PROSPER HOUSING FINANCE LIMITED

ASSET LIABILITY MANAGEMENT (ALM)

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(The Policy is revised as per directives of NHB vide Circular No. NHB/ND/DRS/Pol-No.35/2010-11 dated October 11, 2010)

I. INTRODUCTION

Considering the recent international developments and the corresponding concerns regarding the enhanced systemic risk associated with the activities and operations of the Prosper Housing Finance Companies and exposure to credit and market risks which also give rise to Asset Liability mismatches and interest rate risk exposures, the Prosper Housing Finance Limited is inclined to introduce an ALM System as part of their overall system for effective risk management in their various portfolios in accordance with the revised guidelines of NHB for Housing Finance companies issued by the Bank vide Circular No. NHB/ND/DRS/Pol-No.35/2010-11 dated October 11, 2010. This is a living document and supposed to be updated on a regular basis. Any regulatory change that would impact the aspects of the company would be reflected here.

II. OBJECTIVES

The ALM Policy encompasses the strategic management of the balance sheet aimed at achieving sustained growth, profitability and solvency. It involves a multiplicity of management activities and responsibilities, including the formulation of long-term strategic goals and objectives and the management of various risks including liquidity risk, interest rate risk, credit risk and market risk. Asset liability management is an approach that provides company with protection that makes such risk acceptable. Asset-liability management models enable company to measure and monitor risk, and provide suitable strategies for their management. It is therefore appropriate for the company to focus on asset-liability management when it faces financial risks of different types. Asset-liability management includes not only a formalization of this understanding, but also a way to quantify and manage these risks. Further, even in the absence of a formal asset-liability management program, the understanding of these concepts is of value to a company as it provides a truer picture of the risk/reward trade-off in which the company is engaged.

Asset-liability management is a first step in the long-term strategic planning process. Therefore, it can be considered as a planning function for an intermediate term. In a sense, the various aspects of balance sheet management deal with planning as well as direction and control of the levels, changes and mixes of assets, liabilities, and capital.

III. <u>KEY ELEMENTS</u>:

As Per NHB Directions:

1. Applicability

As per NHB requirements, the guidelines for asset liability management system in housing finance companies are applicable to all HFCs irrespective of whether they are accepting / holding public deposits or not. Accordingly, all HFCs are required to put in place the ALM system.

2. Reporting

The periodicity of the Statement of short term dynamic liquidity shall be quarterly and that of Statement of structural liquidity and Interest rate sensitivity, half-yearly. The quarterly statement shall be submitted within 10 days of the close of the quarter to which it relates and half yearly statements within 20 days of the close of the half year to which they relate to NHB by those HFCs meeting the criteria of asset base of Rs. 100 crore (whether accepting / holding public deposits or not) or holding public deposits of Rs. 20 crore or more (irrespective of their asset size) as per the audited balance sheet. The Company is exempted from the reporting to NHB as per define criteria of Guidelines.

3. Additional Disclosures in Balance Sheet

Prosper Housing Finance Limited is disclosing the following particulars in its Balance Sheet from the year ending 31st March 2011, relating to:
i. Capital to Risk Assets Ratio (CRAR)
ii. Exposure to real estate sector, both direct and indirect; and
iii. Maturity pattern of assets and liabilities

4. Dynamic and Integrated Risk Management System

Prosper Housing Finance Limited is exposed to credit and market risks in the normal course, in view of the asset-liability transformation. With liberalization in Indian financial markets over the last few years and growing integration of the domestic markets with external markets, the risks associated with the operations of the Company has become complex and large, requiring strategic management.

Prosper Housing Finance Limited is operating in a fairly deregulated environment and is required to determine interest rates on its own, subject to the ceiling on maximum rate of interest, on a dynamic basis. Intense competition for business involving both the assets and liabilities has brought pressure on the managements of Prosper Housing Finance Limited to maintain a good balance amongst spreads, profitability and long-term viability. These pressures call for structured and comprehensive measures and not just *ad hoc* action. The management of Prosper Housing Finance Limited has to base its business decisions on a dynamic and integrated risk management system and process driven by corporate strategy. Prosper Housing Finance Limited is exposed to several major risks in the course of its business - credit risk, interest rate risk, liquidity risk, operational risk etc.

Hence, Prosper Housing Finance Limited is introducing effective risk management systems that address the issues relating to interest rate and liquidity risks.

5. Risk Management and Asset Liability management Practices in Structured Manner

Prosper Housing Finance Limited would address the risks in a structured manner by upgrading their risk management and adopting more comprehensive Asset-Liability Management (ALM) practices than has been done hitherto.

ALM, among other functions, is also concerned with management of risks and provides a comprehensive and dynamic framework for measuring, monitoring and managing liquidity and interest rate risks of the Company that is closely integrated with the Company’s business strategy. It involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

6. ALM Function

The focus of the Company’s ALM function would be to enforce the discipline of market risk management viz. managing business after assessing the market risks involved. The objective of the Company‘s risk management system would be to evolve into a strategic tool for effective management of the Company.

7. Three Pillars of ALM Process

The ALM Process rests on three pillars:

i. ALM Information System
   - ⇒ Management Information Systems
   - ⇒ Information availability, accuracy, adequacy and expediency

ii. ALM Organisation
   - ⇒ Structure and responsibilities
   - ⇒ Level of top management involvement

iii. ALM Process
   - ⇒ Risk parameters
   - ⇒ Risk identification
   - ⇒ Risk measurement
   - ⇒ Risk management
   - ⇒ Risk policies and tolerance levels

8. ALM Information Systems

i. A pre-requisite for putting in place the ALM System is a strong Management Information System (MIS). For a quick analysis and consolidation of the data, it is necessary to computerise the MIS and make use of specialised software for managing the assets and liabilities with respect to the maturity mismatches and the various risks associated with such mismatches.

   Therefore, considering the aforesaid, Prosper Housing Finance Limited would put in place a strong Management Information System in line with the requirements of NHB.

ii. ALM has to be supported by a management philosophy that clearly specifies the risk policies and tolerance limits. This framework needs to be built on sound methodology with necessary supporting information system as the central element of the entire ALM exercise is the availability of adequate and accurate information with expedience. 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 data intensive Risk Adjusted Profitability Measurement methods.

   In view of the above, Prosper Housing Finance Limited would develop a well-built Management Philosophy corresponding to the directives of NHB.

9. ALM Organisation

1. a) Successful implementation of the risk management process would require strong commitment on the part of the senior management in the HFC, to integrate basic operations and strategic decision making with risk management.

Taking into consideration, the Board undertakes to have overall responsibility for management of risks and would decide the risk management policy of the Company and would set limits for liquidity, interest rate, exchange rate and equity price risks.

b) The Asset-Liability Committee (ALCO) consisting of the HFC's senior management including the Ms. Gurvir Kaur Sran, Director acknowledges to take responsibility for ensuring adherence to the limits set by the Board as well as for deciding the business strategy of the Company (on the assets and liabilities sides) in line with the Company's budget and decided risk management objectives.

c) The ALM Support Groups consisting of operating staff would be responsible for analysing, monitoring and reporting the risk profiles to the Management. The staff would also prepare forecasts (simulations) reflecting the impact of various possible changes in market conditions on the balance sheet and recommend the action needed to adhere to Company's internal limits.

2. The ALCO is a decision-making unit responsible for integrated balance sheet management from risk-return perspective including the strategic management of interest rate and liquidity risks.

The Company would decide on the role of its ALCO, its powers and responsibilities as also the decisions to be taken by it. The business and the risk management strategy of the Company should ensure that it operates within the limits/parameters set by the Board. The business issues that an ALCO would consider will, *inter alia,* include product pricing for both deposits and advances, desired maturity profile and mix of the incremental assets and liabilities, prevailing interest rates offered by other peer HFCs for similar services/product, etc.

In addition to monitoring the risk levels of the Company, the ALCO would review the results of and 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 decisions for future business strategy on this. In respect of the funding policy, for instance, its responsibility would be to decide on the source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between fixed vs. floating rate funds, wholesale vs. retail funds, money market vs. capital market funding, domestic vs. foreign currency funding, etc. The Company would decide the frequency of holding its ALCO meeting.

3. Composition of ALCO

To ensure commitment of the Top Management and timely response to market dynamics, Ms. Gurvir Kaur Sran, Director would head the Committee. The Chiefs of Investment, Credit, Resources Management or Planning, Funds Management/ Treasury, International Business and Economic Research can be members of the Committee. In addition, the Head of the Technology Division may also be an invitee for building up of MIS and related computerization.

At present the Composition of ALCO Committee of the Company is as follows:

Name	**Designation**
Ms. Gurvir Kaur Sran	Director
Mr. Pavinder Khanna	Chief Risk Officer
Mr. Magandeep Singh	Independent Director
Ms. Tanu Sharma	Company Secretary/ Risk Officer

Wherein the Chief Risk Officer reports to the Director of the company and thereafter, the matter is put before the Managing Director.

4. Committee of Directors

The Management Committee of the Board would oversee the implementation of the ALM system and review its functioning periodically.

10. ALM Process

The scope of ALM function can be described as under:

- Liquidity risk management
- Management of market risks
- Funding and capital planning
- Profit planning and growth projection

- Forecasting and analysing 'what if scenario' and preparation of contingency plans

The policy contained in this note mainly address Liquidity and Interest Rate risks.

11. Liquidity Risk Management

1. Measuring and managing liquidity needs are vital for effective operation of HFCs. By assuring an HFC's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system.

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. However, The Company is exempted from the reporting of Statement of Structural Liquidity to NHB as per define criteria of Guidelines.

2. The Maturity Profile would be used for measuring the future cash flows of the Company in different time buckets. The time buckets may be distributed as under:

1. 1 day to 14 days
2. Over 14 days to one month
3. Over one month and upto 2 months
4. Over 2 months and upto 3 months
5. Over 3 months and upto 6 months
6. Over 6 months and upto 1 year
7. Over 1 year and upto 3 years
8. Over 3 years and upto 5 years
9. Over 5 years and upto 7 years
10. Over 7 years and upto 10 years
11. Over 10 years

3. HFCs holding public deposits are required to invest a prescribed percentage of their deposits in approved securities in terms of liquid asset requirement under Section 29B of the NHB Act, 1987. There is no such requirement for Prosper Housing Finance Limited as the Company is not holding deposits.

4. A copy of the policy note recorded by the HFCs on treatment of the investment portfolio for the purpose of ALM and approved by their Board should be forwarded to the NHB. However, there is no such requirement for Prosper Housing Finance Limited as the Company is not holding deposits.

5. The Statement of Structural Liquidity may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. However, The Company is exempted from the reporting of Statement of Structural Liquidity to NHB as per define criteria of Guidelines.

6. In order to enable the HFCs to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1 day to 6 months, HFCs may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes. However, The Company is exempted from the reporting of Statement of Short Term Liquidity to NHB as per define criteria of Guidelines.

12. Currency Risk

Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of HFCs' balance sheets, if having foreign assets or liabilities. Since the Company does not have any foreign assets and liabilities, thus the Company’s balance sheet is not vulnerable to exchange rate movements.

13. Interest Rate Risk

1. The operational flexibility given to HFCs in pricing most of the assets and liabilities imply the need for the financial system to hedge the interest rate risk. Interest rate risk is the risk where changes in market interest rates might adversely affect an HFC's financial condition. The immediate impact of changes in interest rates is on HFC's earnings (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on HFC's Market Value of Equity (MVE) or 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).

2. 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:
i. within the time interval under consideration, there is a cash flow;
ii. the interest rate resets/re-prices contractually during the interval;

iii. it is contractually pre-payable or withdrawal before the stated maturities;
iv. It is dependent on the changes in the Bank Rate by RBI.

3. The Gap Report would 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 a specified time-frame are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the Prosper Housing Finance Limited expects to receive it within the time horizon. This includes final principal repayment and interim installments. Certain assets and liabilities carry floating rates of interest that vary with a reference rate and hence, these items get re-priced at pre-determined intervals. Such assets and liabilities are rate sensitive at the time of re-pricing.

While the interest rates on term deposits are generally fixed during their currency, the tranches of advances are basically floating. The interest rates on advances could be re-priced any number of occasions, corresponding to the changes in PLR. The interest rate gaps may be identified in the following time buckets:

i. 1 day to 14 days
ii. Over 14 days to one month
iii. Over one month to 2 months
iv. Over 2 months to 3 months
v. Over 3 months to 6 months
vi. Over 6 months to 1 year
vii. Over 1 year to 3 years
viii. Over 3 years to 5 years
ix. Over 5 years to 7 years
x. Over 7 years to 10 years
xi. Over 10 years
xii. Non-sensitive

4. 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 vice versa.

5. Prosper Housing Finance Limited would set prudential limits on individual Gaps in various time buckets with the approval of the Board. Such prudential limits would have a relationship with the Total Assets, Earning Assets or Equity. In addition to the interest rate gap limits, the Company may set the prudential

limits in terms of Earnings at Risk (EaR) or Net Interest Margin (NIM) based on their views on interest rate movements with the approval of the Board/ALCO.

14. General

1. The classification of various components of assets and liabilities into different time buckets for preparation of Gap reports (Liquidity and Interest Rate Sensitivity). The Company would classify them in the appropriate time buckets, subject to approval by the Board. A copy of the note approved by the Board would be sent to the NHB.

2. The Company would evolve suitable mechanism, supported by empirical studies and behavioural analysis, to estimate the future behaviour of assets, liabilities and off- balance sheet items to changes in market variables and estimate the probabilities of options.

3. A scientifically evolved internal transfer pricing model by assigning values on the basis of current market rates to funds provided and funds used is an important component for effective implementation of ALM System. The transfer price mechanism can enhance the management of margin i.e. lending or credit spread, the funding or liability spread and mismatch spread. It also helps centralising interest rate risk at one place which facilitates effective control and management of interest rate risk. A well-defined transfer pricing system also provides a rational framework for pricing of assets and liabilities.

15. Applicability

Business of company involves the identifying, measuring, accepting and managing the risk, the heart of company's financial management is risk management. One of the most important risk-managemnet functions in bank is Asset Liability Management.

The Prosper Housing Finance Limited has very limited volume of the business and the company does not have any deposits. Nonetheless, in keeping the long term perspective of the issue the company will ensure implementation of the "Guidelines of asset liability Management" which is the responsibility of the entire organization.

16. Reasons for growing significance of ALM

-Volatility
-Product Innovation

-Regulatory Framework
-Management Recognition

An effective Asset Liability Management technique aims to manage the volume mix, maturity, rate sensitivity, quality and liquidity of assets and liabilities as a whole so as to attain a predetermined acceptable risk/reward ratio.

17. Asset Classification

(a) As per NHB guidelines- Every housing finance company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely :-

(i) Standard assets;
(ii) Sub-standard assets;
(iii) Doubtful assets; and
(iv) Loss assets.

(b) The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

18. Company chalk out the guidelines as under:

- Asset Liability Management will be analysed & supervised by the ALCO of the company.
- At present the company does not have any liability except Working Capital Limit with nationalized bank. The limits are to be renewed in every 12 months. In case of limit recall by the bank, the company can repay the outstanding of the bank from the recovery of the advances and infusion of the fresh share capital.
- The rate of interest charged by the bank is affordable to the company.
- The Company is charging the rate of interest on advances from 10% to 16% p.a. on reducing basis.
- The present repayment period of the advances is 1-15 years

19. General

(i) The Board of Director of company provide for periodical review of the compliance at various levels of management. A consolidate report of such reviews (if required) may be submitted to the Board at regular intervals, as may be prescribe by it.

(ii) The Company reserves to itself the right to alter/delete/add to these codes at any time without prior individual notice and such alterations /deletion/addition shall be binding.

For and on behalf of
Prosper Housing Finance Limited

GURVIR KAUR SRAN
(Director)
DIN: 00057473

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