

ASSET – LIABILITY MANAGEMENT POLICY

The Asset - Liability Management (ALM) Policy of The Bihar State Cooperative Bank Ltd prepared after taking into consideration the guidelines/circulars issued by Reserve Bank of India from time to time.

The Indian financial market have witnessed wide-ranging changes at a vast pace during the last few years. The intense objectives for business involving both Assets and Liabilities together with increasing volatility in the interest rates has brought pressure on the Management to maintain a good balance among spreads, profitability and long term, viability. The comprehensive policy has to put in place for measuring, monitoring and managing the composition of assets and liabilities to safeguard the bank's interest in view of volatile market trends change in interest rate and various risks. .

Definition: Considering the structure, Balance Sheet i.e. Assets & Liabilities and skill development of the personnel's of the bank in such a way that the earnings are maximized at the optimum level while ensuring liquidity and safety in the system. The Management has to base its business decisions on a dynamic and integrated risk management system and process.

OBJECTIVES :

The key objective shall be liquidity management, which refers to liability of the bank to meet demands from time to time. Broadly objectives shall be to plan and manage the assets and liabilities in a manner so as to ensure achieving satisfactory and consistent earnings, liquidity and safety in the system. It should serve as a protection in various market/business related risks.

Asset Liability Management among other functions also provide dynamic framework for measuring, monitoring and managing liquidity, interest rate risks. The ALM process rests on three pillars.

1. ALM INFORMATION SYSTEM

This includes Management Information System & Information Availability, Accuracy, Adequacy and expediency. This framework needs to be built on sound methodology with necessary information system as backup. Thus, information is the key to the ALM process. The central element for the entire ALM exercise is the availability of timely, adequate and accurate information. Considering the customer profile and inadequate support system for collecting information required for ALM which analyses various components of assets and liabilities on the basis of residual maturity and behavioral pattern.

2. ALM Organization

The Bank shall have over and all responsibility for management of risk and shall decide the Risk Management Policy and procedure, set prudential limits, auditing report and review mechanism in respect of liquidity interest rates.

3. ALM PROCESS :

This includes Risk Parameters, Risk Identifications, Risk Measurements, Risk Management and Risk Policies, Tolerance Levels. Liquidity Risk Management & Interest Risk Management are most important tools and guidelines for cooperative banks.

Risk can be defined as the uncertainty in outcome or more specifically as volatility of unexpected outcomes. There are financial risks and non financial risks. Non financial risks are business risks and strategic risks, financial risks are classified into broad categories of liquidity risk, market risk, credit risk, operational risks and legal risks etc.

a) Liquidity Risk

Usually there are two forms of liquidity risk

- i) Market or product liquidity
- ii) Cash flow or funding

Market or product liquidity i.e. the first type of risk arises when a transaction cannot be conducted at prevailing market prices due to insufficient market activity. The liquidity risk is very difficult to quantify and it can vary across market conditions. The market or product liquidity risk can be managed by setting limits on certain market or products and by means of diversification.

The cash flow or funding type of risk refers to inability to meet cash flow and obligations, which may force early liquidation. Funding risks can be controlled by proper planning of cash flow needs and by diversification.

Measuring and managing liquidity needs are vital for effective operation of the cooperative banks. The bank should measure not only liquidity position on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions/scenario. Liquidity measurement is quite a different task and can be measured through stock or cash flow approaches. The stock approach uses certain liquidity ratio i.e. credit deposit ratio, loans to total assets, loans to core deposits etc. While the liquidity ratios are the ideal indicators of a liquidity of banks operating in developed financial markets, the ratio do not reveal the real liquidity profile of a bank which is operating generally in an illiquid market. Thus analysis of the liquidity involves tracking of cash flow mismatches(flow approach). The main focus should be on short term mismatching ie. 1-14 and 15-28 days time band. The mismatches (negative gap between cash inflows and outflows) during 1-14 and 15-28 days time band in normal course should not exceed 20% of the cash outflows in each time band.

The statement of structural liquidity may be prepared by placing all cash inflows and outflows in the maturity ladder according to expected time of cash flows. A maturity liability will be a cash outflow while a maturing assets will a cash inflow in order to enable the bank to monitor their short term liquidity on a dynamic basis over a time horizon spanning from 1-90 days through short term liquidity profiles on the basis of business projections and other commitments for planning purposes.

Maturity profile to be used for measuring the future cash flow in different bands is given as under :

Maturity Profile - Liquidity

Heads of Accounts	Classification into time bands
A. Outflows	
1. Capital, Reserves and Surplus	Over 5 years band.
2. Demand Deposits (Current and Savings Bank Deposits)	Savings Bank and Current Deposits may be classified into volatile and core portions. Generally 10 % of Savings Bank and 15 % of Current Deposits are withdrawable on demand. This portion may therefore be treated as volatile. While volatile portion can be placed in the first time band i.e., 1-14 days, the core portion may be placed in over 1-3 years time band.
	The above classification of Savings Bank and Current Deposits is only a benchmark. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures; etc. on the basis of past data / empirical studies could classify them in the appropriate time bands, i.e. behavioural maturity instead of contractual maturity, subject to the approval of the Board / ALCO.
3. Term Deposits, Long Term Deposits (Tier II)	Respective residual (remaining period to maturity) time bands. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures, etc. on the basis of past data / empirical studies could classify the retail deposits in the appropriate time bands on the basis of behavioural maturity rather than residual maturity. However, the wholesale deposits (deposits over Rs.15 lakhs and interbank deposits) should be shown under respective residual time bands.
4. Certificates of Deposit, Borrowings and Bonds (including Sub-ordinated Debt)	Respective residual time bands.
5. Other Liabilities and Provisions	
i. Bills Payable	1-14 days time band.
ii. Branch Adjustments	The net credit balance may be shown in 1-14 days time band.
iii. Provisions other than for loan loss and depreciation in investments	Respective time bands depending on the purpose.
iv Other Liabilities	Respective time bands. Items not representing cash payables (i.e. guarantee fee received in advance, etc.) may be placed in over 5 years time bands.
B. Inflows	
1. Cash	1-14 days time bands.

2. Balances with RBI / Public Sector Banks and SCBs and DCCBs for CRR / SLR purpose.	While the excess balance over the required CRR / SLR may be shown under 1-14 days time bands, the Statutory Balances may be distributed amongst various time bands corresponding to the maturity profile of DTL with a time-lag of 28 days.
3. Balances with other Banks	
(i) Current Account	(i) Non-withdrawable portion on account of stipulations of minimum balances may be shown under over 1-3 years time band and the remaining balances may be shown under 1-14 days time band.
(ii) Money at Call and Short Notice, Term Deposits , Long Term Deposits (Tier II) and other placements	(ii) Respective residual maturity time bands.
4. Investments (Net of provisions)	
(i) Approved securities	(i) Respective residual maturity time bands excluding the amount required to be reinvested to maintain SLR corresponding to the DTL profile in various time bands.
(ii) PSU bonds, CDs and CPs. Units of eligible categories of mutual funds (close ended), etc.	(ii) Respective residual time bands. Investments classified as NPIs should be shown under over 3-5 years time bands (sub-standard) or over 5 years time band (doubtful).
(iii) Equity of All India FIs and co-operatives Units of eligible categories of mutual funds (open ended)	(iii) Listed shares in 1-14 days bucket, with a haircut of 50% Other shares in 'Over 5 years' bucket.. Units of eligible categories of mutual funds (open ended) may be kept under 1-14 days bucket.
(iv) Securities in the Trading Book	(v) 1-14, 15-28 and 29-90 time bands corresponding to defeasance periods.
5. Advances (Performing)	
i) Bills Purchased and Discounted (including bills under DUPN)	(i) Respective residual maturity time bands.
ii) Cash Credit / Overdraft (including TOD) and Demand Loan component of Working Capital.	(ii) Banks should undertake a study of behavioural and seasonal pattern of availments based on outstandings and the core and volatile portion should be identified. While the volatile portion could be shown in the near-term maturity time bands, the core portion may be shown under over 1-3 year time band.
iii) Term Loans	(iii) Interim cash flows (instalments) should be shown under respective maturity time bands.
6. NPAs (Net of provisions, Overdue Interest Reserves and claims received from ECGC / DICGC	
i) Sub-standard	i) Over 3-5 years time band.
ii) Doubtful and Loss	ii) Over 5 years time band.
7. Fixed Assets	
8. Other Assets	
i) Branch Adjustments	The net debit balance may be shown in 1-14 days time band. Intangible assets and assets not representing cash receivables may be shown in over 5 years time band.
ii) Leased Assets	Interim cash flows may be shown under respective residual maturity time bands.
C. Contingent Liabilities / Lines of Credit committed / available and other inflows / Outflows	

1. Unavailed portion of Cash Credit / Overdraft / Demand loan component of Working Capital limits (outflow)	(i) Banks should undertake a study of the behavioural and seasonal pattern of potential availments in the accounts and the amounts so arrived at may be shown under relevant residual maturity-time bands within 12 months.
2. Letters of Credit / Guarantees devolvement (outflow)	Based on past history, these should be distributed across time bands.
3. Interest payable / receivable (outflow / inflow) - Accrued interest which are appearing in the books on the reporting day	Respective time bands.
Note :	
(i) Liability on account of event cash flows i.e. short fall in CRR / SLR balance on reporting Fridays, wage settlement, capital expenditure, etc. which are known to the banks and any other contingency may be shown under respective maturity bands.	
(ii) All overdue liabilities should be placed in the 1-14 days time band.	
(iii) Interest and instalments from advances and investments, which are overdue for less than one month may be placed in over 3-6 months, time band. Further, interest and instalments due (before classification as NPAs) may be placed in over 6-12 months time band if the earlier receivables remain uncollected.	
D. Financing of Gap	In case the negative gap exceeds the prudential limit of 20% of outflows. (1-14 and 15-28 days time bands) the bank may show by way of a foot note as to how it proposes to finance the gap to bring the mismatch within the prescribed limits. The gap can be financed from market borrowings (call/term),

b) Interest Rate Risk

The deregulation of interest rates and optional flexibility given to banks in pricing most of the assets and liabilities to imply need for the banking system to hedge the interest rate risk. The interest rate risk is the risk where changes in the market interest rate might adversely affect the bank's financial condition both current as well as future earnings. Interest rates on term deposits are fixed till their maturity, whereas the interest rate on advances are subject to change from time to time.

The risk from earning prospective can be measured as changes in the net interest income (NII) or net interest margin (NIM). The traditional gap analysis is considered as a suitable method to measure the interest rates risk for the banks. 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 rates sensitive liabilities and rate sensitive assets (including off-balance sheet positions). All investment, advances, borrowings etc that mature/reprice within a specified time frame are interest rates sensitive and repayment of loan installments is also rate sensitive. Thus gap has to be identified in the following bands and corrective measures be taken accordingly, with regard to various time buckets commencing 1028 days and onward

- i) Day 1
- ii) 2 to 7 days
- iii) 8 to 14 days
- iv) 15 to 30 days
- v) 31 Days to 2 Months
- vi) Over 2 Months to 3 months
- vii) Over 3 months and upto 6 months
- viii) Over 6 months and upto 1 year
- ix) Over 1 year and upto 3 years
- x) Over 3 years and upto 5 years
- xi) Over 5 years

The Various items of rate sensitive assets and liabilities and off-balance sheet items may be classified as under :

Heads of Accounts	Rate sensitivity and time band
Liabilities	
1. Capital, Reserves and Surplus	Non-sensitive.
2. Current Deposits	Non-sensitive.
3. Savings Bank Deposits	Sensitive to the extent of Interest paying (core) portion. This should be included in over 3-6 months time band. The non-interest-paying portion may be shown in non-sensitive band.
4. Term Deposits, Long Term Deposits (Tier II) and Certificates of Deposit	Sensitive: reprices or resetting of interest rates on maturity. The amounts should be distributed to different time bands on the basis of remaining term to maturity.
5. Borrowings – Fixed	Sensitive: reprices on maturity. The amounts should be distributed to different time bands on the basis of remaining maturity.
6. Borrowings – Floating	Sensitive: reprices when interest rate is reset. The amounts should be distributed to the appropriate time band that refers to the resetting date.
7. Borrowings - Zero Coupon	Sensitive: reprices on maturity. The amounts should be distributed to the respective maturity time band.
8. Borrowings from RBI	Upto 3 months time band.
9. Refinances from other Agencies	(a) Fixed rate : As per respective Maturity. (b) Floating rate : Reprices when Interest rate is Reset.
10. Other Liabilities and Provisions	
i) Bills Payable	i) Non-sensitive.
ii) Branch Adjustments	ii) Non-sensitive.
iii) Provisions	iii) Non-sensitive.
iv) Others	iv) Non-sensitive.
11. Repos / Bills Re-discounted (DUPN). Swaps (Sell / Buy) etc.	Sensitive reprices only on maturity and should be distributed to the respective maturity bands.
Assets	
1. Cash	Non-sensitive.
2. Balances with RBI	Interest earning portion may be shown in over 3-6 months time band. The balance amount non-sensitive.
3. Balances with other Banks	
i) Current Account	i) Non-sensitive.
ii) Money at Call and Short Notice, Term Deposits , Long Term Deposits (Tier II) and other placements	ii) Sensitive on maturity. The amounts should be distributed to the respective maturity bands.

4. Investments (Performing)	
i) Fixed Rate / Zero Coupon	i) Sensitive on maturity.
ii) Floating Rate	ii) Sensitive at the next repricing date
5. Shares of All India FIs and other cooperatives / eligible categories of mutual funds.	Sensitive, may be shown under 3 months category.

6. Advances (Performing)	
(i) Bills Purchased and Discounted (including bills Under DUPN)	(i) Sensitive on maturity.
(ii) Cash Credits / Overdrafts (including TODs) / Loans repayable on demand and Term Loans	(ii) Sensitive; may be shown under over 3-6 months time band.
7. NPAs (Advances and Investments)*	
(i) Sub-Standard	(i) Over 3-5 years time band.
(ii) Doubtful and Loss	(ii) Over 5 years time band.
8. Fixed Assets	Non-sensitive.
9. Other Assets	
(i) Inter-office Adjustment	(i) Non-sensitive.
(ii) Leased Assets	(ii) Sensitive on cash flows. The amounts should be distributed to the respective maturity bands corresponding to the cash flow dates.
(iii) Others	(iii) Non-sensitive.
10. Reverse Repos, Swaps (Sell / Buy) and Bills Rediscounted (DUPN)	Sensitive on maturity.
11. Other products (Interest Rate)	
(i) Swaps	(i) Sensitive and should be distributed under different bands with reference to maturity.
(ii) Other	(ii) Should be suitably classified as and when introduced.
* Amounts to be shown net of provisions, Overdue interest Reserve and claims received from ECGC	

c) Market Risks

Market risks are those which cause volatility in earning or valuing to variations for market factors like interest rate, exchange rates, equity and commodity prices. Market risk can take two forms: Absolute Risks, measured by the loss potential in rupee terms on the focuses volatility of total returns and relative risk relative to the bench mark index measures risk in term of tracking error or deviation from an index.

d) Credit Risks

This risk arises when counter parties are unwilling to or unable to fulfill their contractual obligations. Its effect is measured by the cost of replacing cash flows if the other party defaults. Credit risk can also lead to losses when debtors, even when not defaulting are downgraded by credit rating agencies, usually leading to a fall in market value of their obligations (and also rise in cost of new borrowings). The loans and investments, which may not get repaid or realized timely or on date of their maturity may prove to be a potential **to the liquidity in the system**. In such cases the bank shall take immediate measures to overcome these eventualities.

e) Operational Risks

The operational risks refer to potential losses resulting from inadequate system, management failure, faulty control, fraud or human error. This includes execution risks which encompasses situations whether trade fails to be executed. Operational risk also includes fraud, situation where traders intended to falsify information and technology risks, which refers to the need to protect systems from unauthorized access and tempering. The best protection against operational risks consist of redundancies of systems, clearing separation of responsibility with strong internal control and regular contingency planning.

f) Legal Risks

Legal risks includes compliance and regulatory risks, which concern activities that might breach Government regulations, such as market manipulations insider trading and suitability restrictions. The imperfect understanding of regulations can lead to penalties. Regulatory risk manifests itself in enforcement actions, and interpretations. The bank shall exercise all caution and to implies such a system so that no violations/lapses occur.

g) Options Risks

Customers/borrowers may opt with pre-payment or before maturity payment of their loans and withdraw their deposits before maturity. This should also pose the liquidity problem. The funds management has to be in such a manner that bank may not get exposed liquidity crunch.

h) Reputation Risks

Reputation risk may lead to tarnish its reputation through any adverse publicity. In such a situation there may be a run on withdrawal of deposits from the bank which may lead to serious liquidity crunch. The bank should remain prepared to meet such challenge by getting its investment uplifted so as to enable the bank to meet the demand of depositors and keep its reputation.

4. The Asset - Liability Committee

Consisting of Bank's Senior Managers including the Managing Director/Chief Executive Officer shall be responsible for ensuring adherence to the policies and limits set by the Board as well as decided the business strategy (on the assets and liabilities side) in the Bank's business and Risk Management objectives. The composition of the Asset – Liability committee (ALCO) of the bank consisting of the following members:

- 1) The Managing Director/Chief Executive Officer
- 2) Senior Manager/Manager, Head Office
- 3) Two Managers from the branches
- 4) The IT Head

The committee shall be headed by the Managing Director/Chief Executive Officer of the bank responsible for analyzing, monitoring and reporting the risk profile with the support of operating staff. The supporting staff should also prepare forecast showing effects of various possible changes in market conditions to the balance sheet and recommend the action needed to adhere the banks internal limit. Its composition may be changed/reviewed as and when required.

In view of the size/business, the committee shall meet at least once in a quarter to discuss asset liability management issues viz a viz statement of structural liquidity, statement of interest rates sensitivity and statement of short term dynamic liquidity. The

Committee may meet more frequently to assess and review the reports/ procedures to ensure adherence with policy and regulatory guidelines issued, if needed. It should take decision after measuring the future cash flows in different time bands. The committee recommendations/observations/actions may be put up before the Board on quarterly basis.

5. Reporting :

The assets and liability management, statements/returns shall be prepared as on the last reporting Friday of March/June/September/December or any other day or period specified by Reserve Bank of India from time to time, shall be placed before the Board/committee within a month from the last reporting Friday for its necessary perusal and approval prior to submitting the statements as required within stipulated time frame.

6. Revision:

The Board shall review its policy once in a financial year and shall recommend or make the required changes.