ELECTRONICA FINANCE LIMITED

Policy on Asset Liability Management

Version Control

Document version	**Description of changes**	**Memorandum of change**	**Prepared by / Changed by**	**Proposed by**	**Owner Dept.**	**Approval Date**
1.0	First	Introduction of Policy	Treasury	CFO	Treasury	01-Nov-2017
2.0	Regulatory changes	Regulatory changes	Treasury	CFO	Treasury	13-Nov-2024

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1. PREFACE

Electronica Finance Limited [the "**Company**"], is a Non- Banking Financial Company registered under section 45-IA of the Reserve Bank of India Act, 1934 ["**RBI Act**"]. In terms of the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 (the Directions), the Company is classified in the Middle Layer category (NBFC-ML).

The Company is providing loans or financial assistance to micro, small, medium enterprises and small businesses. Such loans are of secured or unsecured in nature and interest rate on such loans are usually fixed rate in nature.

The lending to borrowers is financed through a mix of owned funds (equity) and borrowed funds (debt). Debt is sourced from both domestic and offshore lenders through various products such as term loans, working capital facilities, NCDs, Bonds including ECBs (domestic or foreign currency) and off-balance sheet through direct assignment/co-lending/PTCs. The Company will also explore other potential debt sources, including commercial papers, as part of its evolving funding strategy. The interest rate on such debt can be floating rate or fixed rate.

The Company is thus exposed to various risks such as liquidity risk and interest rate risk in the normal course of its business.

This Asset Liability Management Policy ("**ALM Policy**") is being adopted in line with norms on Asset Liability Management prescribed by the RBI through the RBI Master Directions for non-deposit taking NBFC-ML, as amended from time to time. The ALM Policy aims to monitor the liquidity and interest rate risk and mitigate those risks through various means as may be propounded by Asset Liability Management Committee (ALCO) and Board.

The purpose of this Asset Liability Management Policy (ALM Policy) is to strategically manage the balance sheet of the Company focusing on maximizing shareholder value, enhancing profitability, and safeguarding the institution from unforeseen financial impacts arising from changes in macroeconomic conditions. This policy, aligned with RBI's ALM framework, seeks to maintain a balance among profitability, spreads, and long-term financial stability across assets and liabilities. Through effective ALM systems, the Company aims at realizing solid operating results, strengthen capital, and manage liquidity, interest rate, and market risks to support sustainable growth with effective corporate governance.

2. SCOPE OF ALM

The Asset Liability Management framework (ALM framework) for the Company has been established for achieving the following objectives:

a. Liquidity risk management
b. Interest rate risk management
c. Planning for debt funding
d. Forecasting and analysing 'what-if' scenarios on liquidity
e. Preparation of contingency funding plans

3. ALM FRAMEWORK

The Company has built an ALM framework that rests on the following key foundations:

a. ALM Governance
b. ALM Information Systems
c. ALM Process

4. ALM GOVERNANCE

a) Board of Directors

The Board of Directors shall have the overall responsibility for management of the liquidity risk. The Board shall decide the strategy and policies of the Company to manage liquidity risk in accordance with risk tolerance limits, as maybe decided by it from time to time. The Board has constituted the Asset Liability Management Committee ("**ALCO**") for an effective management of risks arising from liquidity and interest rate movements. The ALCO shall operate as per the terms of reference provided by the Board and ensure the Company remains within the risk tolerance limits specified in the ALM Policy or by the Board from time to time.

b) Asset Liability Management Committee (ALCO)

The ALCO shall comprise of the following members:

- Managing Director or Chief Executive Officer
- Nominee Directors on behalf of the equity investors
- Chief Financial Officer
- Chief Risk Officer *
- Head of Treasury

**CRO as and when the appointment is made shall join the ALCO*

The ALCO at its discretion can invite such other Officer of the Company, as it may deem fit for any of its meetings. The MD/CEO shall be the Chairperson of ALCO and in any meeting held in the absence of MD/CEO, the members present may elect a Chairperson from amongst themselves. The quorum of the ALCO shall be at least 3 members which shall include 1 Director or MD/CEO. The ALCO at its discretion can decide to appoint ALM Support Group based on the scale of operations of the Company and complexities arising in the monitoring of various risks.

c) Role of ALCO

The ALCO shall be primarily responsible for the following aspects:

- Monitor the liquidity position within the risk tolerance levels approved by the RMC/Board and define the metrics and strategy used to measure both Liquidity risk and Interest rate risk.
- Monitor and review the framework for pricing, based on cost of funding, liquidity cost, risk premium for each product and for each borrower based on the internal rating, processing fee backed by the opex and expected rate of return on the capital (RAROC).
- Review the liquidity position of the Company and its adequacy vis-à-vis growth projections, liabilities maturities and debt profile, etc
- Review various liquidity scenarios based on asset/liability maturity profile
- Review the external economic situation particularly on interest rates
- Review the debt pipeline and contingency funding
- Develop asset liability management strategies as required and review the execution of the strategies

d) Meetings of the ALCO

The Committee shall convene at least at quarterly interval a formal meeting of the ALCO. Additional meetings may be scheduled during periods of heightened economic activity, unexpected liquidity volatility, or when specific issues demand immediate review and follow-up. There would be an ATR to be placed in the ensuing meeting of the Committee for each action point and progress therefor.

e) Annual Operating Plan

The ALCO is responsible for reviewing and incorporating the ALM Policy into the Company's annual budgeting process. This includes consideration of interest rate risk, liquidity management, and funding needs within the strategic goals set by the Board. Budgeting ensures that the Company's capital position, projected growth trends, and funding mix are adequately aligned with market conditions.

5. ALM INFORMATION SYSTEMS

The Company shall put in place adequate information reporting systems for timely providing of information to the ALCO for decision-making. The RBI guidelines on Asset Liability Management have to be adhered to and following ALM reports have to be compiled at the specified frequency:

- Statement of Structural Liquidity
- Statement of Interest Rate Sensitivity
- Statement of Short-term Dynamic Liquidity
- Public Disclosure on Liquidity Risk

The Company shall have a mechanism to monitor the liquidity position and update the ALCO at periodic intervals. The Company should be able to furnish granular and time-sensitive information during stress events.

6. ALM PROCESS

The ALM Process shall comprise essentially of the following key sub-processes:

a) Liquidity Risk Management

The Company shall identify, measure, monitor and control liquidity risk. It should maintain adequate liquidity at all times to meet its commitments and obligations, more particularly in the form of High Quality Liquid Assets arising within next 30 days. The Liquidity Risk Tolerance Ratio should be maintained at greater than 1.5 times. This ratio is calculated as follows:

a) High Quality Liquid Assets, plus the unutilized Cash Credit Limit (as of month-end) and Confirmed Sanctions in hand

b) Gross cash outflows anticipated in the next 30 days

The Liquidity Risk Tolerance Ratio is derived by dividing (a) by (b).. The Board/Senior Management shall develop the strategy to manage liquidity risk in accordance with the risk tolerance limits and ensure that sufficient liquidity is maintained by the Company including the cash flow arising from off-balance sheet exposures. Management shall quantify the liquidity cost and incorporate the same in determination of product pricing. Such liquidity shall be reviewed and redefined based on growth projections, macro events, etc.

b) Funding strategy

The Company shall develop a funding strategy to ensure it has adequate funds to meet growth requirements, repayment of liabilities and other obligations including expenses, statutory dues, etc. The funding strategy shall ensure the following:

- Diversified funding sources in terms of lenders, products
- Tenor of funding – balance between short-term and long-term, based on asset profile and principal repayment structures (monthly/quarterly/half-yearly/yearly/bullet)
- No concentration from any single funding source
- Behaviour of certain lenders during stress events

- Interest rate on borrowing – fixed / floating and if floating, the benchmarks to which the interest rates are linked

c) Investment Policy

The ALCO shall periodically review the list of eligible investment instruments as per Investment Policy and recommend addition of new instruments to the Board. The ALCO shall ensure that investments are made within defined exposure limits to avoid concentration risk and maintain liquidity for upcoming cash flow requirements.

d) Resource Planning

Resource planning is an integral part of the Company's ALM process, aimed at balancing long-term and short-term funding needs based on projected asset-liability management requirements. The Company's funding sources are structured to ensure diversification and avoid dependency on any single source. The ideal mix of resources includes:

- **Bank and Financial Institution Funding (Domestic/Foreign)**: 70% to 85%
- **Market Instruments (e.g., NCDs/ECBs)**: 10% to 30%
- **Short-Term Instruments (e.g., Commercial Paper, Cash Credit and WCDL)**: 3% to 10%

Additionally, off-book transactions, including Direct Assignment, Co-lending, and Business Correspondent models, will be strategically managed to ensure that the managed book as a percentage of total AUM does not exceed 30%.

ALCO reviews the resource planning strategy annually to ensure alignment with business needs and regulatory limits and any deviation from the above mix can be ratified by presenting detailed rationale in the next ALCO meeting and reporting to the RMC/Board. Resources are classified based on maturity, with long-term resources defined as those over 18 months and short-term resources as those below 12 months. The Company strategically raises funds from a diversified group of sources, ensuring no single lender exposure exceeds 25% of total funding.

e) Collateral Position Management

The Company shall actively monitor its collateral positions. It should maintain a sufficient stock of unencumbered assets so that any unexpected borrowing needs and potential increases in margin requirements over different timeframes are addressed. The stock of unencumbered assets should not fall below 20% of total on-book AUM and atleast 35% of such unencumbered pool should be seasoned and available for securitisation. It should monitor the delinquent assets position particularly during any stress event, take suitable action to have adequate collaterals for fulfilling borrowing needs.

f) Stress Testing

The Company shall conduct stress tests at a periodicity as defined by the ALCO but at least as and when the net cumulative negative mismatch crosses the tolerance levels prescribed by Board. Scenarios have to be designed for such stress tests affecting either the Company in particular or market wide scenarios in general. Aspects relevant to the NBFC such as nature of the business, activities, and vulnerabilities should be taken into consideration so that the scenarios incorporate the major funding and market liquidity risks to which the Company is exposed.

g) Contingency Funding Plan

i. The Company shall formulate a contingency funding plan (CFP) for responding to severe disruptions which might affect the NBFC's ability to fund some or all of its activities in a timely manner and at a reasonable cost. Contingency plans should contain details of available/ potential contingency funding sources and the amount/ estimated amount which can be drawn from these sources, clear escalation/ prioritisation procedures detailing when and how each of the actions can and should be activated, and the lead time needed to tap additional funds from each of the contingency sources.

ii. The sources shall include the following:
(a) Short term funding such as Cash credit facilities/Overdraft
(b) Off-Balance sheet through direct assignment/co-lending/PTCs

7. MATURITY PROFILING

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 shall be adopted as a standard tool. RBI has prescribed the format of Statement of Structural Liquidity, which shall be utilized by the Company for this purpose. The maturity profile of assets and liabilities, including listed non-mandatory securities, shall be used by the Company for measuring the future cash flows categorized in time buckets as under:

Sr. no.	Time bucket
i.	1 day to 7 days
ii.	8 days to 14 days
iii.	15 days to 30 / 31 days (One month)
iv.	Over 1 month and upto 2 months
v.	Over 2 months and upto 3 months
vi.	Over 3 months and upto 6 months
vii.	Over 6 months and upto 1 year
viii.	Over 1 year and upto 3 years
ix.	Over 3 years and upto 5 years
x.	Over 5 years

The Company shall, on a quarterly basis, prepare a Statement of Structural Liquidity by placing all the expected cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability shall be a cash outflow while a maturing asset shall be a cash inflow. The format of the same shall be as per RBI Form DNBS-4B on Statement of Structural Liquidity. While determining the expected cash inflows / outflows, the Company may make realistic and practical assumptions according to the asset - liability profiles and taking into consideration the past behaviour. The ALCO shall consider the immediate positions of asset-liability base, nature of business, future strategy, etc. for determining tolerance levels in mismatches.

The Company shall also estimate its short term liquidity profiles on the business projections and other commitments for planning purposes on quarterly/monthly basis. The time buckets to be utilized for short term liquidity profile shall be:

Sr. no.	Time bucket
i.	1 to 7 days
ii.	8 to 14 days
iii.	Over 14 days to one month
iv.	Over 1 month upto 2 months
v.	Over 2 months upto 3 months
vi.	Over 3 months upto 6 months

The format prescribed by RBI for Short Term Dynamic liquidity shall be used for this purpose. The Maturity Profile for bucketing of assets / liabilities of the Company shall be as per RBI norms.

8. LIQUIDITY MISMATCHES

Within each time bucket of the Statement of Structural Liquidity, there can arise mismatches depending on cash inflows and cash outflows. The ALCO shall focus on the negative mismatches upto one year bucket since these provide early warning signals of impending liquidity problems, however the main focus shall be particularly in the short-term time buckets upto 30/31 days. As a matter of prudence, the ALCO shall monitor and ensure that the net cumulative negative mismatches do not cross the following tolerance levels:

Sr. no.	Time bucket	Tolerance level (negative mismatch)
i.	1 to 7 days	10% of outflows
ii.	8 to 14 days	10% of cumulative outflows
iii.	Over 14 days to one month	20% of cumulative outflows

Further, the cumulative negative mismatch in the upto 1-year time-bucket shall not exceed 15% of the cumulative cash outflows. This tolerance level maybe reviewed by the ALCO/Board on a dynamic basis as per the prevailing market situation particularly liquidity and interest rates. In case of breach of aforesaid limits during any month / period, stress test will be conducted as explained hereinabove and a correction plan shall be prepared for addressing the mismatches beyond tolerance level and presented to ALCO.

9. LIQUIDITY RISK MANAGEMENT – STOCK APPROACH

The stock approach to liquidity risk management requires the Company to monitor certain ratios as prescribed by the Board and accordingly manage the liquidity risk. As a policy guidance, the Company through the ALCO shall monitor the following key ratios:

a. Debt-equity ratio [should be <= 4.50x]
b. Capital Adequacy ratio [should be >= 18%]
c. Market borrowings to total borrowings
d. Short term liability repayments (1 year) as a percentage of Short term asset inflows (1 year) [should be <=100%]
e. Short-term liability to total assets [should be <=40%], Short-term liability to total liabilities [should be <=45%] and Short-term liability to long term assets [should be <=70%]
f. Commercial papers to total assets [should be <=5%]
g. Total outside liabilities to tangible net worth [should be <=5x]
h. NCDs with original maturity of less than two years to total assets [should be <=5%]
i. Unencumbered liquidity position [should be >=1.5x as explained above]

Above ratios shall be measured and presented in the ALCO meeting and suitable changes initiated as per assessment of any increase in liquidity risk.

10.INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk whereby Company's financial position is adversely impacted by changes in market interest rates. 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 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).

In order to measure and manage the interest rate risk, Gap analysis shall be adopted. 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 any of the following condition exists:

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

The Gap Report shall 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 reporting period shall be considered interest rate sensitive. Similarly, any principal repayment of loan, including interim instalments, shall also be considered interest rate sensitive. Assets and liabilities of the Company having contractual rights / obligations to receive / pay rates that vary with a reference rate, re-priced at pre-determined intervals, are rate sensitive at the time of re-pricing. The behaviour of borrowers for pre-maturity repayments should also be factored in for the interest rates sensitivity of the assets.

The Gaps may be identified in the following time buckets:

Sr. no.	Time bucket
i.	1 day to 30 / 31 days (One Month)
ii.	Over 1 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
ix.	Non-Sensitive

The Gap is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. Positive gap indicates more RSAs than RSLs whereas a negative gap indicates RSLs exceed RSAs. Gap reports indicate whether the Company 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.

Presently, all the lending by the Company is on a fixed rate basis, while borrowings are a mix of fixed rate and floating rates. The Board may review the Earnings at Risk (EaR) or Net Interest Margin (NIM) and decide to review lending rates based on the market situation and the likely impact on the Company's NIMs.

The bucketing of assets/liabilities for the purpose of measuring Interest Rate Sensitivity shall be as per RBI norms. Further the proportion of Borrowing with rate resets options with lenders of less than 12 months as % of total outstanding borrowing should be <=60% and proportion of debt facilities with more than 5 years of balance maturity should be <=25%.

11.GENERAL

The ALCO shall review following additional aspects as per requirement and market situation:

a. Off balance sheet and contingent liabilities
b. Internal controls
c. Public disclosure of ALM information, as part of annual financial statements and as may be required under RBI norms
d. Internal controls in preparation of ALM information

The Company shall utilize tools on the basis of empirical studies and behavioural analysis, to consider the impact of pre-payment of loans and advances, roll-over of revolving credit lines in the Structural Liquidity and Interest Rate Sensitivity positions of the Company, especially in the short term.

Guidelines on Liquidity Coverage Ratio (LCR) are applicable once total assets as per Balance Sheet cross Rs. 5000 cr. The Company shall review the ALM Policy to ensure compliance with the LCR norms, once it crosses total assets of Rs. 4500 crore or as required by regulations whichever is earlier.

12.REVIEW OF POLICY

The ALCO and/or the Board may review the policy as maybe required due to regulatory changes or for any other reasons. Revised policy shall be approved by the Board. Any regulatory changes pending incorporation into the policy or Board approval thereof shall prevail over the existing policy.

13.COMPLIANCE WITH BANKING LAWS AND REGULATIONS

The Company's asset-liability management activities are governed by applicable banking laws, RBI regulations, and generally accepted financial management practices. All policies, procedures, and strategies related to ALM will be reviewed and updated regularly to ensure they remain compliant with regulatory changes and support the Company's risk management goals.