ESG Strategy and Policy

Introduction

COP26 and the World Economic Forum's Global Risk Report have highlighted the failure of countries to address climate change and the growing likelihood and increasing impact of extreme weather events. Climate risk is further compounded by additional social megatrends, presenting risks that could affect the underlying business of investee companies.

As a result, climate change is at the top of the global risk agenda, with lack of adequate preparation potentially resulting in financial loss, reputational damage, regulatory penalties, and loss of market share.

The Board believes in a strong corporate governance framework to ensure responsible investing focussed on the values of the Company and that building trusted relationships with the Company's stakeholders is crucial for the long-term success of the Company.

The Company is not a sustainable investment fund and whilst the Investment Objective of the Company has no direct impact on the environment per se, when pursuing the Investment Objective and in the selection of the service providers and advisers of the Company, the Company aims to conduct itself responsibly, ethically and fairly with the impact of all material factors, including ESG, on the financial risk and return being considered in the decisions it makes.

The Directors and Manager are working closely to further develop the Company's ESG Strategy & Policy recognising that the integration of ESG into risk assessments at both a corporate and investment portfolio level is their joint responsibility.

As a result, the approach taken has been for the Company to align, where possible with the UN PRIs, to allow stakeholders to benchmark the Company's commitment to accepted industry standards.

ESG Strategy

I.	**ESG will be incorporated into the Company's decision-making processes, policies and procedures and will be kept up to date.**
II.	**The ESG policies of the Company's service providers and advisers will be broadly aligned with the Company's to the extent possible.**
III.	**ESG risks will be considered in investment decisions.**
IV.	**The Company will promote ESG acceptance with those it deals with and invests in.**
V.	**The Company will regularly report on its progress.**

Policy

The Company

Whilst, the Board of Directors has overall responsibility for ensuring the effectiveness of the Company's processes, policies and procedures with respect to ESG and considering the value preservation and potential value generation for shareholders and the long-term sustainable success of the Company, ESG matters are considered within the Audit and Risk Committee.

Once ESG is fully integrated, the Audit and Risk Committee will:

i. regularly review the Company's:
    - strategy and opportunities;
    - key operating manual and compliance manual and monitoring procedures, and
    - the Board and Committee's terms of reference

   to ensure ESG considerations are incorporated, relevant and current;
ii. identify and manage ESG risks;
iii. receive regular ESG reporting from the Company's service providers and advisers;
iv. receive relevant training on ESG matters where required; and
v. report regularly to the Board on ESG matters.

Initially, to assess the impact of ESG associated risks on the Company, facilitate integration of ESG mitigants across all of the Company's policies and procedures, ensure that the Company remains compliant with all legal and regulatory requirements and has in place meaningful metrics that can be reported, a working group comprising a Director and an executive of EJF has been formed.

The Investment Portfolio

The Company invests in opportunities created by regulatory and structural changes impacting the financial services sector. The target investments, comprising primarily securitisations, significantly lag other fixed income asset classes with respect to ESG disclosures due to the complex nature of the market and lack of available data.

Investment decisions are made by the Manager in the best interest of the Company taking into account the long term interests of the shareholders and other stakeholders of the Company. However, the Manager believes that companies that successfully manage their ESG risks, and proactively follow ESG best practices, may experience risk-adjusted outperformance over the longer-term and underpins their commitment to being a responsible fiduciary.

Included in these decisions are the Manager's view of ESG issues and the overall impact they have on the creation of long-term investor value when conducting initial due diligence in respect of the main focus of EJFI's investment thesis and post investment monitoring.

Whilst uniformity is being introduced in banks via the European Banking Association and its Sustainable Finance Action Plan, with a mandate from the European Commission to sequentially integrate them in prudential regulation, the landscape for ESG considerations and reporting in the US currently lags that of the EU & UK. This presents a challenge when conducting investment due diligence in certain aspects of ESG risks with respect of the main focus of the Investment Portfolio.

The financial services sector, unlike other sectors, creates an underlying asset exposure that is inherently fluid. The Manager estimates that there are in excess of 4,700 financial institutions in the US with only around 800 being publicly traded. Further, of those that are publicly traded the Manager has identified that only a small percentage disclose selected ESG related risks. Moreover a survey of the prominent data providers concluded insufficient coverage of EJF's existing equity investments, let alone the landscape of potential investments.

As EJF's investment exposure is predominantly in lower information issuances and securities, an internal framework to evaluate ESG risks and exposures of the investment universe is being developed using commoditised data supplemented by existing information to evaluate material ESG risks for each investment.

EJF recognizes that there are several reporting frameworks to build from when considering the relevant materiality factors and have chosen to focus on the Sustainability Accounting Standards Boards ("SASB") approach to its ESG framework. The SASB focuses on financial materiality using an overall assessment, which is applied to each industry to determine the relative importance of each factor and sub-factor depending on external environment and business model, using existing metrics where possible.

- **Securitisations, and Related Investments**

The selection of collateral positions for securitisations is carried out by the Manager taking into account many factors including:

i. The financial risks from both physical and transition risks of climate change arising as a result of increased costs and degradation of value of assets and/or collateral held by the underlying banks. In addition, with respect to underlying insurance companies, a third risk, liability risk, has been identified arising from parties seeking to recover losses;
ii. Social Megatrends that have the potential to impact portfolio diversification, default projections, and overall risk profile of underlying banks and insurance companies. Demographic trends also drive the economy, which in turn influences growth, consumption, and the performance of corporate credit. Shifting banking habits of the general population, especially millennials, has changed the client profile of many of the regional banks across the US. Increased automation and technology, prompted by the COVID-19 pandemic, is appearing across many regional banks and insurance companies, and remote working has grown in a sector that was previously seen as lagging behind the larger banks. On one hand this can lead to increased profit margins and market share, but may also result in the displacement of workers due to job replacement. Automation and technological disruption presents both risks and opportunities; and
iii. Governance considerations are made in respect of underlying investment company management teams and alignment with their shareholders, customers and other stakeholders but also, in respect of EJF's exposure to securitisations, how each securitization is managed.

Additionally, at issuance, EJF sponsored securitisations receive a credit rating from both Kroll Bond Rating Agency and Moody's for which the former include ESG considerations within its credit factors. In addition, any collateral position that would negatively impact the overall rating would be excluded by the Manager, but at this time there is no transparency from the rating agencies on which ESG factors are deemed material and how they impact the final credit rating.

Kroll Bond Rating Agency generally views the collateral manager, EJF, favorably and has rated eight EJF sponsored securitizations up to the latest TFINS 2020-2. They note that the senior management team has largely stayed the same over the last several years and EJF has proven to both acquire and originate diversified credits that can withstand a downturn.

- **Specialty Finance Investments**

  MSRs – The mortgage servicing rights Seneca acquires are all linked to Fannie Mae and Freddie Mac mortgages. Both are shareholder owned companies that operate under a congressional charter and perform an important role in the US's housing finance system, providing liquidity to the thousands of banks, savings and loans, and mortgage companies that make loans to finance housing. Both Fannie Mae and Freddie Mac are incorporating ESG risks into their decision making when acquiring these mortgages from the underlying banks.

  Litigation Loans – The Armadillo portfolio represents less than 2% of the Company's NAV and no further investments are anticipated at this time.

Who the Company works with

The Directors believe that in order for the Company to have a sustainable business model, those that support it recognise the importance of strong corporate governance based on a culture of integrity, respect and diversity with adopted ESG standards based on internationally recognised principles and international conventions in the areas of human rights, labour standards, environmental stewardship and anticorruption.

Through the Company's Management Engagement Committee, the Manager and service providers' alignment with the Company's ESG approach and corporate and social responsibility is considered on a regular basis.

- **Manager**

The Manager believes that in order to deliver the best long-term results and enhance value they must operate with a focus on the health of their business in a world with a constantly evolving social and economic landscape. They recognise the importance of ESG factors on the risk-return characteristics of our investments and are committed to integrating them into their investment processes.

They are currently in the process of developing frameworks and policies to cover the integration of ESG into their investment process where appropriate and non-investment responsibilities as a firm and an employer and, once published, they will be available on request.

- **Other Service Providers and Advisers**

All critical service providers have documented and implemented policies on day-to-day functioning and supporting initiatives to minimise the environmental impact they have on the climate and, where possible or relevant, have integrated ESG criteria into their processes through the larger group within which they operate.

Further details on the ESG and corporate responsibility of our service providers are available on their websites.