THE TIRUVALLA EAST CO-OPERATIVE BANK LTD. NO.3260

ASSET LIABILITY MANAGEMENT POLICY (ALM) 2023

The Asset Liability Management (ALM) Policy depicts Bank's comprehensive methodology with respect to funding, deployment and pricing of resources and provides the foundation to build systems and procedures to measure, monitor, regulate and manage liquidity and interest rate risk, wherein it closely integrates bank's business and corporate strategy with prudential controls and regulatory compliance laid down by the Reserve Bank of India (RBI) from time to time. Managing liquidity and interest rate risk are perceived as the ultimate goals of asset liability management of the Bank. This document intends to put together the concerns of managing assets and liabilities with specific focus on maximization of profits while keeping liquidity and interest rate risks in check. The Management of the Bank have to base their business decisions on sound risk management systems with the ultimate objective of protecting the interest of depositors and stake holders. It is therefore, important that the bank has to introduce effective Asset Liability management (ALM) systems to address the issues related to liquidity, interest rate and currency risk.

The Tiruvalla East Co-operative Bank Ltd. No.3260, Eraviperoor (TECB) resolved to laid down broad guidelines in respect of interest rate and Liquidity Risk Management systems which form part of ALM Policy. These guidelines laid down broad frame work for measuring liquidity, interest rate and currency risk. The initial focus of the ALM function would be to enforce the risk management discipline namely managing business after assessing the risk involved.

1. Objectives

1.1 To manage both assets and liabilities simultaneously for the purpose of mitigating the liquidity risk and interest rate risk.

1.2 To manage the net margin to ensure increasing profitability of the Bank

1.3 To plan, Direct and control the flow, mix, cost and yield of the consolidated funds of the Bank

1.4 To assess various asset mixes funding combinations, price volume relations and their implications on liquidity, income and capital ratio.

1.5 To carry out the operations in such a manner so as to bring the assets and liabilities in each selected maturity to near equal position in order to reduce the risk to the minimum

1.6 To measure the liquidity risk through measurement of mismatches or gaps between assets and liabilities grouped into time buckets based on residual maturity.

1.7 To measure the interest rate risk through measurement of interest rate sensitivity

1.8 To measure the risk through other techniques namely duration gap analysis, Simulation, Value at Risk etc. and adopt suitable policies in due course.

The Bank need to address the market risk in a systematic manner by adopting necessary sector specific ALM practices then has been done hitherto. ALM, among other functions also provides a dynamic frame work for measuring, monitoring and managing liquidity, interest rate and currency risk. It involves assessment of various types of risk and altering balance sheet (Assets and Liabilities) items in a dynamic manner to manage risk.

2. Asset Liability Management (ALM)

The ALM process rests on three pillars

- ALM Information Systems
  Management Information Systems (MIS)
  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 procedures, prudential limits and auditing, reporting and review.

2.1 ALM Information Systems

ALM has to be supported by a management philosophy which clearly specifies the risk policies and procedures and prudential 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.

2.2 ALM Organisation

Successful implementation of the risk management process would require strong commitment on the part of the BoD and senior management. The BoD should have overall responsibility for management of risks and should decide the risk management policy and procedures, set prudential limits, auditing, reporting and review mechanism in respect of liquidity, interest rate and currency risks

2.3 Asset Liability Committee.

The Asset Liability Committee (ALCO), consisting of the bank's senior management including MD/ CEO, should be responsible for ensuring adherence to the policies and limits set by the BoD as well as for deciding the business strategy (on the Assets and Liabilities sides) in line with the bank's business and risk management objectives. The ALCO shall be constituted with the following members:

1. Managing Director/Chief Executive Officer
2. General Manager
3. Deputy General Manager
4. Accounts Manager
5. Investment Manager
6. Manager Establishment

The Quorum of the meeting shall be 4 including MD/CEO, General Manager, Accounts Manager**.** ALCO shall meet at least once fortnightly or more frequently depending upon the requirements.

3. **Business of ALCO**
   - Reviewing the impact of the regulatory changes on the Banking sector
   - Overseeing the budgetary process.
   - Reviewing the interest rate outlook for pricing of assets and liabilities
   - Deciding on the introduction of any new loan/deposits products and their impact on interest rate/exchange rate and other market risk.
   - Reviewing the Asset and Liability portfolios and the risk limits and thereby assessing the capital adequacy.
   - Deciding on the maturity profile of incremental assets and liabilities and thereby assessing the liquidity risk
   - Reviewing the variances in actual and projected performances with regard to Net Interest Margin NIM), spreads and other balance sheet ratios.

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 bank's internal limits.

The ALCO is a decision making unit responsible for balance sheet planning from risk-return perspective including the strategic management of liquidity, interest rate and forex risks. The business and risk management strategy of the bank should ensure that the bank operates within the limits / parameters set by the BoD. The business issues that an ALCO considers, includes pricing of both deposits and advances, desired maturity profile and mix of the incremental assets and liabilities, etc. In addition to monitoring the risk levels of the bank, the ALCO should review the results of and progress in implementation of the decisions made in the previous meetings.

The ALCO's future business strategy decisions should be based on the banks views on current interest rates.

4. **Board of Directors**

The BoD of the Bank will oversee the implementation of the system and review its functioning periodically. It shall review various decisions taken ALCO for managing market risk.

5. **Scope of ALM Process.**

The scope of ALM function can be described as follows:

- Liquidity risk management
- Interest rate risk management
- Funding and capital planning
- Profit planning and business projection

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

5.1. Liquidity Risk Management

Measuring and managing liquidity needs are vital for effective operation of the Bank. By assuring the Bank'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 problem of the Bank need not necessarily confine to itself but its impact may be felt on other banks as well. The Bank should measure not only the liquidity positions on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions/scenarios. Liquidity measurement is quite a difficult task and can be measured through stock or cash flow approaches. The Maturity Profile could be used for measuring the future cash flows of the Bank in different time buckets. The format of the Statement of Structural Liquidity as prescribed by RBI may be used for this purpose. The time buckets may be distributed as under.

i) Up to 1 month
ii) Over 1 month and up to 2 months
iii) Over 2 months and up to 3 months
iv) Over 3 months and up to 6 months
v) Over 6 months and up to 1 year
vi) Over 1 year and up to 3 years
vii) Over 3 years and up to 5 years
viii) Over 5 years

This approach involves tracking of cash flow mismatches through maturity ladders at selected maturity dates through the mechanism of time buckets. Within each time buckets, there could be mismatches depending on cash inflows and out flows. While the mismatches up to 1 year could be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short term mismatches up to one month. Bank, 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. The mismatches (negative gap) up to one month in normal course may not exceed 15% of the cash outflows in this time buckets.

The ALCO shall measure liquidity risks in conformity with the standards prescribed by RBI in its guidelines on asset liability management. ALCO would review the following statements stated hereunder at such periodicity Bank may stipulate from time to time.

- Statement of structural liquidity
- Statement of short term dynamic liquidity
- Ratio analysis

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 maturity liability will be a cash outflow while a maturity asset will be a cash inflow. While determining the likely cash inflows and outflows, Bank will have to make a number of assumptions according to their asset liability profiles.

In order to enable the Bank to monitor the short term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, Bank will estimate their short term liquidity profiles on the basis of business projections and other commitments for planning purposes. An indicative format of ALM I issued by RBI for short term dynamic liquidity will be used for the said purpose. The ALCO should recommend the managing committee the tolerance levels to be fixed by the Bank in each time bucket in conformity with the RBI guidelines in the matter.

Behavioural pattern of assets and liabilities that do not have any definite contractual maturity (like savings bank, current account, cash credits, overdrafts etc) need to be estimated for arriving at cash flow pattern on the basis of past data/empirical studies.

ALCO should frame short term and long term investment policies to meet contingency funding. Possibility of raising of short term bulk deposits in emergencies is also to be analyzed.

6. Interest Rate Risk (IRR)

Interest rate risk is the risk where changes in the market interest rates might adversely affect the Bank's financial condition. Interest rate risk is prevalent on both the assets and liabilities. Deposits constitute major part of resources bear fixed interest rate. The deposits accepted from the public are also mostly at fixed rates. The Bank manage the risk on Net Interest Income (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 or Net Interest Margin. 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 finalised accordingly.

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. The gap report should be generated by grouping rate sensitive liabilities, assets and off balance sheet positions into time bands according to residual maturity or next repricing period whichever is earlier.

ALCO should submit prudential limits on individual gaps for the approval of the BoD. ALCO will review interest rate sensitivity statement on monthly basis. Interest rate risk in the fixed income portfolio of bank's investments will be managed through duration analysis.

The interest sensitive assets and liabilities will be clubbed into the following buckets for ascertaining the gap in individual buckets and cumulative gap.

1) Upto 3 months
2) Over 3 to 6 months
3) Over 6 to 1 year
4) Over 1 year to 3 years
5) Over 3 to 5 years
6) Over 5 years

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 Bank is in a position to benefit from rising interest rate 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.