SBFC FINANCE LIMITED
(Erstwhile Small SBFC Finance Private Limited)

Liquidity Risk Management Framework

Introduction, Objective & Scope

SBFC Finance Limited (Erstwhile **SBFC Finance Private Limited**) (SBFC), a Company registered as systematically important non deposit taking NBFC with Reserve Bank of India, is predominantly engaged in the business of lending against property, loan against gold, and unsecured personal and business loan. SBFC's funding consists of different sources of debts, NCDs with different maturity patterns and varying rates of interest. Its assets also are of varying duration and interest rates.

Hence, maturity mis-matches can occur which has an impact on the liquidity and profitability of the Company. It is therefore necessary that SBFC constantly monitor and manage its asset and liability in such a manner that asset liability mismatches remain within reasonable limits. This is also a statutory obligation as RBI has stipulated that Company should have an effective Liquidity Risk Management Framework as part of their overall system for effective risk management.

The objective of this policy is to create an institutional mechanism to compute, review and monitor periodically all the elements of the liquidity, develop suitable Liquidity Risk Management Framework, identify potential risks, take suitable decisions and mitigate such risks.

This policy shall also define the governance mechanism, MIS systems, review mechanisms, elements of the risks and the processes to identify and mitigate it.

Liquidity Risk Management:

Liquidity means The Company's capacity to fund the increase in assets and meet both expected and unexpected cash and collateral obligations at reasonable cost and without incurring unacceptable losses.

Liquidity Risk: means inability of a Company to meet such obligations as they become due without adversely affecting the Company's financial condition. Effective liquidity risk management help to ensure the Company's ability to meet its obligations as and when they fall due and reduces the probability of an adverse situation developing.

Besides liquidity, management ensures that funds are available for anticipated loan growth, investment and cash management transactions and general operational expenses without causing undue rise in cost and without causing a disruption in normal operating conditions.

A. LIQUDITY RISK MANAGEMENT POLICY, STRATEGIES AND PRACTICES:

1. **Governance of Liquidity Risk Management:** SBFC shall have a comprehensive governance structure to review, monitor and take suitable decisions on liquidity risk management, which is enumerated below:

   a) **Board of Directors**: The Board of SBFC shall have the overall responsibility for management of liquidity risk. The Board shall decide strategy, policies and procedures of the SBFC to manage liquidity risk in accordance with the liquidity risk tolerance/limits decided by it.

   b) **Risk Management Committee**: The Risk Management Committee of SBFC shall be reporting to Board and shall be responsible for evaluating the overall liquidity risks faced by the Company in addition to other risks.

   c) **Asset Liability Management Committee (ALCO):** Asset Liability Management & Liquidity risks will be overseen by a ALCO.

   ALCO shall be responsible for ensuring adherence to the risk tolerance/limits set by the Board or Risk Management Committee; implementing Liquidity Risk Management strategy of the Company; take decisions on desired maturity profile and mix of incremental assets and liabilities; sale of assets as a source of funding; the structure, responsibilities and controls for managing liquidity risk.

   d) **Asset Liability Management (ALM) Support Group**: The ALM Support Group shall comprise of Head Finance and Head Treasury and shall be responsible for analyzing, monitoring and reporting the liquidity risk profile to the ALCO.

2. **Liquidity Risk Tolerance**: ALCO shall define Liquidity Risk Tolerance on several elements of liquidity as specified in this document. ALCO shall continuously identify, measure, monitor and control liquidity risk, by articulating liquidity risk tolerance that is appropriate for its business strategy and its role in the financial system.

3. **Liquidity Costs, Benefits and Risks in the internal pricing**: The Board, Risk Committee or ALCO shall maintain policies on Liquidity coverage ratio, the negative carry of which will be considered as a part of the cost of the Company. ALCO will review and monitor liquidity cost, benefits and risks associated with liquidity program of the Company while forming liquidity risk tolerance.

4. **Off-balance sheet Exposure and Contingent Liabilities**
   SBFC shall identify, measure and project cash flows arising from assets, liabilities and off-balance sheet items over different time buckets. Off-Balance items will include exposures on account of special purpose vehicles, financial derivatives, guarantees, commitments, and any other off-balance items which may be lead to liquidity exposures.

5. **Funding Strategy – Diversified Funding**
   ALCO shall review & monitor debt raising strategy that provides effective diversification in the sources and tenor of funding. It will periodically assess its capacity to raise funds from each such source. Such debt raising strategy shall also consider the qualitative dimension of the concentrated

behavior in typical market conditions and over reliance on other funding sources arising out of unique business model.

6. Collateral Position Management

ALCO shall review and monitor asset cover ratio and shall decide on the sufficiency of the asset cover to borrow expected and unexpected funds or potential increase in the margin requirements over different time frames.

7. Stress Testing

ALCO shall review and monitor stress test periodically for a set of short-term and protracted Company specific and market-wide stress scenarios (individually and in combination). The Stress test should consider scenarios on the basis of its nature of business, major funding risks, market liquidity risks to which it is exposed.

8. Contingency Funding Plan:

SBFC shall raise funds through securitization and / or run down of gold loan portfolio as a Contingency Funding Plan (CFP) for responding to severe disruptions which might affect its ability to fund its activities in a timely manner. Such CFP would be reviewed by ALCO from time to time. The details of potential contingency funding sources and the amount which be drawn from such sources, the action plan and lead time needed to source such fund are as follows :

A. Rundown of gold loan portfolio in the range of Rs 100 cr per month with negligible lead time
B. Securitization of portfolio in the range of Rs 200 cr with lead time of 30 days
C. Stopping the fresh disbursements with negligible lead time.

9. Public disclosure:

SBFC shall publicly disclose information as prescribed in Appendix I of RBI circular on Liquidity Risk Management Framework and as amended from time to time. Such disclosure will be on a quarterly basis on the official website of the Company and in the annual financial statements as notes to accounts. This will enable market participants to make an informed judgment about the soundness of its liquidity risk management framework and liquidity position.

B. Management Information System (MIS):

SBFC shall develop reliable MIS designed to provide timely and forward-looking information on its liquidity position to its Board and ALCO, both under normal and stress situations, which captures all sources of risk, including contingent risks and those arising from new activities. SBFC shall also develop MIS capabilities to provide more granular and time-sensitive information during stress events.

C. Internal Controls

Chief Financial officer (CFO) shall review the internal controls, systems and procedures to ensure adherence to liquidity risk management policies and procedures.

In addition, Internal Audit function shall conduct regular independent reviews to ensure adherence to liquidity risk management policies and procedures and evaluates various components of its liquidity risk management process.

D. Maturity Profiling:

ALCO will deliberate on the ability of SBFC to meet its maturing liabilities as they become due and take decisions and actions as required to ensure that the net cumulative mismatch norms as mentioned below are not breached. ALCO will review periodically on the different situation as may merge under different assumptions and scenarios. For measuring and managing net funding requirements, ALCO will use the maturity ladder and calculation of cumulative mismatches at selected maturity dates as a standard tool. ALCO will use the time buckets as prescribed by RBI (shown below) for measuring the net funding needs, which may be revised based on the amendments by RBI from time to time.

i. 1 day to 7 days
ii. 8 to 14 days
iii. 15 days to 30/31 days (1 month)
iv. Over 1 month and up to 2 months
v. Over 2 months and up to 3 months
vi. Over 3 months and up to 6 months
vii. Over 6 months and up to 1 year
viii. Over 1 year and up to 3 years
ix. Over 3 years and up to 5 years
x. Over 5 years

Structural Liquidity:

The Statement of Structural Liquidity shall be prepared by placing all cash inflows and outflows in the maturity ladder according to expected timing of cash flows. A maturing liability shall be a cash outflow while a maturing asset shall be cash inflow.

There can be mismatches depending on cash inflows and outflows in each time bucket. The mismatches up to 1 year shall be relevant since these provide early warning signals of impending liquidity problems.

The net cumulative negative mismatches in the Statement of Structural Liquidity in the respective maturity buckets shall not exceed specified percentage of cumulative cash outflows in the respective time buckets, which is specified below.

Sl. No.	Time Buckets	Max net cumulative negative mismatches of the cumulative cash outflows
i.	1 day to 7 days	10%
ii.	8 to 14 days	10%
iii.	15 days to 30/31 days (1 month)	20%
iv.	Over 1 month and upto 2 months	20%
v.	Over 2 months and upto 3 months	20%
vi.	Over 3 months and upto 6 months	20%
vii.	Over 6 months and upto 1 year	20%

Dynamic Liquidity:

SBFC shall monitor short term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months by estimating its short term liquidity profiles on the basis of business projections and other commitments for planning purposes.

E. Liquidity Risk Monitoring Tools

SBFC shall adopt following tools for internal monitoring of liquidity risks, which shall be reviewed by ALCO on a periodical basis:

- **Concentration of funding:**
  SBFC shall have diversification of funding in order to avoid situation where withdrawal of a single/concentrated/high value lender, could trigger liquidity problems.

- **Available Unencumbered Assets:**
  SBFC shall capture details of the amount and type of available unencumbered assets that could serve as collateral for secured borrowing.

- **Market related monitoring tools:**
  ALCO shall review on the periodical basis market data that can serve as an early warning indicators in monitoring potential liquidity risks at SBFC.
  ALCO and the Board committee shall review on a periodical basis its debt to equity ratio, cost of borrowings and information on breach/penalty in respect of regulatory liquidity requirements.

F. Liquidity Risk Measurement- Stock Approach

ALCO shall monitor on the periodical basis several critical liquidity ratios and the maximum permissible limits which are given below:

Sl. No.	Liquidity Ratios	Max permissible limit
i.	Short Term liabilities with original maturity of less than 1 year to total assets	15%
ii.	Short term liabilities (with original maturity of less than 1 year) to total liabilities	20%

G. Currency Risk:

SBFC shall review and monitor its currency risk arising out of exchange rate volatility and its implications on the liquidity.

H. Interest Rate Risk:

Interest rate risk is the risk where changes in market interest rates might adversely affect SBFC's financial condition.

Interest rate risk management and reporting helps identify potential risks to earnings and capital resulting from adverse fluctuations in market interest rates. It also identifies asset and funding balance and re-pricing mismatches. Proper identification of potential risks and mismatches assists management in devising asset/liability strategies to minimize these potential risks.

The interest rate risk when viewed from these two perspectives is known as earning perspective and economic value perspective, respectively. The risk from earnings perspective can be measured as changes in the Net Interest Income (NII) or Net Interest Margin (NIM). There are many techniques for measurement and management of IRR, but SBFC has followed traditional GAP analysis as a suitable method to measure the IRR in the first place.

The interest sensitive assets and liabilities will be clubbed into the following buckets for ascertaining the Gap in individual buckets and the cumulative Gap.

i. 1 day to 7 days
ii. 8 to 14 days
iii. 15 days to 30/31 days (1 month)
iv. Over 1 month and up to 2 months
v. Over 2 months and up to 3 months
vi. Over 3 months and up to 6 months
vii. Over 6 months and up to 1 year
viii. Over 1 year and up to 3 years
ix. Over 3 years and up to 5 years
x. Over 5 years

SBFC shall monitor & manage interest rate risks as per the extant regulatory guidelines.

I. LIQUIDITY COVERAGE RATIO (LCR):

As per RBI circular dated November 04, 2019, all non-deposit taking systematically important NBFC with asset size of Rs 5000cr or more (except Core Investment Companies, Type 1 NBFC-ND1s, Non-Operating Financial Holding Companies and Standalone Primary Dealers) and all deposit taking NBFCs shall adhere to the following guidelines.

I. Maintain the required level of LCR as per the time-line given below:

From	December 01, 2020	December 01, 2021	December 01, 2022	December 01, 2023	December 01, 2024
Minimum LCR	30%	50%	60%	85%	100%

II. The Company shall maintain an adequate level of unencumbered High Quality Liquid Assets (HQLA) that can be converted into cash to meet its liquidity needs for a 30 day calendar time horizon under a significantly severe liquidity stress scenario. (Kindly refer to Annexure 1 for HQLA definition)

III. Liquidity coverage Ratio (LCR) shall be maintained as below on an ongoing basis to help monitor and control liquidity risk.

IV. LCR is represented by the ratio “Stock of HQLA” divided by “Total Net Cash Outflows over the next 30 calendar days”.

V. Total Net Cash Outflows shall be defined as total expected cash outflows minus expected cash inflows for subsequent 30 calendar days.

VI. All assets in the stock of liquid assets must be managed as part of that pool by the Company and shall be subject to the following operational requirements:
   a. must be available at all times to be converted into cash;
   b. shall be unencumbered;
   c. shall not be co-mingled/ used as hedges on trading position; designated as collateral or credit enhancement in structured transactions or designated to cover operational costs;
   d. shall be managed with sole intent for use as a source of contingent funds; and,
   e. shall be under the control of specific functions charged with managing liquidity risk of the bank, e.g. ALCO

VII. The Company should periodically monetize a proportion of assets through repo or outright sale to test the sale-ability of these assets and to minimize the risk of negative signaling during period of stress

VIII. If an eligible liquid asset becomes ineligible (e.g. due to downgrade), Company will be allowed to keep the asset in their stock of liquid assets for an additional 30 calendar days in order to have sufficient time to adjust the stock / replace the asset

IX. The potential need for the Company to buyback debt or honour non-contractual obligations in the interest of mitigating reputational risk,

X. LCR Disclosure Standards:
   a. Company is required to disclose information on their LCR every quarter
   b. Further, the Company in their annual financial statements under Notes to Accounts, starting with the financial year ending March 31, 2021, shall disclose information on LCR for all the four quarters of the relevant financial year. The disclosure format is given in the Appendix I of Liquidity Risk Management guidelines dated 04-Nov-19.
   c. Data must be presented as simple averages of monthly observations over the previous quarter (i.e., the average is calculated over a period of 90 days).
   d. However, with effect from the financial year ending March 31, 2022, the simple average shall be calculated on daily observations

Annexure 1:

High Quality Liquid Assets (HQLAs): HQLAs means liquid assets that can be readily sold or immediately converted into cash. Such assets shall be valued at an amount no greater than their current market value for the purpose of computing the LCR.

Depending upon the nature of assets, they have been assigned different haircuts, which are to be applied while calculating the HQLAs. The assets and the haircuts are as under:

I. HQLA without haircut: Assets included are as under
   - Cash on hand and demand deposits with scheduled commercial bank
   - Government securities
   - Marketable securities issued or guaranteed by foreign sovereigns satisfying all the following conditions:
     - Assigned at 0% risk weight
     - Traded in large, deep & active repo or cash markets
     - Not issued by a bank/ financial institution/
     - NBFC or any of its affiliates entities

II. HQLA with minimum of 15% haircut: Assets included are as under
   - Marketable securities assigned at 20% weight guaranteed by sovereigns, public sector entities or multilateral development banks
   - Corporate bonds rated AA- or above by an eligible credit rating agency
   - Commercial papers rated AA- or above by an eligible credit rating agency
   - All these instruments above shall not be issued by bank/ financial institution/ NBFC or any of its affiliates entities

III. HQLA with minimum of 50% haircut: Assets included are as under
   - Marketable securities assigned at risk weight higher than 20% but not more than 50% guaranteed by sovereigns and have credit rating not lower than BBB-
   - Common equity shares included in NSE CNX Nifty index and/or S&P BSE Sensex index and not issued by a bank/ financial institution/ NBFC or any of its affiliates entities
   - Corporate debt securities (including CP)
     - Not issued by a bank/ financial institution/ NBFC or any of its affiliates entities
     - Long term credit rating between A+ and BBB- from an eligible credit rating agency or short-term rating equivalent in quality to the long-term rating
     - Traded in large, deep and active repo or cash markets
     - Record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions, i.e., maximum decline in price not exceeding 20% or increase in haircut