S&P Global Ratings

An S&P Global Second Party Opinion (SPO) includes S&P Global Ratings' opinion on whether the documentation of a sustainable finance instrument, framework, or program, or a financing transaction aligns with certain third-party published sustainable finance principles. Certain SPOs may also provide our opinion on how the issuer's most material sustainability factors are addressed by the financing. An SPO provides a point-in-time opinion, reflecting the information provided to us at the time the SPO was created and published, and is not surveilled. We assume no obligation to update or supplement the SPO to reflect any facts or circumstances that may come to our attention in the future. An SPO is not a credit rating, and does not consider credit quality or factor into our credit ratings. See Analytical Approach: Second Party Opinions.

Second Party Opinion

Annapurna Finance Pvt. Ltd. Social Financing Framework

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Location: India	**Sector:** Non-banking financial institutions

Alignment With Principles

Aligned = ✓ Conceptually aligned = O Not aligned = ✕

✓ Social Bond Principles, ICMA, 2023

✓ Social Loan Principles, LMA/LSTA/APLMA, 2023

See Alignment Assessment for more detail.

Strengths

Eligible projects support financial inclusion, gender equality, entrepreneurship, and economic empowerment. Annapurna Finance Pvt. Ltd. (AFPL) provides microloans to low-income and rural households; women; micro, small, and medium enterprises (MSMEs); and underprivileged and disadvantaged segments of the population who lack access to formal financing channels.

Weaknesses

No weaknesses to report.

Areas to watch

Given the socioeconomic profile of microfinance borrowers, they could be exposed to over-indebtedness risks. This requires safeguards to manage borrower exposure to risks. AFPL's know your customer (KYC) process, client rating model, and relevant analysis and check on cash flow, partly mitigate repayment risk.

There is increasing regulatory and public scrutiny of the microfinance sector's lending practices. This stems from concerns surrounding the sector's potential predatory lending practices (for example, lack of transparency about borrowing terms and conditions, over-indebtedness, collection processes, and lender-intermediary conflicts of interest). AFPL's Fair Practices Code, Code of Conduct, and borrower training, partly mitigate regulatory risk.

Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

Company Description

AFPL was established in 2009 and is based in Bhubaneswar, India. It is a nonbanking financial company-microfinance institution (NBFC- MFI) registered with the country's central bank, the Reserve Bank of India (RBI). AFPL offers microfinance services to women and low-income households in rural and semi-urban areas in India, serving approximately 2.8 million customers through 1,379 branches across 21 states in India. In terms of customers, 84% come from rural areas, and the remainder from semi-urban areas. The company offers income generation loans for self-help group (SHG) and joint liability group (JLG) clients and offers individual MSME loans to existing micro and small enterprises. As of March 31, 2024 (fiscal 2024), AFPL's assets under management was Indian rupees (INR) 103.36 billion (US$ 1.25 billion), and the company has an INR16.48billion (US$ 0.20 billion) interest income. Its products include business, housing, water and sanitation, dairy development, consumer durables, and home improvement loans.

The company operates in two main segments. The microfinance segment provides small credit support to vulnerable communities, promoting the well-being of individuals, and empowering marginalized households and businesses. The MSME segment offers business loans and services to MSMEs, helping them meet their working capital needs and facilitating business growth.

Material Sustainability Factors

Access and Affordability

NBFCs provide individuals and businesses with access to alternative financing options. While banks may offer financial services as a package deal, NBFCs usually unbundle these services, tailoring specific-purpose offerings for particular groups. However, challenges such as asymmetric information and limited financial literacy can result in high expenses for borrowers. Technology advances should help NBFC lenders improve their cost efficiencies and provide innovative product solutions. In India, formal credit use is low. According to the National Multidimensional Poverty Index India had a 19% poverty rate in rural areas--5% in urban areas--in 2019-2021. In India, income inequality is high, with a Gini coefficient of 0.34, according to the World Bank and World Inequality Report. A Gini coefficient of 0 equals perfect equality, with 1 equal to perfect inequality.

Impacts on Communities

NBFCs can address a wide range of community issues by providing economically vulnerable groups with access to essential services. This may help alleviate income inequality and foster upward social mobility. The realization of these objectives hinges on the responsible lending practices of NBFCs. These include transparent contractual terms, financial education programs, and support for borrowers encountering unexpected financial hardships. By contrast, obscure loan terms or predatory lending practices can exacerbate existing socioeconomic disadvantage in the customer base. By actively addressing such concerns, NBFCs can access new markets, achieve better financial performance, attract top talent, and mitigate reputational and regulatory risk.

Responsible Labeling and Marketing

While the financial services sector depends on customer satisfaction and trust, opaque pricing and misleading sales have undermined customer trust in some NBFCs. Regulators are closely watching certain subsectors such as subprime lending, student loans, and residential mortgage origination/servicing. But the regulation and supervision of this industry remains lighter than that applying to banks. That can result in aggressive underwriting or collection practices, or in opaque pricing. Furthermore, investors, regulators, and the broader community are subjecting NBFCs' sustainable products to particular scrutiny. There is skepticism about sustainability claims, based on the possibility that such statements may make the products and services appear more proactive on the issues than they are. Such ethical challenges, if not properly managed with responsible marketing practices and customer engagement considerations, could pose material social risks to issuers. Regulation and consumer protection mechanisms have evolved over the past decade and should continue to help limit these risks in the financial services sector. For example, the RBI has issued the Fair Practices Code to guide microfinance institutions on responsible lending.

Physical Climate Risk

Physical climate risks will affect many economic activities as climate change increases the frequency and severity of extreme weather events. NBFCs finance a wide array of business sectors that are exposed to physical climate risks. However, while climate change is a global issue, weather-related events are typically localized. So, the magnitude of NBFCs' exposure is linked to the geographical location of the activities and the assets they finance. Similarly, NBFCs' physical footprint (e.g. branches) may also be exposed to physical risks, which may disrupt the ability to service clients in the event of a natural catastrophe, amplifying the impact on communities. India faces vulnerability from physical risk hazards such as flooding and heat waves; this exposure may be heightened in rural areas that lack investment in physical resilience.

Issuer And Context Analysis

The eligible categories aim to improve access to and affordability of credit. Microloans financed through AFPL's framework aim to enhance the target groups' (underprivileged and disadvantaged segments of the population in India, primarily women in rural regions) ability to borrow money through formal channels. In terms of customers, 84% come from rural areas, which is higher than the industry average of 74%, according to Bharat Microfinance Report 2023. Meanwhile, as per AFPL, 78% of its clients have gained access to formal financial services for the first time. According to the 2021 Global Findex Database, 45% of adults in India have borrowings, but only a third of these are from formal sources. Due to the geographic isolation of the customer bases, and lack of access to customer data, most financial institutions do not consider it cost effective to penetrate rural areas. This suggests NBFCs have a role to play in enabling financial inclusion. To prevent over-indebtedness risks for its borrowers, AFPL has a client rating model to predict defaults and uses cash flow analysis and credit bureau checks to determine borrowers' creditworthiness. In addition, the monthly outflows of all loan repayment obligations of a household including the proposed loan shall not exceed 50% of monthly household income or the available average monthly income after expenses, whichever is lower.

Women make up 98% of AFPL's customers and its focus on empowering women entrepreneurs with small businesses contributes to their financial independence. Its income-generating loans adopt the JLG model, a concept introduced to India by the National Bank for Agriculture and Rural Development. A JLG is an unofficial association of four to 10 people who participate in various economic activities and who are willing to jointly repay the loans taken by the group. By giving women business owners access to traditional banking services through this model, AFPL addresses the financial needs of women from rural areas with annual household incomes falling below INR300,000 (US$3,578.65). In addition to 84% of AFPL's customers coming from rural backgrounds, 60% are engaged in agriculture or related activities, and 89% belong to economically disadvantaged groups.

AFPL's policies mitigate social risks related to consumer protection and collection practices. The company has formulated a Code of Conduct and a Fair Practices Code, which are available on the company website. They commit to conducting business in a fair and ethical manner. For example, all communications with clients must be in the vernacular language or a language understood by the borrower, ensuring all the key terms and conditions are explained clearly. Both codes also guide employees on noncoercive recovery practices. In terms of financial literacy and transparency, the company offers free compulsory group training (CGT) and financial and digital literacy training (FDLT) to its customers. The CGT is mandatory as part of the JLG lending procedures, covering aspects such as product details, monthly installments, interest rates, and processing charges. The FDLT focuses on personal wealth management, household budgeting, financial planning, and basic investment knowledge.

In addition, AFPL has a grievance redressal mechanism and a publicly accessible customer support service helpline. Instances of customer feedback, including complaints, queries, and service/information requests increased by 18% from fiscal 2022 to fiscal 2024. As complaints received were mostly related to insurance, the company has since looked to improve and streamline the claim settlement process for better customer experience.

Physical climate risk is an increasing sustainability risk for NBFCs, particularly in India. AFPL relies on assessments and analysis, such as the geographical information system, to identify vulnerable areas by integrating environmental factors, climate risks, and natural hazards. By aiming to maintain a single state exposure of not more than 20% of its portfolio, the company mitigates its concentration risk during geographic expansion. However, AFPL has yet to set company-level policy on managing physical climate risk in its lending activities. Given that the customers are low-income and underserved populations from rural areas, their ability to rebuild and recover from climate hazards may be more limited than it would be for a broader borrower base.

Alignment Assessment

This section provides an analysis of the framework's alignment to Social [Bond/Loan] principles.

Alignment With Principles

Aligned = ✓ Conceptually aligned = ○ Not aligned = ✕

✓ Social Bond Principles, ICMA, 2023

✓ Social Loan Principles, LMA/LSTA/APLMA, 2023

✓ Use of proceeds

All the framework's social project categories are considered aligned, and the issuer commits to allocate the net proceeds issued under the framework exclusively to eligible social projects. Please refer to the Analysis of Eligible Projects section for more information on our analysis of the social benefits of the expected use of proceeds. The company will disclose the proportion of financing versus refinancing in its allocation reporting. The maximum look-back period is not disclosed, which reduces insight into the projects' additionality.

✓ Process for project evaluation and selection

AFPL will establish a cross-departmental social financing team (SFT), comprising of representatives from the finance, ESG, treasury functions, and other relevant personnel. It will be headed by the company's highest approving authorities (Chief Executive Officer or Director) and will meet quarterly to screen and select the potential projects based on the framework's eligibility criteria. The company will identify and manage environmental and social risks related to eligible projects, according to its environmental and social management system (ESMS) policy. As part of AFPL's KYC process, borrowers are required to submit relevant documents in accordance with RBI's guidelines to verify the identity of borrowers. AFPL follows the exclusion criteria defined by the International Finance Corp. (IFC)'s Exclusion List and Asian Development Bank (ADB)'s Prohibited Investment Activities List, covering topics such as weapons and munitions, alcoholic beverages, tobacco, gambling, and forced or child labor. In addition, AFPL defines the target populations of each eligible category by referring to official or government definitions, which adds to the credibility of the target population selection.

✓ Management of proceeds

The net proceeds will be deposited into a segregated account. The SFT will monitor and track the allocation of proceeds. AFPL commits to allocating the net proceeds within 24 months after the issuance of a social financing instrument and to replace projects that cease to comply with the framework's eligibility criteria within three months. Specifying the maximum time for reinvestment adds transparency to its proceeds management practices. Pending allocation, net proceeds will be held in cash, cash equivalent, or readily marketable instruments, in accordance with the company's liquidity management policy.

✓ Reporting

AFPL will publish a social finance investor report, including allocation and impact reporting, on its website annually until full allocation of net proceeds. Allocation reporting will include a brief description of financed projects with their associated target populations, and the proportion of financing versus refinancing, among other metrics. Impact reporting will include direct and indirect beneficiaries covered, coverage in target segments, and change indicators. AFPL shared that change indicators will vary based on the product type. For example, indicators would focus on the increase in income or business (when applicable) if they are for group loans and MSME loans. The company also commits to publishing an annual socioeconomic impact assessment on its website, in which it conducts research to understand further the development in change indicators among clients over time.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects considered to have clear social benefits and to address or mitigate a key social issue.

While AFPL does not have an expected allocation plan, the company expects the majority of proceeds will be directed to finance new projects.

Social project categories

Affordable basic infrastructure

Sample projects:

- Water/sanitation loans
- Home improvement loans

Target population:

- Low-income groups (LIGs) and economically weaker section (EWS) households

Analytical considerations

- This category aims to enable affordable access to basic infrastructure, such as water facilities and home improvement. AFPL defines the target populations by referencing the local government's guidelines .The Ministry of Housing and Urban Affairs classifies LIGs as households having an annual income between INR300,001 and INR600,000; while the Ministry of Social Justice and Empowerment defines EWS as persons whose family has a gross annual income below INR800,000 and are not covered under the scheme of reservation for scheduled castes, scheduled tribes, and underprivileged groups referred to as "other backward classes" in India.
- Water or sanitation loans contribute to the socioeconomic wellbeing of rural households by renovating existing sanitation facilities (for example, toilet improvement) and improving water quality, with a ticket size between US$60 to US$299. This is in line with the Swachh Bharat Mission, the sanitation initiative launched by the Prime Minister of India in 2014, to promote sanitation in rural villages in the country.
- Home improvement loans aim to uplift low-income households by enabling them to enhance their homes for better living conditions. It covers basic renovation and expansion, with a ticket size between US$240 to US$1,796. Examples include transition to semi-pucca (a house that has fixed walls made up of pucca material but roof is made up of the material other than those used for pucca house) and pucca (a house which has walls and roof made of burnt bricks, stones, cement concrete, timber, ekra, etc.) housing from kuccha (a house which walls are made up of bamboo, mud, grass, reed, stones, thatch, straw, leaves, and unburnt bricks) and semi-pucca housing respectively, leading to beneficial features such as waterproof roofing and additional rooms.
- AFPL shared that home improvement activities and water/sanitation infrastructure construction would be at a small-scale, at the household level, thus the environmental impacts are relatively smaller. It will also provide training to customers on resource-efficient construction activities. As per AFPL's ESMS policy, the company will ensure compliance with applicable law and regulations, as well as the ADB's Social Protection Strategy (covering measures related to labor standards) for its business activities.

Employment generation, unemployment prevention and poverty alleviation

Sample projects:

- Group loans

- Just in Time (emergency loans)

Target population:

- Women from the rural pockets with annual household income as defined by RBI for microfinance loans

Analytical considerations

- Group loans (ticket size between US$120 to US$1,198) are for income-generating purposes, primarily for women to expand their existing business or venture into new livelihood activities, while Just in Time loans (ticket size between US$12 to US$60) are for existing customers to meet emergency financial needs. Group loans adopt the JLG model which bring together individuals with similar economic backgrounds and goals. These activities can serve as platforms for entrepreneurship, allowing skilled individuals to start their own small businesses, and potentially hire additional employees as businesses grow. The target population is defined by referencing the RBI's Regulatory Framework for Microfinance Loans whereby a household's annual income is up to INR300,000.
- In terms of affordability, for instance, AFPL's joint liability group loan's interest rate ranges from 19.9% to 23.99% as of March 2024. Interest rates are comparable to those charged by other NBFCs in India. In contrast, informal money lenders, who are not regulated by the RBI, often charge much higher rates and resort to unethical practices for loans collection.
- Financial inclusion is a national strategy for India, highlighted in the RBI's 2019-2024 National Strategy for Financial Inclusion report. AFPL is targeting underserved segments of the population, primarily women in rural areas, who do not have access to formal financing channels due to reasons such as a lack of collateral, low financing needs sizes, or no credit history. Likewise, in India formal use of credit by women is lower than it is for men. The percentage of women who borrow through formal channels is 10%, compared with 15% of men, according to the World Bank. Accordingly, the eligible activities address key social issues such as gender equality and financial inclusion.
- AFPL will conduct an annual socioeconomic impact assessment with parameters such as changes in income level, expenditure patterns, and asset holdings. Utilization checks will also be conducted to verify the use of loan funds.

Employment generation, unemployment prevention, and poverty alleviation

Sample projects:

- MSME loans (secured and unsecured)
- Individual business loans

Target population:

- Businesses developed/co-developed and/or managed/co-managed by women
- Businesses operating in rural and semi-urban areas

Analytical considerations

- This category aims to support the growth of MSMEs, which typically have a higher reported income and do not qualify for microfinance loans. According to the IFC, potential debt demand from MSMEs in India was INR69.3 trillion (US$83 billion) in 2018. Formal financial sources (commercial banks, NBFCs, other smaller banks, and government financial institutions) met only 16% of that demand. The RBI considers MSMEs a priority lending category because such businesses contribute 31% of India's GDP and 45% of the country's exports.
- The definition of MSMEs references the Ministry of Micro, Small and Medium Enterprises:
    - Micro enterprises are classified as businesses with investment in plant and machinery or equipment that does not exceed INR10 million and turnover does not exceed INR50 million.
    - Small enterprises are classified as businesses with investment in plant and machinery or equipment that does not exceed INR100 million and turnover does not exceed INR500 million.

  - Medium enterprises are classified as businesses with investment in plant and machinery or equipment that does not exceed INR500 million and turnover does not exceed INR2.5 billion.

- MSME owners can utilize funds to expand businesses such as procuring machinery, equipment, raw materials, and working capital. AFPL is primarily targeting micro and small enterprises in rural and semi-urban areas, mitigating the risks of channeling financing to less underserved segments, such as medium enterprises that have a relatively high annual turnover ceiling of up to INR2.5billion, i.e. close to US$30 million. For secured MSME loans, AFPL will follow its collateral and collection policy in case of delinquency, adhering to applicable laws and regulations. AFPL's Code of Conduct and Fair Practices Code also guide employees on noncoercive recovery practices.
- Individual business loans (ticket size between US$479 to US$2,395) aim to empower women entrepreneurs for business expansion and support. As communicated by AFPL, business developed or managed by women is defined by businesses having more than 50% women ownership or management while businesses co-developed or co-managed by women means having female participation in strategic roles (e.g. plays a crucial role in business decisions). However, this criterion is an unstable metric as ownership or management structures can evolve. AFPL will ensure female co-borrowers have control and influence over the proper usage (i.e. income generation) of loan amounts through utilization checks. However, it is unclear how it will be implemented in practice, and to what extent.
- AFPL will conduct an annual socio-economic impact assessment to understand its social impacts. Parameters include increase in income, increase in assets, and improvement in employment generation.

Mapping To The U.N.'s Sustainable Development Goals

Where the Financing documentation references the Sustainable Development Goals (SDGs), we consider which SDGs it contributes to. We compare the activities funded by the Financing to the International Capital Markets Association (ICMA) SDG mapping and outline the intended linkages within our SPO analysis. Our assessment of SDG mapping does not impact our alignment opinion.

This framework intends to contribute to the following SDGs:

Use of proceeds	SDGs			
Affordable basic infrastructure	***6. Clean water and sanitation**	**10. Reduced inequalities**	***11. Sustainable cities and communities**	
Employment generation, unemployment prevention and poverty alleviation	**1. No poverty**	***8. Decent work and economic growth**	**10. Reduced inequalities**	**11. Sustainable cities and communities**
Employment generation, unemployment prevention and poverty alleviation	***8. Decent work and economic growth**	***9. Industry, innovation and infrastructure**	**10. Reduced inequalities**	**11. Sustainable cities and communities**

*The eligible project categories link to these SDGs in the ICMA mapping.

Related Research

- Analytical Approach: Second Party Opinions: Use of Proceeds, July 27, 2023
- FAQ: Applying Our Integrated Analytical Approach for Use-of-Proceeds Second Party Opinions, July 27, 2023
- Analytical Approach: Shades of Green Assessments, July 27, 2023
- S&P Global Ratings ESG Materiality Maps, July 20, 2022

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