ASSET LIABILITY MANAGEMENT (ALM),

ASSET CLASSIFICATION

Document review and approval

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I. Introduction

The purpose of this document is to define the Asset Liability Management & asset classification Policy for the company in accordance with the vide Master Direction DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016 ("**RBI Circular**") and amendments thereon.. This is living document and supposed to be updated on a regular basis. Any regulatory change that would impact the aspects of the company would be reflected here.

In the present market scenario every Housing Finance Company are exposed to credit and market risk in view of the Asset – Liability transformation with liberalization in Indian financial markets over the last few years and growing integration of the domestic markets with external markets, the risk associated with operation of a Company have become complex and large, requiring strategic management. Company are operating in a fairly deregulated environment and are required to determine their own, interest rates on advances and deposits subject to the ceiling on maximum rate of interest they can offer on deposit on dynamic basis.

It is therefore important that Company introduce effective Asset Liability Management Policy

II. COMPANY'S PHILOSOPHY

IKF Home Finance Limited's (IKFHFL) ("the company") Management believes in Commitment, Transparency, Accountability to tune with the requirements of the Dynamic Market Conditions and to comply with the Regulatory compliances as Directed by RBI/NHB to Housing Finance Companies.

IV. OBJECTIVES OF ASSET LIABILITY MANAGEMENT & ASSET CLASIFICATION

Asset-liability management basically refers to the process by which a company manages its balance sheet in order to allow for alternative interest rate and liquidity scenarios. Banks and housing financial companies provide services which expose them to various kinds of risks like credit risk, interest Rate risk, and liquidity risk.

Asset liability management is an approach that provides company with protection that makes such risk acceptable. Asset-liability management models enable company to measure and monitor risk, and provide suitable strategies for their management.

It is therefore appropriate for the company to focus on asset-liability management when it face financial risks of different types. Asset-liability management includes not only a formalization of this understanding, but also a way to quantify and manage these risks. Further, even in the absence of a formal asset-liability management program, the understanding of these concepts is of value to a company as it provides a truer picture of the risk/reward trade-off in which the company is engaged.

Asset-liability management is a first step in the long-term strategic planning process. Therefore, it can be considered as a planning function for an intermediate term. In a sense, the various aspects of balance sheet management deal with planning as well as direction and control of the levels, changes and mixes of assets, liabilities, and capital.

V. KEY ELEMENTS:

This Policy has been framed in accordance with the ALM framework as issued by Reserve Bank of India (**"RBI"**) vide Master Direction DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016 ("**RBI Circular**") and amendments thereon.

1. Applicability

As per the RBI Guidelines for asset liability management system in housing finance companies are applicable to all HFCs irrespective of whether they are accepting / holding public deposits or not as per NHB requirements. Accordingly, all the HFC 's are required to put in place ALM Policy and Framework.

2. Reporting

The periodicity of the Statement of shortterm dynamic liquidity shall be quarterly and that of Statement of structural liquidity and Interest rate sensitivity, half-yearly. The quarterly statement shall be submitted within 10 days of the close of the quarter to which it relates and half yearly statements within 20 days of the close of the half year to which they relate to NHB by those HFCs meeting the criteria of asset base of Rs. 100 crore but less than Rs. 5000 Crore as per the audited balance sheet.

3. Additional Disclosures in balance Sheet

Further, each HFC shall disclose the following particulars in its Balance Sheet from the year ending March 31, relating to:

i. Capital to Risk Assets Ratio (CRAR)
ii. Exposure to real estate sector, both direct and indirect; and
iii. Maturity pattern of assets and liabilities

4. Related terms:

1. The Company being HFC is exposed to credit and market risks in the normal course, in view of the asset-liability transformation, with liberalization in Indian financial markets over the last few years and growing integration of the domestic markets with external markets, the risks associated with the operations of an HFC have become complex and large, requiring strategic management. HFCs are operating in a fairly deregulated environment and are required to determine on their own, interest rates on advances and deposits, subject to the ceiling on maximum rate of interest they can offer on deposits, on a dynamic basis.

   The interest rates on investments of in government and other securities are also market related.

Intense competition for business involving both the assets and liabilities has brought pressure on the managements of IKFHFL to maintain a good balance amongst spreads, profitability and long-term viability. These pressures call for structured and comprehensive measures and not just *ad hoc* action.

The Company is required to base its business decisions on a dynamic and integrated risk management system and process driven by corporate strategy since a financial company is exposed to several major risks in the course of its business such as credit risk, interest rate risk, liquidity risk, operational risk etc. It is, therefore, important that the company to introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.

The Company needs to address these risks in a structured manner by upgrading its risk management and adopting more comprehensive Asset-Liability Management (ALM) practices that has been done hitherto. ALM, among other functions, is also concerned with management of risks and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate risks of a financial company that need to be closely integrated with the company's business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage ALM risks.

5. ALM Function

This note lays down broad guidelines for the Company in respect of systems for management of liquidity and interest rate risks which forms part of the ALM function. The initial focus of the ALM function would be to enforce the discipline of market risk management viz. managing business after assessing the market risks involved. The objective of a good risk management system should be to evolve into a strategic tool for effective management of company.

The ALM process rests on three pillars:

- ALM Information System
  a) Management Information Systems
  b) Information availability, accuracy, adequacy and expediency

- ALM Organisation

  a) Structure and responsibilities
  b) Level of top management involvement

- ALM Process
  a. Risk parameters
  b) Risk identification
  c) Risk measurement
  d) Risk management
  e) Risk policies and tolerance levels

a. ALM Information Systems

A pre-requisite for putting in place the ALM System is a strong Management Information System (MIS). For a quick analysis and consolidation of the data, it is necessary to computerize the MIS and make use of specialized software for managing the assets and liabilities with respect

to the maturity mismatches and the various risks associated with such mismatches.

ALM has to be supported by a management philosophy that clearly specifies the risk policies and tolerance limits. This framework needs to be built on sound methodology with necessary supporting information system as the central element of the entire ALM exercise is the availability of adequate and accurate information with expedience. 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.

b. ALM Organisation

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

b) The ALM Support Groups consisting of operating staff will be responsible for analysing, monitoring and reporting the risk profiles to the Management. The staff will also prepare forecasts (simulations) reflecting the impact of various possible changes in market conditions on the balance sheet and recommend the action needed to adhere to HFC's internal limits.

The Management is a decision-making unit responsible for integrated balance sheet management from risk-return perspective including the strategic management of interest rate and liquidity risks. The business and the risk management strategy of the HFC will ensure that it operates within the limits/parameters set by the Board. The business issues that management would consider will, *inter alia,* 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 HFCs for similar services/product, etc. In addition to monitoring the risk levels of the HFC, the Management will review the results of and progress in implementation of the decisions made in the previous meetings. The Management would also articulate the current interest rate view of the HFC and base its decisions for future business strategy on this. In respect of the funding policy, for instance, its responsibility would be to decide on the source and mix of liabilities or sale of assets.

Composition of ALCO Committee

To ensure commitment of the Top Management and timely response to market dynamics, Ms. Gurvir Kaur Sran, Director would head the Committee. The Chiefs of Investment, Credit, Resources Management or Planning, Funds Management/ Treasury, International Business and Economic Research can be members of the Committee. In addition, the Head of the Technology Division may also be an invitee for building up of MIS and related computerization.

The Asset Liability Management & Asset Classification Committee of the Board will oversee the implementation of the ALM system and review its functioning periodically.

c. ALM Process

The scope of ALM function can be described as under:

I. Liquidity risk management
II. Management of market risks
III. Funding and capital planning
IV. Profit planning and growth projection
V. Forecasting and analyzing 'what if scenario' and preparation of contingency plans

The guidelines contained in this note mainly address Liquidity and Interest Rate risks.

6. Liquidity Risk Management

1. Measuring and managing liquidity needs are vital for effective operation of HFCs. By assuring an HFC's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. HFCs' management will measure not only the liquidity positions of HFCs on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that assets commonly considered to be liquid, such as 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 is given in Annex I.

2. The Maturity Profile, as detailed in Appendix I, could be used for measuring the future cash flows of HFCs in different time buckets. The time buckets may be distributed as under:

1. 1 day to 7 days
2. 8 days to 14 days
3. Over 15 days to one month
4. Over one month to 2 months
5. Over 2 months to 3 months
6. Over 3 months to 6 months
7. Over 6 months to 1 year
8. Over 1 year to 3 years
9. Over 3 years to 5 years
10. Over 5 years

3. HFCs holding public deposits are required to invest a prescribed percentage of their deposits in approved securities in terms of liquid asset requirement under Section 29B of the NHB Act, 1987. There is no such requirement for HFCs which are not holding deposits. Thus various HFCs would be holding in their investment portfolio securities which could be broadly classifiable as 'mandatory securities' (under obligation of law) and other 'non- mandatory securities'. The HFCs holding deposits may be given freedom to place the mandatory securities in any time buckets as suitable for them.

4. A copy of the policy note recorded by the HFCs on treatment of the investment portfolio for the purpose of ALM and approved by their Board should be forwarded to the NHB.

5. The Statement of Structural Liquidity may 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 inflow/ outflows, HFCs have to make a number of assumptions according to their asset-liability profiles. While determining the tolerance levels, the HFCs may take into account all relevant factors based on their asset-liability base, nature of business, future strategies, etc. The NHB is interested in ensuring that the tolerance levels are determined keeping all necessary factors in view and further refined with experience gained in Liquidity Management.

8 In order to enable the HFCs to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, HFCs may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes. An indicative format for estimating Short-term Dynamic liquidity is enclosed.

7. Currency Risk

Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of HFCs' balance sheets, if having foreign assets or liabilities. The increased capital flows across free economies following deregulation have contributed to increase in the volume of transactions. Large cross border flows together with the volatility may render the HFCs' balance sheets vulnerable to exchange rate movements.

8. Interest Rate Risk

2 The operational flexibility given to HFCs 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 HFC's financial condition. The immediate impact of changes in interest rates is on HFC's earnings (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on HFC's Market Value of Equity (MVE) or Net Worth as the economic value of the assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value perspective', respectively. The risk from the earnings

perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). There are many analytical techniques for measurement and management of interest rate risk. To begin with, the traditional Gap analysis is considered to be a suitable method to measure the interest rate risk in the initial phase of the ALM system. It is the intention of NHB to move over to the modern techniques of interest rate risk measurement like Duration Gap Analysis, Simulation and Value at Risk over time when HFCs acquire sufficient expertise and sophistication in acquiring and handling MIS.

3 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:

1. within the time interval under consideration, there is a cash flow;
2. the interest rate resets/reprices contractually during the interval;
3. it is contractually pre-payable or withdrawable before the stated maturities;
4. It is dependent on the changes in the Bank Rate by RBI.

4 The Gap Report should 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, deposits, borrowings, purchased funds, etc. that mature/re-price within a specified time-frame are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the HFC expects to receive it within the time horizon. This includes final principal repayment and interim instalments. Certain assets and liabilities carry floating rates of interest that vary with a reference rate and hence, these items get re-priced at pre-determined intervals. Such assets and liabilities are rate sensitive at the time of re-pricing. While the interest rates on term deposits are generally fixed during their currency, the tranches of advances are basically floating. The interest rates on advances could be re-priced any number of occasions, corresponding to the changes in PLR.

The interest rate gaps may be identified in the following time buckets:

1. 1 day to 7 days
2. 8 days to 14 days
3. Over 15 days to one month
4. Over one month to 2 months
5. Over 2 months to 3 months
6. Over 3 months to 6 months
7. Over 6 months to 1 year
8. Over 1 year to 3 years
9. Over 3 years to 5 years
10. Over 5 years
11. Non-sensitive

5 The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that it has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs. 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 can, therefore, be used as a measure of interest rate sensitivity.

9. Prudential Limits

In order to limit the magnitude of ALM Risk and also keeping in view the maturity profile of the assets and liabilities, prudential limits are laid down as under:

1.	1 day to 7 days	10%
2.	8 days to 14 days	10%
3.	Over 15 days to one month	20%
4.	Over one month to 2 months	20%
5.	Over 2 months to 3 months	20%
6.	Over 3 months to 6 months	20%
7.	Over 6 months to 1 year	20%

10. Such prudential limits should have a relationship with the Total Assets, Earning Assets or Equity. In addition to the interest rate gap limits, the HFCs may set the prudential limits in terms of Earnings at Risk (EaR) or Net Interest Margin (NIM) based on their views on interest rate movements with the approval of the Board/ALCO.

11. General

1 The classification of various components of assets and liabilities into different time buckets for preparation of Gap reports (Liquidity and Interest Rate Sensitivity) . HFCs which are better equipped to reasonably estimate the behavioural pattern of various components of assets and liabilities on the basis of past data/empirical studies could classify them in the appropriate time buckets, subject to approval by the Board. A copy of the note approved by the Board may be sent to the NHB.

2 The present framework does not capture the impact of premature closure of deposits and pre-payment of loans and advances on the liquidity and interest rate risks profile of HFCs. The magnitude of premature withdrawal of deposits during the periods of volatility in market interest rates is quite substantial. HFCs should therefore evolve suitable mechanism, supported by empirical studies and behavioural analysis, to estimate the future behaviour of assets, liabilities and off- balance sheet items to changes in market variables and estimate the probabilities of options.

3 A scientifically evolved internal transfer pricing model by assigning values on the basis of current market rates to funds provided and funds used is an important component for effective implementation of ALM System. The transfer price mechanism can enhance the management of

margin i.e. lending or credit spread, the funding or liability spread and mismatch spread. It also helps centralizing interest rate risk at one place which facilitate effective control and management of interest rate risk. A well defined transfer pricing system also provide a rational framework for pricing of assets and liabilities.

VI. APPLICABILITY:

Business of company involves the identifying, measuring, accepting and managing the risk the heart ofcompany's financial management is risk management. One of the most important risk-management functions in bank is Asset Liability Management.

The IKF Home Finance Limited have very limited volume of the business and the company does not have any deposits. Nonetheless, in keeping the long term perspective of the issue the company will ensure implementation of the "Guidelines of asset liability Management" which is the responsibility of the entire organization. However due to mandatory requirements-

Reasons for growing significance of ALM

-Volatility
-Product Innovation
-Regulatory Framework
-Management Recognition

An effective Asset Liability Management technique aims to manage the volume mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio.

a. Company chalk out the guidelines as under-

- Asset Liability Management will be analyzed & supervised by the board of Directors of the company.
- At present the company do have liability with Various Financial Institutions, NBFC & Banks. The company can repay the outstanding of the bank from the recovery of the advances and infusion of the fresh share capital.
- The rate of interest charged by the bank is affordable to the company.

VII. ASSET CLASSIFICATION

As per NHB guidelines-

Every housing finance company shall, after taking into account the degree of well- defined credit weaknesses and extent of dependence on collateral security for realization, classify its loans and advances and any other forms of credit into the following classes, namely :-

(i) Standard assets;
(ii) Sub-standard assets;
(iii) Doubtful assets; and
(iv) Loss assets.

(2) The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless itsatisfies the conditions required for the upgradation.

Loan to Value (LTV) Ratio

Maximum LTV is 80% in the case of purchases and 75% in the case of Self construction which is far below NHB norms (not exceeding 90% for housing loans upto Rs.30 lacs and not exceeding 80% for housing loans above Rs. 30 lacs upto Rs. 75 Lacs and Not Exceeding 75% for loans above Rs. 75 Lacs) and home equity / LAP loans maximum it is 60%.

a. Provisioning Requirement

Every housing finance company shall, after taking in to account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as providedhereunder:-

1. Loans, Advances and Other Credit Facilities Including Bills Purchased and Discounted

The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

(i) Loss Assets	The entire assets shall be written off. If the assets are permitted to remainin the books for any reason, 100% of the outstanding shall be providedfor.
(ii) Doubtful Assets	(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the housing finance company has avalid recourse shall be made. The realisable value is to be estimated on a realistic basis;

	(b) in addition to item (a) above, depending upon the period for which theasset has remained doubtful, provision to the extent of 25% to 100% of the secured portion (i.e. estimated realizable value of the outstanding) shall be made on the following basis:-

Period for which the asset has beenconsidered as doubtful	% of provision
Up to one year	25
one to three years	40
More than three years	100

(iii) Sub-standard Assets	A general provision of 15% of totaloutstanding shall be made
(iv) Standard Assets	

a) Standard Assets in respect of housing loansat teaser/special rates i.e. housing loans at comparatively lower rates of in Respect in thefirst few years after	2% provision on the total outstanding amount of such loans. The provisioning of these loans to be reset after one year at the applicable rates from the date on which the ratesare re-

which rates are re-set at higher rates.	set at higher rates if the account remain 'standard'.
b) Standard Asses in respect of Commercialreal estates (residential housing) & all other Commercial Real Estates (CRE) (office buildings, retail space, multi-tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction etc).	1.00 % on the total outstanding amount of such loans.
c) Standard Assets in respect of allloans other than (a) & (b) above.	A general Provision of 0.4% of the total outstanding amount of loans which are standard assets shall bemade.