

Asset Liability Management (ALM) System

December 31, 1999

Ref DBS.FID No. C-11 /01.02.00/99-2000

To All India Financial Institutions

Dear Sir,

Asset Liability Management (ALM) System

Please refer to our Circular FID.No.38/01.02.00/98-99 dated 20th April 1999 forwarding the draft ALM guidelines for the FIs. In the light of the comments received from the FIs and the subsequent meetings held with the select FIs, the draft guidelines have been reviewed by us and the final guidelines are enclosed. The guidelines should be implemented with effect from 1 April, 2000.

2. The FIs need to constitute an Asset Liability Committee, headed by CEO/CMD/DMD/ED, on which the senior management of the FI from various relevant functions/departments should be represented. The Management Committee of the Board or any other specific committee constituted for the purpose should oversee the implementation of the ALM System. Setting up an effective supporting MIS would be critical to successful operationalisation of the ALM system. In case, some of the FIs have more sophisticated system already in place, they may continue with it but should ensure due compliance with the reporting requirements under the guidelines.

3. The reporting mechanism under the ALM system envisages a liquidity gap report and a report on interest rates sensitivity. For the liquidity report, various items of assets and liabilities need to be classified into one of the prescribed 10 time-buckets as per their residual maturity / timing of the cash flow, as detailed in the guidelines. The liquidity report should be compiled **at quarterly intervals**, commencing from the position as on 1 April 2000 and at **fortnightly** intervals from 1 April 2001. For the interest rate sensitivity report, the items of assets and liabilities are to be slotted into the prescribed 10 time-buckets as per the timing of the interest rate sensitivity of the cash flow or the repricing date for the asset or liability, in accordance with the guidelines. The IRS statement should be prepared **at quarterly intervals** beginning from the position as on 1 April 2000 and at **monthly** intervals from 1 April 2001. It may be noted that the ALM System contemplated in the guidelines

seeks to capture not only the items of assets and liabilities appearing on the balance sheet as on the reporting date but also the **cash flows** emanating from these items **over the entire life** of the asset, liability or the contingent commitments.

4. Under the guidelines, the prudential **liquidity gap limits for negative gaps** in the first two time-buckets (viz. 1 – 14 days and 14 – 28 days) have been fixed at 10 per cent and 15 per cent of the cash outflows in the respective time-buckets. For **cumulative negative gaps** across all time-buckets, the FIs are expected to fix their own prudential limits, with the approval of the Board / ALCO. Also for the **interest rate gaps** in various time buckets, the prudential limits will have **to be fixed by the Board / ALCO** of each FI. The limits for interest rate risk could be set either as simple gap limits or in terms of impact on Net Interest Income (NII)/ Net Interest Margin (NIM) or Value / Earnings at Risk .

5. Some of the FIs have been granted restricted Authorised Dealer licence by Reserve Bank and are, therefore, not subject to the full scope of reporting requirements under the Exchange Control Regulations. Besides, the FIs which do not hold restricted AD licence may also have foreign currency exposures. Hence, the ALM System intends to capture the operations of FIs not only in the domestic currency but also in various foreign currencies. It would, therefore, be necessary for all the FIs to compile the **currency-wise liquidity and IRS reports** in respect of their foreign currency portfolio in the prescribed formats – which are similar to those prescribed for rupee resources.

6. We also enclose a copy each of BIS papers on “A Framework for Measuring and Managing Liquidity” and “Principles for the Management of Interest Rate Risk” for your information and guidance. As regards furnishing of data on an on-going basis to Reserve Bank of India, a separate communication will follow.

7. This circular may please be placed before the Board of Directors at its next meeting.

Please acknowledge receipt.

Yours faithfully,

(K. C. Bandyopadhyay)
Chief General Manager