Operating Principles for Impact Management

Annual Disclosure Statement 2024

The
Scottish
National
Investment
Bank

The Scottish National Investment Bank plc* hereby affirms its status as a Signatory to the Operating Principles of Impact Management (the "Impact Principles").

The Scottish National Investment Bank was established in 2020 by Scottish Ministers. All of our investments must meet the aims of at least one of our three key missions – to support Scotland on its journey to net zero, to improve places and communities, or to harness innovation.

The total value of assets under management were valued at £463.2 million/$582.1 million on 12 December 2023. This Disclosure Statement affirms that all investments held within Scottish Investments Limited during 2023 were aligned with the nine Impact Principles and sets out how the Bank operationalises the principles within its investment practices.

As a young institution with a focus on patient capital, the Bank has not yet undertaken any exits.

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*Scottish National Investment Bank plc is wholly owned by Scottish Ministers. Registered in Scotland with Company number SC677431, with a registered address at 1-North, Waverley Gate, 2-4 Waterloo Place, Edinburgh, EH1 3EG.

Principle 1: Define strategic impact objective(s), consistent with the investment strategy

Principle 1: *The Manager shall define strategic impact objectives for the portfolio or fund to achieve positive and measurable social or environmental effects, which are aligned with the Sustainable Development Goals (SDGs), or other widely accepted goals. The impact intent does not need to be shared by the investee. The Manager shall seek to ensure that the impact objectives and investment strategy are consistent; that there is a credible basis for achieving the impact objectives through the investment strategy; and that the scale and/or intensity of the intended portfolio impact is proportionate to the size of the investment portfolio.*

Our Strategic Objectives

The Bank is a mission-led impact investor. The missions have been set by our Shareholder, Scottish Ministers, to address three grand challenges facing Scotland – the climate emergency, place-based opportunity, and demographic change. Our missions are outcome orientated and serve as the primary filter through which investment decisions are made.

Grand Challenges

Climate Emergency
Addressing the social, environmental, and economic impacts of a warming climate (including energy, labour, infrastructure, and supply chains) during the transition to a low carbon economy.

Place-Based Opportunity
Addressing place-based inequality, which disadvantages individuals and communities leading to poorer social, health, economic & environmental outcomes at an individual and population level.

Demographic Change
Addressing Scotland's demographic challenges (including age, health profile and rural depopulation). Leveraging technology and targeting investment in innovation to improve productivity and manage associated public health and workforce challenges.

Bank's Missions

Net Zero Mission
Address the climate crisis, through growing a fair and sustainable economy.

Place Mission
Transform communities, making them places where everyone thrives.

Innovation Mission
Scale up innovation and technology, for a more competitive and productive economy.

Principle 1: Define strategic impact objective(s), consistent with the investment strategy continued

To support the development of our Impact Framework against which our investment performance can be determined, we have created a Theory of Change, and a set of 'mission impact objectives' with associated Key Performance Indicators (KPIs), for each of the three missions. These impact objectives and KPIs have been designed to provide greater understanding of the Bank's strategic impact investment priorities and are aligned to the National Outcomes and Indicators within the Scottish Government's National Performance Framework, and the UN Sustainable Development Goals, with the mission focus specifically contributing to delivering the following six goals:

UN Sustainable Development Goals

How we deliver Impact

We are a patient investor, providing long-term investment to businesses and projects connected with Scotland. Our investments are designed to deliver impact through and beyond our investment's lifespan and delivery of our missions and wider environmental and societal benefits are central to our decision-making. Over time, our investment portfolio will enable impact in four distinct ways:

1. Delivery of missions:

- **Net Zero** – Address the climate crisis, through growing a fair and sustainable economy.
- **Place-Based Opportunity** – Transform communities, making them places where everyone thrives.
- **Innovation** – Scale up innovation and technology, for a more competitive and productive economy.

In delivering our three defined investment missions, we integrate key principles to amplify our portfolio-level, positive impact in the Scottish ecosystem:

2. The promotion of a diverse and inclusive workforce through high-quality employment aligned to the Scottish Government's 'Fair Work First Principles'.
3. Increasing business understanding around carbon emissions and climate risk.
4. Creating equality of investment opportunity for people who are marginalised, minoritised, or under-represented.

Responsible Investing

Above and beyond the impacts we aim to deliver via our missions, we are a responsible investor who aims to promote better outcomes in all our investments where we can. This starts with a commitment to the implementation of the Bank's Ethical Investment Policy, through to the promotion and support of a range of Fair Work and employment opportunities that we agree with investees, and the broader influence we have across Scotland's investment and private sector communities.

Promoting diversity, equality, and inclusion is a core component of our activity both within the Bank and through our external engagement and investments. We collect Fair Work and diversity monitoring information from our portfolio and support investees to implement more ambitious and impactful approaches to diversity, equality, and inclusion wherever we can.

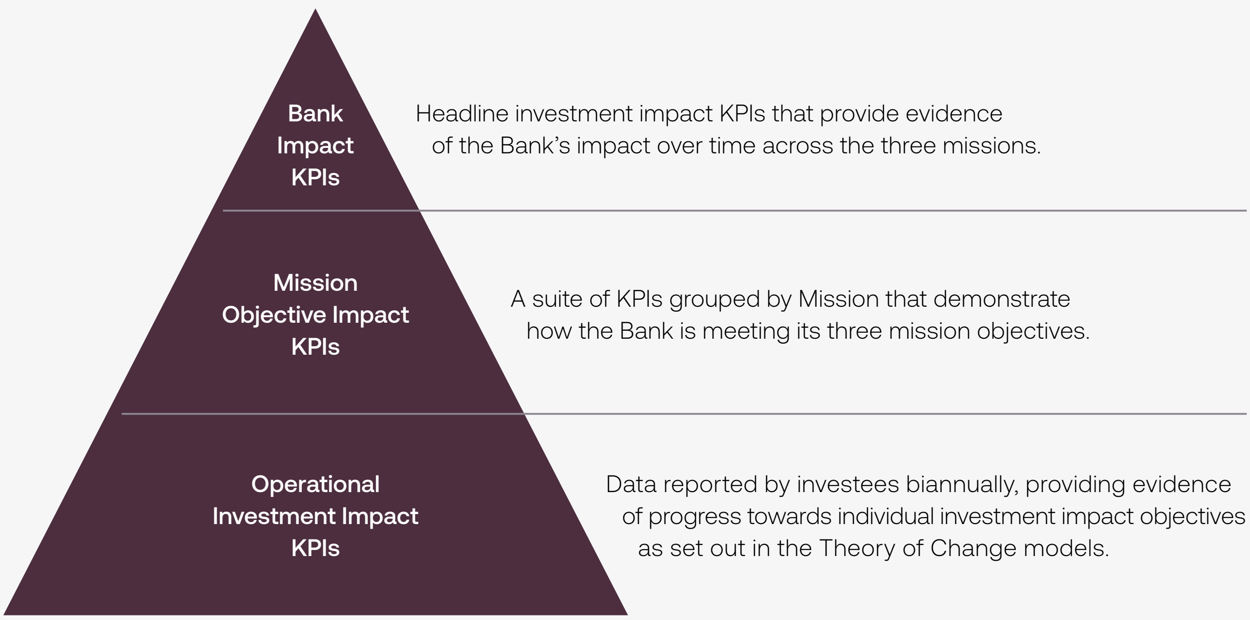
Principle 2: Manage strategic impact on a portfolio basis

Principle 2: *The Manager shall have a process to manage impact achievement on a portfolio basis. The objective of the process is to establish and monitor impact performance for the whole portfolio, while recognising that impact may vary across individual investments in the portfolio. As part of the process, the Manager shall consider aligning staff incentive systems with the achievement of impact, as well as with financial performance.*

Operating Principles for Impact Management

To support the measurement of the Bank's investment impact performance, we have designed a performance reporting hierarchy that was formally embedded within the 2023-24 Financial Year (FY23/24).

Impact Reporting Hierarchy



Responsible Investor KPIs
A suite of cross-cutting KPIs that demonstrates both the Bank's commitment to being a responsible impact investor and its contribution to delivering wider shareholder policy objectives as set out in the Bank's legislation.

Principle 2: Manage strategic impact on a portfolio basis continued

This suite of performance indicators is bespoke to the Bank but where possible is aligned to existing recognised impact indicators, such as the IRIS+ metrics.

During 2023 the Bank has also developed mission-focussed portfolio level investment targets (Ambitions) that will drive strategic impact across the portfolio and support the delivery of our missions.

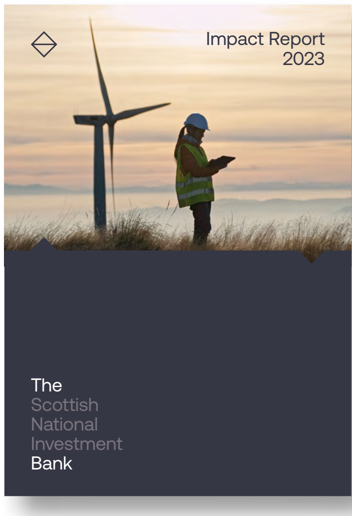
As part of the Bank's due diligence activity all investments are assessed against the five dimensions of impact, as identified by the Impact Management Project, to create a tailored Impact Thesis (see information presented against Principle 4). All dimensions are scored on a low-high impact rating, allowing comparison of expected impact across and within the Bank's Portfolio.

To support final investment decision-making, the Bank conducts an Impact Assessment for each investment. The purpose of the assessment is to review the Bank's approach to impact and ESG throughout the deal process against four of the Principles for Impact Management. The assessment is based on how the Bank team has approached impact through the process – not how strong the company's impact case is, which is captured within the Impact Thesis – and is focused on how well we have evidenced the commitment to positive Impact and ESG management within the investment decision-making process. The Assessments also help us to understand, over time, whether we are improving our internal practices and approaches to assessing and delivering impact through the deal process.

Post investment, impact data is collected from investees on a bi-annual and annual basis, with investee and portfolio impact performance considered as part of the Bank's Balanced Scorecard and within the Bank's corporate governance processes (Portfolio Management Committee and Valuations Committee). Impact performance is discussed with investees as part of our portfolio monitoring engagement activities – see information provided against Principle 6.

Our impact performance is reported publicly on an annual basis in our Impact Report, with portfolio and mission level highlights also provided within our Annual Report and Accounts.

Staff incentive systems, including the Mission Contribution and the Long-Term Incentive Plan (LTIP) schemes, have been developed to ensure impact is embedded within and across the culture of the organisation.



Principle 3: Establish the Manager's contribution to the achievement of impact

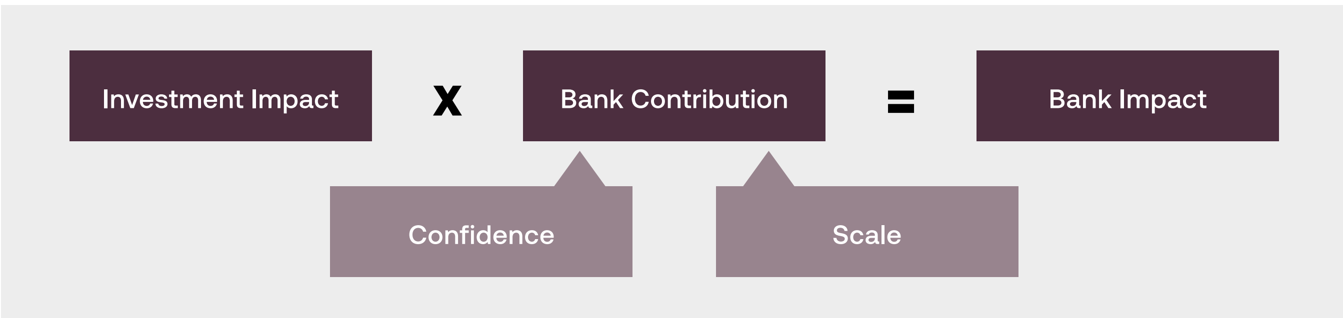
Principle 3: *The Manager shall seek to establish and document a credible narrative on its contribution to the achievement of impact for each investment. Contributions can be made through one or more financial and/or non-financial channels. The narrative should be stated in clear terms and supported, as much as possible, by evidence.*

Operating Principles for Impact Management

In addition to delivering mission-focussed impact, a core principle of our Investment Strategy is to attract private sector funds to co-invest alongside our public sector capital. This improves scale of investment, sustainability and future exit prospects. Fundamentally, the complex nature of the grand challenges means that our investments alone will not be enough to deliver solutions; they require a mix of public policy, private and third sector initiatives, delivered by a range of stakeholders drawing on both public and private finance to achieve the necessary scale and impact. As part of our investment decision-making process, we therefore consider all investment opportunities against the five dimensions of impact identified within the Impact Management Project, which includes an analysis of the Bank's 'Contribution' to delivery of impact. Within this we identify and score our contribution against three dimensions:

1) **Financial additionality** - capital is not available, or not available in sufficient quantity or terms.
2) **Value additionality** - knowledge, advice, governance support, ESG, climate and impact expertise.
3) **Mobilisation** – the Bank's presence provides assurance or other comfort that allows others to invest at the same time or subsequently.

The Bank determines its level of contribution through a combination of the confidence we take that we are providing an additional financial and/or mobilisation role and the scale of our contribution, which is typically an assessment of the value add the Bank can bring.



Additionally, as part of our due diligence activity we create a Theory of Change (ToC) model for each investment to illustrate how our actions and capital support the delivery of mission impacts over the longer term (see information provided against Principle 4). This model identifies the input contribution of the Bank and the outputs, outcomes, and impact that this contribution is expected to support. The Bank's contributions are both financial and non-financial in nature.

Post investment we review our contribution internally within our investment governance and portfolio management processes, and seek external validation of our assessment through our Portfolio Customer Survey, which is reviewed at an individual company and aggregate level, and through our ongoing impact monitoring and regular investee engagement activity.

Principle 4: Assess the expected impact of each investment, based on a systematic approach

Principle 4: *For each investment the Manager shall assess, in advance and, where possible, quantify the concrete, positive impact potential deriving from the investment. The assessment should use a suitable results measurement framework that aims to answer these fundamental questions:*

(1) What is the intended impact?
(2) Who experiences the intended impact?
(3) How significant is the intended impact?

The Manager shall also seek to assess the likelihood of achieving the investment's expected impact. In assessing the likelihood, the Manager shall identify the significant risk factors that could result in the impact varying from ex-ante expectations. In assessing the impact potential, the Manager shall seek evidence to assess the relative size of the challenge addressed within the targeted geographical context. The Manager shall also consider opportunities to increase the impact of the investment. Where possible and relevant for the Manager's strategic intent, the Manager may also consider indirect and systemic impacts. Indicators shall, to the extent possible, be aligned with industry standards and follow best practice.

Operating Principles for Impact Management

The Bank's approach to impact investing has been built on international good practices. We have developed an impact assessment and reporting framework which considers investment impact from the point of origination through to portfolio management. The delivery of this framework is supported by a suite of internal guidance to support the integration of impact within investment decision-making across the investment lifecycle, which helps to ensure consistency and transparency in our assessment and reporting processes. This guidance includes the development and application of a suite of key impact performance indicators that are applied at investment, mission, and portfolio level, enabling us to measure impact over the investment period and against our strategic mission objectives.

Principle 4: Assess the expected impact of each investment, based on a systematic approach continued

The Bank's Approach to Impact Assessment

First Step	Investment process	Investment agreement	Portfolio
Define and confirm mission fit	Impact thesis for every investment: ◆ What impacts? ◆ Who benefits? ◆ How much benefit/impact? ◆ What contribution does the Bank make? ◆ What risks to impact? Theory of Change model for every investment with associated KPIs determined for each vertical: ◆ Activity ◆ Outputs ◆ Outcomes ◆ Impact Climate Risk Assessment for every investment.	Incorporating impact requirements (risk and opportunity) in investment and reporting requirements.	Support investee companies in integrating environment and social practices (such as GHG reporting and enabling a more diverse and inclusive workforce) and impact reporting.

Impact Thesis – Five Dimensions of Impact

Each investment proposition that the Bank receives is filtered through a mission impact lens from the point of initial enquiry. Once mission fit is established, we consider all investment opportunities against the five dimensions of impact, identified by the Impact Management Project, to create a bespoke 'Impact Thesis'. This is an industry recognised framework which supports a consistent approach to assessing the potential scale of impact based on five dimensions (What, Who, How much, Contribution, Risk). All dimensions are scored on a low-high impact rating.

This process, alongside individualised Theory of Change models that we create for each investment, enables the identification of the type, scale, and beneficiaries of the investment, as well as understanding the specific contribution the Bank's finance and involvement is adding. The Bank then uses this thesis to assess the performance of its investments at an individual and portfolio level, and to consider any ESG risks that require ongoing management or mitigation.

Principle 4: Assess the expected impact of each investment, based on a systematic approach continued

Theory of Change Models

The Bank's focus is on patient capital to help solve long-term challenges. This means that for many of our investments the intended impact is often not demonstrable in the near term, and in some instances may only become evident after the period of investment. Given this time lag we have created a Theory of Change (ToC) model for each mission to highlight how our actions and investments support the delivery of mission impacts over the longer-term. We then produce individual ToCs for each investment to illustrate how our actions and capital support the delivery of mission impacts over the longer term. The model is comprised of four key pillars:

Theory of Change model

Activity	Outputs	Outcomes	Mission Impact
Bank activity to support impact delivery	Immediate change as a result of investment	Short to medium-term change that follows from outputs and contributes to impact	Longer-term change identified in the missions

These models are co-created with investees and include mutually agreed Key Performance Indicators that allow us to monitor and assess impact performance against expectations over time.

ESG and Climate Risk

To support investment decision-making and on-going monitoring we conduct ESG related due diligence and complete a Climate Risk Assessment for every investment. This information is used to determine the impact reporting framework and shape the post investment impact-related actions that the investee is expected to deliver as a condition of our investment.

Principle 5: Assess, address, monitor, and manage potential negative impacts of each investment

Principle 5: *For each investment the Manager shall seek, as part of a systematic and documented process, to identify and avoid, and if avoidance is not possible, mitigate and manage Environmental, Social and Governance (ESG) risks. Where appropriate, the Manager shall engage with the investee to seek its commitment to take action to address potential gaps in current investee systems, processes, and standards, using an approach aligned with good international industry practice. As part of portfolio management, the Manager shall monitor investees' ESG risk and performance, and where appropriate, engage with the investee to address gaps and unexpected events.*

Operating Principles for Impact Management

As an institution we not only invest to enable the Bank's missions, but we also act as a responsible investor, adopting a 'do no harm' approach in all investments. Our Ethical Investment Policy sets out Environmental, Social and Governance ('ESG') requirements applied to all our investments and outlines how we aim to enhance ESG outcomes where practical.

To support this objective, we have developed an ESG Toolkit to support investment and portfolio teams to assess and monitor ESG risks throughout the investment lifecycle. The output of our ESG due diligence is used to shape our Post Investment Action Plans (agreed with investees ahead of final investment decision) to support the monitoring and management of ESG-related risks within their own businesses. The nature of these plans will differ by company and/or sector but, as a minimum, all our investees are now expected to develop/hold an Environmental and Social Management System and a Carbon Management Plan within the first 12 months of our investment, as well as adhering to the Scottish Government's Fair Work First Principles. Support is provided to investees as appropriate to ensure adherence to the requirements, and to encourage the embedding of strong ESG practices within their operations.

Additionally, promoting diversity, equality, and inclusion is a core component of our activity both within the Bank and through our external engagement and investments. We recognise many of the businesses within our portfolio are in the early stages of their growth, and we can use our knowledge to share and instil positive practices that support equality as their business grows. For example, we use investment covenants in a proportionate and relevant manner to positively influence change. As a minimum these covenants will include:

- Reporting of diversity data.
- Development and or review of Equality, Diversity and Inclusion (EDI) policies.
- Requirement to put a plan in place to increase equality of opportunity as well as diversity and inclusion where appropriate.
- Monitoring progress of agreed actions.

Where we invest equity, we also typically have observer rights on investee boards. This allows us to better understand the needs and challenges of individual businesses.

Information relating to investee ESG risk management practices, EDI and Fair Work is collected as part of our annual impact monitoring practices and considered within impact performance governance.

Principle 6: Monitor the progress of each investment in achieving impact against expectations and respond appropriately

***Principle 6:** The Manager shall use the results framework (referenced in Principle 4) to monitor progress toward the achievement of positive impacts in comparison to the expected impact for each investment. Progress shall be monitored using a predefined process for sharing performance data with the investee. To the best extent possible, this shall outline how often data will be collected; the method for data collection; data sources; responsibilities for data collection; and how, and to whom, data will be reported. When monitoring indicates that the investment is no longer expected to achieve its intended impacts, the Manager shall seek to pursue appropriate action. The Manager shall also seek to use the results framework to capture investment outcomes.*

Operating Principles for Impact Management

As part of our due diligence and Investment Committee decision-making process we produce an Impact Thesis and Theory of Change (ToC) for each investment. These tools identify the output(s), outcome(s) and impact(s) expected to be demonstrated as a result of our investment. These are set out as qualitative narrative and quantified against delivery timeframes where appropriate.

The ToC models are co-created with investees and include mutually agreed Key Performance Indicators that allow us (and the investee) to monitor and assess impact performance against expectations over time.

The indicators identified in the ToC are transposed into an impact monitoring report, which includes a wider set of reporting metrics to help determine the impact performance of the investment. Monitoring reports, associated data collection expectations, and impact related post-investment actions are agreed with investees as part of the Investment Agreement.

Impact performance is reported to the Bank by investees on a bi-annual basis for direct investments and an annual basis for Fund investments. Investees are asked to identify and explain any areas of under-performance or issues that may affect impact delivery.

Presently, impact reporting is undertaken through monitoring forms. The Bank is developing a portfolio and impact management platform that will support the collection, management, and analysis of impact data (and commercial MI), which will strengthen the Bank's existing data collection, analysis, and reporting functionality.

We internally review investee impact performance within our monthly Portfolio Management Committee and quarterly Valuations Committee at an investee and portfolio level, including consideration of under-performance and action required to remediate. To support this we review all known impact data and create a RAG rating to monitor changes to impact performance over time. We publish an annual Impact Report in April each year, which sets out the impact delivered by our investments within the preceding calendar year.

During 2023 we have developed a suite of mission-related impact targets (Ambitions) which will be operationalised within FY23/24 as part of the Bank's existing impact assessment and monitoring processes. Performance against ambitions will be considered within our existing impact performance governance.

The Bank has regular engagement with investees and undertakes a Portfolio Customer Survey to ensure investees have opportunity to provide feedback on the investment process, impact management, and relationship with the Bank.

Principle 7: Conduct exits considering the effect on sustained impact

Principle 7: *When conducting an exit, the Manager shall, in good faith and consistent with its fiduciary concerns, consider the effect which the timing, structure, and process of its exit will have on the sustainability of the impact.*

Operating Principles for Impact Management

As a young institution with a focus on the provision of patient capital, the Bank has not yet undertaken any exits.

Mission alignment and impact is the primary lens through which we invest. We recognise that delivery of impact is a long-term objective and for many investments the anticipated impacts may not be observable during the investment term. The Bank has created specific internal 'Responsible Exits Guidance' and discussion of responsible exits is included within our due diligence and Investment Committee framework, with Investment Committee papers including a section on 'Responsible Exits' to ensure that this is considered within the decision-making process.

Additionally, the expected duration of impact is assessed and scored within the Impact Thesis which is completed for each investment. Guidance to support assessment of impact at exit has been developed for the use of Bank teams, providing detailed information on considerations for debt, equity, and fund investments.

A core element of the Bank's impact value add is supporting our investee companies in embedding their own impact management frameworks through the development of policies, procedures, management capability and systems. It is therefore anticipated that the positive cultural changes enacted within companies as the result of our investment would be sustained, and a continuation of impact delivery seen post the Bank exiting an investment.

Principle 8: Review, document, and improve decisions and processes based on the achievement of impact and lessons learned

Principle 8: *The Manager shall review and document the impact performance of each investment, compare the expected and actual impact, and other positive and negative impacts, and use these findings to improve operational and strategic investment decisions, as well as management processes.*

Operating Principles for Impact Management

The Bank has developed a culture of learning and development in relation to its Impact Management and wider investment practices. This is evidenced through the on-going evolution and refinement of our impact frameworks and supporting investment and impact documentation, and the use of 'Insight Debriefs' post deal-closure to review investment processes and consolidate and share learning. The Bank has also committed to periodic review and verification of its impact strategy and performance via its Long-Term Incentive Plan.

Operationally, Impact Management and the impact performance of each investment (and aggregate portfolio) is routinely considered as part of the Bank's governance and forms a core standing item within the Bank's Portfolio Management Committee and Valuations Committee.

Externally, we are keen to play a central role in bringing together and broadening the impact investment community in Scotland. To support this ambition, we regularly publish Insight blogs and web publications that draw on our impact investment experience and engage widely across the public, private and third sector on impact investing. In November 2022, the Bank held its first Impact Investing Summit bringing together leaders of 'impact' businesses, who have received impact focused investment alongside investors who are developing and shaping how this innovative approach to finance works in practice. This was supported by the development and publication of a landscape review (working in partnership with The Good Economy) titled: "Unlocking the potential of impact investing in Scotland". Further events are planned in 2024.

Principle 9: Publicly disclose alignment with the Impact Principles and provide regular independent verification of the alignment

Principle 9: *The Manager shall publicly disclose, on an annual basis, the alignment of its impact management systems with the Impact Principles and, at regular intervals, arrange for independent verification of this alignment. The conclusions of this verification report shall also be publicly disclosed. These disclosures are subject to fiduciary and regulatory concerns.*

Operating Principles for Impact Management

The Disclosure Statement affirms the alignment of The Scottish National Investment Bank Plc's (the Bank) policies and procedures with the Impact Principles and will be updated annually.

The Bank's Disclosure Statement is submitted to the Impact Principles for public disclosure and is publicly disclosed on the Bank's website.

Independent verification will be undertaken on a regular basis (no less than every three years). The findings of verifications will be disclosed publicly via the Operating Principles of Impact Management and the Bank's website and are subject to fiduciary and regulatory concerns.

BLUE MARK
PRACTICE VERIFIED
DECEMBER 2023

BlueMark Verification

In December 2023, the Bank engaged BlueMark, a Tideline company, to independently verify the alignment of the Bank's impact management practices with the Operating Principles for Impact Management, which included reviewing our Disclosure Statement. BlueMark's assessment findings cover both areas of strength and areas for improvement, as reflected in the Verifier Statement, which we are pleased to publish alongside our 2024 Disclosure Statement.

BlueMark's verification does not constitute either an endorsement of the client's practices or a verification of the resulting impacts achieved.

ABOUT BLUEMARK

BlueMark is a leading provider of impact verification services for investors and companies. Founded in 2020, BlueMark's mission is to "strengthen trust in impact investing." BlueMark's verification methodologies draw on a range of industry standards, frameworks, and regulations, including the Impact Management Project, the Operating Principles for Impact Management, the Principles for Responsible Investment, SDG Impact, and the Sustainable Finance Disclosure Regulation.

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