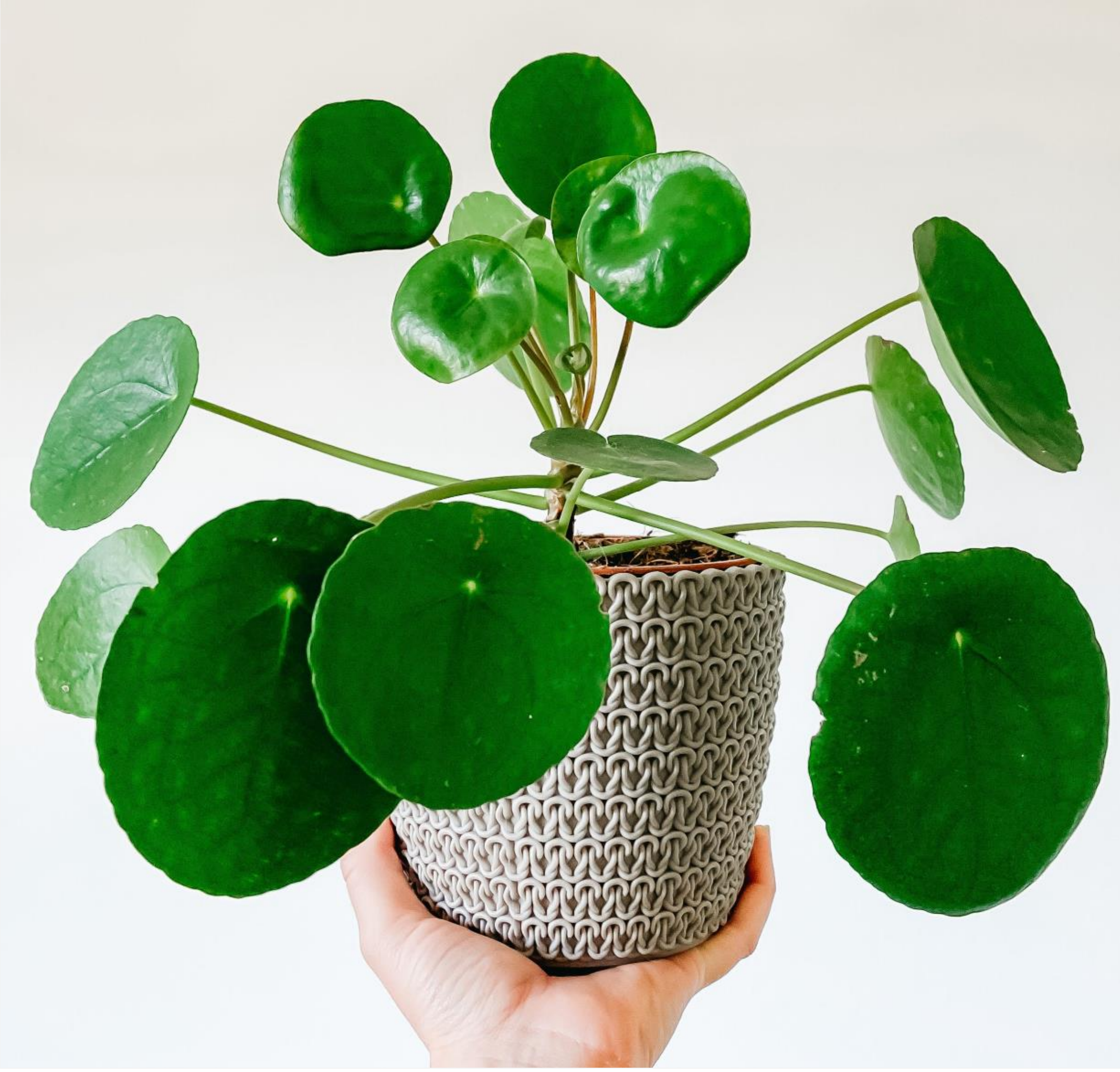

Second Party Opinion

Lloyds Banking Group

LLOYDS BANKING GROUP's CARBON OFFSET PRINCIPLES

12 January 2024

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ERM Certification and Verification Services Ltd.

SECOND PARTY OPINION

LLOYDS BANKING GROUP's CARBON OFFSET PRINCIPLES

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1. DEFINITIONS

Emissions:	Greenhouse gases that enter the atmosphere as a result of anthropogenic activity
Financed emissions:	Absolute emissions that banks and investors finance through their loans and investments[1]
Supply chain emissions:	Upstream indirect emissions[2]
Beyond value chain Emissions:	Emissions outside the value chain[3]
Greenhouse Gas Program:	Greenhouse Gas Program: Organisations that set and govern rules and requirements (i.e., standards) that carbon credit projects must meet to be eligible to generate tradeable carbon credits
Value Chain:	All the upstream and downstream activities associated with the operations of the reporting company, including the use of sold products by consumers and the end-of-life treatment of sold products after consumer use[4]
The Principles	The term "The Principles" referred to in this report, constitute third-party carbon offsetting principles, guidelines, and standards for best practices in navigating the voluntary carbon market, i.e., the foundation for the evaluation criteria used and that are at the basis of ERM CVS' independent opinion on Lloyds Banking Group's Carbon Offset Principles

[1] Source: PCAF Global GHG Accounting and Reporting Standard for the Financial Industry

[2] Source: Lloyds Banking Group own definition of supply chain emissions

[3] Source: Lloyds Banking Group own definition of beyond value chain emissions (in reference to SBTi definition of beyond value chain mitigation)

[4] Source: GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard

2. ACRONYMS

GHGP	Greenhouse Gas Protocol
CTP	Credible Transition Plan
NZBA	Net-Zero Banking Alliance
CIB	Corporate and Investment Banking
BCB	Business and Commercial Banking
CCC	Climate Change Committee[5]
LBG	Lloyds Banking Group
VCM	Voluntary Carbon Market
ICVCM	Integrity Council for the Voluntary Carbon Market
CCP	Core Carbon Principles
SBTi	Science Based Targets initiative
VCMI	Voluntary Carbon Market Integrity Initiative
TCFD	Task Force on Climate-Related Financial Disclosures
BVCM	Beyond Value Chain Mitigation
GHG	Greenhouse Gas
ICROA	International Carbon Reduction and Offset Alliance

[5] UK focussed recommendations on mitigating risks associated with the use of carbon credits

3. BACKGROUND

Lloyds Banking Group (hereinafter referred to as “LBG” or “The Group”) is the largest UK retail and commercial financial services provider with over 26 million customers. The Group operates multiple brands through three core divisions: Consumer Lending, Business & Commercial Banking, and Insurance, Pensions & Investments (IP&I). The Group’s core business activities include retail and commercial banking, general insurance, and long-term savings, provided through multiple well-recognised brands including, but not limited to, Lloyds Bank, Halifax, Bank of Scotland, and Scottish Widows. Scottish Widows is a wholly owned but separate legal entity, unlike other brands which are subsidiaries of LBG and included in The Group’s own operations from a perspective of greenhouse gas emissions accounting.

LBG has identified the role that it can play in private sector efforts to scale decarbonisation through channelling finance towards activities that can reduce atmospheric greenhouse gas concentrations. The voluntary carbon market [VCM] is a mechanism that can aid such efforts, if it operates in a manner that it is intended to and is in accordance with principles around integrity. The latter is the challenge that organisations face when entering the VCM. This is because high quality credits are not available in abundance. Adopting robust principles on how to source and use carbon credits can contribute to minimising the risk of unintentionally undermining efforts to contribute to the global effort of limiting the average global temperature rise to 1.5°C since pre-industrial temperatures.

LBG has asked ERM CVS to review their Group Carbon Offsetting Principles against the current best practices in the market. Among a myriad of third-party published principles, ERM CVS has identified The Oxford Principles for Net Zero Aligned Carbon Offsetting [Oxford Principles] together with the Integrity Council for the Voluntary Carbon Market [ICVCM]’s Core Carbon Principles [CCPs] as the most relevant standards and guidelines, but has also considered principles laid out by the Science Based Target initiative [SBTi], the Voluntary Carbon Markets Integrity Initiative’s [VCMI] Claims Code of Practice, and the recommendations of the Task Force on Climate-Related Financial Disclosures [TCFD], among others. For greater ease of reading this document, all these public third-party published carbon offsetting principles, guidelines, and standards are further referred to as “The Principles.”

4. THE PRINCIPLES

The Oxford Principles contain best practices for companies that wish to use carbon credits for mitigating operational and indirect emissions. The Oxford Principles propose a hierarchy of greenhouse gas mitigation activities reflecting best practices when using carbon credits for achieving mitigation targets. This requires one to reduce emissions first, and only compensate residual emissions that cannot be mitigated otherwise, with high quality offsets. The Oxford Principles consider that currently, high-quality credits representing greenhouse gas removals with long-lived storage are not available in abundance and therefore recommend organisations to continuously review their carbon credit project portfolio to transition from a reduction-based to a removal-based portfolio. Like other standards and guidance protocols, the Oxford Principles provide guidance on how to transparently disclose performance on decarbonisation efforts at frequent intervals, including annual emissions, accounting practices, targets to reach net zero, and the carbon credit project portfolio.

LBG acknowledges the importance of compensating emissions with high quality carbon credits only; therefore, the Core Carbon Principles [CCPs] of the ICVCM have been consulted in our review of the Group Offsetting Principles. The CCPs are a global benchmark for high-integrity carbon credits. Carbon credits are issued by organisations that set and govern rules and requirements (i.e., standards) which carbon credit projects must meet to be 'rewarded' for their atmospheric greenhouse gas concentration reducing impacts. These rewards are an equal amount of carbon credits, issued by such GHG Programs, representing the quantified impact that a project has had during a specific period of time on atmospheric greenhouse gas concentration reductions. There are multiple GHG Programs operational on the VCM each with their own rules and requirements. Although there is overlap and similarity between the rules and requirements of individual GHG Programs, the CCPs are providing a set of minimal requirements that these GHG Programs must meet to demonstrate a base level of quality. GHG Programs, including Verra's VCS and Gold Standard have recently applied for ICVCM assessment against its Core Carbon Principles of which the outcome shall aid carbon credit buyers with identifying and sourcing higher quality credits, amongst the pool of credits being available.

The VCMI Claims Code of Practice [VCMI] is a guidance document for organisations that want to make credible claims regarding their efforts to transform their operations to align with net zero emissions. Central to the VCMI are the Science Based Target initiatives [SBTi] guidelines on how to set near-term and long-term emissions reduction targets that have a real and measurable impact on reducing atmospheric greenhouse gas concentrations. Moreover, transparent disclosure of progress is also important for adherence to the VCMI. Apart from providing guidance on how to set near-term and long-term reduction targets, the SBTi is also developing guidance to support companies to go beyond their science-based targets by channelling additional climate finance towards mitigation activities outside of their value chains.

5. METHODOLOGY[6]

LBG has grouped its 9 Group Carbon Offsetting Principles into four categories: 1) Use of carbon credits; 2) Carbon credit services engagements; 3) Carbon credits characteristics; and 4) Reporting and disclosures.

The SPO has assessed the Group Offsetting Principles at both a collective level, based on completeness, relevance, and consistency and at the principle level.

At a principle level, each of the Group Offsetting Principles is assessed against a set of criteria that ERM CVS has extracted from The Principles. The terms used to qualify LBG's Group Offsetting Principles against these criteria are: 1) not aligned; 2) on track; 3) fully aligned; and 4) advanced. The table below defines the criteria required to obtain the associated level of alignment. Due to continuously evolving insights in best practices for carbon credit generation and use, interpretation of an organisation's adherence to The Principles comes with professional judgement and an understanding of technical and practical nuances characterising the VCM. For this reason, ERM CVS adopts the term 'alignment' to The Principles rather than 'adherence' to The Principles.

TABLE 1: EVALUATION OUTCOME CATEGORIES USED IN ERM CVS' SPO

Score	Interpretation
Not aligned	If ***any*** of the following criteria are met: • No public greenhouse gas emissions mitigation performance disclosure • Using carbon credits as a means to achieve net-zero/ mitigation claims instead of changing operations to reduce emissions • No internal targets to reduce greenhouse gas emissions • Carbon credit sourcing guided by financial considerations only
On track	Not yet meeting but working towards full alignment to ***all*** the following criteria: • Performance disclosure, using acknowledged formats • Only using carbon credits to compensate for residual emissions • Best practices for target setting • Carbon credit sourcing guided by carbon credit quality An example of on track is to set near-term targets including at least absolute reduction of scope 1 and scope 2 emissions, with scope 3 emission reduction targets covered by long term targets. This example demonstrates that full alignment to the criteria is not achieved as the near-term target is not meeting the requirements set out by the SBTi[7], but that provisions enabling future alignment are put in place.
Fully aligned	Adoption of ***all*** the following criteria: • Performance disclosure, using acknowledged formats • Only using carbon credits to compensate for residual emissions • Best practices for target setting • Carbon credit sourcing guided by carbon credit quality

[6] ERM CVS' internally-derived assessment methodology and rating framework established based on The Principles.

[7] SBTi stipulates that near term targets boundary and emissions coverage must be 95 percent coverage of scopes 1 and 2 emissions, and 67 percent coverage of scope 3 emissions.

	An example of fully aligned would be when an organisation consistently discloses its performance, e.g., in its annual review and backed by third-party opinion, demonstrating that carbon offsets are only used to mitigate those emissions that cannot be abated with currently available interventions, validated net-zero targets, and measures to ensure the use of carbon credits of the highest quality.
Advanced	Incorporation of carbon offsetting principles that go beyond the aim of ***all*** the following criteria: • Performance disclosure, using acknowledged formats • Only using carbon credits to compensate for residual emissions • Best practices for target setting • Carbon credit sourcing guided by carbon credit quality An example of an advanced performance against The Principles would be a requirement for overcompensation and/or an addition of a provision that requires carbon offset projects, identified for carbon credit supply, to be subjected to a *project-level* assessment[8] of risks of non-additionality, reversal, and creation of non-intended negative side effects guiding carbon credit quality. Beyond Value Chain Mitigation [BVCM] is also a principle that goes beyond current best practices.

[8] Core Carbon Principles are currently designed to provide assessment at GHG Programme level.

6. EVALUATION

1 High level assessment of LBG Group Principles as a collective

1.1 Completeness

Completeness is assessed, based on the guidance provided by the Oxford Principles which include three topics: 1) Minimising the need for offsets as the primary expectation; 2) Use offsets that are of high quality; 3) Be transparent in terms of performance towards reaching targets.

The LBG Group Principles as a collective cover all these topics and therefore considered to provide a complete set of Offsetting Principles.

1.2 Relevance

Relevance is assessed, based on the guidance provided by The Principles, including the need for setting emissions reduction targets that are aligned to the 1.5°C average global warming limit.

The LBG Group Principles as a collective cover this and therefore are considered to provide a relevant set of Offsetting Principles.

1.3 Consistency

Consistency is assessed, based on guidance provided by The Principles, by the meaningful comparability of the assessment criterion between Financial Institutions and best practices in the Financial Sector.

The LBG Group Principles as a collective, cover concepts that are common to the Institutions operating in the Financial Sector, e.g., Financed Emissions and Beyond Value Chain Emissions, and therefore are considered to provide a consistent set of Offsetting Principles.

2 Principle level assessment of LBG Group Principles

Principle 1 of the LBG Group Principles – Use of carbon credits				
Alignment	LBG's Group Offset Principles around the use of carbon credits for offsetting greenhouse gas emissions is fully aligned with The Principles.			
	Not aligned	On Track	**Fully aligned**	Advanced

1.1. LBG prioritises science-aligned emission reductions across The Group to support the decarbonisation of its business in line with the goal of limiting global warming to 1.5°C, before allocating internal investment and resources towards purchase of carbon credits for use in offsetting such emissions.

1.2. • **Financed emissions ambition:** LBG does not currently plan to use carbon credits to offset its financed emissions but will monitor and seek to contribute to emerging industry standards in this area as they develop.

• **Own operations ambition:** LBG will use carbon credits to offset residual emissions from its operations for 2030 and beyond.

• **Supply chain:** LBG does not currently plan to use carbon credits to offset its supply chain emissions, recognising that it is still early stages of supplier engagement activity. The Group will continue to evolve and adapt its approach whilst learning through supplier engagement.

1.3. LBG may use carbon credits for mitigation beyond its value chain for propositions, customer benefit or for relevant projects that support wider emissions reductions. Where such activity overlaps with LBG Scope 1, 2 and 3 emissions this will not be accounted for as per principles 1.1 and 1.2 and will seek to capture and report the benefit on behalf of its customers or the project.

LBG's first principle suggests that carbon credits shall only be used for compensation of residual greenhouse gas emissions. In addition, it prioritises emissions abatement before compensation and carbon offsets are only deployed in achieving its long-term target after 2030. This is in full alignment with The Oxford Principles' best practice to minimise the need for offsets in the first place and the VCMI's guidance to transition to net-zero through an emissions reduction pathway which includes a near-term and long-term emissions reduction pathway.

LBG's first Principle demonstrates its commitment to mitigate emissions that are not covered by its scope 1, scope 2, and scope 3 emissions. Since LBG has no operational control over the emissions beyond its value chain, using carbon credits for such purposes is an effective way to mitigate the same. The use of offsets for beyond value chain mitigation efforts shall not undermine the principle of abatement before compensation because these mitigations are not accounted for should they overlap LBG's unmitigated direct or indirect emissions.

Principle 1 is considered fully aligned to the criteria to only use carbon credits to compensate for residual emissions and on track to using best practices for target setting. Beyond Value Chain Mitigation ambition is considered an advanced element of Principle 1. Collectively, Principle 1 is fully aligned to current best practices regarding the use of carbon credits.

Principle 2 of the LBG Group Principles – Carbon credit services engagements

Alignment	LBG's Group Offset Principles around engagement with carbon credit service providers is fully aligned with The Principles.				
	Not aligned	On Track	**Fully aligned**	Advanced	

2.1. LBG will only engage with parties in relation to the development, sourcing or management of carbon credits where it is satisfied that those parties are acting in line with the International Carbon Reduction and Offsetting Alliance (ICROA) Code of Best Practice for accredited organisations and the Integrity Council for the Voluntary Carbon Market (ICVCM) Core Carbon Principles.

Alignment to ICROA's Code of Best Practice means that a certain level of integrity and application of best practices is followed as this Code sets out requirements for organisations and their corporate clients to adhere to carbon management strategies that lead to ambitious and impactful climate action. LBG's second principle, requiring that carbon credit service providers must be aligned to ICROA's Code of Best Practice and the Integrity Council for the Voluntary Carbon Market Core Carbon Principles, provides the intent to support carbon credits that are accurately established and that the carbon credits bought or sold meet minimum quality standards. This is consistent with The Oxford Principles' guidance to only use high quality carbon offsets. Moreover, ICROA requires organisations to transparently communicate carbon inventories and reduction activities, including carbon credit retirement practices.

Principle 2 is considered fully aligned to the criterion that carbon credit sourcing is guided by carbon credit quality and that transparent disclosure of performance is adhered to and therefore meets the requirements and guidance set out in The Principles.

Principle 3 of the LBG Group Principles – Carbon credits characteristics

Alignment	LBG's Offset Principles around the characteristics of carbon credits eligible for use of compensating greenhouse gas emissions is fully aligned with The Principles.			
	Not aligned	On Track	**Fully aligned**	Advanced

3.1 LBG aims to ensure all carbon credits bought or sold by LBG align to the International Carbon Reduction and Offsetting Alliance (ICROA) Standards Endorsement and align with the recommendations of the Integrity Council for the Voluntary Carbon Market (ICVCM) Core Carbon Principles and assessment framework. Further, independent third-party verification will be utilised as necessary to confirm project delivery and quality.

3.2 LBG aims to ensure all carbon credits it buys or sells will be supported by the appropriate safeguards to support benefits and manage impacts on indigenous groups, local communities and biodiversity. Further, third party verification will be utilised where deemed necessary to confirm delivery of co-benefits and quality.

3.3 LBG recognises the importance, in particular, of sequestration (removal) projects and aims to preferentially support these.

LBG's third principle installs some form of quality safeguard that the carbon credits used for LBG's offsetting activities are meeting a minimum quality threshold. Historically, carbon offset standards, issue carbon credits for a range of carbon offset project types, each with their own inherent risk to the quality of the credits issued. For this reason, the exclusive use of carbon credits issued by ICROA endorsed, is not a guarantee that the carbon credits are of high-quality. Principle three is mitigating this through the condition that carbon credits must also be aligned to the CCPs. As carbon offset standards only just began submitting their applications to the ICVCM for CCP labelling, alignment to these principles is considered current best practice. Furthermore, the implied preference for removal credits is to an extent aligned with The Oxford Principles' guidance to progressively increase the portion of offsets that come from carbon removals, rather than from emission reductions, to ultimately reach 100% carbon removals by mid-century. Finally, the third principle acknowledges the added value of carbon credits from projects with additional benefits like biodiversity and social upliftment.

Principle 3 is considered fully aligned to the criterion that carbon credit sourcing is guided by carbon credit quality and therefore meets the requirements and guidance set out in The Principles.

Principle 4 of the LBG Group Principles – Reporting and disclosure

Alignment	LBG's Offset Principles around the disclosure of its decarbonisation performance, is fully aligned with The Principles.			
	Not aligned	On Track	**Fully aligned**	Advanced

4.1. Carbon credits retired in The Group's name will be separately accounted for in its external reporting in line with GHGP standard and Voluntary Carbon Markets Integrity Initiative (VCMI) guidance.

4.2. Analysis and disclosure of any client or investee use of carbon credits may be considered once these disclosures are made and further guidance from standard setters is available.

As per guidance set out in the Greenhouse Gas Protocol [GHG Protocol], LBG is accounting carbon credits retired in its name separately. LBG has been submitting its climate change mitigation performance to CDP (formerly the Carbon Disclosure Project) since 2010 which is a recognised by most third-party principles to be a format for best practices in transparent disclosure. LBG aligns its disclosure to the recommendations set by the Task Force on Climate-Related Financial Disclosures [TCFD] and the GHG Protocol.

Principle 4 is fully aligned with the criterion to report on its performance using acknowledged reporting and disclosure formats like the GHG Protocol, CDP and TCFD.

Moreover, LBG has a defined system for methodology or structural changes and improved data quality, which indicates a commitment to continuously improving its capacity to monitor its progress on meeting the objective of the LBG Group Principles. This is aligned to the VCMI's first foundational criterion which encourages companies to take measures to expand and improve processes for capturing better quality and more comprehensive data across all relevant scope 3 emissions.

Principle 4 is considered fully aligned to the requirements and guidance set out in The Principles.

7. OPINION

Lloyds Banking Group's Carbon Offset Principles are a complete, relevant, and consistent set of principles that are fully aligned to published third-party carbon offsetting principles, guidelines, and standards for best practices in navigating the voluntary carbon market.

APPENDIX A SECOND PARTY OPINION

This document was developed by ERM CVS Ltd. ["ERM CVS"] with the express intent of providing a Second Party Opinion ["Opinion"] on the alignment of Lloyds Banking Group's Offset Principles with the relevant principles set out by ICVCM, The Oxford Principles, the VCMI, the ICROA Code of Best Practice, and other relevant standards governing carbon offsetting activities. The Opinion is for information purposes only, and ERM CVS does not accept any form of liability for the substance of the Opinion, liability for damage arising from the use of this Opinion, and/or information provided in the Opinion. Nothing herein shall be construed as providing a representation or warranty, express or implied, regarding the advisability to invest in or include companies in investment vehicles, or investment universes or portfolios. The Opinion is based on information made available by the client, and as such, ERM CVS does not warrant that the information used and presented in this Opinion is complete, accurate or contemporary. The client is fully responsible for assuring and certifying its compliance, implementation, and monitoring under its framework. No part of this Opinion may be reproduced, transmitted, or published in any form or by any means without the express prior written and full consent of ERM.

ERM CVS is an institution with environmental expertise, independent from the issuer of the principles subject to the second party assessment. Independence is ensured through ERM CVS' protocol on impartiality management that sets out procedures to manage impartiality at policy-, organisational-, and individual-level. ERM CVS is part of the ERM Group, which provides sustainability consultancy services globally. ERM CVS has therefore undertaken an assessment of any potential risks arising from its relationship with ERM Group and other conflict of interest issues and these are set down in the Risk Register.

APPENDIX B LIST OF DOCUMENTS CONSULTED

	Date	Document
1	13 November 2023	LBG Group Principles
2	13 November 2023	Carbon Market Principles, JPMorgan Chase & Co.
3	13 November 2023	ICROA Code of Best Practice
4	13 November 2023	ICVCM's Core Carbon Principles
5	14 November 2023	VCMI Claims Code of Best Practice
6	15 November 2023	Building a sustainable future, Lloyds Banking Group, Environmental Sustainability Report 2022
7	15 November 2023	ESG Performance Review Lloyds Banking Group, ESG Performance Review 2022
8	15 November 2023	The SBTi Financial Institutions Net-Zero Standard, Conceptual Framework and Initial Criteria, Consultation Draft, June 2023
9	16 November 2023	The Oxford Principles for Net Zero Aligned Carbon Offsetting, September 202o