Final Guidelines on Asset-Liability Management (ALM) System in Banks

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The Reserve Bank of India has today issued final guidelines on Asset-Liability Management (ALM) System for implementation by banks effective April 1, 1999. The guidelines mainly address liquidity and interest rate risks and have been formulated to serve as a benchmark for banks not having formal ALM systems. Banks which have already adopted more sophisticated systems, have been permitted to continue their existing systems but have been asked to finetune their management information systems (MIS) to be compatible with the ALM system suggested in the guidelines. Other banks have been asked to upgrade their MIS to meet the prescriptions of the new ALM System. Keeping in view, however, the prevailing MIS and low level of computerisation, banks have been asked to ensure a coverage of at least 60 per cent of their assets and liabilities to start with. Banks have also been asked to set targets in the interim, for covering 100 per cent of their business by April 1, 2000.

It may be recalled that the Reserve Bank had, in September 1998, issued broad draft guidelines for asset-liability management systems in banks. The draft guidelines were reviewed by the Reserve Bank in the light of the feedback received from the banks. The final guidelines issued on the basis of this feedback require banks to give adequate attention to putting in place an effective ALM system. Banks have been asked to set up an internal Asset-Liability Committee (ALCO), headed by the CEO/CMD or the ED. The Management Committee or any specific Committee of the Board should oversee the implementation of the system and review its functioning periodically.

The statement of structural liquidity, designed to measure the maturity profile of cash flows should be prepared at quarterly intervals. It is intended to eventually move over to a monitoring system on a fortnightly basis by April 1, 2000. As a prudent measure, banks have been advised to operate within negative gap of 20 per cent of cash outflows during 1-14 days and 15-28 days time periods. Banks, which have structural mismatches and need higher limits, could operate with higher limit with the approval of board/management committee. Such banks should, however, comply with the prudential limit by April 1, 2000.

The statement of interest rate sensitivity should be prepared at quarterly intervals and move over to monthly schedule by April 1, 2000. The statement would provide useful feedback on interest rate risk faced by banks. Banks' boards should fix prudent level of earnings at risk (EaR) or net interest margin (NIM) to minimise the risk profile.

Banks will now have to capture the impact of embedded options, exercised by depositors/ borrowers to finetune ALM practices. Banks should also evolve internal transfer pricing mechanism for supplementing the efficacy of ALM techniques.

The final guidelines are available on the website of the Reserve Bank of India (URL: http//www.rbi.org.in).

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