



SBI PENSION FUNDS PVT LTD

RISK MANAGEMENT POLICY

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SBI PENSION FUNDS PVT LIMITED

RISK MANAGEMENT POLICY

1. Preamble:

SBI Pension Funds Pvt. Ltd (SBIPFPL) is engaged in the business of investment management of the pension corpus received from NPS Trust and regulated by the Pension Fund Regulatory and Development Authority (PFRDA).

In terms of the Investment Management Agreement (IMA) entered into with the NPS Trust, the Company is required to have a Risk Management Policy duly approved by the Board of Directors. The Policy was last approved by the Board of Directors at its meeting held on 15.01.2019

2. Objective:

The main objective of the risk management policy of the Company is to

- put in place a risk management framework to effectively identify, measure, manage and control risks inherent in the Company's Business.
- define an appropriate risk management structure with clear role responsibilities.
- ensure regulatory compliances & business continuity at all times.
- ensure compliance with the requirements of the Group Risk Management Policy of State Bank of India to the extent applicable to the operations of the Company.

3. Risk Management Framework:

The risk management framework of the Company is based on the tenets of identification, measurement, control and mitigation of various risks and reporting to the Top Management. The Company follows a Committee based approach to business decisions and for effective risk management, a well-defined risk management architecture with clear roles and responsibilities is put in place.

3.1. Role as Pension Fund Manager (PFM)

The Company has entered into separate Investment Management Agreements (IMA's) with the NPS Trust for managing Government Sector NPS on 18.04.2012 & for managing Private Sector NPS on 25.03.2015. Investment activities are governed by Investment Guidelines issued by PFRDA and the Investment Policy approved by the Board of

Directors of the Company. The investment portfolio is required to be mark to market and NAV is declared on daily basis. Consequently, investments made are exposed to various risks viz. market risk, credit risk, liquidity risk and operational risk.

3.2. Range of Activities

The business undertaken by the Company may broadly be classified as under:

- Investment in Government Securities/SDL.
- Investment in Corporate Bonds.
- Investment in Equity.
- Investment in Money Market Instruments
- Investment in Term deposits/ Mutual Funds.

3.3. Key Risks:

In the current PFM business model, credit and market risks of the portfolio are “pass through” to the subscribers. Net Asset Value (NAVs) is arrived at by valuing the securities on mark-to-market basis and any loss in market value has to be borne by the subscriber. Nevertheless, reputation risk is a pass through to the Company and thereby, to the Group. As PFM, the business objective of the Company is to maximize returns to the subscriber and as such, the Company is required to identify, measure, control and mitigate such risks. Keeping this in view, and inter-relationships between the risks, the following have been identified as key risks for the Company.

- Operational Risk
- Reputation Risk
- Market Risk
- Credit Risk & Investment Risk
- Other Risks (Compliance/Contagion/Strategic)

Settlement of deals for all transactions is routed through Stock Holding Corporation of India Limited (SHCIL), the Custodian appointed by NPS Trust. Further, settlement of government securities transactions is guaranteed by CCIL and equities transactions by Stock Exchanges. As such, the Settlement Risk stands mitigated.

3.3.1 Risk Identification:

We have adopted Risk Control Self-Assessment (RCSA) methodology to identify organization wide risks.

RCSA is a systematic and rigorous process which leverages collective knowledge of individuals within organization to proactively identify, assess, mitigate/control, monitor and report significant risks in the areas of operative business.

All the functions shall participate in the identification exercise and document the results and analysis in the risk register. The register is to be reviewed annually or whenever there are material changes to the business environment.

The risks identified through the process of self-assessment includes:

- Credit/Market Risk
- Operational Risk
- Reputation Risk
- Regulatory/Compliance Risk
- Contagion Risk

An annexure detailing the reporting structure of RCSA is attached here with.

3.4. Risk Limits, Monitoring & Reporting:

3.4.1. Market Risk

a) Limit :

- Duration of the securities to be taken to consideration at the time of making investment decisions, depending on the market conditions.
- Management action trigger threshold:
 - ✓ Bonds: Bonds: In case of bonds, MAT would not be applicable for the price movements on account of interest rate movements. However, in case of downgrade of a security in the corporate bonds, an in-depth analysis would be carried out to assess the exposure based on the fundamentals of the company and the overall market scenario. A note would be recorded in such cases mentioning the proposed course of action and put up to the Investment Sub-Committee of the Company.

The position would be continuously monitored and the Investment & Risk committee of the Company would be apprised of the same on a quarterly basis.

- ✓ Equities: MAT for investment in equities would be monitored under two categories, viz.
 - a) Securities which are part of benchmark equity indices, i.e NIFTY or SENSEX.
 - b) Securities which are outside the benchmark.

The MAT would be monitored as under:

Category (a) :

MAT may not be applicable in the case of securities in NIFTY/Sensex universe. In case of significant price corrections in these securities, the investment sub-committee may evaluate the merit in holding, going under weight/overweight depending on the outlook. In case of sale/purchase of any securities that has fallen more than 15% from the weighted average holding price, the reason for the same may be substantiated in the investment sub-committee note.

Category (b): MAT would be triggered on 15% adverse movement in the weighted average price (WAP) of a stock.

The investment Sub-committee (ISC) shall review the position in case of Bonds and decide whether to continue with the investment or to exit. The same will be recorded by way of note and will be informed to Investment/Risk Committee of the Company on quarterly intervals. In case of equities, the investments are based on fundamental evaluation. Once MAT is triggered in a security, the Investment subcommittee would evaluate the merit in continuing, adding to the holding or to exit partially or fully based on the fundamentals and capital market perception. An in-depth analysis would be carried out to assess the reason for the price correction based on the overall market scenario and the fundamentals of the company and a strategy to correct the position within a reasonable time frame would be chalked out.

In case of addition to the existing holding is made in a security where MAT is triggered, the same should be substantiated in the investment sub-committee note. Further, in case the prices continue to be on a downward trend for the 3 consecutive quarters after the quarter in which the MAT was triggered, partial/full exit from the position would be done gradually in the following quarter. The position would be continuously monitored and the Investment & Risk committee of the Company would be apprised of the same on a quarterly basis.

In the event of any securities getting excluded from NIFTY/Sensex, the security would be monitored as per the norms mentioned under category (b) and the rules would be applicable retrospectively; i.e. from the original date of fall by 15% from the weighted average price.

Monitoring and Control:

Business head shall monitor operations in their respective areas to guard against breach of limits and put in place various strategies to control the risk. The Mid-Office will independently track risk as per the limit structure and in case of breach of the threshold limits, will put up the position to the Investment Sub- Committee, for necessary action.

b) Management Reporting:

- Valuation report monitoring appreciation/depreciation of portfolio.
- Review of Daily portfolio NAV and NAV return.
- Action taken by the Investment Sub Committee on the occasion of breach of the threshold limits shall be reported to the Investment and Risk Management Committee of the Company.

3. 4. 2. Credit Risk:

a) Exposure Limits-Equity & Debt:

i. Exposure Limits: Sponsor Group

- NPS investments have been restricted to 5% of the 'paid up equity capital'* of all the sponsor group companies or 5% of the total AUM under Equity exposure whichever is lower, in each respective scheme.

*Paid up share capital': Paid up share capital means market value of paid up and subscribed equity capital.

- Investment exposure in debt securities of Sponsor Group Companies shall be restricted to 5 % of the net-worth of all Sponsor Group Companies or 5% of total Debt securities (excluding G-Securities) under each scheme, whichever is lower.

ii. Exposure Limits: Non-Sponsor Group

- NPS investments have been restricted to 15% in the paid-up Equity capital of all the non-sponsor group companies or 15% of the total AUM under Equity exposure whichever is lower, in each respective scheme.
- NPS investments have been restricted to 10% of the net-worth of all the non-sponsor group companies or 10% of the total AUM in Debt securities (excluding Govt. securities) whichever is lower, in each respective scheme.

iii. Exposure Limit: Industry Sector:

- Investment exposure to an industry sector (classification as per NIC classification) shall be restricted to 15% of all NPS schemes.

iv. Credit Rating:

- All investments to have minimum AA or equivalent grade rating from at least two rating agencies, with exception as mentioned in investment policy.
- In addition to the credit ratings, investments under debt instruments and related investments category shall be made after proper due diligence on the investee companies. The process which is to be followed are as under:

- a) Proper credit appraisal has to be carried out to assess the risk associated with any particular security/bond before investment is made by the fund.
- b) The risks analyzed should include, inter alia, credit risk, liquidity risk and solvency risk.
- c) A comparison of following parameters with the sector & industry to be done:
 - i) Revenue
 - ii) EBITDA
 - iii) PAT

Large variations if any need to be commented upon in details.

- d) A complete documentation of the analysis and assessment and due diligence done along with all backing documents, references and research needs to be maintained for scrutiny.
- e) The credit appraisal should include detailed analysis of financials of company, the management of the issuer company, liquidity position and other parameters such as liquid investment or cash balances

excess to unutilized credit lines, liquidity coverage ratio and adequacy of cash flows for servicing maturing debt obligation need to be analyzed.

- f) It should also comment on the nature of business, industry characteristics, impact of economic conditions, business strategy, the competencies or deficiencies of management, key business and financial risk and its mitigating factors.
 - g) Comment should also be made in credit appraisal regarding pledge of shares by promoters, contingent liabilities of the company and group level leverage.
- v. If the securities/entities have been rated by more than two rating agencies, the two lowest of all the ratings shall be considered.
- vi. The maximum tenor for investment in Corporate Bonds shall be 15 years. No investment shall be made in perpetual bonds of any Body Corporate except in Basel III Tier-1 Bonds.
- vii. Transactions routed through an empaneled broker not to exceed 5% of the aggregate purchase and sale of securities. In case this limit is exceeded, the justification therefore should be recorded and all such investments reported to the Trustees on yearly basis.
- viii. For investment in equities, a list of Companies conforming will be compiled and reviewed periodically by the Investment Sub- Committee. Out of the list of companies compiled for investment in equities, the due diligence process which is to be undertaken before making any under equity market instruments are as under:
- a) A detailed research note should cover the promoter credentials, reputation, corporate governance, performance evaluation versus peers and benchmarks.
 - b) A comparison of following parameters with the sector & Industry to be done:
 - i) Revenue
 - ii) EBITDA
 - iii) PATLarge variations if any, need to be commented upon in detail.

- c) A complete documentation of the analysis and assessment and due diligence done along with all backing documents, references and research needs to be maintained for scrutiny.
- d) The research note should include detailed analysis of financials of company (past and projections), business strategy, liquidity position, industry characteristics, impact of economic conditions, the competencies or deficiencies of management, key business and financial risk and its mitigating factors.
- e) It should also comment upon pledge of shares by promoters, contingent liabilities and group level leverage.
- f) The research note will be put up by Chief Investment Officer (CIO) to Investment Sub-Committee (ISC) for approval.

b) Monitoring and Control:

- All the corporate bonds shall be reviewed periodically i.e. once in every six months, or more frequently in case of any adverse development.
- The equity portfolio shall be reviewed once in six months or more frequently in case of any adverse development.
- Ratings shall be monitored at monthly intervals or more frequently, in case of any adverse information.
- In the event of slippage in the rating below the minimum permissible investment grade prescribed for investment in the instrument when it was purchased, as confirmed by one credit rating agency, the option of exit shall be considered and exercised, as appropriate, in a manner that is in the best interest of the subscribers.

Credit risk in terms of failure of counterparty in a deal does not arise as the deals are settled on exchanges through the custodian. Settlement of the government securities transactions are guaranteed by CCIL.

c) Management Reporting:

- Rating slippages, if any, initially shall be reported to MD & CEO. Rating slippage shall also be reported to Investment Committee of the Company at quarterly intervals, for necessary action.
- Deviations from exposure limits, if any, to be reported to the Risk Management Committee of the Company on quarterly basis and to NPS Trust at monthly intervals.

3. 4. 3. Liquidity Risk:

Premature redemption of contributions is envisaged in the following circumstances:

- Death of Subscriber.
- Redemption of units under Tier 2 (which is essentially a savings scheme)
- Switch out of schemes.
- Change of PFM.

a) Monitoring and Control:

The redemption request /withdrawals from the various NPS schemes have to be met/managed from the schemes as per regulatory guidelines.

As of now redemption request, is generally matched with corresponding inflows. However, if corresponding inflows are insufficient to match the outflows, the shortfall can be met by liquidating the securities by accessing the markets on T+1/T+2 basis, since the pay-out of the funds take place on T+3 basis.

Asset Liability Management /Liquidity of investments has been addressed in Investment policy. To meet out any eventuality of mass redemption, liquidity and ALM concerns, in Scheme Corporate CG, Scheme E Tier I and Scheme G Tier I, which may occur if a Corporate decides to change the Pension Fund Manager, the scheme should have sufficient investments in liquid securities in G-Secs and liquid equity scrips.

b) Management Reporting:

The quantum of premature redemptions shall be monitored from the perspective of adequacy of the mitigation mechanism.

3. 4. 4. Operational Risk:

Operational risks are arising due to inadequate or failed internal processes, people and systems or from external events. Such risks include failure of critical systems and infrastructure, obsolete systems, critical knowledge loss/skill shortage, administrative errors and natural disaster risks etc.

Monitoring and control/ Management reporting:

- a. People
 - Financial and administrative powers shall be defined and delegated.
 - The accounting system shall be based on maker-checker concept.

- The work ethics for dealing room is laid down.
- b. Processes
- Investment Management Operations Manual has been prepared and updated.
 - Company operations are subjected to Concurrent and Internal Audit by external agencies. Observations, if any, are attended to & reported to appropriate authorities.
- c. Systems
- IT systems are secured and reliable. IT operations are subject to comprehensive system audit to identify and address shortcomings.
- d. External Events
- A formal backup and recovery plan have been developed for major physical disaster for systems, communications and power failures.
 - The Disaster Recovery and Business Continuity plan is in place. The Company has far disaster recovery site at CTRL S, Hyderabad and near DR site at BKC, Mumbai.
 - Fire Alarms and protection equipments are in place. The physical assets of the company at the Company office are adequately insured.

3. 4. 5. Other risks:

- ✓ **Compliance Risk:** The Company faces the following major compliance risks:
- Risk of non-compliance with regulatory requirements leading to censure and/or penalties,
 - Financial or reputational loss resulting from non-adherence to the Company's internal compliance rules, regulations, code of conduct, other best practices and standards.

Monitoring and Control/ Management Reporting:

The Company has put in place a comprehensive Compliance Policy duly approved by the Board of Directors defining the minimum standards that shall guide the Company and the Compliance risk management framework including compliance structure/ roles and responsibilities/ risk monitoring and reporting requirements.

✓ **Reputation Risk:**

- Non-compliance inviting regulatory action
- Cases of system failures, breakdown of internal controls
- Adverse press coverage
- Performance slippage in comparison with other PFMs.

a) **Monitoring and Control:**

- Review and analysis of Audit Findings relating to internal controls and business processes issues.
- Reputation Risk scoring sheet updated at annual intervals and reviewed along with the ICAAP at annual intervals
- Performance tracking on absolute and comparative basis (peer group).

b) **Management Reporting:**

- Quarterly Internal Audit Report to be placed before the Audit Committee of the Board along with Management comments and corrective measures initiated, if any.
- Certificate from the Internal Auditor for regulatory compliances relating to investment management shall be obtained and placed before the Audit Committee of the Board.
- Certificate of Compliance with various Laws and Regulations governing the operations of the Company shall be submitted to the Board at quarterly intervals.
- Reputation Risk scoring sheet shall be compiled and placed with ICAAP at annual intervals.
- Performance of the Company shall be reviewed by the Board at quarterly intervals.

✓ **Contagion Risk:**

With the corporate strategy of using common logo and uniform branding across the SBI Group, adverse developments in any Group entity could affect the operations & image of the Company.

a) **Monitoring & Control / Management Reporting:**

- The Back Office shall submit exception reports, if any relating to dealing processes/rates to the Top Management, if any.

- Concurrent Auditors will conduct audit of all transactions to mitigate regulatory risk.
- The Internal Audit Reports and Audit Reports from other external agencies appointed by NPS Trust shall be put up to the Audit Committee of the Board.

✓ **Strategic Risk**

As the Company cannot undertake any other business without the specific, prior approval of the Regulators, the best indicators for Strategic Risk shall be in terms of consistent inability to meet business goals and objectives despite favorable market conditions. The inability of the Company to grow due to lackadaisical performance consistently vis –a-vis the peer group shall also be an indicator under this risk.

a) Monitoring and Control/ Management Reporting:

The progress on the implementation of various strategic initiatives viz. Business Development, AUM Growth, League table ranking shall be monitored by the Top Management and the Board through regular performance reviews. The Strategic Risk Index shall be compiled and reviewed along with the ICAAP at annual intervals.

3.5. Risk Management Committee of the Company(RMCC):

The Company has constituted a Risk Management Committee of the Company with two Independent Directors, the MD & CEO, Chief Risk Officer (CRO) as members. The Committee shall exercise Board level oversight over the risk management operations of the Company. The minimum quorum for the Committee meetings shall be two with at least one Independent Director present in the meeting. The Committee shall meet quarterly.

The role of the Committee will include inter-alia, formulating and reviewing risk policy, reviewing deviations from Guidelines/Policy, if any, examining underlying business processes to identify inherent and emerging risks, assess/ prioritize and put in place mitigation plans, etc. In its' oversight functions, the Committee will be assisted by Chief Risk Officer.

3.6. Chief Risk Officer (CRO):

The risk monitoring & control function shall be the responsibility of the CRO who shall report directly to the Managing Director & CEO. Broadly the role and responsibilities shall, inter-alia, include:

- Identification, measurement, monitoring/ control/ reporting, analysis and mitigation of risks, embedded and emerging, in the Company's business.
- Assisting RMCB in formulating and reviewing risk management policies, setting and reviewing risk parameters, formulating ICAAP etc.
- Risk Control Self-Assessment (RCSA) exercise with a view to identify and mitigate various risk
- Monitoring ALM/Liquidity Management, Management Action Trigger (MAT), Monitoring of Investment Guidelines, Broker Limits, NIC Limits (sectoral limits), Downgrades in Corporate Bonds. In case of any deviation /breach of limits, flag the same to investment subcommittee.
- Appointment of Internal & Concurrent Auditors. Ensure smooth conduct of various audits, to deal with audit reports objectively.
- Preparation of reports for submission to NPS Trust/Regulators, Sponsors; MIS reports for Top Management
- Periodical review of external credit ratings of investments in debt securities, preparation/ review of NSE F&O lists, empanelment of brokers and review, etc.
- Monitoring all information security logs, configurations, Access Controls and incidents. Report any breaches of any deviations and mitigate and report all IT security incidents, take appropriate actions to prevent recurrence in coordination with IT department.
- Fraud Monitoring and timely reporting: Checking Bank Reconciliation (for scheme & Company) & reconciliation of security holding with SHCIL Holding for scheme holdings.

3.7. Operational Guidelines

The Company has in place IC/Board approved Investment Management Operations Manual covering all the operations of the Company. The operations of the company shall be subject to Internal/ Compliance audit by external auditors. The Company has a Compliance Officer to ensure compliance with various laws and regulations applicable to its operations and a Compliance Certificate relating to regulatory and statutory compliance governing the operations of the Company is submitted to the Board of Directors at quarterly intervals.

3.8. Audit

The operations of the company shall be subject to Internal/ Concurrent audit by an external agency/Statutory Audit by CAG appointed Auditor/Scheme Audit by NPS Trust appointed Auditors. Observations, if any, of the auditors shall be attended to immediately and action taken reported to the Audit Committee of the Board at quarterly intervals.

4. Review/ Renewal

The Risk Management Policy shall be reviewed at half yearly intervals or earlier, if required. If any change is approved by the Board subsequent to this policy, consequent upon any change in corporate strategy, regulatory guidelines, market conditions, changes in risk profile of the Group. etc., such changes and approvals shall be deemed to be a part of the policy until the next review.