ANDHRA PRADESH POWER FINANCE CORPORATION LIMITED

ASSET – LIABILITY MANAGEMENT POLICY

Approved in 167th Board Meeting

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1. Summary of Policy:

Policy Name	Asset - Liability Management Policy
Reference	RBI Master Direction & Circulars
Date of Approval	07-09-2020 (167th Board Meeting)
1st Revision of Policy	21-10-2021 (173rd Board Meeting)
2nd Revision of Policy	04-03-2022 (174th Board Meeting)
Periodicity of review	Annual
Owner / Contact	Compliance
Approver	Board of Directors

2. Introduction:

Andhra Pradesh Power Finance Corporation limited (APPFCL) is a Government Company established vide G.O.Ms. No. 54 Energy (Power–III) dated 19-05-2000 under the Companies Act, 1956 and commenced business on 13th July, 2000 with 100% ownership by Government of Andhra Pradesh. APPFCL is registered with Reserve Bank of India (RBI) as Non-Banking Finance Company (NBFC) – NDSI (Non-Deposit Taking Systematically Important) Company with effect from 25th August, 2000.

3. Main Objects of the Company:

To mobilize funds with competitive interest rates by issuing medium to long term (10 to 20 years) Bonds and availing Loans from Scheduled Commercial Banks and Inter Corporate Deposits from other Government Corporations for onward lending to Power Generating Companies and Power Distribution companies owned by Govt. of AP to finance their infrastructure and working capital needs.

For the past two decades, APPFCL has been in the business of raising financial resources mainly by issuing Power Bonds and lending to power distribution companies.

4. Major Assets & Liabilities of the Company

Following are the major assets of the company:

a. Loans issued to the Government owned Power Generating and Distribution Companies

b. Cash balance at Bank

c. Sundry Debtors

d. Fixed Assets.

Following are the major liabilities of the company:

a. Capital, reserves & surplus

b. Borrowings from Banks

c. Sundry Creditors

The company's loans as well borrowings consist of medium term to long terms with different maturity periods. During the course of conducting business, the company can face maturity mis-matches which will have an impact on liquidity and profitability of the company. It is therefore necessary that APPFCL monitors and manages liquidity constantly in such a manner that the mismatches remain within a reasonable and regulator prescribed limits. RBI also requires NBFCs to have effective ALM Policy as a part of overall risk management.

The company majorly depends on borrowings from banks as well ICDs from AP Govt owned entities for funding its activities. The funds mobilised through these sources at different times have different costs in accordance with movement of interest rates in the market. In the absence of due analysis and proper monitoring of interest rates on borrowings vis a vis loans, it can have adverse impact on the bottom line of the company. It is necessary to address interest rate risk as well, as a part of company's risk management. APPFCL is not exposed to Currency risk as it does not have foreign currency assets and liabilities.

5. Objective & Scope of the Policy:

Asset Liability Management (ALM) policy of the Corporation is aimed at managing the liquidity and interest rate risks. The present document seeks to integrate the overall concerns of managing Assets and Liabilities with specific accent on maximizing returns while controlling the risks.

The Policy is an exposition of the Corporation's approach to funding, deployment and pricing of various resources and assets; and aims to create systems and procedures to collect information, monitor, regulate and manage Liquidity and Interest Rate Risks. The management must necessarily operate within the "Framework of the Corporation's Vision and Mission" along with capital gearing, prudential controls as per the regulatory compliance laid down from time to time by Reserve Bank of India. The Corporation's ALM policy will pave the way for balance sheet positioning based on perception of Risk and Returns.

Having understood the importance and significance of sound ALM practices, APPFCL proposes to lay down the broad guidelines in respect of interest rate and liquidity risk management systems in the company, which form part of the Asset-Liability Management (ALM) function. The initial focus of the ALM function would be to enforce the risk management discipline viz. managing business after assessing the risks involved. The objective of good risk management systems is to facilitate evolution of these systems into a strategic tool for APPFCL's management.

An efficient ALM needs

(a) Good information system

(b) Policy for the company setting limits for liquidity, interest rate

(c) Committee of senior functionaries to ensure adherence to the limits prescribed by the Board of Directors

(d) Well defined process.

6. ALM Information Systems:

ALM has to 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. The central element for the entire ALM exercise is the availability of adequate and accurate information from the existing systems.

The company has employed "Tally" software for recording transactions duly complying with accounting standards applicable to the company. The software is capable of providing data on various aspects of balance sheet and profit and loss of the company. As a company with AUM of more than Rs.10,000 crore, as per extant RBI guidelines, it is necessary to segregate the 1-30 day time bucket in the statement of structural liquidity into granular buckets of 1-7 days, 8-14 days, and 15-30 days. In order to be able to meet this requirement, it is now proposed to take up further analysis with the help of data from Tally software and using excel spreadsheets before buying a tool, if necessary. It should be ensured by the preparer and checker to keep audit trails of the data collected/ extracted from the software for verification of regulatory authority and/ or auditors.

7. ALM Committee (ALCO):

The Asset Liability Management Committee (ALCO) will oversee the implementation of ALM policy and review its functioning periodically and provide direction on interest rate for deposits and loans. It also should ensure participation of senior functionaries to ensure Board approved policies are prescriptions are strictly adhered to. Accordingly, it is proposed to have ALM Committee in the corporation comprising of the flowing senior functionaries.

- Managing Director – Chairman
- Sri V.N Babu, Director– Member Secretary
- Company Secretary – Member
- Chief Financial Officer – Member

Quorum: The chairman and one of the 2 members will constitute the quorum.

Periodicity: Member Secretary will convene the meeting of ALCO quarterly or as and when needed.

ALCO will deliberate and discuss the following:

a. Liquidity Risk Management
b. Funding and Capital planning
c. Profit planning and Growth projection

Interest Rate movements and prescribing interest rate ranges for loans and borrowings

Minutes of the meeting to be prepared and preserved.

The Chairman of ALCO may appoint one or more personnel into the ALCO committee as and when required.

The ALM Support Group consisting of operating staff should be responsible for analyzing, monitoring and reporting the risk profiles to the ALCO. The staff should 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 APPFCL internal limits.

The Board shall have overall responsibility for management of risks and should decide the risk management policy of the company and set limits for liquidity, interest rate, foreign exchange and equity price risks. The Board of Directors, in their Board meetings, shall oversee the implementation of the system and review its functioning periodically.

8. ALM Process:

The scope of ALM function can be described as follows:

- Liquidity risk management
- Maturity profiling
- Management of interest rate risk
- Funding and capital planning
- Profit planning and growth projection

Liquidity Risk:

Liquidity risk relates to potential inability to meet all payment obligations when they fail due or only being able to meet them at excessive costs. The objective of the liquidity risk management framework is to ensure that the company can fulfil its payment obligations at all times and can manage liquidity and funding risk within its risk appetite. The Asset liability Committee regularly monitors the liquidity position and the duration of assets/liabilities. The Company maintains liquidity ratio as per regulatory requirements by investing in government securities.

Maturity Profiling

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

Time buckets are as under:

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

Inflows

1. Cash, Current Account balances with banks LESS minimum balance required are classified in 1-7 days bucket
2. Current Account minimum balances are classified under >6 months- 1 year bucket
3. Term Loan Instalments are classified in respective buckets as per maturity dates

4. Interest receivable on Term Loans is classified as per due dates
5. Other Assets are classified as per the timing of cashflows
6. Fixed assets are classified under > 5 years bucket

Outflows

1. Bonds/ Debentures are classified as per residual maturity
2. ICDs are classified as per residual maturity
3. Term Loans from Banks are classified as per residual maturity
4. Interest payable on Term Loans are classified in the buckets as per due dates
5. Working Capital loans are classified in the bucket > 6 months- 1 year
6. Expenses payable is classified as per likely time of cash flows
7. Sundry Creditors are classified as per likely time of cash flows
8. Other provisions are classified in the buckets as per purpose/ nature of underlying transaction
9. Capital, Reserves & Surplus are classified in > 5 years bucket

Details/ As on	1-7 days	8-14 days	15-30/31 days	>1 month - 2 months	>2 months – 3 months	>3 months – 6 months	> 6 months – 1 year	>1 year – 3 years	>3 years – 5 years	> 5 years
Inflows										
Outflows										
Mismatch										
Cumulative surplus/ deficit										

Main focus is on 1-30/31 days bucket. Since on lending is tied up before availing bank borrowings and funds are immediately deployed in sync with terms of bank borrowings, maturing obligations are tagged to instalment and interest payments falling due. Therefore, on meeting the short term and medium-term liabilities on account of bank borrowings which is the largest part of APPFC's liabilities, no mismatches are faced.

The net cumulative negative mismatches in the maturity buckets of 1-7 days, 8-14 days, and 15-30 days shall not exceed 10 per cent, 10 per cent and 20 per cent of the cumulative cash outflows in the respective time buckets. Analysis of mismatches will be carried out to ensure that

they are kept well within the RBI prescriptions.

Prudential Limits for negative mismatches:

In the light of RBI's guidelines on maturity mismatches, it is proposed to have in place the following prudential limits for negative mismatches in time buckets upto 1 year:

Details	1-7 days	8-14 days	15-30/31 days	>1 month - 2 months	>2 months – 3 months	>3 months – 6 months	> 6 months – 1 year
Prudential Limits for cumulative negative mismatch	10%	10%	20%	30%	30%	40%	50%

Liquidity Coverage Ratio:

As per RBI guidelines, all non-deposit taking NBFCs with asset size of ₹ 10,000 crore and above, and all deposit taking NBFCs irrespective of their asset size, shall maintain a liquidity buffer in terms of LCR which will promote resilience of NBFCs to potential liquidity disruptions by ensuring that they have 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 NBFCs shall be minimum of 100% of total net cash outflows over the next 30 calendar days. The ratio worked out on the following formula and tested at monthly intervals by the ALCO committee staffs and submitted to ALCO at quarterly meetings. Besides, in the event of adverse situation observed at the time of monthly testing, meeting of ALCO to be convened to address and to take immediate corrective measures.

$$\text{Liquidity Coverage Ratio} = \frac{\text{Stock of High Quality Liquid Assets (HQLA)}}{\text{Total Net Cash Outflows over the next 30 calendar days}}$$

"High Quality Liquid Assets (HQLA)" means liquid assets that can be readily sold or immediately converted into cash at little or no loss of value or used as collateral to obtain funds in a range of

stress scenarios.

In terms of RBI Master Direction vide **DOR.NBFC (PD) CC. No.102/03.10.001/2019-20 dated November 4, 2019** the LCR is required to be maintained by NBFCs as per the following schedule:

From	December 1, 2020	December 1, 2021	December 1, 2022	December 1, 2023	December 1, 2024
Minimum LCR	50%	60%	70%	85%	100%

In accordance with the above requirement, APPFCL will maintain LCR at the present required level of 60% which will be built up gradually to 70% by December 01, 2022.

Liquidity Monitoring Metrics:

In order to be able to identify the liquidity strains in the Company early, it is proposed to adopt tools to periodically measure the liquidity position. Keeping in view the growing balance sheet of the company, it is proposed that the management shall carry out analysis of following ratios which are appropriate for the company's profile at quarterly intervals, which should be submitted to ALCO at its quarterly meetings.

1. Short term Liability to Total assets
2. Short term Liability to Long Term assets
3. Non-convertible debentures to Total assets
4. Short term liabilities to Total liabilities
5. Long term assets to Total assets

On a quarterly basis it will be monitored to keep the ratios from 1 to 4 above towards the lower end by making necessary changes in resources mobilization and deployment strategies. It would be the endeavour to rely more on the long term resources to fund the long term assets.

Stress Testing – Scenario Analysis

As an NBFC the Company is exposed to the risk of meeting the demands from depositors for premature payments and also the delays that could occur in repayment of the loans by the borrowers. It is therefore, proposed to carryout scenario analysis at quarterly intervals so as to ensure the Company is equipped to meet the challenges on liquidity front.

For quarterly stress testing the following will be analysed:

1. Demand for immediate payment of 10%, 20% and 50% of all liabilities.
2. Delay in repayment of 10%, 20% and 50% of demand on Company's borrowers.

Contingency Funding Plan

The following are the important sources of funds for the Company:

a. Non-Convertible Debentures
b. Term loans from Commercial Banks
c. Inter Corporate Deposits
d. Capital of Shareholders (Govt. of AP)

Keeping in view the time lines required for meeting the SEBI compliances, raising funds through NCDs would not be an appropriate solution to meet the demands for immediate payments. Since relationships are well established with 5 public sector banks, the Company will be able to raise loans from banks within 7 to 10 days. The Company can also resort to raising funds from other Government entities under ICDs to meet the immediate liquidity requirements. Finally, since APPFCL is a 100% owned by the Government of Andhra Pradesh, the Company can resort to seeking infusion of additional capital funds from the GoAP.

<u>Interest Rate Risk</u>:

The Company's exposure to changes in interest rates relates to its investment in debt securities. All the debt securities of the Company are in local currency and on fixed rate basis and hence not subject to interest rate risk.

In order to cover the risk of changes in interest rates on borrowings from various banks which are at floating rate, effective prior planning to cover such risks has been in place from time to time.

Since APPFC is meant for exclusively catering to the requirements of state government undertakings, borrowings are raised for immediate on lending. Bank Borrowings and Loans to Power sector state government companies are the only major interest bearing liabilities and assets. While negotiating pricing with Banks/ other lenders, the likely yield on onward lending is considered which is always at a mark-up on borrowing rate. Thus, Interest Rate Risk is well addressed in the designing the loan product itself.

However, it is proposed to explore deploying a cost effective tool to segregate and classifying these assets and liabilities into maturity, interest rate buckets for preparation Gap Reports so as to carry out a meaningful Interest Rate sensitivity analysis.

Funding and Capital Planning

The Board shall take necessary actions as and when required for the purpose of funding and for capital infusion in order to comply with RBI guidelines from time to time.

Profit Planning and Growth Projection

Profit Planning and the future growth projections are the core functions of the management.

ALCO should deliberate and debate on issues and opportunities concerning business growth and pricing of loans to company's borrowers and cost of raising funds.

9. Internal Controls:

The company has well defined processes, checks and balances put in place. The Internal Audit is being conducted half-yearly. Keeping in view with the growth of the company, the internal audit may have to be conducted quarterly. The Company also has a well-defined Internal Control Systems in place.