EXCLUSIONS POLICY
WHAT DO WE MEAN BY EXCLUSIONS?

This is an approach that involves excluding certain companies, or types of companies, from our investments if they're involved in certain activities based on specific criteria. We call them restricted companies.*

* A restricted company is defined as a company, including its subsidiaries, which meets one or more of the criteria outlined in this exclusion policy.

OUR APPROACH TO EXCLUSIONS

As a responsible investor, we aim to deliver good outcomes for our customers in a sustainable way. Where possible, we prefer to have a constructive dialogue with the senior management of a company where we believe it needs to improve its performance on environmental, social and governance (ESG) factors. If we simply exclude companies from our investment portfolios, we lose the opportunity to drive positive change by exerting an influence on them.

However, there are some companies involved in activities that have such a negative impact on the planet and society that they pose an investment risk. This is because their growth is likely to be severely limited by future regulations; they could be hit with large fines; and they run the risk of becoming out-of-favour with investors and consumers, leading to significant falls in their share prices. Due to the nature of their businesses or the nature of our investments in them, we believe engagement is not always appropriate. So these companies are the focus of our exclusions policy.

OUR POLICY

This policy is designed to mitigate long-term investment risk by excluding investment in companies which fail to meet minimum criteria and/or invest in activities that are outside our Responsible Investment & Stewardship Framework.

Implementation of this policy further aligns us with our customers’ interests and helps us protect their savings from the related risks.

The policy expands on Principle 2 of our Framework, which is that we’ll take a position on the companies we won’t support, to help us manage downside risk, and we’ll implement exclusions throughout funds managed or mandated by us.

The policy defines the rules for these exclusions and will be applied in conjunction with our Stewardship Policy.

We have a robust governance process to ensure the policy continues to meet our needs on an ongoing basis.

SCOPE

This policy applies to all investments in the Insurance division of Lloyds Banking Group, including but not limited to:

- Life and Pension funds
- SWUTM OEICs
- HIFML OEICs
- ACS Property funds
- With Profits funds
- Shareholder market-traded investments
OUR EXCLUSIONS PRINCIPLES

PRINCIPLE 1: 
Adherence to international standards aiming to minimise harm

We aim to minimise the harm which could arise as a result of our investments by avoiding companies which don’t adhere to international standards of minimum acceptable behaviour as identified in relevant international treaties and United Nations initiatives. These include:

Controversial Weapons

The production and use of certain weapons have been deemed unacceptable under international conventions. Pension investment in these weapons is illegal in certain jurisdictions, because they may cause severe harm to civilians during and after conflicts, and generate significant long-term health and safety effects on civilian populations.

We won’t invest in manufacturers of controversial weapons prohibited by international conventions such as anti-personnel landmines, cluster munitions, and chemical and biological weapons.

Our fund manager partners may use their own definitions of controversial weapons, as long as our minimum list of exclusions is met.

Tobacco

This Policy recognises the high social, reputational, and regulatory risks linked to the tobacco industry. Use of tobacco is also counter to the goals of the United Nations, 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, we will not invest in companies with more than 10% of value chain revenues from tobacco products – this includes tobacco manufacturers, distributors, and others who rely heavily on revenues generated by tobacco.
OUR EXCLUSIONS PRINCIPLES (CONTINUED)

UN Global Compact Violators

Companies violating the principles of the United Nations Global Compact (UNGC) will be excluded from our investments. The UNGC consists of 10 principles guiding corporate behaviour in the areas of Human Rights, Labour, Environment and Corruption.

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<th>Human Rights</th>
<th>Anti-Corruption</th>
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<td>1. Businesses should support and respect the protection of internationally proclaimed human rights; and</td>
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<td>2. make sure that they are not complicit in human rights abuses.</td>
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<td>3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;</td>
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<td>4. the elimination of all forms of forced and compulsory labour;</td>
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<td>5. the effective abolition of child labour; and</td>
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<td>6. the elimination of discrimination in respect of employment and occupation.</td>
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<td>10. Businesses should work against corruption in all its forms, including extortion and bribery.</td>
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<th>Environment</th>
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<td>7. Businesses should support a precautionary approach to environmental challenges;</td>
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<td>8. undertake initiatives to promote greater environmental responsibility; and</td>
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<td>9. encourage the development and diffusion of environmentally friendly technologies.</td>
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PRINCIPLE 2: Mitigating exposure to climate risk

Thermal coal and oil extracted from tar sands are two of the most CO₂ 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 CO₂-emitting sectors. Instead, we focus on excluding individual companies that we believe pose the most significant risks.

Thermal Coal & Tar Sands

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. So we won’t invest in companies where 5% or more of their revenue is derived from thermal coal or tar sand extraction.

PRINCIPLE 3: Size-related exemptions

There will be no size-related exemptions for companies involved in controversial weapons, those deriving more than 10% of their value chain revenues from tobacco, or companies where 5% or more of their revenue is derived from the extraction of thermal coal and tar sands – they will be excluded from our investments.

For UNGC violators, we intend to apply the following approach where possible due to the nature of our investment:

- There are no exemptions for UNGC violators in our passively-managed mandated funds; there is not the same scope for effective engagement as there is with actively-managed funds.
- For actively-managed mandated funds, where a company represents less than 0.5% of a relevant stock market index, it is excluded. This is because the size of our investment in these companies is too small to enable us to influence them to change.
- In those actively-managed funds where a company represents more than 0.5% of a relevant stock market index, it will be flagged as a priority engagement target. We’ll use our scale to influence for change over a three-year period. If there’s no change after that period, the company will no longer be exempt from our exclusions policy and we’ll consider selling out of our investment.

Where a company is not listed on a stock market, but has issued debt in the form of a corporate bond, we will sell out of the bond without adhering to the three-year engagement period.
APPLYING THE EXCLUSIONS

It’s mandatory for the managers of our mandated funds to comply with this policy. Our mandated funds are those where we have specified how the investments are to be managed. Scottish Widows is responsible for defining these funds’ aims and determining the strict parameters on how they should be run.

The managers of these mandated funds will screen the exclusions at least annually and apply them to all investments falling within this policy’s remit.

New mandated funds will comply with this Policy from launch.

Existing actively-managed funds have three months to implement, whilst passively-managed funds may be permitted a longer transition period.

After this, failure by fund managers to meet this policy’s requirements will be deemed non-compliant with their contractual obligations. Accordingly, this may result in financial penalties or termination of the contract.

Managers of funds in which our multi-asset funds invest, where we’re not responsible for how the investments are managed, are expected to adhere to this policy on a ‘comply or explain’ basis. We’ll engage with these managers to encourage them to implement the same, or similar, exclusions for the benefit of all investors in these funds.

Managers of external fund links will be informed of this policy.
This is a public version of an internal policy.