

ELECTRONICA FINANCE LIMITED
Policy on Liquidity Risk Management
(Part of Asset Liability Management (ALM) Policy)

Document version	Description of changes	Memorandum of change	Prepared by / Changed by	Proposed by	Owner Dept.
1.0	First	Introduction of Policy	Treasury	CFO	Treasury

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Policy on Liquidity Risk Management

PREAMBLE

Electronica Finance Limited (“the Company” or “EFL”) is 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).

This Liquidity Risk Management (LRM) Policy outlines the framework for EFL to effectively identify, measure, monitor, and control liquidity risk.

The LRM policy has been framed taking into account the RBI guidelines and reflects the business model requirements of the Company pursuant to the recommendation of ALCO

POLICY COMPONENTS:

- 1) Liquidity Risk Management System, Strategies, and Practices
- 2) Management Information System (MIS)
- 3) Internal Controls
- 4) Maturity profiling
- 5) Liquidity Risk Measurement – Stock Approach
- 6) Currency Risk
- 7) Managing Interest Rate Risk
- 8) Liquidity Risk Monitoring Tools

A. Liquidity Risk Management System Strategies and Practices

In order to ensure a sound and robust liquidity risk management system, the Company has framed the liquidity risk management policy to ensure that it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources.

Key elements of the liquidity risk management framework are as under:

i) Governance of Liquidity Risk Management

The Asset Liability Management Committee (ALCO) shall be involved in the process of identification, measurement and mitigation of liquidity risks. The Board of Directors shall have the overall responsibility for the management of liquidity and decide the strategy, policies and procedures of the Company to manage liquidity risk in accordance with the liquidity risk tolerance/limits decided by it.

Role of Asset Liability Management Committee (ALCO)

(a) Asset - Liability Management Committee (ALCO):

The ALCO consisting of the Company’s top management shall be responsible for ensuring adherence to the risk tolerance/limits set by the Board as well as implementing the liquidity risk management strategy of the Company.

The CEO/MD or the Executive Director (ED) should head the Committee.

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The Chief Financial Officer, Treasury Head, shall be members of the Committee.

The ALCO shall be responsible for the following:

- (a) Ensuring the adherence to the Risk tolerance/limits set by the Board and implementing the liquidity risk management strategy as defined in this Framework
- (b) Decision on desired Maturity Profile and Mix of incremental assets and liabilities,
- (c) Sale of Assets as a source of Funding
- (d) Structure, responsibilities and controls for managing Liquidity Risk;
- (e) Overseeing the Liquidity Position
- (f) Such other matters, as required by the Board or the RBI in terms of any amendment in the Rules, Regulations, Master Directions etc from time to time.

The ALCO will, apart from reviewing the liquidity returns being submitted to RBI, consider all the aspects of the Framework and update to the ALCO on any of the adverse features of the operations of the Company along with the mitigation plans.

ii) Liquidity risk Tolerance

A strategy to manage liquidity risk in accordance with risk tolerance and ensure that the Company maintains sufficient liquidity has been put in place. A sound process for identifying, measuring, monitoring and controlling liquidity risk has also been developed. 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. Such liquidity shall be reviewed and redefined based on growth projections, macro events, etc.

iii) Liquidity Costs, Benefits and Risks in the Internal Pricing

The Company endeavours to develop a process to quantify liquidity costs and benefits so that the same may be incorporated in the internal product pricing, performance measurement and new product approval process for all material business lines, products and activities.

iv) Off-balance Sheet Exposures and Contingent Liabilities

The process of identifying, measuring, monitoring and controlling liquidity risk includes a robust framework for comprehensively projecting cash flows arising from assets, liabilities and off-balance sheet items over an appropriate set of time horizons.

v) Funding Strategy - Diversified Funding

There shall not be over-dependency on a single source of funding and thus the Company with the approval of the Board shall establish a funding strategy that provides effective diversification in the sources,

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nature/instrument and tenor of funding. It should maintain an ongoing presence in its chosen funding markets and strong relationships with fund providers to promote effective diversification of funding sources and regularly gauge its capacity to raise funds quickly from each 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%. The Company strategically should raise funds from a diversified group of sources, ensuring no single lender exposure exceeds 25% of total funding.

vi) Collateral Position Management

Collateral positions, differentiating between encumbered and unencumbered assets shall be managed by the Company. It shall monitor the legal entity and physical location where collateral is held and how it may be mobilised in a timely manner. The Company shall have sufficient collateral to meet expected and unexpected borrowing needs and potential increases in margin requirements over different timeframes. The stock of unencumbered assets should not fall below 20% of total on-book AUM and at least 35% of such unencumbered pool should be seasoned and available for securitisation.

vii) Stress Testing

Stress testing shall form an integral part of the overall governance and liquidity risk management culture in the Company. In designing liquidity stress scenarios, the nature of the Company's business, activities and vulnerabilities shall be taken into consideration so that the scenarios incorporate the major funding and market liquidity risks to which the Company is exposed, if the maturity mismatch is above the RBI prescribed tolerance limits. The Company shall conduct stress tests on a regular basis for a variety of short-term and protracted Company-specific \ and market-wide stress scenarios (individually and in combination), if the maturity mismatch is above the RBI- prescribed tolerance limits.

viii) Contingency Funding Plan

A contingency funding plan (CFP) shall be formulated for responding to likely severe disruptions which might affect the Company's ability to fund some or all of its activities from market borrowings 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/ prioritization 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. The Company shall keep at least next 2 month's debt obligations (which will be more than 1.5 times) and opex in form of cash/bank/liquid investments. The cashflow and liquidity is tracked by ALCO and any reduction in the tolerance amount actually held by the company is discussed in detail at the ALCO.

The contingency 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, for which at least 20% of own book will be kept unencumbered and 35% of such unencumbered pool should be seasoned and available for securitisation.

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ix) Public disclosure

The Company shall publicly disclose information in a format prescribed by RBI in this regard on a quarterly basis on its website and in the annual financial statement as notes to account that enables market participants to make an informed judgment about the soundness of its liquidity risk management framework and liquidity position.

x) Intra Group transfers

With a view to recognizing the likely increased risk arising due to Intra-Group transactions and exposures (ITEs), the Chief Financial officer is expected to develop and maintain liquidity management processes and funding programmes that are consistent with the complexity, risk profile and scope of operations of the companies in the Group. The liquidity risk management processes are expected to take into account lending, investment, and other activities, and ensure that adequate liquidity is maintained at the head and each constituent entity within the group. Processes and programmes should fully incorporate real and potential constraints, including legal and regulatory restrictions, on the transfer of funds among these entities and between these entities and the parent Company.

B. MANAGEMENT INFORMATION SYSTEM (MIS)

The Company shall have a reliable MIS designed to provide timely and forward-looking information on the liquidity position of the Company to the Board and ALCO, both under normal and stress situations. It shall capture all sources of liquidity risk, including contingent risks and those arising from new activities, and have the ability to furnish more granular and time-sensitive information during stress events.

C. INTERNAL CONTROLS

The Company shall have appropriate internal controls, systems and procedures to ensure adherence to liquidity risk management policies and procedure. ALCO shall ensure that an independent party regularly reviews and evaluates the various components of the Company's liquidity risk management process.

D. MATURITY PROFILING

a) 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 Maturity Profile shall be used for measuring the future cash flows of the Company in different time buckets. The time buckets shall be distributed as under:

- (i) 1 day to 7 days
- (ii) 8 days to 14 days
- (iii) 15 days to 30/31 days (one month)
- (iv) Over one month and upto 2 months
- (v) Over two 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

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- b) The Company will be holding in its investment portfolio, securities which could be broadly classifiable as 'mandatory securities' (under obligation of law) and other 'non-mandatory securities'.
- c) Within each time bucket, there could be mismatches depending on cash inflows and outflows. While the mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus shall be on the short-term mismatches, viz., 1-30/31 days. The net cumulative negative mismatches in the Statement of Structural Liquidity in the maturity buckets 1-7 days, 8-14 days, and 15-30 days shall not exceed 10%, 10% and 20% of the cumulative cash outflows in the respective time buckets. The Company, however, shall monitor its cumulative negative mismatches (running total) upto 1 year bucket shall not exceed 15% of the cumulative cash outflows. The Company shall also adopt the above cumulative mismatch limits for their structural liquidity statement for consolidated operations.
- d) The Statement of Structural Liquidity shall be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability shall be a cash outflow while a maturing asset shall be a cash inflow.

E. LIQUIDITY RISK MEASUREMENT – STOCK APPROACH

The Company shall adopt a “stock” approach to liquidity risk measurement and monitor certain critical ratios in this regard by putting in place internally defined limits as approved by their Board, based on the recommendation of the ALCO. As a policy guidance, the Company through the ALCO shall monitor the following key ratios:

- a. Debt-equity ratio [should be $\leq 4.50x$]
- b. Capital Adequacy ratio [should be $\geq 18\%$]
- 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 $\leq 100\%$]
- e. Short-term liability to total assets [should be $\leq 40\%$], Short-term liability to total liabilities [should be $\leq 45\%$] and Short-term liability to long term assets [should be $\leq 70\%$]
- f. Commercial papers to total assets [should be $\leq 5\%$]
- g. Total outside liabilities to tangible net worth [should be $\leq 5x$]
- h. NCDs with original maturity of less than two years to total assets [should be $\leq 5\%$]
- i. Unencumbered liquidity position [should be $\geq 1.5x$ 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.

F. CURRENCY RISK

The Company shall identify and manage liquidity risk arising from foreign currency exposures, including External Commercial Borrowings. Hedging strategies shall be approved by ALCO and any mismatch in currency flows will be reviewed periodically to prevent risk of disruption.

G. MANAGING INTEREST RATE RISK (IRR)

- a) As per RBI mandate, 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:

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- i. within the time interval under consideration, there is a cash flow;
- ii. the interest rate resets/reprices 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 shall be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time buckets according to residual maturity or next repricing period, whichever is earlier. The difficult task in Gap analysis is determining rate sensitivity. All investments, advances, deposits, borrowings, purchased funds, etc. that mature/reprice within a specified timeframe are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the Company expects to receive it within the time horizon. This includes final principal payment and interim instalments. Certain assets and liabilities to receive/pay rates that vary with a reference rate. These assets and liabilities are repriced at pre-determined intervals and are rate sensitive at the time of repricing. While the interest rates on term deposits are fixed during their currency, the tranches of advances portfolio is basically floating. The interest rates on advances received could be repriced any number of occasions, corresponding to the changes in interest rate.

b) The Gaps may be identified in the following time buckets:

- i. 1 day to 7 days
- ii. 8 days to 14 days
- iii. 15 days -30/31 days (One month)
- iv. Over one month to 2 months
- v. Over two months to 3 months
- vi. Over 3 months to 6 months
- vii. Over 6 months to 1 year
- viii. Over 1 year to 3 years
- ix. Over 3 years to 5 years
- x. Over 5 years
- xi. Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items shall be classified as per the Master Direction – Core Investment Companies (Reserve Bank) Directions 2016.

c) 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 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 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 $\leq 60\%$ and proportion of debt facilities with more than 5 years of balance maturity should be $\leq 25\%$.

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H. LIQUIDITY RISK MONITORING TOOLS

The Statement of Structural Liquidity is currently one of the prescribed monitoring tools. In addition to this, the following tools shall be adopted by the ALCO of the Company for internal monitoring of liquidity requirements:

a) Concentration of Funding

This metric is meant to identify those significant market sources of funding, withdrawal of which could trigger liquidity problems. The metric thus encourages diversification of funding sources and monitoring of each of the significant counterparty, significant product / instrument and significant currency.

b) Available Unencumbered Assets

This metric provides significant information on available unencumbered assets, which have the potential to be used as collateral to raise additional secured funding in secondary markets. It shall capture the details of the amount of available unencumbered assets that could serve as collateral for secured borrowing in secondary markets.

c) Market-related Monitoring Tools

This includes high frequency market data that can serve as early warning indicators in monitoring potential liquidity difficulties at the Company.

The ALCO shall monitor on a quarterly basis, the movements in their book-to equity ratio and the coupon at which long-term and short-term debts are raised by them. This also includes information on breach/penalty in respect of regulatory liquidity requirements, if any.

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.

3. AMENDMENTS

The ALCO/ RMC may, subject to applicable law, amend, suspend or rescind this Policy at any time. Any difficulties or ambiguities in this Policy will be resolved by the ALCO/RMC and/ or administrative committee of the ALCO, in line with the broad intent of this Policy, as and when required.

4. CHANGE IN LAW

In case of any subsequent changes in the provisions of the Act or further rules and regulations / guidelines from the Reserve Bank of India or any other regulations / Directions which makes any of the provisions of this Policy inconsistent, then the provisions of the Act or such other regulations / Directions would prevail over this Policy and the relevant provisions contained in the Policy would be modified accordingly in due course to make it consistent with applicable laws.

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