ASSET LIABILITY MANAGEMENT POLICY OF ELARA FINANCE (INDIA) PRIVATE LIMITED

SECTION 1: BACKGROUND AND SCOPE

Elara Finance (India) Private Limited (hereinafter referred to as EFPL), similar to industry peers and other NBFC's, is exposed to credit and liquidity risks in view of the Asset-Liability transformation in its business operations. With significant evolution of Indian financial markets over the last few years, the risks associated with business operations have become complex and require continuous monitoring & strategic management. EFPL is operating in a fairly regulated environment and is required to continuously monitor its liquidity and borrowing profile on a dynamic basis in conjunction with its onward lending portfolio.

Intense competition for business involving dynamic movement in asset and liabilities is expected to keep increasing pressure to maintain a fine balance amongst spreads, profitability and long term viability. Any gap in asset liability management can put EFPL business earnings and reputation at great risk. This responsibility calls for structured and comprehensive business measures and not just ad hoc actions. The management of EFPL have to base their business decisions on dynamic and integrated management information systems and robust processes driven by comprehensive strategy. EFPL is exposed to several kinds of risks in the course of business such as; credit risk, interest rate risk, liquidity risk, and operational risk. It is therefore important that EFPL introduce effective management system that addresses the issues relating to these risks.

EFPL needs to address above stated risks in a structured manner by continuously upgrading risk management processes and by adopting more comprehensive Asset Liability Management (ALM) practices through implementation of this policy. ALM similar to other functions; is also concerned with risk management and provides comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate risks that EFPL is faced with. It requires the financial systems and management information systems to be closely integrated with the EFPL's business strategy. It involves assessment of various types of risks and alteration of the asset-liability portfolio in a dynamic manner in order to manage risks.

Having understood the significance of sound ALM practices, EFPL has laid down broad guidelines in respect of interest rate and liquidity risk management, which form part of the Asset-Liability Management (ALM) function. The primary focus of the ALM function is to enforce the risk management discipline i.e. managing business after assessing the risks involved. The objective of good risk management systems is that these systems continue to evolve into a strategic tool for ongoing business management.

SECTION 2: ALM PROCESS

The ALM process followed by EFPL rests on three pillars:

A. ALM Organisation

- Structure and responsibilities
- Level of top management involvement

B. ALM Process

- Risk parameters
- Risk identification
- Risk measurement
- Risk management
- Risk policies and tolerance levels

C. ALM Information Systems

- Management Information Systems
- Information availability, accuracy, adequacy and expediency

SECTION 3: ALM ORGANISATION

Successful implementation of the risk management process requires strong commitment on the part of the senior management in the company, to integrate basic operations and strategic decision making with risk management. The Board of Directors have overall responsibility to determine the risk management policy and to manage business liquidity & interest rate risks.

The Asset - Liability Committee (ALCO) consisting of following members is responsible for ensuring adherence to the policy approved by the Board as well as for deciding the business strategy of the company (on the assets and liabilities sides) in line with the company's budget and risk management objectives.

1. Mr. Rakesh Puri, Director
2. Mr. Kamal Kishore Sati, Director

The ALCO is the primary decision making unit responsible for balance sheet planning from risk / return perspective including the strategic management of interest rate and liquidity risks. The business and risk management strategy of the company will ensure that the company operates within the parameters set by the committee. The business issues that an ALCO would consider, inter alia, will include product pricing for both borrowings and onward lending portfolio, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rates offered by peer NBFCs for the similar services/products, etc. In addition to monitoring the risk levels of the company, The ALCO should review ongoing 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 decide future business strategy. In respect of the funding policy, for instance, its responsibility would be to decide on source and mix of liabilities. Towards this end, it will have to develop view on future direction of interest rate movements and decide on funding mixes between fixed v/s floating rate funds, money market v/s capital market funding, domestic v/s foreign currency funding, etc.

SECTION 4: ALM PROCESS

The scope of ALM function can be described as follows:

• Liquidity risk management

• Interest rate risk management
• Management of asset liability match & maturity profiles
• Funding requirements and capital planning
• Profit and growth projection
• Forecasting and analysing 'What if scenarios'
• Cost of funds budgeting

SECTION 5: ALM INFORMATION SYSTEMS

ALM framework has to be supported by the management philosophy which clearly specifies the risk policies and tolerance parameters. 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.

There are various methods prevalent world-wide for measuring risks. These range from the simple Gap Statement to extremely sophisticate and data intensive Risk Adjusted capital adequacy / Profitability Measurement methods.

The central element of the ALM is the availability of adequate and accurate information in a timely manner; and the systems support for data availability. Adequate measures should be taken to report accurate data in a timely manner through enhanced use of management information systems for ongoing review of business liquidity & ALM profile.

SECTION 6: LIQUIDITY RISK MANAGEMENT

6.1 Measuring and managing liquidity needs are vital for effective operations of the 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. Assets commonly considered as liquid like Government securities and other money market instruments, could also become illiquid when the market and players are unidirectional. Therefore, 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.

6.2 The Maturity Profile based on ALM 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 less than or equal to 1 month
ii. Greater than 1 month and less than or equal to 2 months
iii. Greater than 2 months and less than or equal 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

Any mismatches between bucket-wise cash inflows and cash outflows need to be closely monitored at all times. Any mismatches up to one year would be more sensitive since these provide early warning signals of potential liquidity problems. The main focus should be on the short-term mismatches viz. from 1 month to 3 month buckets where the negative gap in normal course should not exceed 15% of cash outflows in these time buckets. EFPL, 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 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 the asset - liability risk profile. While analyzing any mismatch in any categories, the management will take into account all relevant factors based on the asset-liability base, nature of mismatch, strategy to address any identified issues etc.

6.3 In order for company to monitor the short-term liquidity on a dynamic basis over the 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.

SECTION 7: CURRENCY RISK

The company does not have any currency risk as of now as there are no transactions entered into by the company which involve currency risk. However, in future, if any foreign currency transactions are entered into, the company will take appropriate measures to check currency risk.

SECTION 8: INTEREST RATE RISK (IRR)

Interest rate risk is the risk where changes in market interest rates might adversely affect company’s financial condition. The operational flexibility in pricing company assets and liabilities imply the need for considering hedging of interest Rate Risk. The changes in interest rates affect company in many ways. 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 EFL is funding loans which are always fixed interest rate loans. The loans borrowed from banks are mostly at floating rates. 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 are finalized.

BOARD OF DIRECTORS MEETINGS AND REVIEW

The Board of Directors, in their board meetings, will oversee the implementation of the system and review its functioning periodically.