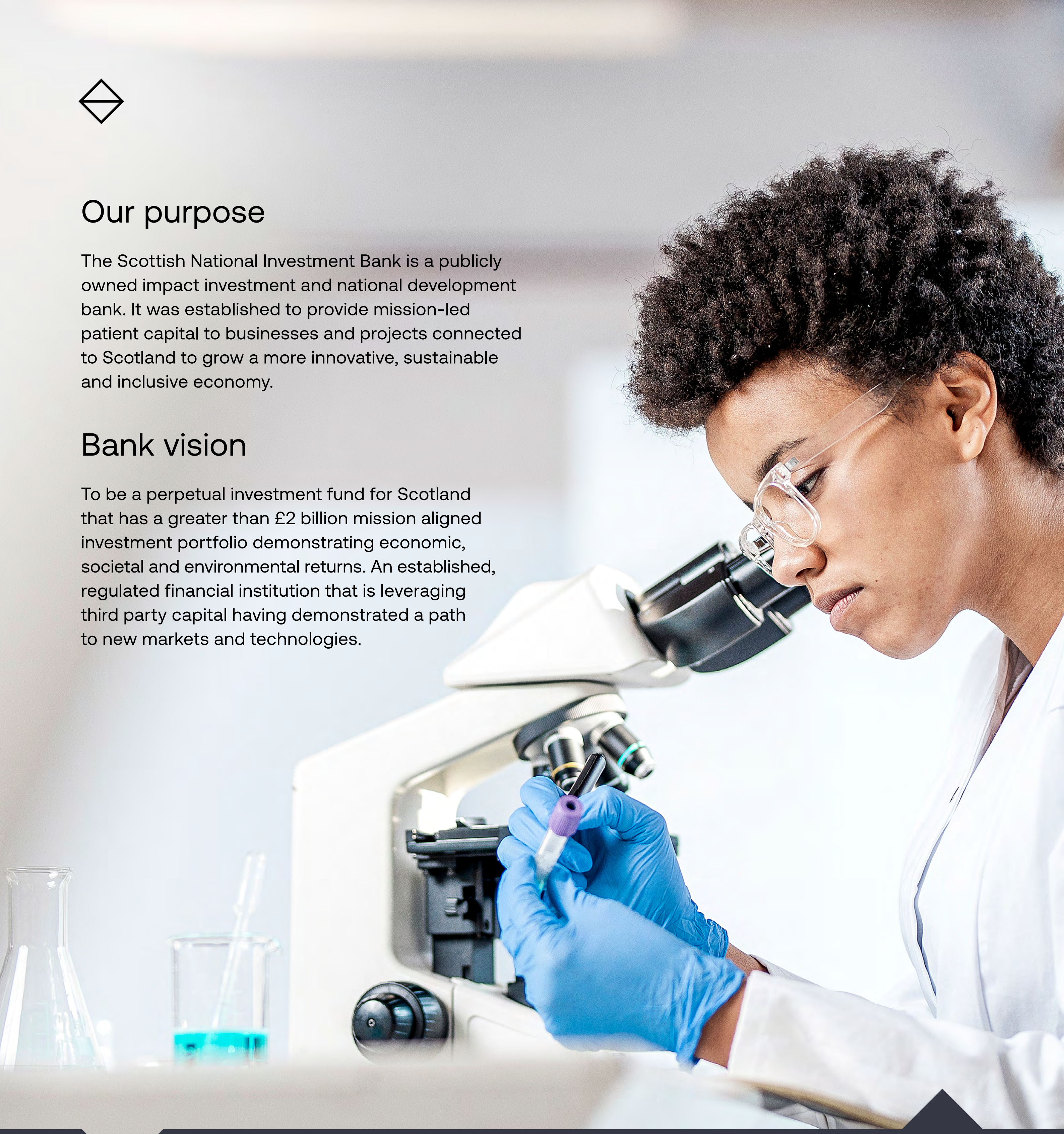
The Scottish National Investment Bank

Investment Strategy

Financial Year 2024/25



Our purpose

The Scottish National Investment Bank is a publicly owned impact investment and national development bank. It was established to provide mission-led patient capital to businesses and projects connected to Scotland to grow a more innovative, sustainable and inclusive economy.

Bank vision

To be a perpetual investment fund for Scotland that has a greater than £2 billion mission aligned investment portfolio demonstrating economic, societal and environmental returns. An established, regulated financial institution that is leveraging third party capital having demonstrated a path to new markets and technologies.

The Bank's investment strategy forms part of the core strategic framework in which the Bank is governed, operates and reports.

To meet the terms of the Shareholder Relationship Framework, the Bank's investment strategy is reviewed and approved by the Bank Board on an annual basis, and otherwise as necessary, to take account of any additional or amended obligations or responsibilities assumed by the Bank and its Group which are material in nature.

Introduction from our Chief Investment Officer

We take a progressive approach to our investment strategy and as an impact focussed investment team we want to go beyond commercial returns to also deliver our missions and wider measurable benefits for Scotland's people, communities, and environment. These different returns are complementary and mutually reinforcing, adding value to both the Bank as an investor and to the businesses and projects that we invest in.

Our strategy is designed to meet both short and long-term goals; we are agile in identifying key investment themes and sectors that will support our impact ambitions, while also building a portfolio with sufficient financial returns that will enable the Bank to achieve its aspiration to become the perpetual investment fund for Scotland.

During the past year we have prioritised our relationships with key sectors in the Scottish economy, growing our networks across the private, public and third sector and working as a catalyst for change and seeking to attract more investment into Scotland alongside our own.

As a result of Scottish Government budgetary constraints, we have a reduced capital budget for the 2024/25 Financial Year. However, through refining our active origination strategy to focus on priority investment themes, I am confident that in the year ahead we can continue to grow our portfolio and build a better economy that is innovative, high-value, and delivers shared and sustainable prosperity.

Mark Munro
Chief Investment Officer

Investment strategy principles

Our investment activity is shaped by four key principles:

Key principles

Mission impact

The Bank is a mission impact investor, seeking commercial, societal and environmental impacts from its investments.

Patient capital investor

The Bank is a patient capital investor, investing up to £50 million in businesses and projects across Scotland.

Crowding in

The Bank seeks to catalyse economic activity by crowding in private sector investment.

Commercial terms

The Bank invests on commercial terms.

Investment strategy principles continued

We invest for impact:

- We align all investment against our missions and wider social and environmental impact objectives.
- We are an ethical and responsible investor. We use our Ethical Investment Policy and ESG standards to guide our investment decisions.
- We are a Signatory to the Operating Principles of Impact Management (OPIM) and have integrated impact considerations throughout our investment lifecycle.
- We work with other impact investors, including other development banks, to develop the field of impact measurement, and work to support the growth of impact investment in Scotland.

We invest on commercial terms:

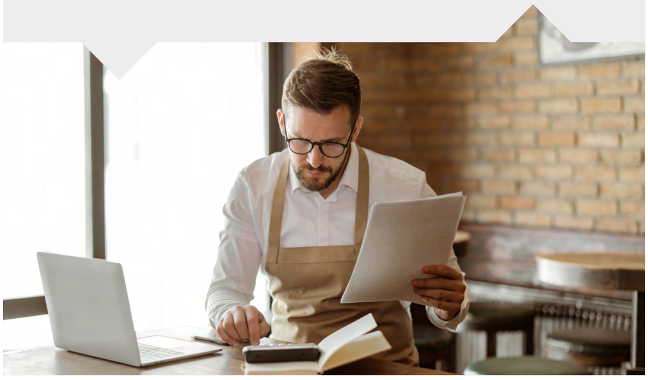
- We invest on commercial terms with appropriate returns set at individual investment and portfolio level. Investments will include covenants and protections for our capital in line with market norms and the risk profile of each investment.
- We are a patient investor, investing patient capital in businesses and projects across Scotland.
- We invest between £1 million and £50 million with the focus on debt and equity investments that support our missions. From time to time, we will also invest in funds aligned to the Bank missions and portfolio requirements. By exception, we may invest outside of these financial parameters where a business or project has particularly strong mission alignment or specific locational benefit to smaller and more remote communities.†
- We understand that the higher risk appetite in our role as Scotland's development bank will inevitably lead to individual investment losses, however, positive net returns across the whole portfolio will demonstrate our stewardship of public capital.
- We aim to generate sufficient income from our investments and investment related activity to cover our operating costs by the end of the first five financial years and become financially self-sustaining.
- We will, subject to Shareholder approval, reinvest repaid capital investment and any profits we make back into mission impact investments, creating a perpetual investment fund for Scotland.

We invest to leverage private capital:

- We comply with subsidy control requirements. We apply measures to ensure we are not crowding out private sector finance and actively seek to 'crowd-in' other investors alongside our public capital to help catalyse critical economic activity in pursuit of our missions.

What we don't do:

- ☒ We don't provide grant or sub-commercial funding.
- ☒ We don't provide short-term working capital including bridging finance or revolving capital facilities.
- ☒ We don't provide government guarantees.
- ☒ We don't originate investment in distressed businesses or projects, or those in need of emergency financial support.
- ☒ We don't provide retail banking or deposits to individuals or micro businesses.



†The Scottish Government Urban Rural Classification defines 'Remote' areas as those that are more than a 30 minute drive time, or areas that have a drive time between 30–60 minutes from a Settlement with a population of 10,000 or more. Additionally, 'Very Remote' is defined as areas that are more than a 60 minute drive time from a Settlement with a population of 10,000 or more. (Scottish Government Urban Rural Classification 2020 (www.gov.scot))

1. Mission-led impact investing

The Bank is a mission-led impact investor. Our investments are structured to generate positive, measurable social and environmental impact alongside a commercial return.

Our missions were set in 2020 by our Shareholder, Scottish Government Ministers, to address three grand challenges facing Scotland:

- The climate emergency
- Place-based inequality
- Demographic change and productivity deficit.

The Bank's Missions

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

Our missions provide clear strategic direction and focus for our investment activity. They are outcome orientated and set out the impact that our investments are designed to enable over the longer term. Information about our approach to impact investment, including the impact we aim to deliver beyond our missions, can be found in our Impact Report and our Impact Management Framework.

To support the delivery of our missions, and reflecting industry best practice, we have introduced a set of quantitative impact targets against which we'll be able to track progress. For each mission we have set two clear Ambitions for the Bank to achieve by 2030. These have been designed to drive focus and intent in our investment decisions and ensure that we are able to meet the mission objectives by 2040 and 2045.

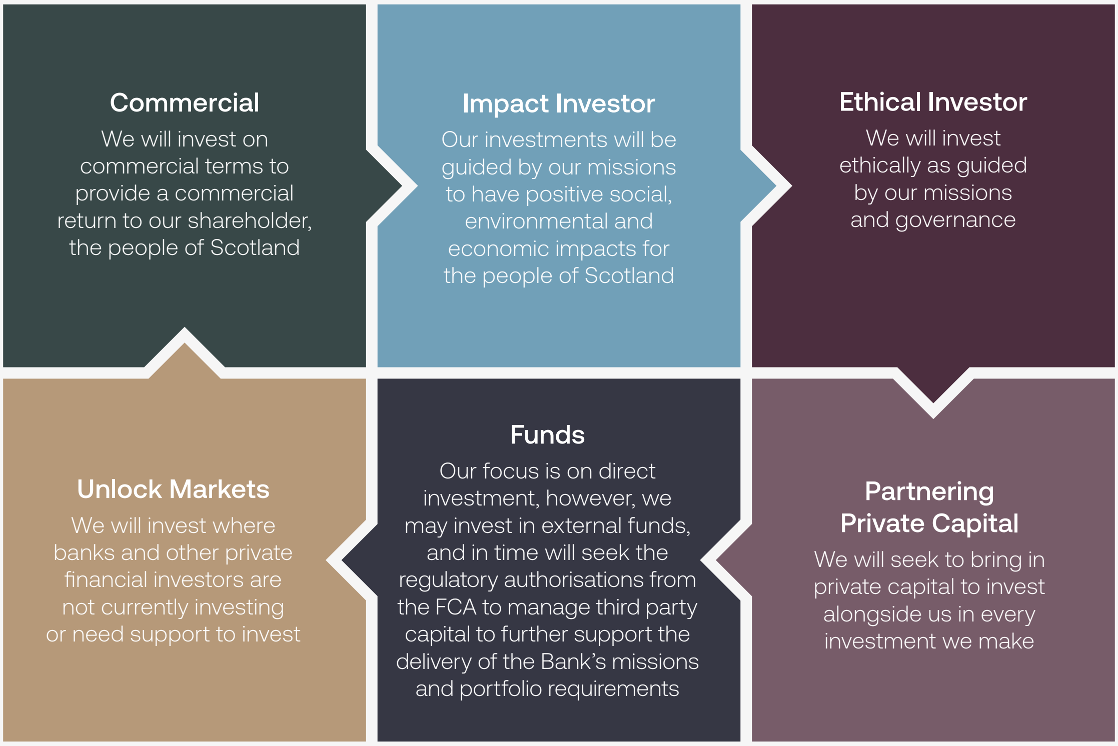
The targets we have set are based on data and insight received to date from our portfolio, however, we recognise that they are subject to real-world volatilities, including companies' commercial performance, changes to the construction and profile of our portfolio, and external market factors beyond our control. To support our commitment to continuous learning, we may look to re-baseline the targets as necessary between now and 2030 as our database expands and we refine our impact measurement practices.

1. Mission-led impact investing continued

2030 Mission Ambitions

Mission	Ambition	Investment	Impact
Net Zero	"Address the climate crisis, through growing a fair and sustainable economy"	By 2030, the Bank will have invested £800 million - £1 billion in high potential Net Zero businesses and projects.	By 2030, the Bank's investments will have helped to avoid, reduce or remove 185,000 – 225,000 tCO_2e from the Earth's atmosphere.
Place	"Transform communities, making them places where everyone thrives"	By 2030, the Bank will have invested £400 million - £500 million in improving Scotland's places and communities.	By 2030, the Bank's investments will have positively impacted the lives of 350,000 – 430,000 people through regeneration, high-quality housing, and connectivity (both digital and physical).
Innovation	"Scale up innovation and technology, for a more competitive and productive economy"	By 2030, the Bank will have invested £400 million – £500 million in innovative, productive businesses.	By 2030, the Bank's investments in innovative industries will have contributed towards the creation and safeguarding of 6,300 – 7,700 jobs.

2. Our role in the Scottish financial ecosystem



While our Shareholder – Scottish Government Ministers – sets our investment missions, we are independent of government with all operational and investment decisions made by our Executive and overseen by our Board.

As a public sector organisation that works on a commercial basis with the private sector we have a unique position within the Scottish investment ecosystem. We seek to use our relationships and investment insights to share learning, drive system changes and act as a conduit between the market and government.

As a provider of patient commercial public capital, our role is complementary to enterprise agencies and central government. Businesses and projects require different types of funding throughout their growth and development. Our role is to provide commercial patient capital to develop growth and scale up of businesses, support strategic infrastructure projects, and/or to prove new markets and technologies to leverage private sector finance. To achieve this, we work closely with government, the Enterprise Agencies, and other key public sector partners including the British Business Bank and UK Infrastructure Bank, to ensure that businesses and projects are referred smoothly to the correct source of potential support according to their needs.

This is complemented by our engagement with the private market, where we work with a range of investors in Venture Capital, Private Equity, the financial services sector and social investment space to grow impact investing in Scotland.

We are well placed to help the development of new markets, as seen in our role supporting the delivery of ScotWind, a key national opportunity, to which we are contributing as an investor in the development of the required infrastructure and a sustainable offshore wind supply chain.

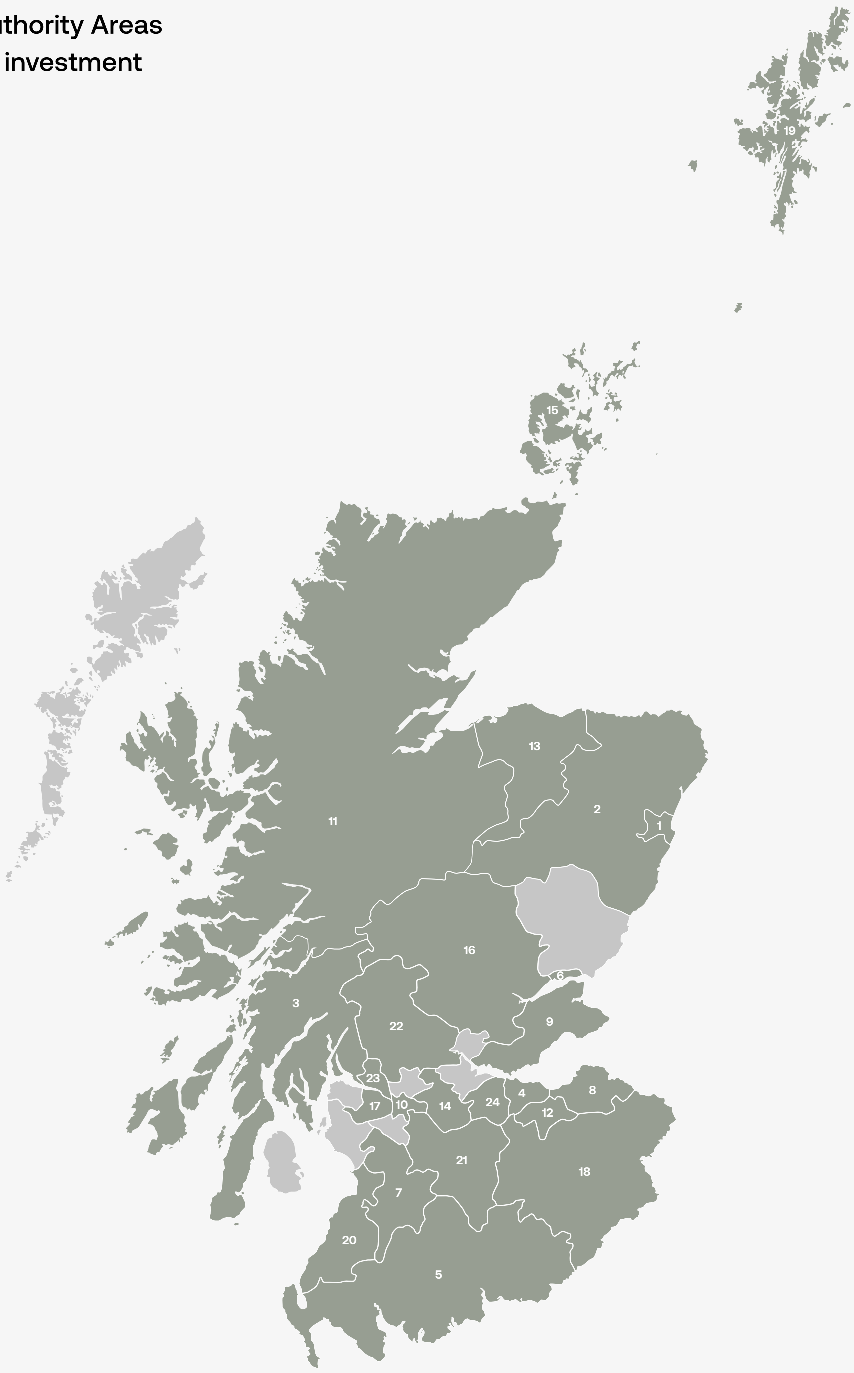
2. Our role in the Scottish financial ecosystem continued

Scotland wide investment

Given our remit to only invest in businesses and projects with a connection to Scotland, we will not have traditional geographical portfolio limits as are commonly found in other investment firms. We will monitor and report on the geographic distribution of our investment across Scotland as a whole, to ensure that we are investing fairly and broadly across the whole of Scotland and in support of our place mission.

Overview of Scottish Local Authority Areas that have benefitted from our investment

1. Aberdeen City
2. Aberdeenshire
3. Argyll and Bute
4. City of Edinburgh
5. Dumfries and Galloway
6. Dundee City
7. East Ayrshire
8. East Lothian
9. Fife
10. Glasgow City
11. Highland
12. Midlothian
13. Moray
14. North Lanarkshire
15. Orkney
16. Perth and Kinross
17. Renfrewshire
18. Scottish Borders
19. Shetland
20. South Ayrshire
21. South Lanarkshire
22. Stirling
23. West Dunbartonshire
24. West Lothian



3. Our investment approach

We will invest responsibly and profitably, and use our position to challenge and actively influence markets and ecosystems to harness investment to address the grand challenges facing Scotland.

Our investment approach is grounded in generating a commercial return and delivering our missions and wider strategic objectives, as set out in our Equality Strategy, Carbon Management Plan, and Ethical Investment Policy.

We identify investment opportunities through inbound enquires and active origination. We may also look to make follow-on investments in businesses and projects within our existing portfolio and at the appropriate time seek to responsibly exit investments to ensure our portfolio balances commercial returns against delivery of impact. Our active origination activity seeks to target the growth sectors and developing markets where our investment capital will maximise the economic, social and environment impact. To support the development of a mission orientated investment pipeline we also undertake market creation activity, with a current focus on developing place-based investment opportunities.

Active origination

We use our insights developed through our portfolio, relationships, and understanding of the policy and investment landscape to review our active origination strategy regularly to identify our investment themes and priority sectors for the following financial years.

Sectors included in our active origination strategy are those that we believe have significant investment opportunity, have strong co-investment potential, can contribute strongly to our missions and target rate of return, and are consistent with our 2030 Impact Ambitions.

Due to the Scottish Government's budgetary constraints, we will have less capital to deploy in Financial Year 2024/2025 (FY24/25). We have therefore identified a narrow set of priority themes and sectors in which to focus our active origination to achieve maximum impact.

Active origination priority sectors FY24/25

Bank missions:	**Net Zero**	**Innovation**	**Place**
Priority themes:	Net Zero Solutions & Alternatives	High-Growth Tech	Regional Equality & Regeneration
	Transition Finance		
Cluster sectors:	Alt Fuels & Climatech	Scalable Tech	Housing
	Energy Supply Chain	Life Sciences	Social & Financial Inclusion
		Quantum & Photonics (including AI)	
		Space	

3. Our investment approach continued

ScotWind will remain a priority for FY24/25 and beyond due to its strategic importance to Scotland.

Investment criteria

To reflect the lower capital allocation for FY24/25, we have also revised our investment criteria. All new and follow-on investment opportunities will need to satisfy the following conditions prior to being actively considered for investment*.

- **Proven management teams** - executive and/or board-level experience of proven delivery in relevant sector.
- **Revenue generating** – opportunities should be revenue generating at the point of investment.
- **Cash runways** – opportunities should be able to demonstrate a cash runway of a minimum of six months before engaging with the Bank and have a minimum two-year runway post investment.
- **Technology Readiness Levels (TRLs)** – innovation-led investment opportunities should be at TRL 8 or higher.
- **Attracting additional investment** – for every £1 we invest, there should be at least an additional £1 from private sector investors when aggregated across the portfolio.

Direct investment

For FY24/25, our primary focus for capital allocation is on direct equity or debt investments from £1 million up to £50 million, or a combination of both, in an individual business or project subject to our investment approval process. However, we will not take equity positions that obtain a majority or controlling stake. We may make follow-on investments where continuing to invest supports the delivery of the Bank's missions and is consistent with our investment criteria.

As a patient capital investor, we typically view our equity investments for the longer term.

*All conditions are subject to the discretion of the Investment Committee.

ScotWind will remain a priority for FY24/25 and beyond due to its strategic importance to Scotland.

It is expected that most of our investment in businesses will be focussed on investing in small and medium sized enterprises (SMEs)†. We focus our investment activity on those businesses that are in their scale-up phase, demonstrating commercial progress and who are seeking investment to support their growth.

As a growth capital investor, we seek to invest in Series A or later funding rounds. By exception, we may invest in earlier funding rounds at the discretion of our Investment Committee. It is expected that these businesses will have high growth potential that we can support, alongside co-investors, to provide the funding gap to reach Series A investment.

†A Small and Medium Enterprise is determined by headcount, turnover or balance sheet total:

Company category	Staff headcount	Annual Turnover	or	Balance sheet total
Medium-sized	< 250	≤ £50m		≤ £43m
Small	< 50	≤ £10m		≤ £10m
Micro	< 10	≤ £2m		≤ £2m

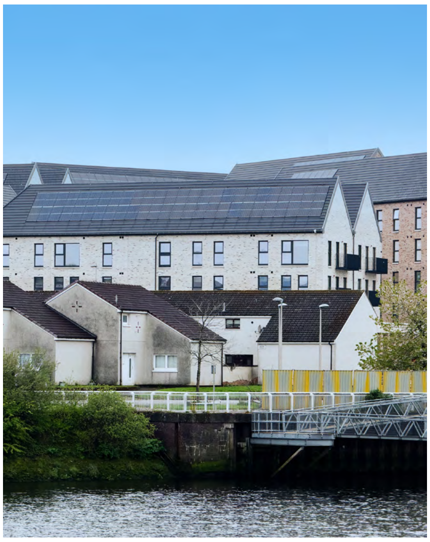
3. Our investment approach continued

Investment in projects

Project investment is distinct from direct investment as it typically involves investment in a structure that brings together several 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 housing developments.

We seek to invest in commercially viable projects that support our missions. We expect to invest in viable projects requiring debt and/or equity investment up to £50 million. We will invest in the construction stage (development projects) as well as the operational stage (operational projects) depending on the specific investment need.

Appetite for project finance will vary across years depending on our capital allocation.



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 and inclusive economies through investing in commercially viable local and/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.

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

Investment in university spinouts and innovation clusters

Scotland has an enduring reputation as a leading provider of tertiary education and has a strong record in attracting investment in its university spinouts. We expect to build relationships and work with Scottish universities and colleges to ensure they maintain their reputations as internationally leading tertiary education and research providers. Our investment in this sector will focus on delivering innovation and place-based benefits through supporting the growth of spinouts and the development of knowledge hubs and innovation clusters that nurture university developed and incubated innovative businesses and projects.

3. Our investment approach continued

Impact assessment

As an impact investor we consider all potential investment opportunities through a mission impact lens and will only invest in projects and businesses where there is clear alignment with one or more of our missions and supports our impact ambitions. We are a Signatory to the 'Operating Principles for Impact Management' (OPIM) and have embedded their globally recognised principles across our investment processes, ensuring that our impact assessment and monitoring practices are aligned to industry standards. We will continue to support our investee businesses to integrate, create and report on impact as part of their business strategies and plans and hold businesses and projects to account through impact covenants as terms of investment.

We publish an annual Impact Report, which provides a summary of investment impacts achieved across our portfolio, as well as the evolution of practice that will be needed over time.

Ethical investment practices

Our Ethical Investment Policy (EIP) sets out how we integrate Environmental, Social and Governance (ESG) requirements in our investments and outlines a set of excluded activities for which the Bank's capital cannot be used. We will continue to review and update these standards to ensure they are appropriate and current.

We consider alignment with our EIP throughout our investment assessment process with final investment approval contingent on compliance with this policy (or a legally binding action plan that will define the compliance timeline).

Once invested, we ensure our investments comply with our EIP through regularly monitoring and engagement. We always seek to include options in our investments to cease funding, take remedial action or exit should the business or project breach the EIP and be unable or unwilling to work with us to remedy the situation.

Equality

We published our inaugural Equality Strategy in 2022 and will continue to work with stakeholders and the wider ecosystem to continuously improve equality and diversity in the Scottish economy via our investments, impact and insights.

As part of our formal due diligence, we collect and review data relating to equality and fair work practices, in the projects and businesses we consider investing in, and where relevant make recommendations for change.

Where appropriate, we utilise covenants within our investment agreements, shareholder rights and other mechanisms to deliver more ambitious and impactful approaches to equality with the aim of improving business practices in Scotland.

Equality data is regularly collected from our portfolio companies to monitor progress against our ambitions.

In 2024, we became a "founding signatory" for the Pathways Forward group, where we work alongside other committed organisations to support meaningful change for women across the entrepreneurial ecosystem.

pathways forward

3. Our investment approach continued

Investment portfolio management

We seek to construct a balanced and diverse portfolio of investments that delivers commercial financial returns, based on a variety of risk exposures, combined with positive impacts across all three of our missions and wider impact ambitions.

To achieve commercial returns and positive impact we actively monitor the performance of each of our investments.

The purpose of closely monitoring the investment portfolio is three-fold:

1. Working in partnership to add value to the portfolio company through our expertise in impact investing and accelerating growth and supporting scaleup.
2. To maintain the quality of our investments and to safeguard our assets with a view to avoiding potential losses.
3. To inform our active origination strategy to help ensure that we continue to build a cohesive portfolio that can deliver our impact and commercial objectives.

Responsible exit strategy

In making our equity investments we consider our investment exit strategy at the outset of our investment and review these assumptions annually to ensure we continue to balance delivery of impact against commercial return.

When an opportunity to exit arises, we will work with the management and other shareholders of the business or project to determine whether it is the right time, the right value, or the logical point within a business' life for us to exit.

We seek to responsibly exit our investments with the aim of ensuring that in exiting, the positive societal or environmental mission impacts delivered by the investment will continue. We believe that through our investees adopting and embedding lasting policies and practices within their businesses or projects that support sustainability, equality and responsible governance it creates value which will be reflected at exit.

The Banks intention, subject to Shareholder approval, is for positive financial returns to be re-invested into further mission aligned investments to create the perpetual investment institution.

4. Form of investment

Equity investments

We invest in equity and equity-like instruments, and convertible loan notes.

The nature of the equity investment we make will depend on the type of business or project we are investing in and the most suitable investment instrument, considering the existing or expected capital structure of the business or project.

It is expected that we could invest equity in:

- Growing businesses.
- Businesses seeking capital investment to scale up operations.
- Businesses seeking capital to support a permanent relocation to Scotland for commercial reasons or Scotland based projects.
- 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 our missions and supports continued connection to Scotland of a particular business or project.
- Commercial community assets which support our missions and impact ambitions.
- Project finance as sponsor (equity).

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

We will actively manage our equity investments in businesses and projects to ensure we effectively steward the public capital we are investing. To support this, we will require an 'Investor Observer' Board attendee and may also require the appointment of an independent Non-Executive Director to the Board.

It is noted that in investing equity in a project, equity returns tend to be paid out by dividend gradually over the period of the project, which may be up to a maximum of 35 years, 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.

4. Form of investment continued

Debt investments

We will invest in debt across the capital structure including:

- Senior debt
- Subordinated debt
- Mezzanine debt
- Junior debt

Where possible and appropriate, given the business entity status and capital structure in place within the business or project in which we are investing, we will always seek to take the appropriate security and enforcement rights for the type of debt instrument we are providing.

We will be a patient capital investor with debt of up to a maximum of 15 years for corporate entities and up to 35 years in project finance structures. When determining the appropriate structure and capital investment we will consider the cash flow profile taking account of amortisation and refinance risk as part of our investment assessment and approval process.

When investing pari-passu we will seek to apply the same market level fees and margins as the other lenders or investors.

Where we are investing in a different type of instrument, at a different time, or are the sole investor or lender, we will benchmark our debt fees and margins with the market, in line with common market practices and our subsidy control requirements. As with commercial lenders we will seek security and financial covenants on the debt we invest that is proportionate to the ranking of debt within the business.

As a responsible lender we will always consider whether a business or project will be able to afford to repay the debt it is taking on, based on a set of reasonable assumptions of the business's performance.

Fund investment

The Bank's focus is on direct investment but where, by exception, we invest via a fund it will be to allow us to leverage our capital through a larger investment vehicle, which has aligned interests in terms of impact or investment in sectors/businesses that may otherwise be inaccessible to us through a direct investment route due to the size of investments at individual asset level. It also allows us to leverage technical and expert knowledge on investments that the Fund has in-house in their area of specialism. In line with the market, we may be offered co-investment opportunities to invest alongside the fund in a specific project or business. We will invest in both debt and equity funds and, if acting as a cornerstone investor as part of a first close, will seek commercial equalisation fees and a position on the Limited Partner Advisory Committee.

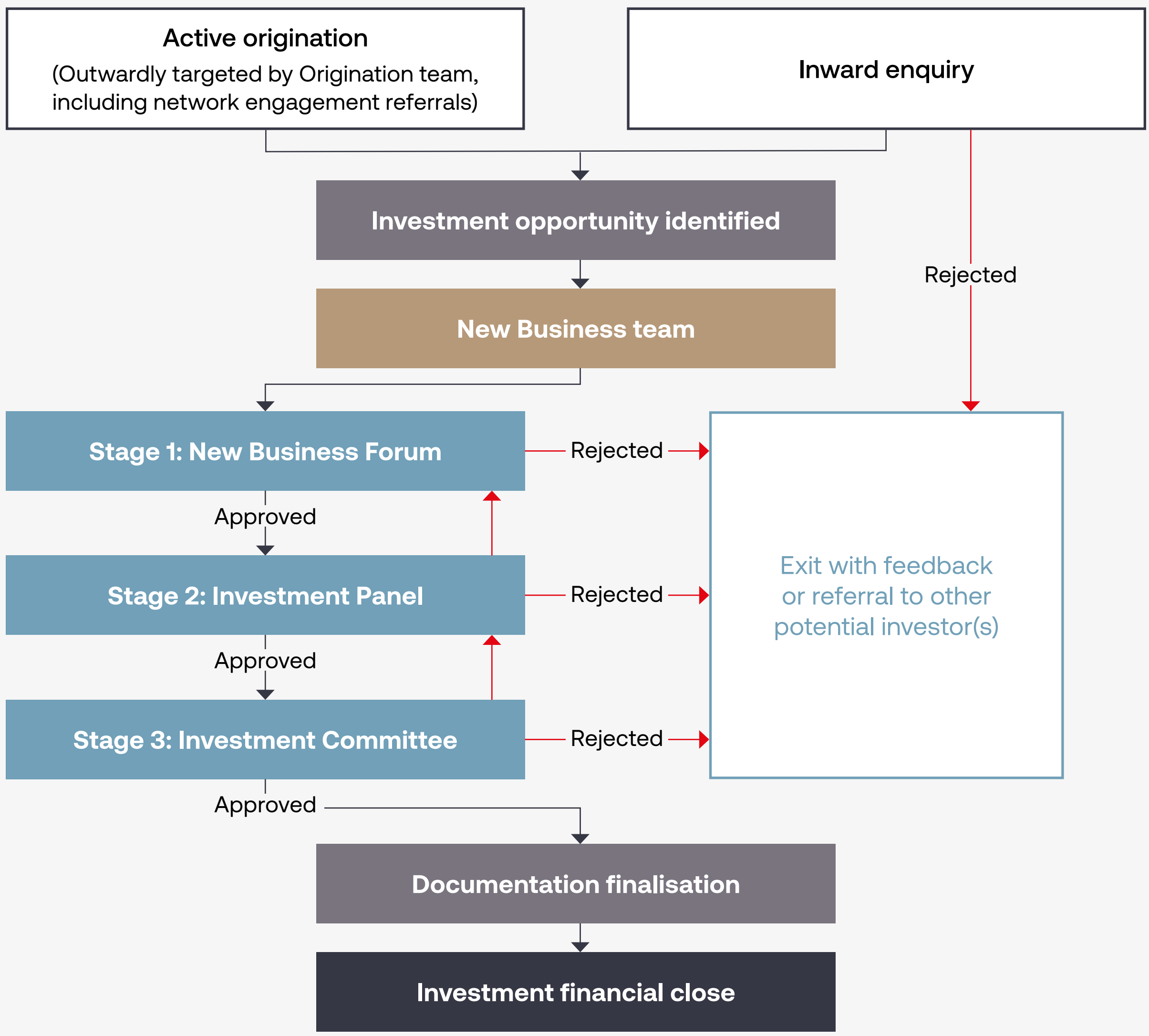
5. Investment operations

The delivery of our ambition to be a perpetual investment fund for Scotland requires a passionate, diverse mission-aligned team that operates in a well governed, controlled and risk aware operational structure. Investments will be made based on the measured judgement of our team of expert investors.

Investment approval process

All investments made are subject to a multi-stage approval process. Investments will only be sanctioned if approved at the Investment Committee, including all follow-on investments. All other stages in our investment process are progressive with permission to proceed only. The time taken to complete an investment is determined by a range of factors, including the complexity and availability of due diligence. We work with potential investees to ensure that they understand our investment approval process and the information that they are required to provide at each stage.

Investment approval process



5. Investment operations continued

TRR
3%-4%
gross IRR*

Agreed medium term TRR for our portfolio

Investment due diligence

We will undertake due diligence in line with market standards in making our direct debt and equity investments. This can cover Legal, Technical, Financial, Commercial and Management, Insurance, Taxation, and/or Environmental Social and Governance (ESG) due diligence, as appropriate for each investment opportunity. We will apply our own stringent investment assessment standards to all investment opportunities we consider, and we will make our investment decisions independently of the Scottish Government or any other investor.

Financial self-sustainability and Target Rate of Return (TRR)

We aim to generate sufficient income from our investments and investment related activity, to cover our operating costs by the end of our first five years, reaching what is termed financial self-sustainability on a cash basis.

Over the longer term, subject to Shareholder approval, we aim to reinvest repaid capital investment and any profits we make back into mission impact investments, creating a perpetual investment fund for Scotland.

We have now agreed a Target Rate of Return (TRR) for our investments with our shareholder. The TRR complements our mission impacts by setting out the rate of financial return we aim to deliver over time, across our investment portfolio. The TRR was set considering a broad range of factors, including our role and risk appetite as a development bank and a patient investor, the sectors in which we are likely to invest, and the anticipated mix of equity, debt and fund investments. The result of this is that we have agreed 3%-4% as an appropriate medium term TRR, to be formally tested at the end of FY25/26 as the Bank's portfolio matures, at which point it is the intention that a longer-term TRR is set.

Valuation

We have a Valuations Policy that is aligned with global valuation standards, which provides a framework to ensure that valuations are performed across the investment portfolio on a timely basis, prepared, reviewed and authorised by those independent to the investment origination and portfolio monitoring teams, and are prepared in compliance with relevant accounting standards and legislation.

We have a dedicated Valuations Committee that has responsibility to provide assurance to the Board that our valuation methodology and policies are robust. Through independent challenge, the Committee considers specific valuations of individual investments and of the portfolio. All investments are reviewed quarterly, with a full revaluation performed at a minimum six monthly frequency.

*Gross IRR, short for gross internal rate of return, is a key metric used in the private equity industry to measure the rate of return on an investment before accounting for any fees or costs. It represents the total return generated by an investment at the fund level, without deducting any expenses. Gross IRR provides a clear and comprehensive assessment of the investment's performance, focusing solely on the returns generated during the investment period.

5. Investment operations continued

Subsidy Control and State Aid

The operative parts of the UK's Subsidy Control Act 2022 were enacted on 4 January 2023. Under the new legislation and operational guidance, the Bank acts as a Commercial Market Operator, ensuring that investment pricing and terms are commercial and reflect the risk and anticipated return we are taking within the capital structure of any given transaction.

We also assess compliance with the European Union State Aid approval obtained from the European Commission in 2020 prior to the Bank's establishment. This is because the European Union State Aid Approval continues to act as a legacy scheme under the new UK legislation. 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 us to invest, with the flexibility to deliver our missions with impact. Scope to invest in market failures outside of the existing Commission framework may also be considered where appropriate analysis and/or consultation has taken place.
- **Crowding in** – we will deploy a series of measures to ensure that we do not 'crowd out' private sector investment, but instead actively seek to 'crowd in' other investors to help catalyse critical economic activity in pursuit of our missions.
- **Pricing and terms** – we will invest on a commercial basis (in line with the Market Economy Operator Principle) in all cases in a similar manner to the considerations required as a Commercial Market Operator under the UK regime.

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 Investment Committee.

Risk management

The Bank is exposed to various risks in pursuit of its investment strategy and impact missions and we have established a set of policies, procedures and structures to manage these risks. These are described in the Risk Management Framework (RMF) which defines our approach to risk management, from ensuring that our risk strategy reflects the organisation's overall corporate strategy, to defining the methodology for assessment and measurement of current and emerging risk.

While we will deliver our missions through our investments, it is recognised that, by its nature, any investment carries risk. Investment risk for the Bank is risk of financial losses or write-downs due to failed loans, under-performance of investments, or inadequate portfolio management.

Risk Appetite Statements are in place for each of the Bank's principal risks, including Investment Risk. The risk appetite statement for investment risk states that as a development bank, we will seek out underinvested risk which by its nature will be high risk. We therefore have a high appetite for investment risk and a low appetite for losses due to inadequate controls over the investment process or inadequate portfolio management. Key Risk Indicators (KRI) are in place against each of the principal risks. These are monitored on a quarterly basis to ensure that the Bank is operating within its stated appetite with breaches reported to the Board; it is important that net returns across the whole portfolio are positive, allowing us to demonstrate appropriate stewardship of public capital.

As a development bank, we will seek out underinvested risk which by its nature will be high risk.

5. Investment operations continued

Additionally, as part of commitment to be a responsible investor we also consider climate risk as part of our investment assessment and reporting requirements and provide climate reporting through the Task Force on Climate-Related Financial Disclosures (TCFD).

The Bank seeks to identify, measure, monitor and mitigate various investment risks in its investment decision making and portfolio management processes. This is primarily achieved by comprehensive risk assessment of the proposed investments during investment origination and active risk monitoring of the investments in the Bank's portfolio. The Investment Risk team conducts thorough independent risk analysis and evaluation of all investment proposals presented by the investment team and aims to minimise the Bank's losses by identifying and measuring the key risks and mitigants present.

Partnership and engagement

Our ambition is to be a trusted and credible Impact Investor at the forefront of using insights collaboratively to transform markets.

We operate within a complex landscape of key stakeholders within the public, private and third sectors and can play a pivotal role in catalysing change.

We have established strong relationships with those representing the Scottish Government and other public bodies. This will aid us in our role as a development bank in understanding the areas of market failure across the Scottish economy that form part of our active origination strategy. We will seek to increase the role of impact investment in Scotland as a whole, through our investments and the delivery of insights.

Reporting

We operate an annual reporting cycle and report on the financial performance of our investment portfolio through our Annual Report and Accounts.

One of our core objectives is to develop leading investment impact assessment and reporting capability. This will ensure we can demonstrate the impact that is being enabled by our investment. To support this ambition, we produce an annual Impact Report that demonstrates how we are using our investment activity to deliver against our missions and wider impact objectives.

Both reports can be found on the Bank's website.

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