LIQUIDITY RISK MANAGEMENT POLICY

OF

GUJARAT STATE FINANCIAL SERVICES LTD. (GSFS)

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Background

GSFS was established to ease and facilitate financial resources to the state-owned undertakings. To further this objective, the State Government has given mandate to the company to manage the surplus funds of the state entities and has issued directions from time to time to Government of Gujarat (GoG) entities for placing their funds with GSFS, in order to effectively implement the mandate. GSFS primarily provides these funds as loans to GoG entities only and hence acts as an in-house fund manager to the GoG entities. Thus, the idea of formation of GSFS is to manage funds of GoG entities which results into the circulation of funds within the State Government ambit. With respect to this mandate, it is prudent for GSFS to manage the liquidity for its assets and liabilities in a manner such that it is able to repay its obligations in a timely manner. This is also a statutory obligation as RBI, the regulating authority for NBFCs, has stipulated that NBFCs should have an effective Liquidity Risk Management Policy as a part of their overall effective risk management system.

Business Model of GSFS

GSFS has a unique business model in India which creates a win-win situation for GoG entities placing their funds with GSFS, GoG entities taking loans from GSFS and Government of Gujarat. The basic objective of the company is to manage the surplus funds of GoG entities as per the mandate of State Government. The funds received are primarily provided as loans to other GoG entities at a lower rate as compared to banks/FIs. The business model of GSFS is a unique time-tested model in India which has been in operation since last more than two decades and continues to be so. The Board approved business model of GSFS is as under:

i. Pooling the financial resources of GoG entities under one umbrella for effective supervision by the State Government.
ii. Providing hassle-free loans to GoG entities as per their requirement.

iii. In case of low credit requirement of GoG entities and to maintain adequate liquidity, investing the remaining available funds received from GoG entities in safe and highly liquid avenues for timely repayment of liabilities and to generate reasonable returns.

iv. Optimum utilisation of the available financial resources in a manner which is beneficial to the State Government as a whole.

v. Providing financial intermediation for effective and efficient management of GoG funds which may help the State Government in the administration of public policy matters related to State finances.

vi. All processes to be carried out through simplified mechanism that ensures ease of operations for GoG entities.

The entire business model of the company runs on the strength of the State Government parentage and as per the Credit and Investment Policy approved by Government of Gujarat.

The major assets and liabilities of GSFS consist of the following:

A. Liabilities – Deposits in the form of Inter Corporate Deposits (ICDs) received from GoG entities with tenors ranging from 15 days to 3 years and Liquid Deposit Scheme (LDS) received from GoG entities having tenor less than 15 days.

B. Assets – Deployment of funds as Loans to GoG entities and Money Market Investments.

Objective and Scope

The objective of this policy is to formulate a framework to deal with following aspects of liquidity risk management.

a) Liquidity Risk Management, Strategies and Practices
b) Management Information System (MIS)
c) Internal Controls
d) Maturity profiling
e) Liquidity Risk Monitoring Tools

The above mentioned aspects of the liquidity risk management framework shall be exercised taking into account the Government of Gujarat centric business model of the company.

a) Liquidity Risk Management, Strategies and Practices

The company shall strive to ensure maintaining of sufficient liquidity including availability of unencumbered, high quality liquid assets to withstand a range of stress events, having potential to lead to loss or diminution in value of investments of the Company. Key elements of the liquidity risk management framework shall be as under:

i. Governance of Liquidity Risk Management

The successful implementation of any risk management process emanates from the top management with a strong commitment to integrate basic operations and strategic decision-making with risk management. In this regard, the ALM support group consisting of senior officials shall analyse and monitor the liquidity position of the company and in case of any adverse situation, shall report to Asset Liability Management Committee (ALCO) and Risk Management Committee (RMC).

The company shall have the following set up for identification, measurement, and mitigation of risks for effective management of its liquidity risks:

a. Board of Directors

The Board of Directors (BoD) shall provide the leadership and guidance for liquidity risk management (LRM) framework as defined in this LRM Policy, keeping in perspective the unique business model of the company. The ALCO and RMC shall oversee the implementation of the LRM framework as per this LRM Policy. The Board shall note the Minutes of the Meeting of ALCO and RMC on periodic basis to review the company's position in accordance with the LRM framework.

b. Risk Management Committee

The Risk Management Committee of the Board shall provide guidance in identification and management of overall risks faced by the company. The RMC shall review the overall risk assessment of the company on periodic basis, including liquidity risk. The Minutes of the RMC meeting shall be placed in the ensuing Board Meeting.

c. Asset-Liability Management Committee (ALCO)

The liquidity risk management of the company shall be overseen by the ALCO on periodic basis. The ALCO shall review the liquidity position of the company based on certain crucial parameters as desired by the LRM framework of RBI, including review of net cumulative liquidity position for different tenor buckets as prescribed by the internal prudential limits, desired maturity profile & mix of asset-liabilities, sensitivity analysis for Liquidity Coverage Ratio, structural liquidity position, contingency funding plan and collateral management position. The Minutes of the ALCO meeting shall be placed in the ensuing Board meeting.

ii. Liquidity Risk Tolerance

The Liquidity Risk Tolerance of the company shall be the internal prudential limit prescribed in the Asset Liability Management (ALM) Policy of the company. The internal prudential limits measure the liquidity position across different tenor buckets as suggested by the RBI. The Company shall strive to adhere to these limits by managing its liquidity position in a manner that is in accordance with its business model while ensuring availability of adequate liquidity for timely repayment of its obligations.

In case of any mismatch in any of the tenor buckets, the company shall use its on-hand balance, its investments in open-ended liquid/debt schemes of Asset Management Companies (AMCs) or can also utilise likely fresh inflow of funds to repay its obligations across tenors in a timely manner.

iii. Off-balance Sheet Exposures and Contingent Liabilities

The projected cash flows arising on account of off-balance sheet items and contingent liabilities along with the availability of liquidity avenues shall be included in the Structural Liquidity Statement report which is prepared on monthly basis and submitted to RBI.

iv. Collateral Position Management

The entire business model of the company runs on the strength of the State Government parentage and as per the Credit and Investment Policy approved by Government of Gujarat. As per the Credit & Investment Policy, the company shall provide loans to GoG entities only and not to any retail or private entities. Moreover, the policy does not permit GSFS to take any mortgage on assets of the loanee GoG entities. Hence, as the company does not take any collateral, the collateral management activity for its fund management shall not be required in case of GSFS.

v. Funding Strategy - Diversified Funding

The company shall receive the funds from GoG entities according to the mandate of the State Government directing the GoG entities to park their funds with GSFS. Hence, the funding strategy of the company shall comprise of funds received from GoG entities as per the GoG mandate which shall be the only source of funding for the company.

vi. Stress Testing

The company shall carry out stress testing to assess its liquidity position under certain variety of stress scenarios, which shall be placed for the review of ALCO and RMC members on periodic basis. Some of the situations which may be simulated by the company while conducting stress testing may include a) review of LCR position against stipulated levels of RBI and b) sensitivity analysis to assess the LCR position of the company over next 30 days under stress scenario of simultaneous increase in outflows and decrease in inflows, along with applicable hair-cuts as prescribed by RBI.

vii. Contingency Funding Plan

The company functions as per the mandate of the State Government which aims at pooling the financial resources of GoG entities under one umbrella for effective supervision by the State Government. By virtue of its business model, the supply of funds received by GSFS from GoG entities remains continuous. Moreover, the company also witnesses a high ratio of roll over of these funds placed by GoG entities on maturity. The company provides these funds as loans to GoG entities as per their requirement and invests the remaining funds in safe and highly liquid avenues for timely repayment of liabilities. Hence, by virtue of this business model the company has a comfortable liquidity position as evident from the consistently high LCR ratio maintained by the company.

However, despite the above reasons, in case if any situation of contingency funding arises in future, it may be addressed by the company in consultation and under the guidance of the State Government as the company receives its entire funding from the State Government entities as per the directions of the State Government.

Process to quantify liquidity costs in the internal product pricing, performance measurement and new product approval process:

As per the business model of the company, it receives funds from Government of Gujarat (GoG) entities as per the mandate of the State

Government which directs GoG entities to park their funds with GSFS. Hence, this is the only source of funding for the company. These funds are provided as loans to other GoG entities and remaining funds are invested in the GSGS (Gujarat State Government Securities) and open ended overnight/liquid/debt schemes of Mutual Funds.

The company uses its on-hand balance, its investments in open-ended overnight/liquid/debt schemes of Mutual Funds and fresh inflow of funds from GoG entities for its repayment requirements. Hence, as per the business model, the liquidity requirements of the company are met through internal avenues only and the company does not require to undertake any outside borrowings.

In the absence of any outside borrowing, the process to quantify the liquidity cost of company for internal product pricing and performance measurement is not prescribed.

In case of change in the above business model of the company, the process to quantify the liquidity costs will be considered accordingly and made a part of this policy.

viii. Public disclosure

The company shall publicly disclose information on its website and in the annual financial statements as notes to accounts as per the "Appendix 1: LCR Disclosure Template" in Liquidity Risk Management Framework for Non-Banking Financial Companies, as prescribed by the RBI directions.

b) Management Information System (MIS)

As per the LRM framework, the company shall prepare the liquidity position under normal and stress scenarios on periodic basis for its review by ALCO and RMC. If required, the ALCO and RMC may also refer to the stipulated templates by RBI viz Dynamic Liquidity Statement (DNBS-4A) and Structural Liquidity Statement (DNBS-4B), to review the net cumulative liquidity position under different granular time buckets, on account of maturing repayments and those arising from contingent liabilities and off-balance sheet items.

c) Internal Controls

The company shall have adequate internal control measures to monitor its liquidity position on periodic basis. These measures may include maintaining MIS on periodic (daily, weekly, fortnightly, monthly, need based) basis for funds received from GoG entities, movement of funds for major GoG entities and the likelihood of loan off take by loanee entities.

d) Maturity Profiling

The company shall use the Statement of Structural liquidity prepared on monthly intervals towards maturity profiling of its assets and liabilities across different time buckets. The maturity profile shall be used for measuring the net cumulative liquidity position of the company arising on account of future cash inflows from maturing assets and outflows from maturing liabilities across different time buckets. The time buckets shall be distributed in the same intervals as provided in the ALM Policy of the Company which are as prescribed by RBI. A maturing liability shall be a cash outflow while a maturing asset shall be a cash inflow.

Within each time bucket, there could be mismatches depending on cash inflows and outflows. While the mismatches up to one year would be relevant since these provide early indications of impending liquidity requirements, the primary focus shall be on the short-term liquidity mismatch over next 30 days. In this regard, the internal prudential limits to monitor the cumulative mismatches across all time buckets shall be as prescribed in the ALM Policy of the company.

e) Liquidity Risk Monitoring Tools

The Statement of Structural Liquidity shall be the prescribed monitoring tool to assess liquidity risk. In addition to the Statement of Structural Liquidity, the company shall monitor the following attributes from the perspective of effective liquidity risk management:

a. **Concentration of Funding**

   The company, as per its business model, has a single source of funding from GoG entities on account of the mandate of the State Government. The company shall maintain list of top 25 GoG entities placing funds with GSFS and submit to RBI on periodic basis.

b. **Available Unencumbered Assets**

   On account of its business model, all the assets in the form of loans and investments of the company are unencumbered in nature. The company shall place details of these assets in every ALCO and RMC meetings held on periodic basis.

c. **Market-related Monitoring Tools**

The company shall present a review of macro-economic scenario with its likely effect on interest rate and profitability to the RMC members on periodic basis. The review shall be based on certain key parameters for global and domestic economy, like movement in benchmark yields, inflation trajectory & economic outlook and commentary by major central banks that may provide early indications on potential liquidity situation going forward.

Framework for computation, monitoring and reporting of the Liquidity Coverage Ratio (LCR)

RBI's Liquidity Risk Management (LRM) Framework has made the Liquidity Coverage Ratio (LCR) requirements binding on all non-deposit taking NBFCs with asset size of ₹10,000 crore and above from December 1, 2020, with the minimum LCR to be 50%, progressively reaching upto the required level of 100%, by December 1, 2024, as per the timeline given below:

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

Liquidity Coverage Ratio (LCR) is represented by the following ratio:

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

As per the framework, NBFCs are required to maintain an adequate level of unencumbered HQLA that can be converted into cash to meet its liquidity needs for a 30 calendar-day time horizon under a significantly severe liquidity stress scenario, as specified in the RBI guidelines.

High Quality Liquid Assets (HQLA) means liquid assets that are available at all time and 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. Unencumbered means free of legal, regulatory, contractual or other restrictions which may prevent NBFC from liquidating such asset during liquidity stress scenario.

While the LRM Framework of RBI describes in detail the components to be considered while computing LCR along with their respective hair-cuts/stress factors, the company, by virtue of its business model, has very limited basket of asset-liabilities which majorly consists of funds received as per GoG mandate on continuous basis, loans to GoG entities and investments in avenues like Gujarat State Government Securities (GSGS) and Overnight & Liquid/Debt schemes of top mutual funds having high safety and liquidity. Hence, the company shall categorize its assets-liabilities as per the table mentioned below for computation of LCR:

Components	Items to be included	Hair-cut/Stress Factor as per LRM Framework
HQLA	Cash & Bank Balance	0%
	Gujarat State Government Securities (GSGS)	0%
	Strategic Equity Investments (Shares included in either NSE CNX Nifty index and/or S&P BSE Sensex index and Not including shares issued by a bank/ financial institution/ NBFC or any of its affiliated entities)	50%
Outflows	Funds payable to GoG Entities (Both ICD +LDS maturing in next 30 days)	115%
	Other outflows such as payments of taxes, Deferred Tax Liability (DTL), and other expenses such as Salaries, PF contribution etc.	115%
Inflows	From the investments in Overnight & Liquid Debt Schemes of empaneled Mutual Funds	75%
	Other inflows such as maturing loans and installments, maturing ICDs placed with Primary Dealers, coupon receipts and maturing Bond investments	75%

The company shall compute its LCR as per the methodology defined in the LRM Framework of RBI and shall disclose information on its LCR every quarter on its website as per Appendix-XXI-A of the LRM framework. Furthermore, the company shall disclose information on LCR for all the four quarters of the relevant financial year along with sufficient qualitative discussion to facilitate understanding of LCR under Notes to Accounts in its annual financial statements.

f) Review and Approval

The Policy may be reviewed at the end of 3 years or earlier, if required.