TAMIL NADU TRANSPORT DEVELOPMENT FINANCE CORPORATION LIMITED, CHENNAI - 600 002.

LIQUIDITY RISK MANAGEMENT FRAMEWORK

1. Preamble

The Board of Directors (**''Board''**) of Tamil Nadu Transport Development Finance Corporation Limited (**"Company" or "TTDFC"**), has adopted the following policy to establish guidelines to ensure prudent management of assets and liabilities. These guidelines address the management and reporting of capital, liquidity, and interest rate risk.

2. Purpose

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

This Policy intends to establish the importance of Asset Liability Management System that needs to be put in place, since intense competition for business, involving both the assets and liabilities requires the company to maintain a good balance among spreads, profitability, and long-term viability. Imprudent liquidity management can put TTDFC's earnings and reputations 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. TTDFC is exposed to several major risks in the course of its business i.e.,

- Credit risk
- Interest rate risk
- Liquidity risk
- Operational risk.

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

3. <u>Policy</u>

3.1 Role and Responsibility of ALCO

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

The ALCO shall perform the following roles and responsibilities:

a) Understanding business requirement and appropriate pricing strategies.
b) Management profitability by maintain relevant Net Interest Margin (NIM).
c) Ensuring liquidity through maturity matching.
d) Management of balance sheet in accordance with internal policies and applicable regulatory requirements.
e) Ensure the efficient implementation of balance sheet management policies as directed by ALCO.
f) Review reports on liquidity, market risk and capital management.
g) To identify balance sheet management issues those are leading to under performance and take corrective actions.
h) Ensuring appropriate mix of different forms of debts i.e., Bank loans, Commercial Papers, Non-convertible debentures etc.
i) Provide direction to the TTDFC team on the interest rate risk.
j) To delegate the daily management of Liquidity risk and interest rate risk.
k) Approving major decisions affecting TTDFC’s risk profile or exposure (product pricing for advances, desired maturity profile and mix of the incremental assets and interest rate on deposits considering the prevailing interest rate offered by peer NBFC’s for the similar service/product, etc.).
l) Satisfy itself that the less fundamental risks are being actively managed, with the appropriate controls in place and working effectively.
m) Articulate the current interest rate review and formulate future business strategy on this view.

3.2 Key pillars of ALM

The ALM system of the company is based on the following key pillars:

ALM information system

- Management information system
- Information availability, accuracy, adequacy and expediency.

ALM Organization

- Structure and responsibilities
- Level of top management involvement.

ALM process

- Risk parameters
- Risk measurement
- Risk management
- Risk policy and tolerance.

I. ALM information system

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The ALM needs to be supported by management philosophy which clearly specifies the risk policies and tolerance limits. This framework needs to be built in using 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 date intensive Risk Adjusted Profitability Measurement Methods.

➢ **Information availability, accuracy, adequacy and expediency**

The center element of the entire ALM exercise is the availability of adequate and accurate information with expedience from the existing system. Adequate measures are to be taken to collect accurate data in a timely manner through computerization.

II. ALM Organization

- **Structure and responsibilities**

Successful implementation of the risk management shall require strong commitment on the part of the senior management in the Company, to integrate basic operation and strategic decision making, with risk management. The Board shall have overall responsibility for management of risks and shall decide risk management policy of the Company and set limits for liquidity, interest rate and equity price risks.

Risk Management Committee:-

This committee is responsible for evaluating the overall risk faced by the Company including liquidity risk. The risk management committee shall ensure that the risk associated with the business / functioning of the company are identified, controlled and mitigated and shall also lay down procedure for managing and mitigating the risk through integrated risk management system, strategies and mechanism.

This committee shall consist of the members of the Board and/or Senior Executives/heads of various risk verticals. The majority of members of this committee shall be the Board of Directors.

Meetings and Quorums:-

The Committee shall meet as and when required, but shall, meet at least twice in a year. The quorum shall be two-third of the total members of the committee (nearest rounded to one).

Terms of Reference:

- To assist the Board in setting risk strategy policies in liaison with management and discharge of its duty relating to corporate accountability and associated risk in terms of management assurance and reporting.
- To identify, monitor and measure of the risk profile of the TDFC Ltd., including market risk policies and strategies and manage them effectively.
- To review processes and procedures to ensure the effectiveness of internal control system so that decision making capability and accuracy of reporting the financial risks are always maintained at an optimum level.

- To monitor external development relating to the practice of corporate accountability and reporting of specifically associated risk, including emerging and prospective impacts.
- To provide an independent and objective oversight and view of the information presented by management on corporate accountability and specifically associated risk, also taking into account the reports of the Audit Committee to the board on all categories of identified risk faced by TDFC Ltd., and review minutes of meeting of the ALCO.
- To review the risk bearing capacity of TDFC Ltd., in light of its reserves, insurance coverage, guarantee funds or other financial structures.
- To perform such other act as may be prescribed by the Board, including the acts and functions stipulated by the statutes, the Reserve Bank of India and any other regulating authority, as prescribed from time to time.

The Chairman of the Risk Committee shall report to the Board regularly on the deliberation of the committee.

The members of the Risk Management Committee shall be as follows:

1) Finance Director, Finance Department - Chairman of the Committee.
2) Joint Managing Director - Member of the Committee.
3) Independent Director - Member of the committee.

Asset – Liability Management Committee (ALCO):-

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 ALCO shall ensure adherence to the risk tolerance limits set by the Board as well as implement the liquidity risk management strategy of the Company. The business that an ALCO would consider inter alia, include product pricing of deposits and advances/loans, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rate offered by other peer NBFCs, review the progress in implementation of the decisions made in the previous meetings. The ALCO would also articulate the current interest rate view of the Company and base its decision for suture business strategy on this view. In respect of funding policy, for instance, its responsibility would 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 directors of interest rate movement and decide on funding mixes between fixed Vs floating rate funds, whole sale Vs retail deposit, money market Vs capital marketing funding, domestic Vs foreign currency funding, etc.,

Meetings and Quorums:-

The Committee shall meet as and when required, but shall, meet at least twice in a year. The quorum shall be two-third of the total members of the committee (nearest rounded to one).

Terms of Reference:

- To review and monitor company's borrowing from existing or new lenders.
- To review the asset – liability profile of TDFC Ltd., with the view to manage the market exposure assumed by the company.
- To explore the options made available by the banks and financial institutions for the lending, compare the earnings, approve the borrowings after considering the market scenario and conditions of the borrowings.
- To negotiate the terms of lending with lenders and finally approve the same.
- To continuously review the fund requirement of a company on monthly and quarterly basis in accordance with the ongoing business plan (projections etc.).
- To safeguard the necessary at any point of time.
- To review the cash management and optimum utilization of the funds available to the company at frequent intervals.
- To review the Risk Monitoring system, ensure payment of liability on its due dates, liquidity risk management, funding and capital planning, profit planning and growth projections, forecasting & analyzing different scenarios and preparation of contingency plans.
- To review the fund position in each prescribed ALM buckets.
- To report the Board of Directors on a regular basis and act as Financial Advisory.

The members of the Asset Liability Management Committee shall be as follows:

1) Finance Director, Finance Dept. - Chairman of the Committee.
2) Joint Managing Director, TDFC Ltd. - Member of the Committee.
3) Independent Director, TDFC Ltd. - Member of the Committee.

Board of Directors and Meeting Reviews

The Board of Directors shall ensure that the ALM guidelines as issued by RBI from time to time are being adhered to by the Company.

III. ALM process

The scope of ALM process is as follows:

a) Liquidity risk management

b) Management of market risk

c) Funding and capital planning

d) Profit planning and growth projection

e) Forecasting and analyzing 'What if scenario' and preparation contingency plans

(i) Liquidity risk management

Measuring and maintaining liquidity needs are vital for effective operation. Liquidity management can reduce the probability of development of adverse situation. TTDFC management shall measure not only the liquidity positions on an going basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows the assets commonly considered as liquid like the Government securities could also be liquid when the market and players are unidirectional. Therefore, liquidity has to be tracked through maturity or cash flow mismatches

ALCO is responsible for overseeing that the appropriate mix of available funding sources are utilized to ensure that company's liquidity is managed prudently and approximately. With regard to the process of liquidity management, ALCO shall consider the current economic and market environment, near-term loan growth projection and long-term strategic business decisions.

For measuring and managing the net funding requirements, the use of maturity ladder and calculation of cumulative surplus or deficit funds at selected maturity dates is to be adopted as a standard tool.

The maturity profile would be used for measuring the future cash flows of TTDFC in different time buckets as under:

(i) 1 day to 7 days
(ii) 8 days to 14 days
(iii) 15 days to 30/31 days
(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 month s an d upto 1 year
(viii) Over 1 year and upto 3 years
(ix) Over 3 years and upto 5 years
(x) Over 5 years

Granular Maturity Buckets and Tolerance Limits

The net cumulative negative mismatches in the Statement of Structural Liquidity in the maturity buckets of 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.

However, with reference to the RBI circular dated November 04, 2019, the company will monitor cumulative mismatches (running total) across all other time buckets upto 1 year and the cumulative negative mismatch in the maturity buckets upto one year shall not go beyond 15%.

The statement of structural liquidity should be prepared by placing all cash inflows and out flows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while maturing assets will be in cash inflow.

While determining the likely cash inflows / outflows, TTDFC have to make a number of assumptions according to its asset – liability profiles. While determining the tolerance levels, TTDFC may take into account all relevant factors based on their asset-liability base, nature of business, future strategy etc.

In order maintain short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, TTDFC may estimate its short-term liquidity profile on the basis of business projection and other commitments for planning purpose. Risk identification is not annual process and hence employees are encouraged to dynamically assess changes that may occur throughout the year.

(ii) Maintenance Liquidity Coverage Ratio (LCR)

The Company shall maintain a liquidity buffer in terms of LCR which will promote resilience of NBFCs to potential liquidity disruptions by ensuring that the Company has sufficient High Quality Liquid Asset (HQLA) to survive any acute liquidity stress scenario lasting for 30 days. The stock of HQLA to be maintained by the Company shall be minimum of 100% of total net cash outflows over the next 30 calendar days.

The LCR requirement shall be progressively reached up to the required level of 100% as per the time-line prescribed by RBI, in this regard.

(iii) Currency Risk

The Company does not have any borrowing on instrument in foreign currency and hence not suffered by currency risk.

(iv) Interest Rate Risk ('IRR')

IRR management and reporting helps to protect against fluctuation in earnings and capital, resulting from adverse fluctuation in market interest rates. It also identifies asset/funding balance and repricing mismatches. Proper identification of potential risk and mismatch assists management in devising asset/liability strategies to minimize these potential risks. The Company's exposure to change its interest rates relates to its investments on Government Securities. All the Government securities of the company are in local currency and on fixed rate basis and so, are not subject to interest rate risk.

(v) Credit Risk

Credit risk is the risk of financial loss to the company if borrower fails to meet his contractual obligations, and arise principally from the company's loan receivables. The company's exposure is only to government departments and retail loans against deposits. Loans against deposit are disbursed after retaining adequate margin and risk of default by the government departments is also minimal. Hence, the company is subjected to limited risk. The company shall apply the existing prudential norms set out by Reserve Bank of India for NBFCs.

(vi) Maintenance of liquid assets

The Company Shall invest up to 15 % of their public deposits in approved securities (mandatory securities) in terms of liquid assets requirement stipulated by RBI.

(vii) Investment Portfolio

TDFC shall hold in its investment portfolio, securities which could be broadly classifiable as 'mandatory securities' (under obligation of law) and other 'non-mandatory securities'. Any surplus securities (held over and above the 'mandatory securities'), shall fall in the category of 'non-mandatory securities'.

(viii) Liquidity Costs, Benefits and Risks in the internal pricing

TDFC has to quantify liquidity costs and benefits so that the same may incorporated in the internal product pricing, performance measurement and new product approval process for all material business lines, products and activities.

(ix) Off-balance Sheet Exposure and contingent Liabilities

TDFC has to identify, measure, monitor and control liquidity risk and shall have a robust framework for comprehensively projecting cash flows arising from the assets, liabilities and off-balance sheets over an appropriate set of time horizons. The management of liquidity risks to certain off-balance sheet exposure on account of special purpose vehicles, financial derivatives, and, guarantees and commitments may be given particular importance due to the difficulties that many NBFCs have in assessing the related liquidity risks that could materialise in times of stress.

(x) Funding Strategy – Diversified Funding

TDFC shall have effective diversification in the sources and tenor or funding. There should not be over-reliance on a single source of funding. Funding strategy should also take into account the qualitative dimension of the concentrated behavior of the deposit withdrawal in typical market conditions and over-reliance on other funding sources arising out of unique business model.

(xi) Collateral Position Management

TDFC has to manage its collateral positions, differentiating between encumbered and unencumbered assets. It should monitor the legal entity and physical location where collateral is held and how it may be mobilized in a timely manner.

(xii) Stress Testing

TDFC should conduct stress test on regular basis on a variety of short-term and market wide stress scenarios. The scenarios incorporate the major funding and market liquidity risk.

(xiii) Contingency Funding

TDFC may consider the following option to sail through any unforeseen contingency of stressed liquidity with the approval of Board.

- Reserve undrawn line of 10% of the limits, having sufficient drawing power, with the lenders and churning of undrawn lines frequently.
- Raise debentures and tier II capital.
- Maintain liquid funds in the form of investment in government securities and treasury bills.
- Sale of portfolios through securitization or direct assignment.
- Enter into arrangements with banks for co-origination of priority sector loans.
- ALCO shall have the powers to exercise any of the options as deems fit according to the circumstances.

(xiv) Internal Controls

Effective internal controls are an integral part of managing financial risk. Pursuant to the guidelines set forth in this policy, adequate controls must be established to ensure proper management of financial risk and to provide safeguards against mismanagement of TTDFC's funds and capital resources.

(xv) Responsibility of CRO

The Chief Risk Officer shall be involved in the process of identification, measurement and mitigation of all risks including liquidity risks.

(xvi) Asset Liability Management (ALM) Support Group

The ALM Support Group consisting of all the operating staffs shall be responsible for analysing, monitoring and reporting the liquidity risk profile to the ALCO.

3.3 ALM Reporting

Comprehensive reporting is designed to monitor key risks and their controls as per the NBFC regulations as enacted from time to time by RBI. Decisions relating to any corrective action shall be made as and when they seem necessary.

The following reports shall be provided to ALCO showing compliance with the established guidelines outlined in this policy and in accordance with guidelines established by RBI.

- Quarterly, 3 XBRL return in place NBS- 7
- Quarterly return on important financial parameters
- Quarterly DNBS 4A XBRL return in place of NBS-ALMI
- Monthly DNBS4 B XBRL return in place of NBS-ALM2 and NBS-ALM

Exception to guidelines outlined in this policy shall be reported to ALCO no later than the next regularly scheduled meeting after policy exception is identified.

3.4 Policy Review and Approval

The policy governing financial risk management activities that guidelines described herein shall be submitted to the ALCO of TTDFC at least annually for the review and approval.

3.5 Public Disclosure

TDFC shall publicly disclose information, in the prescribed format, on a quarterly basis on the official website of the company and in the annual financial statement as notes to account about the soundness of its liquidity risk management framework and liquidity position, which will enable market participants to make an informed judgement.

(V.Venkatarajan)
Joint Managing Director