ABANS

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RISK MANAGEMENT POLICY

ABANS FINANCIAL SERVICES LTD.

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RISK MANAGEMENT POLICY

BONDS

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ABANS FINANCIAL SERVICES

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Introduction

Managing risk is crucial to keeping our investments safe and profitable. This section explains how we handle the different types of risks that come with investing in bonds. Our aim is to protect our investments from extreme losses while also looking for opportunities to grow. We cover various risks, including sovereign risk, interest rate risk, liquidity risk, and more. By following these guidelines, we strive to keep our portfolio balanced and strong, matching our investment goals and risk tolerance. We regularly review and update our risk management practices to stay ahead of market changes and regulatory requirements. This helps us navigate the bond market's complexities and consistently deliver returns.

All bond trading and investment activity is carried out in accordance with the RBI Master Directions applicable to the entity, SEBI regulations applicable to the relevant segment (including the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 where applicable), CCIL rules for TREPS transactions, and the internal Investment Policy and Resource Planning Policy.

Risk Framework

We follow a 5-step risk management process:

- Identify: Recognising potential events or conditions that could negatively impact our investment.
- Analyse: Assessing risks and determining their likelihood of occurring.
- Evaluate: Evaluating the severity of each risk and its potential impact on our investments.
- Treat: Using various strategies to treat each risk effectively.
- Monitor: Continuing to monitor our process even after we have dealt with the risk.

Investment Strategy

Currently, the desk is majorly investing in Indian government issued bonds of different tenure, taking a view on interest rates in India, and pledging these bonds on TREPS for secured borrowings. The underlying trade is to capture the movement in bond prices along with the yield differential between the borrowing rate and coupons on the bonds.

This differential between yields allows us to leverage our books while positioning for a rise in bond prices.

Any investment in instruments other than Indian government securities, or any material change in the leverage profile of the book, requires prior approval in line with the Investment Policy and Resource Planning Policy.

Yield Curve

The desk's positioning is guided by the shape and movement of the government securities yield curve. Strategic allocation across different tenors is undertaken to capitalise on steepening or flattening trends, with a focus on optimising carry and roll-down returns. Changes in the yield curve whether parallel shifts, slope changes, or curvature changes are closely monitored and used to refine duration exposure and enhance risk-adjusted returns.

Overnight Indexed Swap

The Overnight Indexed Swap (OIS) curve serves as a key tool for gauging market expectations of future RBI policy rate movements and for benchmarking funding costs. The desk monitors the spread between government security yields and corresponding OIS rates across tenors.

Risks Associated with Bonds

There are two legs of risk here: risks associated with the bonds themselves, and risks associated with the TREPS borrowing leg.

Sovereign Risk

Sovereign Risk refers to the risk that a government might default on its debt obligations. Government Securities issued by the Reserve Bank of India on behalf of the Government of India are considered to have sovereign credit. This means they are backed by the Government's promise to pay interest and principal, implying no default risk. For domestic borrowers and lenders, the credit risk on such securities is nearly zero, earning them the label "risk-free securities" or "zero-risk securities".

Price Risk or Interest Rate Risk

In fixed-income-bearing securities, the coupon rate is determined at the time of investment and paid/received at a predetermined frequency. These types of bonds (Government Securities, from our current perspective) run price risk.

Generally, when interest rates rise, prices of fixed-income securities fall, and when interest rates drop, prices increase. The degree of fall or rise in prices depends on coupon, coupon frequency, days to maturity, and the magnitude and direction of change in the level of interest rates. The prices of Government Securities (existing and new) will be influenced primarily by movements in interest rates in the financial system.

Reinvestment Risk

Investments in fixed-income securities may carry reinvestment risk, as the yield prevailing on the buying date may differ from interest rates on coupon-receiving dates, forcing us to reinvest coupons at lower rates.

Liquidity Risk

Longer-maturity Government Securities (G-secs) are relatively illiquid compared to shorter-maturity G-secs. This illiquidity makes them difficult to sell and may require us to sell at a discount.

Risks Associated with TREPS

Increase in Borrowing Costs

Increasing borrowing costs will erode our spread, reducing overall returns from the strategy. If erosion of spread sustains beyond a particular level for an extended period, we may be exposed to the risk of unwinding the strategy abruptly, incurring additional costs. This, combined with falling prices of G-secs, can significantly impact returns.

Unable to Roll TREPS Borrowing

Due to liquidity issues, if we are unable to roll over our borrowing from TREPS, we will have to borrow at significantly higher costs until we can unwind our leveraged position. A contingency funding line is maintained and reviewed at least annually to address this risk.

Risk Analysis and Evaluation Methods

We employ robust risk analysis and evaluation mechanisms to stay ahead of the curve, proactively identifying and mitigating risks to protect our portfolio. To support this, we conduct various exercises both daily and periodically. The Bond Risk Metrics we monitor are:

Bond Value at Risk

The Value at Risk (VaR) of a bond portfolio represents the estimated maximum potential loss, at a specified level of confidence, over a given time horizon. It provides a quantitative measure of the portfolio's risk by assessing the range of potential losses based on market fluctuations and other relevant factors.

Bond VaR Calculated at 95th Percentile Level

A 95th percentile bond VaR is a measure used to estimate the potential loss in the value of a bond portfolio at a 95% confidence level over a specific time horizon. In 5% of cases, losses may exceed the calculated VaR.

Bond VaR Calculated at 99th Percentile Level

A 99th percentile bond VaR is a measure used to estimate the potential loss in the value of a bond portfolio at a 99% confidence level over a specific time horizon. In 1% of cases, losses may exceed the calculated VaR.

Modified Duration of Bond Portfolio

Modified Duration is a measure used to estimate the sensitivity of a bond's price to changes in interest rates. It is expressed as a percentage and provides an approximation of the percentage change in the bond's price for a 1% change in yields.

We derive yield from the current market price of the bond, and prices are shocked by 1% increase and decrease in yield to reach the Modified Duration.

DV01 of Bond Portfolio

DV01 is a measure used to quantify the change in the market value of a bond (or a bond portfolio) for a 1 basis point (0.01%) change in yield or interest rates. It represents the rupee amount by which the bond's value is expected to change for a 1 basis point movement in yield.

Bond_Portfolio	Amount in Crores						
Bond	Face Value	VaR - 95%	VaR - 99%	Expected Shortfall	Duration	5 Day Avg Vol	Face Value / 30% of Vol
7.26GS2032	0	0.00	0.00	0.00	5.15%	322	0.00
7.36GS2052	0	0.00	0.00	0.00	11.75%	85	0.00
7.40GS2062	0	0.00	0.00	0.00	12.98%	136	0.00
7.25GS2063	0	0.00	0.00	0.00	12.66%	89	0.00
7.26GS2033	0	0.00	0.00	0.00	5.44%	122	0.00
7.30GS2053	5	-0.02	-0.04	-0.05	11.79%	109	0.15
7.18GS2033	0	0.00	0.00	0.00	5.76%	244	0.00
7.18GS2037	10	-0.04	-0.06	-0.07	7.82%	486	0.07
7.34GS2064	400	-1.82	-3.76	-4.46	12.68%	89	14.98
7.09GS2054	50	-0.22	-0.39	-0.47	11.97%	424	0.39
6.79GS2034	0	0.00	0.00	0.00	6.48%	309	0.00
6.90GS2065	335	-1.46	-3.02	-3.58	12.85%	619	1.80
7.09GS2074	0	0.00	0.00	0.00	14.06%	27	0.00
6.33GS2035	25	-0.07	-0.12	-0.15	7.17%	560	0.15
6.48GS2035	355	-1.72	-2.17	-2.17	7.08%	16829	0.07
Total	1,180	- 5.35	- 9.56	- 10.95	10.85%		

DV01	- 1,19,47,466
DV1	- 1,11,46,70,094
Convexity @1%	11,75,36,320

Note - FV, DV01, DV1, Convexity@1% in INR

*Note - Fomula of Ratio is Face Value / (Volume * 30%)*

Fig: Bond VaR & DV01 (*values in Crores)

Convexity of Bond Portfolio

Convexity measures the rate of change of Modified Duration with respect to changes in yield, capturing the curvature or non-linearity of the price-yield relationship. While Modified Duration provides a first order (linear) estimate of the bond's price sensitivity, Convexity provides the second-order correction, making the combined estimate more accurate for larger yield movements.

The convexity adjustment in rupee terms represents the additional gain or loss over and above what Modified Duration predicts for a 1% change in yield.

YTM	DV01	DV1	convexity	CONVEXITY IN RUPEE	Expected shortfall
6.72%	0	₹ -	31.95	₹ -	0
7.25%	0	₹ -	218.19	₹ -	0
7.48%	0	₹ -	272.45	₹ -	0
7.45%	0	₹ -	278.74	₹ -	0
6.78%	0	₹ -	35.79	₹ -	0
7.41%	- 57,731	₹ -52,26,223.76	220.89	₹ 5,38,140.70	-522209.7111
6.76%	0	₹ -	40.42	₹ -	0
6.93%	- 80,552	₹ -74,85,169.26	78.48	₹ 3,96,772.22	-928851.3772
7.48%	- 35,57,230	₹ -31,87,37,128.17	280.10	₹ 3,93,06,925.55	-32429560.65
7.42%	- 5,73,383	₹ -5,15,93,970.18	230.58	₹ 54,70,532.98	-5166220.562
6.82%	0	₹ -	51.61	₹ -	0
7.47%	- 39,88,005	₹ -35,21,59,237.75	289.30	₹ 4,43,63,171.99	-35889220.83
7.20%	0	₹ -	348.56	₹ -	0
6.20%	- 1,74,423	₹ -1,66,03,683.70	61.05	₹ 7,40,743.35	-1666253.47
6.34%	- 33,29,716	₹ -31,03,13,268.01	61.05	₹ 1,34,81,529.04	-31185935.75
	- 84,31,323	- 75,18,05,413	2,438	9,08,16,287	- 7,66,02,317
		difference	**₹ -5,10,632.06**	**₹ 1,97,55,551.96**	

Fig: DV01, DV1 & Convexity

Leverage Ratio

We monitor the leverage of our position constantly and adjust it actively according to risk metrics and our macro-economic views. A maximum leverage ratio of 10 times is applied to the bond book (measured as total bond portfolio value divided by own capital deployed), reviewed and approved by senior management at least annually. Any utilisation above 80% of the cap (i.e. leverage of 8x or above) is flagged to senior management the same business day and triggers a review of hedging and liquidity buffers.

Stress Testing and Scenario Analysis

We perform stress testing daily of our multi assets portfolio across various parameters and market scenarios to remain fully informed about potential risks if market conditions deteriorate. Standard scenarios include parallel upward and downward shifts in the yield curve, steepening and flattening of the curve, and stressed TREPS rate scenarios. The outcomes are reviewed by the Risk team and escalated to senior management where a scenario produces a loss beyond an internally agreed tolerance.

Stressed VaR - BONDS									
Scenarios	Net Exposure	VaR95	VaR97.5	VaR99	VaR99.9	ES95	ES97.5	ES99	ES99.9
Lehman(Dec'07- Nov'09)	1115.4	-25.2	-38.5	-61.5	-96.9	-45.6	-60.4	-78.4	-104.4
Taper Tantrum(Jan'13-Dec'14)		-20.2	-34.2	-63.4	-129.1	-47.2	-68.2	-94.5	-161.6
Minibear(Jan'15-Dec'16)		-2.4	-3.3	-6.3	-9.2	-4.4	-6.0	-7.7	-10.2
Covid(Dec'19-Nov'21)		-4.1	-7.0	-10.4	-16.9	-8.0	-10.6	-13.3	-16.9
Current(Apr'24-Present)		-3.2	-5.4	-6.7	-10.8	-5.7	-7.1	-8.9	-11.4

Fig: Stressed VaR & ES (*values in Crores)

Macroeconomic Trends

Additionally, we monitor and analyse domestic and global macroeconomic trends to stay aware of potential risks to our portfolio and to position ourselves according to changing market conditions.

Risk Factors Associated with Imperfect Hedging

Hedging is a valuable tool for managing risk, but it does come with its own set of challenges and complexities.

Hedging Cost

Hedging instruments act as insurance for adverse moves in the markets with respect to our portfolio. The cost attached to buying this insurance will affect P&L if the anticipated change does not occur.

Credit Risk

There can be default risk on the counterparty providing the hedge leg. However, in the case of Interest Rate Swaps (IRS), the counterparties are Banks governed by the RBI, and in the case of Interest Rate Futures (IRFs) the counterparties are the national exchanges, thereby reducing the overall credit risk of the transaction.

Basis Risk

This arises from the imperfect correlation between the securities in the portfolio and the IRF/IRS contracts. The movements in their prices might not match perfectly, leading to differences in the P&L from both the legs.

Regulatory Disclosures and Record-Keeping

Where applicable to the entity, risk exposures relating to derivatives in the bond book are disclosed in the financial statements in line with the applicable regulatory framework (including the RBI Scale Based Regulations for NBFCs, and Ind AS / IFRS accounting standards, as applicable). Trade, valuation, and risk-metric records are retained for a minimum of 5 years, or such longer period as may be required by the applicable regulator.

Glossary of Abbreviations

Abbreviation	Full Form / Definition
CCIL	Clearing Corporation of India Limited
DV01	Dollar Value of a Basis Point (change in bond value for a 1 bp yield change)
DV1	Dollar Value of 1% (change in bond value for a 1% yield change)
ES	Expected Shortfall (average loss beyond VaR)
G-sec	Government Security
IRF	Interest Rate Futures
IRS	Interest Rate Swap
NBFC	Non-Banking Financial Company
OIS	Overnight Indexed Swap
SEBI	Securities and Exchange Board of India
TREPS	Tri-Party Repo Dealing System (operated by CCIL)
VaR	Value at Risk
YTM	Yield to Maturity