K Z LEASING AND FINANCE LIMITED

ASSET – LIABILITY MANAGEMENT (ALM) POLICY

OBJECTIVES:

The key objective shall be liquidity management which refers to liability of the firm 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 adequate support system for collecting information required for ALM which analyses various components of assets and liabilities on the basis of residual maturity and behavioural pattern.

2. ALM Organization

The Firm 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. 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 ricks, 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 firms. The firm 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. While the liquidity ratios are the ideal indicators of a liquidity of firms operating in developed financial markets, the ratio do not reveal the real liquidity profile of a firm which is operating generally in an illiquid market.

b) Interest Rate Risk

The deregulation of interest rates and optional flexibility given to firms in pricing most of the assets and liabilities to imply need for the firming system to hedge the interest rate risk. The interest rate risk is the risk where changes in the market interest risk might adversely affect the firm'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 is 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 firms. 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 instalments is also rate sensitive.

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 fulfil 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 firm 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 consists of redundancies of systems, clearing separation of responsibility with strong internal control and regular contingency planning.

f) Legal Risks

Legal risks include 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 firm 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 firm 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 firm which may lead to serious liquidity crunch. The firm should remain prepared to meet such challenge by getting its investment uplifted so as to enable the firm to meet the demand of depositors and keep its reputation.

4. The Asset - Liability Committee

Consisting of Firm's Senior Managers including the Managing Director 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 Firm's business and Risk Management objectives. The composition of the Asset – Liability committee (ALCO) of the firm consisting of the following members:

1) The Managing Director
2) CFO
3) Director

The committee shall be headed by the Managing Director of the firm responsible for analysing, 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 firms 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 ensuring the future cash flows in different time bands. The committee recommendations/ observations/actions may be put up before the Board on quarterly basis.

5. Revision

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