to adopt these in a proportionate and relevant way. At a minimum we require projects and companies we invest in to pay the Real Living Wage to direct employees and to justify any use of zero hours labour to the Bank's satisfaction. Other aspects of the Fair Work agenda should be implemented as appropriate and as relevant to a company's operations.

6. Policy Governance and Oversight

For the purposes of this Policy, the Bank comprises of Scottish National Investment Bank PLC, Scottish Investments Limited (“SIL”) and Scottish Investments Services Limited. It is recognised that the Bank and SIL sets their approach to ethical investing and their ethical investing policy. This Policy is therefore approved by both Bank and SIL and applicable to both entities. SIL, as the legal entity that considers and makes the investments, will comply with this Policy when doing so. This policy is applicable to all staff and will be reviewed at least every 18 months, or as necessary.

The Bank Act identifies the need for this Policy, and that the Bank’s Board is responsible for having ethical investment standards which align with our main object and ancillary objects as set out in our Articles of Association and strategic missions.

Figure 1: Integrating Ethical Performance in the Bank’s Investments

Principles for Impact Management
Defines the process through which impact can be demonstrated and ESG risks managed over the course of an investment, provides an internationally recognised framework and will be independently verified on a regular basis to provide credibility on approach to impact.

Investment Due Diligence

An initial assessment of compliance with the Ethical Investment Policy and alignment with the Bank’s missions informs the Bank’s appetite for an investment.

For the Bank, impact is a combination of better managed ESG risks (including climate and human rights risks), Fair Work and Diversity and Inclusion ambitions **and** intentional mission focussed impacts. Climate risk assessment and an assessment of Green House Gas emissions form an important element of the Bank’s due diligence.

Each investment will have an Impact Thesis and Theory of Change which maps out the Bank’s assumptions re impact in terms of scale, significance, timing and duration, Bank contribution, who benefits and other factors.

Understanding investee **capacity, commitment and track record** – and how to support the evolution of this over time is an important consideration of the Bank’s due diligence.

Impact and ESG DD assessment will **inform investment covenants (and potentially Action Plans)**, reporting and portfolio management needs.

Appropriate Key Performance Indicators (KPIs) and targets will be selected to allow monitoring and reporting.

Investment

Ensuring impact requirements (risk and opportunity) are captured in legal documents and reporting requirements.

Portfolio

Impact and portfolio management teams manage for evidence and delivery of impact.

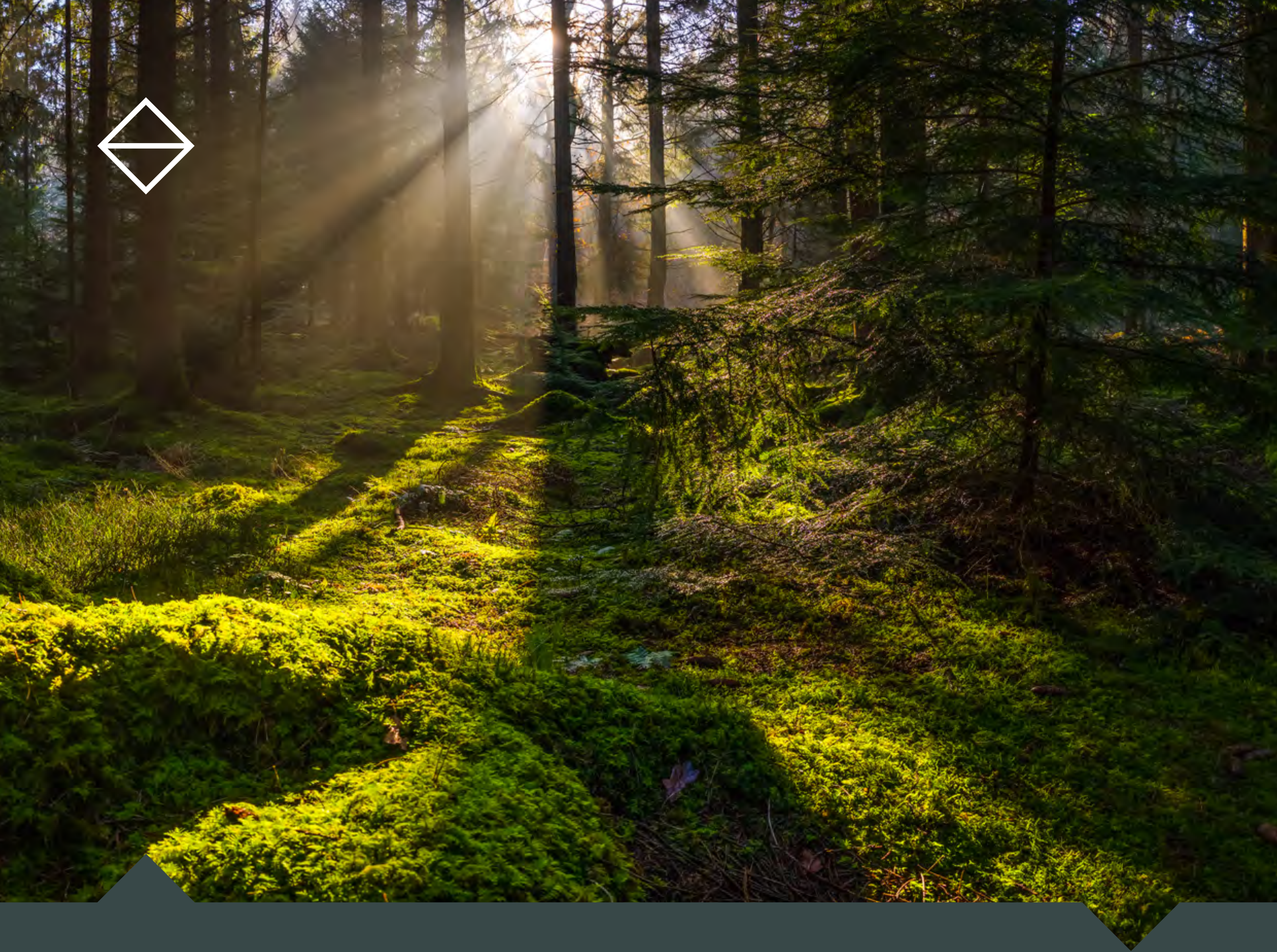
Potential **value adding role** in helping investees build more effective processes and narrative around benefits of impact.

Potential collaboration and scale influence through **partnerships**.

6. Policy Governance and Oversight continued

Document version history

Created on	10 June 2021
Last Updated	28 February 2023
Approval Date	2 March 2023 by Bank and SIL
Review Date	December 2024
Owner	Executive Director of Impact Assessment and Reporting
Version	V2



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