



Environmental, Social & Governance Policy

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Preamble

The system for integrating the Environmental, Social and Governance (ESG) aspects at Utkarsh Small Finance Bank Limited's (USFBL) business operations consists of the following:

- *Environmental, Social & Governance (ESG) Policies*
- *Environmental, Social & Governance Management System (ESG-MS) Manual*

The ESG Policy document present the E&S Policy Statement and Operational Principles and Corporate Governance policy of USFBL that translate the Policy to action. The Policy document states USFBL's intentions on environmental, social and governance aspects of the business and can be circulated with USFBL's stakeholders.

The Environmental, Social & Governance Management System (ESG-MS) manual has been developed to enable implementation of the ESG Policies and Principles of USFBL. The ESG-MS Manual articulates the operational procedures to be adopted by USFBL for each loan transaction. The ESG-MS is an operational level document that will remain dynamic in nature and is internal to the Bank.

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1 Introduction

1.1 About Utkarsh Small Finance Bank Limited

Utkarsh CoreInvest Limited (UCL) or the promoter of USFBL, originally commenced operations as an NBFC in fiscal 2010 and later converted to an NBFC – MFI. UCL has a history of serving customers in the microfinance segment with a particular focus on financial inclusion for unserved or underserved customer segments in rural/ semi-urban areas of Uttar Pradesh, Bihar, Jharkhand, Madhya Pradesh, Chhattisgarh and Uttarakhand. On October 7, 2015, UCL received the RBI In-principle approval to establish a Small Finance Bank (SFB), following which it incorporated Utkarsh Small Finance Bank Limited (“USFBL or “the Bank”) as a wholly owned subsidiary on April 30, 2016. The Bank is headquartered at Varanasi, India and operates through banking outlets across India.

Subsequent to obtaining the RBI Licence on November 25, 2016 to establish and carry on business as an SFB, UCL transferred its business of providing microfinance, as a going concern to the Bank, which commenced its operations from January 23, 2017. USFBL was included in the second schedule to the RBI Act as a Scheduled Commercial Bank pursuant to a notification dated October 04, 2017 issued by the RBI and published in the Gazette of India (Part III - Section 4) dated November 07, 2017.

The primary objective of USFBL is to provide affordable and accessible banking services which are process centric, technology enabled, and people oriented thus developing it into a reliable, scalable, and sustainable institution facilitating socioeconomic change. The Bank primarily focuses on rural and semi-urban areas in India with microfinance for women entrepreneurs being the key focus areas. However, over a period the Bank has also added various loan products to its portfolio, besides the liabilities products and services.

Given the legacy of UCL as a NBFC-MFI, microfinance remains a focused business segment for USFBL. The Bank has been diversifying its product portfolio to include non-micro banking loans allowing it to diversify from its microfinance business and further grow secured loan portfolio. USFBL offers a range of financial products and services that address the specific requirements of its customer segments while assessing factors including income profile and the type of security available. USFBL’s asset products include (i) microbanking loans that include Joint Liability Group loans, individual loans and two-wheeler loans; (ii) retail loans that includes unsecured loans, such as business loans and personal loans and secured loans, such as loans against property (“LAP”) and vehicle loans; (iii) wholesale lending that includes short term and long-term loan facilities to SMEs, mid and large corporate and institutional clients; and (iv) housing loans with a focus on affordable housing. On the liabilities side, USFBL offers savings accounts, current accounts and a variety of term and recurring deposit accounts. In addition, the Bank also provides services comprising ATM-cum-debit cards, bill payment system and distributes third party point of sales terminals, mutual funds, and insurance products.

1.2 Background to ESG Policies

USFBL recognises that it has widened its business scope over the years and that activities of its borrowers under this widened scope has the potential to cause both adverse and beneficial Environmental, Social and Governance (ESG) impacts. In order to achieve its vision of being a trusted financial service provider, the Bank realises the need to address these ESG risks and impacts in a structured manner and take measures and initiatives at the appropriate stage. The

adverse impacts, if left unaddressed, could translate to credit risks and/or reputation risks in the long run. Engagements with the borrowers also present opportunities through downside risk management and upside value creation in terms of brand differentiation, portfolio performance, stronger relations, and increased loyalty.

Cognizant of this need, USFBL has developed ESG Policy that states its commitment to integrating ESG considerations in its business operations. The E&S Policy has been developed in alignment with the national E&S laws and regulations and relevant E&S Good International Industry Practices (GIIP). USFBL has also developed a Corporate Governance Policy in line with requirements of SEBI (Listing Obligation and Disclosure Requirement) Regulations 2015 and the Companies Act 2013.

1.3 Reference Framework

The E&S Policy has been developed with reference to:

- Applicable Indian E&S laws and regulations (including occupational health and safety)
- Relevant E&S Good International Industry Practice (GIIP)

For all loan transactions, the E&S Policy and its requirements will be implemented in compliance to Indian regulations. However, in cases where there is a difference between Indian regulations and GIIP, more stringent of the two requirements would be adhered to by the Bank.

1.4 Scope of ESG-MS

The ESG-MS is applicable to all loan products of USFBL under the following verticals:

- Microbanking
- Retail Lending
- Wholesale Lending
- Commercial and Construction Vehicle Finance

The ESG-MS and its requirements will be applicable only to lending and investments products and shall excludes all liabilities products and services or deposits.

2 Environment, Social & Governance Policies & Principles

2.1 E&S Policy

The E&S Policy of USFBL has been prepared in alignment with requirements of the reference framework and will be applicable to all loans extended by the Bank from the date of approval.

USFBL's Environmental & Social Policy

USFBL envisions to be a trusted financial institution that creates a financially and socially inclusive environment for its customers through insightful, sustainable, and scalable technology enabled solutions. USFBL believes that its core values of persistence, diligence, responsible and ethical dealings, inclusiveness and excellence will deliver 'best in class' experience for its valued customers and enable the Bank in achieving its vision.

Building upon its core values, USFBL is committed to give due consideration to environmental & social sensitivities in its portfolio, integrating these into its business operations and decision-making process. USFBL will thus,

- Conduct business in an environmentally sensitive, socially responsible, fair and transparent manner.
- Encourage borrowers to maintain compliance to relevant national and State E&S regulations including worker rights; and encourage adoption of industry best practices and relevant international E&S safeguards, as appropriate.
- Be conscious of responsibilities towards its stakeholders, maintain a high level of social and ethical conduct within its own operations and communicate its expectations to the customers, third parties, investors and other relevant stakeholders.
- Continually improve its E&S performance by reducing direct and indirect impacts of its business operations, assessing E&S risks of its portfolio and defining E&S requirements for customer compliance, thus adding value to the businesses.
- Establish and maintain systems to achieve the E&S Policy objectives.

2.2 E&S Operational Principles

The E&S Policy of USFBL will be supported by the following operational principles to guide the E&S performance of the Bank:

I. Excluded Activities

- USFBL will not invest / lend in any activity that features in the E&S Exclusion List presented in **Annex 1**.

II. Achieving E&S Compliance

USFBL will encourage its borrowers to comply with:

- All relevant Indian E&S (including labour, health, and safety) policy and legislative requirements
- E&S Good International Industry Practice relevant to USFBL's borrowers

III. Preventing Pollution & Using Resources Efficiently

Encourage borrowers to:

- Adopt appropriate controls (where relevant), including processes and procedures to manage pollution generated in the form of air emission hazardous and solid waste generation in an environmentally sound manner.

- Identify opportunities to reduce material and energy inputs, **reduce greenhouse gas emissions**, reuse, recycle and recover resources, improve process efficiencies and safety, and minimize waste generation.

IV. Ensuring Good Working Conditions and Fair Labour Practices

Influence borrowers to comply with applicable labour regulations, and establish procedures to:

- Provide safe and healthy workplaces and mitigating health impacts related to the work.
- Prevent sexual harassment in all forms especially of women and establishing policy and procedures for the same.
- Treat all workers fairly in terms of recruitment, remuneration and progression irrespective of gender, race, colour, language, disability, political opinion, age, religion, or national/social origin
- Prevent employment of forced or child labour.
- Provide training, communication and tools to workers, as appropriate, to ensure good working conditions.

Note: Workers means workers directly engaged as well as contracted workers engaged through third parties.

V. Engaging with Stakeholders and Access to Remedy

USFBL will engage with their stakeholders by:

- Providing fair, transparent, and timely redressal of internal and external grievances reported in written or verbal format by all stakeholders.
- Establishing borrower feedback mechanism and analyzing inputs for service improvement.
- Reporting to relevant stakeholders in a planned manner.

VI. Borrower Protection

USFBL will establish the following mechanisms and processes to ensure protection of borrowers of its loan products:

- Design financial products that are affordable, flexible, and suiting borrower interests, excluding waiver of borrower right's under host country law.
- Prevent over-indebtedness by performing adequate due-diligence on the borrower's repayment capacity and designing appropriate loan repayment schedules and using collaterals and guarantees judiciously.
- Communicate necessary information about the product clearly, timely and in a language understood by the borrower.
- Price the product affordable to borrowers while allowing the financial institution to be sustainable.

- Convey in writing in a language understood by the borrower, by means of a sanction letter, the loan sanctioned along with the terms and conditions including the rate of interest and the method of application.
- Treat borrowers fairly and respectfully, free of discrimination through code of conduct for staff, incentivizing good client relations and responsible use of agents.
- Respect individual client data in accordance with host country law and regulations and implementing appropriate mechanisms to maintain client confidentiality on personal data.

VII. Operating E&S Management System

USFBL will:

- Establish, implement and maintain systems for assessing and managing E&S risks and opportunities to ensure compliance as well as add value through appropriate procedures, resource allocation, monitoring and reporting.

2.3 Corporate Governance Policy

USFBL believes that good corporate governance practices are a pre-requisite to sustainable business growth and generates long-term value to all its shareholders and other stakeholders and thus seeks to implement a responsible, transparent, and ethical governance framework.

At USFBL, the Corporate Governance philosophy stems from the belief that Corporate Governance is a key element in cultivating efficiency, growth and boosting investor confidence. The Bank strongly believes in ethical values and self-discipline to achieve higher standards of Corporate Governance and continues to strive for excellence in business operations through transparency, accountability to its Stakeholders, Government, and others who deal with the Bank.

Thus, USFBL in 2017 adopted Corporate Governance Policy to strive for excellence in business operations through transparency and accountability. The Bank's Corporate Governance policy aims at meeting the Corporate Governance requirements as per Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI) and The SEBI (Listing Obligation and Disclosure Requirement) Regulations-2015 ('Listing Regulations'), Bank for International Settlements (BIS) - Corporate Governance Guidelines, besides good practices either recommended by professional bodies or practiced by leading Banks/ companies in India.

This policy enables the Bank to adopt transparent systems, safeguard the interest of its Stakeholders and create an environment of trust and confidence by means of transparent and timely disclosure of information.

In order to implement the Corporate Governance Policy effectively, the Bank has adopted the sound corporate governance principals prescribed under BASEL norms by Bank for International Settlements (BIS). These include:

1. Board's overall Responsibilities
2. Board Qualifications and Composition

3. Board's Structure & Practices
4. Senior Management
5. Governance of Group structures
6. Risk Management function
7. Risk identification, monitoring and controlling
8. Risk communication
9. Compliance
10. Internal Audit
11. Compensation
12. Disclosure and transparency

Additional details on policy and its implementation framework are as provided in USFBL's Corporate Governance Policy (2017) and as amended from time to time.

3 Approval, Communication, Implementation & Update of ESG Policies

3.1 Approval

The ESG Policies and Principles are formally adopted by USFBL Board of Directors and is applicable to all loans extended by the Bank from the date of approval.

3.2 Communication

The ESG Policies and Principles will be communicated to all employees through suitable training programs and also communicated to other stakeholders, such as investors, borrowers, as relevant. The ESG Policies and Principles may also be disclosed through USFBL's website.

3.3 Implementation

The policies are supported by an Environmental, Social & Governance Management System (ESG-MS) to achieve the policy objectives. The ESG-MS is formally adopted by the top management and will be implemented in all loan transactions of the Bank from the date of approval.

Under the ESG-MS, procedures and tools for ESG risk and opportunity identification, management and monitoring are developed and integrated with the loan cycle. The institutional structure with roles and responsibilities of various departments towards implementation of the ESG-MS is defined.

The policies and principles on Corporate Governance shall be implemented as outlined in USFBL's Corporate Governance Policy (2017) and as amended from time to time.

3.4 Review and Update of ESG Policies

The ESG Policies and Principles will be reviewed and updated as required, at least once in three years, to ensure its effectiveness, adequacy, and suitability to the changing scenarios of environmental, social and governance.

The ESG Policies and its requirements will be audited as per the existing Internal Audit processes of USFBL.

Where a need for revision in the ESG Policies is realized, the revised policy documents will be placed before the Board for approval before implementation.

4 Applicability of ESG Policies and ESG-MS to Loan Products

Based on nature of business and extent of interaction with ESG aspects, the ESG-MS is applied to the loan products in a differential manner as presented in the subsequent sub-sections.

4.1 Level of Application & ESGMS Procedures

The level of application of the ESGMS to loan products is classified as:

- Full Application
- Partial Application
- Minimal Application
- Nil Application

The ESGMS procedures that will be implemented for each of the above-mentioned four levels are as presented below:

Level of Application	Details on Application
1) Full Application	<p>The potential interaction of the sectors with ESG aspects to which this level will be applicable is expected to be higher. The size of loan to borrowers is comparatively large. Hence the following risk assessment and management procedures of the ESG-MS will be applicable:</p> <ul style="list-style-type: none">• Step 1: Screening against Exclusion List• Step 2: ESG Risk and Opportunity Identification• Step 3: ESG Loan Covenants• Step 4: ESG Action Plan• Step 5: ESG Action Plan Implementation
2) Partial Application	<p>The potential interaction of the sectors with ESG aspects to which this level will be applicable is expected to be lower. The size of loan to borrowers is smaller. Hence the following risk assessment and management procedures of the ESG-MS will be applicable:</p> <ul style="list-style-type: none">• Step 1: Screening against Exclusion List• Step 2: ESG Risk and Opportunity Identification• Step 3: ESG Loan Covenants
3) Minimal Application	<p>The size of loan to borrowers is small. The potential interaction of the sectors with ESG aspects to which this level will be applicable is expected to be minimal. Hence the following risk assessment and management procedures of the ESG-MS will be applicable:</p> <ul style="list-style-type: none">• Step 1: Screening against Exclusion List• Step 2: ESG Loan Covenants
4) Nil Application	<p>The loans and loan products to which this level will be applicable are not envisaged to interact with ESG aspects and hence only screening against exclusion list and client protection requirements will continue to be fulfilled along with applicable requirements of the RBI's Fair Practice Code.</p>

4.2 Loan Products & Level of Application

The level of application to the sectors and loan thresholds under each loan product is presented below.

Loan Product	Level of Application			
	Full Application	Partial Application	Minimal Application	Nil application
Wholesale Lending	<ul style="list-style-type: none"> Non-Banking Financial Companies (NBFC's) – loans > INR 30 crore Housing Finance Corporations (HFC's) – loans > INR 30 crore 	<ul style="list-style-type: none"> Non-Banking Financial Companies (NBFC's) – loans > INR 2 crore upto 30 crore Housing Finance Corporations (HFC's) – loans > INR 2 crore upto 30 crore Non-NBFCs – loans > INR 2 crore 	<ul style="list-style-type: none"> Business Correspondent (Other than JLG) Non-Banking Financial Companies (NBFC's) – loans < INR 2 crore Housing Finance Corporations (HFC's) – loans < INR 2 crore Non-NBFC - loans < INR 2 crore 	<ul style="list-style-type: none"> Business Correspondent - JLG
Retail Lending	<ul style="list-style-type: none"> Micro, Small and Medium Enterprises – loans > INR 30 crore Trading and Warehousing – loans > INR 30 crore 	<ul style="list-style-type: none"> Micro, Small and Medium Enterprises – loans > INR 2 crore upto 30 crore Trading and Warehousing – loans between INR 2 crore to 30 crore Loan Against Property – loans > INR 2 crore 	<ul style="list-style-type: none"> Micro, Small and Medium Enterprises – loans > INR 50 lakh upto 2 crore Trading and Warehousing – loan > INR 1 crore upto 2 crore Loan Against Property – loan > INR 1 crore upto 2 crore 	<ul style="list-style-type: none"> Personal loans Housing Finance (Individual home loans) Trading and Warehousing – loans < INR 1 crore Micro, Small and Medium Enterprises – loans < INR 50 lakh Loan Against Property – loans < INR 1 crore
Commercial and Construction Vehicle Finance	<ul style="list-style-type: none"> Commercial & Construction Vehicle Finance – loans > INR 30 crore 	<ul style="list-style-type: none"> Commercial & Construction Vehicle Finance – loans > INR 2 crore to 30 crore 	<ul style="list-style-type: none"> Commercial & Construction Vehicle Finance – loans > INR 50 lakh to 2 crore 	<ul style="list-style-type: none"> Commercial & Construction Vehicle Finance – loans < 50 lakh Two wheeler loans
Micro Finance	-	-	-	<ul style="list-style-type: none"> Micro banking business loans (MBIL) Joint Liability Group Loans

Note : NBFCs shall not utilize funds borrowed from USFBL in providing loans, funding or other support to Clients engaged in any of the activities mentioned in the Exclusion List.

Annex 1: USFBL's ESG Exclusion List

USFBL as part of its credit policy shall not finance the items listed below.

Exclusion List Means the following list of prohibited activities:

- (a) Production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements, or subject to international bans such as pharmaceuticals, pesticides / herbicides, ozone depleting substances, PCB's, wildlife or product regulated under CITES.
- (b) Production or trade in weapons and munitions.
- (c) Production or trade in alcoholic beverages (excluding beer and wine) This does not apply to project sponsors who are not substantially involved in these activities. "Not substantially involved" means that the activity concerned is ancillary to a project sponsor's primary operations.
- (d) Production or trade in tobacco.*
- (e) Gambling, casinos and equivalent enterprises.
- (f) Pornography
- (g) Production or trade in radioactive materials. This does not apply to the purchase of medical equipment quality control Measurement) equipment and any equipment which the company considers the radioactive source to be trivial and/ or adequately shielded.
- (h) Production or trade in unbonded asbestos fibers. This does not apply to purchase and use of bonded asbestos cement sheeting where the asbestos content is less than twenty percent. (20%)
- (i) Drift net fishing in the marine environment using nets in excess of 2.5 KM in length.
- (j) Production or activities involving harmful or exploitative forms of forced labour/harmful child labour. Forced labour means all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty. Harmful child labour means the employment of children that is economically exploitive, or is likely to be hazardous to, to interfere with, the child's education, or to be harmful to the child's health, or physical, mental, spiritual, moral or social development.
- (k) Production, trade, storage, or transport of significant volumes of hazardous chemicals, or commercial scale usage of hazardous chemicals. Hazardous chemicals include gasoline, kerosene, and other petroleum products.
- (l) Production or activities that impinge on the lands owned, or claimed under adjudication, by indigenous peoples, without full documented consent of such peoples.
- (m) Prostitution.

** In case of tobacco the Bank shall use all reasonable efforts not to provide funding to clients engaged in such activities and shall ensure that in all events, the company's aggregate funding to such clients shall not at any time exceed two percent (2%) of the company's total disbursed portfolio in respect of such relevant financing operations.*