

Guidelines for Asset Liability Management system in Housing Finance Companies

In the normal course, Housing Finance Companies (HFCs) are exposed to credit and market risks in view of the asset-liability transformation. With liberalisation in Indian financial markets over the last few years and growing integration of the domestic markets with external markets, the risks associated with the operations of an HFC have become complex and large, requiring strategic management. HFCs are operating in a fairly deregulated environment and are required to determine on their own, interest rates on advances and deposits, subject to the ceiling on maximum rate of interest they can offer on deposits, on a dynamic basis. The interest rates on investments of HFCs in government and other securities are also now market related. Intense competition for business involving both the assets and liabilities has brought pressure on the managements of HFCs to maintain a good balance amongst spreads, profitability and long-term viability. These pressures call for structured and comprehensive measures and not just *ad hoc* action. The managements of HFCs have to base their business decisions on a dynamic and integrated risk management system and process driven by corporate strategy. HFCs are exposed to several major risks in the course of their business - credit risk, interest rate risk, equity/commodity price risk, liquidity risk and operational risk. It is, therefore, important that HFCs introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.

2. HFCs need to address these risks in a structured manner by upgrading their risk management and adopting more comprehensive Asset-Liability Management (ALM) practices than has been done hitherto. ALM, among other functions, is also concerned with management of risks and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate risks of an HFC that need to be closely integrated with the HFC's business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

3. This note lays down broad guidelines for HFCs in respect of systems for management of liquidity and interest rate risks which forms part of the ALM function. The initial focus of the ALM function would be to enforce the discipline

of market risk management viz. managing business after assessing the market risks involved. The objective of a good risk management system should be to evolve into a strategic tool for effective management of HFCs.

4. The ALM process rests on three pillars:

- ALM Information System
 - ⇒ Management Information Systems 9- n
 - ⇒ 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 tolerance levels

ALM Information Systems

5.1 ALM has to be supported by a management philosophy that clearly specifies the risk policies and tolerance limits. This framework needs to be built on sound methodology with necessary supporting information system as the central element of the entire ALM exercise is the availability of adequate and accurate information with expedience. 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 sophisticated and data intensive Risk Adjusted Profitability Measurement methods. The systems existing in some of the major HFCs do not generate information in the manner required for ALM. Collecting accurate data in a timely manner will be the biggest challenge before the HFCs, particularly those lacking full-scale x. However, the introduction of base information system for risk measurement and monitoring has to be addressed urgently.

5.2 HFCs have heterogeneous organisational structures, capital base, asset sizes, management profile, and geographical spread. Some of them have large number of branches and agents/brokers whereas some have unitary offices. Considering the present network of branches and the lack of (an adequate) support system to collect information required for ALM which analyses information on the basis of residual maturity and re-pricing pattern of liabilities and assets, it will take time for HFCs in the present state to get the requisite information. In respect of investment portfolio and funds management, in view of the centralised nature of the functions, it would be much easier to collect reliable information. The data and assumptions can then be refined over time as the HFC management gain experience of conducting business within an ALM framework. The spread of computerisation will also help HFCs in accessing data.

ALM Organisation

6.1 a) Successful implementation of the risk management process would require strong commitment on the part of the senior management in the HFC, to integrate basic operations and strategic decision making with risk management. The Board should have overall responsibility for management of risks and should decide the risk management policy of the HFC and set limits for liquidity, interest rate, exchange rate and equity price risks.

b) The Asset-Liability Committee (ALCO) consisting of the HFC's senior management including the Chief Executive Officer (CEO) should be responsible for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of the HFC (on the assets and liabilities sides) in line with the HFC's budget and decided risk management objectives.

c) 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) reflecting the impact of various possible changes in market conditions on the balance sheet and recommend the action needed to adhere to HFC's internal limits.

6.2 The ALCO is a decision-making unit responsible for integrated balance sheet management from risk-return perspective including the strategic management of interest rate and liquidity risks. Each HFC will have to decide on the role of its ALCO, its powers and responsibilities as also the decisions to be taken by it. The business and the risk management strategy of the HFC should

ensure that it operates within the limits/parameters set by the Board. The business issues that an ALCO would consider will, *inter alia*, include product pricing for both deposits and advances, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rates offered by other peer HFCs for similar services/product, etc. In addition to monitoring the risk levels of the HFC, the ALCO should review the results of and progress in implementation of the decisions made in the previous meetings. The ALCO would also articulate the current interest rate view of the HFC and base its decisions for future business strategy on this. In respect of the funding policy, for instance, its responsibility would be to decide on the source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between fixed vs. floating rate funds, wholesale vs. retail funds, money market vs. capital market funding, domestic vs. foreign currency funding, etc. Individual HFCs will have to decide the frequency of holding their ALCO meeting.

Composition of ALCO

6.3 The size (number of members) of ALCO would depend on the size of each institution, business mix and organisational complexity. To ensure commitment of the Top Management and timely response to market dynamics, the CEO/CMD/President or the ED should head the Committee. The Chiefs of Investment, Credit, Resources Management or Planning, Funds Management/Treasury, International Business and Economic Research can be members of the Committee. In addition, the Head of the Technology Division should also be an invitee for building up of MIS and related computerisation. Large HFCs may even have Sub-committees and Support Groups.

Committee of Directors

6.4 The Management Committee of the Board or any other Specific Committee constituted by the Board should oversee the implementation of the ALM system and review its functioning periodically.

ALM Process

7. The scope of ALM function can be described as under:

- Liquidity risk management
- Management of market risks
- Funding and capital planning
- Profit planning and growth projection
- Forecasting and analysing 'what if scenario' and preparation of contingency plans

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

Liquidity Risk Management

8.1 Measuring and managing liquidity needs are vital for effective operation of HFCs. By assuring an HFC'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 transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. HFCs' management should measure not only the liquidity positions of HFCs on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that assets commonly considered to be liquid, such as 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. The format of the Statement of Liquidity is given in Annex I.

8.2 The Maturity Profile, as detailed in Appendix I, could be used for measuring the future cash flows of HFCs in different time buckets. The time buckets may be distributed as under:

- i. 1 day to 30/31 days (one month)
- ii. Over one month and upto 2 months
- iii. Over 2 months and upto 3 months
- iv. Over 3 months and upto 6 months
- v. Over 6 months and upto 1 year
- vi. Over 1 year and upto 3 years

- vii. Over 3 years and upto 5 years
- viii. Over 5 years and upto 7 years
- ix. Over 7 years and upto 10 years
- x. Over 10 years

8.3 HFCs holding public deposits are required to invest a prescribed percentage of their deposits in approved securities in terms of liquid asset requirement under Section 29B of the NHB Act, 1987. There is no such requirement for HFCs which are not holding deposits. Thus various HFCs would be holding in their investment portfolio securities which could be broadly classifiable as 'mandatory securities' (under obligation of law) and other 'non-mandatory securities'. The HFCs holding deposits may be given freedom to place the mandatory securities in any time buckets as suitable for them. The listed non-mandatory securities may be placed in any of the "1 day to 30/31 days (One month)", "Over one month and upto 2 months" and "Over two months and upto 3 months" buckets depending upon the defeasance period proposed by HFCs. The unlisted non-mandatory securities (e.g., equity shares, securities without a fixed term of maturity, etc.) may be placed in the "over 10 years" bucket, whereas unlisted non-mandatory securities having a fixed term of maturity may be placed in the relevant time bucket as per the residual maturity. The mandatory securities and listed securities may be marked to market for the purpose of the ALM system. Unlisted securities may be valued as per the Prudential Norms.

8.4 Alternatively, the HFCs may also follow the concept of Trading Book which is as under:

- i. The composition and volume are clearly defined;
- ii. Maximum maturity/duration of the trading portfolio is restricted;
- iii. The holding period does not exceed 90 days;
- iv. Cut-loss limit(s) are prescribed;
- v. Product-wise defeasance periods (i.e. the time taken to liquidate the position on the basis of liquidity in the secondary market) are prescribed;

HFCs which maintain such 'Trading Books' consisting of securities that comply with the above standards may show the trading securities under "1 day to 30/31 days (one month)", "over one month and upto 2 months" and "over 2 months and upto 3 months" buckets on the basis of the defeasance periods. The Board/ALCO of the HFCs should approve the volume, composition, maximum

maturity/duration, holding/defeasance period, cut loss limits, etc., of the 'Trading Book' . The remaining investments should also be classified as short term and long term investments as required under Prudential Norms.

8.5 A copy of the policy note recorded by the HFCs on treatment of the investment portfolio for the purpose of ALM and approved by their Board/ALCO should be forwarded to the NHB.

8.6 Within each time bucket there could be mismatches depending on cash inflows and outflows. While the mismatches upto one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-30/31 days. HFCs, however, are expected to monitor their cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the Board/ Management Committee. The mismatches (negative gap) during 1-30/31 days, in normal course, should not exceed 15 per cent of the cash outflows in this time bucket. If an HFC, in view of its current asset-liability profile and the consequential structural mismatches, needs higher tolerance level, it could operate with higher limit sanctioned by its Board/Management Committee giving specific reasons on the need for such higher limit. The discretion to allow a higher tolerance level is intended for a temporary period, i.e. till September 30, 2002.

8.7 The Statement of Structural Liquidity (Annex I) may 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 inflow/ outflows, HFCs have to make a number of assumptions according to their asset-liability profiles. While determining the tolerance levels, the HFCs may take into account all relevant factors based on their asset-liability base, nature of business, future strategies, etc. The NHB is interested in ensuring that the tolerance levels are determined keeping all necessary factors in view and further refined with experience gained in Liquidity Management.

8.8 In order to enable the HFCs to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, HFCs may estimate their short-term liquidity profiles on the basis of business projections

and other commitments for planning purposes. An indicative format (Annex II) for estimating Short-term Dynamic liquidity is enclosed.

Currency Risk

9. Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of HFCs' balance sheets having foreign assets or liabilities. The increased capital flows across free economies following deregulation have contributed to increase in the volume of transactions. Large cross border flows together with the volatility may render the HFCs' balance sheets vulnerable to exchange rate movements.

Interest Rate Risk

10.1 The operational flexibility given to HFCs in pricing most of the assets and liabilities imply the need for the financial system to hedge the interest rate risk. Interest rate risk is the risk where changes in market interest rates might adversely affect an HFC's financial condition. The immediate impact of changes in interest rates is on HFC's earnings (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on HFC's Market Value of Equity (MVE) or Net Worth as the economic value of the assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value perspective', respectively. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). There are many analytical techniques for measurement and management of interest rate risk. To begin with, the traditional Gap analysis is considered to be a suitable method to measure the interest rate risk in the initial phase of the ALM system. It is the intention of NHB to move over to the modern techniques of interest rate risk measurement like Duration Gap Analysis, Simulation and Value at Risk over time when HFCs acquire sufficient expertise and sophistication in acquiring and handling MIS.

10.2 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 including off-balance sheet positions. An asset or liability is normally classified as rate sensitive if:

- i) within the time interval under consideration, there is a cash flow;
- ii) the interest rate resets/reprices contractually during the interval;
- iii) it is contractually pre-payable or withdrawable before the stated maturities;
- iv) It is dependent on the changes in the Bank Rate by RBI.

10.3 The Gap Report should be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time buckets according to residual maturity or next re-pricing period, whichever is earlier. All investments, advances, deposits, borrowings, purchased funds, etc. that mature/re-price within a specified time-frame are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the HFC expects to receive it within the time horizon. This includes final principal repayment and interim instalments. Certain assets and liabilities carry floating rates of interest that vary with a reference rate and hence, these items get re-priced at pre-determined intervals. Such assets and liabilities are rate sensitive at the time of re-pricing. While the interest rates on term deposits are generally fixed during their currency, the tranches of advances are basically floating. The interest rates on advances could be re-priced any number of occasions, corresponding to the changes in PLR.

The interest rate gaps may be identified in the following time buckets:

- i. 1 day to 30/31 days (one month)
- ii. Over one month to 2 months
- iii. Over 2 months to 3 months
- iv. Over 3 months to 6 months
- v. Over 6 months to 1 year
- vi. Over 1 year to 3 years
- vii. Over 3 years to 5 years
- viii. Over 5 years to 7 years
- ix. Over 7 years to 10 years
- x. Over 10 years
- xi. Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items may be classified into various time-buckets, as explained in Appendix II and the Reporting Formats for short term dynamic liquidity and interest rate sensitive assets and liabilities are given in Annex II and Annex III, respectively.

10.4 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 institution is in a position to benefit from rising interest rates 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.

10.5 Each HFC should set prudential limits on individual Gaps in various time buckets with the approval of the Board/Management Committee. Such prudential limits should have a relationship with the Total Assets, Earning Assets or Equity. In addition to the interest rate gap limits, the HFCs may set the prudential limits in terms of Earnings at Risk (EaR) or Net Interest Margin (NIM) based on their views on interest rate movements with the approval of the Board/ALCO.

General

11.1 The classification of various components of assets and liabilities into different time buckets for preparation of Gap reports (Liquidity and Interest Rate Sensitivity) as indicated in Appendices I & II is the benchmark. HFCs which are better equipped to reasonably estimate the behavioural pattern of various components of assets and liabilities on the basis of past data/empirical studies could classify them in the appropriate time buckets, subject to approval by the ALCO/Board. A copy of the note approved by the ALCO/Board may be sent to the NHB.

11.2 The present framework does not capture the impact of premature closure of deposits and pre-payment of loans and advances on the liquidity and interest rate risks profile of HFCs. The magnitude of premature withdrawal of deposits during the periods of volatility in market interest rates is quite substantial. HFCs should therefore evolve suitable mechanism, supported by empirical studies and behavioural analysis, to estimate the future behaviour of assets, liabilities and off-balance sheet items to changes in market variables and estimate the probabilities of options.

11.3 A scientifically evolved internal transfer pricing model by assigning values on the basis of current market rates to funds provided and funds used is an important component for effective implementation of ALM System. The transfer price mechanism can enhance the management of margin i.e. lending or credit spread, the funding or liability spread and mismatch spread. It also helps centralising interest rate risk at one place which facilitate effective control and management of interest rate risk. A well defined transfer pricing system also provide a rational framework for pricing of assets and liabilities.



Maturity Profile for Liquidity Statement**A. OUTFLOWS**

Heads of Account	Time-bucket category
1. Capital funds :	
a) Equity capital, non-redeemable or perpetual preference capital, Reserves, Funds and Surplus	The 'Over 10 years' time-bucket.
b) Preference capital - redeemable/non-perpetual	As per the residual maturity of the shares.
2. Gifts, grants, donations and benefactions	The 'Over 10 years' time-bucket. However, if such gifts, grants, etc., are tied to specific end-use, then these may be slotted in the time- bucket as per purpose/end-use specified.
3. Notes, Bonds and debentures :	
a) Plain vanilla bonds/debentures	As per the residual maturity of the instruments
b) Bonds/debentures with embedded call / put options (including zero-coupon/deep discount bonds)	As per the residual period for the earliest exercise date for the embedded option.
c) Fixed rate notes	As per the residual maturity
4. Deposits :	
a) Term deposits from public	As per the residual maturity
b) Inter corporate deposits	These, being institutional/wholesale deposits, should be slotted as per their residual maturity
c) Certificates of deposit	As per the residual maturity
5. Borrowings	
a) Term money borrowings	As per the residual maturity
b) From RBI, Govt., & others	As per the residual maturity
c) Bank borrowings in the nature of WCDL, CC, etc.	As per the residual maturity
5. Current liabilities and provisions:	
a) Sundry creditors	As per the due date or likely timing of cash outflows. A behavioral analysis could also be made to assess the trend of outflows and the amounts slotted accordingly.
b) Expenses payable (other than interest)	As per the likely timing of the cash outflow.
c) Advance income received, receipts from borrowers pending adjustment	In the 'over 10 years' time-bucket as these do not involve any cash outflow.
d) Interest payable on bonds/deposits	In respective time buckets as per the due date of payment
e) Provisions for NPAs	The amount of provision may be netted out from the gross amount of the loan portfolio and the net amount of NPAs be shown as an item under inflows in stipulated time-buckets.
f) Provision for investments portfolio	The amount may be netted from the gross value of investments portfolio and the net investments be shown as inflow in the prescribed time-slots. In case provisions are not held security-wise, the provision may be shown in 'over 10 years' bucket.
g) Other provisions	To be bucketed as per the purpose/nature of the underlying transaction.

B. INFLOWS

Heads of Account	Time-bucket category
1. Cash	In 1 to 30/31 day time-bucket.
2. Remittance in transit	In 1 to 30/31 day time-bucket.
3. Balances with banks :	

a) Current account	The stipulated minimum balance be shown in 6 months to one year bucket. The balance in excess of the minimum balance be shown in 1 to 30/31 day time bucket.
b) Deposit accounts/short term deposits	As per residual maturity.
4. Investments (net of provisions) :	
a) Mandatory investments	As suitable to the HFC
b) Non-mandatory listed	'one day to 30/31 days', 'Over one month and upto 2 months' and 'over 2 months and upto 3 months' buckets depending upon the defeasance period proposed by the HFC.
c) Non-mandatory unlisted securities (e.g. shares, etc)	Over 10 years
d) Non-mandatory unlisted securities having a fixed term maturity	As per the residual maturity
e) Venture capital units	In the 'over 10 years' time bucket
5. In case trading book is followed	
Equity shares, convertible preference shares, non-redeemable perpetual preference shares; shares of subsidiaries/joint ventures and units in open ended mutual funds and other investments	(i) Shares classified as "current investments" representing trading book of the HFC may be shown in time buckets of '1 day to 30/31 days (one month)', 'Over one month and upto 2 months' and 'over 2 months and upto 3 months' depending upon the defeasance period proposed by the HFC. (ii) Shares classified as "long term investments" may be kept in 'over 10 years' time bucket. However, the shares of the assisted units/companies acquired as part of the initial financing package, may be slotted in the relative time bucket keeping in view the pace of project implementation/time over-run, etc., and the resultant likely time-frame for divesting such shares.
6. Advances (performing) :	
a) Bill of Exchange and promissory notes discounted and rediscounted	As per the residual usance of the underlying bills.
b) Term loans (rupee loans only)	The cash inflows on account of the interest and principal of the loan may be slotted in respective time buckets as per the timing of the cash flows as stipulated in the original/revised repayment schedule.
c) Corporate loans/short term loans	As per the residual maturity
7. Non-performing loans : (May be shown net of the provisions and interest suspense held)	
a) <u>Sub-standard</u>	
i) All overdues and instalments of principal falling due during the next three years	In the 3 to 5 year time-bucket.
ii) Entire principal amount due beyond the next three years	In the time-bucket arrived at after adding 3 years to the respective due dates of various instalments of principal.
b) <u>Doubtful and loss</u>	
i) All installments of principal falling due during the next five years as also all overdues	In the 5 to 7 year bucket.
ii) Entire principal amount due beyond the next five years	In the time-bucket arrived at after adding five years to the respective due dates of various instalments of principal.
8. Assets on lease	Cash flows from the lease transaction may be slotted in respective time buckets as per the timing of the cash

	flow.
9. Fixed assets (excluding leased assets)	In the 'Over 10 years' time-bucket
10. Other assets	
(a) Intangible assets and items not representing cash inflows	In the 'Over 10 year' time-bucket
(b) Other items (such as accrued income, other receivables, staff loans, etc.)	In respective maturity buckets as per the timing of the cash flows.

C. CONTINGENT LIABILITIES

a) Letters of credit/guarantees (outflow through Devolvement)	Based on the past trend analysis of the devolvments vis-à-vis the outstanding amount of guarantees (net of margins held), the likely devolvments should be estimated and this amount could be distributed in various time buckets on judgmental basis. The assets created out of devolvments may be shown under respective maturity buckets on the basis of probable recovery dates.
b) Loan commitments pending disbursal (outflow)	In the respective time buckets as per the sanctioned disbursement schedule
c) Lines of credit committed to/by other Institutions (outflow/inflow)	As per usance of the bills to be received under the lines of credit

NOTE

- a) Any event-specific cash flows (e.g. outflow due to wage settlement arrears, capital expenses, income tax refunds, etc.) should be shown in a time bucket corresponding to timing of such cash flows.
- b) All overdue liabilities be shown in the 1 to 30/31 days time bucket.
- c) Overdue receivables on account of interest and instalments of standard loans/hire purchase assets/lease rentals should be slotted as below:

(i) Overdue for less than one month.	In the 3 to 6 month bucket.
(ii) Interest overdue for more than one month but less than seven months (i.e. before the relative amount becomes past due for six months)	In the 6 to 12 month bucket without reckoning the grace period of one month.
(iii) Principal instalments overdue for 7 months but less than one year	In 1 to 3 year bucket

FINANCING OF GAPS

The negative gap (i.e. where outflows exceed inflows) in the 1 to 30/31 days time-bucket should not exceed the prudential limit of 15 per cent of outflows of each time-bucket and the cumulative gap upto the period should not exceed 15% of the cumulative cash outflows upto one year period. In case these limits are exceeded, the measures proposed for bringing the gaps within the limit, should be shown by a footnote in the relative statement.

Interest Rate Sensitivity Profile

Heads of accounts	Time bucket for rate sensitivity
<u>A. LIABILITIES</u>	
1. Capital, Reserves & Surplus	Non-sensitive
2. Gifts, grants & benefactions	Non-sensitive
3. Notes, bonds & debentures :	
a) Floating rate	Sensitive; reprice on the roll-over/repricing date, should be slotted in respective time buckets as per the repricing dates.
b) Fixed rate (plain vanilla) including zero coupons	Sensitive; reprice on maturity. To be placed in respective time buckets as per the residual maturity of such instruments.
c) Instruments with embedded options	Sensitive; could reprice on the exercise date of the option, particularly in rising interest rate scenario. To be placed in respective time buckets as per the residual period till the immediately ensuing exercise date.
4. Deposits :	
a) Deposits/Borrowings	
i) Fixed rate	Sensitive; could reprice on maturity or in case of premature withdrawal being permitted, after the lock-in period, if any, stipulated for such withdrawal. To be slotted in respective time buckets as per residual maturity or as per residual lock-in period, as the case may be. The prematurely withdrawable deposits with no lock-in period or past such lock-in period, should be slotted in the earliest/ shortest time bucket.
ii) Floating rate	Sensitive; reprice on the contractual roll-over date. To be slotted in the respective time-buckets as per the residual period till the earliest ensuing re-pricing date.
b) ICDs	Sensitive; reprice on maturity. To be slotted as per the residual maturity in the respective time buckets.
5. Borrowings:	
a) Term-money borrowing	Sensitive; reprices on maturity. To be placed as per residual maturity in the relative time bucket.
b) Borrowings from others	
i) Fixed rate	Sensitive; reprice on maturity. To be placed as per residual maturity in the relative time bucket.
ii) Floating rate	Sensitive; reprice on the roll-over/ repricing date. To be placed as per residual period to the repricing date in the relative time bucket.
6. Current liabilities and provisions :	

a) Sundry creditors b) Expenses payable c) Swap adjustment a/c. d) Advance income received/ receipts from borrowers pending adjustment e) Provisions f) Interest payable on bonds/ deposits)))))) Non-sensitive.)))
7. Repos/bills rediscounted/forex-rupee swaps (sell/buy)	Sensitive; re-price on maturity. To be placed as per the residual maturity of the underlying transaction in respective buckets.

B. ASSETS:

1. Cash	Non-sensitive
2. Remittance in transit	Non-sensitive
3. Balances with banks in India a) In current account b) In deposit accounts, money at call and short notice and other placements	Non-sensitive. Sensitive; reprices on maturity. To be placed as per residual maturity in respective time-buckets.
4. Investments	
a) Fixed income securities (e.g. govt. securities, zero coupon bonds, bonds, debentures, cumulative/non-cumulative redeemable preference shares, etc.)	Sensitive on maturity. To be slotted as per residual maturity. However, the bonds/debentures valued by applying NPA norms due to non-servicing of interest, should be shown, net of provisions made, in the time buckets prescribed at items B.7(a) and B.7(b) in Appendix I.
b) Floating rate securities	Sensitive; re-price on the next re-pricing date. To be slotted as per residual time to the re-pricing date.
c) Equity shares, convertible preference shares, shares of subsidiaries/joint ventures, venture capital units	Non-sensitive.
5. Advances (performing)	
a) Bills of exchange, promissory notes discounted & rediscounted	Sensitive on maturity. To be slotted as per the residual usance of the underlying bills.
b) Term loans/corporate loans/Short Term Loans (rupee loans only) i) Fixed Rate ii) Floating Rate	Sensitive on cash flow/maturity. Sensitive only when the risk premium is changed by the HFCs. The amount of term loans should be slotted in time buckets which correspond to the time taken by HFCs to effect changes in their PLR in response to market interest rates.
6. Non-performing loans: (net of provisions, interest suspense and claims received from ECGC)	

a) Sub-standard b) Doubtful and loss	To be slotted as indicated at items B.7 (a) & B.7(b) of Appendix I.
7. Assets on lease	The cash flows on lease assets are sensitive to changes in interest rates. The entire cash flows on leased assets should be slotted in respective time-buckets as per the timing of the cash flows.
8. Fixed assets (excluding assets on lease)	Non-sensitive
9. Other assets	
a) Intangible assets and items not representing cash flows.	Non-sensitive.
b) Other items (e.g. accrued income, other receivables, staff loans, etc.)	Non-sensitive
10. Reverse Repos/Swaps (buy/sell)/Bills rediscounted (Derivative Usance Promissory Notes)	Sensitive on maturity. To be slotted as per residual maturity of the underlying transaction.
11. Other (interest rate) products	
a) Interest rate swaps/FRAs	Sensitive; to be slotted as per residual maturity in respective time buckets.
b) Other derivatives	To be classified suitably as and when introduced.

Statement of Structural Liquidity
(as on :)

Name of the HFC :

(Amount in crore of rupees)

A. OUTFLOWS

Items/time buckets	1 to 30/31 days (one month)	Over one month to 2 months	Over 2 months to 3 months	Over 3 to 6 months	Over 6 months to 1 year	Over 1 year to 3 years	Over 3 to 5 years	Over 5 to 7 years	Over 7 to 10 years	Over 10 years	Total
1. Capital											
a) Equity and perpetual preference shares											
b) Non-perpetual preference shares											
2. Reserves & Surplus											
3. Gifts, grants, donations & benefactions											
4. Notes, bonds & debentures											
a) Plain vanilla bonds/debentures											
b) Bonds/debentures with embedded options											
c) Fixed rate notes											
5. Deposits											
a) Term deposits from public											
b) ICDs											
c) CDs											
6. Borrowings											
a) Term money borrowings											
b) From RBI, Govt, & Others											
7. Current Liabilities & Provisions:											
a) Sundry Creditors											
b) Expenses Payable											
c) Advance income received											
d) Interest payable on bonds/deposits											
e) Provisions											

(other than for NPAs)											
8. Contingent liabilities											
a) Letters of credit/ guarantees											
b) Loan commitments pending disbursement (outflows)											
c) Lines of credit committed to other institutions (outflows)											
d) Outflows on account of forward exchange contracts, rupee/dollar swaps & bills rediscounted											
9. Others (specify)											
A. TOTAL OUTFLOWS (A)											

B. INFLOWS

Items/Time buckets	1 to 30/3 days (one month)	Over one month to 2 months	Over 2 months to 3 months	Over 3 to 6 months	Over 6 months to 1 year	Over 1 year to 3 years	Over 3 to 5 years	Over 5 to 7 years	Over 7 to 10 years	Over 10 years	Total
1. Cash											
2. Remittance in transit											
3. Balances with banks a) Current account b) Deposit /short-term deposits c) Money at call & short notice											
4. Investments (net of provisions) under various categories as enumerated in Appendix I											
5. Advances (performing) a) Bills of exchange and promissory notes discounted & rediscounted b) Term loans (only rupee)											

loans) c) Corporate loans/short term loans											
6. Non-performing loans (net of provisions and ECGC claims received) under various categories enumerated in Appendix I											
7. Inflows from assets on lease											
8. Fixed assets (excluding assets on lease)											
9. Other assets a) Intangible assets & other non-cash flow items b) Interest and other income receivable c) Others											
10. Lines of credit committed by other institutions (inflows)											
11. Bills rediscounted											
12. Inflows on account of forward exchange contracts, dollar /rupee swaps (sell/buy)											
13. Others											
B. TOTAL INFLOWS (B)											
C. Mismatch (B - A)											
D. Cumulative Mismatch											
E. C as percentage of A											

Statement of short-term dynamic liquidity

(as on :)

Name of the HFC :**(Amount in crore of rupees)**

	1-14 days	15-28 days	29 days to 3 months	3-6 months
A. OUTFLOWS				
1. Increase in loans and advances				
2. Net increase in investments				
i. Government/approved securities				
ii. Bonds/debentures/shares				
iii. Others				
3. Net decrease in public deposits, ICDs				
4. Net decrease in borrowing from various sources/net increase in market lending				
5. Outflow on account of off-balance sheet items				
6. Other outflows				
TOTAL OUTFLOWS (A)				
B. INFLOWS				
1. Net cash position				
2. Net increase in deposits				
3. Interest inflow on investments				
4. Interest inflow on performing advances				
5. Net increase in borrowing from various sources				
6. Inflow on account of off-balance sheet items				
7. Other inflows				
TOTAL INFLOWS (B)				
C. Mismatch (B-A)				
D. Cumulative mismatch				
E. C as percentage to total outflows				

Statement of Interest Rate Sensitivity

(as on :)

Name of the HFC :

(Amount in crore of rupees)

A. OUTFLOWS

Items/Time buckets	1 to 30/3 days (or month)	Over one month to 2 months	Over 2 months to 3 months	Over 3 months to 6 months	Over 6 months to 1 year	Over 1 year to 3 years	Over 3 to 5 years	Over 5 to 7 years	Over 7 to 10 years	Over 10 years	Non-Sensitive	Total
1. Capital												
a) Equity and perpetual preference shares												
b) Non-perpetual preference shares												
2. Reserves & Surplus												
3. Gifts, grants, donations & benefactions												
4. Notes, bonds & debentures												
a) Plain vanilla bonds/debentures												
b) Bonds/debentures with embedded options												
c) Fixed rate Notes												
5. Deposits												
a) Term deposits from public												
b) ICDs												
c) CDs												
6. Borrowings												
a) Term money Borrowings												
b) From RBI, Govt, & others												
7. Current Liabilities & provisions												
a) Sundry Creditors												
b) Expenses Payable												
c) Advance income received												
d) Interest payable on Bonds/Deposits												

e) Provisions (other than for NPA)												
9. Others (specify)												
A. TOTAL OUTFLOWS (A)												

B. INFLOWS

1. Cash												
2. Remittance in transit												
3. Balances with banks												
a) Current account												
b) Deposit /short-term deposits												
c) Money at call & short notice												
4. Investments (net of provisions) under various categories as enumerated in Appendix I												
5. Advances (performing)												
a) Bills of exchange and promissory notes discounted & rediscounted												
b) Term loans (only rupee loans)												
c) Corporate loans/short term loans												
6. Non-performing loans (net of provisions and ECGC claims received) under various categories enumerated in Appendix I												
7. Inflows from assets on lease												
8. fixed assets (excluding assets on lease)												
9. Other assets												
a) Intangible assets & other non-cash flow items												
b) Interest and other income receivable												
c) Others												
10. Lines of credit committed by other institutions (inflows)												
11. Bills												

rediscounted (inflow)												
12. Inflows on account of forward exchange contracts, dollar-rupee swaps (sell/buy)												
Others												
B. TOTAL INFLOWS (B)												
C. Mismatch (B-A)												
D. Cumulative mismatch												
E. C as percentage of A												

To all housing finance companies

Dear Sir,

Asset Liability Management (ALM) System for HFCs - Guidelines

As you are aware, the guidelines for introduction of ALM system by banks, all India financial institutions and non-banking financial companies have already been issued by the Reserve Bank of India. Since the operations of housing finance companies also give rise to asset liability mismatches and interest rate risk exposures, it has been decided to introduce an ALM system for the Housing Finance Companies (HFCs), as part of their overall system for effective risk management in their various portfolios. A copy of the guidelines for ALM system in HFCs is enclosed.

2. The above mentioned guidelines would be applicable to all HFCs irrespective of whether they are accepting/holding public deposits or not. However, to begin with, HFCs meeting the criteria of asset base of Rs. 100 crore (whether accepting/holding public deposits or not) or holding public deposits of Rs. 20 crore or more (irrespective of their asset size) as per the audited balance sheet as of March 31, 2002 would be required to put in place the ALM system.

3. HFCs may commence trial run during the period ending September 30, 2002, which may continue during the half year beginning October 1, 2002. The guidelines should however, be fully operational by the year ending March 31, 2003. A system of half yearly reporting is being put in place in this regard and the first Asset Liability Management return as on September 30, 2003 may be submitted to the NHB within a month of close of the relevant half year i.e., before October 31, 2003 and continue thereafter in similar manner. The half-yearly returns would comprise of three parts:

- i. Statement of structural liquidity in format Annex - I
- ii. Statement of short term dynamic liquidity in format Annex - II
- iii. Statement of Interest Rate Sensitivity in format Annex - III

4. It would be desirable to constitute a small group under the charge of the Chief Executive Officer or a senior executive responsible for treasury function of the institution, with members drawn from resources, investments, foreign exchange, credit and MIS areas. The group should be entrusted with the task of carrying out necessary spadework for formalising the ALM system in the institution. A certificate regarding constitution of the Asset Liability Management Committee i.e., ALCO should be sent to NHB before October 31, 2002.

5. A pre-requisite for putting in place the ALM System is a strong Management Information System. For a quick analysis and consolidation of the data, it may be necessary to computerise the MIS and make use of specialised software for managing the assets and liabilities with respect to the maturity mismatches and the various risks associated with such mismatches. The HFC would do well to install such systems at the earliest, if not already done.

6. In the meanwhile, in the course of the trial runs during the period ending September 30, 2002 and beginning October 1, 2002, if the companies face any operational difficulties in implementing the guidelines or if they have any suggestions to make for improvement of the guidelines, they may communicate the same to NHB.

7. Other HFCs which do not meet the criteria mentioned in para 2, are also recommended to put in place the system of ALM as it is the endeavour of NHB to gradually introduce it for all the HFCs, for safeguarding interest of depositors and preventing systemic risks.

8. Please acknowledge receipt.

Yours faithfully,

(R. Bhalla)
Deputy General Manager

Encl.: as above