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MODULE 6

ASSET LIABILITY MANAGEM

OUTLINE

- Asset Liability Management (ALM) in b
- Components of Liabilities
- Components of Assets
- Significance of Asset Liability managen
- Purpose and objectives
- Prerequisites for ALM
- Assets and Liabilities Committee (ALC
- Activities of ALCO

INTRODUCTION:

- The process by which an institution manag
balance sheet in order to allow for alter
interest rate and liquidity scenarios.

- Banks and other financial institutions pr
services which expose them to various kin
risks like credit risk, interest risk, and liquidit

- Asset-liability management models e
institutions to measure and monitor risk
provide suitable strategies for their managem

DEFINITION:

Asset Liability Management (ALM) can be defin
mechanism to address the risk faced by a bank due to
mismatch between assets and liabilities either due to
liquidity or changes in interest rates.

• Liquidity is an institution's ability to meet its liabiliti
either by borrowing or converting assets.

• Apart from liquidity, a bank may also have a misma
to changes in interest rates as banks typically tend to
short term (fixed or floating) and lend long term (fixe
floating).

COMPONENTS OF ASSETS AND LIABILI

- COMPONENTS OF LIABILITIES:

✓ Capital
✓ Reserves and Surplus
✓ Deposits
✓ Borrowings
✓ Other liabilities and Provisions

COMPONENTS OF LIABILITI

1. **Capital:**

- Capital represents owner's contribution/ in the bank.
- - It serves as a cushion for depositors and creditors.
- - It is considered to be a long term source the bank.

2. **Reserves & Surplus**

- Components under this head includes:
- I. Statutory Reserves
- II. Capital Reserves
- III. Investment Fluctuation Reserve
- IV. Revenue and Other Reserves
- V. Balance in Profit and Loss Account

3. **Deposits**

This is the main source of bank's func deposits are classified as deposits payable c 'demand' and 'time'.

They are reflected in balance sheet as unde

- a) Demand Deposits
- b) Savings Bank Deposits
- c) Term Deposits

4. Borrowings:

Borrowings include Refinance / Borrowi
from RBI, Inter-bank & other institutions

- I. Borrowings in India
- i) Reserve Bank of India
- ii) Other Banks
- iii) Other Institutions & Agencies
- II. Borrowings outside India

5. Other Liabilities & Provisions

- It is grouped as under:
- I. Bills Payable
- II. Inter Office Adjustments (Net)
- III. Interest Accrued
- IV. Unsecured Redeemable Bonds (Subordinated Debt for Tier-II Capital)
- V. Others (including provisions)

COMPONENTS OF ASSETS

- 1) Cash & Bank Balances with RBI
- 2) Balances with Banks and Money at Ca
  Short Notice
- 3)Investments
- 4)Advances
- 5) Fixed assets
- 6) Other Assets

COMPONENTS OF ASSETS

- ***1) Cash & Bank Balances with RBI***
- I. Cash in hand
- (Including foreign currency notes)
- II. Balances with Reserve Bank of India
- In Current Accounts
- In Other Accounts

- **Balances with Banks and Money at Call & Short Notice**

I. In India

i) Balances with Banks

a) In Current Accounts

b) In Other Deposit Accounts

ii) Money at Call and Short Notice

a) With Banks

b) With Other Institutions

II. outside India

a) In Current Accounts

b) In Other Deposit Accounts

c) Money at Call & Short Notice

2) Investments

A major asset item in the bank's balance sheet. Reflected under 6 buckets as under:

I. Investments in India in:

- i) Government Securities
- ii) Other approved Securities
- iii) Shares
- iv) Debentures and Bonds
- v) Subsidiaries and Sponsored Institutions
- vi) Others (UTI Shares, Commercial Papers, COD Mutual Fund Units etc.)

II. Investments outside India in

- Subsidiaries and/or Associates abroad

3) Advances

The most important assets for a bank.

- A. i) Bills Purchased and Discounted

  ii) Cash Credits, Overdrafts & Loans repayable on demand

  iii) Term Loans

- B. Particulars of Advances:

  i) Secured by tangible assets (including advances ag Book Debts)

  ii) Covered by Bank/ Government Guarantees

  iii) Unsecured

4) Fixed Asset

- I. Premises
- II. Other Fixed Assets (Including furniture
fixtures)

5) Other Assets

I. Interest accrued

II. Tax paid in advance/tax deducted at s
(Net of Provisions)

III. Stationery and Stamps

IV. Non-banking assets acquired in satisfa
of claims

V. Deferred Tax Asset (Net)

VI. Others

Significance of Asset Liability Manage

- *Liquidity risk*
- *Interest rate risk*
- *Currency risk management*
- *Funding and capital management:*
- *Profit planning and growth.*

Purpose and objectives of ALM

- An effective Asset Liability Management Technique aims to manage the volume, m maturity, rate sensitivity, quality and liqui assets and liabilities as a whole so as to at predetermined acceptable risk/reward rat

- It is aimed to stabilize short-term profits, l term earnings and long-term subsistance o bank.

Prerequisites for ALM

- 1. Awareness for ALM in the Bank staff at all lev supportive Management & dedicated Teams.
- 2. Method of reporting data from Branches/ oth Departments. (Strong MIS).
- 3. Computerization-Full computerization, netwo
- 4. Insight into the banking operations, economic forecasting, computerization, investment, credit
- 5. Linking up ALM to future Risk Management St

Assets and Liabilities Committee (A

- ALCO, consisting of the bank's senior management (incl CEO) should be responsible for ensuring adherence to th limits set by the Board Is responsible for balance sheet planning from risk - return perspective including the stra management of interest rate and liquidity risks.
- The role of ALCO includes product pricing for both depo and advances, desired maturity profile of the increment assets and liabilities, It will have to develop a view on fu direction of interest rate movements and decide on a fu mix between fixed Vs. floating rate funds, wholesale vs. deposits, money market Vs. capital market funding, don vs. foreign currency funding.
- It should review the results of and progress in impleme ~~of the decisions made in the previous meetings.~~

Activities of ALCO

1. ALCO decision making unit- Responsible for bala sheet planning from risk return perspective.
2. Monitoring the market risk levels by ensuring a to the various risk limits set by the bank.
3. Articulating the current interest rate view and a future direction of interest rate movements.
4. Deciding the business strategy of the bank, con with the interest rate view, budget and pre-det risk management objectives.

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Activities of ALCO

5. Determining the desired maturity profile and assets and liabilities.
6. Product pricing for both assets and liabilities s
7. Deciding the funding strategy i.e. source and liabilities or sale of assets.

8.Reviewing implementation of decisions made previous meeting.

IMPORTANT QUESTIONS

- 1. What is ALM? June/July 2016 (3 marks)
- 2. Discuss the components of liabilities and asse
banks balance sheet. June/July 2016 (10 marks)
- 3. Discuss in detail: ALCO Dec.15/Jan16 (10 marl
- 4. Explain the significance of ALM Dec.15/Jan16