KERALA STATE INDUSTRIAL DEVOLOPMENT CORPORATION LTD

ASSET LIABILITY MANAGEMENT POLICY 2022-2023

JUNE 2022

ASSET LIABILIIY_MANAGEMENT POLICY

1. INTRODUCTION:

KSIDC, as a systemically important non-deposit taking NBFC, is operating in a fairly deregulated environment and determines its own interest rates on assets on a periodic basis. The competition in business involving both the assets and liabilities has necessitated KSIDC to maintain a stable balance among spreads, profitability and long-term viability. KSIDC is exposed to several risks in the course of its business such as credit risk, interest rate risk, liquidity risk and operational risk, etc., which require comprehensive risk management system & process.

Reserve Bank of India, has, from time to time, emphasized the need to address these risks, in a structured manner by upgrading the risk management systems, practices and procedures and for adopting more comprehensive asset liability management practices. It is therefore important to have effective risk management systems that address the issues inter-alia, related to interest rate and liquidity risks. KSIDC is therefore basing its business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy.

Asset Liability Management (ALM) can be termed as a risk management technique designed to earn an adequate return while maintaining a comfortable surplus of assets over liabilities. It takes into consideration interest rates, earning power and degree of willingness to take on debt and hence is also known as Surplus Management. ALM, among other functions, is also concerned with risk management and provides a comprehensive as well as dynamic framework for measuring, monitoring and managing liquidity and interest rate risks of major operators in the financial system, that need to be closely integrated with KSIDCs business strategy. Thus, ALM is an integral part of the financial management process of KSIDC. It is concerned with strategic balance sheet management, involving risks caused by changes in the interest rates, exchange rates and the liquidity position of KSIDC. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

The Reserve Bank of India (RBI), vide its circular No. DNBS (PD). CC.No.15/ 02.01/2000-2001 dated June 27, 2001, issued ALM guidelines for NBFCs, updated vide RBI Circular No.RBI/DNBR/2016-17/45 Master Direction DNBR.PD008/03.10.119/2016-17 dated September 1, 2016 (updated March 03, 2022), with focus on liquidity risk and interest rate risk. Further, RBI's Circular No.RBI/DNBS/2016-17/47 Master Direction DNBS.PPD.02/66.15.001/2016-17 dated September 29, 2016 specifies current reporting mechanism under ALM system, to be submitted by Non-Deposit Taking Systemically Important NBFCs, which envisages submission of quarterly short-term dynamic liquidity statement.

2. SCOPE OF THE POLICY

The ALM Policy of KSIDC has been framed in line with the extant Risk Management and ALM practices prevailing at KSIDC and the guidelines issued by RBI, from time to time for NBFC-ND- SI. It primarily lays down guidelines in respect of interest rate and liquidity risk management system in KSIDC.

The ALM process would rest on three pillars:

(A) ALM Information Systems:
- Management Information Systems
- Information availability, accuracy, adequacy and expediency

(B) ALM Organization:
- Structure and responsibilities.
- Level of senior management involvement.

(C) ALM Process:
- Risk parameters
- Risk identification, measurement & mitigation
- Risk policies and tolerance levels.

(A) ALM Information system:

A sound information system is the key to the ALM process. ALM has to be supported by the management clearly specifying the risk policies and tolerance limit. This framework needs to be built on a sound methodology with necessary information systems as back up. Thus, collecting information/ data in a timely manner is the key to the ALM process. The status of Assets & Liabilities on a given date would continue to be obtained from the accounting software. The other information with regard to future cash outflows including proposed disbursements, proposed recovery from NPAs, repayment schedule of borrowings and other cash flows would be obtained from concerned operational divisions of KSIDC which would be analyzed on the basis of residual maturity and re-pricing of various assets and liabilities.

(B) ALM Organization:

Successful implementation of the risk management process requires strong commitment on the part of the senior management to integrate basic operations and strategic decision making with risk management. The Board of Directors of KSIDC will have the overall supervision on management of risk and shall decide the risk management policy of the organization and set limits for capital management, interest rates and liquidity through the ALM Process. The organizational structure for Asset-Liability Management would be as follows:

I. Risk Management Committee of the Board (RMCB)

The RMCB would review the ALM policy, Credit Risk Management Policy and Treasury & Investment Policy for a financial year and would recommend the same to Board of Directors for their approval. RMCB shall also oversee the implementation of the policies and review its functioning periodically.

RMCB would review the tolerance limits for liquidity/ interest rate risks and would recommend to Board of Directors for its approval from time to time.

II. Asset Liability Management Committee (ALCO):

The ALCO shall be headed by Managing Director and the members shall include Executive Director, Chief Financial Officer, General Manager(s) (Projects) and AGM (F&A). ALCO is responsible for implementing ALM policies and for managing the liquidity risk as well as interest-rate risks.

ALCO would meet every quarter and minimum 3 members including the Committee Chairman shall be the quorum for the meeting. The Committee shall review the cash flows as well as the prevailing interest rate scenario, its likely impact on the profitability and the steps to be initiated for effectively meeting the liabilities on the due dates. ALCO would also be responsible for ensuring adherence of limits set by the Board as well as deciding business strategies of KSIDC in line with the overall budget and risk management policy and shall review/decide the following:

- Review of Liquidity mismatches
- Review of Interest-Rate Sensitivity position
- Stress testing of loan portfolio
- Decision on capital/fund raising and deployment vis-a-vis Cost of borrowings/ Yields on advances
- Review of the product mix and product pricing
- Strategies for deployment of surplus funds

(C) ALM Process:

The scope of ALM function would include the following:

- Liquidity risk management
- Interest risk management
- Capital and funding planning

Out of the above-mentioned functions, the most important functions of ALM are management of liquidity and interest rate risks. Considering the volatility of such risks, certain limit/parameters as per RBI norms are required to be fixed for preparation/submission of ALM statement to RBI. These risks are detailed below:

I. Liquidity Risk Management

a) Measuring and managing liquidity needs are vital for effective business operation of KSIDC. By ensuring KSIDCs ability to meet its liabilities as they become due, liquidity management can reduce the probability of developing an adverse situation. Liquidity management involves measuring liquidity position on an ongoing basis. For measuring and managing net funding requirements, the use of a maturity ladder (tool to compare future cash inflows to future cash outflows over a series of specified time periods) and calculation of cumulative surplus or deficit of funds at selected maturity bucket will be adopted as a standard tool, in line with RBI stipulations.

b) In line with RBI guidelines, the following maturity profile shall be used for measuring the future cash flows of KSIDC in different time buckets:

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

c) Within each time bucket, there could be mismatches depending on cash inflows and outflows. While the mismatches up to 1 year would be relevant since these provide early warning signals of an impending liquidity problem, the main focus has to be short term mismatches i.e. 1-day to 30/31 days (one month). RBI has therefore advised NBFCs to monitor their cumulative mismatches across all time buckets and establish/ fix internal prudential limits for the time buckets. As per the RBI guidelines, the mismatches occurring in 1-30/31 days buckets in normal course may not exceed 15% of the cash outflows in each time bucket & the cumulative gap upto 1 year may not exceed 15% of the outflows.

d) The Statement of Structural Liquidity (as per the format prescribed by RBI) shall be prepared on quarterly basis by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be treated as a cash outflow while a maturing asset will be a cash inflow. Likely cash inflows / outflows would be estimated based on KSIDCs asset - liability profile. The quarterly Structural Liquidity Statement shall be filed with RBI within the specified timelines.

e) In order to monitor its short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, KSIDC would estimate its short-term liquidity profile on the basis of business projections and other commitments for planning purposes.

f) After studying the behavioral pattern of cash flows of KSIDC, short term mismatches can be managed by investment and redemption through appropriate short term financial instruments. With reference to the longer time buckets, KSIDC needs to plan raising long term resources to reduce the negative gaps prevailing at the higher end of the time buckets.

II. Interest Rate Risk (IRR)

a) RBI has allowed NBFCs to price most of their assets and liabilities. Thus, there is a 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 KSIDC's financial condition and the changes in interest rates affect KSIDC in a larger way. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value perspective', respectively. There are many analytical techniques for measurement and management of Interest Rate Risk. However, in line with RBI guidelines, the traditional Gap analysis is considered as a suitable method to measure the Interest Rate Risk for KSIDC.

b) The Gap or Mismatch risk can be measured by calculating Gaps over different time intervals as at a given date. Gap analysis measures mismatches between rate sensitive liabilities and rate sensitive assets (including off-balance sheet positions). An asset or liability is normally classified as rate sensitive if:

i) within the time interval under consideration, there is a cash flow;
ii) the interest rate resets/re-prices contractually during the interval;
iii) dependent on RBI changes in the interest rates/Bank Rate;
iv) it is contractually pre-payable or withdrawal before the stated maturities.

c) The Gap Report would be generated by grouping rate sensitive liabilities, assets and off- balance sheet positions into time buckets according to residual maturity or next re-pricing period, whichever is earlier. All investments, advances, borrowings, purchased funds, etc. that mature/re-price within a specified timeframe are interest rate sensitive. Certain assets and liabilities receive/pay rates that vary with a reference rate. These assets and liabilities are re-priced at pre-determined intervals and are rate sensitive at the time of re-pricing. The Gaps would be identified in the following time buckets:

i. 1 day to 7 days
ii. 8 days to 14 days
iii. 15 days to 30/31 days (one month)
iv. Over one month and up to 2 months
v. Over 2 months and upto 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
xi. Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items would be classified as per the RBI guidelines and reported as per the format provided by RBI. The quarterly Interest Rate Sensitivity Statement shall be filed with RBI within the specified timelines.

d) The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that KSIDC has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs than RLAs. The Gap reports indicate whether the institution is in a position to benefit from rising interest rates by having a positive Gap (RSA>RSL) or whether it is in a position to benefit from declining interest rates by a negative Gap (RSL>RSA). The Gap is, therefore, used as a measure of interest rate sensitivity.

e) RBI has advised NBFC's to set prudential limits on individual Gaps with the approval of the Board/Management Committee. The prudential limits shall have a relationship with the Total Assets, Earning Assets or Equity. The objective of the interest rate sensitive analysis will mainly be focused on interest rate gap for more than one year period. Since KSIDC has started bank borrowings only recently, the RSA would be much higher than RSL and consequently the RSA-RSL gap would be substantial. However, it is proposed to set the prudential limit to be approved by the Board viz. such positive/negative gap should not exceed 90% of Risk Sensitive Assets (RSA).

(III) Capital and Funding planning:

a) Maintaining adequate Capital:

KSIDC has CRAR of 94% as on 31.03.2021 which gives ample scope for further leveraging of its capital to meet its business requirements. KSIDC may leverage its capital ensuring its capital adequacy ratio is always above the minimum level prescribed by RBI. The optimum mix of own capital to borrowed funds would increase the total assets under management and will also improve the overall profitability. However, the optimum CRAR shall be based on the review of asset quality on a continuous basis. The special reserves, which are not part of net worth as per RBI regulations, shall be utilized for any contingency on account of sudden increase in non-performing assets or major bad debts write-off .

b) Funding planning:

KSIDC would ensure that both short and long term funds requirements for its business are made available by way of bank borrowings in the form of term loans, cash credit, FCNR (B) loans, and market borrowings by raising funds through commercial papers, bonds, debentures and/or any other financial instrument. KSIDC shall endeavor to prepare a Contingency Funding Plan (CFP) to fund the normal operating requirements of the corporation in case of any stressed situation or asset-liability mismatch.

3. POLICY REVIEW

The Policy would ideally be reviewed on an annual basis. However, the policy can be reviewed at short notice depending on the exigencies/extraordinary situations, which may emanate during the course of KSIDCs business. Such extraordinary situations may include significant changes in Government/Reserve Bank of India policies, global/national macro- economic conditions, financial performance, etc. This Policy shall remain in force till the next revision is carried out and disseminated.

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