PROTECTING OUR FUTURE

Task Force on Climate-related Financial Disclosures (TCFD)
Report 2021
INTRODUCTION

With environmental, social, and governance (ESG) issues becoming critical for investors who are looking to make responsible investment decisions, the Task Force on Climate-related Financial Disclosures (TCFD) provides an important framework for companies:

To help identify the information needed by investors, lenders and insurance underwriters to appropriately assess and price climate-related risks and opportunities.

To make recommendations for consistent company disclosures that will help financial market participants understand their climate-related risks.

In 2017, the TCFD published its initial recommendations, as outlined by the Financial Stability Board. These were subsequently updated in 2021 to provide further guidance for organisations seeking to establish relevant metrics, targets and transition plans around their climate-related risks and opportunities.

Further information on the TCFD recommendations can be found at https://www.fsb-tcfd.org/recommendations/

This is the Scottish Widows Group inaugural annual TCFD Report and is intended as a supplement to our 2021 Annual Report and Accounts.

Read the Lloyds Banking Group Climate Report 2021

At 31 December 2021 Scottish Widows Group Limited was a wholly owned subsidiary of Lloyds Banking Group plc (the Group). Lloyds Banking Group plc, a company registered in the UK, is quoted on the London Stock Exchange and the New York Stock Exchange and is one of the largest companies in the FTSE 100 index of leading UK companies.

Scottish Widows Group Limited and its subsidiaries form part of the Lloyds Banking Group Insurance & Wealth Division.

Scottish Widows Group Limited has an interest in the life assurance, pensions and workplace savings sectors through its 100% investment in Scottish Widows Limited and its subsidiaries Scottish Widows Administration Services Limited and Scottish Widows Europe S.A. Its interest in general insurance is through its 100% investment in Lloyds Bank General Insurance Holdings Ltd, which owns Lloyds Bank General Insurance Limited and St Andrew’s Insurance plc. It also has an interest in the management of Individual Savings Accounts (ISAs) and Open Ended Investment Company (OEIC) sub-funds through its investments in the Authorised Corporate Directors, Scottish Widows Unit Trust Managers Limited and HBOS Investment Fund Managers Limited.
Helping customers invest their money in a more sustainable future

Scottish Widows’ founding mission was to help our customers face an uncertain future. This mission remains as important to us today as it was during the 1800s. We want to help customers invest their money in a more sustainable future, meeting the needs of today without compromising tomorrow.

We look after the retirement savings of millions of people and our role is to help them plan for long-term financial prosperity and build their financial resilience. Scottish Widows Group also plays an essential role in underwriting the home insurance propositions sold under some of our other Group brands. We’re on a mission to support our Home Insurance customers, promoting more sustainable, lower carbon repairs and improving flood resilience.

As a result of the customers we support, we have a responsibility to take action on the climate agenda whilst there’s still time to make a difference – this includes considering the risks and opportunities that will occur along the way as well as advocating for change in the industry and government.

In conjunction with other major asset owners and the United Nations (UN), we’re using our investments to encourage companies to change and move toward net zero emissions before 2050. Scottish Widows is a key member of the Institutional Investors Group on Climate Change (IIGCC) and by the end of 2021, more than 370 members (mainly asset owners and asset managers) have joined us in this initiative, with €50 trillion in assets under management in scope.

Over the past 12 months, following the announcement of our net zero commitment, we’ve continued to share our ambitions in this space with our Responsible Investment and Stewardship Framework, the financed emissions baseline of our current portfolio and our Climate Action Plan.

And today, we are continuing with this transparency by publishing our first annual Scottish Widows TCFD Report, providing a summary of the TCFD recommendations and our progress against these. I’m proud of the progress we’ve made so far and excited by the prospect of what we’ll achieve as we move forward, both in delivering for our customers and the wider society.

Antonio Lorenzo
Chief Executive, Scottish Widows

“We’re using our investments to encourage companies to change and move toward net zero emissions before 2050.”

Read our Strategy on Page 6
### Executive summary

**SUMMARY OF TCFD RECOMMENDATIONS AND OUR PROGRESS AGAINST THESE**

We are continuing to make progress against the TCFD recommendations, however, progress still needs to made due to transitional challenges in obtaining relevant data and embedding climate modelling capabilities.

In particular, these challenges impact:
- **Scenario Analysis (resilience of strategy)** – Describe the resilience of the organisation’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario
- **Metrics & Targets** – Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process
- **Metrics & Targets** – Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

#### Recommended disclosures

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Summary of progress</th>
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</thead>
<tbody>
<tr>
<td>Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long-term</td>
<td>We have prioritised our activities around net zero ambitions associated with achieving net zero in our own operations by 2030 and for the activities of those we finance by 2050, with interim ambitions set for 2030</td>
</tr>
<tr>
<td>Describe the impact of climate-related risks and opportunities on the organisation’s businesses, strategy, and financial planning</td>
<td>We have described the key climate-related risks and opportunities identified to date and defined our short, medium and long-term time horizons</td>
</tr>
<tr>
<td>Describe the resilience of the organisation’s strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario</td>
<td>Over the medium to long-term, transition risk on our investment portfolio is significant but an orderly transition to net zero would provide an opportunity for better customer outcomes. Physical risk will manifest over all time periods</td>
</tr>
</tbody>
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#### Metrics and Targets

<table>
<thead>
<tr>
<th>Metrics and Targets</th>
<th>Summary of progress</th>
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</thead>
<tbody>
<tr>
<td>Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process</td>
<td>We have published our initial 2019 financed emissions baseline to track progress against our commitments</td>
</tr>
<tr>
<td>Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks</td>
<td>We have disclosed a metric on flood risk exposure for the Home Insurance business underwritten by Scottish Widows</td>
</tr>
<tr>
<td>Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets</td>
<td>Scope 1, 2 and 3 operational emissions are calculated at a Group entity level and are provided in the Lloyds Banking Group Climate Report</td>
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</table>

#### Governance

<table>
<thead>
<tr>
<th>Governance</th>
<th>Summary of progress</th>
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</thead>
<tbody>
<tr>
<td>Describe the board’s oversight of climate-related risks and opportunities</td>
<td>Our governance structure provides clear oversight and ownership of the sustainability strategy and management of climate risk at Board and Executive levels</td>
</tr>
<tr>
<td>Describe management’s role in assessing and managing climate-related risks and opportunities</td>
<td>The Board is engaged on a regular basis on our sustainability agenda and in 2021, received training to continue to develop understanding of climate risk</td>
</tr>
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</table>

#### Risk Management

<table>
<thead>
<tr>
<th>Risk Management</th>
<th>Summary of progress</th>
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<tbody>
<tr>
<td>Describe the organisation’s processes for identifying and assessing climate-related risks</td>
<td>We have continued to embed climate risk into our activities and enterprise risk management framework, through consideration of climate risk as its own principal risk, and integration into other principal risks materially impacted</td>
</tr>
<tr>
<td>Describe the organisation’s processes for managing climate-related risks</td>
<td>In 2021 we have introduced the Group Climate Risk Policy to provide an overarching framework for the management of climate risks and opportunities across the Group</td>
</tr>
<tr>
<td>Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation’s overall risk management</td>
<td>Ongoing development of climate risk assessment tools and methodologies</td>
</tr>
</tbody>
</table>
About Scottish Widows

HELPING PEOPLE PLAN FOR THEIR FINANCIAL FUTURES FOR OVER 200 YEARS

Scottish Widows was set up in 1815 to take care of women and children who lost their fathers, brothers and husbands in the Napoleonic Wars, taking its name after the people it was founded to look after. Now more than 200 years on, we look after almost six million customers across the UK. Today our commitment is still the same — to help people plan for their financial futures.

Taking on the future together

That purpose is more important than ever in a world where COVID-19 has dramatically altered our ways of living and working, and the consequences of climate change are already having a profound impact on our environment.

As part of the UK’s largest financial services group, we can make a real difference to tackling climate change by helping to finance a greener future together. This will require not only new ways of thinking, living and working, but new ways of investing too.

We know there’s an urgent need to transition to a low carbon future and to grow the green economy, both for the prosperity of the UK and to safeguard our customers’ investments and financial futures. This presents us with opportunities to participate in and influence this transition for the long-term benefit of our customers.

That’s why we’re setting ourselves an ambitious goal to decarbonise all our investments by 2050, backing climate solutions and using our engagement and shareholder voting power to drive companies to make the changes necessary within this timescale.
Our ambitions

SCOTTISH WIDOWS AMBITIONS, ALIGNING TO OUR WIDER GROUP'

The need for change
Climate change is one of the biggest issues facing society today but we still have time to change course if we take action now.

As part of the UK’s largest financial services group, we can make a real difference to tackling climate change by helping to finance a greener future together. This will require not only new ways of thinking, living and working – but new ways of investing too. We know there’s an urgent need to transition to a low-carbon future and to grow the green economy, both for the prosperity of the UK and to safeguard our customers’ investments and financial futures. This presents us with opportunities to participate in and influence this transition for the long-term benefit of our customers.

How fast is the temperature rising?
The average temperature of the planet has risen by around 1°C since the Industrial Revolution. Scientists say this is a rapid change in terms of our global climate system. According to the Met Office, the five warmest years have all occurred since 2006*. Greenhouse gases can stay in our atmosphere for tens or hundreds of years and we can’t avoid some level of warming. But the increase we experience – beyond what’s already been caused – depends on the changes we make.

Reducing our operational and supply chain emissions
Scottish Widows operational Scope 1 and 2 emissions are included as part of our wider Group emissions and reported in detail within the Group’s Climate Report.

Our own operations
In 2021, our Group announced a new set of operational climate pledges, including a commitment to achieve net zero carbon operations across Scope 1 and 2 by 2030, against a 2018/19 baseline, while at the same time halving our energy consumption and maintaining travel-related carbon emissions from business travel and commuting below 50 per cent of a pre-COVID baseline. We are also embedding our response to natural capital preservation as part of our approach to sustainable operations by protecting our operational green spaces, through restoring natural ecosystems, decreasing human intervention and encouraging native species.

Our supply chain
For our suppliers, we have focused our efforts on understanding the carbon emissions generated through our sourcing activities and how we can positively influence a sustainable supply chain. We know that we cannot achieve our net zero ambitions without the support of our suppliers and in 2021 we have been developing our methodology for measuring our supply chain emissions. We are building our programme to further enhance sustainability considerations in our sourcing approach and to engage those suppliers that have the biggest impact on our carbon emissions with the aim of developing specific ambitions for reducing supply chain emissions and working collaboratively to achieve them.

For more on our own operations and supply chain see the Lloyds Banking Group Climate Report 2021.

Net zero ambitions

FINANCED EMISSIONS

Target halving the carbon footprint of our investments by 2030 on the path to net zero by 2050

OWN OPERATIONS

Net zero carbon operations by 2030

Reduce total energy consumption by 50% by 2030

Maintain travel carbon emissions below 50% of pre-COVID-19 levels

Reducing our operational and supply chain emissions

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For more on our own operations and supply chain see the Lloyds Banking Group Climate Report 2021.

*source: Met Office

1  Carbon footprint is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.

2 From 2019 baseline.

3 All from a 2018/19 baseline.
Our strategy

ALIGNING OUR STRATEGY WITH OUR AMBITIONS AND GOALS

As part of the UK’s largest financial services group, we can make a real difference to tackling climate change by helping to finance a greener future together. Our Strategy, ambitions and approach to risk management have been embedded to both support the global net zero transition and mitigate any adverse effects on our business or customers.

OUR AREAS OF FOCUS

1. Climate-related risks and opportunities over the short, medium, and long-term
We recognise the importance of embedding climate-related risks and opportunities into our strategy and operations and have undertaken a business wide review of where we expect climate to have an impact.

2. Partnerships, initiatives and collaborations
We participate in a number of industry initiatives, working alongside a wide range of stakeholders, including others in the insurance community, UK regulators and government departments.

3. Pensions and Investments
Our ambition
To be the leading UK pension provider that offers customers and colleagues sustainable investment choices and challenges companies we invest in to behave more sustainably and responsibly.

Our goals
- 2025 target to invest between £20bn – £25bn in climate-aware investment strategies, with at least £1bn invested into climate solutions investments*. To define climate solution investments, we look at the proportion of company revenue associated with activities such as alternative energy, energy efficiency, green building, sustainable agriculture, sustainable water, and pollution prevention. We use MSCI Environmental Impact Revenue data to help with this classification.
- 2030 target of halving the carbon footprint** of our investment portfolios.
- 2050 target of net zero across the entirety of Scottish Widows’ investments.

4. General Insurance
Our ambition
To be the leading UK insurer in improving the resilience of customers’ lives against extreme weather caused by climate change.

Supporting our sustainability commitments
- Propositions to Improve Flood Resilience.
- Reducing Carbon Emissions.
- Advocating Change Internally and Externally.

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*Climate-aware investment strategies: We’re working closely with our strategic fund management partners BlackRock and Schroders to develop and refine a range of funds that have a bias towards investing in companies that are adapting their businesses to be less carbon-intensive and/or developing climate solutions. We will invest in climate solution investments either within these strategies or other funds. To define climate solution investments, we look at the proportion of company revenue associated with activities such as alternative energy, energy efficiency, green building, sustainable agriculture, sustainable water, and pollution prevention. We use MSCI Environmental Impact Revenue data to help with this classification.

**Carbon footprint is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.
PHYSICAL RISK
Primary economic activities are sensitive to the consequences of climate change due to their significant dependence on the natural environment.

This type of risk can be further sub-divided into acute (event-driven) and chronic (longer-term shifts). Acute risks are extreme events, yet, if global warming is left unchecked, today’s extremes may become tomorrow’s new normal. Chronic risks arise from incremental changes. They take longer to materialise, but impacts are much more persistent.

Read more on Page 10

TRANSITION RISK
Key transition risks for companies include policy and legal risk, technology risk, market risk, and reputation risk due to policy or legal changes in support of meeting global carbon emissions targets.

These are risks associated with the evolution of local, national, regional and global economies towards being net zero. Transition risks are typically more pervasive than physical risks. However, there is also more opportunity for companies to influence and shape the broader response to transition risks.

Read more on Page 10
Our strategy continued

Climate-related risks and opportunities over the short, medium and long-term continued

Climate-related opportunities

Opportunities arise from the ability to invest in companies which are efficient with resources and energy transition, and those creating new sustainable products and services. We will continue to engage with our customers, asset managers and supply chain to realise the potential for a significant contribution in supporting the transition to a low carbon economy.

The efforts to mitigate and adapt our business will lead towards efficiencies and cost savings, and we have already seen the positive impact of low-emissions energy sources through the decarbonisation of our own operations.

Managing these risks and opportunities is key to not only ensuring our investments move towards net zero, but that they continue to deliver good growth for our customers.

Time horizon

The time horizon over which climate-related risks and opportunities will manifest and the scale of the potential impact will vary significantly across our operations. Consistent with other types of risk, the variability in the time horizon will be dependent on several different factors, some of which are in the control of our organisation and some of which are not. The ability to identify, measure and monitor the risks associated with climate change is integral to our Enterprise Risk Management Framework. This is consistent with other key risks that we manage, however, the time horizon to which climate risk will present itself may be a significantly longer time horizon than what we have previously experienced, which are set out below.

Read more on Page 33

The time horizon over which Scottish Widows categorises short, medium and long-term risks is as follows:

- **Short-term**: 0 - 1 YEARS
- **Medium-term**: 1 - 5 YEARS
- **Long-term**: 5 YEARS +

EFFECTS ON HEALTH AND LIFE EXPECTANCY

Global warming is increasing the frequency and duration of heatwaves; conversely there is an observed reduction in colder weather and likely corresponding decrease in cold-related excess deaths.

Although warmer weather may offer certain health benefits such as reducing cold-related mortality, fuel poverty and rising related energy costs may continue to jeopardise the survival of those most vulnerable in the community. However, these lives are less likely to have insurance, reducing the impact on our book. Amongst insured lives, the impact of these risks is likely to be more material for older lives meaning that our annuity book is more exposed than our protection or investment books.

As the number of people reaching extreme older age continues to rise, many with pre-existing medical ailments, the level of vulnerability to associated climate change health impact is likely to increase as climate change accentuates. Stressors on the health and social care system are also more likely to impact the elderly who are already more likely to require medical intervention. However, the impact of air pollution is likely to affect both the elderly and younger lives impacting both Annuity and Protection book and the impact of new diseases may have more of an impact on those of working age.
Our strategy continued

Climate-related risks and opportunities over the short, medium and long-term continued

Identified risks

Physical risk may impact our business through:

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property insurance risk</td>
<td>Potential for increased levels of claims due to damage to property caused by changes to weather patterns and climate (e.g. flood or storm).</td>
</tr>
<tr>
<td>Market and credit risk</td>
<td>The value of assets held by Scottish Widows will be affected by balance sheet performance of the underlying companies while government bonds values will be affected by economic performance. Damage and revenue disruption from extreme weather events could erode value on a short or long-term basis depending on the hazard type and the impact on the affected assets.</td>
</tr>
<tr>
<td>Data security</td>
<td>Potential risk if physical impacts result in IT or service failures across the Group and third-parties.</td>
</tr>
<tr>
<td>Business continuity risk</td>
<td>Potential cost and disruption due to physical (e.g. flood, heat) damage to Lloyd Banking Group’s estate, branch network, data centres etc.</td>
</tr>
<tr>
<td>Conduct risk</td>
<td>Disruption to customer service provision due to physical impacts on buildings, colleagues, IT services, or on the supply chain or external suppliers.</td>
</tr>
<tr>
<td>Mortality risk</td>
<td>Potential for people to die sooner than expected due to climate-related factors (e.g. temperature shocks and volatility or air pollution) resulting in increased life insurance claims.</td>
</tr>
<tr>
<td>Morbidity risk</td>
<td>Potential for people to become sick more often than expected or for longer than expected due to changes to climate (e.g. spread of vector borne disease, impact on resources or deteriorating air pollution) resulting in increased critical illness claims.</td>
</tr>
<tr>
<td>Longevity risk</td>
<td>Potential for reduced excess winter mortality due to warmer conditions, but conversely, increased heat-related deaths, resulting in some variation in the duration of annuity payments.</td>
</tr>
</tbody>
</table>

Transition risk may impact our business through:

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk</td>
<td>Risk of loss of value of shareholder or customer assets due to poor transition by asset providers; there will be winners and losers during the transition with more significant impact on those companies deemed to be less valuable in the new economy.</td>
</tr>
<tr>
<td>Credit risk</td>
<td>Corporate customers who are in sectors specifically exposed to the transition will see potential disruption to business models, impacts from upward pressure on carbon-related costs and likely increased expenses as they try and adapt. This will lead to changes in their balance sheets that ultimately increase the credit risk of lending to them.</td>
</tr>
<tr>
<td>Risks to our operations or that of our suppliers</td>
<td>Requirement to upgrade IT and buildings to mitigate climate impacts with high costs and potential impacts on employees/customers, including disruption to critical business processes, due to the level of change driven by climate adaptations and transitions required.</td>
</tr>
<tr>
<td>Litigation or regulatory risk</td>
<td>Risk from not delivering on public targets and commitments or clearly disclosing current position on climate or from poor management of customer/client exposures.</td>
</tr>
<tr>
<td>Regulatory risk from not meeting existing and upcoming climate risk</td>
<td>Driven regulatory requirements; new climate-related regulation may be costly to implement and lead to additional processes, data and resources, and diverging regulation across jurisdictions may add risk.</td>
</tr>
</tbody>
</table>

While the impacts above might be seen in the short to medium term, physical impacts are also expected on the following risks although they are harder to assess and unlikely to manifest materially for some years. The impact might be longer lives due, for example, to fewer deaths in winter, or shorter lives due to more deaths in high temperatures or from new diseases.

The speed with which the wider economy transitions and the extent to which we align with this will affect the level of exposure we have to these risks.
Scottish Widows recognises that we can be most effective through collaboration, and we continue to work with other external bodies, organisations and initiatives pursuing responsible investment and climate-related policy or advocacy initiatives.

The UK’s Asset Management Taskforce’s 2020 report, *Investing with Purpose*, recommended that a dedicated council of UK pension schemes ... to promote and facilitate high standards of stewardship of pension assets’ was needed to boost engagement. In response to this recommendation, the Department for Work and Pensions created an Occupational Pensions Stewardship Council in mid-2021. The Council provides pension schemes with a forum for sharing experience, best practice and research, and providing practical support. Scottish Widows have been an inaugural member of this Council, focusing on its ‘service providers’ strand, with a focus on Asset Managers with an intention to develop a stronger overall voice of trustees within the market and remove barriers to pension scheme voting.

We are also a member of the Association of British Insurers’ (ABI) Board and the Board’s Climate Change Sub-Group, as well as the Climate Change Working Group. The collaborative work of this group resulted in a publication of ABI’s climate change roadmap in summer 2021, covering short and medium-term decarbonisation milestones for the insurance sector, proposals on how insurers can provide one-third of investments needed to meet the UK’s decarbonisation targets and plans to support customers in making sustainable choices, and much more. Scottish Widows helped draft the IIIGC Net Zero Investment Framework, published in 2021, leading on the Listed Equity & Corporate Fixed Income Working Group. Since publication, several members of our responsible investment team have been participating in working groups focussing on developing detailed guidance on climate solutions, material emissions and stewardship engagement for users of the Net Zero Investment Framework.

In addition to the net zero working groups, we also participate in efforts to inform policy by collaboratively writing to governments.

The following are just a couple of examples:

1. Signatories to the 2021 Global Investor Statement to Governments on the Climate Crisis, ahead of COP26, asking governments to take specific and immediate actions to meet the Paris Agreement goals. 2. Signatories to the two parallel letters to UK and EU governments, urging them to deliver a clean, just and sustainable recovery from COVID-19, thereby providing the basis of a more inclusive and resilient economy.

Over 200 organisations worldwide have adopted the four Principles for Sustainable Insurance, including insurers representing more than 25% of world premium volume and USD 14 trillion in assets under management.

Principles for sustainable insurance

Launched at the 2012 UN Conference on Sustainable Development, the UN Environment Programme Finance Initiative (UNEP FI) Principles for Sustainable Insurance (PSI) serve as a global framework for the insurance industry to address ESG risks and opportunities.

Endorsed by the UN Secretary-General, the Principles have led to the largest collaborative initiative between the UN and the insurance industry — the PSI Initiative. Over 200 organisations worldwide have adopted the four Principles, including insurers representing more than 25 per cent of world premium volume and $14 trillion in assets under management. The Principles are part of the insurance industry criteria of the Dow Jones Sustainability Indices and FTSE4Good.

The vision of the PSI Initiative is of a risk aware world, where the insurance industry is trusted and plays its full role in enabling a healthy, safe, resilient and sustainable society. The purpose of the PSI Initiative is to better understand, prevent and reduce ESG risks, and better manage opportunities to provide quality and reliable risk protection.

Our in-house weather modelling and sustainability teams formed part of an industry working group with other PSI Initiative members to produce a report on piloting the TCFD recommendations with a focus on medium to long-term scenario analysis.

The report, published in January 2021, discusses the overall climate change risk assessment approach, outlines key findings across various lines of business, provides insights on an integrated insurance risk framework for climate-related disclosures, and suggests additional actions to further enhance climate risk management and disclosures in the insurance industry.
Our strategy continued

3 PENSION AND INVESTMENTS

Our mission
Our ambition is to align all our investments with limiting global warming to 1.5°C above pre-industrial levels by targeting net zero carbon emissions, by 2050 at the latest.

‘Net zero’ refers to achieving a balance between the amount of greenhouse gases, such as carbon dioxide, emitted into the atmosphere and the amount removed from it.

Emissions referred to are Scottish Widows’ Scope 3 ‘financed emissions’ which are calculated from the Scope 1 and 2 emissions generated from our investments or lending.*

To achieve our mission, we have set ourselves the following targets and milestones:

### 2025
- Invest £20 – £25 billion in climate-aware investment strategies**, with at least £1 billion invested into climate solutions investments*

### 2030
- Halve the carbon footprint*** of our investment portfolios

### 2050
- Net zero across the entirety of Scottish Widows’ investments

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**Carbon credits and offsetting on the journey to net zero**

Net zero strategies should prioritise carbon reduction in line with science, ahead of considering the use of carbon credits to offset emissions. While carbon credits can be an important tool in combating climate change if used responsibly, it is important that such credits are deployed as part of an ambitious, science-based decarbonisation plan.

Our financed emissions capture the emissions attributable from our investment activities. We do not currently plan to use carbon credits to offset our financed emissions and we will monitor and contribute to emerging industry standards in this area as they develop. However, we will engage with investees both directly and via our asset managers to encourage them to develop their own net zero plans, which may involve them using carbon credits for offsetting residual emissions for some of their activity, where applicable and in line with science.

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*For more information on emissions calculation see page 18.

**Climate-aware investment strategies: We’re working closely with our strategic fund management partners BlackRock and Schroders to develop and refine a range of funds that have a bias towards investing in companies that are adapting their businesses to be less carbon-intensive and/or developing climate solutions. We will invest in climate solution investments either within these strategies or other funds. To define climate solution investments, we look at the proportion of company revenue associated with activities such as alternative energy, energy efficiency, green buildings, sustainable agriculture, sustainable water and pollution prevention. We use MSCI Environmental Impact Revenue data to help with this classification.

***Carbon footprint is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.

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For further detail on our Climate Action Plan which outlines our current plans for action on climate change with regard to our overall portfolio. As best practice evolves, so too will this Climate Action Plan and our actions to implement it.
Pension and investments continued

**SCOTTISH WIDOWS ENVIRONMENTAL FUND**

In 2021 we launched our refreshed Scottish Widows Environmental Fund. The fund, which dates back to 1989, is now fossil fuel-free and UK-centric with the objective to deliver both positive financial returns and environmental impact. It has a dual approach; invest in companies which make a positive impact on the environment through their products and services, and invest in environmental leaders – companies making a difference with their progressive policies. Investors in this fund are therefore investing in companies directly contributing to better outcomes and a more sustainable environment as well as best-in-class companies from outside of the green economy.

**Environmental impact**

These companies contribute directly to better environmental outcomes through their products and services. They have a large proportion of revenue directly associated with facilitating a cleaner, more sustainable, human-built and natural environment. Companies that fit into this category can often be at an earlier stage of maturity — in other words they tend to be small or medium in size — and involved in more capital-intensive research or development than more mature companies.

**Environmental leaders**

These companies are ‘best-in-class’ when it comes to having sustainable environmental policies which relate to their business. These companies can come from any sector (energy, consumer goods, financials, telecommunication services, etc.) and they will not typically be specifically targeted at the green economy.

 Nonetheless, these companies play an important role in environmental protection through, for example, living up to their progressive policies and procedures that:
  - Ensure they have responsible sourcing of sustainable natural resources in their own supply chains
  - Don’t facilitate environmental harm through commercial lending, insurance or other financial products
  - Promote environmentally responsible consumer behaviour in their products or services through activities such as product recycling or making net zero corporate commitments

**Fossil fuel exclusions**

Crude oil, coal and gas are fossil fuels. They were formed over millions of years from the remains of dead plants and animals. Because of their origins, fossil fuels have a high carbon content. For more than a century, burning fossil fuels has generated most of the world’s energy. They provide electricity, heat and transport, as well as feeding the processes that make a huge range of products from steel to plastics.

But we’re paying the price. Using fossil fuels for energy has taken an enormous toll on the environment — from air and water pollution to global warming, as well as all the negative impacts from petroleum-based products such as plastics and chemicals. So, in this fund, we won’t invest in any companies that derive revenue from fossil fuels. This includes extraction, production, supply, generation, owning reserves or receiving revenue from fossil fuels. In addition, we exclude companies that receive revenue from nuclear energy, including nuclear uranium mining.

**Environmental impact themes**

- **Energy transition**
  - Companies whose technologies contribute to or assist the transition to low carbon energy.
  - Examples: Wind, solar, energy storage, fuel

- **Environmental infrastructure**
  - Companies that finance, build or operate energy infrastructure that contributes to supporting a net zero world.
  - Examples: Wind farms, solar farms, anaerobic digestion, energy from waste assets

- **Environmental industry**
  - Companies whose products or services reduce the environmental impact of industrial activity.
  - Examples: Clean air catalyst technologies, LED lighting, thermal and water management, building insulation

- **Low carbon consumer**
  - Companies that enable consumers to live more sustainably.
  - Examples: Use of recycled/recyclable packaging, plant-based products, sustainable land management policies

- **Circular economy**
  - Companies involved in the use of, and investment in, recycling technologies.
  - Examples: Recycling and waste management technologies, energy from waste

*Excludes companies deriving revenue from: fossil fuel reserves (if there is evidence of ownership), fossil fuel extraction and production (if companies receive any revenue from thermal coal, oil and gas extraction and production), fossil fuel processing and supply (if companies received any revenue from thermal coal or oil and gas value chain), fossil fuel power generation (if companies receive any revenue from fossil fuel power generation), nuclear power generation, nuclear energy (if companies receive any revenue from nuclear energy, including nuclear uranium mining, or those that do not meet Scottish Widows’ other house exclusions policies – i.e., contaminated weapons and UN Global Compact violators (below 0.5% materiality threshold).
Our strategy continued

4

GENERAL INSURANCE

Scottish Widows plays an important role in underwriting the home insurance propositions for our parent Group; whose ambition is to be a leading UK insurer in improving the resilience of customers’ homes against extreme weather caused by climate change.

Three strand approach

Our strategy is split into three separate, yet interlinked, strands.

1. Propositions to improve flood resilience
   The increasing occurrence and devastating impacts that flooding is having on our customers has resulted in us making flood resilience a priority. We recognise our responsibility to improve future flood resilience amongst those customers’ worst affected. Our approach to achieve this involves investigating what we can do to reduce susceptibility to flooding, changing our approach to claims and ensuring the technology used by external partners is appropriate.

   Property flood resilience measures are being introduced to reduce the number of customers susceptible to flooding, including flood gates, a removable flood defence product which can be quickly deployed to protect from flash flooding. Other measures include the use of self-closing air bricks and raising white goods where necessary. In order to identify the most appropriate measures for our customers we are onboarding specialist flood surveyors to support our Build Back Better initiative.

   During the claims process we have recognised the opportunity to improve the flood resilience of our customers’ homes at the greatest risk of re-flooding. Our Build Back Better initiative (backed by Flood Re) is a commitment to spend up to £10,000 on specialist flood surveys and fitting property flood resistance and/or resilience measures following eligible flood claims. Property flood resilience measures are expected to be offered to c.600 customers per year. We have an anticipated launch date of mid-2022 pending Parliamentary approval for Flood Re to offer the scheme.

2. Reducing carbon emissions
   To achieve our ambition of reducing the carbon emissions of the Insurance business, we believe that while much of this is in our control through our claims process, there is also the potential to encourage our customers to think about the changes they can make to reduce their own carbon footprint. Our hope is that by developing a green home insurance proposition we can achieve this. Assessments of our existing suppliers’ environmental impact, considering sustainability in our procurement process and exploring the potential to incentivise our customers to repair over replace where possible will improve the sustainability of our claims fulfilment.

   Secondly, we will be piloting our app, My Carbon Manager, which will allow our customers to identify home improvements that will reduce the carbon emissions of their home. Other ways we will reduce our carbon footprint is by employing sustainable infrastructure, reinstating properties to best practice sustainability levels (e.g. heat pumps and solar panels) and working with our colleagues to minimise the carbon footprint of the Insurance and Protection business.

3. Advocating change internally and externally
   In order to make a real difference, we believe that everyone has a responsibility to change their approach towards sustainability. Externally, we are building lasting relationships with environmental groups and experts, who are supporting us by delivering training and embedding sustainability into our leadership roles. We have also identified the need to advocate change within policymaking, leveraging our relationships with government and industry to influence policy in the areas of flood resilience and sustainability.

   Educating our colleagues is vital to delivering change internally, therefore, we have been actively working alongside our culture team to be able to engage and educate our colleagues on sustainability matters, highlighting opportunities for them to act more sustainably.

   Internal research outlined the key areas of focus and best practice in the market regarding sustainability in insurance companies. This has allowed us to benchmark our performance against peers and identify where improvements can be made.
GENERAL INSURANCE WEATHER MODELLING TEAM

In-house expertise on physical risk is retained in the form of a dedicated weather modelling team.

The team was created in 2016 and comprises of catastrophe modelling and environmental hazards specialists in fields including meteorology and hydrology. One of the team’s primary functions is to determine a credible view of weather-driven perils to be applied in both pricing and solvency capital estimation. The team extensively evaluates a number of catastrophe models with appropriate adjustments to represent the portfolio and construct a view of weather risk.

The team maintains links with academia in order to bring cutting edge research and knowledge into the business. An example of this includes the Knowledge Transfer Partnership conducted from 2018–20 with Reading University on the subject of correlation between flood and windstorm perils in the UK. This is a relatively under-researched subject, and therefore, represented a valuable contribution to both academic research and to the business.

As well as academic knowledge, the team seeks to utilise public sector data that might not commonly be used within the insurance industry, to complement traditional catastrophe model data.

The team also seeks to engage with the wider industry and public sector, engaging heavily with Flood Re since its inception, and has been active in government lobbying on areas of public environmental policy, such as flood risk management.

Regarding climate change, the team have studied the latest state of climate science as it applies to UK weather-driven perils, including multiple literature reviews.

This work has translated into business benefits in the areas of solvency capital estimation, and more recently in stress testing, including the 2021 Climate Biennial Exploratory Scenario (CBES) stress test exercise ran by the Bank of England. This climate change research and knowledge allows improved incorporation of climate data into catastrophe models — a field which is still in its infancy.

MY CARBON MANAGER

Making it easier to go green with home insurance

Customers making a claim for a large leak or significant water damage where home renovations are needed, will be given the option of accessing an app called My Carbon Manager, which shows people how to make their lives more energy efficient.

The tool provides personalised suggestions and estimates on how to reduce their home’s carbon footprint. Customers can use the app to see estimates for costs and savings and how carbon dioxide equivalent emissions could potentially be reduced. The tool is a one-stop guide on how to make their homes more environmentally friendly before looking for suppliers for repair work. All suggestions will depend on the type of property and claim but could include options such as insulating walls or having solar panels fitted.

The app has been created by Ideavate, as part of a programme to support start-up companies. The service was piloted for six months from July 2021 and is now being rolled out more widely for other types of large home insurance claims that need home renovation to be done, such as a large fire or flood.
Over 2021 we have focused on expanding our climate-related metrics, not just for disclosure but for internal management and monitoring of the risks faced. This includes the construction of value adding risk appetite statements that we will regularly report to our Board and internal metrics which can be used to monitor progress as we transition to 2030 and beyond.

We intend to expand on the metrics we disclose in future reporting as our capability improves. Potential areas for future disclosure could include an assessment of our portfolios against alignment to the Paris Agreement and scenario-based analysis of the sectors and assets our investments are exposed to.

Scottish Widows operational Scope 1 and 2 emissions are included as part of our wider Group emissions and reported in detail within the Group’s Climate Report.
Our investments' carbon footprint is the principal metric for measuring our investment portfolio's financed emissions and monitoring progress towards our 2030 and 2050 targets. The footprint is the tonnes of GHG emissions 'owned' by the portfolio. This is measured as carbon dioxide equivalents (CO2e) 'owned' per £1 million invested.

We’ve selected 2019 to be the baseline year in line with the science-based recommendations of the Intergovernmental Panel on Climate Change and guidance from the IIGCC. To calculate a reduction of emissions produced by the companies in our investment portfolios, we’ve used the emerging industry standard for calculating financed emissions developed by the Partnership for Carbon Accounting Financials (PCAF).

PCAF is an international industry-led initiative to measure and disclose the GHG emissions financed by loans and investments. It’s now recognised as the most widely adopted global standard for measuring financed emissions by the financial sector, referred to here and across the industry as ‘financed emissions’. Where possible, we have adopted the guidance afforded by the PCAF standard across all material asset classes where published methodologies have been made available.

To establish emissions data for corporate bonds and equities, we matched our investments against the published emissions data available on those companies from S&P Global Trucost’s data and analytics tool. Trucost provides carbon and environmental data and risk analysis for more than 15,000 companies. However, there is a lack of published emissions data on loan investments. Therefore, we adopted an alternative PCAF-aligned approach to calculate emissions using estimates from the Office for National Statistics and Department for Business, Energy and Industrial Strategy sector averages.

Example of how we calculate emissions financed by our investment

<table>
<thead>
<tr>
<th>SW Investment</th>
<th>Total enterprise value*</th>
<th>Total company emissions**</th>
<th>Financed emissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>£160m</td>
<td>£4,000m</td>
<td>2.8 MtCO2e</td>
<td>0.1 MtCO2e</td>
</tr>
<tr>
<td></td>
<td></td>
<td>700 tCO2e per £1m invested</td>
<td></td>
</tr>
</tbody>
</table>

*Market cap + book value of debt and minorities' interests
**Scope 1 + Scope 2
### Metrics and targets continued

#### What emissions do we calculate?

Emissions are classified into three distinct ‘scopes’, as defined by the GHG Protocol Corporate Standard, which covers the different kinds of carbon emissions a company creates in its own operations and in its wider value chain. Scope 1 and 2 emissions are a mandatory part of reporting for many organisations across the world and relate to emissions that a company makes directly, for example, while running its boilers and vehicles, and those made indirectly, like when the electricity or energy it buys for heating and cooling buildings is being produced on its behalf. Scope 3 emissions are those that are more external to a specific organisation, such as from buying products from its suppliers and from its products when customers use them. Our baseline represents Scottish Widows’ Scope 3 financed emissions which is calculated from the Scope 1 and 2 emissions generated from our investment or lending.

#### Total financed emissions

<table>
<thead>
<tr>
<th>Policyholder</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total assets under management (AUM) (£m)</strong></td>
<td>143.1</td>
</tr>
<tr>
<td><strong>AUM in scope according to PCF methodology (£m)</strong></td>
<td>126.7</td>
</tr>
<tr>
<td><strong>In-scope AUM for which emissions are available (%)</strong></td>
<td>76%</td>
</tr>
<tr>
<td><strong>Estimated total MCO₂e (Scope 1 and 2 emissions, for investments where data is available)</strong></td>
<td>11.0</td>
</tr>
<tr>
<td><strong>Emissions per £m invested (where data is available) (tCO₂/£m Invested)</strong></td>
<td>116.6</td>
</tr>
<tr>
<td><strong>PCAF Data Quality Score</strong></td>
<td>2.1</td>
</tr>
</tbody>
</table>

#### PCAF methodology applied

<table>
<thead>
<tr>
<th>Emissions data</th>
<th>Policyholder</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>% of reported portfolio</strong></td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Financed emissions MCO₂e</strong></td>
<td>11.0</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Emissions per £m invested</strong></td>
<td>116.6</td>
<td>112.3</td>
</tr>
<tr>
<td><strong>PCAF data quality score</strong></td>
<td>2.1</td>
<td>3.7</td>
</tr>
</tbody>
</table>

#### Notes on tables

- Only asset types where a PCAF-aligned methodology exists, and where we have access to the data required to meet the PCF standard, have been included within the above emissions baselines. For listed equity and corporate bonds, we have followed PCF methodology 5.1 “listed equity and corporate bonds” to calculate emissions. For emissions data associated with loan investments, we have followed PCF methodology 5.2 “business loans and unlisted equity”. The exception to this is our infrastructure loan investments, as this asset type is not part of the PCF standard. Derivatives or securitised loans are also excluded on this basis unless data on the underlying loan portfolio is available enabling an alternative PCF methodology to be followed.

#### Assets not in scope of PCAF methodology 2019

<table>
<thead>
<tr>
<th>Policyholder</th>
<th>Shareholder</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Collateralised securities</strong></td>
<td>1.0</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Derivatives</strong></td>
<td>-0.5</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Government bonds</strong></td>
<td>12.2</td>
<td>5.9</td>
</tr>
<tr>
<td><strong>Cash</strong></td>
<td>3.7</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>16.4</td>
<td>8.9</td>
</tr>
</tbody>
</table>

#### Data quality score

The PCF standard outlines an approach to measuring the data quality of the emissions calculated and is specific to each asset class and align to the following classification. Further details of this can be found in the PCF methodology.

### PCF general data quality score card

<table>
<thead>
<tr>
<th>Score</th>
<th>Audited GHG emissions data or actual primary energy data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score 1</td>
<td>Non-audited GHG emissions data, or other primary data</td>
</tr>
<tr>
<td>Score 2</td>
<td>Averaged data that is peer/(sub) sector specific</td>
</tr>
<tr>
<td>Score 3</td>
<td>Proxy data on the basis of region or country</td>
</tr>
<tr>
<td>Score 4</td>
<td>Estimated data with very limited support</td>
</tr>
<tr>
<td>Score 5</td>
<td>Uncertain (40–50% error margin in estimations)</td>
</tr>
</tbody>
</table>
Limitations of PCAF methodology

Due to the nature of the calculations, we would expect short-term variation of the carbon intensity number generated by the PCAF standard. In any given year the metric is impacted by:

a) changes in reported emissions,
b) changes in enterprise value, and
c) our own investment activity.

In the example where equity markets are strong and the value of our investment increases in line with the enterprise value, this would drive a material reduction in carbon intensity even in the absence of any underlying change in the reported emissions of the company in which we are invested. Therefore, acknowledging this is a long-term target, it is important to study the medium-term trend from future reporting.

Scope 3 emissions

Scope 3 emissions include all other indirect GHG emissions (not included in Scope 2) that occur in the value chain of the reporting company. Scope 3 can be broken down into upstream emissions that occur in the supply chain (for example, from production or extraction of purchased materials) and downstream emissions that occur as a consequence of using the organisation’s products or services.

The comparability, coverage, transparency and reliability of Scope 3 data still varies greatly per sector and data source. Scottish Widows have used the S&P Global Trucost database as the source of Scope 3 emissions in line with Scope 1 and 2. Scottish Widows have used the S&P Global Trucost database as the source of Scope 3 emissions in line with Scope 1 and 2.

When it comes to Scope 3 of the companies we invest in, at this time we do not feel the data is robust enough or has wide enough coverage for us to be able to set targets using it. We will continue to watch the developments in data quality and will consider extending our portfolio targets to cover Scope 3 of our underlying holdings when there is market consensus on the appropriateness of available data.

The PCAF guidance for financial institutions is to report Scope 3 emissions for the oil, gas and mining sectors from 2021 onward and additional sectors will be added from 2024. In the years toward 2024, PCAF will monitor the data availability and impact for these additional sectors and will provide additional guidance on the reporting requirements.

Scope 3 financed emissions for oil, gas and mining sectors 2019

<table>
<thead>
<tr>
<th>Sector</th>
<th>Policyholder</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets under management (AUM) £bn</td>
<td>Estimated total MtCO2e (Scope 3 emissions, for investments where data is available)</td>
<td>Data Quality Score</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>6.8</td>
<td>26.0</td>
</tr>
<tr>
<td>Mining</td>
<td>3.5</td>
<td>14.5</td>
</tr>
<tr>
<td>Total</td>
<td>10.3</td>
<td>40.5</td>
</tr>
<tr>
<td>Policyholder</td>
<td>Shareholder</td>
<td></td>
</tr>
<tr>
<td>Oil and gas</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Mining</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Total</td>
<td>0.2</td>
<td>0.7</td>
</tr>
<tr>
<td>SW total</td>
<td>10.5</td>
<td>41.2</td>
</tr>
</tbody>
</table>

The table above shows the total assets under management and the estimated total MtCO2e (Scope 3 emissions, for investments where data is available) for oil and gas, mining, and total sectors. The data quality score is also provided for each sector.
Metrics and targets continued

GENERAL INSURANCE METRICS

Many of our customers have been impacted by weather events in the last few years, specifically from events which have led to claims from inland flooding, coastal flooding and storm damage.

Climate scientists predict that the frequency and severity of flooding could increase in coming years. For example, sea level in the UK could rise by up to one metre by the end of the century¹. This size of increase would likely affect the frequency and severity of our claims experience.

Being able to identify and monitor trends in the increased physical risks, through a variety of metrics, is therefore very important.

Properties in high-risk areas

Weather pricing models are used to inform how insurance premiums should vary across the book. The outputs are used to create a relative view of risk across the geographic domain of the book.

We assign properties risk bands from 1 to 30 to reflect the level of flood risk, with 1 being low and 30 being high.

We can use this banding to manage our exposure in high-risk areas. Increasing the proportion of our portfolio in bands greater than 20 could lead to significant increases in losses in the event of increasing severe events.

Other metrics

Average annual loss metrics are reviewed regularly to ensure that we’re not exposed to large potential losses from a small number of high-risk areas. While we are not disclosing these, we monitor these monthly and look to ensure there are no significant movements and have triggers in place to drive action as needed. We can actively manage our accumulation risk through reviewing our acceptance criteria and pricing strategy.

Internally, these and other metrics indicative of our exposure to river flood, coastal flood and windstorm events are reported monthly to senior committees for review and any necessary action.

% insured properties in high risk band (> Band 20) as at June Dec

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>June</td>
<td>Dec</td>
</tr>
<tr>
<td>Inland flood</td>
<td>4.3%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Coastal flood</td>
<td>0.7%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>

¹ Chapter 4: Sea Level Rise and Implications for Low-Lying Islands, Coasts and Communities – Special Report on the Ocean and Cryosphere in a Changing Climate (2019)
<table>
<thead>
<tr>
<th>Overview</th>
<th>Our strategy</th>
<th>Metrics and targets</th>
<th>Climate governance</th>
<th>Risk management</th>
<th>Scenario analysis</th>
</tr>
</thead>
</table>

Scottish Widows
TCFD Report 2021
Climate governance

ROLES AND RESPONSIBILITIES

Given the strategic importance of our sustainability ambitions and commitment in managing the impacts arising from climate change, our governance structure provides clear oversight and ownership of our sustainability strategy and management of climate-related risk.

Governance for climate-related risk has been embedded into our existing governance structure and is complementary to governance of our wider Group’s sustainability strategy, with key boards and committees meeting at least eight times in a calendar year. The governance structure will continue to evolve as we embed our approach to managing climate-related risks. During the course of 2021 two committees have been introduced:

Insurance Sustainability Committee
The Board of Directors as a whole is responsible for sustainability and has oversight via the Insurance Sustainability Committee chaired by Gayle Schumacher, an Independent Non-Executive Director. This is a committee of the Board of Directors of the entities which comprise the Insurance Board* and the Board of Directors of the entities which comprise the Authorised Corporate Director (ACD) Board**.

Responsible Business Executive Committee
The Responsible Business Executive Committee is chaired by Craig Thornton, General Insurance, Protection and Investments Director. It is responsible for recommendation and delivery of the ESG strategy for the Insurance Group (including stewardship activities across Scottish Widows’ investment book and other sustainability goals such as decarbonisation).

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Notes:
** The entities which comprise the ACD Board are Scottish Widows Unit Trust Managers Limited and HBOS Investment Managers Limited.
Climate governance continued

The Board is accountable for the Company's long-term resilience with respect to potential shifts in the business landscape that may result from climate change.

The Board also ensures that its composition is sufficiently diverse in knowledge, skills, experience and background to effectively debate and take decisions informed by an awareness and understanding of climate-related threats and opportunities. The Board maintain regular exchanges and dialogues with peers, policymakers, investors and other stakeholders to encourage the sharing of methodologies and to stay informed about the latest climate-related risks and regulatory requirements.

As the stewards for long-term performance and resilience, the Board determine the most effective way to integrate climate considerations into its structure and committees. The Board also ensures that management assesses the short, medium and long-term materiality of climate-related risks and opportunities for the Company on an ongoing basis and that the organisation's actions and responses to climate are proportionate to the materiality of climate to the Company.

The Board ensures that material climate-related risks, opportunities and strategic decisions are consistently and transparently disclosed to all stakeholders – particularly to investors and, where required, regulators. Such disclosures should be made in financial filings, such as annual reports and accounts, and be subject to the same disclosure governance as financial reporting.

Divisional roles and responsibilities

Our structure provides clear oversight and ownership of our sustainability strategy and management of climate risk across the three lines of defence, with dedicated teams in place focused on both these areas, including a number of new teams set up in 2021.

In the first line, our proposition teams are responsible for developing our strategic response to climate risk, including setting the business strategy, ambitions and product level response to support the Group’s sustainability strategy. The Finance division is responsible for the calculation of financial emissions and developing appropriate climate models for scenario analysis.

The Risk division (second line) is responsible for overseeing the climate risks arising from climate change and for ensuring alignment with regulatory expectations. This includes, ownership of climate-related methodologies and frameworks, including material assumptions to quantify climate risk and generate scenarios and stress testing, integration into risk management processes and setting the Climate Risk Appetite.

Internal Audit (third line) have established a team to focus on sustainability and climate risk. This team, supported by other subject matter experts, provides independent assurance to the Audit Committee and the Board. Internal Audit also attend key sustainability and climate risk governance committees and forums.

As we continue to further embed climate risk into the enterprise risk management framework, we will ensure that climate-related risks are considered as part of existing processes, aligned to the three lines of defence model:

• To support the Board, the purpose of the Insurance Sustainability Committee is to review and recommend the ESG strategy of the Insurance Group to the Board, to oversee the implementation of the broader sustainability activity, including our approach to responding to global issues of environmental sustainability, and to ensure the delivery of our ESG ambitions and commitments, including stewardship. They also provide oversight to the adoptions of codes, principles and standards, including those that are publicised externally, and regulatory disclosures

• Day-to-day accountability for sustainability rests with executive management. The purpose of the Responsible Business Executive Committee is to develop the ESG strategy.

Sustainable Investments

Provide direction for Responsible Investment activities across Scottish Widows’ investment book and support insurance funds (life, pension, shareholder and with-profit funds) in managing activities, to provide customers with sustainable investment choices, ensuring the long-term interests of Scottish Widows customers. Oversight of stewardship strategy and approval of annual stewardship report which supports challenging companies we invest in to behave more sustainably and responsibly.

Sustainable Operations

Review our operational activity and footprint, consider the scope of emissions and deliver on regulatory commitments and disclosures on climate risk.

Sustainable Propositions

Identify areas for innovation, where existing partners and third-party relationships may provide opportunities for meeting our evolving customer needs to improve the resilience of customers’ lives against extreme weather caused by climate change.

Sustainable Colleagues

On matters related to sustainability, provide direction and input on shaping our culture, training, internal communications and objective setting.

Oversight

The Chief Risk Officer has Senior Management Function responsibility for overseeing the management of risks from climate change across the Solvency II regulated entities.
Climate governance continued

Roles and responsibilities continued

Board membership capability

The Insurance Sustainability Committee is responsible for overseeing the development, delivery and embedding of the Insurance Group’s Environmental, Social and Governance (ESG) Strategy and its management of climate risk. The Committee’s core membership is made up of four Independent Non-Executive Directors (includes the Chair Gayle Schumacher), and Scottish Widows Chief Executive, Antonio Lorenzo, supported by:

James Hillman,
Finance Director

Clare Beale,
Chief Risk Officer

Craig Thornton,
General Insurance, Protection and Investments Director

Antonio Lorenzo
Having joined the Group in 2011 and appointed Scottish Widows CEO in 2016, Antonio is responsible for managing the business of the Insurance Group in accordance with the strategy and long-term objectives approved by the Insurance Board and within the parameters set out by Lloyds Banking Group. He has a wide and varied background in both banking and insurance and is a board member of the Association of British Insurers.

Gayle Schumacher
Gayle has over 25 years’ experience within the wealth and asset management industry as an investment specialist with a strong track record (in previous and current appointments) of driving growth through the implementation of prudent customer-focused strategies and cost-conscious operational management. She has a strong understanding of responsible investment and stewardship principles and an interest in Natural Capital and the importance of biodiversity. She is also highly experienced in the delivery of risk frameworks to effectively manage risk across investment mandates, providing oversight and challenge, and championing performance transparency & robust ESG strategies amongst third-party investment fund managers and suppliers.

John Reizenstein
John is an experienced financial professional with over 40 years’ experience in the financial services industry. He is experienced at leading highly complex, multi-functional finance and commercial divisions of insurance businesses through challenging circumstances and is comfortable in making strategic financial and operational decisions on the basis of data. As Risk Oversight Committee Chair, John supports and challenges management’s approach to TCFD compliance and sustainability reporting. John is a member of Chapter Zero and undertakes frequent training to develop his understanding of climate risk and reporting.

Sophie O’Connor
Sophie is a Fellow of the Institute of Chartered Accountants with more than 25 years’ experience in the financial services industry across banking, accountancy, investments, pensions and insurance sectors. She acknowledges the role which insurance firms must play in supporting global efforts to reduce climate risk, recognising that much work needs to be done to this end in terms of assets, liabilities, products and reporting. She is experienced at providing advice, oversight and challenge to management and control functions, including to ensure an effective audit and risk culture is embedded and maintained throughout the business.

Chris Moulder
Chris is a Fellow of the Institute of Chartered Accountants of England and Wales and is a senior finance and risk executive with over 20 years’ experience operating at board-level within a highly regulated environment. He is familiar with all elements of the risk management framework, from the strategic risk profile and risk appetite of the firm to the development of risk assessments at an operational level. He has a proven track record of providing sound strategic advice and the expert delivery of transformational change that has resulted in successful business outcomes and tangible and sustainable operational efficiencies.
KEY DECISIONS IN THE PAST YEAR MADE BY THE BOARD/COMMITTEES

The Board is engaged on a regular basis on our sustainability agenda, receiving regular briefings to build understanding and capability and attending relevant external briefings. Briefing sessions provided to our Boards share information on critical sustainability trends, stakeholder responses (e.g., government, regulators and investors) and strategic responses from a business perspective.

SETTING OUR STRATEGY

Net zero ambitions: As part of the IGCC, the Insurance Board agreed in February 2021 that Scottish Widows will target a 50 per cent reduction in the carbon intensity (across the investment portfolio of customer and shareholder funds) by 2030 and net zero by 2050.

Publication of our first Climate Action Plan which sets out our long-term strategy and actions to drive our investments towards net zero for the benefit of customers.

- Strengthening of our exclusions policy to minimise exposure to potential ‘stranded assets’ across our mandated funds (active and passive).
- Thermal coal and tar-sands: Revenue threshold reduced from 10 per cent to 5 per cent.

OVERSIGHT

Enhancement to corporate governance with the introduction of the Insurance Sustainability Committee and Insurance Responsible Business Executive Committee.

Embedding of climate risk into the risk management framework including setting Risk Appetite metrics for internal monitoring.

Insurance Board review and support for the qualitative and quantitative 2021 CBES stress test performed by the Bank of England.

METRICS AND TARGETS

Approval and publication of our financed emissions baseline used for monitoring progress towards our 2030 and 2050 targets (see page 16).

Approval of a 2025 target to invest between £20–25 billion in climate-aware investment strategies*, with at least £1 billion invested into climate solution investments*.

*Climate-aware investment strategies: We’re working closely with our strategic fund management partners BlackRock and Schroders to develop and refine a range of funds that have a bias towards investing in companies that are adapting their businesses to be less carbon-intensive and/or developing climate solutions. We will invest in climate solution investments either within these strategies or other funds. To define climate solution investments, we look at the proportion of company revenue associated with activities such as alternative energy, energy efficiency, green building, sustainable agriculture, sustainable water and pollution prevention. We use MSCI Environmental Impact Revenue data to help with this classification.
We are serious about embedding environmental sustainability into our culture and for all colleagues to understand the role they can play in managing climate risks, helping our customers and making a positive contribution individually to the transition to net zero.

To support this, in 2021 we have delivered:

**Board training**
Board training on climate change, climate-related risks and what this means in respect of our strategy; this was developed and delivered in conjunction with the University of Cambridge Institute for Sustainability Leadership (CISL).

**Leadership training**
A series of training workshops on climate risk and sustainability for leadership teams across the organisation, supported by CISL, to deepen knowledge and drive forward activity to embed sustainability into our day-to-day decision-making and strategic delivery; in addition, the University of Edinburgh’s Centre for Business, Climate Change and Sustainability led training for 30 colleagues who undertook their multi-week programme in Climate Change Risk in Finance.

**Colleague e-learning**
In 2021, a new colleague e-learning programme on sustainability was launched which all colleagues have been asked to complete. This course introduces the topic of climate change and includes a series of modules covering climate risk, our strategy, what we are doing across our business to support the transition to net zero and what colleagues can do to live and work more sustainably. It pulls together a range of internal and external resources that are available for our colleagues.

30 colleagues received specialised training
3,000+ colleagues received training

**REMUNERATION**
Remuneration is set at parent entity level and this year the Group Balanced Scorecard has evolved to bring greater focus on climate change ambitions and ensure the purpose of Helping Britain Prosper is at the heart of everything. The 2022 scorecard now includes two ESG measures that are aligned to climate change to reflect net zero ambitions. The measure on reducing operational carbon emissions remains and a new measure on sustainable financing and investment has been added. The scorecard and remuneration policies will continue to be reviewed taking into account market practices and strategy alignment.

For further detail see page 117 in the Lloyds Banking Group’s 2021 Annual Report and Accounts.
Climate governance continued

RESPONSIBLE STEWARDSHIP

Stewardship is the management of our investments to create sustainable benefits in the long-term for our clients, savers, the economy, the environment and society. It includes challenging the companies we invest in to behave more sustainably and responsibly. We hold shares on behalf of customers who invest with us which means we are a significant shareholder in many of the world’s companies. As a result, we’re the stewards of these investments and have a responsibility to manage and protect them in the best way possible.

Most of our customers will invest with us for decades and major risks that are on the horizon will impact their savings if we don’t act now. We have been a long-standing signatory of the UN Principles for Responsible Investment and are committed to being responsible stewards of the assets we oversee on our customers’ behalf. We strive to influence the companies we invest in to make positive changes.

Starting in 2021, our first stewardship priority of climate change has seen us focus our stewardship activity on selecting companies which are failing to address climate change risks. This is in line with our aspirations as a member of the IIGCC. We challenge our investee companies to report on the financial impact of climate change on their business, to improve their business practices and reduce their carbon footprint.

We additionally recognised those companies in our portfolio which have performed well in reducing their carbon footprints, providing positive feedback, and encouraging them to continue the hard work.

Our second stewardship priority is cognitive diversity on corporate boards; we believe that more diverse boards make better decisions and deliver stronger results in the long-term. In October 2021 we published a report Great Minds Don’t Think Alike in collaboration with Dr Johanne Ward-Grosvold, a senior lecturer at the University of Bath’s School of Management, to explore the challenges facing boards as they look to improve diversity and reduce groupthink in senior positions.

When we’ve a significant investment in a company and have concerns that their business practices are not aligned with the long-term interests of our customers, we’ll always engage with them first. Where we don’t see material progress, we’ll use our shareholder rights to challenge the company and will sell our shares where it is clear that progress won’t be made.

We delegate most of our shareholder voting to our fund manager partners. We work with them to understand their voting practices and monitor their voting activities. This ensures their approach to issues, like climate change, preserves or enhances the value of investments. We will act if we have material concerns.

We primarily delegate to our appointed investment managers the responsibility to conduct direct engagement with our equity and bond holdings. During 2020, at least one of BlackRock, Schroders and State Street Global Advisors engaged with companies accounting for over half of the AUM in equity and corporate credit. This engagement coverage increases to 79 per cent of AUM in high impact* sectors.

*High Impact sectors are as per GICs classification presented in IIGCC Net Zero Investment Framework Implementation Guide Appendix B.
RESPONSIBLE INVESTMENT FRAMEWORK

To ensure we consistently deliver sustainable investment decisions, we have developed our Responsible Investment Framework.

The Framework is now embedded into our overarching insurance investment policy and guides our decisions on asset allocation, manager selection and fund additions.

We are taking a series of steps over time to fully integrate this framework across our investments.

1. We will be a responsible investor. We will strive to protect our investments from material ESG-related risks and seek to capitalise on ESG-related opportunities.

2. To help us manage downside risk, we will take a position on the companies we will not support and will implement exclusions throughout funds managed or mandated by us.

3. We will aim to reduce the carbon intensity of our whole portfolio to 50 per cent by 2030 and achieve net zero by 2050.

4. We will aim to offer an industry-leading fund range to our customers to help support causes that are close to their hearts while growing their savings for the future.

5. We will seek to extend our responsible investment principles into all asset classes over time.

6. We will work with policymakers and industry participants to promote direct investment opportunities required to successfully transition to a lower carbon economy.
### Stewardship principles

1. **Additionality**
   - Stewardship over our asset managers, monitoring their engagement and voting activity so that we can override their voting plans and direct their votes, should the need arise.

2. **Collaborate and consult**
   - Collaborating with other asset owners and industry organisations like Climate Action 100+ and the IIGCC to drive positive change at the systemic level.

3. **Strong expectations**
   - Engaging directly with our larger holdings and maintaining ongoing dialogue to influence developments that impact the value of our investments.

### Stewardship approach

**Oversight and governance of asset managers**
- One of our responsibilities as an asset owner is to support and enable our asset managers to exercise their full range of shareholder rights, as we can achieve much greater progress by leveraging their stewardship resources and the collective stake we hold in investee companies. We also seek to ensure that the activity of our asset managers does not undermine our own activity and priorities as a steward. This is achieved through strong governance and oversight.

**Direct and collaborative engagement**
- Although we delegate authority for engagement to our asset managers as a matter of course, there are some circumstances in which we choose to engage with our investee companies directly, either because it is a key holding or we are engaging as part of a coalition with other investors.

**Contributing to well-functioning markets**
- Our global inter-connectedness leaves us vulnerable to the catastrophic impacts of systemic risks unless collaboration occurs across markets and governments to keep these risks at bay. We are involved in a number of market-wide initiatives to support low carbon transition and cognitive diversity on boards, as we believe that by collaborating with the wider industry, we can further strengthen our engagement with companies and policymakers.

### Exclusions policy

**A key tool to help enable our responsible investing aims is our exclusions policy.**

**Our exclusions policy states that we will not invest in companies who are in breach of the conditions set out. This policy is currently being implemented, starting with the active funds, with passive mandated funds to follow.**

Where we have a financially material holding (defined as >0.5 per cent of a relevant index) in a company that is in scope of the exclusions policy, the company will be flagged as a priority engagement target, where we will use the size of our holding to influence for change over a three-year period, following which the company will no longer be exempt from the exclusions policy and divestment will be considered.

At the end of 2020, we started a direct engagement process with the companies covered by this clause.

We are also engaging with external managers of pooled funds that we invest in where we have a large-scale investment and are encouraging them to implement our exclusions policy on a comply or explain basis.

Our exclusions policy will be reviewed annually and will develop in line with legislative and regulatory developments, customer expectations and market best practice.
Scottish Widows Group has a well-established and robust risk management framework used to identify, measure, monitor, manage and report on the risks faced by our business. Climate risk is now managed under this framework.
Risk management

OVERVIEW

Climate risk has been integrated into Scottish Widows Group’s existing risk management framework after considering how the effects of climate change will impact both our risk profile and our business model, by:

- Processes
  - Embedding new, or developing existing, processes for the identification and management of climate-related risk. This includes horizon scanning activities, risk appetite and scenario analysis.

- Updates to risk frameworks
  - Climate risk has been added to enterprise risk management frameworks as a primary risk.

- Risk drivers
  - Reflecting the impact of climate risk as a risk driver on all other risks within the enterprise risk management framework by engaging with key business stakeholders and either updating or setting new risks and controls.

- Climate risk policy
  - Creating a climate risk policy that provides an overarching framework and principles and requirements for the management of climate risks across the business. Insurance climate risk procedures aligned under this policy provide further guidance to the business on management of climate-related risks.

- Existing procedures
  - Developing our existing suite of policies and procedures by adding climate-related guidance when relevant to the management of the risk or underlying processes, strengthening our existing framework and ensuring that business decisions allow appropriately for climate risk.

- Risk appetite framework
  - The Risk Appetite Framework monitors the level and type of risk the business is willing to accept in delivering its business plan. In 2021, climate-focused appetite metrics have been set and approved by the Board. In addition, existing risk appetite metrics have been reviewed and updated to reflect our latest views on climate change.
To effectively identify all climate-related risks faced several different approaches are used.

**RISK IDENTIFICATION PROCESS**

Climate and environmental change has been included on the emerging risks register for some years. The details of the risk and its mitigants are reviewed and updated at least twice a year. Since the definition we use of emerging risks includes risks which are evolving, we expect it to remain on the register for some years. Executive owners are agreed for all risks to ensure the necessary mitigating actions and monitoring activity is carried out.

Our approach to risk identification includes consideration of environmental factors, including climate change, among the external sources of risk to be proactively identified. The impact and likelihood of these potential risks should be assessed in line with our enterprise risk management framework to understand the potential effects on performance and reputation.

We assess a number of factors to determine the materiality of these impacts, including customers, reputation, regulatory, financial losses, impact on business objectives, and impact on management time, resources and colleagues. These factors are relevant for consideration in assessing climate-related risks given that these risks may potentially impact a number of our traditional risk categories, while also impacting a broad range of stakeholders.

**HORIZON SCANNING**

The uncertain and long-term nature of the risks from climate change increases the importance of horizon scanning for these risks. Scottish Widows performs horizon scanning activities across several areas, and there is an expectation the focus on climate-related risks will increase as the information available improves. Examples of the horizon scanning performed include:

- **Weather and physical impacts**
  We carry out ongoing reviews of the impacts of climate change on weather risk by considering the latest published research and model predictions of climate change.

- **Demographic developments**
  Climate risk is registered as a threat to mortality, morbidity and longevity on our risk register. We review the latest medical journals and press releases and formally update it on a quarterly basis.

- **Regulatory Developments**
  We monitor the changing regulatory environment and actively participate in the ABI Climate Group.

**SCENARIO ANALYSIS**

To date our tools for identifying climate-related risks have been largely qualitative including horizon scanning of regulatory change and industry research. We have begun supplementing this with stress and scenario analysis, although this work is in its infancy. This includes climate stress testing the medium-term business plan and projections of financed emissions and contributing to the Bank of England CBES in 2021.

The outlook for climate change is rapidly changing as governments and companies are continually updating their commitments to tackle climate change and implementing policies to support these commitments. We continue to monitor these developments; for example, commitments to reduce methane emissions and deforestation were agreed at COP26.

We will develop our scenario analysis in recognition of the external environment and by enhancing our modelling capabilities with a view to disclosing appropriate results in future disclosures.

**MEDIUM TERM PLANNING**

Over 2021, we have developed a more detailed understanding of the risk and opportunities arising from climate risk and how they may impact on our medium-term business plans (1–5 years). This has included the following considerations:

- **Risk of increased weather events and the potential impact on our General Insurance liabilities and related capital, ensuring adequate solvency**
  The impact of our strategy under different climate scenarios and in particular, the reliance on the wider economy to transition to a low carbon economy

- **Opportunities for improved customer outcomes from investments with positive ESG credentials**

- **Consideration of required investment in business processes, data and tools to aid monitoring and reporting of key climate metrics**
  Read more in Scenario analysis section on Page 38
ASSESSMENT OF RISKS

Our risk management framework aims to help us identify, measure, monitor, manage and report the financial risks related to climate change with regular reporting to the Board to enable timely decisions to be taken.

Short-term risks and risks that have already crystallised are logged then continually monitored and assessed. This includes consideration of all risk drivers, including those relating to climate change, to ensure both inherent and residual risk ratings effectively reflect the true exposure.

In 2021, a series of focused workshops were held to assess the impact of climate on each risk-type with input from a wide variety of subject matter experts from across the business. Following these workshops, updates were made to the risks and controls recorded on our internal risk system.

In 2021, a series of focused workshops were held to assess the impact of climate on each risk-type with input from a wide variety of subject matter experts from across the business. Following these workshops, updates were made to the risks and controls recorded on our internal risk system.

ESG tool

One area where the assessment of transition risk is key is for assets within our shareholder funds. To aid this assessment, our in-house investment team will utilise an ESG tool developed in-house. The tool is being designed to generate an overall rating for individual clients based on industry and a series of questions to assess progress in embedding ESG into their business strategy. The rating provides an indication of where the customer is in terms of embedding climate risk into their business strategy and the credibility of their transition plan.

This is a sample of the key risks faced by Scottish Widows Group and is not exhaustive. It is intended to illustrate how we have further embedded climate-related risks into our framework. It will continue to be reviewed and evolve over time.
EMBEDDING CLIMATE RISK WITHIN OUR RISK MANAGEMENT FRAMEWORK

We have adopted a comprehensive approach to embedding climate risk into our enterprise risk management framework through:

- Consideration of climate risk as its own principal risk, to drive dedicated focus and a consistent approach, while enhancing Board-level insight
- Integration of climate risk into our other principal risks, to ensure comprehensive consideration across all aspects of our business activity

As its own principal risk, climate risk captures the risk that the Group experiences losses and/or reputational damage as a result of climate change, either directly or through its customers.

Group climate risk policy

The Group climate risk policy applies to all parts of Scottish Widows Group and its subsidiaries. The policy is structured around seven principles, with the corresponding requirements designed to support achievement of these principles, as well as supporting our external ambitions relating to climate change and the relevant regulatory requirements, including the TCFD recommendations.

PRINCIPLE 1

The Group will ensure climate risk is fully embedded through effective policies, procedures, processes, systems and controls.

PRINCIPLE 2

The Group will identify and assess potential climate risks and opportunities, including how these could impact on the Group’s strategy, external commitments, operating model and customer journeys.

PRINCIPLE 3

The Group will embed appropriate scenario analysis capabilities to support its understanding and proactive management of climate risk and opportunities.

PRINCIPLE 4

The Group’s strategy will consider climate risks and opportunities to support our customers and meet our strategic objectives.

PRINCIPLE 5

The Group will set appropriate Risk Appetite for climate risk against which it will operate.

PRINCIPLE 6

The Group’s governance structure will provide oversight of climate risk impacts, effective decision-making and timely escalation to senior management.

PRINCIPLE 7

The Group’s reporting will support monitoring and management of climate risks as well as the Group’s relevant strategic commitments, alongside appropriate disclosures to inform our external stakeholders.

Insurance climate risk procedures

Our Risk Committee have approved internal climate risk procedures which sit under the wider Group policy providing further guidance specific to the management of climate-related risks within the Insurance sector. It highlights where requirements differ due to a difference in operating model or where the focus is changed due to the climate risk related to customer funds. It cross references climate-related material in Group and Insurance-specific policies and procedure documents and provides clarity over the business units responsible for managing the relevant risks arising from climate change.
Existing risk preference statements have been updated to explicitly reflect the physical aspects of climate risk in underwriting risks and new statements have been added formalising our intent to:

- Avoid exposure to physical risk, or where this is not possible, appropriately allow for the risk
- Minimise exposure to transition risk, while recognising that the ability to meet our targets is dependent on changes in the wider economy
- Avoid litigation risk through failing to meet customer expectations

Embedding climate risk within our risk management framework continued

Insurance investment stewardship policy
Also introduced in 2020, this defines the stewardship and engagement policy which we undertake in support of our Responsible Investment Framework and our commitments to:

- Be responsible stewards of the assets we oversee
- Influence investee companies to engage in positive change
- Be strong and sustainable returns.

This policy was developed to meet the requirements of the Financial Conduct Authority (FCA) Policy Statement 19/13 (PS19/13) in relation to the Shareholders Directive II (SRD II) (COBS 2.2B) and the Financial Reporting Council (FRC) Stewardship Code.

Insurance underwriting policy
This policy requires that climate change be embedded in underwriting risk management processes including:

- Incorporating the effects of climate change in the demographic risk register
- Internal model development and improvement to incorporate the impact of climate change on both a short and long-term time horizon
- Monitoring of reinsurer stability with respect to climate change events

Reinsurance policy
As part of the assessment of new reinsurance arrangements, reinsurers’ exposure to climate risk should be considered in their approach to managing forward-looking climate risk.

Product Management policy
Supplementary guidance requires that climate risk, in particular the associated conduct risk, is specifically considered at all stages in the product lifecycle.

Stress Testing Procedures
Climate stress testing has been added as a regular requirement for medium and long-term strategic planning.

“Scottish Widows Group will manage the risks and opportunities associated with the required transformation of the economy, taking into account and responding to physical, transitional and litigation risks. We adapt to the adverse impacts of climate risk and foster climate resilience by delivering our contribution to achieving net zero emission plans to disclosed timescales, while acknowledging a dependency on the wider economy to also deliver improvements.”

Overview
Our strategy
Metrics and targets
Climate governance
Risk management
Scenario analysis
Scottish Widows
TCFD Report 2021
RISK MITIGATION
PENSION AND INVESTMENTS

Given the importance of managing the transition and our net zero commitments, Scottish Widows established in 2020 a dedicated responsible investment team made up of professionals with diverse backgrounds in responsible investment, policy, the charity sector, data and climate science. The team is fully integrated within the Investment Strategy function. Despite being recently formed, the responsible investment and wider Scottish Widows investment team have been very active. We continue to develop propositions that provide sustainable futures of our customers while also influencing and benefiting from the real-world economic transition.

£5bn+
invested in the BlackRock, Climate Transition World Equity Fund

In 2020 we collaborated with BlackRock to design and launch the Climate Transition World Equity Fund, which Scottish Widows seeded and have continued to invest in, reaching more than £5 billion by end 2021. The fund uses a new data-driven investment approach from BlackRock which measures a company’s exposure to transition risks and opportunities, providing investors the opportunity to invest in the transition to a greener economy. BlackRock’s approach scores companies on energy production, clean technology, energy management, water management and waste management. The fund is tilted in favour of companies that rank more favourably on these measures, while retaining diversification across sectors, regions and business maturities.

Find Your Impact (FYI)

In November 2021 we launched the Find Your Impact (FYI) feature on the Scottish Widows app. It assesses the carbon footprint, waste to landfill, and board diversity of the companies within a member’s pension and then provides this information at portfolio, fund or holding level. This allows members to see where their money is invested and the impact these companies have on the world around them. Additionally, it will allow members to give their views on a range of issues, telling Scottish Widows (and their scheme trustees where applicable) what matters to them; we will use this to inform our stewardship activity.

Exclusions policy

Our exclusions policy, first approved in 2020, aims to remove from customers’ investments companies and sectors whose activities are so high-risk that they are likely to become stranded assets and investment losses.

Effective Investment and Stewardship Report

Our 2020 Responsible Investment and Stewardship Report was published in Q2 2021, with Scottish Widows being in the first cohort of signatories to the FRC’s 2020 Stewardship Code. Stewardship activity continues, with additional engagement both directly with investee companies (e.g. those flagged by the exclusions policy as being UN Global Compact violators) and investment managers.

Scottish Widows Environmental Fund

In 2021 we launched our refreshed Scottish Widows Environmental Fund. The fund, which dates back to 1989, is now fossil fuel-free.

It has a dual approach; invest in companies which make a positive impact on the environment through their products and services, and in invest in environmental leaders – companies making a difference with their progressive policies.

Shareholder fund portfolio

Loan investments which are held within the shareholder fund portfolio are less liquid than our traded assets and are managed on a buy and hold basis. In this area, we’re introducing changes to our credit risk assessment to increase focus on both physical and transition risks to the companies we lend to, as well as targeting continued growth in low emissions investments.
Given the short-term nature of home insurance policies, we are able to review our view of risks regularly and change our approach as risks develop to mitigate long-term exposure of climate risks. Our overall strategy is to continually review our acceptance criteria and pricing strategy for each risk based on both a short-term and long-term view.

Financial management
An assessment of climate-related risks to General Insurance liabilities is integrated into our internal model governance process. Climate change is identified as a key topic for model review and approval within this process, and specifically, the appropriateness of the view of risk for the weather perils in the context of climate change science.

This view of risk is integrated into assessments of capital requirements, reserving, reinsurance and pricing. It also feeds into the quarterly exposure management where insurance portfolio exposure arising from weather-related perils is monitored and controlled.

A third-party vendor model is used for the perils of flood, coastal/storm surge and wind. The vendor model results are adjusted internally to better reflect our own exposure and experience.

Catastrophe modelling
The catastrophe weather model is a key component of the capital model. The results of the model by weather peril are used to inform the base rates for risk pricing. Accordingly, weather pricing models are used to inform how insurance premiums should vary across the book. The outputs are used to create a relative view of risk across the geographic domain of the book, i.e. how risk varies from location to location.

The weather modelling team conducts an ongoing review of available research and models on climate change.

Customer support
The introduction of Build Back Better (our commitment to spend up to £10,000 on specialist flood surveys and fitting property flood resistance and/or resilience measures following eligible flood claims), dedicated flood surveyors and My Carbon Manager (which will allow our customers to identify home improvements that will reduce the carbon emissions of their home) are all designed to give our customers the information they need to make informed decisions and support resilience to climate change and minimise future emissions.

Through piloting of these ideas, we can look to introduce tools to customers before point of claim and are currently exploring how weather modelling data can be shared with customers to better prepare for imminent flood events.

We also work with the Woodland Trust to protect trees during subsidence claims, ensuring felling of trees is a last resort, and avoided wherever possible.
Definition: “Scenario analysis involves the consideration of various plausible future scenarios under a set of assumptions and constraints, to arrive at a range of hypothetical outcomes. With respect to climate change, the purpose is to explore and better understand the potential impact of climate-related risks and opportunities over time. The process and outputs can help firms to identify key drivers of climate-related exposure and thereby enhance their risk and investment decisions.”

1 FCA CP21/17 Enhancing climate-related disclosures by asset managers, life insurers, and FCA-regulated pension providers.
Scenario analysis

SCENARIOS

Scenario analysis captures the physical risks arising from a changing climate and transition risks from moving to a net zero economy. The starting point for climate scenario analysis is the identification of relevant use cases of the analysis and the selection of appropriate scenarios to consider.

**Scenarios**

Scenarios are selected that provide different combinations of these risks and that explore the short, medium and long-term impacts of climate change. It should be noted that scenario analysis is not a prediction, the scenarios are not equally likely to occur and there is not yet consensus in the financial sector on the scenarios to be used.

There are multiple different scenarios that achieve similar climate outcomes, for example, organisations including NGFS and IEA provide different scenarios. Consequently, there is a wide margin of uncertainty in the economic impacts of similar climate outcomes.

Climate scenario analysis integrates the impacts from climate models and economic models, however, as observed by the CFRF ‘Dynamic non-linear feedback loops between the real economy, corporate earnings, asset prices, asset allocation and financial balance sheets are generally outside of the scope of most models used for scenario analysis’. This industry-wide limitation in translating climate model projections into financial impacts necessarily constrains the credibility of the analysis.

The analysis can nevertheless produce useful outputs; for example, on concentrations of risk and to inform strategy.

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1. Derived from NGFS Climate Scenarios for Central Banks and Supervisors, June 2020.
2. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS), launched at Paris One Planet Summit on 12 December 2017, is a group of Central Banks and Supervisors willing, on a voluntary basis, to share best practices and contribute to the development of environmental and climate-risk management in the financial sector and to mobilise mainstream finance to support the transition towards a sustainable economy. See ngfs.net/en.
4. The Climate Financial Risk Forum (CFRF), co-chaired by the FCA and PRA, builds capacity and shares best practice across financial regulators and industry. In advance the financial sectors respond to the financial risk from climate change.
As part of our wider Group, Scottish Widows participates in Group-wide climate scenario analysis, as well as conducting scenario analysis tailored to assess our products: General Insurance, Protection, Pensions and Investments.

A wide range of scenario analysis is used to produce insightful outputs that aid the understanding of climate risk and support decisions. The analysis is tailored to our needs with different scenarios, time horizons and outputs depending on the purpose. The scenario analysis we used during 2020/21 is:

- **Strategy**: Considering climate scenarios in short to medium-term strategic outlook
- **Investment strategy**: Supporting our net zero and financed emissions targets
- **Risk management**: Assessing the effectiveness of capital management actions
- **Regulatory/Financial**: participating in Bank of England 2021 Climate Biennial Exploratory Scenario (CBES)

**Strategy**

We regularly review our strategy using scenario analysis to assess risks to the achievement of our objectives. This year, we considered a climate scenario and compared this to the base planning scenario. The key components are:

- **Home Insurance**: Weather events that previously occurred once every 10 years occur every year
- **Pensions, Investment and Annuities**: Economic deterioration with reduced sales and increased lapsation

The outcome of this analysis was to identify the variation in projected profitability caused by the climate scenario.

**Investment strategy**

In publishing our targets to halve the carbon intensity of our investments by 2030 and achieve net zero by 2050, we considered both the impact of our own management actions across our customer and shareholder funds, as well as our reliance on the pace toward net zero of the wider economy. There is no firm forecast as to the rate of decarbonisation across the economy; as such, we have incorporated what we consider to be a prudent approach in arriving at our projections.

**Management actions**

The financial risks from climate change will vary, dependent on the steps taken to reduce emissions and the reaction of the climate to the change in emissions. We maintain a suite of capital management actions that can be used, if required, to improve or protect our balance sheet in the face of external stress. These actions are reviewed annually to determine the effectiveness of the actions in different scenarios, including a climate-related scenario.

**Bank of England (CBES)**

In 2021 we participated in the CBES. This was intended to be a learning exercise with desired outcomes as follows:

- Size the financial exposures of participants and the financial system more broadly to climate-related risks
- Understand the challenges to participants’ business models from these risks
- Assist participants in enhancing their management of climate-related financial risks

The CBES assessed three scenarios over a long-time horizon:

- **Early Action**: An ‘Orderly Scenario’. The transition to a net zero emissions economy starts in 2021 so carbon taxes and other policies intensify gradually over the scenario horizon
- **Late Action**: A ‘Disorderly Scenario’. The implementation of policy to drive transition is delayed until 2031 and is then more sudden and substantial
- **No Additional Action**: A ‘Hot House Scenario’. No new climate policies introduced beyond those already implemented prior to 2021

We conducted scenario analysis for the entire range of products we offer. For example, for our General Insurance portfolio we have assessed at the required level of specificity the impact of physical risks including flood, subsidence and storm.

The Bank of England have requested that all CBES participants avoid sharing contents from CBES submissions.

**Summary**

As a result of all the scenario analysis, we continue in our belief that an orderly transition to a low carbon economy is in our interests.

**Next steps**

The outlook for climate change is rapidly changing as governments and companies are continually updating their commitments to tackle climate change and implementing policies to support these commitments. We continue to monitor these developments.

We will develop our scenario analysis in recognition of the external environment and by enhancing our modelling capabilities with a view to making appropriate future disclosures.