Second Party Opinion

Banco Finandina S.A. BIC's Sustainability Framework

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Location: Colombia **Sector:** Banks

Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Social Bond Principles, ICMA, 2023

✔ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

✔ Sustainability Bond Guidelines ICMA, 2021

See Alignment Assessment for more detail.

Strengths

The framework incorporates robust eligibility criteria, in line with local best practices, such as the incorporation of the Colombian Green Taxonomy guidelines for hybrid vehicles, which increases stringency over project selection and aligns its lending activity with the country's transition pathway.

Banco Finandina's framework leaves refinancing of eligible projects out of its scope, which we view as a strength because all financed projects must meet eligibility requirements in effect when the loan agreement is made. This may lead to broader environmental and social benefits. For example, financing newer--versus older--vehicles generally ensures greater environmental characteristics.

Weaknesses

Green eligible projects have no minimum performance thresholds. In line with local taxonomy, Banco Finandina does not include direct emission thresholds for hybrid vehicles, which is a common global and regional practice.

Areas to watch

As Banco Finandina continues to diversify its credit offering into personal and micro-, small-, and medium enterprise (MSME) loans in Colombia, its underwriting standards and discipline will be key in ensuring affordable access to financial services while avoiding introducing social risk to vulnerable population, such as over indebtedness.

In line with market practices, social lending, indicators are limited to inputs and outputs, such as the number of people benefited and amounts disbursed, which provide limited insight about social impact, both from a benefit and risk perspectives.

The bank has another green transaction that includes clean transportation, outside the scope of this framework. It is important that the bank keeps separate management of proceeds to avoid double-counting between different transactions.

Eligible Green Projects Assessment Summary

Eligible projects under Banco Finandina S.A. BIC's Sustainability Framework are assessed based on their environmental benefits and risks, using Shades of Green methodology.

Clean Transportation	Medium to Light green
Financing the acquisition of electric vehicles (EVs), plug-in and non-plug-in hybrid EVs, and electric micro mobility (electric bicycles, scooters, or ither light wheeled vehicles fueled by electricity).	

See Analysis Of Eligible Projects for more detail.

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

Banco Finandina S.A. BIC (Banco Finandina) is headquartered in Chía and regulated by the Superintendencia Financiera de Colombia. Established in 1977, the bank primarily engages in retail lending (91% of its loan book), which mostly consists of auto loans (57%), consumer loans (26%), payroll deductible loans (8%), and credit cards (7%). The bank controls roughly 9% of the domestic auto loan market and it has been diversifying its retail business in the past five years by focusing on expanding its digital channel and position itself as a fintech. This strategy has allowed the bank to grow at a faster pace than the peer average by expanding its presence in Colombia. SEISSA, a leading conglomerate in Colombia with a strong position in automobile imports, sales, and leasing, as well as other financial services, owns 75% of Banco Finandina.

Material Sustainability Factors

Access and affordability

Banks' large impact on society and the economy stems from their role in enabling access to financial services to individuals and businesses, and in ensuring the correct functioning of payment systems, which are cornerstones of economic development and stability. In most countries, unbanked and underserved population segments are still meaningful, although the access gap is most acute in emerging economies. Market imperfections such as low competition, incomplete information, and lack of financial literacy, often result in costly alternatives for small businesses and low-income individuals, so ensuring affordable access to financial services, especially to the most vulnerable population, remains a challenge for the banking industry. New technologies will, however, increasingly enable banks to close this gap through cost efficiencies and product innovation. While structural issues such as poverty, informality, and lack of financial literacy partly limit access to financial services, banks have large opportunities to support economic development through financial inclusion.

Climate transition risk

Banks are highly exposed to climate transition risk through their financing of economic activities, which impact the environment. Banks' direct environmental impact is small, compared to financed emissions, and stems mainly from power consumption (e.g. data centers). Policies and rules to reduce emissions could raise credit, legal, and reputational risks for banks with large exposures to high-emitting sectors, such as oil and gas, metals and mining, real estate, or transportation. These medium- to long-term risks are significant and will be proportional to the impact of climate change on the economy. Historically, Banco

Finandina only engaged in auto lending, significantly increasing its climate transition exposure. In recent years, the bank has worked to diversify its loan portfolio.

Physical climate risk

Physical climate risks will affect many economic activities because climate change will increase the frequency and severity of extreme weather events. Banks finance a wide array of business sectors that are exposed to physical climate risks, exposing banks through their financing activities. However, while climate change is a global issue, weather-related events are typically localized, so the magnitude of banks' exposure is linked to the geographical location of the activities and assets they finance. Similarly, banks' physical footprint (e.g. branches or ATMs) may also be exposed to physical risks, which may disrupt their ability to service clients in the event of a natural catastrophe, amplifying the impact on communities. Colombia is exposed to natural disaster risks, such as earthquakes, floods, landslides, and volcanic eruptions. Banks may mitigate the effects of physical climate risks by financing adaptation projects and climate-resilient infrastructure, as well as by investing in solutions that support business continuity.

Privacy protection

Banks rely heavily on IT systems, using digitization (or computer processing of information) extensively. The increasing use of client data collection, data mining, and artificial intelligence (AI) has brought significant efficiency gains and facilitated financial access. However, this has increased banks' exposure to the risk of IT infrastructure failures, cyberattacks, and other rapidly evolving risks. The resulting disruptions (such as client data leakage, data theft, or AI-related unintended or biased use of private personal data) could subject banks to higher and unpredictable risks, given their large number of customers and business partners. In addition, stolen data may be used by criminals to commit various types of frauds. We view privacy protection risks as rising and evolving as cyber hackers become more sophisticated, but most banks have strong risk governance and controls in place to prepare for these risks.

Issuer And Context Analysis

All project categories included in the framework aim to address some of Banco Finandina's material sustainability factors. Clean transportation to address climate transition risk. Socioeconomic advancement, and empowerment and access to essential services through MSME financing projects seek to widen access to financial services , and contribute to the economic development of targeted groups such as women and people living in vulnerable communities in Colombia.

Banco Finandina is developing tools to measure and manage its financed carbon footprint and the physical risks in its portfolio. The bank, in line with local and global peers, has measured its direct emissions, and has programs and targets to address them. However, it's reporting of Scope 3 emissions does not include financed emissions, which are the most relevant for the sector. The bank uses internal software to help calculate and analyze emissions from financed vehicles, although it's yet to include this as part of its public reporting. Nevertheless, Banco Finandina has already taken steps to contribute to decarbonization by tailoring its financing offering for electric and hybrid vehicles, currently representing around 5% of its total loans. Still, limitations in the Colombian market, such as infrastructure and pricing, are slowing the transition, which may undermine the bank's progress. We view favorably Banco Finandina's engagement in promoting such infrastructure investing through three charging stations it has installed at its branches.

Banco Finandina has been gradually diversifying its lending to individuals and MSMEs in Colombia. Auto loans currently represent around 60% of the bank's total loans, down from 80% in 2016. The bank's digital and marketing strategy allows it to post higher growth than those of peers, as well as an expand presence across the country, including geographical areas where it hasn't operated previously, and financial services are scarce. The bank has a record of sound business performance and providing loans and other financial services to underserved population, while maintaining relatively low delinquency rates. For instance, expanding lending to

MSMEs, which represent about 95% of Colombia's total companies, and narrowing the gap in accessing financial services are fueling Banco Finandina's growth, which its framework addresses.

Banco Finandina's expansion of its digital fintech operations exposes it to cyber crime and increased data privacy risks, including sensitive client data. Colombian financial institutions are adopting systems to manage cyber security risks that are aligned with the regulator's requirements (reports and indicators, well-defined strategies, contingency plans, etc.) We are not aware of major cyber security breaches or significant financial losses from cyber crime in Colombia or at Banco Finandina, although this remains a material factor for banks. Banco Finandina's framework does not include eligible projects to address this material sustainability factor.

Alignment Assessment

This section provides an analysis of the framework's alignment to the Social and Green Bond/Loan principles and the Sustainability Bond Guidelines.

Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Social Bond Principles, ICMA, 2023

✔ Sustainability Bond Guidelines ICMA, 2021

✔ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

✔ Use of proceeds

Banco Finandina's green project category is shaded in green, and we consider that all social project categories provide clear social benefits to defined target populations. Environmental projects relate to clean transportation and contribute to climate change mitigation, and pollution prevention and control. On the other hand, social projects are aimed at increasing access to essential financial services to vulnerable and/or women-led/owned MSMEs.

The issuer commits to allocate the net proceeds issued under the framework exclusively to new eligible green and social projects. Banco Finandina does not consider refinancing under its framework, which ultimately leads to broader environmental and social benefits. Please refer to the Analysis of Eligible Projects section for more information of the expected use of proceeds.

✔ Process for project evaluation and selection

Banco Finandina has set eligibility criteria to select projects financed under the framework. Technological tools are used to perform an initial screening and pre-select applicants complying with the bank's risk and credit policies. Such businesses are then segmented to be analyzed under specific criteria, according to the economic activity. For sustainable transportation projects, for example, the combustion system is checked to ensure that the project is in line with the criteria established under the framework. In addition, Banco Finandina has a risk department to oversee, monitor, control and verify all the analyses carried out in this process.

Moreover, the issuer has defined an exclusion list comprised of prohibited activities in line with The InterAmerican Development Bank's policies and high-risk activities, such as large mining operations. We view favorably that Banco Finandina already identifies heavy debt burden as a potential social risk related to the financing and has put in place certain mitigants, such as monitoring tools and increased transparency in client communication. Finally, key project criteria follows recognized and/or official definitions, such as International Finance Corporation (IFC), Colombian Green Taxonomy and local regulations, which we view as a strength.

✔ Management of Proceeds

Banco Finandina's Liquidity Risk Committee will be responsible for monitoring the allocation of proceeds, which will be earmarked to ensure exclusive allocation to eligible projects. Unallocated proceeds will be kept in the bank's treasury account in high liquidity and low risk instruments. Moreover, the issuer commits to replace projects that no longer comply with the eligibility criteria or are fully/pre-paid with new eligible projects within six months.

✔ Reporting

Banco Finandina commits to produce an annual report on the allocation of proceeds, which will be externally verified. In addition, the issuer will produce an impact report, aligned with ICMA's Harmonized Framework, comprised of a set of pre-defined and independently audited indicators. We view favorably that the impact reporting will include details on the calculation of key indicators. However, for social lending, indicators are limited to inputs and outputs, such as the number of people benefited and amounts disbursed, which gives little detail about the social impact--both from a benefit and risk perspective--associated with Banco Finandina's lending activities. That said, we believe tracking such social impact remains difficult for many lenders, aligning the bank's metrics with market practices.

Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects, based on their environmental benefits and risks, using the "Analytical Approach: Shades Of Green Assessments," as well as our analysis of eligible projects considered to have clear social benefits and to address or mitigate a key social issue.

Under its framework, Banco Finandina expects to allocate at least 20% of the proceeds to finance clean transportation, and the remainder for social project categories. Colombia's unfavorable conditions for EV infrastructure and pricing are slowing the country's transition to low or zero emissions vehicles, which may limit the bank's ability to allocate resources into green projects. On the other hand, the framework only contemplates financing of new projects, which we view as a strength.

The framework has an extensive exclusion list that involves Banco Finandina and IDB Invest's negative screening criteria, such as coal mining and oil extraction, as well as projects that are assessed as high risk under the bank's environmental and social risk management process, such as large infrastructure projects.

Green project categories

Clean Transportation

Assessment	Description
Medium to Light green	Financing the acquisition of EVs: • Vehicles powered exclusively by one or more electric motors, which draw energy from batteries. These vehicles do not have internal combustion engines or on-board electrical generation systems as a means of supplying electrical energy. Financing the acquisition of plug-in hybrid electric vehicles (PHEV): • Vehicles in which the powertrain combines an internal combustion engine with an electric propulsion system, and which can recharge their batteries through regenerative braking or using the combustion engine, but primarily by connecting to a dedicated charging infrastructure such as the one used by EVs. • Hybrid vehicles will only be eligible until 2025. Financing the acquisition of non-plug-in hybrid electric vehicles (NPHEV): • Vehicles powered by an internal combustion engine and one or more electric motors, which uses energy stored in batteries. Unlike PHEVs, NPHEVs cannot be plugged in. Therefore, they rely on regenerative braking and the internal combustion engine to recharge the battery. • Mild hybrid electric vehicles are not eligible under this category. • Hybrid vehicles will only be eligible until 2025. Financing the acquisition of electric micro mobility: • Includes small, low-speed, electrically powered transportation device, such as electrically assisted bicycles, electric scooters, and other small, lightweight, wheeled, electrically powered transportation devices.

Analytical considerations

- EVs are key for the transition of the private and public transport sectors to a low carbon economy. Transport is a significant contributor to Colombia's greenhouse gas emissions, accounting for around 19% of national emissions. Under its updated nationally determined contributions (NDC), Colombia aims to have 600,000 EVs by 2030. The Law 1964, passed in 2019, sets the legal basis for the 2030 EV target, along with intermediate targets for proportional increases of EVs in the national fleet and public transport networks, tax incentives for purchasing EVs, and minimum requirements for the charging infrastructure in major cities. Implementation of the law has been challenging. In 2022, EVs and hybrid vehicles represented 1.2% and 8.3%, respectively, of the country's total automobile sales, although they still account for less than 1% of the country's total fleet.

- While hybrid vehicles involve combustion of fossil fuels and associated emissions, they represent initial steps to transition toward electric modes of transportation, including by supporting behavioral change and where charging infrastructure is nascent. In addition, the framework excludes mild hybrid vehicles, which have limited impact in terms of avoided emissions, ensuring the eligible category's positive environmental impact.
- In line with the Colombian Green Taxonomy, eligibility for hybrid vehicles financing is only considered up to 2025. In our view, the asset's useful life is consistent with the country's transition path and does not extend to the mid-century, with limited risk of becoming stranded before the end of its useful life.
- The bank does not commit to direct emission thresholds for hybrid vehicles, which is a common global market practice. However, we note that a maximum emission threshold does not necessarily safeguard against high fossil fuel consumption of hybrid vehicles.
- Although the supporting infrastructure for EVs is still limited in scale in Colombia, charging stations will be connected to the national grid, in which renewable energy is the major source of electricity production (more than 70% based on hydropower generation). That said, there are indirect issues of carbon emissions throughout the lifecycle of such projects, such as from materials sourcing and manufacturing.
- EV production presents risks around sourcing of battery materials. Critical minerals such as lithium and nickel are often mined and have detrimental impact on the environment. The supply chains for EV batteries need to be appropriately managed to avoid negative environmental impacts.

S&P Global Ratings' Shades of Green

Assessments	**Dark green**	**Medium green**	**Light green**	**Yellow**	**Orange**	**Red**
Description	Activities that correspond to the long-term vision of an LCCR future.	Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions.	Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions.	Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures.	Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets.	Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets.
Example projects	Solar power plants	Energy efficient buildings	Hybrid road vehicles	Health care services	Conventional steel production	New oil exploration

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

Social project categories

Employment generation, and programs designed to prevent and/or alleviate unemployment through the potential effect of SME financing

Lending to MSMEs includes tailored financing products targeted to women-owned businesses, those in marginalized zones, and to other MSMEs in Colombia in connection to sustainable development goals.

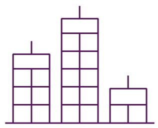
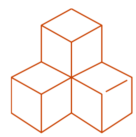
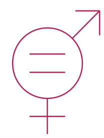
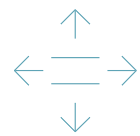
Analytical considerations

- We view these loans, including all three target populations (women-owned MSMEs, those in vulnerable areas, and SMEs in general) as having a social benefit helping reduce the financing gap and contribute to the growth and development of these businesses in several areas of Colombia. This is facilitated by the bank's digital strategy, allowing for underserved entities to access loans.
- Banco Finandina defines MSMEs based on annual revenues for three different economic activities (services, manufacturing and commerce) following the Decree 957 of the Ministry of Commerce, Industry, and Tourism of Colombia. As of 2022, only 27.3% of Colombian enterprises had access to credit. Access is particularly limited for microentrepreneurs (15.8%) and the service sector (24.4%), according to the 2022 Financial Inclusion Report published by the Colombian government.
- The bank specifies SMEs lending subcategory to be women-owned MSMEs with at least a 51% women ownership and/or more than a 20% of women ownership, at least one woman as executive manager and at least 30% representation at the board of directors. Such definitions are in line with IFC's international definition for women-owned enterprise, which we view as positive.
- Moreover, Banco Finandina screens for MSMEs that operate in vulnerable municipalities with a multidimensional poverty index greater than 50%, according to Colombia's National Statistic Department. Important to note that non-vulnerable MSMEs are also part of the bank's social lending scope. While access to financial services in Colombia is widespread (92% of adults have access), access to these services is more limited among the rural population (55.4%).
- In our view, the bank has comprehensive policies and processes to identify and manage perceived social risks as part of its underwriting standards. It has also lower delinquency rates than those of peers, which signals prudent credit standards. Nevertheless, we note that loans under this category are not subsidized, and Banco Finandina has presented above-average interest rates according to Superintendencia Financiera de Colombia. During the loan's term, installments must not exceed 40% of the borrower's income, following local regulations, although credit records may be incomplete, especially across low-income borrowers in Colombia, so the risk of heavy debt burden needs to be closely assessed and monitored.
- The bank has incorporated financial education as one of the main actions of its sustainability strategy, and has developed financial literacy programs, and communication strategies for all customers. This helps the Banco Finandina mitigate social risks related to underfinanced population and helps further the positive social impact of the projects.

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	SDG				
Clean Transportation	 ***11. Sustainable cities and communities**	 ***13. Climate action**			
Access to Essential Services- General SMEs and Microfinancing	 ***1. No poverty**	 ***8. Decent work and economic growth**	 ***9. Industry, innovation and infrastructure**	 **5. Gender equality**	 ***10. Reduced inequalities**

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

Related Research

- Inclusión Financiera, Feb. 24, 2023
- Informe de Tejido Empresarial, Nov, 2023

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