# Asset Liability Management Policy

## Introduction

Pioneer Financial & Management Services Limited (PFMS), a NBFC registered as systematically important non deposit taking NBFC with Reserve Bank of India. PFMS funding comprises short-term and long-term sources with diverse maturity patterns and interest rates. Similarly, its assets exhibit varying durations and interest rates, potentially leading to maturity mismatches that can affect liquidity and profitability. Therefore, it is imperative for PFMS to continuously monitor and manage its asset and liability positions to ensure that mismatches remain within acceptable limits. This obligation is also mandated by the RBI, the regulatory authority for NBFCs, which requires NBFCs to maintain an effective Asset- Liability Management (ALM) system as part of their risk management framework..

## Objective and Scope

The objective of this policy is to establish an institutional mechanism for computing and periodically monitoring the maturity pattern of PFMS's liabilities and assets. This mechanism aims to

(a) determine the nature and extent of mismatches in different maturity buckets, especially in the 1-7 days, 8-14 days, and 15-30 days periods, reflecting the structural liquidity;

(b) assess the cumulative mismatches in different buckets, indicating short-term structural liquidity;

(c) analyze the residual maturity pattern of asset and liability repricing, assessing the potential impact of interest rate movements on profitability. This policy serves as a guideline for PFMS's ALM system, emphasizing

(d) the maintenance of high-quality liquidity assets capable of withstanding various stress events, including the loss or impairment of both unsecured and secured funding sources.

An effective ALM requires

- robust information systems,
- internal controls,
- a policy defining limits for liquidity and interest rates,

- contingency funding plans for alternate scenarios,
- a committee of senior officials ensuring adherence to board-approved limits, and
- a clearly defined process.

Process: Reserve Bank of India has stipulated templates for reporting Structural liquidity (ALM-1). Dynamic Liquidity (ALM-2) and Interest Rate Sensitivity (ALM-3). They have also provided indicative formats as per Annexure I and Annexure II, for compiling the figures. ALCO will use the indicative formats for compiling the figures and the Reports on ALM 1, ALM 2 and ALM 3 for reviewing the liquidity and interest rate risk.

The Finance team will arrange for convening the meetings of ALCO once in a quarter or as and when needed depending upon the necessity. Minutes of the meeting shall contain discussions in detail and shall be placed to the Board for noting.

The following areas of liquidity risks (Illustrative) should be deliberated by ALCO

- Compliance to Liquidity risk tolerance levels
- Liquidity cost, benefits, and risks in internal pricing
- Off balance sheet exposures and contingent liabilities
- Funding and capital planning
- Collateral position management
- Profit planning and growth projection
- Forecasting and analyzing 'What if scenario' and preparation of contingency plans.
- Management of market risks

1. Liquidity Risk Management

1.1 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. herefore, 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.

1.2 The Maturity Profile based on ALM - II 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 day to 7 days
ii. 7 day to 14 days
iii. 15 days to 1 month
iv. Over 1 month to 2 months
v. Over 2 months to 3 months
vi. Over 3 months to 6 months
vii. Over 6 months to 1 year
viii. Over 1 year to 3 years
ix. Over 3 to 5 years
x. Over 5 years

As PFMS 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.

i) The composition and volume are clearly defined;
ii) Maximum maturity/duration of the portfolio is restricted;
iii) The holding period not to exceed 90 days;
iv) Cut-loss limit prescribed;
v) Defeasance periods (product-wise) i.e. time taken to liquidate the position on the basis of Liquidity in the secondary market is prescribed;

1.3 When company proposed to maintain such 'Trading Books' and complying with the above standards may show the trading securities under "1 day to 30/31 days (One month)", Over one month and up to 2 months" and "Over two months and up to 3 months" buckets on the basis of the defeasance periods. The Board/ALCO of the company should approve the volume, composition, holding/defeasance period, cut loss, etc. of the 'Trading Book'.

The remaining investments should also be classified as short term and long term investments as required under Prudential Norms.

1.4 The policy note recorded by the company on treatment of the investment portfolio for the purpose of ALM and approved by their Board/ALCO should be forwarded to the Regional Office of the Department of Non-Banking Supervision of RBI under whose jurisdiction the registered office of the company is located.

1.5 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., 1-30/31 days.

1.6 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.

1.7 ln 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 ALM - I issued by RBI for estimating Short-term Dynamic Liquidity will be used for the said purpose.

2. 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.

3. Interest Rate Risk (IRR)
The operational flexibility given to NBFCs in pricing most of the assets and liabilities simply 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 PFMS is majorly into funding of loans which are always fixed rate loans. 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 of the new loans are finalized accordingly. The interest sensitive assets and liabilities will be clubbed into the following buckets for ascertaining the Gap in individual buckets and the cumulative Gap.

i. 1 day to 7 days
ii. 7 day to 14 days

iii. 15 days to 1 month
iv. Over 1 month to 2 months
v. Over 2 months to 3 months
vi. Over 3 months to 6 months
vii. Over 6 months to 1 year
viii. Over 1 year to 3 years
ix. Over 3 to 5 years
x. Over 5 years

The Reporting Format ALM-3 will be used for computing the Gaps in each time bucket. Within 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 ensure that such Gap, individual as well as cumulative, do not exceed 50%.