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ALM POLCY

Introduction:

In the normal course, UCBs are exposed to credit and market risks in view of the asset-liability transformation. With liberalization in Indian financial markets over the last few years and growing integration of domestic markets with external markets, the risks associated with UCB's operations have become complex and large, requiring strategic management. Though UCBs are now operating in a regulated environment, they are given freedom to determine their own, interest rates on deposits and advances on a dynamic basis. The interest rates on investments of UCBs in government and other securities are also now market related.

Objectives:

1. Intense competition for business involving both the assets and liabilities has brought pressure on the management of UCBs to maintain a good balance among spreads, profitability and long term viability. Imprudent liquidity management can put earnings and reputation of UCBs at great risk. These pressures call for structured and comprehensive measures and not just ad hoc action.
2. The managements of UCBs have to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. UCBs are exposed to several major risks in the course of their business - credit risk, interest rate risk, equity/commodity price risk, liquidity risk and operational risk. It is, therefore, important that UCBs introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.
3. UCBs need to address these risks in a structured manner by upgrading their risk management and adopting more comprehensive Asset-Liability Management (ALM) practices than has been done hitherto. ALM, among other functions, is also concerned with risk management and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate equity and commodity price risks of major operators in the financial system that needs to be closely integrated with the UCBs' business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

Policy:

Having understood the significance of sound ALM practices The "bank" resolves to lay down broad guidelines in respect of interest rate and liquidity risks management systems which form part of the Asset-Liability Management (ALM) function. The initial focus of the ALM function would be to enforce the risk management discipline i.e. managing business after assessing the risks involved.

4. The ALM process rests on three pillars:

- ALM Information Systems
- Management Information Systems



- Information availability, accuracy, adequacy and expediency

- ALM Organisation
 - Structure and responsibilities
 - Level of top management involvement

- ALM Process
 - Risk parameters
 - Risk identification
 - Risk measurement
 - Risk management
 - Risk policies and tolerance levels.

5. ALM Information Systems

ALM has to be supported by a management philosophy which clearly specifies the risks, policies and tolerance limits. This framework needs to be built on sound methodology with necessary information system as back up. Thus, information is the key to the ALM process. There are various methods prevalent world-wide for measuring risks. These range from the simple Gap Statement to extremely sophisticated and data intensive Risk Adjusted profitability Measurement methods.

However, though the central element for the entire ALM exercise is the availability of adequate and accurate information with expedience; and the systems existing. Adequate measures are to be taken to collect accurate data in a timely manner through full scale computerization.

6. ALM Organization

6.1 a) Successful implementation of the risk management process would require strong commitment on the part of the senior management in the bank, to integrate basic operations and strategic decision making with risk management. The ALCO headed by the General Manager will have overall responsibility for management of risks and should decide the risk management policy of the bank and set limits for liquidity, interest rate and equity price risks.

b) **The Asset-Liability committee (ALCO)** consisting of General Manager, chief accountant & Senior Accountant should be responsible for ensuring adherence to the limits set by it as well as for deciding the business strategy of the bank (on the assets and liabilities sides) in line with the bank's budget and decided risk management objectives.

c) The ALM Support Groups consisting of operating staff should be responsible for analyzing, monitoring and reporting the risk profiles to the ALCO. The staff should also prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to the balance sheet and recommend the action needed to adhere to bank's internal limits.



6.2 The ALCO is a decision making unit responsible for balance sheet planning from risk return perspective including the strategic management of interest rate and liquidity risks. The business and risk management strategy of the bank will ensure that the bank operates within the limits/parameters set by the Board. The business issues that an ALCO would consider, inter alia, product pricing for both deposits and advances, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rates offered by other peer UCBs for the similar services/product, etc. In addition to monitoring the risk levels of the bank, the ALCO should review the results of and progress in implementation of the decisions made in the previous meetings. The ALCO would also articulate the current interest rate view of the bank and base its decisions for future business strategy on this view. In respect of the funding policy, for instance, its responsibility would be to decide on source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between various loan schemes, wholesale vs retail deposits, money market vs capital market funding, etc.

The frequency of holding the ALCO meetings will be quarterly. However, if the need arises for a meeting at a short notice, the ALCO can meet at a shorter notice.

6.3 Board of Directors Meetings and Review

The Board of Directors, in their board meetings, will oversee the implementation of the system and review its functioning periodically.

6.4 ALM Process:

The scope of ALM function can be described as follows:

- Liquidity risk management
- Management of market risks
- Funding and capital planning
- Profit planning and growth projection
- Forecasting and analysing 'What if scenario' and preparation of contingency plans

7. Liquidity Risk Management

7.1 Measuring and managing liquidity needs are vital for effective operation of bank. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. ALCO should measure not only the liquidity positions of bank on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that assets commonly considered as liquid like Government securities and other money market instruments, could also become illiquid when the market and players are unidirectional. Therefore, liquidity has to be tracked through maturity or cash flow mismatches. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of cumulative surplus or deficit of funds at selected maturity dates is adopted as a standard tool. The format of the **Statement of Structural Liquidity** as prescribed by Reserve Bank of India (RBI) may be used for this purpose.



7.2 The Maturity Profile based on ALM-II could be used for measuring the future cash flows of bank in different time buckets. The time buckets, may be distributed as under:

- i) Over 1 day and up to 14 days
- ii) Over 15 days and up to 28 days
- iii) Over 29 days and up to 3 months
- iv) Over 3 months and up to 6 months
- v) Over 6 months and up to 1 year
- vi) Over 1 year and up to 3 years
- vii) Over 3 years and up to 5 years
- viii) Over 5 years

7.3 Within each time bucket, there could be mismatches depending on cash Inflow and Outflows. While the mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-30/31 days. Bank, however, has to monitor its cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the ALCO. The mismatches (negative gap) during 1-30/31 days in normal course may not exceed 20% of the cash outflows in this time bucket.

The threshold limit to monitor and address mismatches is as follows:

Sl.No.	Period	Individual Mismatch	Cumulative Mismatch
I.	1 Day up to 28 days	-20	-20
II.	29 Days up to 3 Months	-25	-45
III.	3 Months up to 6 Months	-25	-70
IV.	6 Months up to 1 Year	-25	-95
V.	1 Year up to 3 Years	20	-75
VI.	3 Years up to 5 Years	30	-45
VII.	Over 5 Years	NIL	-45

If the negative mismatch exceeds above tolerance level, the ALCO should report the same to the Board and also suggest the measures by means of which the mismatch to be brought to the tolerance level. It can be done through deposit mobilization, borrowings or sale of Government securities. It can also be regularized by means of share collection by bringing the same before the state holders.

7.4 The **Statement of Structural Liquidity** shall be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. While determining the likely cash inflows/outflows bank will have to make a number of assumptions according to their asset liability profiles. While determining the tolerance level the bank may take in to account all relevant factors based on their asset-liability base, nature of business, future strategy etc.

7.5 In order to enable the bank to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from one day to 6 months, bank will estimate their short term liquidity profile on the basis of business projection and other commitments for planning



purposes. An indicate format ALM-I issued by RBI for estimating **Short –term, Dynamic Liquidity** will be used for the said purpose.

8. Currency Risk

The bank does not have any currency risk as of now as there are no transactions entered by the bank which will involve currency risk. However, in future if such transactions are entered in to, the bank will take appropriate steps to modify this policy incorporate measures to check currency risk.

9. Interest Rate Risk (IRR)

9.1 The operational flexibility given to UCBs in pricing most of the asset liabilities imply the need for the financial system to hedge the Interest Rate Risk. Interest rate risk is the risk where changes in market interest rates might adversely affect an UCB's financial condition. The changes in interest rates affects the bank in some way. The immediate impact of changes in interest rates is on bank's earnings (i.e. reported profits) by changing its Net Interest Income (NII). As such the bank is majorly into funding of loans which are always fixed rate loans. The deposits accepted from the public are mostly at fixed rates. The bank manages this risk on NII by pricing its loan products to customers at a rate which covers interest rate risk. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). Measurement of such risk is done at the time of deciding rates to be offered to customers. Once interest rate risk is measured by the ALCO, lending rates of the new loans are finalized accordingly.

The interest sensitive asset and liabilities will be clubbed in to the following buckets for ascertaining the Gap in individual bucket and the cumulative Gap.

1. Up to 3 months
2. Over 3 months to 6 months
3. Over 6 months to 1 year
4. Over 1 year to 3 years
5. Over 3 years to 5 years
6. Over 5 years

The Reporting Format ALM 3 will be used for computing the Gaps in each time bucket. With in each time bucket there could be mismatches depending on interest rate sensitive cash inflows and outflows. If at any time a negative Gap were to arise ALCO will ensured that such Gap, individual as well as cumulative, do not exceed 50%.

10. Validity of policy

This updated/revised policy was placed before the meeting of Board of Directors held on 15/03/2025 and was approved wide Resolution No.IV. The validity of Policy shall be extended later for further period after thorough review.