ALGEBRIS INVESTMENTS
Net Zero AUM Commitment

2022

Algebris Investments became a signatory to the Net Zero Asset Managers Initiative (NZAM) in 2021. As part of this commitment, we set an initial target of 57% of total AUM (79% of AUM excluding discretionary mandates) to be managed in line with attaining net zero emissions by 2050 or sooner. This target will be reviewed at least every 5 years with a view to reach 100%.

1. Background

The Net Zero Asset Managers initiative (NZAM) is an international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5°C. The initiative was launched in December 2020 with an initial group of 30 signatories and is convened by six investor networks: AIGCC (Asia), Ceres (North America), IGCC (Australasia), IIGCC (Europe), UN PRI (global), CDP (global). The commitment is consistent with the UNFCCC Race to Zero criteria, and NZAM is accredited by Race to Zero.

As of date, the initiative has reached 220 signatories, representing over USD 57 trillion in assets under management (AUM)[1]. In line with the best available science on the impacts of climate change, NZAM signatories acknowledge that there is an urgent need to accelerate the transition towards global net zero emissions and for asset managers to play our part to help deliver the goals of the Paris Agreement and ensure a just transition.

NZAM Signatories must comply with a ten-points commitment, encompassing accountability and due diligence requirements for both the assets they commit to manage in line with the attainment of net zero emissions by 2050 or sooner, and any other assets not initially included in the perimeter of such commitment. Specifically, signatories commit to:

a) Set an interim target for the proportion of assets to be managed in line with the attainment of net zero emissions by 2050 or sooner. This interim target will be reviewed at least every 5 years, working in partnership with asset owner clients with a view to increasing the proportion of AUM covered until 100% of assets are included.

For assets committed under (a),

b) set interim decarbonisation targets for 2030 consistent with a fair share of 50% global reduction in CO_2 identified as a requirement in the IPCC special report on global warming of 1.5°C. This target should be set using one of three available methodologies (see next section for details) and taking account of portfolio Scope 1 & 2 emissions and, to the extent possible, material portfolio Scope 3 emissions.

c) Prioritise the achievement of real economy emissions reductions within the sectors and companies in which we invest. If using offsets, invest in long-term carbon removal, where there are no technologically and/or financially viable alternatives to eliminate emissions. As required, create investment products aligned with net zero emissions by 2050 and facilitate investment in climate solutions.

For all assets under management (including those not initially committed to be managed in line with next zero emissions by 2050 or sooner):

d) provide clients with information and analytics on net zero investing and climate risk and opportunity; implement a stewardship and engagement strategy, with clear escalation and voting policy, consistent with the ambition for all AUM to reach net zero emissions by 2050 or sooner; engage with actors key to the investment system to ensure that products and services available to investors are consistent with the aim

[1] As of 11th February 2022.

of achieving global net zero emissions by 2050 or sooner; and ensure any relevant direct and indirect policy advocacy we undertake is supportive of achieving this goal.

e) Publish annually TCFD disclosures, including a climate action plan, and submit them to the Investor Agenda via its partner organisations for review.

Within 12 months of signing on to the NZAM initiative, asset managers are required to disclose the initial proportion of assets that will be managed in line with the attainment of net zero emissions by 2050 or sooner (as per (a) above), the 'fair-share' interim targets and target date for AUM managed in line with net zero (as per point (b) above) and the methodology used.

This document fulfils our obligations under our NZAM membership, by setting targets for the proportion of our AUM to be managed in line with net zero emissions by 2050 or sooner and discussing our choice of methodology. Consistently with the Network Partners' expectation of signatories on fossil fuel investment, we have also drafted a robust fossil fuel investment policy that incorporates the recommendations of the Science Based Target Initiative (SBTi) on phaseout of coal investment.

We acknowledge that the scope for asset managers to invest for net zero and to meet the commitments set forth above depends on the discretionary mandates agreed with clients, as well as clients' and managers' regulatory environments. We aim to ultimately include discretionary mandates in our Net Zero AUM commitment, subject to approval from such clients.

These commitments are made in the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met, including increasing the ambition of their Nationally Determined Contributions, and in the context of our legal duties to clients and unless otherwise prohibited by applicable law. In some asset classes or for some investment strategies, agreed net zero methodologies do not yet exist. Where our ability to align our approach to investment with the goal of net zero emissions by 2050 is, today, constrained, we commit to embark with determination and ambition on a journey, and to challenge and seek to overcome the constraints we face.

2. Methodology

To ensure Net Zero AUM targets are robust and science-based, NZAM signatories are allowed to choose among three target-setting methodologies currently endorsed by the Initiative:

- Paris Aligned Investment Initiative Net Zero Investment Framework
- Science Based Targets Initiative for Financial Institutions (SBTi)
- Net Zero Asset Owner Alliance Target Setting Protocol

For setting our Net Zero AUM targets, Algebris uses the methodology laid out in the **Science Based Target Initiative (SBTi) Guidance for Financial Institutions**[2] – as we believe this framework is the best suited to our current investment focus and portfolio structure. The AUM that Algebris commits to manage in line with achieving Net Zero emission by 2050 or sooner will therefore be subject to science-based portfolio targets.

The SBTi process for target setting entails presenting the target to SBTi for official validation within 2 years of committing to it. NZAM signatories indicating use of the SBTi methodology for the purpose of setting their NZAM target are not specifically required to have committed or have targets validated by SBTi at the point of this disclosure. However, Algebris aims to pursue the process to get this target officially validated by the SBTi in the future.

[2] April 2021 version.

1. Defining the Perimeter of our Net Zero AUM

The perimeter of a science-based emission reduction target at the portfolio level is defined by recommendations FI-C15 and FI-C16 in the SBTI's guidance on target-setting for financial institutions. FI-C16 states that financial institutions shall set targets on a list of 'Required Activities', with certain minimum coverage requirements. For investment managers, required activities encompass all listed corporate equity and bond instruments. Derivatives, sovereign/agency/supranational bonds, and securitized fixed income instruments are not yet in scope for target setting, while the inclusion of private equity and private debt is optional.

Our initial Net Zero AUM target commitment includes all Algebris financial sector strategies (Financial Credit, Financial Credit IG, Financial Income, Financial Bond Fund, Long Only Fund and Financial Equity) – accounting altogether for 57% of our total AUM and 79% of our AUM excluding discretionary mandates[3] (henceforth, these will be referred to as "Net Zero aligned AUM" and/or "Net Zero-aligned portfolios").

For asset managers, FI-C15 and FI-C16 also apply to funds managed under discretionary mandates, so we will work in partnership with discretionary mandate clients to ensure financial strategy mandates are progressively added to this target. Pending approval from such clients, however, we have taken the prudent stance to not include discretionary mandates in our initial Net Zero AUM targets. Discretionary mandates account for approximately 27% of our total AUM, as of December 2021.

Our Italian Equity Securities strategy will initially not be part of our Net Zero-aligned AUM, due to its focus on the small-caps universe, where sustainability disclosures and data remains scarce. We expect the EU Corporate Sustainability Reporting Directive (CSRD) to change this by extending sustainability reporting requirements to all listed companies (except micro-enterprises), so this decision will be re-evaluated as the legislative train progresses. Similarly, our Global Credit Opportunities strategy will initially not be included in the perimeter of our Net Zero-aligned AUM, due to its focus on emerging markets and the exposure to sovereign debt in the portfolio. These two strategies account altogether for a residual 5% of Algebris' total AUM, as of December 2021.

For the time being, we think the accepted methodologies are in our view not applicable to our Non-Performing Loans (NPL) strategy which is therefore not included in the perimeter of our Net Zero-aligned AUM. This strategy accounts for approximately 10% of our total AUM, as of December 2021.

Our Green Transition private equity strategy will be included in the perimeter of our Net Zero AUM target following the first closing.

2. Choosing a Target-setting Approach

The SBTi guidance for financial institution – our chosen methodology – outlines three alternative asset class approaches to setting a science-based emission reduction target at the portfolio level. All these approaches are predicated on the idea of linking financial institutions' investment portfolios with different climate stabilization pathways. The three approaches are (see Table 1 for a description and examples of target outputs):

- Sectoral Decarbonization Approach (SDA)
- SBT Portfolio Coverage Approach
- Temperature Rating Approach

[3] All AUM numbers and percentages are as at December 2021.

Table 1 Portfolio Target-setting Approaches for Listed Credit and Equity

Approach	Description	Target Output Example
Sector Decarbonisation Approach (SDA)	Financial institutions set emissions-based physical intensity targets at sector level within the portfolio for the following sectors: power generation, cement, pulp and paper, transport, iron and steel, and buildings.	Investment Firm A commits to reduce GHG emissions from the steel sector within its equity portfolio X% per ton of cement by 2030 from base year.
SBT Portfolio Coverage	Financial institutions commit to having a portion of their investees set their own SBTi-approved science-based targets such that the financial institution is on a linear path to 100% portfolio coverage by 2040 (in emissions or monetary terms).	Investment Firm A commits that X% of its equity portfolio within the asset class/sector by total assets will have science-based targets by 2025.
Temperature Rating	Financial institutions determine the current temperature rating of their portfolio and take actions to align their portfolios to ambitious long-term temperature goals by engaging with portfolio companies to set targets.	Investment Firm A commits to align their scope 1 + 2 + 3 portfolio temperature score within the asset class or sector from X°C in 2018 to Y°C by 2025.

Source: Algebris based on SBTi Financial Sector Science Based Targets Guidance (April 2021)

SDA is a sector-based approach that is not well suited to the strategies included in our initial Net Zero AUM target. The SBT Portfolio Coverage and the Temperature Rating approaches take a more engagement-oriented view, focusing on portfolio companies' actions to measure and reduce their emissions. Both are applicable to all sectors, and they complement each other very well. SBT Portfolio Coverage is a financial sector analogue to supplier engagement targets for non-financial companies' scope 3 emissions, whereas Temperature Rating enables investment managers to assess the ambition of portfolio companies based on their public GHG reduction targets, even if these are not approved SBTs.

To set the initial targets for our Net Zero-aligned AUM, Algebris uses the SBT Portfolio Coverage approach. This target-setting exercise is complemented by a Temperature Rating analysis of the committed AUM, which allows us to evaluate the ambition of investee companies' targets in terms of the temperature path they imply at the portfolio level.

3. Setting a Target

In line with the prescriptions of the SBT Portfolio Coverage approach, Algebris commits to drive adoption of Science-Based Targets (SBT) by all investee companies in our Net Zero-aligned portfolios. For investees to have enough time to implement their target and ultimately achieve an economy-wide transition to net zero by 2050, investees will need to have had their SBTs approved by 2040. For Algebris, this implies **a target to reach 100% SBT coverage of portfolios within our Net Zero-aligned AUM by 2040.**

As of end-2020 – which we use as baseline year – none of the investees in our Net Zero-aligned portfolios had set a SBT yet. Applying a linear growth path, as per SBT methodology, our ambition to reach 100% SBT coverage of our Net Zero-aligned portfolios by 2040 translates in an **interim target of 25% SBT coverage by 2025, and 50% by 2030**.

We are confident that our Net Zero AUM target is achievable. As of November 2021, only one investee (representing 0.4% across the total of the equity and credit exposure in our Net Zero-aligned portfolios) had set a SBT. As of the same date, however, about a third of our Net Zero-aligned credit and equity portfolio had already *committed* to set a science-based target. SBTs are only recognized when the target is set and approved, rather than when a commitment is made, but companies committing are bound to submit their target for approval within two years – so we expect SBT coverage of our Net Zero-aligned portfolios to increase with the same lag.

In setting their SBTs, investee companies will need to follow SBTi criteria for covering scope 1 and 2 emissions, as well as scope 3 emissions when these account for more than 40 percent of total scope 1,2, and 3 emissions (which is the case for the banks and financial institutions that constitute the focus of our Net Zero-aligned portfolios).

For banks, setting an SBT will imply at a minimum setting decarbonization targets for 100% of their corporate lending and project finance to companies in the electricity generation sector, 95% of their long-term corporate lending to fossil fuel companies, 67% of corporate lending to commercial real estate companies, and 67% of all other long-term corporate lending.

Targets adopted by companies are considered "science-based" if they are in line with what the latest climate science says is necessary to meet the goals of the Paris Agreement — to limit global warming to well-below 2°C above preindustrial levels and pursue efforts to limit warming to 1.5°C.

The SBT Portfolio Coverage approach therefore gives us reassurance that each of our portfolio companies will be focusing on real economy emissions reductions, and setting targets consistent with delivering a fair share of the 50% global reduction in CO2 emissions by 2030 as identified by the IPCC special report on global warming of 1.5°C. It will also allow us to structure our engagement around the importance for banks and financial institutions to be transparent about the carbon content of their lending and investing activities.

4. Adding a Temperature Angle

While our NZAM target is defined in terms of SBT Portfolio Coverage as discussed above, we also calculate Temperature Ratings for the portfolios we have included in our Net Zero-aligned AUM. This allows us to determine the current temperature score of those portfolios based on the public GHG emissions reduction targets (be them SBTs or not) of the investee companies.

In line with the SBTi recommendations, for the purpose of this exercise we use the temperature rating methodology developed by WWF and CDP. This method enables assessing the ambition of any corporate emissions reduction targets against a wider range of temperature outcomes. Three subsequent procedures (a target-level protocol, a company-level protocol, and a portfolio-level protocol) are combined to produce base year temperature scores at a scope 1 + 2 and a scope 1 + 2 + 3 level for each portfolio[4].

Applying this methodology to our Net Zero-aligned portfolios, we obtain a temperature path for the equity and credit components (Table 2 below). Based on these estimated temperature ratings, we can then derive the linear annual temperature reduction compatible with reaching a desired temperature goal by a given year. For example, if we wanted to reach a temperature well below 2°C (eg. 1.75°C) by 2040, we would need to reduce the temperature score of our portfolio by between 0.07°C and 0.02°C per year, depending on the type of instrument (credit versus equity) and the scope considered.

[4] For more details, please refer to the WWF-CDP temperature rating methodology at: https://www.cdp.net/en/investor/temperature-ratings/cdp-wwf-temperature-ratings-methodology

Table 2 Temperature Rating (SBTi methodology) – portfolio as at end-2020

		Short-Term (2021-24)	Mid-Term (2025-35)	Long- Term (2035-50)
Equity	*Scope 1+2*	2.7	2.7	2.6
	Scope 1+2+3	3.1	3.1	2.7
Credit	*Scope 1+2*	2.2	2.2	2.1
	Scope 1+2+3	2.9	2.9	2.2

While useful for assessing the alignment of portfolios with temperature objectives, these metrics are subject to a number of assumptions that in our view make them problematic for target setting. First, companies without any relevant, publicly disclosed targets, or without targets covering an important GHG emissions scope, are assigned a default temperature score of 3.2°C. This default score is based on current pledges at 66% probability, but it is unclear whether it is the most credible 'business as usual' scenario. The owners of the methodology recognise that more work needs to be done to determine the most representative economy wide average temperature, as well as default scores for non-target disclosing companies based on a distribution around this representative economy wide average. More attention to the specificities of different sectors would also be needed.

Second and related, only targets that have not already been completed are counted as valid by the current methodology – meaning that companies that have already set and achieved a target would be assigned the default score for as long as they do not set a new target. The default score would however not be representative of the 'business as usual' for a company that has already set and achieved a decarbonisation target, and this gap could therefore lead to overestimation of the temperature rating at the portfolio level. As an exercise, we tried re-estimating our portfolio temperature ratings using for companies with achieved targets but no new targets the score implied by their latest achieved target (rather than the default score). As presented in Table 3, this has an impact on the final rating of our portfolio – particularly for the Credit component, where the required linear annual temperature reduction would be lower.

Table 3 Temperature Rating (adjusted methodology) - portfolio as at end-2020

		Short-Term (2021-24)	Mid-Term (2025-35)	Long- Term (2035-50)
Equity	*Scope 1+2+3*	2.5	2.5	2.5
	Scope 3	3.0	3.0	2.5
Credit	*Scope 1+2*	2.04	2.01	1.97
	Scope 1+2+3	2.8	2.8	2.04

For all the reasons expressed above, we are of the view that the SBTi-accepted Temperature Rating methodology is currently still too sensitive to the definition of default targets and to the choice of underlying scenarios to serve as a fully reliable basis for target setting, and we prefer to use the SBT Portfolio Coverage approach for that purpose. Nevertheless, we think there is value in running a temperature analysis alongside the monitoring of Portfolio Coverage, as it can help us better understand the climatic implications of our SBT Portfolio Coverage target and evaluate the effectiveness of our engagement with investee companies in terms of the ambition of the target they will set.

APPENDIX

Net Zero Asset Managers

Targets Disclosure Template

Information indicated in bold text is required. Information indicated in plain text is to be provided as relevant/necessary.

Name of Asset Manager	**Algebris Investments**
Total AUM (USD)	USD 20.2 billion (as at December 2021)
Proportion of AUM to be managed in line with net zero initially (expressed as a % of total AUM, and provide USD total currently implied)	Our initial target includes all Algebris financial strategies (*Financial Credit Fund, Financial Credit Fund IG, Financial Equity Fund, Financial Income Fund, Financial Bond Fund, Long Only Fund).* As at December 2021, these funds account for approximately **USD 12 billion**, corresponding to **57% of Algebris total AUM** (**79% of AUM excluding discretionary mandates**)*. **Percentages are on a committed AUM basis*
If less than 100%, briefly explain why this proportion is the maximum achievable and the actions to be taken to increase the proportion over time	*The Net Zero methodologies currently recognised by the NZAM initiative are in our view not applicable to our Non-Performing Loans (NPL) strategy, which has therefore not been included in our Net Zero AUM commitment for the time being. Our NPL strategy accounts for approximately 10% of total AUM as at December 2021.* *Discretionary mandates account for approximately 27% of our total AUM as at December 2021. We aim to progressively add discretionary mandates to our interim target, upon approval by such clients, but we prudently exclude these assets from our interim AUM target for the time being.* *A residual ~5% of our total AUM combined is invested in our Italian Equity Securities strategy and in our Global Credit Opportunities strategy, These have not been included in our interim Net Zero AUM target at this time, but we are working towards including them in the near future.*

Target Year (e.g. 2030)	2040
Baseline Year (e.g. 2019)	2020
Quantified Target(s) to be achieved by target year (this may include more than one target type if relevant to the methodology used, or if using a combination)	Target to reach 100% SBT coverage of portfolios in our Net Zero AUM by 2040. As of end-2020 – which we use as the baseline year – none of the investees in our Net Zero-aligned portfolios had set a SBT yet. Applying a linear growth path, as per SBT methodology, our ambition to reach 100% SBT coverage by 2040 translates in an interim target of 25% SBT coverage of NZ AUM by 2025, and 50% by 2030.
Baseline Year Performance for the target metric(s) (if possible/relevant)(e.g. xxtCO2/$ invested)	As at end-2020 (baseline year), none of the investees in our Net Zero-aligned portfolios had set a SBT (0% coverage)
Methodology used to set target(s)	SBTi Financial Sector Science-Based Targets Guidance – Portfolio Coverage methodology (as in April 2021 draft)
Confirm and describe coverage of Scope 1,2 and extent of Scope 3 coverage of financed emissions.	In setting SBTs, investee companies will need to follow SBTi criteria for covering scope 1 and 2 emissions, as well as scope 3 emissions when these account for more than 40% of total emissions.
Underlying science-based net zero scenario(s)/pathway(s) from which target(s) is derived	Well below 2°C.
Brief description of how the asset manager considers the target to be consistent with delivering a fair share of the 50% global reduction in CO2 emissions by 2030 identified as a requirement in the IPCC special report on global warming of 1.5°C.	As discussed in the SBTi target-setting guidance for financial institutions, the SBT Portfolio Coverage approach with a 100% coverage target by 2040 is consistent with delivering a fair share of the 50% global reduction in CO2 emissions by 2030 as identified by the IPCC special report on global warming of 1.5°C.
If not using one of the recommended methodologies, please explain rationale and how it sufficiently rigorous and consistent with the target setting commitment	
Information on target for operational emissions, if set	

Confirm whether the organisation adopted a science-based policy on coal and other fossil fuel investment (Yes/No)	YES
If yes, provide a link to information on this policy (or a very brief summary, and indicate the scope of AUM to which the policy applies. If no, please include any information available on plans to develop such a policy.	We have an SBT aligned fossil fuel policy. Funds included in the perimeter of our Net Zero AUM commitment are prevented from any investment in companies operating in the coal sector, Arctic oil and Tar sands, and are subject to strict limits for investment in companies operating in conventional Oil and Gas. Funds currently not yet included in our Net Zero AUM target are nevertheless also subject to strict limits regarding investment in coal and/or unconventional oil and gas. Policy available here
Link to further information in relation to targets or net zero strategy (must be in public domain)	

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