PROTECTING OUR FUTURE

Task Force on Climate-related Financial Disclosures (TCFD)
Report 2022

SCOTTISH WIDOWS

INTRODUCTION

Scottish Widows has been helping people prepare for the future since 1815. Now, more than 200 years on, we look after almost six million customers across the UK. Today we remain as committed as ever to empowering our customers to make the most of their financial future.

Millions of customers entrust us with their pension savings, and we have a duty to them to make good decisions, which will aid their long-term prosperity and help to build their financial resilience. Our promise to them extends to us considering the impact of our decisions on the planet and Britain's transition to net zero.

We believe that, over the long-term, investing in companies that are working hard on things like reducing their impact on the environment and improving people's wellbeing will ultimately result in better returns for our customers. This means that we aim to prioritise investing in such companies, and excluding investment in those that are causing severe harm to the planet or society.

6 million

customers across the UK

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OUR 2022 REPORTING

This is the second Scottish Widows Group annual Task Force on Climate-related Disclosures (TCFD) Report and is intended as a supplement to the 2022 Scottish Widows Group Limited Annual Report and Accounts, the 2022 Scottish Widows Limited Annual Report and Accounts as well as Lloyds Banking Group's Environmental Sustainability Report and TCFD disclosures.

This report covers our progress against the TCFD recommendations and recommended disclosures, along with our approach to addressing the broader environmental and associated governance areas.

Scottish Widows is part of Lloyds Banking Group.

Scope of this report

This report covers the period from 1 January 2022 to 31 December 2022.

Please see the disclaimer on pages 61 and 62 for further information about the basis on which this document, and the information contained within it (including forward-looking statements), has been prepared. For further details of the entities covered in this report, please see page 55.

The entity level reporting for Scottish Widows Limited, required under the Financial Conduct Authority's (FCA's) Environmental, Social and Governance (ESG) Sourcebook (set out via PS21/24) can be found in Additional information.

Additional links

Scottish Widows Climate Action Plan

Lloyds Banking Group Annual Report and Accounts 2022

Lloyds Banking Group Environmental Sustainability Report 2022

Scottish Widows Group Limited Annual Report and Accounts

Scottish Widows Limited Annual Report and Accounts

Scottish Widows Responsible Investment and Stewardship Report

Scottish Widows Product Level Reporting

A MESSAGE FROM OUR CEO

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 Lloyds Banking Group brands. We're on a mission to support our Home Insurance customers, promoting more sustainable, lower carbon repairs and improving flood resilience.

"Only by working together can we ensure a more sustainable future."

Read about our strategy in the section starting on **page 10**

As a result of the customers we support, it's important that we 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 organisations such as 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), the European membership body for investor collaboration on climate change. The IIGCC has over 400 members (mainly pension funds and asset managers) across 27 countries, with €65 trillion in assets under management (AUM).

We announced our Scottish Widows Climate Action Plan in February 2022. This transition plan is an aspect of our overall business strategy and lays out a set of targets and actions supporting our transition toward a low-carbon economy. The plan supports our overall target to:

Halve the carbon footprint of Scottish Widows investments by 2030 on the path to net zero by 2050 (from a 2019 baseline).

This aligns to the target set by the UK government to reduce greenhouse gas (GHG) emissions to net zero by 2050. Transitioning to net zero is a universal endeavour and will depend on government, industry and wider society acting together, alongside significant technological advancements in high-emitting sectors. Therefore, our own targets are, in part, reliant on the actions of others. We will actively manage our climate risks and hold ourselves to account to do all we can in how we run our own business. Our priority is to be a constructive partner in the transition and actively manage our investments as they undertake their transition journeys. Where we don't see the level of commitment or progress we believe is necessary to keep key climate ambitions within reach, we will consider disinvestment.

Today, I am pleased to present our 2022 Scottish Widows TCFD Report, covering the period from 1 January 2022 to 31 December 2022. The report provides a summary of the TCFD recommendations and our progress towards these. The climate crisis is one of the most pressing challenges in today's world and we must all play a part in tackling climate change. Only by working together can we ensure a more sustainable future.

Chirantan Barua
Chief Executive, Scottish Widows

CARBON EMISSIONS IN CONTEXT

IMPACTS OF GLOBAL WARMING[1]

Food insecurity

Sea level rise

Extreme drought and flood hazard

Loss of wildlife and habitats

Climate and weather extremes

[1] Source: https://www.ipcc.ch/sr15/

LIMITING GLOBAL WARMING

In an effort to combat climate change, 196 nations adopted the Paris Agreement in December 2015*. Its overarching goal is to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels.

1.5°C

aim to limit global warming by[2]

[2] United Nations Climate Change website

HOW MUCH CARBON BEFORE 1.5°C IS REACHED

Limiting global warming requires limiting the total cumulative global emissions of CO_2 from human activities, staying within what is referred to as a ‘total carbon budget[3]’.

The Intergovernmental Panel on Climate Change (IPCC) give an estimate of the remaining carbon budget of 580 $GtCO_2$ for a 50% probability of limiting warming to 1.5°C. This could be equated to 72.5 tCO_2 per person, assuming a global population of eight billion.

580 $GtCO_2$

carbon budget remaining before 1.5°C temperature increase is reached[3]

72.5 tCO_2

equivalent carbon budget per person[4]

[3] Intergovernmental Panel on Climate Change, Special Report: Global Warming of 1.5ºC
[4] Assuming a global population of eight billion.

1 TCO_2 IS EQUIVALENT TO

11 refrigerators powered for 1 year[5]

Driving 6,000km in a diesel car[5]

121,643 smartphones charged[6]

The average emissions of one passenger on a return flight from London to New York[7]

40 BBQ propane tanks[5]

[5] Source: https://radiclebalance.com/resources/articles/what-is-a-tonne-of-co2/
[6] Source: https://www.epa.gov/energy/greenhouse-gas-equivalencies-calculator#results/
[7] Source: http://www.aef.org.uk/downloads/Carbon_Footprint_Calculator_including_flights.pdf

2022 HIGHLIGHTS

Our ambition is to align all our investments with limiting global warming to 1.5°C by targeting net zero emissions, by 2050 or sooner (from a 2019 baseline). To achieve our mission, we have set ourselves the following targets and milestones.

CLIMATE-AWARE STRATEGIES ASSETS TARGET

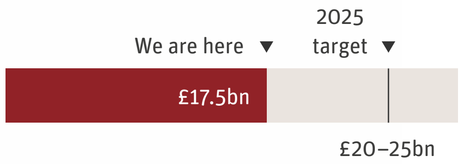
Invest between £20–25 billion in climate-aware investment strategies*, with at least £1 billion invested into climate solutions investments* by 2025

Our climate-aware strategies investment assets increased by £12 billion in 2022. This brings us to a cumulative £17.5 billion, well on the way to meeting our £20–25 billion goal by end of 2025. Our investment in climate solutions within these same strategies amounted to £1.3 billion, achieving our 2025 goal of at least £1 billion.

We are looking to integrate ESG factors across our investment portfolio and we have also enhanced our options to offer a range of specialist funds tilted towards what we currently define as sustainable and impact investments, noting that the FCA is looking to introduce specialist labels for such funds.

£17.5bn

achieved in discretionary investment in climate-aware strategies by the end of 2022



£1.3bn

achieved in discretionary investment in climate solutions

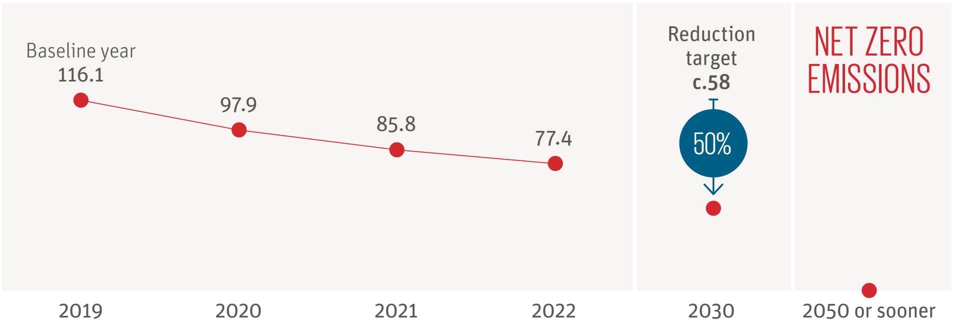
NET ZERO TARGET

Halve the carbon footprint** of our investment portfolios by 2030 on the way to net zero by 2050

Our 2022 carbon footprint was 77.4 tCO_2/£m, down from our 2019 baseline of 116.1 tCO_2/£m. We saw a decrease in the footprint from 2019 to 2020 relating to the fall in investee company emissions during 2020, in part due to reduced production and energy usage during the COVID pandemic. Some company emissions increased during 2021 post-pandemic, but on average global company values increased relative to emissions causing the footprint to fall. The 2022 results reflect the value of investee companies during 2022 but the emissions still largely relate to 2021. Market values and emissions have not moved consistently during 2022 across different regions and sectors, for example, the US and Emerging Market indices fell, but the UK was relatively flat. In terms of higher emitting sectors such as oil & gas, the emissions increased but the company market values increased by more, meaning the oil & gas footprint has reduced relatively.

As the carbon footprint is sensitive to market fluctuations in addition to the absolute value of emissions and our own investment activity, we expect to see short-term variation of the footprint and will be studying the medium-term trend from future reporting.

Carbon footprint (tCO_2/£m)



* Climate-aware investment strategies: We're working closely with our appointed investment managers 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.

OUR PROGRESS AGAINST TCFD RECOMMENDATIONS

We have been continually making progress against the TCFD recommendations. The following table provides an overview of our disclosure progress.

We will continue to assess and develop our disclosures against the TCFD recommendations and recommended disclosures, considering relevant TCFD guidance and materials along with evolving best practice.

The compliance statement, which is required by the FCA ESG Sourcebook, is included in the Additional information section 'Scottish Widows Limited entity level reporting', on page 59.

Pillar	Recommended disclosures	Reference	Summary of progress
Strategy **Recommendation:** Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's business, strategy and financial planning where such information is material	A. Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long-term.	Pages 11-12, 49-50	• Defined the key climate-related risks and opportunities across the Group and identified the potential time horizons over which these may arise.

	B. Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	Pages 11, 13-23	• Prioritised our activities around:
			  • net zero ambitions associated with achieving net zero in our own operations by 2030; and
			  • net zero targets for the activities of those we finance by 2050, with interim targets set for 2030.
			• 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.

	C. Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Pages 24-31	• Developed a model to support decision making within our business. A wide range of scenario analysis is used to produce outputs that aids the understanding of climate risk and can be used to support business decisions. • The combination of both qualitative and quantitative analysis provides insight on potential future outcomes related to climate risk.

Metrics and targets
Recommendation: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material
	A. Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	Pages 33-34	• Progress monitored against our:
			  • net zero ambitions, including measures related to own operations and supply chain emissions; and
			  • net zero targets, including measures related to our financed emissions.
			• Scope 1, 2 and 3 operational emissions are calculated at a Lloyds Banking Group level and are provided in the Lloyds Banking Group Environmental Sustainability Report published February 2023.

	B. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks.	Pages 9, 35-38, 60	• Published updated figures for our financed emissions which can be tracked against our initial 2019 financed emissions baseline to monitor progress against commitments. • Product level TCFD reporting has been published in our 2022 report, offering an additional level of granularity to customers. • Disclosed metrics on flood risk exposure and average annual losses for our General Insurance business.
	C. Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	Pages 8, 15, 34	• We continue to have targets in relation to our financed emissions and climate-aware investments. • This report provides an update on how we are progressing against these targets.

Our progress against TCFD recommendations continued

There are a number of regulatory developments in the pipeline which will impact future reporting. We are monitoring these developments, which include the following:

- **International Sustainability Standards Board (ISSB).** The ISSB consulted on the exposure drafts for IFRS Sustainability and Climate Disclosure standards during 2022. It is expected these standards will be effective for annual reporting periods beginning on or after 1 January 2024. We support the ISSB in its task of developing standards that will result in a high-quality, comprehensive global baseline of sustainability disclosures focused on the needs of investors and the financial markets.
- **Taskforce on Nature-related Financial Disclosure (TNFD).** Final recommendations are expected in the second half of 2023. The TNFD framework will deliver a comprehensive and consistent approach to nature-related financial disclosures. We recognise that nature degradation and biodiversity loss, together with climate change, are among the greatest threats to our planet, society and the economy and encourage the government to leverage the opportunity to make the UK the first country to mandate economy-wide TNFD reporting when the final framework is agreed upon. See our report '<u>Nature and Biodiversity: The pensions imperative</u>'.
- **Sustainable disclosure requirements.** In late 2022, the FCA published a consultation 'Sustainability disclosure requirements (SDR) and Investment labels' focused on asset managers and their UK-based funds. The proposals include sustainable investment labels, disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing. It is expected that the new rules will be published in the form of a policy statement in Q3 2023.

Pillar	Recommended disclosures	Reference	Summary of progress
Governance **Recommendation:** Disclose the organisation's governance around climate-related risks and opportunities	A. Describe the board's oversight of climate-related risks and opportunities.	Pages 40-41, 43-44	• Our governance structure provides clear oversight and ownership of the sustainability strategy and management of climate risk at Board and Executive levels. • The Board is engaged on a regular basis on our sustainability agenda.
	B. Describe management's role in assessing and managing climate-related risks and opportunities.	Pages 42, 44-47	• The Responsible Business Executive Committee is responsible for the development 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).
Risk management **Recommendation:** Disclose how the organisation identifies, assesses, and manages climate-related risks	A. Describe the organisation's processes for identifying and assessing climate-related risks.	Pages 49-51	• Assessment of climate risk has been undertaken to understand key risks. • Ongoing development of climate risk assessment data and methodologies.
	B. Describe the organisation's processes for managing climate-related risks.	Page 52	• Consideration of climate risk incorporated within our existing risk management processes, developing and considering relevant controls to mitigate these risks. • Key risks which incorporate climate include market, credit, insurance underwriting, regulatory and conduct risk.
	C. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	Pages 49-53	• Climate risk is embedded into our Enterprise Risk Management Framework (ERMF), through consideration of climate risk as its own principal risk, and integration into other principal risks materially impacted. • The Lloyds Banking Group Climate Risk Policy and Insurance Procedures provide an overarching framework for the management of climate risks across the Group.

OUR AMBITIONS, ALIGNING TO LLOYDS BANKING GROUP

Scottish Widows is part of Lloyds Banking Group. Lloyds Banking Group supports many sectors of the economy through lending, investments, products and services, and recognises its role in helping to enable the transition to a low carbon future.

The Lloyds Banking Group environmental sustainability strategy

The Lloyds Banking Group strategy	Climate strategy objectives
See the Lloyds Banking Group Annual Report and Accounts 2022	See the Lloyds Banking Group Environmental Sustainability Report 2022
GROW Drive revenue growth and diversification	Capitalising on the opportunities of the transition.
FOCUS Strengthen cost and capital efficiency	Managing our climate-related risks, supply chain and operations.
CHANGE Maximise the potential of people, technology and data	Embedding sustainability in all that we do.

Scottish Widows' net zero ambitions

How we're supporting Lloyds Banking Group's climate strategy objectives

FINANCED EMISSIONS

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

Read about our strategy in the section starting on **page 10**

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

* Carbon footprint is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.
** From a 2019 baseline.
*** All from a 2018/19 baseline.

Our five areas of focus

We will deliver against our net zero ambitions using these five strategic areas of focus

1. Climate-related risks and opportunities over the short, medium, and long-term
Read more on **pages 11 and 12**
2. Partnerships, initiatives and collaborations
Read more on **pages 13 and 14**
3. Pensions and Investments
Read more on **pages 15 to 22**
4. General Insurance
Read more on **page 23**
5. Scenario analysis
Read more on **pages 24-31**

Our ambitions, aligning to Lloyds Banking Group continued

Reducing our operational and supply chain emissions

Scottish Widows operational Scope 1 and 2 emissions are included as part of the wider Lloyds Banking Group emissions and reported in detail within the Lloyds Banking Group Environmental Sustainability Report.

Our own operations

Reducing the environmental impact of our own operations is a key part of our sustainability strategy. We're working towards an ambitious set of commitments to change the way we operate as a business and help to accelerate our plans to tackle climate change.

In 2021, Lloyds Banking Group launched an ambition to achieve net zero carbon emissions across Scope 1 and 2 by 2030, while at the same time it launched targets to halve energy consumption and maintain travel-related carbon emissions from business travel and commuting below 50 per cent of a pre-COVID-19 baseline. Progress is being made against the targets, despite an increase in commuting and business travel-related carbon emissions driven by higher office utilisation compared to the previous year. See page 12 of Lloyds Banking Group Environmental Sustainability Report for further detail.

Our supply chain

Launched in October 2022, Lloyds Banking Group committed to reduce supply chain emissions by at least 50% by 2030 on the path to net zero by 2050. The initial focus has been on engaging 123 suppliers, which it is estimated contribute over 80 per cent of total Lloyds Banking Group supply chain carbon emissions.

Embark Group

The Embark Group, one of the UK's fastest-growing diversified financial services businesses, became part of Scottish Widows Group Limited in January 2022. With c.£35 billion* of assets under administration on its platform (of which the Embark Investments Authorised Corporate Director has responsibility for c.£700 million), representing the interests of over 380,000 individual clients, Embark is committed to developing its ESG policies to align, over time and where appropriate, with those of Scottish Widows in support of investors looking to make better-informed and responsible investment decisions.

The Embark leadership team recognises that the TCFD recommendations provide an important framework for stronger engagement on climate-related risks and opportunities with the management teams of companies represented in its investment solutions. There are additional ongoing efforts to providing financial advisers and customers who access the Embark platform with tools and information to foster greater awareness of where and how they can allocate capital to support investment in ways which represent their views on ESG matters.

Work is underway with Embark's leadership team on finding the right approach to integrate Embark investments into Scottish Widows overall portfolio plans and commitments. The climate strategy for Embark's assets will be communicated in future reports.

* Note this £35 billion does not form part of the net zero targets outlined in this report.

Net zero

carbon emissions across Scope 1 and 2 by 2030

50%

reduction of carbon emissions generated through Lloyds Banking Group supply chain by 2030

STRATEGY

1

CLIMATE-RELATED RISKS AND OPPORTUNITIES OVER THE SHORT, MEDIUM AND LONG TERM

As part of Lloyds Banking Group, Scottish Widows Group approaches climate risk management in a consistent way to the overall Group. Details of the Lloyds Banking Group approach, including definitions, and examples of risks and opportunities that arise in relation to climate change can be found in pages 57-62 of the Lloyds Banking Group Environmental Sustainability Report published with the Annual Report and Accounts in February 2023.

More detail on how Scottish Widows Group recognises climate risk is set out on pages 49-53 of this report.

CLIMATE RISK MANIFESTS IN TWO MAIN CATEGORIES:

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 may take longer to materialise, but impacts are likely to be much more persistent.

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.

Climate-related opportunities

Opportunities arise from the ability to invest in companies which are efficient with resources and energy transition, are resilient to the effects of climate change, and create new sustainable products and services. We will continue to engage with our customers, asset managers and supply chain to help contribute to the transition to a low-carbon economy.

Through our Loan Investments we also seek to support clients investing in their businesses as they transition towards a low-carbon economy, as well as providing investment into a range of green energy infrastructure projects. We currently lend around £7.5 billion from our annuity fund to support social housing, sustainable energy and infrastructure projects, supporting the transition to a low-carbon future and making a contribution to the Lloyds Banking Group ambition of Helping Britain Prosper.

In 2022 we continued to develop our support in this space, with a particular focus on the social housing sector. During the year we invested a total of £320 million, supporting a range of housing associations around the UK and providing funding for a variety of initiatives, including the development of new affordable, energy efficient housing, as well as financing for the retrofitting of existing homes to improve energy efficiency.

These risks and opportunities have helped inform our strategy, set out in this section. Managing these risks is key to not only ensuring our investments move towards net zero, but that they continue to deliver good outcomes 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, investments and liabilities. 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 manage the risks associated with climate change is integral to our ERMF. This is consistent with other key risks that we manage, however, the time horizon over which climate risk will present itself may be a significantly longer time horizon than we experience with other risk types.

Read more on **pages 49-50**

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 +

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

Read more on pages 49-50

Identified risks

The influence of climate change on human health and wellbeing is attracting increased attention with more attribution studies quantifying the impacts of recent events such as heatwaves. Vulnerable populations such as the elderly, infants and those living with clinical impairments are being increasingly exposed to rising temperatures with heat related deaths increasing by 68% between 2000–2004 and 2017–2021*. Similarly, greater exposure to colder temperatures is contributing to a pronounced excess mortality in the UK during the winter months. An increase in health harms secondary to climate change is also compounding co-existing crises: namely energy, cost of living and the transition of COVID-19 to an endemic position. Converging crises are redirecting available resource and focus, by way of example the COVID-19 pandemic reportedly reduced financing available for climate action in 239 (30%) of 798 cities internationally*. Health systems are also increasingly being affected by extreme weather events and supply chain disruptions.

Environmental changes caused by climate change are also altering the geographical range of climate-sensitive infectious diseases, imposing on food and water security, worsening air quality and damaging socio-economic systems*.

A more health-centred response to the co-existing climate, energy and cost of living crises should provide an opportunity to deliver a healthier, low-carbon future. A shift towards clean energy and improved energy efficiency will help mitigate extreme catastrophic climate impacts which should lead to positive increases in life expectancy.

* Romanello M, et al., 2022, 'The 2022 report of the Lancet Countdown on health and climate change: health at the mercy of fossil fuels', Lancet; 400:1619-54.

Key commercial considerations of climate change in the context of demographic risk:

Mortality risk	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.
Morbidity risk	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.
Longevity risk	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.

Physical risk may impact our business through:

Property insurance risk	Potential for increased levels of claims due to damage to property caused by changes to weather patterns and climate (e.g. flood or storm).
Market and credit risk	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.

Transition risk may impact our business through:

Market risk	Risk of loss of value of shareholder or customer assets due to poor, late or costly transition by the companies we invest in; 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.
Credit risk	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 may ultimately increase the credit risk of lending to them.
Litigation or regulatory risk	Risk from not delivering on public targets and commitments or clearly disclosing current position on climate or from poor management of customer/client exposures.
Regulatory risk	Risk from not meeting existing and upcoming climate risk driven regulatory requirements. New climate-related regulation may be costly to implement and lead to additional processes, data and resources; diverging regulation across jurisdictions may add risk.

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. The time horizons during which these risks may manifest is uncertain. We have translated these risks into six overarching risks impacting our business, and more details are on pages 49 and 50. We use continuous risk management and qualitative assessment to help consider the materiality of these risks to our business which helps to inform the controls that we have in place to monitor and manage the risks.

2

PARTNERSHIPS, INITIATIVES AND COLLABORATIONS

Our active participation in partnerships and collaborations fits into our goal to support and encourage greening across the real economy, and not solely achieving a green investment portfolio.

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.

Scottish Widows helped draft the IIGCC 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 focusing on developing detailed guidance on climate solutions, material emissions and stewardship engagement for users of the Net Zero Investment Framework.

In 2022, Scottish Widows participated in the development of IIGCC's Net Zero Stewardship Toolkit. As a follow-on from that, we are now members of the newly created Net Zero Engagement Initiative (NZEI) working group. The Initiative was set up to scale and accelerate climate-related corporate engagement, in order to support investors in aligning more of their investment portfolio with the Paris Agreement and accelerate real world impact. Whilst the Climate Action 100+ (CA100+) initiative focuses solely on the top high emitting companies, the NZEI has expanded their universe of companies beyond the CA100+ focus list, to help investors more broadly align their portfolios with net zero initiatives. In 2022, the IIGCC launched a new Net Zero Engagement Platform, creating a central hub for corporate collaborative engagement workstreams, with the purpose of accelerating progress against goals.

Scottish Widows joined the UK Sustainable Investment and Finance Association (UKSIF) in 2021, and in 2022, our Head of Responsible Investment was elected a member of the board. UKSIF, through influencing policy for positive change, seeks to bring together the UK's sustainable finance and investment community to advance the UK towards a sustainable future. As active members in UKSIF initiatives such as its policy committee, our involvement specifically sees us respond to policy consultations to support the development of the policy environment.

We continue to participate in and contribute to the Climate Engagement workstream of the Occupational Pensions Stewardship Council, initiated in the second year of its running in 2022. This Council for UK pensions schemes was created on the recommendation of UK's Asset Management Taskforce 2020 report, Investing with Purpose. Additionally, following on from the Department of Work and Pensions' Taskforce on Pension Scheme Voting Implementation, in which Scottish Widows was involved, the FCA has set up a Vote Reporting Group to develop a more comprehensive and standard vote disclosure regime. Scottish Widows sits on this Vote Reporting Group to help shape industry standards.

We are also a member of the Association of British Insurers' (ABI) Board and the Board's Climate Change Sub-Group, as well as its Climate Change Working Group. The collaborative work of this group resulted in publication of the ABI's climate change roadmap in the summer of 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.

Partnerships, initiatives and collaborations continued

In addition to our industry group memberships, we also participate in efforts to inform policy by collaboratively writing to governments.

The following are some examples:

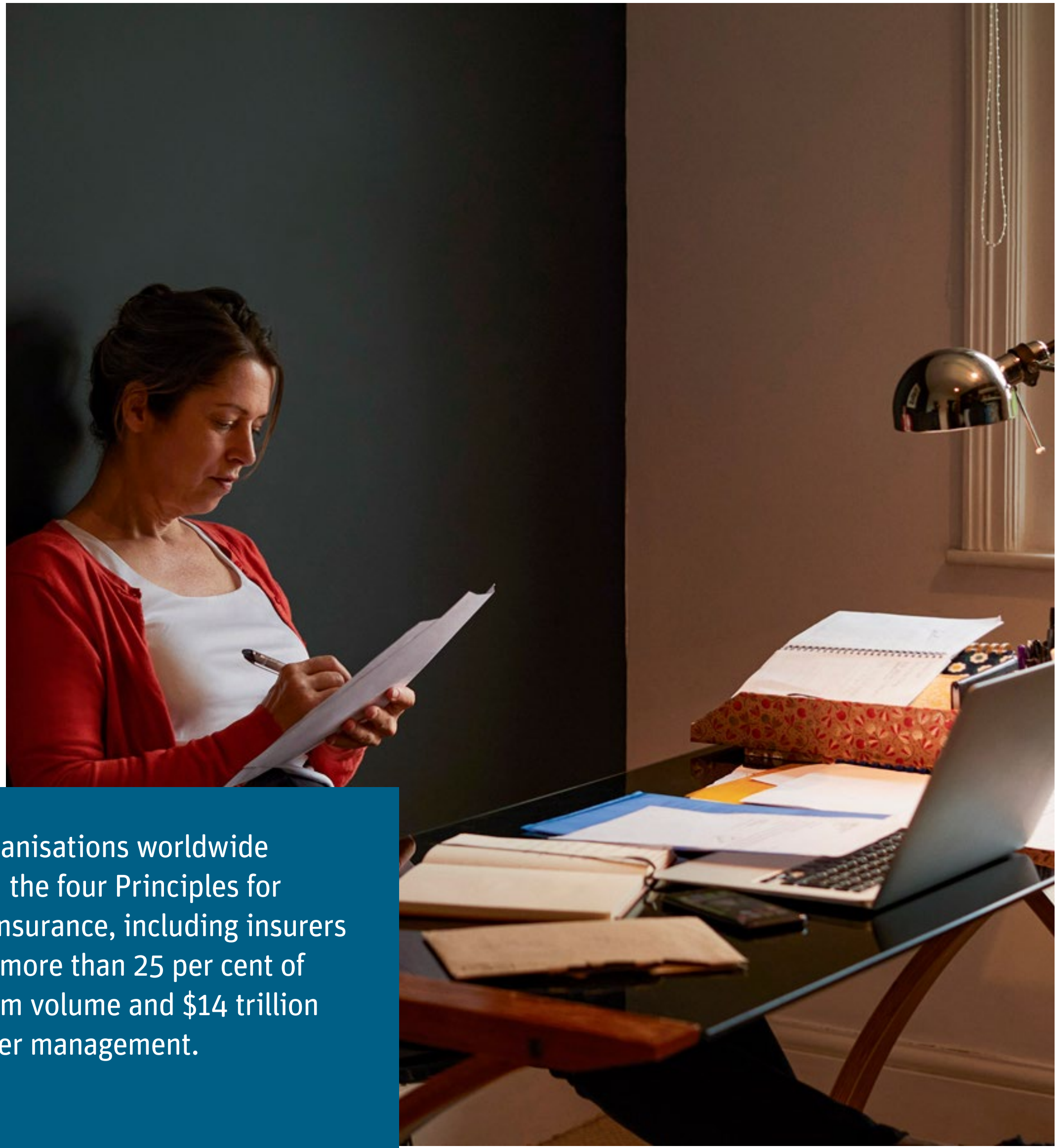
1. Signatories to a letter convened by UKSIF, IIGCC and E3G to the UK government to publish a Net Zero Investment Plan encompassing i) A Net Zero Delivery Tracker to assess the financial flows in support of our climate and nature goals, ii) Assessment of investment needs for decarbonisation in different economic sectors, and iii) an assessment of the low-carbon investment gap for these sectors and how these will be bridged. This was accompanied by a request for an independent unit, like the Office for Budget Responsibility, to conduct this tracking analysis on an ongoing basis.
2. Signatories to the 2022 Global Investor Statement to Governments on the Climate Crisis, calling on governments to raise their climate ambition in line with the goal of limiting global temperature rise to 1.5°C, including mandated climate transition plans from investors. In calling for this action, investors are directly asking for more climate disclosure regulation of the finance sector, in addition to calling for climate regulation of companies. The statement also covers new policy areas, including a focus on tackling methane pollution, climate adaptation and resilience, and scaling up climate finance for developing countries. Investor signatories to the statement are specifically urging governments to rapidly implement policy actions that will allow them to invest the trillions needed to respond to the climate crisis.
3. Global Canopy, in conjunction with Make My Money Matter and several leading investors, including Scottish Widows, developed and published guidance for 'deforestation-free pension funds'. The guidance encourages pension funds to measure and disclose deforestation risk within their investment portfolios, and develop strategy to reduce and eventually eliminate that risk.

Principles for sustainable insurance

Launched at the 2012 UN Conference on Sustainable Development, the UN Environment Programme Finance Initiative's (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.



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

3

PENSIONS AND INVESTMENTS

Our mission

Our ambition is to align all our investments with limiting global warming to 1.5°C by targeting net zero carbon emissions, by 2050 or sooner.

‘Net zero’ refers to achieving a balance between the amount of GHGs, 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 between £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

* For more information on the emissions calculation see pages 33 and 34.

** **Climate-aware investment strategies:** We’re working closely with our appointed investment managers 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.

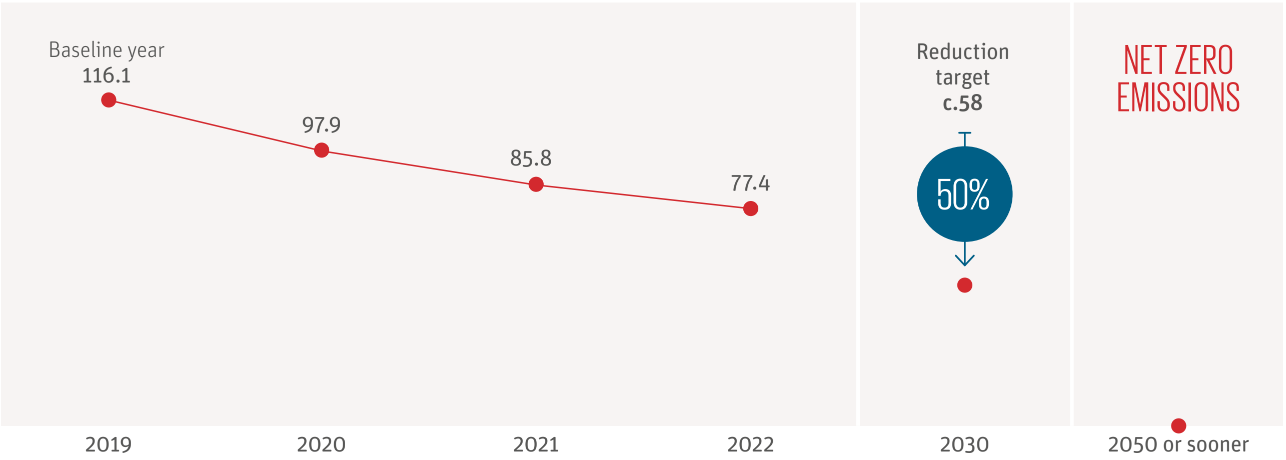
*** **Carbon footprint** is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.

Carbon emission reduction targets

By targeting a gradual reduction in overall emissions contained in our investment portfolios to net zero, we are engaging with companies we invest in directly, and via our investment management partners, to encourage them to embark on decarbonisation pathways of a scale and pace needed to meet the 1.5°C global warming objective of the Paris Agreement.

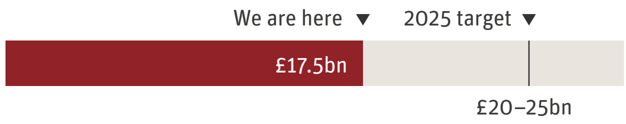
The extent to which we can meet our 2030 and 2050 portfolio decarbonisation targets is influenced by the pace towards net zero of the wider economy. However, our investment decisions on asset allocation, company exclusions and shareholder engagement are consistent with the transition to net zero in the real economy.

Carbon footprint (tCO_2/£m)



£17.5bn

achieved in discretionary investment in climate-aware strategies by the end of 2022



£1.3bn

achieved in discretionary investment in climate solutions

Pensions and Investments continued

CLIMATE ACTION PLAN

Published in 2022, our Climate Action Plan outlines our current plans for action on climate change with regard to our overall portfolio. It sets out four key actions to aid us in achieving our net zero targets and limit global warming to 1.5°C. As best practice evolves, so too will this Climate Action Plan and our actions to implement it. Further details of our Climate Action Plan can be found here.

The following outlines our progress to date:

1

Develop climate-aware investment strategies and climate solutions investments

Over the course of 2022, we have been working closely with our core appointed strategic investment managers to develop and refine a range of funds that have a bias towards investing in companies that are adapting their businesses in a way that is less carbon-intensive and/or developing climate solutions such as the BlackRock Global Corporate ESG Insights Bond Fund. The Fund, which was co-developed with BlackRock in 2022, was designed to incorporate climate change-related risks and opportunities to outperform the index on carbon emissions intensity. Learn more about the strategy here.

As at 2022 year end, our climate-aware strategies assets increased by £12 billion compared with the previous year. This brings us to a cumulative £17.5 billion, well on the way to meeting our £20–25 billion goal by end of 2025. Our investment in climate solutions within these same strategies amounted to £1.3 billion, achieving our 2025 goal of at least £1 billion.

Our activity has included:

- Increasing our target allocation of the BlackRock Climate Transition fund to 20 per cent of equity in our multi-asset funds;
- Converting our Real Estate Investment Trust (REIT) instruments to low-carbon tilts and;
- Relaunching the Scottish Widows Sterling ESG Corporate Bond Tracker with a new mandate.

We continue to seek out opportunities to invest in climate-aware solutions through our loan investment activity too. Our existing book contains a range of green infrastructure projects, including green energy solutions across wind and solar power generation, as well as smart metering. In 2022 we invested £30 million in Zenobe, the UK market leader in the provision of electric bus fleets.

2

Integrate climate considerations into asset allocation optimisation

Our Responsible Investment & Stewardship Framework and policies extend to cover all our asset classes in our portfolio influencing fund selection and asset allocation decisions across our portfolio to ensure that material ESG factors are embedded. Schroders, our strategic appointed manager for active fund management, integrates ESG risks and opportunities into their security analysis and portfolio management decisions to achieve long-term sustainable investment returns. As our appointed passive fund manager, we work with BlackRock to deliver tailored strategies that integrate ESG considerations. For example, the recent launch of the Global Corporate ESG Insights Bond Fund, which applies ESG-related tilts to achieve its aims.

Read more on **page 21**

When setting the strategic asset allocation (SAA) for our multi-asset funds, we use a variety of optimisation tools, including modelling that incorporates climate considerations into the economic forecasts. Specifically, we use long-term (from 10 to 40 years) asset class forecasts from a variety of sources, including Moody's Analytics who provide year-on-year forecasts over the next 40 years and 10/30-year forecasts from Schroders, with the longer-term forecasts incorporating Schroders' projected impact of climate change upon a variety of asset classes. In 2021, we added an additional data set from Moody's Analytics which explicitly takes climate change into account to supplement the existing analysis. The additional data set is based on Network for Greening the Financial System (NGFS)/IPCC aligned climate scenario (orderly, representative) which assumes global warming remains within the 2°C target of the Paris Agreement.

Pensions and Investments continued

3

Exclude high carbon investments that we believe present a high risk of becoming stranded assets

Our exclusion policy has been in effect since 2020. In 2022 we updated our policy regarding tobacco and thermal coal/tar sands exposure. Our exclusion policy helps to ensure that our investment approach is aligned with the long-term interests of our customers.

Tobacco: We recognise the high social, reputational and regulatory risks linked to the tobacco industry. Use of tobacco is also counter to the goals of the UN, particularly the right to health. Engagement for change with tobacco companies is not likely to yield results given that, for most, this is their main line of business. There is no viable transition plan for tobacco producers to become sustainable or responsible, which creates additional risks for investments. Therefore, in our mandated funds our policy[5] is not to invest in companies with more than 10 per cent of value chain revenues from tobacco products – this includes tobacco manufacturers, distributors, and others who rely heavily on revenues generated by tobacco.

Thermal coal and oil extracted from tar sands: These are two of the most CO_2 intensive fossil fuels. Their use is a significant contributor to climate change. Reliance on fossil fuels needs to be significantly reduced in the coming decades to achieve the objective of limiting global warming to below 2°c, which was set out by the Paris Agreement in December 2015. As countries across the globe work towards meeting this target, we believe companies that fail to amend their business models to be less carbon-intensive will pose an investment risk. Our position as a large institutional investor allows us to lobby for positive change in the companies we invest in. As such, we don't seek to exclude all high CO_2-emitting sectors. Instead, we focus on excluding individual companies or sub-sectors that we believe pose the most significant risks. The carbon, climate change and social impact of companies involved in thermal coal and tar sands is not aligned with our long-term investment strategy. As a result, in our mandated funds our policy[5] is not to invest in companies where 5 per cent or more of their revenue is derived from thermal coal or tar sand extraction.

4

Focus our stewardship activity on companies failing to address climate risks

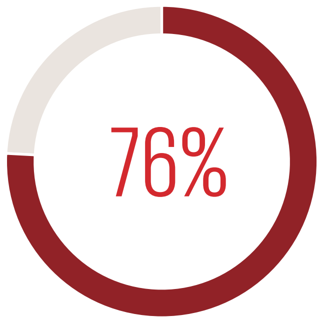
To support decarbonisation in line with our targets, a strong engagement programme is needed with investee companies. Our primary role is to monitor coverage with our appointed investment managers and engage with them to encourage the gradual extension of that coverage. In 2022, we strengthened our Voting Guidelines on climate by naming some of the high carbon sectors we expect Scope 3 reporting from. We also expanded the just transition section of the Voting Guidelines to encourage companies to incorporate the International Labour Organization's (ILO) 'Guidelines for a Just Transition' and to disclose metrics to measure progress on just transition goals and activities. We continued to engage directly with companies on climate through 2022. Stewardship and engagement activities are currently focused on our equity and bond holdings; they represent c.75 per cent[2] of our investment book.

In 2021, our appointed investment managers engaged with companies representing 79 per cent of AUM within high impact sectors outlined by the Transition Pathway Initiative (TPI)[3] including banks and insurers. The equivalent number fell to 76 per cent in 2022. Most recent analysis, based on our year-end 2022 equity and bond holdings, matched a wider base of assets to material sectors following the adoption of a new ESG data platform[4]. We now also include the real estate sector as high impact, and factoring in this wider definition, our engagement reached 73 per cent on climate topics in 2022, including, but not limited to:

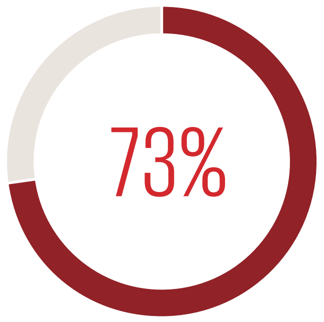
- Climate risk and oversight
- Climate mitigation
- Climate adaptation
- Climate transition plans

These are a mix of 'thematic' and 'focused' engagements, with the majority targeted towards companies with the potential to have the largest negative impact.

2022 engagement coverage in high impact sectors[1] + financials



2022 engagement coverage in high impact sectors[1] + financials + real estate



[1] High impact sectors are as per Global Industry Classification Standard (GICS) classification presented in the NZIP Implementation Guide.
[2] Including equity and bonds owned in externally pooled funds at year-end 2022.
[3] A global, asset owner led initiative that assesses companies preparedness for the low-carbon transition. Home – Transition Pathway Initiative
[4] With full coverage of our external pooled equity and bond exposure, going forward we expect to make this assessment year-on-year on a like-for-like basis.
[5] In the event that an existing holding exceeds a revenue threshold, a review will be carried out by our Investment team. If the review deems that this is likely to persist for the foreseeable future, we would look to exit the holding, taking into account market conditions and any other investment impact to the funds.

Pensions and Investments continued

DELIVERING GOOD CUSTOMER OUTCOMES

PENSIONS AND INVESTMENTS

In 2020, Scottish Widows established a dedicated team of responsible investment professionals bringing with them a diverse range of experience in responsible investment, policy, the charity sector, data and climate science. Now a team of eight, the responsible investment team is fully integrated within the Investment Strategy function, demonstrating the importance in managing our net zero commitments plans. The responsible investment and wider Scottish Widows investment teams have been active in managing the impact of climate risk and continue to develop propositions to help contribute to sustainable futures for our customers. As an asset owner, Scottish Widows leverages its influence on behalf of its customers to help ensure they benefit from the real-world economic transition.

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 £9 billion by the end of 2022 (versus £5 billion at the end of 2021). The fund uses a data-driven investment approach from BlackRock which measures a company's exposure to transition risks and opportunities, providing investors the ability 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.

BlackRock Global Corporate ESG Insights Bond Fund

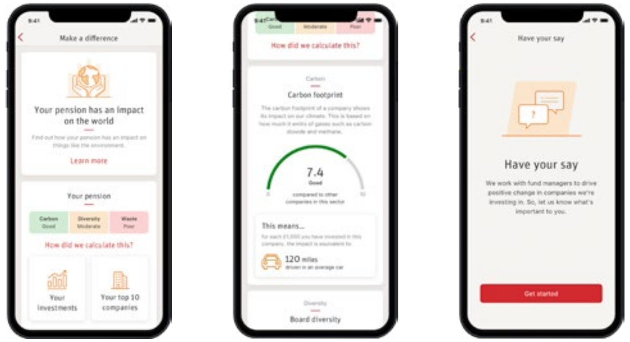
In 2022, Scottish Widows co-developed and became the first investor in BlackRock's new ESG bond fund – BlackRock Global Corporate ESG Insights Bond Fund – with a seed investment of £500 million. The Fund applies an exclusion overlay as well as an assessment of ESG performance to seek to achieve a set of ESG-related aims.

£9bn+

invested in the BlackRock Climate Transition World Equity Fund

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 pension scheme trustees where applicable) what matters to them; we will use this to inform our stewardship activity.



Responsible Investment and Stewardship Report

Our 2022 Responsible Investment and Stewardship Report is due to be published in Q3 2023. Scottish Widows are among the first cohort of signatories to the Financial Reporting Council's (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 (UNGC) violators) and investment managers.

Shareholder fund portfolio

In 2022 we appointed an Emissions Reporting Manager specifically to focus on the Loan Investment and Shareholder Assets book. Of particular focus are the continued development of data coverage and quality for the Loan Investments book. The concentration of these assets in the annuity fund and their illiquid nature means that they are managed on a buy and hold basis; developing better quality emissions data for these loans will assist in both managing the current portfolio as well as informing strategic decisions for future investments in due course.

A Just Transition

As the climate emergency climbs higher up the customer agenda, there is a call for investors to ensure that efforts towards achieving a transition to a low-carbon future are fair and just. Put simply, a Just Transition is one that considers the social consequences of a decarbonising economy, ensuring that the transition brings all impacted communities along with it. These considerations are embedded into our Climate Action Plan and overall Responsible Investment Framework. Read more on how Scottish Widows are considering the social impacts of the climate transition in our report The Just Way here.

Portfolio mapping and monitoring

In the past year, we have been working with our custodian to platform our underlying investment data to enable better measurement and monitoring of climate change and sustainability related portfolio exposures. The tool allows us to import licenced data at company level from chosen vendors to enhance biodiversity and deforestation risk mapping.

Pensions and Investments continued

Case study

ENGAGING DIRECTLY WITH INVESTEE COMPANIES TO DRIVE POSITIVE CHANGE

As an asset owner we are mindful of our appointed investment managers' role and consider what value we can add in addition – known as additionality. We spend significant time engaging with investment managers and taking part in industry collaborations. To strengthen engagement efforts and deepen understanding of emerging ESG themes, we continue to evolve our stewardship and engagement programme through external collaboration with several initiatives, including collective engagement efforts and contribution to industry working groups. However, our direct engagement with investee companies is an increasing focus of our stewardship. Through 2022 we have continued to conduct our own research and develop direct relationships with companies.

We are continuing to engage with companies on their net zero transition plans, targeting companies based on specific criteria to ensure our activity is additional to other engagement by market participants. 49 of our top 100 holdings fall under the six most polluting sectors (per the GICS classification*); 22 of them are already subject to extensive engagement activity by CA100+, of which we are a member. In 2021 we wrote directly to the other 27 companies. Our next stage of engagement in 2022 concentrated our efforts on activities that were additional to those targeted by existing collective action. That focus targeted 15 of the 27 companies we contacted in 2021 which were not covered by the CA100+ engagement. For this second round of engagement, we conducted research on their TCFD reporting, transition plans and approach to nature and biodiversity in order to engage on a company-specific basis.

Our letters to these companies highlighted:

- Scope 3 emissions are often a company's largest set of emissions which require the most work to reduce. We encouraged companies to disclose and develop plans to reduce their Scope 3 emissions.
- Broader environmental impacts including biodiversity loss, waste and water management, pollution, and land use and management.
- The Forest 500 ranking identifies companies with the greatest exposure to tropical deforestation risk and assesses them on the strength and implementation of their commitments. We included companies' places in the ranking and encouraged them to take action to reduce their deforestation risk.

By the end of 2022, eight companies had responded to us, and we were able to meet with three of them to discuss their approach in detail. We will continue to engage with all 15 companies during 2023.

* Global Industry Classification Standard.

CARBON CREDITS AND OFFSETTING ON THE JOURNEY TO NET ZERO

Net zero strategies should prioritise real economy carbon reduction and removals in line with science. Used responsibly, we consider high-quality carbon credits an important tool in combatting climate change to offset residual emissions. Responsible use includes acting soon enough for the removals provided by such offsets to have a positive climate impact rather than as a 'last resort' mitigation tool only considered as we near 2050. We acknowledge that in order to restore trust in the carbon credits used in the voluntary carbon market, heightened governance is essential to ensure enhanced quality and that their use does not seek to avoid or minimise accelerated decarbonisation efforts. Where carbon credits are used, we expect our investee firms to consider associated biodiversity and social impacts, in line with our focus on a Just Transition and nature preservation.

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. 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.

Pensions and Investments continued

SUPPORTING DEFORESTATION-FREE PENSION FUNDS

In 2022, we collaborated with the Global Canopy, Make My Money Matter, and several leading pension funds to develop and publish guidance for 'deforestation-free pension funds'*. This guidance encourages pension funds to measure and disclose deforestation risk within investment portfolios, and develop strategies to reduce and eventually eliminate that risk; it is split into six phases, from identifying where deforestation risks can be found in portfolios to implementation and engaging to ensure funds are deforestation-free.

We are now working to ascertain how this guidance can be applied to our portfolio by reviewing the directory of available datasets and tools.

*https://guidance.globalcanopy.org/further-guidance/pension-funds/

Our work to date

Responsible investment is at the heart of our investment approach at Scottish Widows – nature degradation and biodiversity loss is a systemic risk for our portfolios and our beneficiaries. As we consider how best to embrace this as an investment theme, we have advanced our work on responsible investment in other areas, seeking the mitigation of risk in our portfolios, while aiming to prevent future impacts on the environment, society and the economy.

TNFD final recommendations are expected in the second half of 2023. The TNFD framework will deliver a comprehensive and consistent approach to nature-related financial disclosures. We recognise that nature degradation and biodiversity loss, together with climate change, are among the greatest threats to our planet, society and the economy and encourage the government to leverage the opportunity to make the UK the first country to mandate economy-wide TNFD reporting when the final framework is agreed upon.

Our thematic stewardship and engagement programme now includes the theme of biodiversity including but not limited to issues such as deforestation, within the broader theme of climate change and the environment. We view the elimination of deforestation as key to a sustainable future and, accordingly, it is one of our engagement priorities.

In our engagement with asset managers and relevant investee companies, dialogue is now beginning to include broader environmental characteristics and factors which affect ecological limits. To support this focus, in 2022 we joined the FAIRR (Farm Animal Investment Risk & Return) Initiative, which will be a key mechanism for us to collaboratively engage on biodiversity – with expertise in sustainable proteins, the initiative opens avenues to collectively engage with the food and agriculture industry on identified major pathways to address biodiversity loss.

Furthermore, we have advanced our approach to responsible investment and stewardship through the implementation of Voting Guidelines, which we use to monitor and, where appropriate, challenge our key managers' voting policies and practices to influence and encourage them to make their own in-house policies more progressive. Where relevant, our guidelines adopt a stance that investee companies should promote biodiversity, conservation, water quality, waste management and nature-based solutions to allow nature and people to flourish. These guidelines also set out our expectations that companies have (or are actively working towards) adequate policies and programmes on sustainable land and water use to protect biodiversity and address community concerns on land use.

Coming up next

Nature degradation and loss of biodiversity and ecosystem services expose investee companies to transition, physical, litigation and systemic risks, which could impact investment value in the short, medium, and long term. It is therefore important for us as an investor to develop a clear understanding of the potential impact from nature on the risk-return profile of these companies and develop a strategy to reduce and eventually eliminate risk. We are committed to playing a role in the prevention of further degradation and look forward to working within our industry on contributing to positive nature outcomes.

As we look ahead to further advancing our focus on biodiversity and nature through our stewardship and engagement programme, we have identified participation across future, relevant collective engagement initiatives as a key opportunity through which we will support the fight against biodiversity and ecosystems loss.

Having contributed to the Global Canopy's development of guidance for 'deforestation-free pension funds', we have commenced adoption of appropriate areas of this guidance, which will help us to identify and map key areas of deforestation risk within our portfolio and allow us to report on our activity to reduce the risk. As previously noted, we are also considering how we can best embrace biodiversity as an investment theme so that matters linked to biodiversity and ecosystem loss such as deforestation, use of water, waste and pollution, and sustainable food can be included in our investment design. Additionally, to support the pensions industry, we have researched the ways in which it can overcome existing challenges and begin to take action on nature and biodiversity across investment activities. We published our thoughts on this early 2023 in our report 'Nature and Biodiversity: The pensions imperative'.

Pensions and Investments continued

In our inaugural Green Pensions research carried out in 2022*, 72% of respondents agreed it was important to them that their employers invested their pension savings sustainably. It is important that we continue our ESG integration for our flagship pension default option given what we know about our customers' attitudes. In terms of ESG specifically, the majority of customers agreed that this has to be built into the default option. We expect the long-term customer benefit to be improved risk adjusted returns with heightened ESG characteristics. During 2022, we focused on the fixed income and real estate elements, which we outline in the following case studies.

Case study

IRWELL VALLEY

Irwell Valley are a traditional housing association based in Greater Manchester, with c.7,700 homes under management.

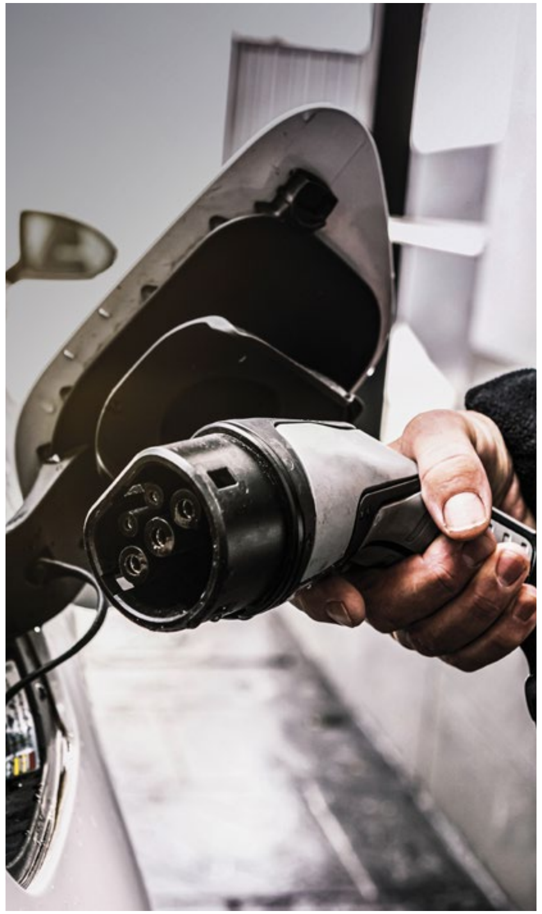
Scottish Widows provided Irwell Valley with a £60 million 40-year term loan in June 2022. This funding will help support an ambitious development programme that will see them build over 1,000 new homes for social and affordable rent over the next five years, together with a commitment to achieve net zero carbon emissions across all of their properties by 2038.

irwell valley homes

Case study

BLACKROCK GLOBAL CORPORATE ESG INSIGHTS BOND FUND

In the last quarter of 2022, Scottish Widows became the first investor in BlackRock's new ESG bond fund – BlackRock Global Corporate ESG Insights Bond Fund – with an initial backing of £500 million. Through its exposure to global investment grade bonds, the Fund seeks to achieve a set of ESG-related aims, including achieving a carbon emissions intensity score that is 50 per cent less than the index. With an AUM of £942 million at the end of 2022, the Fund's strategy applies an exclusion overlay** before the remaining investible universe is assessed based on issuer ESG performance. Scottish Widows' investment marks the second collaboration with BlackRock, following the seeding of the Climate Transition World Equity Fund in 2020. Working with our appointed asset managers in the design of tailored ESG funds reflects the growing customer demand in climate-aware strategies as well as helping to drive innovation in ESG investing.



** The Fund's exclusion policy removes companies with involvement in thermal coal and tar sands; tobacco; UNGC violators; and controversial weapons including nuclear and civilian firearms.

*https://adviser.scottishwidows.co.uk/assets/literature/docs/60817.pdf

Pensions and Investments continued

Case study

SWUTM ESG STERLING CORPORATE BOND TRACKER

The overall objective is to improve the ESG score and reduce the carbon footprint versus the parent index. The benchmark provider, iBoxx, achieves this by applying a set of screens to the standard index using MSCI data, with the remaining universe reweighted based on market value weights. The following table provides detail on the screens applied to the ESG index, which are a combination of business, climate and controversy screens and ESG ratings from MSCI.

The ESG index has exhibited less volatility than the parent index without giving up returns and delivers a lower carbon footprint. We consider this to be particularly important in the Pension Portfolios, where the bond allocation plays a specific role in countering the volatility of higher risk assets.

Markit iBoxx ESG GBP Non-Gilt Index

Business screens

- Controversial weapons
- Tobacco
- Nuclear weapons
- Civilian firearms

Climate/carbon screens

- Thermal coal
- Oil sands
- Fossil fuel reserves
- Oil and gas equipment and services
- Oil and gas extraction and production

Flags

- UNGC violators
- Controversy score

ESG ratings

- BB and above

Case study

ISHARES ENVIRONMENT & LOW CARBON TILT REAL ESTATE INDEX FUND

ESG screens set by the index provider seek to limit and/or exclude corporate issuers within the Parent Index which have exposure to, or other ties with, activities including but not limited to:

- Non-renewable energy (including extraction of oil sands, thermal coal and thermal coal power generation);
- Tobacco (including related to the manufacture, supply and distribution of tobacco);
- Weapons (including chemical and biological, cluster bombs and nuclear weapons); and
- Controversies (including human rights, labour, environmental and anti-corruption controversies).

The remaining constituent weights are then adjusted (tilted) based on improvements relative to the Parent Index across three sustainable investment considerations:

- Green building certification (the share of total net leasable area owned and/or managed by a company that is certified as part of an eligible green certification scheme, minimum 30 per cent improvement);
- Energy usage (the average modelled energy consumption per square metre of net leasable area owned and/or managed by a company; minimum 10 per cent improvement); and
- Carbon emissions intensity (which is the total operational emissions scaled by company value including cash; minimum 20 per cent improvement).

4

GENERAL INSURANCE

Scottish Widows Group plays an important role in underwriting the home insurance propositions for Lloyds Banking 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

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 the need 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. The scheme went live on 1 July 2022 and the first eligible claim was registered in August.

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 incorporating sustainability and environmental factors into the design of our products 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.

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 sustainability.

Internal research outlined the 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.

5

SCENARIO ANALYSIS

A wide range of scenario analyses is used to provide insights to aid our understanding of climate risk and support our decisions. The key conclusions from the scenarios we have modelled are:

- It is in our long-term interests to have an orderly transition to a low-carbon economy.
- Our business strategy remains resilient.

While climate science itself is very well developed, any analysis of the economic and financial impacts of climate risk involves a measure of subjectivity and simplification, so there is a relatively wide margin of uncertainty in these impacts. This type of modelling is therefore only one of several components of our climate risk management process and is not acted upon in isolation.

What is scenario analysis?

“Scenario analysis is a process for identifying and assessing the potential implications of a range of plausible future states under conditions of uncertainty. Scenarios are hypothetical constructs and not designed to deliver precise outcomes or forecasts. Instead, scenarios provide a way for organizations to consider how the future might look if certain trends continue or certain conditions are met. In the case of climate change, for example, scenarios allow an organization to explore and develop an understanding of how various combinations of climate-related risks, both transition and physical risks, may affect its businesses, strategies, and financial performance over time.”*

The starting point for climate scenario analysis is identifying the uses of the analysis and choosing the scenarios to consider.

Scenario analysis captures the ‘physical risks’ arising from a changing climate due to carbon emissions and ‘transition risks’ from moving to a low-carbon economy. We then assess their economic and financial impacts.

Climate is one part of a wider world, and the impact of climate change and its likelihood depend on the wider global context. We use ‘shared socio-economic pathways’ (SSPs) as used by the IPCC, to provide these different contexts.

The scenarios we analyse are not predictions. They explore the potential impacts of physical and transition risks over short, medium and long terms, and across a wide range of SSPs. There is a range of available approaches to scenario analysis, so different companies’ disclosures may not be directly comparable.

* Source: Recommendations of the TCFD.

Scenario analysis continued

How do we model climate scenarios?

We have worked with external experts to develop our climate scenario analysis modelling. To assess the impact on our assets, our approach is:

- To choose our combinations of SSP and global warming scenario;
- To partition our investment portfolio into cells by sector and region;
- To project the behaviour of each cell under the degree of transition risk designed to achieve our chosen degree of global warming: the greater the transition, the less the global warming; and
- To overlay the impact of physical risk arising from global warming on our sector-region partition.

By modelling at a sector-region level, we seek to avoid the problem of assuming that we are tied to our existing investee counterparties over long periods; instead, our exposure in each cell changes in line with its projected value.

To support the scenario analysis we have collaborated with external partners and used the outputs from their climate-conditioned physical risk models to inform the results of the scenario analysis.

The output of this exercise is a set of projected asset prices across a range of socio-economic and global warming pathways. Impacts are considered relative to counterfactual projections, in which climate risk is not recognised at all but which do capture the effects of the chosen SSPs.

For our general insurance liabilities, we model the average annual cost of damage (AAD) for the same range of scenarios as at 2100.

Scenario choices*

To rationalise what scenario choices are used it's helpful to think about four high-level scenarios that capture different settings along two important dimensions: the strength of the greenhouse gas mitigating policy response; and how smoothly and foreseeably those actions are taken.

Transition risks

DISORDERLY OR DIVERGENT

Scenarios explore higher transition risk due to policies being delayed or divergent across countries and sectors. Carbon prices are typically higher for a given temperature outcome.

TOO LITTLE, TOO LATE

Scenarios would assume that a late transition fails to limit physical risks.

ORDERLY

Scenarios assume climate policies are introduced early and become gradually more stringent. Both physical and transition risks are relatively subdued.

HOT HOUSE WORLD

Scenarios assume that some climate policies are implemented in some jurisdictions, but global efforts are insufficient to halt significant global warming. Critical temperature thresholds are exceeded, leading to severe physical risks and irreversible impacts like sea-level rise.

Physical risks

*Source (scenario definitions): NGFS Scenario Portal.

Scenario analysis continued

ILLUSTRATIVE SCENARIOS

In projecting climate risk, there is of course a wide range of possible outcomes. From our range of modelled outcomes, we have chosen the following scenarios for discussion in this report:

ORDERLY

The socio-economic context is of global cooperation and high technological growth (SSP1). This cooperative world is combined with actions that reduce carbon emissions to limit the increase in surface temperature to below 2°C at 2100 compared to preindustrial levels. We consider this scenario because we believe that SSP1 provides the socio-economic context that is most conducive to achieving an orderly transition.

DIVERGENT

This is a disorderly scenario with more divergent global actions than the orderly. In this SSP social, economic and technological trends do not shift markedly from historical patterns, so development and income growth proceed unevenly (SSP2), following a 'middle of the road' pathway. This middle of the road world is combined with actions that reduce carbon emissions to limit the increase in surface temperature to below 2°C at 2100 compared to preindustrial levels. Although this SSP is not the most conducive to achieving a transition, we believe we should consider the transition in this context because it has been constructed from observed historical patterns.

HOTHOUSE

The socio-economic context is of regional rivalries and low technological development (SSP3). This regional rivalry world is combined with increasing carbon emissions, which we believe to be likely in this context, and an increase in surface temperature of 4.3°C at 2100 compared to preindustrial levels. We consider this hothouse scenario because it gives us insight into a world where we take little or no action to limit climate change.

These three scenarios can be considered to be examples of the three boxes in Chart A for which modelling of impacts is generally most advanced.

The modelling of these scenarios contains simplifying assumptions including: given the socio-economic pathway, any reduction in carbon emissions is achieved by solely applying carbon taxes, expressed as the price per tonne of CO_2 equivalent emitted; no improvements are made to defences against physical risk events; and no costly climate-related litigation or geopolitical instability, such as wars, occurs.

The financial impacts are dependent on the scenario used. For example, an alternative scenario in which a government subsidises a sector's transition to a low-carbon economy will have different sectoral impacts.

These scenarios were chosen as they show the impacts of an orderly transition to a low-carbon economy, a divergent transition, and a minimal transition. These scenarios do not represent upper or lower limits and are not equally likely to occur.

Scenario analysis continued

INVESTMENTS

Climate is one of many factors that influence an asset's performance.

In the illustrative scenarios:

- Global economic performance is best in an orderly transition to a low-carbon economy.
- Coal, oil, gas and petroleum sectors are the most sensitive to the transition to a low-carbon economy.

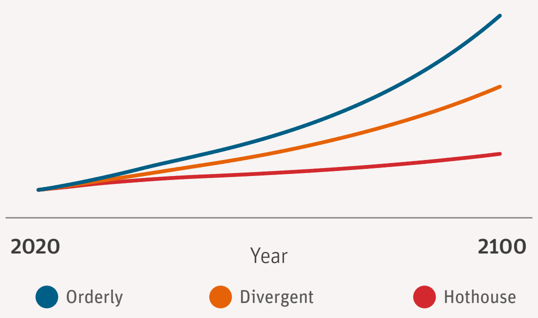
Global outcomes

This graph shows projected global outcomes in the illustrative scenarios. They show the aggregate effects of socio-economic pathways and of climate risk given those pathways. These aggregate effects are influenced more by the choice of socio-economic pathway than by the impact of climate risk.

As GDP measures the size of a country's economy, a higher GDP is expected to lead to higher earnings, growing asset prices and better investment performance.

The orderly transition to a low carbon economy has the best overall performance. This is because it is assumed to have more coordinated actions and a higher rate of technological development.

Global real GDP growth

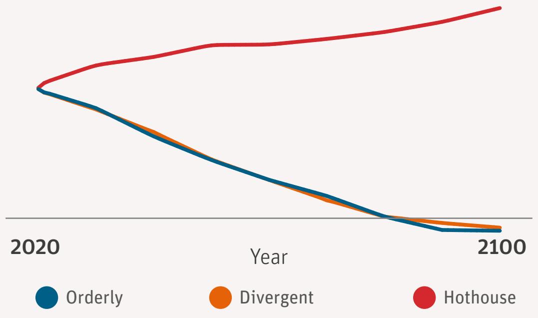


Carbon emissions

In the chart below, we project the pathways of CO_2 equivalent emissions in each of our chosen scenarios. We see that the divergent and orderly scenarios have similar profiles, but that they are not identical, as they arise in different SSPs, where different assumptions are being made about the development and coordinated deployment of technology.

As a result of these emissions pathways, by 2100 in the orderly and divergent scenarios, the increases in surface temperature have stabilised and the global economy is growing, whilst in hothouse the temperature is increasing, and globally economies are experiencing increasing damage from physical risks.

Emissions CO_2 equivalent



Scenario analysis continued

Sectoral sensitivity to climate risks

Since we hold a diversified portfolio of assets, projected aggregate equity returns largely reflect global GDP performance. We consider the impact of physical risk on asset returns to be quite speculative, so we consider the impact of transition risk alone, relative to counterfactual projections that do not recognise climate risk at all.

There are significant differences among the underlying sectors in both the orderly and divergent scenarios. This sectoral differentiation can be helpful in developing our investment strategy, especially when coupled with our view of the relative likelihoods of the scenarios and of the sectoral emissions profiles.

In this chart, we focus on the impact of climate risk on broadly defined sectors. We consider the quantitative impact of transition risk alone in the high transition scenarios, and limit our outlook to 2050.

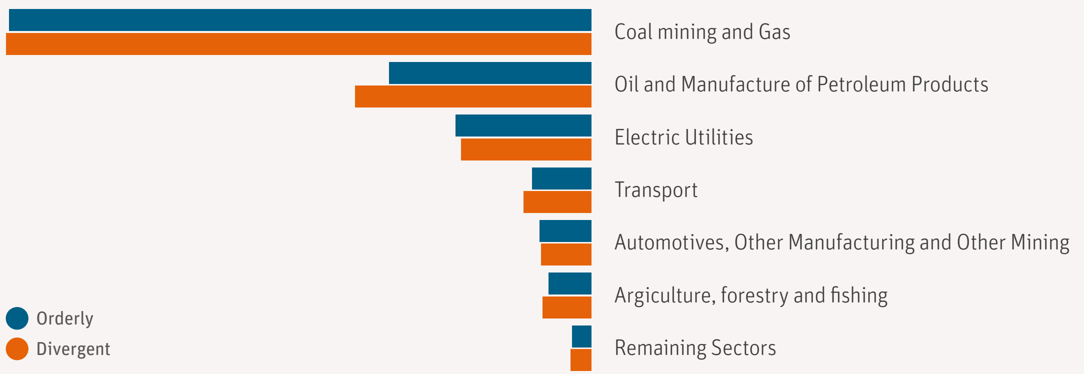
The chart is based on projected equity values at 2050, with currency movements hedged, compared to counterfactual projections.

The sectors that are more sensitive to the transition to a low carbon economy are 'Coal Mining and Gas' (including Gas Utilities) and 'Oil and manufacture of Petroleum Products'. Our modelling suggests that in these scenarios, the impacts on these sectors can be similar in the short to medium term, but that in the very long term the impact is stronger in the divergent scenario. The ordering of the sectors in the chart would also change if we changed the term of the outlook.

More granular analysis suggests that within sectors, there is a wide range of returns by region, and that this range can depend significantly on the underlying SSP.

By design, in our hothouse scenario, we would not see the impact of transition risks, but we would expect to see the impact of physical risk in the long term. As discussed above, we would expect an adverse overall economic outcome, but we consider quantification of these impacts to be speculative at this stage.

Impact of transition risk on equities



Conclusions

The socio-economic pathways have a greater effect on modelled outcomes than climate risk in isolation, though we do see some marked differentiation by climate risk among sectors when we project a significant transition to a low-carbon economy.

Scenario analysis continued

GENERAL INSURANCE

Climate change may alter the frequency, severity and location of weather risks that our UK general insurance portfolio is exposed to.

The change in weather risks could affect the cost of damage resulting from weather events which could have a subsequent impact on:

- **Underwriting risk appetite**, i.e. the type and location of properties that are insured.
- **Product design.** Product design may need to be considered, for example differentiating customer excess by weather risk type, or certain risks may not be covered for a policy in a particular area. Developments in residential housing, for example more modern methods of construction or use of heat pumps, may also require updates or innovation to the insurance products offered.
- **Insurance premiums**. Increasing cost of damage may need to be passed on to customers through higher premiums.
- **Reinsurance**. The cost of reinsurance could increase, reflecting the increased cost of damage. The availability of reinsurance could also be affected by increased frequency and severity of worldwide weather risks.

We have used the three illustrative scenarios to better understand the potential physical risks that could affect residential home insurance cost of damage under different climate scenarios and across different weather risk types.

The potential cost of damage for the most material weather risks has been estimated for future years up to 2100. The weather risks included in the scenario analysis are windstorm, inland flood, coastal flood, freeze and subsidence. Lower materiality and emerging risks are regularly assessed but are not discussed further in this report.

The analysis presented is based on risk levels as at 31 December 2021 and assumes no changes in the extent of flood defences over time.

The table below indicates the change in magnitude of the AAD for a range of scenarios as at 2100. The Red / Amber / Green status indicates the severity of change for the weather risks in each scenario where red indicates the largest change in risk. Note the change in freeze is a reduction, with increasing temperatures.

Weather risk	Orderly	Divergent	Hothouse
Windstorm	Green	Green	Green
Flood	Amber	Amber	Red
Freeze	Amber	Amber	Red
Subsidence	Green	Green	Red

"Even in the orderly and divergent scenarios, where increases in the surface temperatures have stabilised by 2100, sea levels could continue to rise increasing the risk from coastal flood."

The largest increase in physical risk is seen in the hothouse scenario, as the cost of damage is expected to increase with warmer global mean temperatures.

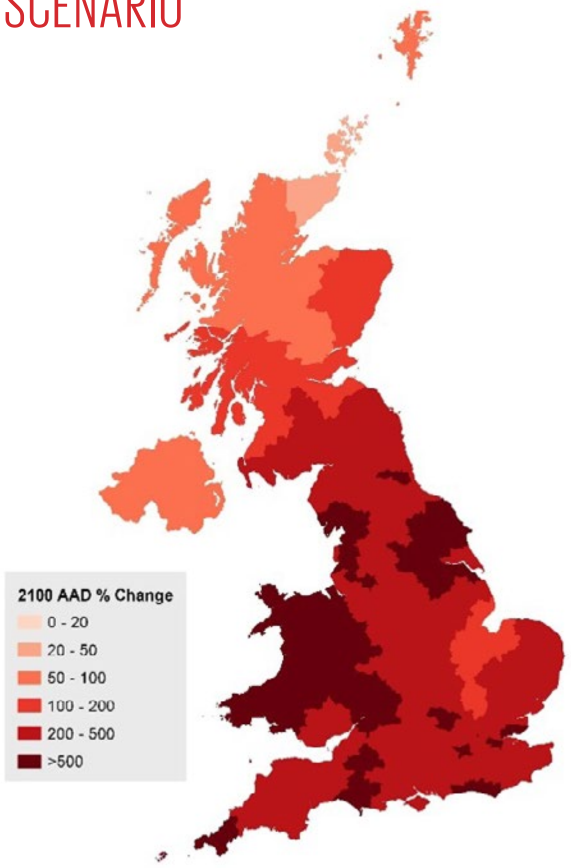
- Large increases in the cost of damage are seen for **flood**, both inland flood and coastal flood risk. The main driver of this increase is that warmer air can hold more moisture, increasing the level of precipitation. Combined with rising sea levels, the level of flood risk increases considerably. Even in the orderly and divergent scenarios, where increases in the surface temperatures have stabilised by 2100, sea levels could continue to rise increasing the risk from coastal flood. There is significant regional variability in flooding impacts and it should be noted that the majority of properties are not materially impacted by flood risk.
- **Subsidence** risk is expected to increase, in particular in the southeast of the UK due to hotter, drier summers leading to more ground movement in the heavy, chalky soils.
- The cost of damage from **windstorm** risk is not projected to materially change, however the modelling of future windstorm risk contains a high degree of uncertainty, in particular windstorm activity in the North Atlantic which influences UK weather.
- The projected increase in temperatures is expected to result in warmer winters on average, reducing the potential cost of damage from **freeze** risk. The prevalence of the weather events that drive UK freeze risk is also projected to decrease. However, the increase in temperature does not remove the risk of significant freeze events affecting the UK in future, even in the hothouse scenario in 2100.

The extent of future changes in weather risks is highly uncertain and is dependent on several factors including environmental conditions and the actions of policy makers.

Scenario analysis continued

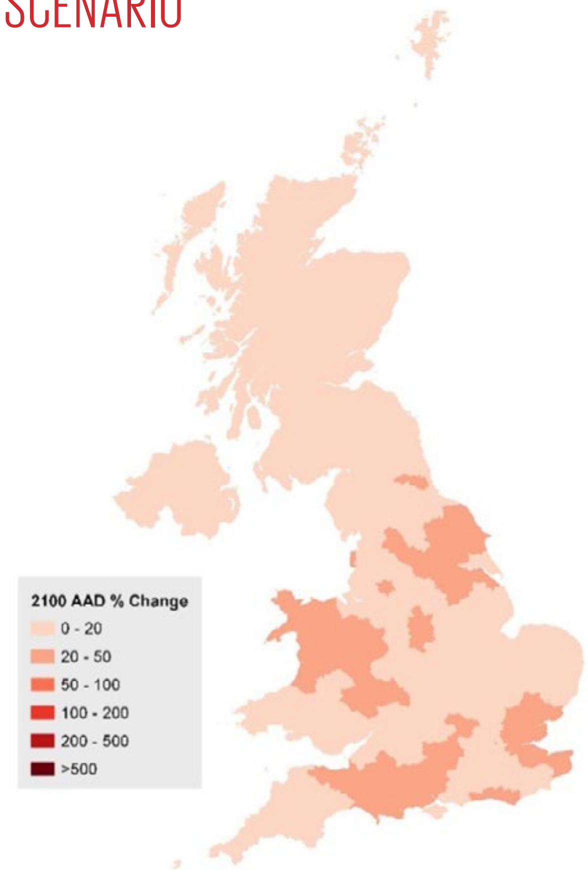
Inland flood 2100

HOTHOUSE SCENARIO



Inland flood 2100

ORDERLY SCENARIO



Flood risk

The most significant changes are seen in respect of inland flood. The maps opposite show the potential projected change for inland flood in both the orderly and hothouse scenarios as at 2100. The maps show, at a high level, the regional variability in changes in flood risk. Data in the maps represents the Lloyds Banking Group portfolio.

The analysis can be used to inform future changes to underwriting risk appetite and indicate how the price of risks may change in future.

The outputs from the flood modelling are used to create a relative view of risk across the geographic domain of the home insurance 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 inform customer premiums and manage our exposure in high-risk areas. Increasing the proportion of our portfolio in bands greater than 20 could lead to significant increases in cost of damage in the event of increasing severe flood events. In the shorter term, the increase in flood risk would likely result in greater use of the Flood Re scheme*. Increased flood risk would also require us to prepare for more intensive claims handling, regardless of whether risk is ceded to Flood Re.

The increased risk of flooding is likely to be concentrated in a relatively small proportion of UK residential properties. The impact of flood risk can be partially mitigated by home improvements to make properties more resilient to flood, i.e. 'building back better', for example by raising electrics, installing hard flooring or flood doors.

Internationally, government actions that restrict or reduce future emissions are likely to reduce the physical risk that residential properties are exposed to, which would consequently moderate the cost of damage to properties.

Investment in flood defences along rivers and coastal defences, along with improved urban drainage systems could help to mitigate some of the increased risk from flooding.

Continuing the Flood Re scheme beyond the current end date of 2039 would allow properties at high risk of flooding to continue to gain access to affordable insurance, particularly under scenarios where the increase in risk of flooding is high.

Improving building standards could also increase the resilience of residential properties to heightened physical risk.

In summary, flood risk is likely to lead to the most material changes in risk to residential properties within the UK in the scenarios considered.

* Flood Re is a joint initiative between the government and insurers. Its aim is to make the flood cover part of household insurance policies more affordable.

Scenario analysis continued

Challenges with the analysis

This analysis requires us to model the global economic impacts over several decades of climate risks. Inevitably, such a task involves simplifications and speculative judgements. For example:

1. We model government policy to effect a transition by means of a single, simple tax on emissions of GHGs, whereas actual policy would also involve regulations and incentives.
2. Since there is no historical precedent to guide us, we must speculate on the impact of physical risk on economic output. It is arguable that for various reasons the economic impact of physical risk is understated, for example we make no explicit allowance for disruptions to supply chains or to political stability.
3. Climate scenario analysis covers carbon emissions but other aspects of sustainability, e.g. biodiversity and its interaction with climate change, are not currently addressed.

Climate scenario analysis requires data for the assets, which is not available for the entire portfolio. While we have been able to model the majority of our assets, for those with inadequate data we do not explicitly model the returns. Implicitly, the projected return on such assets is the same as that on the assets we have modelled. Where precise matching of the sector of an asset to a modelled sector has not been possible, we have adopted an appropriate proxy.

While we consider the approaches we take to be reasonable, we must recognise that our model outputs are indicative rather than definitive and treat them with appropriate caution. While climate science itself is very well developed, determining the economic impacts of climate change is problematic, and there is no single agreed method used across the industry. The margin of uncertainty in any translation of climate risk into economic impacts is wide.

For these reasons, this type of modelling is only one of several components of our climate risk management process and is not acted upon in isolation.

Business strategy

We regularly review our strategy using scenario analysis to assess its resilience.

Short to medium term

We assess risks to the achievement of our strategic objectives over the short to medium term. This year, amongst other stress tests, we considered a bespoke climate scenario and compared this to the base planning scenario. In the analysis, we projected our balance sheet and profit and loss account. The key components of the stress scenario were:

- General Insurance: Weather events that previously occurred once every 10 years occurring every year.
- Pensions, Investment, Protection and Annuities: As well as stresses to asset values, we projected deterioration of the business environment with reduced sales and more people stopping policies, possibly as a consequence of reputational risk.

This analysis showed us the variation in projected profitability caused by an adverse climate scenario. If this scenario were to occur Scottish Widows would remain secure.

Long term

Our business strategy is kept under continual review to ensure that it remains current and resilient in the face of emerging risks.

Long-term climate scenario analysis alerts us to potential changes in the economic and physical environment, to which we adapt by reviewing, for example, our pricing and underwriting standards and our investment strategy.

Next steps

Analysis of the impact of climate risk on the economic and financial system is in its infancy and we will continue to develop our analysis and the availability, coverage and quality of climate-related data.

METRICS AND TARGETS

Over 2022 we have focused on expanding our climate-related metrics, as well as building strategic capability to produce these metrics. For this year's report, we have included additional years, progressing from the baseline figures for 2019 which we published last year. In addition, we have published a further metric, weighted average carbon intensity, in line with developing industry practice and regulatory expectations.

We are currently embedding our strategic capability and developing analytical tools to help provide meaningful insight to the business on climate-related metrics. We are also monitoring methodology developments in this area, both in terms of refinements to existing methodology and development of new methodology to cover assets currently out of scope.

Scottish Widows operational Scope 1 and 2 emissions are included as part of Lloyds Banking Group emissions and reported in detail within Lloyds Banking Group Environmental Sustainability Report.

FINANCED EMISSIONS

PENSIONS AND INVESTMENTS

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 carbon footprint is the tonnes of GHG emissions 'owned' by the portfolio. This is measured as carbon dioxide equivalents (CO_2e) 'owned' per £1 million invested.

2030

Halve the carbon footprint intensity of our investments

2050

Net zero emissions across the entirety of Scottish Widows investments

We've selected 2019 to be the baseline year in line with the science-based recommendations of the IPCC 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.

Read the PCAF standard in The Global GHG Accounting and Reporting Standard for the Financial Industry

The calculation date of the metrics and data published in this document is 31 December 2022. Underlying GHG emissions reported by organisations will take time to be reported to our data supplier following publication – typically 12–18 months. Therefore, for the 2022 reporting period, emissions are typically (but not exclusively) based on those reported at the end of 2021.

Due to the nature of the calculations, we would expect short-term variation of the carbon footprint 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, it is important to study the medium-term trend from future reporting.

Some of the limitations of carbon footprint as an indicator of environmental sustainability are:

- It does not capture other environmental impacts, such as chemical pollution, resource depletion, biodiversity loss, or water use.
- It may not reflect future emission reduction plans or potential low-carbon innovations by companies.
- It does not yet fully account for indirect emissions from upstream and downstream activities (Scope 3 emissions), which can be significant for certain sectors.
- Comparability across different firms' disclosures may be difficult due to difference in data sources, methods, standards and assumptions used to calculate it.

Example of how we calculate emissions financed by our investment

Scottish Widows investment ÷ Total enterprise value* × Total company emissions** = Financed emissions

Example company

£160m ÷ £4,000m × 2.8 $MtCO_2e$ = 0.112 $MtCO_2e$

* Market cap plus book value of debt.
** Scope 1 and Scope 2.

Financed emissions: Pensions and Investments 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

Relates to emissions that a company makes directly from owned or controlled sources, for example while running its boilers and vehicles.

SCOPE 2

Relates to emissions that a company makes indirectly, for example when the electricity or energy it buys for heating and cooling buildings is being produced on its behalf.

SCOPE 3

Relates to emissions that are more external to a specific organisation, such as from buying products from its suppliers and from its products when customers use them.

Scope 1 and 2 emissions are a mandatory part of reporting for many organisations across the world. 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.

What metrics do we calculate?

Climate metric	Overview	Unit	Asset/liability class	Physical/transition risk or opportunity	Year-end 2022
Carbon footprint	This is the principal metric for measuring our investment portfolio's financed emissions and monitoring progress towards our 2030 and 2050 targets. It is a measure of carbon intensity calculated as absolute value of emissions applicable to an investment divided by the value of investment.	tCO_2/£m invested	Equities, corporate bonds, business loans, project finance	Transition	77.4
Weighted average carbon intensity	Expresses the portfolio's financed emissions per unit of sales revenue of the investee companies.	tCO_2/£m revenue	Equities, corporate bonds, business loans, project finance	Transition	188.0
Absolute financed emissions	This is the tonnes of GHG emissions 'owned' by the portfolio.	$MtCO_2e$	Equities, corporate bonds, business loans, project finance	Transition	10.2
Investment in climate-aware investment strategies	This is to measure our investment in climate-aware solutions, with a target of investing between £20–£25 billion by 2025. These are funds that have a bias towards investing in companies that are adapting their businesses to be less carbon-intensive and/or developing climate solutions.	£bn	Funds	Opportunity	17.5
Investment in climate solutions investments	This is to measure our investment in climate solutions, with a target of investing at least £1 billion by 2025. These are investments where 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.	£bn	Funds	Opportunity	1.3

GI specific metrics	Overview	Unit	Asset/liability class	Physical/transition risk or opportunity
Insured properties in high risk band	Shows the percentage of properties in high risk bands for flood risk, to help manage our exposure in these high-risk areas.	%	General insurance liabilities	Physical
Weather-related losses	Actual versus Expected Average Annual Loss (AAL) on a net of reinsurance basis and covers flood, wind, sea surge and freeze.	%	General insurance liabilities	Physical

For product level reporting, a fund level report has been published on the Scottish Widows website outlining key metrics for each in-scope fund. Product level reporting can be found here.

Financed emissions: Pensions and Investments continued

Overview of financed emissions

Our 2022 carbon footprint was 77.4 tCO_2/£m, down from our 2019 baseline of 116.1 tCO_2/£m. We saw a decrease in the footprint from 2019 to 2020 relating to the fall in investee company emissions during 2020, in part due to reduced production and energy usage during the COVID pandemic. Some company emissions increased during 2021 post-pandemic, but on average global company values increased relative to emissions causing the footprint to fall.

The 2022 results reflect the value of investee companies during 2022 but the emissions still largely relate to 2021. Market values and emissions have not moved consistently during 2022 across different regions and sectors, for example, the US and Emerging Market indices fell, but the UK was relatively flat. In terms of higher emitting sectors such as oil & gas, the emissions increased but the company market values increased by more, meaning the oil & gas footprint has reduced relatively. As the carbon footprint is sensitive to market fluctuations in addition to the absolute value of emissions and our own investment activity, we expect to see short-term variation of the footprint and will be studying the medium-term trend from future reporting.

Note the AUM of £166.4 billion represents the total assets in scope of our headline net zero target.

Further detail of financed emissions

Our financed emissions reporting is a key indicator in helping us assess our progress against our net zero commitment. The metrics and targets we monitor help to inform our investment strategy as demonstrated in our Climate Action Plan, namely the launch of our climate-aware investment strategies. For example, see BlackRock ESG Insights Corporate Bond Fund and BlackRock Climate Transition World Equity Fund.

Further detail for the years 2020 and 2019 is contained in the Additional information section on page 60. We have presented weighted average carbon intensity for the first time this year, in line with developing industry practice and regulatory expectations.

However, the carbon footprint is still our preferred measurement of progress against our net zero target. Where there is no current PCAF method for calculating emissions those asset types have been excluded from the scope of the calculations at this time – we will continue to develop our approach and follow industry best practice to include these in future reporting. Asset types excluded on this basis are government bonds, derivatives and cash. Collateralised securities (securitised loans) are also excluded on this basis unless data on the underlying loan portfolio is available enabling an alternative PCAF methodology to be followed.

PCAF methodology applied
Total AUM includes:
Policyholder: unitised and with-profit fund assets held in life and pension funds of Scottish Widows Limited and Scottish Widows Europe; mutual funds managed by Scottish Widows Unit Trust Managers Limited and HBOS Investment Fund Managers Limited; and the workplace savings business of Scottish Widows Administration Services Limited. In scope assets include investment funds structured as insurance contracts. Assets under administration for customers of Schroders Personal Wealth and Halifax Share Dealing Limited are not included. Assets held under the Embark Group are currently excluded from these calculations. **Shareholder:** assets held by Scottish Widows Limited and Scottish Widows Europe backing annuities and non-unitised liabilities. Investment balances in other Scottish Widows Group companies including the General Insurance business. **Policyholder and Shareholder investments** are governed by the Responsible Investment and Stewardship Framework, stewardship policy and exclusions policy, while the direct lending part of Shareholder investments are also covered by Lloyds Banking Group External Sector Statements.

Notes on tables
Only asset types where a PCAF-aligned methodology exists, and for which we have access to the data required to meet the PCAF standard, have been included within the below emissions baseline.

- For listed equities and corporate bonds, we have followed PCAF methodology 5.1 'Listed equity and corporate bonds' to calculate emissions.
- For emissions data associated with loan investments, we have followed PCAF methodology 5.2. 'Business loans and unlisted equity'.
- The exception to this is our infrastructure loans where PCAF methodology 5.3. 'Project finance' has been followed.
- There are some assets where, despite a PCAF methodology being available, we do not currently have access to the data to meet the PCAF standard.

Emissions per £1 million invested has been calculated with reference to equity market values and bond nominal values, in line with PCAF methodology. We have excluded our Commercial Real Estate (CRE) and Equity Release Mortgage loan investments from the calculations until we have sourced the asset-specific emissions data required to meet the current PCAF-aligned methodology. CRE loans are included in the Bank's published financed emissions.

Financed emissions

		Total AUM £bn	AUM in scope according to PCAF methodology and for which emissions data is available £bn	In-scope AUM for which emissions data is available %	Estimated total $MtCO_2e$ (Scope 1 and 2 emissions, for investments where data is available)	Carbon footprint (where data is available)* (tCO_2/£m invested)	PCAF data quality score**	Weighted average carbon intensity (where data is available) (tCO_2/£m sales)
2022	**Policyholder**	**145.7**	**115.1**	**79%**	**9.1**	**77.7**	**2.3**	**192.0**
	Shareholder	**20.7**	**12.7**	**61%**	**1.1**	**75.6**	**3.7**	**121.5**
	Total	**166.4**	**127.8**	**77%**	**10.2**	**77.4**	**2.4**	**188.0**
2021	Policyholder	161.1	114.4	71%	9.7	86.7	2.2	192.8
	Shareholder	27.3	15.4	56%	1.1	78.8	3.6	125.6
	Total	188.4	129.8	69%	10.8	85.8	2.3	188.3

Assets not included in emissions calculations

	2022			2021
	Policyholder £bn	Shareholder £bn	Total £bn	Total £bn
Assets not in scope of PCAF methodology: government bonds	10.1	3.3	13.4	18.4
Assets not in scope of PCAF methodology: other	3.3	2.0	5.3	5.4
Assets for which emissions data is not available	17.2	2.7	19.9	34.8
Total	**30.6**	**8.0**	**38.6**	**58.6**

* Emissions per £1 million invested is calculated using the market value of equity + book value of debt investment rather than the AUM in the table where assets are quoted at market value. The market value of equity + book value of debt equivalent total is £131.5 billion for 2022 and £126.2 billion for 2021. Note: coverage for weighted average carbon intensity may be lower than for footprint due to lack of revenue data on certain asset types.

** See page 36 for an explanation of Data quality score.

Financed emissions: Pensions and Investments continued

Data quality score

The PCAF standard outlines an approach to measuring the data quality of the emissions calculated and is specific to each asset class and aligns to the following classification. Further details of this can be found in the PCAF methodology. Broadly speaking, the lower the number, the more robust the data underlying the calculation. Over time we would expect this to reduce as organisations improve the quality of their emissions reporting and further asset classes come into scope of the PCAF methodology.

PCAF general data quality score card

Certain (5–10 per cent error margin in estimations)

Score 1	Audited GHG emissions data or actual primary energy data
Score 2	Non-audited GHG emissions data, or other primary data
Score 3	Averaged data that is peer/(sub) sector specific
Score 4	Proxy data on the basis of region or country
Score 5	Estimated data with very limited support

Uncertain (40–50 per cent error margin in estimations)

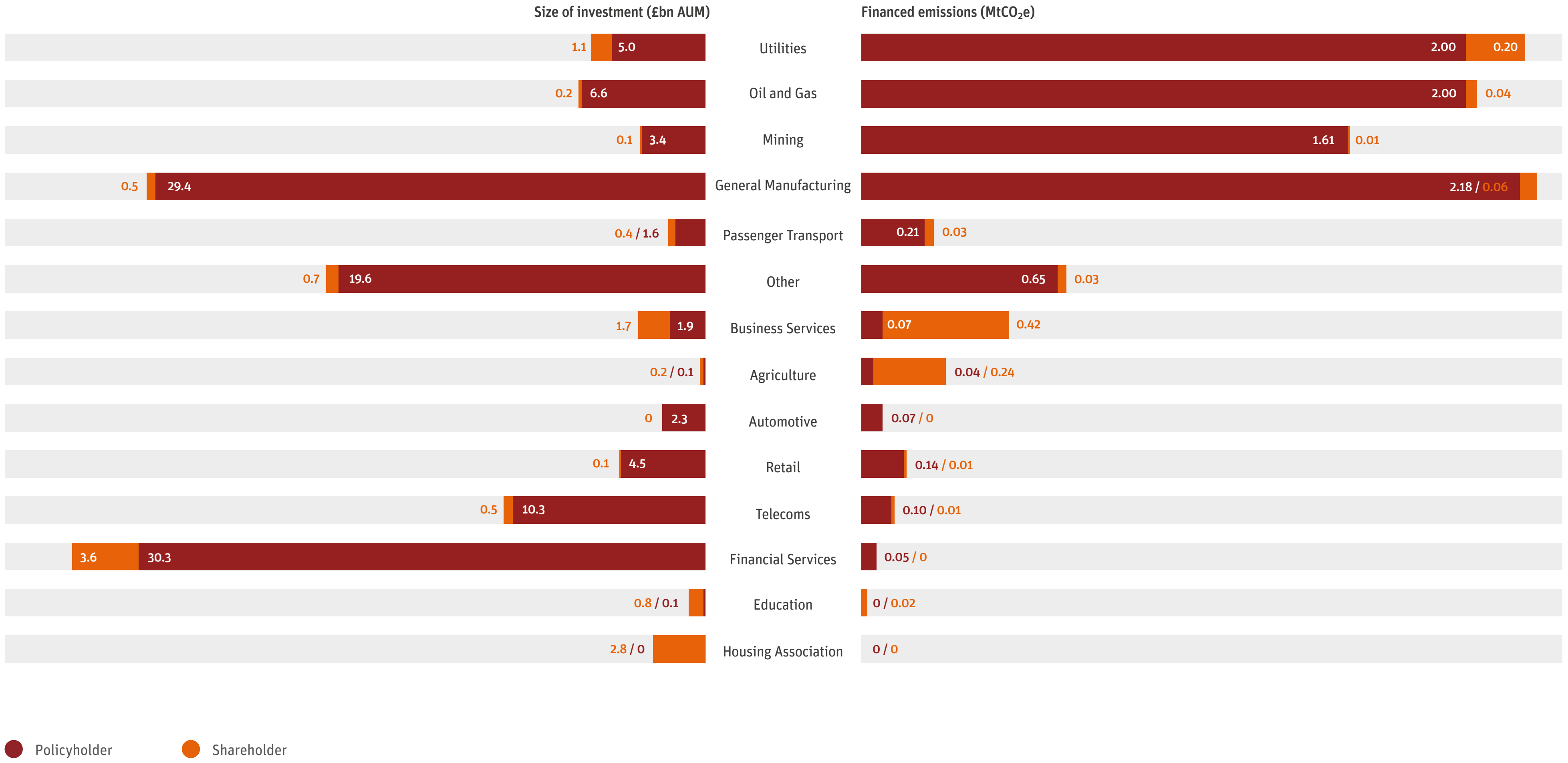
Limitations of PCAF methodology

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.

Sectorial analysis of emissions

The bar chart below shows a sector breakdown of the total financed emissions from **page 35**. This view is intended for illustrative purposes at this time and sector headings and the allocation of individual companies to sectors may be subject to revision as best practices emerge. Data as at 31 December 2022.



Financed emissions: Pensions and Investments continued

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.

When it comes to Scope 3 emissions 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

	2022			2021
	Total AUM £bn	Estimated total $MtCO_2e$ (Scope 3 emissions, for investments where data is available)	Data quality score	Estimated total $MtCO_2e$ (Scope 3 emissions, for investments where data is available)
Policyholder				
Oil and gas	6.6	24.4	3.1	23.5
Mining	3.4	8.4	3.4	12.2
Total	**10.0**	**32.8**	**3.2**	**35.7**
Shareholder				
Oil and gas	0.2	0.6	3.1	0.6
Mining	0.1	0.3	3.0	0.4
Total	**0.3**	**0.9**	**3.1**	**1.0**
Scottish Widows total				
Oil and gas	6.8	25.0	3.1	24.1
Mining	3.5	8.7	3.4	12.6
Scottish Widows total	**10.3**	**33.7**	**3.2**	**36.7**

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 century*. 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.

* 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 (ipcc.ch)

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

AAL metrics are reviewed regularly to ensure that we're not exposed to large potential losses from a small number of high-risk areas. 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.

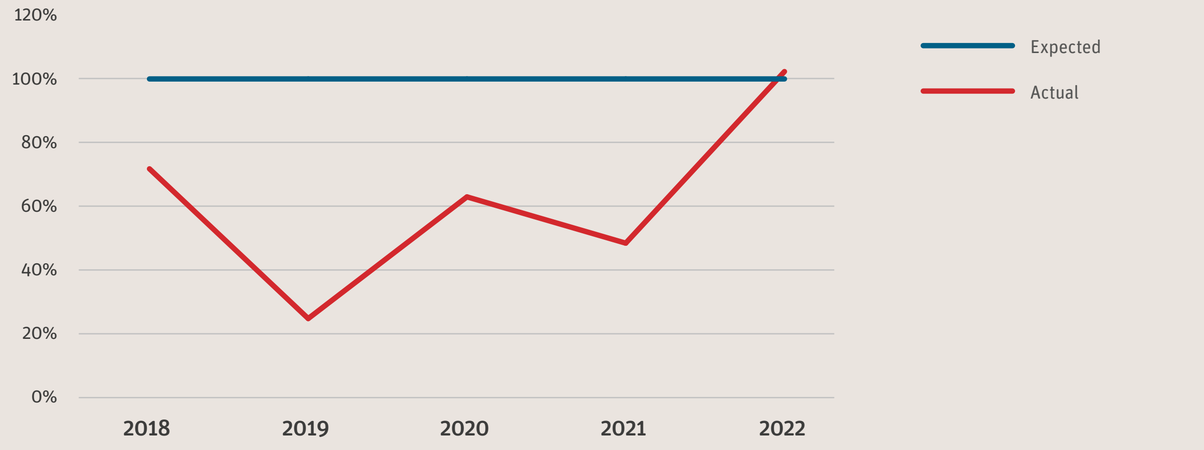
The graph on the right shows Actual versus Expected AAL on a net of reinsurance basis and covers flood, wind, sea surge and freeze. Actual weather losses performed better than expected from 2018 to 2021 due to recent benign activity. However, due to the extreme cold weather in December 2022 in addition to small windstorm losses, actual weather losses for 2022 approximate expected losses. The expected weather losses is a long-term view, so there can be significant volatility depending on weather.

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.

Percentage of insured properties in high risk band (>Band 20) as at:

	December 2020	December 2021	December 2022
Inland flood	4.0%	2.7%	2.7%
Coastal flood	0.6%	0.6%	0.6%

Severe weather losses (actual % of expected loss)



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.

* The entities which comprise the Insurance Board are Scottish Widows Group Limited, Lloyds Bank General Insurance Holdings Limited, Scottish Widows Financial Services Holdings, St Andrew's Insurance plc, Scottish Widows Limited, Lloyds Bank General Insurance Limited, Scottish Widows Administration Services Limited and Scottish Widows Administration Services (Nominees) Limited.

** The entities which comprise the ACD Board are Scottish Widows Unit Trust Managers Limited and HBOS Investment Fund Managers Limited.

Governance for climate-related risk has been embedded into our existing governance structure and is complementary to governance of the wider Lloyds Banking Group's sustainability strategy, with key boards and committees meeting regularly in a calendar year. Our approach to sustainability and responsible investment has developed significantly since we established the Insurance Sustainability Committee back in 2021. Sustainability is now embedded as a core part of our committee governance, which is why in 2023 the Board of Directors decommissioned the Insurance Sustainability Committee and supported the transfer of its sustainability and responsible investment responsibilities within the broader Board committee governance. During 2023, we will continue to review and refine our committee governance to ensure ESG is fully embedded across the committee structure and into all business as usual considerations. The Responsible Business Executive Committee remains in place. The structure as described in the rest of this section was in place throughout 2022, the period covered by this report.

Two committees which have a key role in the governance of the sustainability strategy are the:

Insurance Sustainability Committee

The Board of Directors as a whole is responsible for sustainability and, throughout 2022, had oversight via the Insurance Sustainability Committee chaired by Gayle Schumacher, an Independent Non-Executive Director. This was 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**. The Insurance Sustainability Committee was responsible for overseeing the development, delivery and embedding of the Insurance Group's ESG strategy and its management of climate risk. The Insurance Sustainability Committee met six times in 2022.

Responsible Business Executive Committee

The Responsible Business Executive Committee is chaired by Craig Thornton, General Insurance, Protection and Investments Director. It is responsible for the development 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). The Responsible Business Executive Committee met 10 times in 2022.

Insurance Board

The Insurance Board has an overall responsibility to promote and assess the long-term sustainable success, safety and soundness of the Insurance Group, generating value for Lloyds Banking Group as ultimate shareholder, and to contribute to the wider society and engage actively in the affairs of the Insurance business. This includes a requirement to keep abreast of material changes in its business and the external environment, which includes climate-related issues, as well as to act in a timely manner to protect the long-term interests of the Insurance Group. These responsibilities and certain matters expressly reserved for the approval of the Insurance Board are set out in the Insurance Board's 'Schedule of Matters Reserved', which is reviewed annually, and inform matters for consideration and discussion at Insurance Board meetings. The Insurance Board meets no less than eight times a year. Meeting papers are circulated to the Insurance Board members and other attendees as appropriate at least five days in advance of each meeting. The Insurance Board also undertakes an annual review of each of its committees' purpose and responsibilities (Terms of Reference) and is kept informed at each Board meeting of key matters, including climate-related issues, discussed at its committees via individual committee Chair Reports.

The Insurance 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 Insurance Board maintains 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-relevant risks and regulatory requirements.

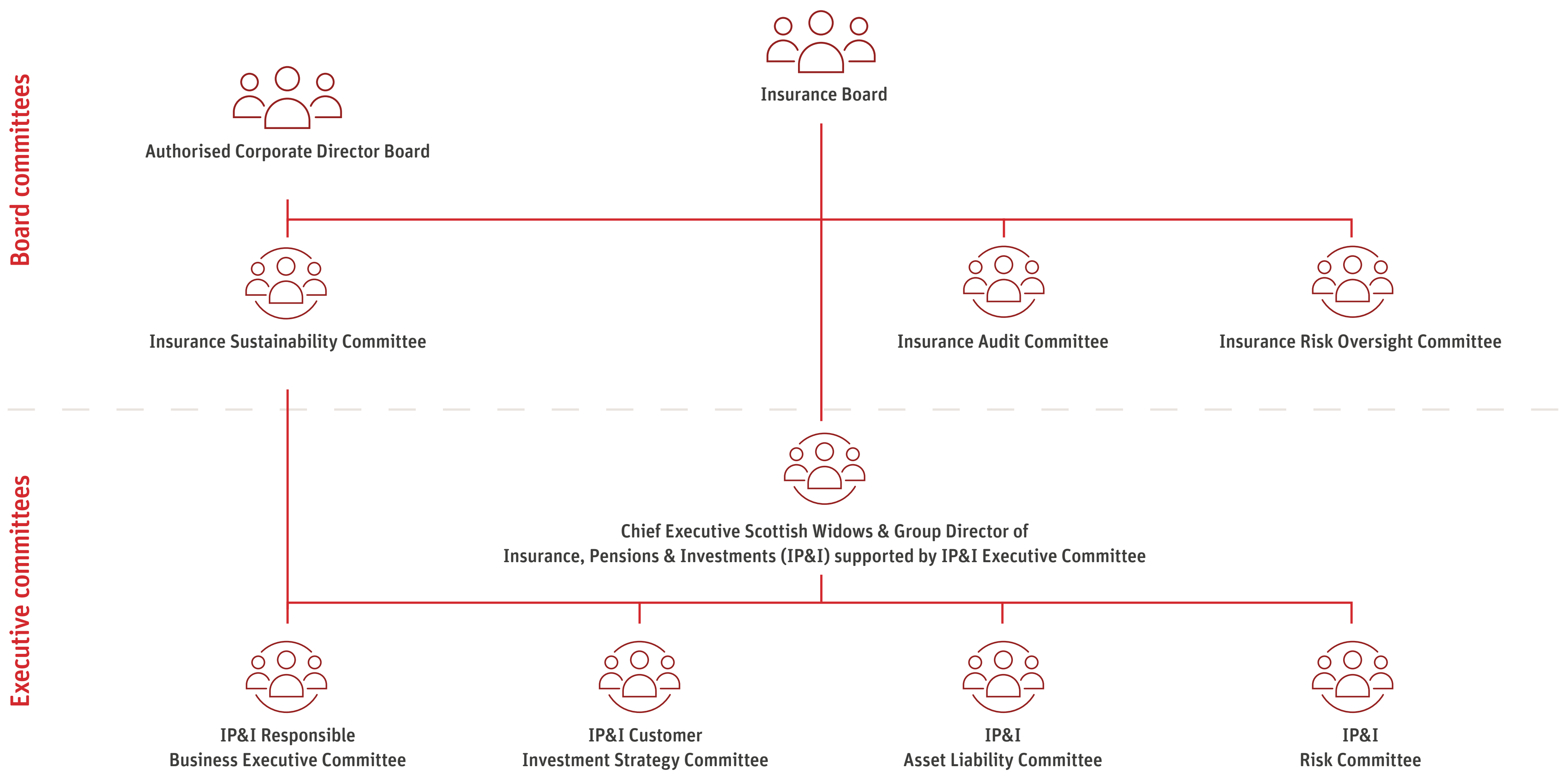
As the stewards for long-term performance and resilience, the Insurance Board determine the most effective way to integrate climate considerations into its structure and committees. During 2022, the Board's consideration of environmental matters and its management of climate risks had been supported by its Sustainability Committee. The Sustainability Committee considered the Insurance Group's management of climate risk and relevant public disclosures, providing oversight and challenge on those activities which impact on the Insurance Group's reputation as a responsible business. For more information on how climate-related issues have influenced decisions taken by the Insurance Board during 2022 see the Scottish Widows Group Limited Annual Report and Accounts Year End 2022 on pages 4 to 5 (Climate Change) and 10 (Communities and the environment; Climate risk; Responsible Investment & Stewardship).

The Insurance Board also ensures that management assesses the short, medium and long-term materiality of climate-related risks and opportunities for the Insurance Group on an ongoing basis and that the organisation's actions and responses to climate are proportionate to the materiality of climate to the Insurance Group.

The Insurance 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.

Roles and responsibilities continued

OUR GOVERNANCE STRUCTURE (AS AT 31 DECEMBER 2022)



Roles and responsibilities continued

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 teams in place focused on both these areas.

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 Insurance Group's sustainability strategy. The Finance division is responsible for the calculation of financed emissions and related disclosures and developing appropriate climate models for scenario analysis.

The Risk division (second line) is responsible for overseeing the 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) provides independent assurance to the Audit Committee and the Board, providing coverage of sustainability and climate risk. Internal Audit also attend key sustainability and climate risk governance committees and forums.

As we continue to further embed climate risk into the ERMF, 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 Insurance (and ACD) Board, the purpose of the Insurance Sustainability Committee has been 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 provided 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 core purpose of the Responsible Business Executive Committee is the development of the ESG strategy.

Sustainable propositions

The Sustainable Propositions team identifies 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' homes against extreme weather caused by climate change.

Senior Management accountabilities

Across the Solvency II regulated entities, the Finance Director has Senior Management Function (SMF) responsibility for managing the risks from climate change whilst the Chief Risk Officer has SMF responsibility for overseeing the management of risks from climate change. Both report to Board level committees on a regular basis on how climate risk and related issues are being managed.

Sustainable colleagues

The Sustainable Colleagues team, on matters related to sustainability, provides direction and input on shaping our culture, training, internal communications and objective setting.

Sustainable operations

The Sustainable Operations team reviews our operational activity and footprint, considers the scope of emissions and delivers on regulatory commitments and disclosures on climate risk.

Sustainable investments

The Sustainable Investments team provides direction for Responsible Investment activities across Scottish Widows' investment book and supports 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. The team also oversights the stewardship strategy and approval of the annual stewardship report which supports the challenging of companies we invest in to behave more sustainably and responsibly.

KEY CLIMATE-RELATED DECISIONS IN 2022 MADE BY THE BOARD/COMMITTEES

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

STRATEGY

Topics discussed

- Knowledge sessions included deforestation risk, focus sessions on high emitting sectors, COP 27 overview and market insights.

Key decisions

- Approved Scottish Widows Group TCFD Report 2021, including input into Lloyds Banking Group Climate Report 2021.
- Approved Scottish Widows Responsible Investment and Stewardship Report 2021.
- Approved Voting Guidelines.

Read about our strategy in the section starting on **page 10**

OVERSIGHT

Topics discussed

- Regular climate risk reporting.
- Target operating model, including responsibilities, structure, resourcing, and development of plans to build capability.
- How risks should be reflected in our risk management framework.
- Knowledge sessions on legal and regulatory risks, including greenwashing risk.

Key decisions

- Approved refresh to risk management system.
- Approved changes to terms of reference, in particular clarification of remit for Embark.
- Approved refinements to External Commitment Framework (followed when a new ESG related membership, affiliation with a code or external commitment is made).

METRICS AND TARGETS

Topics discussed

- Market insights of climate disclosures in the industry.
- Evolution of climate-related metrics for 2022/2023 reporting.
- Development of our approach to climate-related scenario analysis.

Key decisions

- Approved metrics and targets published in the Scottish Widows Group TCFD Report 2021, including input into Lloyds Banking Group Climate Report 2021.
- Approved submission of results of round two of the Bank of England's Climate Biennial Exploratory Scenario exercise.

Read about Metrics and targets in the section starting on **page 32**

TRAINING

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 2022 we have delivered:

INSURANCE BOARD TRAINING

The Insurance Board and executive-level teams are engaged on a regular basis, receiving regular briefings to build understanding and capability. Training sessions have been held for the Insurance Board and its key sub-groups' boards, to develop their understanding of climate risk. This is intended to equip the boards to meet regulatory expectations, including the key climate considerations specific to the Scottish Widows Group, and be in a position to help direct the Scottish Widows Group's response and strategy.

LEADERSHIP TRAINING

Training was provided to executive and Board-level committees throughout 2022, and we plan to build on this training throughout 2023 as we engage senior stakeholders on important topics.

Updates delivered include:

1. Focus session on Energy in April 2022.
2. A deep dive on likely climate scenario outcomes in September 2022.
3. ESG Risks and Investment Funds in September 2022.
4. COP 27 overview November 2022.

COLLEAGUE E-LEARNING

A colleague e-learning programme on sustainability is available for colleagues 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.

During 2023 we will undertake a further training gap analysis to further enhance and develop colleague training to meet future requirements.

REMUNERATION

Remuneration is set at the Lloyds Banking Group parent entity level, and in 2022 we have increased the weighting of climate performance measures in the Lloyds Banking Group balanced scorecard to 10 per cent, placing an increased focus on our climate change ambitions and our purpose of Helping Britain Prosper.

Our 2022 Lloyds Banking Group balanced scorecard include the following two climate performance measures:

Reducing our operational carbon emissions (5%)

Sustainable financing and investment (5%)

We will continue to review ESG and climate measures in our remuneration structures and policies taking into account market practices and aligning with the Lloyds Banking Group strategy.

See page 32 of the Lloyds Banking Group's Annual Report and Accounts 2022 for further details

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.

In 2022, we formally extended our stewardship priority themes to go beyond climate to include other environmental factors like deforestation and biodiversity, as we believe these are closely intertwined and integral to a low-carbon transition. In addition, we have also firmly included the topic of Just Transition in our climate stewardship considerations which captures the societal impacts of the transition, including but not limited to possible human rights infringements.

To play a greater role as active stewards of investments on behalf of our customers, Scottish Widows launched Voting Guidelines in 2022, aligned with our ESG beliefs.

The guidelines cover various ESG factors, from climate to biodiversity, human rights and board diversity.

On climate, the Voting Guidelines support an annual shareholder vote on climate transition plans ('Say on Climate') as Scottish Widows believes that shareholders can encourage better disclosure of corporate climate metrics and transition plans, as well as greater shareholder engagement and board accountability.

Scottish Widows will generally support voting against the Say on Climate, the report and accounts, and/or re-election of directors or members of a relevant committee in the event where there is:

- Insufficient climate disclosures.
- The climate strategy lacks a credible transition plan, along with clear interim targets aligned with the latest science.
- Lack of detail on climate governance and associated link to executive compensation.
- No disclosures on climate lobbying activities.
- No commitment to future capex alignment with the goals of the Paris Agreement.
- No disclosure to indicate that the company incorporates Just Transition considerations into its climate transition strategy.

Given that voting is largely delegated, these guidelines outline expectations for the asset managers Scottish Widows works with, shared with them as an 'expression of wish'. Scottish Widows monitor how core investment managers vote against the guidelines and engage with them on areas of divergence. Where Scottish Widows holds a significant stake in a company, we usually have the ability to direct certain votes when they relate to stewardship priorities, initiated in the 2022 Annual General Meeting season. In addition, we usually have also adopted ISS' Socially Responsible Investment Policy, to be applied to some of our investments, where we believe this policy is more progressive than our managers' in-house voting policy with regards to several ESG criteria.

For further details read our Responsible Investment and Stewardship Report

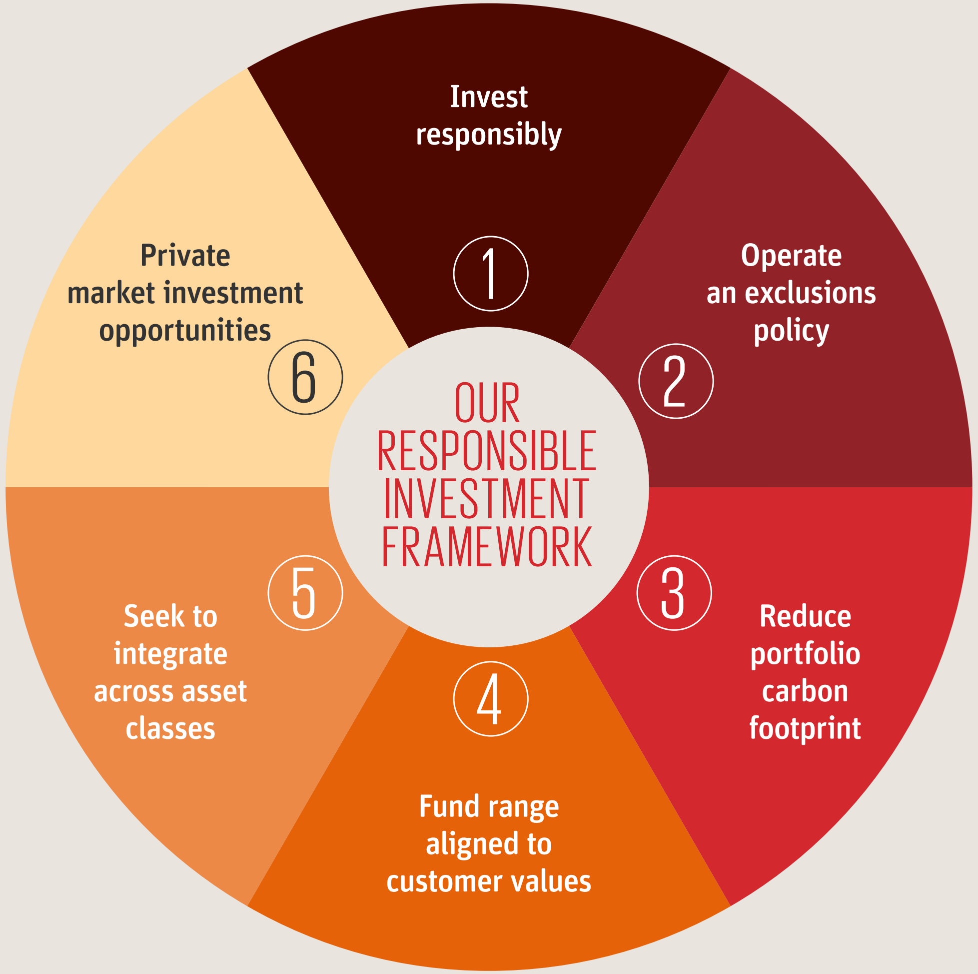
RESPONSIBLE INVESTMENT FRAMEWORK

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.

OUR SIX PRINCIPLES OF RESPONSIBLE INVESTMENT



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 by 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.

Responsible Investment Framework continued

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 CA100+ 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 exclusion policy has been in effect since 2020 and states that we will not invest in companies who are in breach of the conditions set out. In 2021 we made several updates to our exclusions policy. From a climate perspective, we lowered thresholds on revenue generated from thermal coal and tar sands. This update was implemented throughout 2022.

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 is reviewed annually and will continue to evolve in line with legislative and regulatory developments, customer expectations and market best practice.

RISK MANAGEMENT

OVERVIEW

Within Scottish Widows Group, we recognise climate risk as a principal risk within our ERMF and have integrated climate as a 'cross-cutting' risk across other relevant risks in our ERMF such as credit risk, insurance underwriting risk, market risk, conduct risk, and compliance and regulatory risk.

Within our risk management system (Risk and Control Self-Assessment (RCSA)), as well as mapping existing or new controls to our key regulatory obligations to identify, measure, manage and report the impacts of climate change, we have grouped our key risks into six broad themes, which align to the Lloyds Banking Group's definitions of 'inbound and outbound' risk impacts. Inbound risk is the impact on the Group's balance sheet, which can lead to a financial loss driven by physical and transition risk. It is critical to ensure we are managing inbound risks appropriately to mitigate potential financial losses. Outbound risk is the impact of the Group's balance sheet or practices on the environment, driven by our strategic and purpose-driven actions. For example, this could be a liability risk from greenwashing or reputation impact from external perception of the Group's response.

The materiality of these risks is assessed via continuous risk management using the same impact likelihood matrix that is used for all of our risks, and will vary over time. During 2022, given the relatively early stage in our process, we were not able to produce individual scores for these risks, and the overall score was 'amber' or 'Material' Impact and 'High' Likelihood. We are continuing to refine the scoring during 2023.

Our key risks and examples of relevant controls are as follows:

Short term · Medium term · Long term

Risk description	Inbound or outbound	Risk appetite	Key controls	Time horizon
Physical and transition risk for Investments (across customer and shareholder assets) This risk reflects an aggregation of credit, market and conduct risks relevant to the investment products.	Inbound	We accept this risk, as we will seek to minimise physical and transition risks from climate risk in line with our strategy. However, the overall position is dependent on the availability of assets and economic environment, and is therefore not fully within our own control.	• Due diligence around the selection and oversight of our external fund managers, including around ESG factors. • Dedicated Fund investment leads are responsible for all aspects of oversight including review of climate-related risks and ESG factors and related data supplied by external fund managers. • 'ESG tool' is completed as part of our Credit Risk Assessment process.	
Physical risk for General Insurance This risk reflects the underwriting and insurance risks arising from climate risks.	Inbound	We accept this risk, as we will provide General Insurance cover to properties that may be affected by the physical risks from climate risk given our strategic aim to protect customers. The level of risk is managed through our underwriting procedure.	• Weather modelling team of experts analyse trends in climate and weather patterns to inform models. • Sophisticated models have been developed to help inform underwriting decisions. • Robust model governance process is in place around the creation and use of those models.	
Risk of failing to support the transition to net zero This reflects strategic and reputational risk across our business.	Outbound	We accept this risk, as we wish to support the net zero transition in line with external expectations, our strategy and the economic environment. However, it is appreciated that achievement of net zero transition is reliant on many other parties and is therefore not fully within our own control.	• External Commitments Framework in place to report performance of existing commitments. • Stewardship and Exclusions policies, and External Sector Statements are in place to govern our investments and help how we influence the wider economy to move towards net zero.	

Overview continued

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. As discussed in the Strategy section, a wide range of scenario analyses is used to provide insights to aid our understanding of climate risk and support our decisions.

Short term | Medium term | Long term

Risk description	Inbound or outbound	Risk appetite	Key controls	Time horizon
'Greenwashing' risk across our enterprise This reflects reputational, conduct and regulatory risk across our enterprise.	Outbound	We seek to avoid this risk. We have control over our external disclosures, marketing material and customer communications, and ensure that literature, activities and products do not mislead customers as to our green credentials.	• External Commitments Framework in place to govern new commitments. • Compliant Communications checks are undertaken to help ensure 'clear, fair and not misleading'. • First Line risk assess 'green claims' prior to publication, using a dedicated framework.	Short term, Medium term, Long term
Disclosure and modelling risk	Outbound	We accept this risk, as we rely on models to make informed business decisions. We take a risk-based approach to reduce the risk.	• Annual disclosure process for production and governance of external reporting. • Processes in place for ensuring data quality, coverage and methodology for climate-related data/metrics. • Model governance process in place for validation of models, including climate-related models.	Short term, Medium term
Regulatory compliance risks	Outbound	We accept this risk, as we would not willingly be non-compliant with regulatory requirements, but this cannot always be avoided. We therefore take appropriate measures to interpret and comply with all relevant regulation and applicable laws and/or legal obligations.	• Horizon scanning and communication of new regulatory and/or legislative requirements is undertaken including ESG-related developments. • Executives are accountable for regulatory compliance within their own business areas, including ESG-related developments.	Short term, Medium term

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 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 exposure.

As part of Lloyds Banking Group, Scottish Widows Group approaches climate risk management in a consistent way to our overall parent Group. We comply with the Lloyds Banking Group Climate Risk Policy which is set around eight 'Principles', and we have developed our own Insurance Climate Risk Procedures to reflect Insurance-specific practices and processes.

ESG tool

We continue to enhance our internal risk assessment methodologies and tools to identify counterparty level ESG risk.

To assess risks relevant to our clients we use a bespoke, qualitative ESG risk assessment tool which focuses on both the inbound and outbound risks, completed at least annually as part of our regular client engagements. The assessments involve a client-specific questionnaire which assesses exposure and management of climate and ESG risk issues. Within the tool, these outputs are overlaid with a transition risk assessment of the sector which has been analytically-derived using emissions data, to produce scores reflective of the client's climate impacts and exposure to ESG risks. We also ensure that ESG-related risks are considered for all clients, with specific commentary in new and renewal credit applications.

Scores have now been generated for all clients in the Loan Investment book and in 2022 we delivered an MI dashboard to assist with analysis of our book.

EMBEDDING CLIMATE RISK WITHIN OUR RISK MANAGEMENT FRAMEWORK

Existing policy framework

As a cross-cutting risk, climate change impacts will emerge through our existing risks. We have a Lloyds Banking Group Climate Risk Policy and Insurance Climate Risk Procedure which capture the overarching requirements for risk management, governance, scenario analysis and disclosure of climate risks. In addition to this overarching Policy/Procedure, internal policies where climate risk impacts might be expected have been reviewed and where relevant these have been updated, along with any related procedures and underlying processes. These include:

Insurance: Investment Exclusions Policy

Introduced in 2020, this defines the rules for exclusions that will be applied to our investments and aligns to Principle 2 of our Responsible Investment Framework, which forms part of the Insurance Investment Policy: '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'. This policy, which works in tandem with the Investment Stewardship Policy, defines our approach to public equities, bonds, and other corporate debt and is supplemented by the Group External Sector Statements which apply to the direct lending part of shareholder investments. We have key controls around communicating this policy to our investment managers.

Insurance: Investment Stewardship Policy

Also introduced in 2020, this defines the stewardship and engagement activity 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 engender positive change.
- Exercise strong governance over the asset managers we partner with.

It aims to protect and maximise the value of investments in the long term, in line with our beneficiaries' interests, through encouraging investee companies to plan and evolve their activities responsibly, to deliver value through stable and sustainable returns.

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

Insurance: Investment Policy

This policy also references the Responsible Investment Framework and that ESG factors should be considered as part of due diligence and assessment activity when selecting funds or purchasing assets.

Lloyds Banking Group: Insurance Underwriting Risk Policy

This policy requires that climate change is 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.

Insurance: 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.

Lloyds Banking Group: Product Procedures

The product review process requires that climate risk, in particular the associated conduct risk, is specifically considered at all stages in the product lifecycle.

Insurance: Stress Testing Procedures

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

Lloyds Banking Group: Credit Risk Policy and Insurance Credit Framework Policy

For our Loan Investment book, we adhere to the Lloyds Banking Group Credit Risk Policy which was updated in 2021 to incorporate reference to ESG risk, and the Insurance Credit Framework Policy, which supplements the Lloyds Banking Group Policy and sets out the Scottish Widows Group specific approach to management of credit risk. As part of our credit risk assessment, both at origination and at annual review, we include a rating based on the output of the 'ESG tool', together with an assessment of the counterparty's approach to ESG risk. Similar to our Insurance Investment Exclusions Policy, the Lloyds Banking Group External Sector Statements (which can be found here under Group codes and policies) apply to our Loan Investments book and set out our approach to key sectors where we have a direct lending relationship.

Risk appetite

The Risk Appetite Framework has been extended to include specific Climate Risk Appetite Strategy, preferences and metrics. The Board approved a Climate Risk Strategy Statement and statements expressing our preference to avoid risks arising from climate risk:

Climate risk is the risk that the Group experiences losses and/or reputational damage, either from the impacts of climate change and the transition to net zero ('inbound') or as a result of the Group's response to tackling climate change ('outbound'). We have no appetite to fail to proactively manage the risks and opportunities for our business as a result of climate risk. We will take action to support the Group and our customers transition to net zero, and maintain our resilience against the risks relating to climate change.

We have aligned our risk preferences to our key risks, set out in the table on pages 49 and 50. We have risk appetite metrics to help us monitor and report on key climate-related exposures (for General Insurance), progress towards meeting key net zero commitments (for Investments), and to monitor the operation of key controls such as adherence to our External Commitments Framework.

RISK MITIGATION
GENERAL INSURANCE

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 help 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.

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, as well as reinsurance and planning. 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 2018–2020 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 compliment traditional catastrophe model data.

The team also seeks to engage with the wider industry and public sector, in particular engaging with Flood Re since its inception.

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 development of our own scenario modelling capability (see Our strategy section). This climate change research and knowledge allows improved incorporation of climate data into catastrophe models – a field which is still in its infancy.

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) and dedicated flood surveyors 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.

ADDITIONAL INFORMATION

IN THIS SECTION

SCOPE OF REPORT

This report covers the period from 1 January 2022 to 31 December 2022. At 31 December 2022 Scottish Widows Group Limited was a wholly owned subsidiary of Lloyds Banking Group plc. 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, Pensions & Investments Division (also referred to as the Insurance Group within this report). Activities within this division include insurance, asset ownership and asset management.

Scottish Widows Limited is within the scope of the FCA ESG Sourcebook (set out via PS21/24) for YE22 reporting. We have chosen to aggregate entity level reporting up to the parent entity – in our case, Scottish Widows Group Limited, as the approach taken for strategy, risk management and governance is not materially divergent. Our ambitions on tackling climate change cover more entities than Scottish Widows Limited, hence the main body of this report (including reporting metrics, and targets where applicable) is produced at the Scottish Widows Group level, so we can report on the entirety of our ambitions. Entity level reporting for Scottish Widows Limited, compliant with the FCA ESG Sourcebook, is included in the next section.

Subsidiaries of Scottish Widows Group Limited included within this report

	Entity	Business	Type of firm	In scope of FCA ESG Sourcebook (set out via PS21/24)
Scottish Widows or Investments	Scottish Widows Limited	Life assurance, pensions and workplace savings sectors	Asset owner	Yes
	Scottish Widows Administration Services Limited	Life assurance, pensions and workplace savings sectors	Asset owner	No
	Scottish Widows Europe S.A	Life assurance, pensions and workplace savings sectors	Asset owner	No
	Scottish Widows Unit Trust Managers Limited	Management of Individual Savings Accounts (ISAs) and Open Ended Investment Company (OEIC) sub-funds	Asset manager	Yes*
	HBOS Investment Fund Managers Limited	Management of Individual Savings Accounts (ISAs) and Open Ended Investment Company (OEIC) sub-funds	Asset manager	Yes*
General Insurance	Lloyds Bank General Insurance Holdings Ltd	General Insurance holding company	Holding company	No
	Lloyds Bank General Insurance Limited	General Insurance, predominantly home insurance	Insurer	No
	St Andrew's Insurance plc	General Insurance, predominantly home insurance	Insurer	No

* Scottish Widows Unit Trust Managers Limited and HBOS Investment Fund Managers Limited are in-scope but below the threshold for asset managers for mandatory entity reporting. However, product level reports for these firms are published on our website.

SCOTTISH WIDOWS LIMITED ENTITY LEVEL REPORTING

This section covers the disclosures required for Scottish Widows Limited (SWL), which is in scope of the FCA ESG Sourcebook (set out via PS21/24). We have set out how we have complied in the TCFD compliance summary table opposite which includes cross-references to the main body of the report, which details the Scottish Widows Group position, where applicable. Reliance has been placed on relevant sections of the main body of the report, as allowed under the FCA ESG Sourcebook section 2.2.5R, as our approach towards strategy, risk management and governance is not materially divergent between our asset owner and manager entities, and we have therefore cross-referenced these sections as applicable.

TCFD compliance summary table

Pillar	Recommended disclosures	Cross-reference	Rationale
Strategy Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's business, strategy and financial planning where such information is material.	Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long-term.	Pages 11 to 12, 49 to 50 (except property insurance risk on page 12 and physical risk for general insurance on page 49, which are relevant to the General Insurance business)	• SWL's approach to identifying risks and opportunities accords with the Scottish Widows Group section of the report on the pages noted. The exception to this is any reference to physical risk for the General Insurance business which is not of relevance to SWL since SWL does not undertake General Insurance business. On page 11 we reference the Lloyds Banking Group approach to climate risk management in the Lloyds Banking Group Environmental Sustainability Report on pages 57 to 62 of that report; page 61 relates to General Insurance so is not of relevance to SWL. SWL is exposed to the other risks mentioned in these pages.
	Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	Pages 11, 13-22	• The pages noted are applicable to SWL and illustrate how climate-related risks and opportunities impact strategy. • Pages 16 and 17 contains an update on the four key actions we set out in our Climate Action Plan. All of these actions are relevant to SWL. • Part of SWL's strategy is to collaborate with external bodies, organisations and initiatives which are pursuing responsible investment and climate-related policy or advocacy initiatives. Our active participation with such parties fits into our goal to help support and encourage greening across the real economy. SWL is involved with the parties noted on pages 13 to 14.
	Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	Pages 24-28, 31	• SWL's approach to considering climate scenario analysis is consistent with the Scottish Widows Group section of the report on the pages noted. The General Insurance narrative does not apply to SWL.

Scottish Widows Limited entity level reporting continued

TCFD compliance summary table continued

Pillar	Recommended disclosures	Cross-reference	Rationale
Metrics and targets Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.	Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.	Pages 33-34 (except General Insurance specific metrics on page 34)	• These pages detail the metrics which are relevant to SWL, except for the General Insurance specific metrics, since SWL does not undertake General Insurance business. Carbon footprint is the key metric used to assess progress against strategic targets.
	Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks.	Page 9 (own operations for Scope 1 and 2) Page 35 (overview of financed emissions, further details of financed emissions, PCAF methodology applied and notes on tables) Page 36 (data quality score and limitations of PCAF methodology)	• Refer to Metrics and targets section following this table on page 58. The methodology for calculating emissions at SWL level is the same as for the overall Scottish Widows Group financed emissions. • SWL operational Scope 1 and 2 emissions are included as part of our ultimate parent, Lloyd Banking Group, emissions and reported in detail within Lloyds Banking Group's Environmental Sustainability Report.
	Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.	Pages 8, 15, 58	• Our targets are set at the Scottish Widows Group Limited level, not an individual entity level. However, SWL, by virtue of its size, will play a material part in meeting those targets.
Governance Disclose the organisation's governance around climate-related risks and opportunities.	Describe the board's oversight of climate-related risks and opportunities.	Pages 40-41, 43-44	• SWL is represented on climate-related issues to the Insurance Board, the Insurance Sustainability Committee, and the IP&I Responsible Business Executive Committee. • Page 40 references the Scottish Widows Group Limited Annual Report and Accounts Year End 2022 in relation to more information on how climate-related issues have influenced decisions taken by the Insurance Board during 2022. The equivalent references in the Scottish Widows Limited Annual Report and Accounts Year End 2022 are on pages 6 (Climate Change) and 14 (Communities and the environment; Responsible Investment & Stewardship). • All key decisions noted on page 43 were of relevance to SWL.
	Describe management's role in assessing and managing climate-related risks and opportunities.	Pages 42, 44-47	• SWL's governance structure and allocation of responsibilities reflects that set out in the Scottish Widows Group section of this report.

Scottish Widows Limited entity level reporting continued

TCFD compliance summary table continued

Pillar	Recommended disclosures	Cross-reference	Rationale
Risk Management Disclose how the organisation identifies, assesses, and manages climate-related risks.	Describe the organisation's processes for identifying and assessing climate-related risks.	Pages 49-51 (except physical risk for General Insurance on page 49, which is relevant to the General Insurance business)	• SWL's approach to integrating the identification, assessment and management of climate-related risks (and the integration of such processes into overall risk management), accords with the approach set out in the wider Scottish Widows Group report.
	Describe the organisation's processes for managing climate-related risks.	Page 52	• SWL's approach to integrating the identification, assessment and management of climate-related risks (and the integration of such processes into overall risk management), accords with the approach set out in the wider Scottish Widows Group report.
	Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	Pages 49-52 (with the exception of physical risk for General Insurance, which is relevant to the General Insurance business)	• As previously noted, references to the General Insurance business are not relevant to SWL.

METRICS AND TARGETS

SWL financed emissions

Note these emissions are disclosed for informational purposes as the data attributable to funds held under SWL. There are no targets set at this entity level. Net zero targets are set at the Scottish Widows Group level and discussed in the main body of this report.

SWL financed emissions

		Total AUM £bn	AUM in scope according to PCAF methodology and for which emissions data is available £bn	In-scope AUM for which emissions data is available %	Estimated total $MtCO_2e$ (Scope 1 and 2 emissions, for investments where data is available)	Carbon footprint (where data is available)* (tCO_2/£m invested)	PCAF data quality score	Weighted average carbon intensity (where data is available) (tCO_2/£m sales)
2022	**Policyholder**	130.9	104.0	79%	8.0	75.0	2.3	190.8
	Shareholder	18.6	11.6	62%	1.1	82.3	3.8	144.5
	Total	149.5	115.6	77%	9.1	75.8	2.5	188.4
2021	Policyholder	144.0	99.4	69%	8.2	83.8	2.2	192.3
	Shareholder	24.6	13.4	54%	1.1	90.8	3.9	152.7
	Total	168.6	112.8	67%	9.3	84.5	2.4	190.0

* Emissions per £1 million invested is calculated using the market value of equity + book value of debt investment rather than the AUM in the table where assets are quoted at market value. The market value of equity + book value of debt equivalent total is £118.9 billion for 2022 and £109.5 billion for 2021.

Scottish Widows Limited entity level reporting continued

SWL compliance statement

The FCA ESG Sourcebook (set out via PS21/24) regulates compliance with TCFD guidance for all entities and products in-scope.

For the product level reporting, fund level reports [found here] are published on the Scottish Widows website, outlining key metrics for each in-scope fund. The fund reports contain information on the following metrics, using the calculations contained in the TCFD Annex and having regard to the TCFD Guidance (on Metrics, Targets, and Transition Plans), as relevant: Scope 1 and 2 GHG emissions; Total carbon emissions; Total carbon footprint; Weighted average carbon intensity. As far as reasonably practicable, the report must include Climate value at risk (CVAR) for each product and metrics that show the climate warming scenario with which the product is aligned, such as an implied temperature rise metric. These latter two metrics (CVAR and an alignment metric) have not been published as we believe them to be misleading because there is no consensus on their definitions, and they rely on underlying models and assessments which are subject to a high degree of subjectivity. These issues could not be sufficiently addressed using proxy data or assumptions. We believe in transparency and will continue to work with the industry and regulators in respect of developing an approach to narrow this gap in order to make future disclosures that are not misleading.

The content in this section, including any disclosures cross-referenced, sets out the reporting in accordance with the requirements of the FCA ESG Sourcebook Chapter 2 'Disclosure of climate related financial information', acknowledging that data is only published where it is not misleading.

James Hillman
Finance Director, 30 June 2023

FURTHER DETAIL ON SCOTTISH WIDOWS GROUP FINANCED EMISSIONS

The Financed emissions table on this page provides further detail of the financed emissions metrics for the years 2020 and 2019, the latter is the baseline year for financed emissions reporting.

The PCAF methodology applied 2022 table on this page shows how PCAF methodology has been applied in order to derive metrics for 2022 and 2021.

Financed emissions

		Total AUM £bn	AUM in scope according to PCAF methodology and for which emissions data is available £bn	In-scope AUM for which emissions data is available %	Estimated total $MtCO_2e$ (Scope 1 and 2 emissions, for investments where data is available)	Carbon footprint (where data is available) (tCO_2/£m invested)	PCAF data quality score	Weighted average carbon intensity (where data is available) (tCO_2/£m sales)
2020	Policyholder	144.7	95.6	66%	9.1	97.6	2.2	N/A
	Shareholder	28.5	14.5	51%	1.2	100.5	3.8	N/A
	Total	173.2	110.1	64%	10.3	97.9	2.4	N/A
2019	Policyholder	143.1	96.6	68%	11.0	116.6	2.1	N/A
	Shareholder	26.7	14.4	54%	1.5	112.3	3.7	N/A
	Total	169.8	111.0	65%	12.5	116.1	2.3	N/A

PCAF methodology applied 2022

		2022						2021
		Emissions data	In-scope AUM for which emissions data is available £bn	% of reported portfolio	Estimated total $MtCO_2e$	Carbon footprint (tCO_2/£m invested)	PCAF data quality score	Carbon footprint (tCO_2/£m invested)
Policyholder	5.1 Listed equity and corporate bonds	Reported emissions	115.1	100%	9.1	77.7	2.3	86.7
	Total		115.1	100%	9.1	77.7	2.3	86.7
Shareholder	5.1 Listed equity and corporate bonds	Reported emissions	6.8	54%	0.3	45.6	2.5	45.4
	5.2 Business loans and unlisted equity	Economic activity based	3.8	30%	0.3	60.3	5.0	64.6
	5.3 Project finance	Economic activity based	2.1	17%	0.5	192.9	5.0	194.1
	Total		12.7	100%	1.1	75.6	3.7	78.8
Total	5.1 Listed equity and corporate bonds	Reported emissions	121.9	95%	9.4	75.8	2.3	84.3
	5.2 Business loans and unlisted equity	Economic activity based	3.8	3%	0.3	60.3	5.0	64.6
	5.3 Project finance	Economic activity based	2.1	2%	0.5	192.9	5.0	194.1
	Total		127.8	100%	10.2	77.4	2.4	85.8

DISCLAIMERS AND FORWARD-LOOKING STATEMENTS

The reader should be aware that this document, and the information contained within it, has been prepared on the following basis: (i) this document and its contents are not externally audited; (ii) all material contained in this document is subject to change without notice; (iii) the material in this document does not constitute any investment, accounting, legal, regulatory or tax advice or an invitation or recommendation to enter into any transaction; and (iv) this document has been prepared using models, methodologies and data which are subject to certain limitations, as explained in the "data and methodologies" section below.

Data and methodology

While climate related data* and climate models contained in this document reflect best estimates at the relevant time, these should be treated with caution.

These data and models, and the methodologies used to prepare them, are subject to various external challenges and limitations including : (i) the ongoing development of measurement technologies and analytical methodologies across the industry; (ii) the current lack of international coordination on data and methodology standards; and (iii) future transition uncertainty, which includes amongst others, developing global and regional laws, regulations and policies and evolving classification frameworks.

Additionally, the evaluation of climate change and climate related risks cannot be carried out in the same manner, or with the same level of reliability, as the evaluation of financial risks.

In particular:

- Understanding continues to evolve of how climate related risks evolve over time, how these interact (including with non-climate related risks), and of how risks compound;
- Methodologies for the identification, measurement and management of physical and transition risks are not as evolved and underpinned by past experience, as equivalent methodologies for financial risk management; and
- There is inherent complexity and uncertainty related to the interaction of climate related risks under potential long-term climate change scenarios.

The preparation of climate related data relies on data obtained both across Scottish Widows Group Limited and its subsidiaries (the Group) and from third parties within its value chain. However, there remain challenges relating to the availability, reliability, accuracy, verifiability, consistency and comparability of relevant data (e.g. such as emissions data). In particular:

- Methodologies across third parties differ, such that data from different sources are difficult to compare and/or aggregate without assumptions;
- Where data is not available within the Group and/or from third parties, assumptions and/or proxy data may be needed in order to produce the climate related data in this document. The Group will also seek to close such data gaps (where possible) in future as it develops its approach; and
- Where any such assumptions and proxy data have been used, these may impact the reliability and accuracy of climate related data in this report.

The preparation of climate related data and models therefore requires many assumptions, estimates, and judgments to be made – both in the design and implementation of methodologies for preparing climate related data and models – about climate change, technologies, legal and regulatory policy, international standards, third party data and other factors that may be uncertain or not currently known.

Over time, material changes in these factors could render the assumptions, estimates and judgments underpinning the climate related data and models in this document inaccurate.

Equally, as industry standards and practices (and the Group's methodologies), for assessing and modelling climate risk and calculating climate related data continue to evolve, the climate related data in future documents may not be comparable – on a direct like-for-like basis – with those in this document.

Expected and actual outcomes may differ from those set out in the document (as explained in the "forward-looking statements" section below).

Where the Group has used the methodology and tools developed by a third party, the application of the methodology (or consequences of its application) shall not be interpreted as conflicting with any legal or contractual obligations and such legal or contractual obligations shall take precedence over the application of the methodology. Where the Group has used underlying data provided or sourced by a third party, the use of the data shall not be interpreted as conflicting with any legal or contractual obligations and such legal or contractual obligations shall take precedence over the use of the data.

Public information

Some information appearing in this document may have been obtained from public and other third party sources and, while the Group believes such information to be reliable, it has not been independently verified by the Group and no representation or warranty is made by the Group as to its quality, completeness, accuracy, fitness for a particular purpose or non-infringement of such information.

Opinions and views of third parties

Any opinions or views of third parties expressed in this document are those of the third parties identified, and not of the Group, its affiliates, directors, officers, employees or agents. By incorporating or referring to opinions and views of third parties, the Group is not, in any way, endorsing or supporting such opinions or views.

No liability

While reasonable care has been taken in preparing this document, neither the Group nor any of its affiliates, directors, officers, employees or agents make any representation or warranty as to its quality, accuracy or completeness, and they accept no responsibility or liability for the contents of this material, including any errors of fact, omission or opinion expressed.

* Including metrics, targets, projections, forecasts relating to estimates of both historical and future emissions, carbon footprint, carbon intensity and climate change.

Disclaimers and forward-looking statements continued

Forward-looking statements

This document contains certain forward-looking statements with respect to the business, strategy, plans and/or results of the Group and its current goals and expectations.

Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward looking statements.

These statements concern or may affect future matters, including but not limited to: projections or expectations of the Group's future financial position, including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management and other statements that are not historical fact; expectations about the impact of COVID-19; and statements of assumptions underlying such statements.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future.

Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements include, but are not limited to: general economic and business conditions in the UK and internationally; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the tensions between China and Taiwan; market related risks, trends and developments; exposure to counterparty risk; instability in the global financial markets, including within the Eurozone, and as a result of the exit by the UK from the European Union (EU) and the effects of the EU-UK Trade and Cooperation Agreement; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of the Group's securities; tightening of monetary policy in jurisdictions in which the Group operates; natural pandemic (including but not limited to the COVID-19 pandemic) and other disasters; risks concerning borrower and counterparty credit quality; risks affecting insurance business and defined benefit pension schemes; risks related to the uncertainty surrounding the integrity and continued existence of reference rates; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; risks associated with the Group's compliance with a wide range of laws and regulations; assessment related to resolution planning requirements; risks related to regulatory actions which may be taken in the event of a bank or Group failure; exposure to legal, regulatory or competition proceedings, investigations or complaints; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; operational risks; conduct risk; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; technological failure; inadequate or failed internal or external processes or systems; risks relating to ESG matters, such as climate change (and achieving climate change ambitions), including the Group's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively, and human rights issues; the impact of competitive conditions; failure to attract, retain and develop high calibre talent; the ability to achieve strategic objectives; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; assumptions and estimates that form the basis of the Group's financial statements; and potential changes in dividend policy.

A number of these influences and factors are beyond the Group's control.

The Group may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of the Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document whether as a result of new information, future events or otherwise. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

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