



# **SHRIRAM CREDIT COMPANY LIMITED**

## **ASSET LIABILITY MANAGEMENT POLICY**

## **INTRODUCTION:**

In the normal course, NBFCs are exposed to credit and market risks in view of the asset-liability transformation. NBFCs are now operating in a fairly deregulated environment and are required to determine on their own, interest rates on deposits, subject to the ceiling of maximum rate of interest on deposits they can offer on deposits prescribed by the Bank and Loans on a dynamic basis. At present the interest rates on investments of NBFCs in government and other securities are also mostly market related.

1. Intense competition for business involving both the assets and liabilities has brought pressure on the management of NBFCs to maintain a good balance among spreads, profitability and long-term viability. Imprudent liquidity management can put NBFCs' earnings and reputation at great risk. The managements of NBFCs have to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. NBFCs are exposed to various major risks in the course of their business - credit risk, interest rate risk, equity price risk, liquidity risk and operational risk. It is, therefore, important that NBFCs introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.

2. NBFCs 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 that needs to be closely integrated with the NBFCs' 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.

## **OBJECTIVE:**

Having understood the significance of sound ALM practices, **Shriram Credit Company Ltd.** proposed 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. The objectives of good risk management systems are the following,

- Address risks involved in the business in a structured manner by upgrading risk management and adopting more comprehensive Asset-Liability Management (ALM) practices.
- Providing a comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate risks of major operators in the financial system that needs to be closely integrated with the Company's business strategy.
- Assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.
- The Company's capacity to fund the increase in assets and meet both expected and unexpected cash and collateral obligations at reasonable cost and without incurring unacceptable losses.

## **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.

## **ALM INFORMATION SYSTEMS**

ALM has to be supported by a management philosophy which clearly specifies the risk 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 computerisation.

## **ALM ORGANISATION**

a. Successful implementation of the risk management process would require strong commitment on the part of the senior management in the Company, to integrate basic operations and strategic decision making with risk management. The Board of Directors led by Managing Director will have overall responsibility for management of risks and should decide the risk management policy of the NBFC and set limits for liquidity, interest rate and equity price risks.

### **b. The Asset - Liability Committee (ALCO):**

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 Company will ensure that the Company operates within the limits /

parameters set by the Board. The business issues that an ALCO would consider, inter alia, will include 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 NBFCs for the similar services/product, etc. In addition to monitoring the risk levels of the Company, 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 Company 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 the end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between fixed vs floating rate funds, money market vs capital market funding, domestic vs foreign currency funding, etc.

### **COMPOSITION OF THE ALCO:**

ALCO should comprise of the following:

1. Managing Director & CEO as the Chairman of the committee
2. Executive Vice Chairman
3. Chief Financial Officer
4. Chief Risk Officer
5. Other invitee on need basis

### **ASSET LIABILITY MANAGEMENT (ALM) SUPPORT GROUP:**

The ALM Support Groups consisting of operating staff should be responsible for analysing, 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 Company's internal limits.

### **ALCO Meeting:**

The frequency of holding their ALCO meetings will be half yearly. However, if the need be for a meeting at a short notice, the ALCO meet at a shorter notice.

### **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.

### **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

## LIQUIDITY RISK MANAGEMENT:

a. Measuring and managing liquidity needs are vital for effective operation of Company. 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 Company 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.

b. The Maturity Profile based on Appendix-I could be used for measuring the future cash flows of Company in different time buckets. The time buckets, may be distributed as under:

- i. 1 to 7 days
- ii. 8 to 14 days
- iii. 15 to 30/31 days
- iv. Over one month and up to 2 months
- v. Over two months and up to 3 months
- vi. Over 3 months and up to 6 months
- vii. Over 6 months and up to 1 year
- viii. Over 1 year and up to 3 years
- ix. Over 3 years and up to 5 years
- x. Over 5 years

As NBFC does not hold public deposits, all the investment securities would fall in the category of 'non-mandatory securities'. All non-mandatory securities may be kept in buckets of future time frame for the purpose of determining their cash flows based on maturity of such security and intention of holding such security till the time of such maturity.

c. Within each time bucket, there could be mismatches depending on cash inflows 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., 1-7 days, 8-14 days and 15-30/31 days. The Company, however, is expected to monitor its cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the ALCO.

As per the existing norms, the mismatches (negative gap) during 1-30/31 days in normal course shall not exceed 15% of the cash outflows in this time bucket. Pursuant to the revised framework, the 1-30 day time bucket in the Statement of Structural Liquidity is segregated into granular buckets of 1-7 days, 8-14 days, and 15-30 days.

The net cumulative negative mismatches in the maturity buckets of 1-7 days, 8-14 days, and 15-30 days shall not exceed 10%, 10% and 20% of the cumulative cash outflows in the respective time buckets.

d. 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, Company will have to make a number of assumptions according to their asset - liability profiles. While determining the tolerance levels, the Company may take into account all relevant factors based on their asset-liability base, nature of business, future strategy, etc.

e. In order to enable the Company to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, Company will estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes. An indicative format issued by RBI for estimating **Short-term Dynamic Liquidity** will be used for the said purpose.

### **CURRENCY RISK:**

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

### **INTEREST RATE RISK (IRR):**

The operational flexibility given to NBFCs in pricing most of the assets and 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 NBFC's financial condition. The changes in interest rates affect Company in some way. The immediate impact of changes in interest rates is on Company's earnings (i.e. reported profits) by changing its Net Interest Income (NII). As such NBFC is into funding of loans which are always fixed rate loans. The loans borrowed from banks are mostly at floating rates. The Company 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 are finalized. RBI has prescribed ALM – III for the purpose of Interest Rate Risk Monitoring and Company may use the same for the purpose of measurement and monitoring of interest rate risk.

### **MAINTENANCE, REVIEW AND APPROVAL OF THIS POLICY**

- The ALM support group team shall be responsible to own, maintain and update this policy by engaging with relevant business and functional units. It shall have the policy reviewed by the Asset Liability Management Committee (ALCO). The policy shall be subsequently put up for approval to the Board of Directors.
- This policy shall be reviewed by the ALCO on an annual basis. If any change to this policy is subsequently approved, consequent upon any change in regulatory guidelines, market conditions, etc., such changes and approvals shall be deemed to be part of the policy until the policy is comprehensively reviewed and approved next time.

## **DEVIATION TO THIS POLICY**

- Any exceptions or deviations to above policy are to be approved by ALCO
- In case of any material deviation, the same needs to be reported to the Board with the action plan
- In case of any breach to the risk threshold, the same needs to be highlighted to the ALCO promptly and accordingly call to be taken to share with Board and RBI subsequently, based on the nature of the breach.

**Appendix – I:**

**Maturity Profile – Liquidity**

<b><u>Heads of Accounts</u></b>	<b><u>Time-bucket category</u></b>
<b><u>A. Outflows</u></b>	
1. Capital funds	
a) Equity capital, non-redeemable or perpetual preference capital, Reserves, Funds and Surplus	In the 'over 5 years' time-bucket.
b) Preference capital - redeemable/non-perpetual	As per the residual maturity of the shares.
2. Notes, Bonds and debentures	
a) Plain vanilla bonds/debentures	As per the residual maturity of the instruments
b) Bonds/debentures with embedded call/put options (including zero-coupon/deep discount bonds)	As per the residual period for the earliest exercise date for the embedded option.
c) Fixed rate notes	As per the residual maturity
3. Deposits:	
a) Inter Corporate Deposits	As per their residual maturity
b) Commercial Papers	As per the residual maturity
4. Borrowings	
a) Term money borrowings	As per the residual maturity
b) Bank borrowings in the nature of WCDL, CC etc.	WCDL to be considered in respective time buckets as per residual maturity while the outstanding balance of CC is to be considered in 'six months and up to one year' bucket.

<u>Heads of Accounts</u>	<u>Time-bucket category</u>
5) Current liabilities and provisions:	
a) Sundry creditors	As per the due date or likely timing of cash outflows.
b) Expenses payable (other than interest)	As per the likely time of cash outflow.
c) Advance income received, receipts from borrowers pending adjustment	In the 'over 5 years' time-bucket as these do not involve any cash outflow.
d) Interest payable on bonds/deposits	In respective time buckets as per the due date of payment.
e) Provisions for NPAs	The amount of provision may be netted out from the gross amount of the Stage 3 assets portfolio and the net amount of Stage 3 assets be shown as an item under inflows in stipulated time- buckets.
f) Other provisions	To be bucketed as per the purpose/nature of the underlying transaction.

<u>Heads of Accounts</u>	<u>Time-bucket category</u>
<b><u>B. Inflows</u></b>	
1. Cash	In 'Day 1 to 7' time-bucket.
2. Remittance in transit	-----
3. Balances with banks (in India only)	
a) Current account	To be shown under 'Day 1-7' bucket.
b) Deposit accounts/short term deposits	As per residual maturity.
4. Investments	
d) Non- M a n d a t o r y listed shares (Long term Investments)	'Over 5 years'
e) Non-Mandatory unlisted securities (e.g. shares, etc.)	'Over 5 years'
f) Non-mandatory unlisted securities having a fixed term maturity	As per residual maturity
5. Advances (performing)	
b) Term loans (rupee loans only)	The cash inflows on account of the interest and principal of the loan may be slotted in respective time buckets as per the timing of the c a s h flows as stipulated in the original/revised repayment schedule.
c) Corporate loans/short term loans	As per the residual maturity

<b><u>Heads of Accounts</u></b>	<b><u>Time-bucket category</u></b>
6. Stage 3 assets (May be shown net of the provisions, interest suspense held)	
a) Sub-standard i) All overdue and instalments of principal falling due during the next three years ii) Entire principal amount due beyond the next three years	In the '3 to 5 years' time-bucket.  In the 'Over 5 years' time-bucket.
b) Doubtful and loss i) All instalments of principal falling due during the next five years as also all overdue ii) Entire principal amount due beyond the next five years	In the 'Over 5 years' time-bucket.  In the 'Over 5 years' time-bucket
7. Assets on lease	Cash flows from the lease transaction may be slotted in respective time buckets as per the timing of the cash flow.
8. Fixed assets (excluding leased assets)	In the 'over 5 year' time-bucket.
9. Other assets	
(a) Intangible assets and items not representing cash inflows.	In the 'over 5 year' time-bucket.
(b) Other items (such as accrued income, other receivables, staff loans, etc.)	In respective maturity buckets as per the timing of the cashflows.

**Note:**

Any event-specific cash flows (e.g. outflow due to wage settlement arrears, capital expenses, income tax refunds, etc.) shall be shown in a time bucket corresponding to timing of such cash flows.

*(This policy has been reviewed and recommended by the Asset-Liability Management Committee and subsequently approved by the Board of Directors in their meeting held on 16<sup>th</sup> May, 2025.)*