RELIANCE HOME FINANCE

Asset - Liability Management (ALM) Policy

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1. Introduction

National Housing Bank had issued guidelines vide circular NHB(ND)/HFC(DRS-REG)/ALM/1407/2002 dated June 28, 2002 and advised the Housing Finance Companies (HFCs) to introduce an Asset Liability Management (ALM) System as part of their overall system for effective risk management in various portfolios. NHB had made this applicable to all HFCs irrespective of the fact whether they accept deposits or not. NHB has further revised the guidelines vide circular NHB/ND/DRS/Pol-No.35/2010-11 dated October 11, 2010. The revised guidelines would be applicable to all HFCs irrespective of whether they are accepting / holding public deposits or not. All HFCs are required to put in place the ALM system. Taking into account the salient features enumerated in the latest guidelines, the ALM policy is framed as under:

Background

Housing Finance Companies (HFCs) are 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 HFCs 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 HFCs 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 managements of HFCs have to base their business decisions on a dynamic and integrated risk management system and process driven by corporate strategy. HFCs are exposed to several major risks in the course of their business - credit risk, interest rate risk, liquidity risk, operational risk etc. It is, therefore, important that HFCs introduce effective risk management systems that address the issues relating to interest rate and liquidity risk.

- Keen competition for business involving both assets and liabilities, together with increasing volatility in the domestic interest rates as well as foreign exchange rates requires managing balance between spread, profitability and long term viability of any organization engaged in financial services.

- The objective of this Asset Liability Management is to identify the risk associated with the mismatches in assets and liabilities, establish organisational structure, tools, processes etc., necessary for measuring and managing interest rate risk and liquidity risk.

- An effective ALM process depends on every functionary in the company, especially the line functionaries, as they undertake assets and liabilities in the company books on day-to-day basis. The Company hence believes that every functionary needs to play the role of a Risk Manager supplemental to his primary designated role in the Company to guard the Company against the downside of interest rate risk and liquidity risk. Therefore, it is essential for all functionaries to familiarize themselves with ALM requirement and its strategies.

- The policy will keep evolving either in anticipation of or in response to the dynamics of business environment in which the company operates or for an internally felt need, such as change in risk appetite, organizational restructuring, review of business strategy etc. A detailed review will be undertaken periodically by the ALCO Committee.

- The Company will abide by all guidelines, directives, instructions and advices of National Housing Bank (NHB) as may be in force from time to time. This policy should be read in conjunction with these guidelines, directives, instructions and advices. The Company will apply best prevailing practice so long as such practice does not conflict with or violate NHB regulations.

- This document is the property of the Company. It contains information that is internal to the Company and is of competitive value and sensitive in nature. All employees must treat its contents as confidential to the Company and keep it secure.

2. Asset Liability Management

Over the last few years, Indian financial markets have witnessed wide-ranging changes. The interest rates are largely de-regulated. Greater competition has encouraged HFCs to develop new financial products and services. Interest rate structure has become more complex. Further, products like Interest Rate Swaps, Forward Rate Agreements etc., to hedge interest rate risk and change the profiles of assets and liabilities from fixed to floating and vice versa have become common in the market. These products have therefore given flexibility to HFCs to manage their assets and liabilities as per their interest rate view and alter their risk profile to better match their corporate objectives.

The fundamental focus of Asset Liability Management is the protection and enhancement of Net Interest Margin in short run and enhancement of shareholders' value (market value of equity) in the long run. The important aspect of this effort are liquidity management, interest rate risk management and pricing of assets and liabilities.

ALM encompasses the management of total balance sheet dynamics with regard to its size, quality and risk. In other words, it can be defined as the construction of the asset & liability portfolio in a way that maximizes earnings in the short run and builds and preserves the economic value of the firm in the long run.

Our strategy aims to attain a structured Asset Liability Management (ALM) system in the Company with a view to managing for the time being, Liquidity Risk and Interest Rate Risk and eventually supplement all areas of Enterprise-wide Risk Management.

3. Objectives of the Policy

The objectives of the Policy are to put in place a strategic Asset Liability management system in the Company, in order to achieve the following:

- To optimise Net Interest Margin of the Company in short run and to maximise shareholder's value in the long run.
- To provide a reasonable assurance that the Company's interest rate risk management objectives are achieved.
- To manage Liquidity risk and Interest rate risk.
- To facilitate Balance Sheet planning from the risk-return perspective.
- To establish linkages between ALM system and other Risk Management systems in the Company.
- To ensure that ALM objectives are in tune with corporate objectives.

4. ALM Information System

Information system is the key for implementation of ALM process. The basic reconciliation between balances as per GL system and as per ALM system shall be performed by Finance. IT will provide necessary support to Finance in terms of generation of data dumps, reports from ALM system etc.,. Specialized software for ALM can also be considered by the Company in generating such data / reports.

5. ALM Organization, Composition and Responsibility

ALM Committee, known as ALCO, shall be primarily responsible for ALM process in the Company. The functioning of ALCO shall be overseen by the Risk Management Committee (RMC). The important decisions taken by ALCO shall be placed before RMC. ALCO consisting of senior management personnel would be formed and it would be a decision making unit responsible for strategic management of interest rate and liquidity risks besides balance sheet planning. NHB has given discretion to respective HFCs to decide the composition of the Committee and the frequency of the meetings.

The Composition of ALCO is as follows:

Sr. No.	Designation
1.	Chief Executive officer
2.	Chief Financial Officer
3.	Chief Risk Officer
4.	Head Treasury
5.	Head Technology

CEO shall be the Chairman of the Committee. In his absence, the Chairman of the meeting would be decided by the members present. The Chairman of ALCO may also invite any other functional Head / key personnel to the ALCO meeting depending on agenda and other strategy requirements The quorum for any ALCO would be minimum 2 members. Periodicity of the meeting would be once in a quarter.

There shall be a strong process of daily/weekly monitoring of the treasury and market situation. The same shall also be reviewed by the CEO with the other senior functionaries, including ALCO members, both in structured manner and through informal meeting. Further, during monthly meetings, the liquidity and interest rate positions shall be presented to the CEO. The Company shall be highly proactive to the changes in market dynamics and customer sentiments. Hence, depending on the growth of business and size of portfolio, frequency of the meeting would be decided accordingly.

6. Roles and Responsibilities of ALCO

- Balance sheet management and hedging strategies.
- Strategic management of interest rate, liquidity and market risks.
- Consider internal limits and review.
- Monitor liquidity profile of the Company and to act on early warning indicators of liquidity crisis.
- Monitoring maturity profile of outstanding and incremental assets and liabilities.
- Prescribed suitable tolerance limit and over viewing the same.
- To overview the strategy on source and mix of liabilities and quality, type and maturity of assets.
- Articulate current interest rate scenario and strategy for product pricing for both assets and liabilities.
- Review submission status of Regulatory ALM returns.
- Constituting sub-committees as may be required and reviewing the working & the functioning of the same.
- Management shall decide of risks and the risk management policy of the Company and set limits for liquidity, interest rate, exchange rate and equity price risks.
- In addition to monitoring the risk levels of the Company, the ALCO shall 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. 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. Towards this end, it shall develop a view on future direction of interest rate movements and decide on funding mixes between fixed vs. floating rate funds, wholesale vs. retail funds, money market vs. capital market funding, domestic vs. foreign currency funding, etc.

7. Classification of Assets and Liabilities and Monitoring of gaps

The Company shall take into account the benchmarks indicated in the Appendices I and II of the circulars cited above or issued from time to time for classification and treatment of various assets including investments and liabilities into different time buckets. This may be reviewed by ALCO for ensuring proper classification based on behavioral pattern, past data or studies, industry practices or any other reasonable grounds put before them.

The Company shall consider the guideline issued by NHB from time to time and monitor the gaps for taking necessary remedial action. The prudential liquidity gap limits for negative gaps in the first two time buckets (viz. 1 – 14 days and over 14 days to one month) have been fixed at 15% of the cash outflows of each time-bucket and the cumulative gap upto the one year period should not exceed 15% of the cumulative cash outflows upto one year period, as prescribed by NHB. For all other time buckets greater than one year, negative gaps would be restricted to 25% and shall operate on similar basis as the 6 month to one year limit.

In case these limits are exceeded, the measures proposed for bringing the gaps within the limit, should be discussed in ALCO meeting.

For the interest rate sensitivity, cumulative negative gaps in all time buckets of 2 months and above would be restricted to 30%. As there would be always couple of months lagging period for any change of floating interest rate on lending to the borrowers arising out of change in interest rate on borrowing, no negative limit is prescribed for period up to 2 months.

These limits are subjected to annual review. However, the Board has the discretion to review the same at a shorter duration as and when felt necessary or as may be recommended by the ALCO.

8. ALM Return Submission

The Company shall prepare and submit various returns and statements under ALM as prescribed by NHB from time to time. As per the latest guidelines, the periodicity of the Statement of Short Term Dynamic Liquidity shall be quarterly and that of Statement of Structural Liquidity and Interest Rate Sensitivity, half-yearly. The quarterly Short Term Dynamic Liquidity Statement shall be submitted to NHB within 10 days of the close of the quarter to which it relates and half yearly Structural Liquidity and Interest Rate Sensitivity Statements shall be submitted to NHB within 20 days of the close of the half year to which they relate. The Company shall submit such returns strictly as per the formats prescribed and within the timeframe. The ALCO would review such statements and ensure the returns are submitted properly.

9. Additional Disclosures in Balance Sheet

As directed by NHB circular vide NHB/ND/DRS/Pol-No.35/2010-11 dated October 11, 2010, the Company shall disclose the following particulars in its Balance Sheet every 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.

10. ALM Process

The strategies, methodology and implementation of ALM process will be monitored / reviewed by ALCO from time to time. If required, an Interest Rate Committee would supplement the ALCO in decisions regarding the product wise interest structures, special occasion offerings, limited period offerings etc.,. The decisions taken at such IRC would be reviewed at the subsequent ALCO meetings.

Appendix I

Structural Liquidity

A. OUTFLOWS

Report Head	Our Bucketing Assumptions	
	Items	**Assumptions**
Outflows		
1. Capital	(i) Equity capital, Non-redeemable or perpetual preference capital	>10y
	(ii) Preference capital - redeemable/non-perpetual	As per Residual Maturity of the shares
2. Reserves & Surplus	(i) Reserves, Funds and Surplus	>10y
3. Gifts, grants, donations & benefactions	(i) Grants, donations and benefactions	>10y.However, if such gifts, grants, etc., are tied to specific end-use, then these may be slotted in the time- bucket as per purpose/end-use specified
4. Bonds and debentures	(i) Plain vanilla bonds/debentures	As per Residual Maturity
	(ii) 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.
5. ICDs	(i) Inter Corporate Deposits	As per Residual Maturity
	(ii) Term Deposit from public	As per Residual Maturity
6. Borrowings	(i) Short Term borrowings (ii) Long Term Borrowings	Bank Loans - Short Term & Long Term - As per Residual Maturity / timing of cashflows Cash Credit utilized - 20% in '1 to 14 days bucket & 80% in 'Over 1 year to 3 years' Commercial Papers as per residual maturity

		From RBI, Govt., & others - as per residual maturity
7. Current Liabilities & provisions	(i) Sundry creditors	As per the due date or likely timing of cash outflows
	(ii) Expenses payable (other than interest)	As per the due date or likely timing of cash outflows
	(iii) Advance income received, receipts from borrowers pending adjustment	>10y
	(iv) Interest payable on bonds/deposits	Bucketed as per next coupon payment / redemption/ maturity date whichever is earlier
	(v) Provisions for NPAs	Reduced from Loans on the asset side (Inflows)
	(vi) Provision for Investments portfolio	Reduced from Investments on the asset side (Inflows). In case provisions are not held security-wise, the provision may be shown in 'over 10 years' bucket.
	(vii) Other provisions	To be bucketed as per the purpose/nature of the underlying transaction
8. Contingent Liabilities	(i) Letters of credit/guarantees (outflow through devolvement)	Based on the past trend analysis , likely devolvement estimation- on judgmental basis
	(ii) Loan commitments pending disbursal (outflow)	2 % of total undisbursed amount every month
	(iii) Lines of credit committed to other Institutions (outflow)	As per usance period of bills received/ to be received under this.

B INFLOWS:

Report Head	Our Bucketing Assumptions	
	Items	**Assumptions**
Inflows		
1. Cash	Cash	1-14d
2. Remittance in transit	Remittance in transit	1-14d
3. Balances with banks	(i) Current account	1-14d
	(ii) Deposit accounts/short term deposits	(i) FDs pertaining to Securitization have been bucketed either in >5y bucket or as per last payout date (ii) Other FDs are bucketed as per residual maturity
4. Investments (net of provisions)	(i) Approved Trustee securities, government securities, bonds, debentures and other instruments	As Per Residual Maturity of timing of cash flows
	(ii) Non Mandatory Unlisted securities (e.g. shares, etc.)	Over 10 years

B INFLOWS:

Report Head	Our Bucketing Assumptions	
	Items	**Assumptions**
	(iii) Non mandatory Unlisted securities having a fixed term maturity	As per the residual maturity
	(iv) Venture capital units	In the 'over 10 years' bucket'
	(v) Equity shares, convertible preference shares, non-redeemable/perpetual preference shares, shares of subsidiaries/joint ventures and units in open ended mutual funds and other investments.	Equity shares - quoted - Bucketed in 1-14d at Market Value Less: 20% Haircut.
		Equity shares - unquoted (i) Certain items have been bucketed in 6m-1y (ii) Other items bucketed in >10y
		(i) Bucketed in 1-14d at Market Value Less: 20% Haircut
		Preference shares - unquoted - As per residual maturity
		Debentures - quoted - Bucketed in 1-14d at Market Value Less: 20% Haircut
		Debentures - unquoted - Bucketed as per residual maturity
		Warrants >10y
		Mutual Funds (i) Quoted/Liquid - 1 to 14 days (ii) Others >10 years
		Investment in joint venture - in >10y
		Share in Partnership Firm in >10y
5. Advances (performing)	Bill of Exchange and promissory notes discounted and rediscounted	As per residual maturity
	(i) Term loans (rupee loans only) ((iii) Corporate loans/short term loans	(i) Regular loans as per residual maturity / timing of cashflows. Also Consider Prepayment and foreclosures cashflow based on past data trend analysis. (ii) Overdues : Bucketed in 3-6m or 6m-1y as the case maybe based on NHB guidelines regarding the overdue period (net of provisions) (iii) Partial disbursed: CF – 1 to 3 years. LF – 6 months to 1 year and HL & others – 5% in 1 to 3 yrs, 7% in 3 to 5 yrs, 8% in 5 To 7 yrs, 16% in 7 to 10 yrs and 64% in >10yrs.
6. Non-performing loans May be shown net of the provisions and interest suspense held)	(i) Sub-standard - All overdues and instalments of principal falling due during the next three years	3-5y

B INFLOWS:

Report Head	Our Bucketing Assumptions	
	Items	**Assumptions**
	(ii) Sub-standard - Entire principal amount due beyond the next three years	>5y
	(iii) Doubtful and loss - All instalments of principal falling due during the next five years as also all overdues	>5y to 7y
	(iv) Doubtful and loss - Entire principal amount due beyond the next five years	>7y to 10y & >10 y
7. Inflows from assets on lease	Assets on lease	time buckets as per the timing of the cash flow
8. Fixed assets (excluding assets on lease) 9. Other assets	Fixed assets (excluding assets on lease)	>10y
	Intangible assets and items not representing cash inflows.	>10y
	Other items (such as accrued income, other receivables, staff loans, etc.)	as per the timing of the cash flows
10. Contingent Assets	(i) Lines of credit committed by other Institutions (inflow)	Unutilised- Bucketed in 1-14d
11. Other assets	-	>10 y

Appendix II

Interest Rate Sensitivity Profile

Interest Rate Sensitivity Profile Heads of accounts	Time bucket for rate sensitivity
A. LIABILITIES	
1. Capital, Reserves & Surplus	Non-sensitive
2. Gifts, grants & benefactions	Non-sensitive
3. Notes, bonds & debentures :	
a) Floating rate	Sensitive; reprice on the roll- over/repricing date,.
b) Fixed rate (plain vanilla) including zero coupons	Sensitive; reprice on maturity.
c) Instruments with embedded options	Sensitive; could reprice on the exercise date of the option, particularly in rising interest rate scenario. To be placed in respective time buckets as per the residual period till the immediately ensuing exercise date.

4. Deposits : a) Deposits/Borrowings i) Fixed rate	Sensitive; could reprice on maturity or in case of premature withdrawal being permitted, after the lock-in period,
ii) Floating rate	Sensitive; reprice on the contractual roll-over date. To be slotted in the respective time-buckets as per the residual period till the earliest ensuing re-pricing date.
b) ICDs	Sensitive; reprice on maturity.
5. Borrowings:	
a) Term-money borrowing	Sensitive; reprices on maturity.
Borrowings from others	
i) Fixed rate	Sensitive; reprice on maturity.
ii) Floating rate	Sensitive; reprice on the roll-over/ repricing date.
6. Current liabilities and provisions : a) Sundry creditors b) Expenses payable c) Swap adjustment a/c. d) Advance income received/ receipts from borrowers pending adjustment e) Provisions f) Interest payable on bonds/ deposits	Non-sensitive
7. Repos/bills rediscounted/forex-rupee swaps (sell/buy)	Sensitive; re-price on maturity.
B. ASSETS:	
1. Cash	Non-sensitive
2. Remittance in transit	Non-sensitive
3. Balances with banks in India a) In current account b) In deposit accounts, money at call and short notice and other placements	Non-sensitive. Sensitive; reprices on maturity.
4. Investments	
a) Fixed income securities (e.g. govt. securities, zero coupon bonds, bonds, debentures, cumulative/non-cumulative redeemable preference shares, etc.)	Sensitive on maturity. To be slotted as per residual maturity.
b) Floating rate securities	Sensitive; re-price on the next re-pricing date.
c) Equity shares, convertible preference shares, shares of subsidiaries/joint ventures, venture capital units	Non-sensitive.
5. Advances (performing)	
a) Bills of exchange, promissory notes discounted & rediscounted	Sensitive on maturity.
b) Term loans/corporate loans/Short Term Loans (rupee loans only) i) Fixed Rate ii) Floating Rate	Sensitive on cash flow/maturity.
6. Non-performing loans: (net of provisions, interest suspense and claims received from ECGC) a) Sub-standard b) Doubtful and loss	To be slotted as per Structural Liquidity annexure item (6) of Inflow

7. Assets on lease	Sensitive. Respective time-buckets as per the timing of the cash flows.
8. Fixed assets (excluding assets on lease)	Non-sensitive
9. Other assets a) Intangible assets and items not representing cash flows. b) Other items (e.g. accued income, other receivables, staff loans, etc.)	Non-sensitive. Non-sensitive
10. Reverse Repos/Swaps (buy/sell)/Bills rediscounted (Derivative Usance Promissory Notes)	Sensitive on maturity.
11. <u>Other (interest rate) products</u>	
a) Interest rate swaps/FRAs b) Other derivatives	Sensitive; to be slotted as per residual maturity in respective time buckets. To be classified suitably as and when introduced.