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Second Party Opinion

Muthoot Microfin Ltd. Social Financing Framework

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

Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✕

✔ Social Bond Principles, ICMA, 2023

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

See Alignment Assessment for more detail.

Strengths	Weaknesses	Areas to watch
Muthoot Microfin Ltd. (MML) supports financial inclusion, gender equality, entrepreneurship, and economic empowerment. The company provides micro loans to women from low-income and rural households for income generating activities, through its established nationwide network.	No weakness to report.	**The framework's eligibility criteria are broadly defined, and the scope of eligible activities could evolve.** MML could expand the range of eligible social loans if it seeks business opportunities, resulting in finance being channeled to lower-impact projects. **Payment collection could be a challenge, given the socioeconomic profile of microfinance borrowers.** This requires safeguards to manage borrower exposure to risks. MML's Know Your Customer (KYC) process, including verification and customer house visits, partly mitigates 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). MML's Fair Practices Code and borrower training, accompanied by a comprehension test, 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

MML is a non-deposit taking, nonbanking financial company-microfinance institution (NBFC-MFI) based in Kochi, India. The company's primary focus is to provide microloans to women, for income-generating purposes, in rural regions of the country. As of the end of 2023, MML's assets under management were Indian rupee (INR) 114 billion (US$1.38 billion) with over 3.2 million active customers and over 13,000 employees. It has a network of 1,424 branches in India, across 17 states. It is listed on the BSE stock exchange and the National Stock Exchange of India (NSE India).

The company's loan products comprise:

- Group loans, including income-generating loans, Pragathi loans (interim loans made to existing customers for working capital and income-generating activities), as well as individual loans;
- Special purpose loans including mobile phone loans, solar lighting product loans, and household appliances product loans;
- Health and hygiene loans such as sanitation improvement loans; and
- Secured loans in the form of gold loans and Muthoot Small & Growing Business (MSGB) loans. As of the end of 2023, income-generating loans account for 98% of MML's portfolio. By loan amounts, 31% and 26% of its borrowers operate in the animal husbandry and agriculture industries, respectively.

MML is the microfinance arm of Muthoot Pappachan Group (MPG), whose subsidiary, Muthoot FinCorp Ltd., holds 50.2% of MML. MPG is a diversified conglomerate, engaging in financial services, automotive, hospitality, real estate and infrastructure, alternate energy, IT services, healthcare, and precious metals businesses in India.

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. Income inequality is also high, with a Gini coefficient of 0.34., according to the World Bank. A Gini coefficient of 0 equals perfect equality, with 1 equal to perfect inequality.

Impact 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 Reserve Bank of India (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

MML's eligible categories aim to improve access to, and affordability of credit. Microloans financed through MML's framework should enhance the target groups' (underprivileged and disadvantaged segments of the population in India, primarily women in rural regions) ability to borrow money more cheaply than through traditional channels. According to the 2021 Global Findex Database, 45% of adults in India have borrowings. However only a third get credit 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 an important role to play in supporting financial inclusion. For example, MML's principal loan product, income-generating loans, has a loan size of US$120 to $1,025 and a tenure of 12 to 36 months. The current interest rate of its loan products ranged between 21.5% to 25%, as of January 2024. 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. MML's eligible activities could bring more people into formal financing channels.

Payment collection may be a challenge in the microfinance industry, given the socioeconomic profile of its borrowers. To ensure customers have the capacity to repay and avoid over-indebtedness, MML has a KYC process in place, complying with the KYC Guidelines issued by RBI. These include asking borrowers to submit relevant documents, and having credit officers conduct house visits to verify the KYC requirements. MML's Fair Practices Code also identifies collection methods that avoid coercion.

MML's focus on empowering small women entrepreneurs contributes to their financial independence. Its income-generating loans adopt the joint liability group (JLG) model. JLG is a concept introduced to India by the National Bank for Agriculture and Rural Development. Under the model, a JLG is an unofficial association of four to ten 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, MML helps borrowers develop credit records and thereby broadens, over time, their ability to raise money.

MML's customer interactions and policies should ensure responsible marketing and labelling 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. In terms of financial literacy and transparency, the company offers free and compulsory three-day Comprehensive Group Training (CGT) to borrowers once the JLG is set up. The CGT covers topics such as loan tenure, interest rate, terms and conditions, and repayment details. MML subsequently conducts a test to check comprehension. It has also set up a three-level grievance mechanism for customers to raise complaints. The number of customer complaints doubled from FY21 to FY23. According to MML, this was primarily due to a client base increase of 48% over the same period. However, the complaints are a reminder that rapid growth incurs client satisfaction risks. The overall microfinance industry in India also grew substantially. There was a 37% increase in the microfinance loan portfolio in NBFC-MFIs between March 2022 to 2023, according to India's Microfinance Industry Network.

Physical climate risk is an increasing sustainability risk for NBFCs, particularly in India. The country is vulnerable to physical risks such as flooding and heat waves. MML mainly relies on relevant internal policies, covering topics such as environmental, social, and governance (ESG), greenhouse gas emissions, energy management, water, and waste, to identify and manage environmental risks. As stated in its ESG policy, MML has an exclusion list defining the types of projects that it will not finance. These include projects related to hazardous chemicals, forestry products from unmanaged forests, and endangered species. There is no information about how the company factors physical climate risks into existing lending activities. However, MML's Griha Suraksha Shield and natural catastrophes products provide insurance for homes. Policies cover physical loss, damage, and destruction of buildings, helping MML's customers to build climate resilience.

Alignment Assessment

This section provides an analysis of the framework's alignment to Social Bond Principles and Social 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

We consider all the framework's social project categories as aligned, and the issuer commits to allocating the net proceeds exclusively to eligible social projects. The framework's eligibility criteria are broadly defined, and MML has the flexibility to expand the range of eligible social loans. The scope of eligible activities could evolve, suggesting finance could be channeled to lower-impact projects. MML will disclose the proportion of financing versus refinancing in its allocation reporting. The maximum refinancing look-back period is three years after issuance, in line with market practice. 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.

✓ Process for project evaluation and selection

The company has established a cross-departmental social financing team (SFT), led by the chief executive officer and consisting of the chief financial officer, ESG lead, and members from various functions, such as sustainability, internal audit, risk management, and other relevant researchers and analysts. The SFT will meet at least annually to screen proposed projects according to the eligibility criteria. MML's managing director will then approve SFT's outputs. Dedicated risk assessment and due diligence processes will identify and evaluate social, environmental, and financial risks associated with projects. The SFT team will engage with relevant stakeholders, such as non-governmental organizations, and potential beneficiaries. The SFT will apply the International Finance Corp. (IFC)'s exclusion guidelines to both eligible projects and unallocated proceeds. The company's Fair Practices Code helps mitigate some of the risks to borrowers. For example, all communications must be in the vernacular language or a language understood by the borrower, and the company identifies measures to avoid coercive collection.

✓ Management of proceeds

The SFT will manage the net proceeds of social financing instruments issued under this framework. It will deposit the proceeds in a segregated account or otherwise tracked by the company in an appropriate manner, for example, an account separately monitored by the SFT with regular reporting, according to the company. Pending allocation, the SFT will manage unallocated proceeds in accordance with MML's liquidity management policy. The company commits to replacing projects which cease to be eligible within three months. Other frameworks are typically less explicit about the maximum time to reinvestment, a strength of MML's financing.

✓ Reporting

MML will publish a social finance investor report on its website annually, until full allocation of social financing instruments. The report will include the allocation of proceeds and actual impact of financed projects. 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. The company will provide information about the social outcomes achieved, such as the number of people lifted out of poverty, increased financial literacy, and job created within the target populations. Despite the complexity of tracking those indicators, MML does not commit to disclosing its calculation methodology. MML commits to have a third-party verification of its allocation and impact reporting post-issuance, which adds to the transparency of MML's social projects.

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.

Over the two years following issuance of the financing, MML expects to allocate 63% to employment generation and unemployment prevention/alleviation; 30% to food security and sustainable food systems; 5% to socioeconomic advancement and empowerment; and 2% to affordable basic infrastructure. The company expects 100% of proceeds will be directed to financing new projects.

Social project categories

Affordable basic infrastructure

Loans to enable affordable basic infrastructure. Product examples are sanitation loans, water-purifier loans, and solar energy-based product loans.

Analytical considerations

- This category aims to enable affordable access to basic infrastructure, such as water facilities. It contributes to the socio-economic wellbeing of rural households by renovating existing sanitation facilities (for example, toilet improvement) and improving water quality (for example, the purchase of water purifiers). 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.
- Solar energy-based product loans will include solar lights, solar torches, and solar fans, providing a lower-emission alternative for essential electrical appliances and alleviating the lighting problems of rural households.
- MML defines the target population as underserved women lacking access to basic infrastructure with annual household income of less than INR300,000 and engaged in some sort of economic activity.

Employment generation, unemployment prevention/alleviation

Loans to enable employment generation, unemployment prevention or alleviation. Product examples are income-generating loans and Suvidha loans.

Analytical considerations

- Income-generating activities could be tailoring and embroidery shops, textiles, hardware shops, electrical service centers, coir and coir products manufacturing, etc., while Suvidha loans are for meeting emergency financial needs. 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.
- Financial inclusion is a national strategy for India, highlighted in the RBI's 2019-2024 National Strategy for Financial Inclusion report. MML is targeting underserved segments of the population, primarily women in rural areas, who do not have access to formal financing channels due to 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.
- The target population for this category is financially excluded women who lack access to financial services and products, such as bank accounts, loans, insurance, and saving mechanisms. They are often unable to participate fully in the formal financial system, which hinders their ability to save, invest, or access credit for entrepreneurship or personal needs. They are also part of the economically weaker section (EWS), a social category defined by the Ministry of Social Justice and

Empowerment, with a gross annual family income below INR800,000. Low-income group (LIG) households, as defined by India's Ministry of Housing and Urban Affairs, are also eligible for loans. LIG households have a gross annual household income between INR 300,001 and INR 600,000, In our opinion, referring to official or government definitions adds to the credibility of the target population selection.

Food security and sustainable food systems

Loans to facilitate food security and productivity. Product examples are income-generating loans, focusing on agricultural activities, animal husbandry, and dairy.

Analytical considerations

- This category aims to improve food security and productivity by providing income-generating loans. The list of sub-activities under this category includes:
  - Agriculture: fish, flower, gains cultivation; medicinal plant cultivation; nursery; seeds and fertilizers; irrigation; spices cultivation; and fruits and vegetable cultivation.
  - Animal husbandry: cattle farms; poultry; eggs and milk; purchase of cow, goat, chicks, and ducklings; and seafood farms.
- A large proportion of the population in India is rural and depends on agriculture for a living. According to RBI, access to credit has a positive, significant, and immediate impact on agriculture output. MML's eligible activities could help bridge the gap in the current formal credit system to provide credit to farmers. Financing agriculture is also aligned with the government's commitment to ensure food availability and nutrition, demonstrated by the National Food Security Act and other welfare schemes. The target population is underserved women involved in agriculture, based on the same definitions of EWS and LIG.
- There are associated environmental risks raised from agricultural activities such as the use of fertilizers, pesticides, and herbicides. MML mainly relies on its adoption of Do No Significant Harm (DNSH) principles to ensure activities funded by its loans do not cause significant harm to the environment, individuals, communities, or broader societal wellbeing. In addition, its ESG policy has excluded financing for projects that trade in pesticides or herbicides that are subject to international phase outs or bans.

Socioeconomic advancement and empowerment

Loans to facilitate socioeconomic advancement and empowerment. Product examples are income-generating loans, Pragathi loans, individual loans, and MSGB loans.

Analytical considerations

- This category aims to support the growth of micro, small and medium enterprises (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 Pragathi loan is a bridging loan made to existing customers for working capital, income-generating activities, or other purposes such as consumption and medical emergencies. According to MML, all eligible loans in this category are unsecured. Examples of enterprises include tailoring and embroidery shops, textiles, hardware shops, electrical service centers, coir and coir product manufacturing, etc. We believe MML's eligible activities address key social issues such as supporting financial inclusion for India's MSME sector.
- The target populations are financially excluded women and MSMEs owned by women, with reference to the definitions in India's Micro, Small and Medium Enterprises Development Act 2006:
  - For enterprises engaged in the manufacturing, producing, processing, or preservation of goods, micro enterprises are classified as businesses with investments in plant and machinery that do not exceed INR2.5 million, while

small enterprises are classified as businesses with investments in plant and machinery that are more than INR2.5 million but less than INR50 million.

- For enterprises engaged in providing or rendering of services, micro enterprises are classified as businesses with investments in equipment that do not exceed INR1 million, while small enterprises are classified as businesses with investments in equipment that are more than INR1 million but less than INR20 million.

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***	**7. Affordable and clean energy***	**10. Reduced inequalities**	**11. Sustainable cities and communities***
Employment generation, unemployment prevention/alleviation	**1. No poverty**	**8. Decent work and economic growth***	**10. Reduced inequalities**	**11. Sustainable cities and communities**
Food security and sustainable food systems	**2. Zero hunger***	**10. Reduced inequalities**	**11. Sustainable cities and communities**	**12. Responsible consumption and production***
Socioeconomic advancement and empowerment	**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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