Algebris Investments

Coal Sector Investment Policy

2020

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Our Pledge for Climate

At COP 21 in Paris (2015), Parties to the UNFCCC reached agreement to combat climate change and accelerate the actions and investments needed for a sustainable low carbon future. The central aim of the agreement was to keep a global temperature rise this century well below 2 degrees Celsius, and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius[1].

Based on current policies, **projected** warming will be around 3.1-3.7°C by 2100 – well above the Paris pledge. We need to do more and at Algebris (the "Firm") we believe that the business sector has a key role to play in making sure that we succeed. Climate change is the challenge that will define our generation: the lives of hundreds of millions will be affected in the near future.

Algebris has produced an estimate of the Firm's carbon dioxide (CO_2) emissions since inception and in 2019 we initiated a project that will allows us to off-set our carbon footprint to date and going forward. The details of our offsetting project can be found in the dedicated project note **here**.

As investors, however, we are aware that our impact on climate change manifests itself first and foremost through our investment decisions. The choices we make in allocating funds and constructing portfolios allow us, as investors, to be a powerful engine behind a transition towards a greener and more sustainable economy.

Investment strategies with an ESG element or focus are becoming more common in the asset management industry. However, the lack of a clearly-defined and legally binding ESG regulatory framework implies a significant risk of 'green washing' and/or 'tick-the-box' approaches.

At Algebris we believe in doing the right thing and we are against insincere gestures that overshadow climate change. Therefore, we favour a simple and fully transparent approach when it comes to our investment decisions.

Across our funds, we incorporate a clear strategy that is focused on coal-powered energy generation and its funding chain. The strategy combines the exclusion of companies that we deem non-investable due to their role in coal mining or coal power generation, and active engagement with companies that we do invest in.

[1] See: https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

Coal Developers and Coal-intensive Companies

Coal emits the highest amount of CO_2 in relation to the energy it produces when burnt. Historically, coal-fired power has been the largest contributor to CO_2 emissions associated with energy and industrial production. In relative terms, the importance of coal and solid fuels in the energy mix has been declining since the 1920s. Yet, coal still accounts for about 40% of global CO_2 emissions today and this share has remained fairly stable since the 1970s[2].

According to the 2018 IPCC report[3], primary energy from coal must decrease by 59-78% by 2030 compared to 2010, if we want to limit global warming to 1.5°C. And yet, according to publicly available data compiled by the NGO **Urgewald**, new coal plants are still planned or under development in 60 countries. If built, these projects would add over 579 GW to the global coal plant fleet, an increase of almost 29%[4].

Our view is that coal-power generation must be reduced significantly, as a matter of utmost priority. In line with this view, we carefully screen our portfolios for companies that operate in the global coal industry or companies with a business model that is dependent on coal. We completely exclude from our investable universe companies[5] that:

- are planning expansion in coal-fired power, coal infrastructure or mining;
- derive over 30% of their total revenue from coal; and
- whose coal-fired power generation accounts for over 30% of their total power generation

This exclusion list will be monitored and updated on an ongoing basis to reflect the evolution of stricter criteria. In the next step, we plan to apply a lower threshold of 20% (down from 30%) to both the coal share of power and the coal share of revenues of companies that have coal-related business[6].

[2] See https://ourworldindata.org/co2-and-other-greenhouse-gas-emissions#co2-emissions-by-fuel

[3] See table on page 14 here: https://www.ipcc.ch/site/assets/uploads/sites/2/2019/05/SR15_SPM_version_report_LR.pdf

[4] Algebris is proud to financially contribute to the research efforts of Urgewald

[5] All indicators are defined as in the methodology underlying the Global Coal Exit List (GCEL) by Urgenwald, which we use to build the exclusion list. The methodology is available at: https://coalexit.org/methodology

[6] Following the methodology underlying the Global Coal Exit List (GCEL). The methodology is available at: https://coalexit.org/methodology

Coal Investors and Financers

Algebris is a global investment manager with a historical focus on the financial sector, with over 90% of the firm AUM invested in this sector, and a clear investment bias to high quality Global Systemically Important Financial Institutions (G-SIFIs).

As an aftermath of the financial crisis, financial institutions have been subject to the highest regulatory requirements, stringent corporate governance codes and their risk management has been subject to the harshest stress tests. Major improvements in these areas over the last 10 years generally contribute to a favorable ESG assessment of the sector.

Yet, many banks and investors are still involved in coal finance. Between 2017 and the third quarter of 2019, global banks provided US$ 745 billion to major coal plant developers through loans or underwriting services, and as of September 2019, investors were holding bonds and shares worth almost US$ 276 billion in these developers[7].

Coal finance is not only harmful to our planet, it is also a failing business model. In 2019, 79% of EU coal generators ran at a loss and could lose €6.6 billion[8], due primarily to rapid declines in plant utilization and higher carbon costs. The Bank of England's recent insurance stress test assumed losses of between 55% and 65% for coal power equity investment.[9] In 2020, there is clearly no economic rationale for investing in coal.

As an investor in the global financial sector, Algebris is against the practice of coal finance and intends to actively engage against it. We are implementing the following measures:

- **Exclusion of big equity and bond holders:** in our view, it is the buyers of coal plant developers' bonds and shares who ultimately enable new coal business to be initiated. Those investors take a decision to keep supporting the coal business – which, we are convinced, does not have a future. In line with this view, we decided to exclude from our investable universe all firms that account individually for 3% or more of the global shareholding and bondholding in coal plant developers. In 2019, these were 5

[7] Based on a research carried out by Urgewald, Banktrack and 30 partner NGOs. The 2019 GCEL identifies 258 Coal Plant Developers with expansion plans of at least 300 MW. Over half of these companies are not traditional coal-based utilities and are therefore often missed by financial institutions' coal exclusion policies. See a summary of the research at: https://coalexit.org/sites/default/files/download_public/COP25_PR3.pdf

[8] See: https://www.carbontracker.org/reports/apocoalypse-now/

[9] Bank of England Prudential Regulation Authority, General Insurance Stress Test 2019, 18 June 2019, https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2019/general-insurance-stress-test-2019-scenario-specification-guidelines-and-instructions.pdf.

companies[10]: BlackRock (US$ 17.6 bn, 6.4% of total), Japan's Government Pension Investment Fund (US$ 17.4 bn, 6.3% of total), Vanguard (US$ 12.4 bn, 4.5% of the total), Capital Group (US$ 9 bn, 3.3% of total) and Brazil's National Bank for Economic and Social Development (US$ 8.3 bn, 3% of total). We will keep updating this list as new data is released. The financial institutions we invested in 2019 accounted *collectively* for 4.4% of global coal shareholding in major developers, and none of them *individually* accounted for more than 1.2%[11]. We engage actively with them to ensure the phasing out of these positions.

- **Active Engagement with Global Banks:** as an investor in global banks, we are convinced that the most effective way to make an impact is for us to actively engage with the entities we invest in about their coal sector policies. This engagement is carried out on a case-by-case basis, meaning that we study each bank's coal exposure and coal sector policies carefully, and we ask specific questions. For all banks that do not already provide one, we ask for a full disclosure of their coal finance positions as well as for a transparent phase-out plan and a clear timeline. Moreover, we also ask the banks to disclose the risk weights that they apply to their coal exposures.

- **Engagement with Regulators:** coal power financing is highly likely to become non-performing and the underlying assets stranded due to low plant utilization – as emission regulation is tightened globally. The increasing risk of economic loss, reputational damage and climate litigation suggest that the risk-weighting and loan-loss provisioning applied to coal exposures are not reflective of the true risk. Forward looking models introduced with IFRS 9 should account for the high and increasing probability of default, hence leading to provisioning of existing exposures and recognition of a 100-250%[12] risk weighting of the underlying value of these assets. We engage with regulators to ensure that standards and rules are introduced to address the key issues in coal financing.

[10] Based on the data released by Urgewald, Banktrack and other NGOs, and accessible here: https://coalexit.org/finance-data

[11] See footnote (9)

[12] This range reflects the average risk-weighting assigned to corporate exposures and that assigned to non-performing exposures, net of provisions, for a European bank