

**PRATAP CO-OPERATIVE BANK LTD.**

104, Supariwala Bldg., Bhuleshwar road, Mumbai – 400 002.

**ASSET LIABILITY MANAGEMENT POLICY F.Y. 2023-24**

**1. Definition of Asset Liability Management**

Asset Liability Management (ALM) is a continuous rearrangement of both – assets and liabilities to provide adequate liquidity, reasonable profitability and minimize interest rate risk.

- Maturity Mismatch
- Quantum Mismatch
- Interest Rate Mismatch

**2. Purpose**

The assets and liabilities of the bank shall be managed in order to maximize shareholder value, to enhance profitability and increase capital, to serve customer needs, and to protect the institution from any disastrous financial consequences arising from changes in interest rates. In a capsule, the Bank intends, through sound and dynamic funds management, to realize solid operating results produced against a background of a quality balance sheet.

The purpose of the Asset /Liability Management Policy is to:

- Outline the scope and responsibilities of the Asset/Liability Management Committee(ALCO).



- Define, Measure and Manage the Risks of the Bank on a consistent basis.
- Establish guidelines to meet various applicable regulatory rules and statutes.
- Form a consistent co-policy with other policies of the Bank (investments, lending etc.)
- Coordinate the management of the Bank's financial position.

### **3. Responsibilities**

The Asset/Liability Management Policy of the Bank falls under the authority of Board of Directors, who in turn assigns authority for its formulation, revision and administration to the Asset/Liability.

### **4. Board of Directors**

The Board will annually, formally review this policy with Bank's management. The Board of Directors will, at least quarterly, review the funds management activities of the Bank. This review will include:

- The minutes of the Asset Liability Management Committee (ALCO) meeting held since the last board meeting.
- A summary of the Bank's most recent rate sensitive analysis.
- An analysis of the Bank's liquidity position.

The Board of Directors will also review and approve any other data analysis, and transaction as may be appropriate in view



of their overall responsibility for the funds management activities of the Bank.

#### **5. Asset Liability Management Committee (ALCO)**

- Consisting of bank's senior management including CEO
- Responsible for adherence to the policies & limit set by Board.
- Responsible for balance sheet planning from Risk Return Perspective.
- Responsible for deciding business strategies (on Asset Liabilities side) in line with bank's business and risk objectives.

#### **ALM Support Group**

- Consisting of operating staff
- Responsible for analyzing, monitoring and reporting risk profiles to ALCO.

#### **Membership of ALCO**

The ALCO will consist of the following.

- Chief Executive Officer - Designated Director
- Manager / Officer – Credit
- Manager / Officer – Accounts & Investment
- Manager / Officer – Information Technology - Invitee
- Manager / Officer – Recovery Department

For the purpose of separation of key functions, the chairperson of the ALCO cannot be the main person





performing the monthly update and measuring the ALM position using the Asset/Liability Management system.

The monthly update and measurement of the ALM position will be someone without authority to make investment or risk taking decisions. The chairperson may designate that duty to another member of the ALCO or employee of the Bank.

### **Duties of the ALCO**

The items cited below do not necessarily represent an all inclusive list of the duties of the ALCO. However, given the dynamic nature of its responsibilities. On a regular basis the ALCO should,

1. Hold a formal meeting actually once in a quarter. Informal meeting will be held on the basis of needs.
2. Monitor and discuss the status and results of implemented asset/liability management strategies and tactics.
3. Review the current and prospective liquidity position and monitor alternative funding sources.
4. Review measurement reports on various risks that can be measured with a reasonable degree of effort. Discuss and report on the impact of major funding shifts and changes in overall investment and lending strategies.
5. Review the current and prospective capital levels (risk-based as well as net worth) to determine sufficiency in relation to expected growth, interest rate risk, price risk, and asset mix/quality.



6. Review outlook for interest rates and economy at local, regional and international levels.
7. Review maturity/repricing schedules with particular attention to the maturity distribution of large amounts of assets and liabilities maturing (i.e. jumbo CD's, large investments, etc.)
8. Develop alternate strategies deemed appropriate, which take into account changes in:
  - Interest rate levels and trends.
  - Deposit and loan products and related markets.
  - Banking Regulations, and
  - Monetary and fiscal policy.
9. Report the minutes of each ALCO meeting to the Board of Directors.
10. Co-ordinate an ongoing appreciate education program on the subject of ALM for the ALCO members, Senior management, and the Board of Directors.
11. Review actual net interest income and asset/ liability distribution versus budget.
12. Review the liquidity and contingency funding conditions of the Bank.

### **Meeting of the ALCO**

The full Committee will meet at least quarterly and minutes will be kept of the meetings. More frequent sessions may be required in periods of increased economic activity, in times of unanticipated liquidity



volatility, and when specific issues require immediate further study and follow-up. The minutes of each meeting shall have appended to them copies of all reports, analyses, etc. presented at the meeting. The ALCO will formulate courses of action designed to impact the Bank's liquidity, profitability and the capital position and will direct the CEO and/or his/her designates to implement the appropriate courses of action and report to the ALCO the results of these actions at the next meeting.

#### **ALCO & RMC Reporting Requirements.**

The ALCO shall provide the Board with the following reports.

- Structural Liquidity position of the Bank.
- Interest Rate Sensitivity Analysis
- Dynamic Liquidity Position on the basis of inflow and outflow.

The Primary objectives of the bank's asset/liability management process shall be of ensuring availability of adequate liquidity to meet funds needs at any point of time and explore all the possibilities to mitigate various risks which are in existence and are expected to emerge in a course of **business activity.**

The ALCO shall adhere to the Risk Management activities to mitigate the risks in the course of business activity.





## **Liquidity and Funds Management**

Liquidity is measured in terms of having sufficient funds availability at all times, to meet fully and promptly, the legitimate demands for money made on the bank arising from deposit withdrawal, presentation of cheques, maturing instruments, drawn under committed loan facilities, and other bank commitments.

The determination of the adequacy of the Bank's liquidity position depends upon an analysis of the Bank's position relative to the following factors :-

- Historical funding requirements
- Current Liquidity position
- Anticipated future funding needs
- Anticipated future lending needs
- Present and anticipated asset quality
- Present and future earnings capacity
- Sources of funds

## **Liquidity Risk**

Liquidity risk is the risk of having to fund some assets by the acquisition of additional funds under unfavourable market terms. This might occur when unexpected clearing drains occur in close proximity, when depositors are leaving the bank due to a perception of increased risk, or when loan



growth is very strong. The ALCO has to meet the credit /investments and other fund requirement.

### **Measuring Liquidity Exposure**

Liquidity Exposure will be measured by calculating the Bank's Net Liquidity Gap.

### **Ratios**

The ALCO will monitor the Bank's liquidity position by reviewing the following measures:

- Cash Reserve
- Liquid Asset
- Loans /Deposits

### **Funding**

The following are the alternative ways the Bank can meet its liquidity needs.

- Increase Core (retail) deposit
- Borrow from lender of last resort
- Lengthen the average life of the banks liability portfolio.

The ALCO will review annually, as part of the annual budget preparation, or as often as necessary, the Bank's deposit structure, maturity distribution of time deposit and rates paid compared to rates offered by competitors.





## Interest Rate Risk Management

Interest rate risk arises when there is a mismatch between positions which are subject to interest rate adjustments within a specified period. The most important source of interest rate risk is the Bank's lending, funding and investment activities, where fluctuations in interest rates are reflected in interest margins and earnings. Interest rate risk also arises in trading activities, where changes in interest rates may cause fluctuations in portfolio market values. ALCO has to review the interest rate scenario regularly on a monthly basis so as to mitigate any risk arising on account of changes in interest rate scenario.

## Market Risk

Market Risk refers to the uncertainty of future earnings resulting from changes in interest rates, exchange rates, market prices and volatility. The Bank assumes market risk from consumer and corporate loans, position taking and trading and investments activities.

The strategy for controlling market risk shall involve :

- Stringent controls and limits.
- Strict segregation of front and back office duties
- Daily reporting of positions
- Regular independent review of all controls and limits.



## Trading Risk

The Bank conducts some trading activities for its own account. Trading portfolio shall be managed with the intent to buy and sell financial instruments over a short period of time rather than hold position for investments. The Bank shall have in place separate Trading Policy to ensure smooth trading activity.

Rigorous analysis and testing programs will be applied to measure risk and to verify the accuracy of various controls and limits. These will include stress testing and sensitivity analysis.

Presently Bank is not engaged in trading activity.

## 6. Investments

Investments purchased will be consistent with a separate written investment policy. The objectives of the investment policy are to (1) provide liquidity (2) provide for interest rate risk management, and (3) provide additional profit. The investments portfolio shall be diversified to minimise the risk of loss resulting from over concentration of assets in specific class, economic sector.



## 7. Gap Management:

The Asset-Liability Committee (ALCO) of The Pratap Co-operative Bank Ltd. is responsible for ensuring that the gaps in various time buckets of assets and liabilities remain within the tolerance levels stipulated by the Reserve Bank of India (RBI) and/or those set internally by the bank. This is crucial for managing liquidity risk, interest rate risk, and overall financial stability.

### Prudential Limits for Mismatches:

To manage the gaps effectively, The Pratap Co-operative Bank Ltd. has defined prudential limits for mismatches across all time bands. These limits include specific thresholds for interest rate sensitivity gaps in individual buckets. The established limits are as follows:

- 1-14 Days: Negative gap should be less than 20% of total assets.
- 15-28 Days: Negative gap should be less than 20% of total assets.
- 29 Days to 3 Months: Negative gap should be less than 15% of total assets
- 3-6 Months: Negative gap should be less than 15% of total assets





- 6-12 Months: Negative gap should be less than 15% of total assets
- 1-3 Years: Negative gap should be less than 20% of total assets
- Over 3 Years: Negative gap should be less than 20% of total assets

These prudential limits are reviewed periodically and adjusted based on changes in market conditions, regulatory requirements, and the bank's risk appetite.

#### Gap Management Considerations:

The bank recognizes several limitations associated with gap reporting, which need to be accounted for in its gap management strategy:

##### 1. Interest Rate Movements:

- Interest rates on assets and liabilities may not move with the same magnitude or velocity, leading to potential mismatches that gap reports may not fully capture.

##### 2. Repricing Risks:

- Significant risks may be hidden within the repricing time frames of the gap report. Therefore, close attention is required to understand and manage these risks effectively.



### 3. Option Features:

- Many deposit instruments and loans contain option features (such as prepayment options or callable features) that are not readily determinable, adding complexity to gap management.

### 4. New Business Exposures:

- Exposures arising from new business activities are generally not captured in the gap reports, which can lead to underestimation of risks.

### 5. Comprehensive ALM Guidelines:

- The bank follows comprehensive ALM guidelines with 100% coverage of assets and liabilities, effective from April 1, 2010. These guidelines ensure that all aspects of asset-liability management are covered systematically.

To address the mismatches in cash flows, The Pratap Co-operative Bank Ltd. utilizes statements of structural liquidity. If negative gap reports in any of the buckets exceed the tolerance levels set by the RBI or the bank internally, the reasons must be communicated to the ALCO. Additionally, a road map should be provided to ensure that the negative gap does not exceed the prescribed tolerance levels.

### Advanced Modelling:



To overcome the limitations of traditional gap reports, The Pratap Co-operative Bank Ltd. will focus on simulation modelling. This approach involves creating detailed models of the bank's balance sheet under various interest rate scenarios to better understand potential impacts and develop more robust risk management strategies.

#### 8. Asset Allocation / strategies

Interest rate will be managed through (1) Investments (2) loan pricing and (3) deposit pricing. Asset/Liability policies and strategies will be formulated upon the examination of how interest rate risk affects overall business risk i.e. capital risk, liquidity risk, credit risk and interest rate risk. After review of the current situation, the ALCO will devise various strategies to minimise risk while maximising earnings and net worth. The following methods the asset/liability mix will be reviewed.

1. Buying and selling assets.
2. Changing liability structure and mix
3. Balance sheet growth, structure and maturity

#### 9. Compliance with Banking Laws and Regulations

Current laws and regulations, as well as prudent and generally accepted banking practices, will be the foundation for and will act as the guiding hand in the





development of policies, procedures, strategies and tactics relating to the management of the Bank's assets and liabilities.

## 10. Exceptions

All funds management activities pre-dating the adoption of this policy and not in conformity with its various sections will be considered as exceptions to this policy. Management will make a concrete effort to bring the funds management activities of the bank into compliance with the various guidelines and provisions of this policy as quickly as possible, subject to sound financial practices.

In those situations where it seems prudent to act in a manner that is contrary to this policy, and where it is impossible for the entire ALCO to meet, any two members of the committee, with the provision of presence of Chief Executive Officer / Managing Director as must may act for the entire ALCO, provided, however, that all actions taken in the absence of the entire ALCO shall be reported in full at the next regularly scheduled ALCO meeting.

## 11. Revision

The Bank shall review the policy annually and shall recommend all necessary changes to the Board for consideration and adoption.



This policy is intended to be flexible to deal with rapidly changing conditions; therefore, this policy can be amended by the unanimous vote of the members of the ALCO. Any and all modifications of this policy are to be reported to the Board of Directors at its next regularly scheduled meeting.

The Policy is discussed and adopted in the Board Meeting held on 20.04.2024.



*CK Singh*

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