Rothesay

Responsible Investment Policy

December 2021

Contents

I. Purpose and objectives

This Responsible Investment Policy confirms Rothesay's commitment to implementing responsible investment objectives within our investment decision-making.

Rothesay defines responsible investment as the practice of incorporating environmental, social and governance factors ("ESG") into the investment decision-making process and engaging in active ownership. This policy describes Rothesay's approach to the integration of ESG within our investment and lending decisions and demonstrates alignment with The United Nations backed Principles for Responsible Investment ("PRI")

Rothesay is dedicated to protecting the pensions of over 850,000 policyholders. Due to the long-term nature of the pensions we protect, the successful measurement and management of ESG risks within our investment portfolio is a fundamental part of our commitment to our policyholders to secure their future.

Measuring the likelihood and magnitude of financial impacts from climate change, social, and governance factors over extended timeframes is necessarily complex. Rothesay's investment decision-making seeks to take a quantitative view of risk where possible and invest in a manner that maximises policyholder security and enhances shareholder value on a risk-adjusted basis. A key part of this approach is the identification, assessment and monitoring of financially material ESG risks and opportunities.

II. Application

This policy applies to all Rothesay employees, and particularly to those involved in the assessment and execution of investment and lending opportunities.

The Chief Investment Officer ('CIO') and the Chief Risk Officer ('CRO') are the owners of the policy and are accountable for ensuring the implementation of the requirements within it.

Scope

This policy applies across all asset classes and geographies in which we invest and provides guidance to investment and risk teams for implementing our general investment objectives, which are defined as:

- **Policyholder security:** To ensure that liabilities to policyholders can be met in full and in a timely manner via conservative balance sheet and liquidity management;
- **Balance sheet stability:** To maintain financial strength and solvency capitalisation in order to produce stable cashflows from in-force business;
- **Value-driven investment:** To take a quantitative view of risk where possible and invest in a manner that enhances shareholder value on a risk-adjusted basis;
- **Focus on asset-liability management:** To invest assets in a manner appropriate to the nature of the policyholder liabilities in order to reduce risk exposure and to take advantage of illiquidity premium; and
- **Appropriate governance:** To ensure that the governance process reflects Rothesay's investment principles and appropriately takes into account factors that are harder to quantify, such as ESG and reputational risks.

The embedding of ESG within our investment decision-making supports these objectives by taking into account material risks and opportunities across our asset classes to drive policyholder security, balance sheet stability and value-driven investment, as well as ensuring that we are able to meet our ESG commitments.

In addition to the inclusion of ESG within our investment decision-making, Rothesay also ensures that conflicts of interest that may arise as a result are identified and managed in line with our internal policies, procedures and guidelines relating to conflicts of interest.

This policy informs and is reflected in our Board Risk Appetite statements and all relevant internal policies.

Market practice, regulatory expectations and policy, as well as our commitments to ESG-related initiatives, are evolving rapidly and therefore this policy will continue to evolve alongside these changing expectations. It will be regularly reviewed and presented at least annually for approval by the Board.

Roles & responsibilities

The Head of Asset & Liability Management and CRO are accountable for ensuring the implementation of the requirements within this policy, including our ESG commitments.

The responsibility for the definition of these commitments has been delegated to the ESG Working Group ('EWG') as the forum responsible for the development and oversight of Rothesay's Responsible Investment objectives.

As these objectives evolve over time and once they are fully embedded, responsibility for oversight and management will be delegated to the relevant framework owners as part of our business as usual activities.

The Trading, Investment and Credit Risk Teams are responsible for delivering the practices and processes developed by the EWG and the requirements laid out within this policy.

III. Responsible investment framework

A. ESG Commitments

Rothesay has developed a comprehensive Pathway to Net Zero plan which includes the following ESG Commitments with respect to climate change that reflect our objectives for the integration of ESG within our investment decision-making and risk management framework, as well as our wider investment strategy:

1. We will (i) transition our investment portfolios to net-zero GHG emissions by 2050 consistent with a maximum temperature rise of 1.5°C above pre-industrial temperatures, and (ii) regularly report on progress, including establishing intermediate targets every five years in line with the Paris Agreement Article 4.9.
2. We actively seek out opportunities to match our long term investment horizon with investments that support climate risk adaptation and mitigation, including the financing of renewable energy projects. While some green investment opportunities are currently too speculative for our risk appetite, we are always willing to support governments in their efforts to develop low carbon energy generation and infrastructure.
3. We will incorporate broader ESG factors into our investment analysis, decision-making and engagement processes to appropriately take into account Social & Governance and wider Environmental factors, as well as climate change.
4. We recognise the investment required by high emitters to transition to a low carbon future, and will finance companies with robust and credible transition plans, recognising that this may increase our carbon intensity in the short term.

As a signatory to both the UN-convened Net-Zero Asset Owner Alliance and the UN Principles for Responsible Investment, Rothesay is committed to fostering knowledge-sharing and supporting both national and international efforts towards transitioning to Net Zero.

UN-convened Net-Zero Asset Owner Alliance

The UN-Convened Net Zero Asset Owner Alliance (NZAOA) is an institutional asset owner led initiative. Investor members engage with companies on improving climate change governance, cutting emissions and strengthening climate-related financial disclosures. In addition, members collaborate to develop best practice in all aspects of managing the risk posed by climate change.

As a condition of membership we have committed to setting a series of targets for reducing the carbon intensity of our portfolio in successive 5 year periods. For the current period 2020 to 2025 we are aiming for a 20% reduction and in 2025 we will set the next target.

UN Principles for Responsible Investment:

The UN PRI is the world's leading proponent of responsible investment, and it works to understand the investment implications of ESG factors. As part of this initiative and as a condition of becoming a signatory we have adopted the following principles:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of PRI within the investment industry.

Principle 5: We will work together with other members to enhance our effectiveness in implementing PRI.

Principle 6: We will report on our activities and progress towards implementing PRI.

B. Key ESG Factors

ESG refers to a broad range of factors that may on their own, or in combination, influence the risk/return characteristics of our investments. As part of our investment and lending decisions, we will consider those factors that are material. We have adopted the Sustainability Accounting Standards Board ('SASB') definition of financially material in this context: "information is financially material if omitting, misstating, or obscuring it could reasonably be expected to influence investment or lending decisions that users make on the basis of their assessments of short-, medium-, and long-term financial performance and enterprise value".

Material ESG factors are evaluated as part of the due diligence and approvals process for transactions. Depending on the transaction, these factors may include the below. These factors are not intended to be exhaustive, nor will each transaction be reviewed against all ESG factors – a risk-based assessment will be undertaken as to which are the most relevant for that particular transaction:

1. Environment
    - The world economic forum categorises environmental risks into:
        - Extreme weather events and temperatures;
        - Accelerating biodiversity loss;
        - Pollution of air, soil and water;
        - Failures of climate change mitigation and adaptation; and
        - Risks linked to the transition to a low-carbon economy.
    - The factors relevant to the assessment of risks and opportunities as part of the investment decision making process are:
        - Climate change – physical and transition risk;
        - Pressures on natural resources, including water, biodiversity, land use and forestry and marine resources; and
        - Pollution and waste.
2. Social
    - Social factors can be broken down into those considered as impacting internal stakeholders and those impacting external stakeholders.
    - Internal social factors include:
        - Human capital development;
        - Health & Safety;
        - Human rights; and
        - Labour rights.
    - External social factors include:
        - Stakeholder opposition and controversial sourcing;
        - Product liability and consumer protection; and
        - Social opportunities.
3. Governance:
    - In line with the UK Corporate Governance Code, the following are governance factors that we may consider:
        - Board leadership and company purpose
        - Division of responsibilities
        - Composition, succession and evaluation;
        - Audit, risk and internal control including Financial Crime and Anti-Bribery and Corruption risk;
        - Remuneration;
        - Diversity and inclusion.

To aid the investigation of these factors the firm provides access to relevant climate data vendors, including CDP, a database of ESG scores maintained by Vigeo-Eiris and carbon emissions data provided by Trucost.

C. Implementation & stewardship

Rothesay benefits from directly managing all our investments, allowing a very detailed approach to managing ESG and climate risk. Rothesay's approach to the integration of ESG factors within our investment decision-making is to focus on financing the transition to net zero by investing in entities with clear transition plans and which are instrumental in effecting real world emission reductions. As a result of our case by case analysis we do not expect to find it necessary to institute many blanket sectoral exclusions and indeed we have in place just one which covers new thermal coal activity as explained below. We prioritise engagement with issuers and investment selection, rather than pursuing a simple divestment strategy.

Our approach requires the application of clear risk management frameworks at point of purchase and through the duration of the investment. The treatment of ESG risk has been specifically embedded within existing frameworks, with heightened scrutiny triggered as ESG risk increases. Strategies such as shorter duration and liquid investment may be considered for higher risk issuers to ensure we retain more flexibility to manage risk in these circumstances (through divestment or otherwise).

As part of our ESG analysis we have developed climate screening to identify entities with material climate risk. These entities are subject to more detailed analysis and assigned scores. The scores reflect factors such as current emissions and sector challenges, overlaying issuer responses in terms of targets, track record and progress towards green technology.

For illiquid assets and where Rothesay funds the origination of mortgages in the UK, consideration will be given to physical climate risks and energy efficiency where relevant and will typically be captured within the underwriting criteria (mortgage portfolio) and/or investment guidelines (e.g. for commercial real estate).

For any internally rated assets, any ESG risk material to the credit are expected to be captured in the initial internal credit rating.

Material Social and Governance factors are also considered as part of our investment process, including wider ESG risks, such as impact on health and safety, labour rights, biodiversity impact, bribery and corruption and community impact. We actively seek to support sectors which provide wider social benefits, and have material investments in sectors such as social housing, higher education, US non-profit healthcare and UK infrastructure. The scope of our ESG analysis will continue to develop over time.

At the point of purchase

Initial trade screening identifies issuers which are exposed to material ESG or climate risks. Our climate score creates a consistent way to assess an issuer's climate risk, allow comparability between issuers and to trigger additional governance at point of trade where there is heightened ESG or climate risk. This ensures any ESG concerns are subject to detailed analysis at the point of purchase.

Ongoing performance surveillance

We manage our overall portfolio exposure to climate risk with reference to quantitative indices (e.g. the carbon intensity of the portfolio) and monitor this at portfolio, sector and individual issuer level.

We also manage our climate risk exposure at the issuer level by assessing ongoing developments in their climate risk management strategy and performance against target metrics, including carbon intensity and emissions reductions. This aligns the risk management of our investments for the benefit of our policyholders, with real-world decarbonisation.

In addition, we are alert to news flow concerning Social or Governance issues at borrower entities and will adjust our risk position according to the severity of any perceived threat to creditworthiness, reputation or other relevant characteristic.

- The ESG score for issuers will be regularly updated to reflect current ESG & climate commitments, as well as performance against these targets. This classification will also support our understanding of the level of climate risk within our portfolio, by analysing the distribution of issuers allocated each climate score; and
- As part of our business as usual credit assessment processes, we continue to ensure that ESG driven events which may result in a credit rating change are assessed by analysts to understand any potential impacts.

Where Rothesay funds the origination of mortgages in the UK, our lending criteria specify the type of properties that are acceptable and including factors such as construction, location and environmental perils such as flood risk. Our lending criteria are reviewed on at least an annual basis and approved by the Mortgage Steering Committee.

For illiquid assets, we apply a risk based approach with regular bespoke stresses for the various portfolio types depending on the perils assessed as most relevant.

For internally rated assets, any ESG risk material to the credit risk arising during the life of the transaction is also expected to be captured during the review of the internal credit rating assessment.

Scenario Analysis

We conduct sector specific scenario analysis that is used, on the one hand, to differentiate between issuers on the basis of their likelihood of successfully transitioning their business to a low carbon economy and, on the other, to compute the value at risk in a particular asset class (e.g. the flood sensitivity of a mortgage portfolio). The three scenarios considered are directly comparable to those proposed by the IPCC and Network for Greening the Financial System and encapsulate early policy action, late policy action and no action.

Single sector analysis alone, however, is not sufficient because it cannot be assumed that climate risk diversifies among sectors as climate change is likely to affect a great many issuers in all sorts of locations at the same time. To gain an improved and more quantitative understanding of the nature and degree of overall climate change risk that we run, we also undertake scenario analysis at the level of the whole portfolio.

D. Exclusions

Rothesay’s systematic approach to the treatment of ESG risks, which is derived from the commitments and guiding principles laid out in this document, means that it is not necessary to maintain an extensive catalogue of individual, specific carve outs in order for many issuers and industry sectors that appear on typical exclusion lists to be naturally absent from the Rothesay portfolio.

As an example, it is almost impossible that an entity which is developing new thermal coal capacity could be found to have characteristics compatible with Rothesay’s pathway to net-zero and indeed no such names appeared in the portfolio prior to our adopting the following coal policy.

Coal

Rothesay does not support the financing of any new thermal coal activity, including funding of new thermal coal plants or continuation with plans in pre-construction.

Where issuers have coal exposure, we actively target those with clear plans to have minimal coal exposure by the commonly accepted coal exit timeframes of 2030 in the OECD.

We support a ‘Just Transition’[1] in our approach, and acknowledge the interconnectivity of ESG issues relating to activities such as reduction in coal production. We therefore seek to understand an issuer’s coal exit plans through analysis and issuer engagement, with greater credibility given to those with clear closure dates and consideration of employee redeployment.

We make this statement in line with our membership of UN PRI and the NZAOA and note that climate risk management is evolving rapidly, so our strategy will continue to develop to ensure we protect our policyholders and manage to our long term ESG and climate commitments.

E. Approach to Engagement

There are various factors which influence our approach to engagement:

- Rothesay’s approach is focused on real-world impact and supporting the ‘Just Transition’[1] to a low carbon economy, and seeks to engage with issuers to encourage this outcome, rather than simply divest.
- We also recognise that policy responses are evolving rapidly as companies rise to the challenges of managing ESG and climate risk.
- Our investment horizon is long dated reflecting the long-term nature of our liabilities.

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[1] As outlined in Paris Agreement, a Just Transition is defined as ‘the movement towards an environmentally sustainable economy which is well managed and contributes to the goals of decent work for all, social inclusion and the eradication of poverty.’

In order to provide security to our policyholders, engagement with issuers to encourage more sustainable practices to secure long-term financial returns is an important aspect of our approach to ESG integration.

In addition, as a signatory of both the UN PRI and NZAOA, Rothesay has committed to responsible engagement with firms in our portfolio.

We utilise a risk and impact-based approach to our engagement with issuers, identifying those issuers with the highest carbon intensity, laggards within individual sectors and those without Paris aligned transition plans in order to focus on engagement with issuers where it could make the most impact to the mitigation of climate change risks.

We then continue to engage with those identified issuers on an on-going basis as we track their performance against the actions raised, along with the impact on their credit fundamentals. Where actions are not being closed and without clear improvement plans, or we see increasing financial risk, we may consider whether to take one of the following actions:

1. Adjust or sell position;
2. Contact the issuer and request more disclosure; or
3. If we are negotiating a bilateral loan, consider the inclusion of ESG covenants, which can include committing the borrower to disclose or meet certain standards.

Our approach to engagement will continue to develop as industry guidance and regulatory requirements regarding disclosures evolve, and our approach matures.

IV. Reporting

In order to maintain transparency and meet stakeholder expectations, we report annually on our progress against our ESG objectives as part of our annual reporting in our ESG report. Our ESG report includes our Task Force on Climate-related Financial Disclosures ("TCFD") aligned disclosures and is produced based on auditable data sourced both internally and from third party providers. This reporting is designed to align with our commitments under both the UNPRI and Net Zero Asset Owners Alliance, which both require regular reporting of our performance against our commitments under those initiatives.

In addition, internal reporting keeps both management and board up to date. ESG matters are a standing item in the agendas for both the Executive Risk Committee and the Board Risk Committee.

Disclaimer