LIQUIDITY RISK MANAGEMENT & ASSET AND LIABILITY MANAGEMENT POLICY

1. PREAMBLE

1.1. The Board of Directors **("Board")** of Arman Financial Services Limited **("Company")**, has adopted the following policy to establish guidelines to ensure prudent management of assets and liabilities. These guidelines address management and reporting of capital, liquidity, and interest rate risk.

2. PURPOSE

2.1. This Policy has been framed in accordance with the Asset and Liability **("ALM")** framework as issued by Reserve Bank of India **("RBI")** vide Master Direction DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016 **("RBI Circular")** and amendments thereon.

2.2. This policy intends to establish the importance of ALM systems that need to be put in place since intense competition for business involving both the assets and liabilities require the Company to maintain a good balance among spreads, profitability, and long-term viability. Imprudent liquidity management can put Company's earnings and reputation at great risk. The Company's management needs to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. The Company may get exposed to several major risks during its business i.e.

- Credit risk,
- Interest rate risk,
- Equity / security price risk,
- Liquidity risk and
- Operational risk

2.3. It is, therefore, important that Company introduces effective risk management systems that address the issues relating to interest rate and liquidity risks. This policy also defines the process that Asset Liability Committee **("ALCO")** will use to evaluate the effectiveness of the Company's internal control procedures.

3. DEFINITIONS

3.1. **"Board"** means Board of Directors of the Company.

3.2. **"Company"** means Arman Financial Service Limited.

3.3. **"Directors"** mean individual Director or Directors on the Board of the Company.

3.4. **“ALCO”** means Asset Liability Committee.

3.5. **“ALM”** means Asset Liability Management.

3.6. **“Policy”** means Asset & Liability Management Policy.

3.7. **“RBI”** means Reserve Bank of India.

4. POLICY

4.1. Role and Responsibilities of ALCO

The ALCO constituted by the Board of Directors shall be responsible for ensuring adherence to various operational limits set by the Board of Directors as well as deciding the business strategy of the Company (assets and liabilities) in line with overall business objectives. The adherence would also ensure that the statutory compliances set out by the Reserve Bank of India (‘RBI’) are complied with.

The ALCO shall perform the following roles and responsibilities:

4.1.1. Understanding business requirement and devising appropriate pricing strategies;
4.1.2. Management of profitability by maintain relevant Net interest margins (NIM);
4.1.3. Ensuring Liquidity through maturity matching;
4.1.4. Management of balance sheet in accordance with internal policies and applicable regulatory requirements;
4.1.5. Ensure the efficient implementation of balance sheet management policies as directed by ALCO;
4.1.6. Review reports on liquidity, market risk and capital management;
4.1.7. To identify balance sheet management issues that are leading to under-performance and ensure corrective action;
4.1.8. Ensuring appropriate mix of different forms of debt / sub debt i.e. Bank / Financial Institution Loans, Non-Convertible Debentures, External Commercial, securitization, direct assignment etc;
4.1.9. Giving directions to the ALM team on the interest rate risk;
4.1.10. ALCO delegates the daily management of liquidity risk and interest rate risk to ALM.
4.1.11. Approving major decisions affecting Company’s risk profile or exposure (product pricing for advances, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rates offered by peer NBFCs for the similar services/product, etc);
4.1.12. Satisfy itself that the less fundamental risks are being actively managed, with the appropriate controls in place and working effectively;
4.1.13. Articulate the current interest rate review and formulate future business strategy on this view;
4.1.14. To decide on minimum Liquid assets (1-15 days) to be maintained for disbursement

requirements;

4.1.15. To review the funding funnel for 2-3 quarters on forward basis.

4.2. Key Pillars of ALM

The ALM process would rest on three pillars:

A. ALM Information Systems:

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

B. ALM Organization:

- Structure and responsibilities
- Level of senior management involvement

C. ALM Process:

- Risk parameters
- Risk identification, measurement & management
- Risk policies and tolerance levels.

4.2.1. ALM Information systems

4.2.1.1. MIS

ALM needs be supported by a management philosophy which clearly specifies the risk policies and tolerance limits. 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 sophisticated and data intensive Risk Adjusted Profitability Measurement methods.

4.2.1.2. Information availability, accuracy, adequacy and expediency

However, though the central element for the entire ALM exercise is the availability of adequate and accurate information with expedience; and the systems existing. Adequate measures are to be taken to collect accurate data in a timely manner through computerization.

4.2.2. ALM Organization

4.2.2.1. Structure and responsibilities

Successful implementation of the risk management process shall require 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 shall have overall responsibility for management of risks and shall decide the risk management policy of the NBFC and set limits for liquidity, interest rate and equity price risks.

4.2.2.2. Level of top management involvement

The Asset - Liability Committee (ALCO) consisting of the Company's senior management including Managing Directors and C.F.O. shall be responsible for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of Company (on the assets and liabilities sides) in line with the Company's budget and decided risk management objectives.

The ALM Support Groups consisting of operating staff shall be responsible for analyzing, monitoring, and reporting the risk profiles to the ALCO. The staff shall also prepare forecasts (simulations) showing the effects of various possible changes in market conditions related to the balance sheet and recommend the action needed to adhere to Company's internal limits.

The ALCO is a 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 shall ensure that the it operates within the limits / parameters set by the Board. The business issues that an ALCO shall consider, inter alia, shall 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 NBFCs for the similar services/product, etc. In addition to monitoring the risk levels of the NBFC, the ALCO shall review the results of and progress in implementation of the decisions made in the previous meetings. The ALCO shall also articulate the current interest rate view of the NBFC and base its decisions for future business strategy on this view. In respect of the funding policy, for instance, its responsibility shall be to decide on 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 deposits, money market vs capital market funding, domestic vs foreign currency funding, etc. Individual NBFCs shall have to decide the frequency of holding their ALCO meetings.

4.2.3. ALM Process

4.2.3.1. Liquidity Risks Management

Measuring and managing liquidity needs are vital for effective operation of the Company. By ensuring Company's ability to meet its liabilities as they become due, liquidity management can reduce the probability of developing an adverse situation. Liquidity management involves measuring liquidity position on ongoing basis. 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 bucket may be adopted as a standard tool, in line with RBI stipulations.

In line with RBI guidelines, the following maturity profile would be used for measuring the future cash flows of the Company in different time buckets:

4.2.3.1.1. 1 day to 30/31 days (One month)
4.2.3.1.2. Over one month and upto 2 months
4.2.3.1.3. Over two months and upto 3 months
4.2.3.1.4. Over 3 months and upto 6 months
4.2.3.1.5. Over 6 months and upto 1 year
4.2.3.1.6. Over 1 year and upto 3 years
4.2.3.1.7. Over 3 years and upto 5 years
4.2.3.1.8. Over 5 years

Within each time bucket, there could be mismatches depending on cash inflows and outflows. While the mismatches up to 1 year would be relevant since these provide early warning signals of an impending liquidity problem, the main focus has to be short term mismatches i.e. 1 day to 30/31 days (one month). **The net cumulative negative mismatches in the Statement of Structural Liquidity in the maturity buckets 8-14 days, and 15-30/31 days shall not exceed 15% each of the cumulative cash outflows in the respective time buckets.** Company, however, is expected to monitor their net cumulative mismatches (running total) across all other time **buckets up to 1 year, may not exceed 15% of the outflows**. Further establishing internal prudential limits with the approval of the Board the company has also adopted the above cumulative negative mismatch limits of 15% for their structural liquidity statement for buckets Over 1year and upto the "Over 5 years" bucket for monitoring purpose.

4.2.3.2. Interest Rate Risk (IRR)

RBI has allowed NBFCs to price most of their assets and liabilities. Thus, there is a 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 Company's financial condition and the changes in interest rates affect Company in a larger way. The immediate impact of changes in interest rates is on earnings (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on Net Worth as the economic value of Company's assets, liabilities and off-balance sheet positions get affected (re-priced) due to variation in market interest rates. 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. However, in line with RBI guidelines, to begin with, the traditional Gap analysis is considered as a suitable method to measure the Interest Rate Risk.

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/re-prices contractually during the interval;
iii. dependent on RBI changes in the interest rates/Bank Rate;
iv. it is contractually pre-payable or withdrawal before the stated maturities.

The Gap Report would 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, borrowings, purchased funds, etc. that mature/re-price within a specified timeframe are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if it is expected to be received it within the time horizon. This includes final principal payment and interim instalments. Certain assets and liabilities receive/pay rates that vary with a reference rate. These assets and liabilities are re-priced at pre-determined intervals and are rate sensitive at the time of re-pricing. The Gaps would be identified in the following time buckets:

4.2.3.2.1. 1 day to 30/31 days (One month)
4.2.3.2.2. Over one month and upto 2 months
4.2.3.2.3. Over two months and upto 3 months
4.2.3.2.4. Over 3 months and upto 6 months
4.2.3.2.5. Over 6 months and upto 1 year
4.2.3.2.6. Over 1 year and upto 3 years
4.2.3.2.7. Over 3 years and upto 5 years

4.2.3.2.8. Over 5 years
4.2.3.2.9. Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items would be classified as per the RBI guidelines and reporter as per the format provided by RBI. The biannual Interest Rate Sensitivity Statement shall be filed with RBI within the specified timelines.

The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that the Company has more RSAs than RSLs whereas the negative Gap indicates that it has more RSLs than RLAs. 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 is, therefore, used as a measure of interest rate sensitivity.

RBI has advised NBFC's to set prudential limits on individual Gaps with the approval of the Board/Management Committee. The prudential limits shall have a relationship with the Total Assets, Earning Assets or Equity. The objective of the interest rate sensitive analysis will mainly be focused on interest rate gap for more than one year period. It is proposed to continue with the present prudential limit approved by the Board viz. such positive/negative gap should not exceed 30% of Risk Sensitive Assets (RSA). In case the gap exceeds 30% it will be hedged/reduced by restructuring of composition of fixed/floating assets/liabilities or interest rate derivatives as decided by ALCO.

4.2.3.3. Funding & Capital Planning

a) Maintaining Adequate Capital

The Company would ensure that the capital adequacy ratio is always well above the minimum level prescribed by RBI. This would be possible by ensuring increased profitability and thus an increase in the Tier I and Tier II Capital on one hand and to ensure reduction in risk-weighted assets on the other.

b) Funding planning

The Company would ensure that both short term and long term funds requirement for its business are made available by way of bank / financial borrowings, external commercial borrowing, commercial papers, bonds, debentures and any other financial instrument.

5. POLICY REVIEW

5.1. The Policy would ideally be reviewed at periodic intervals. However, the policy can be reviewed at short notice depending on the exigencies/extraordinary situations, which may emanate during the course of Company's business. Such extraordinary situations may include significant changes in Government/Reserve Bank of India policies, global/national macro-economic conditions, financial performance, etc. This Policy shall remain in force till the next revision is carried out and disseminated.

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