



A STUDY ON EFFECTIVE STRATEGIES AND TECHNIQUES IN ASSET LIABILITY MANAGEMENT

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Abstract

Asset Liability Management or ALM is a mechanism designed to address the risk faced by banks due to a mismatch between assets and liabilities, which arise either because of liquidity or because of changes in interest rates. As such, asset liability management techniques involve ALM finance and ALM banking. Banks use asset liability management techniques as part of an overall asset liability management system. The paper aims to introduce a number of definitions and market practices that are fundamental for an effective asset and liability management (ALM) strategy. The paper analyses the various strategies used for asset liability management in financial institutions. The reader can make use of the proposed ALM strategies to build more complex management approaches.

Keywords:ALM, Banks, System, Strategies, Institutions

Introduction

Recent financial crisis brought considerable change to the marketplace for lending and borrowing, as well as caused increased uncertainty in funding conditions and capital requirements for most financial institutions. Economic slowdown had an adverse effect on credit quality of many institutions, which resulted in their decreased profitability, lower returns on equity (ROE) and higher level of risk-weighted assets (RWA). It has also forced policymakers to come up with the proposals for tighter regulations, requiring the higher level of capital to be maintained with the function of a protective buffer. Tougher capital requirements, such as an upcoming enforcement of Basel III in 2013, might force some non-compliant banks to take quick actions to improve profitability. Continuous significant losses and failures in the financial industry over the past few years created a greater awareness of the importance of effective risk management. Even “too-big-to-fail” companies were in a deep liquidity crisis and in need of considerable amounts of cash for survival. The way a financial institution operates, the importance of setting risk limits, as well as precise business targets, are presented in the third section. Fourth section explains the concept of funds transfer pricing (FTP) and term liquidity premium (TLP). It explains why FTP and TLP are the key tools in liquidity risk management. The conclusion is summarised in the fifth section.

Concept of Assets /Liabilities Management (ALM):

ALM refers to the management of a bank's portfolio of assets and liabilities in order to maximize profitability and stockholders' earnings over long term, consistent with safety and liquidity considerations. ALM addresses to the responsibility of managing the acquisition and allocation of funds to ensure adequate liquidity, maximum profitability and minimizing risks.

It includes reviewing recent/past performance of exposures as an indicator to take up future activities. It involves the assessment of the funding strategies, as consideration is required to be given to, both liquidity and return. Such exercise calls for monitoring the distribution of assets and liabilities in terms of volume, rates and mix. The review of budgets and earnings is generally the tool used for this purpose.

Objectives of Assets /Liabilities Management (ALM):

Based on the aforesaid premise, the broad objectives of ALM are:

1. Planning to Meet the Liquidity Needs:

Making funds available at a competitive price when they are required is the first task of ALM. The task is to achieve a proper mix of funds by keeping the level of non-interest funds to the bare minimum, maximize the fund allocation to high profit areas while simultaneously ensuring availability of funds to meet all eventualities.

2. Arranging Maturity Pattern of Assets and Liabilities:

Matching of assets and liabilities over different time bands and keeping a tag on their pricing by limiting their exposure to interest rate risk are issues to be looked at in the ALM process.

3. Controlling the rates received and paid to assets /liabilities to maximize the spread or net interest income is the final responsibility of ALM.

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The aforesaid objectives are accomplished without exposing the bank to excessive risk of default. Primarily employing a three pronged strategies described below ensures the attainment of these tasks,

4. Spread Management:

Spread or margin, known differently as interest spread or interest margin or net interest spread/margin or net interest income refers to the difference between interest earned on deployment and interest paid on the acquisition of financial resources.

Spread maximization strategy involves:

1. Reducing bank's exposure to cyclical rates and stabilizing earnings over the long term,
2. Predicting rate changes and planning for such eventualities,

3. Coordinating rate structure,
4. Balancing default risk on loans and investments against probable benefits, and
5. Ensuring a steady but controlled growth as also gradual increase in profitability.

5. Gap Management:

Gap refers to the difference between assets and liabilities that can be impacted due to the change in the interest rates. Such assets/liabilities are referred to as rate sensitive assets (RSA) and rate sensitive liabilities (RSL) respectively.

For the gap management purpose, the assets and liabilities are distributed over different time bands/buckets calling for:

1. Identifying and matching assets and liabilities over different time bands,
2. Optimizing the earnings over a complete economic cycle without moving to an extreme position during any one phase, and
3. Building a mechanism to expand and contract assets/liabilities in response to rate cycle phases.

6. Interest Sensitivity Analysis:

This analysis is an extrapolation of gap management strategy. It concerns with the analysis of the impact of interest changes on the bank's spread/margin and resultant overall earnings.

The strategy includes:

1. Separating fixed and variable interest rate components of balance sheet,
2. Listing assumptions regarding rate, volume and mix of the projected portfolio,
3. Making alternative assumptions on rise and fall in interest rates, and
4. Testing the impact of assumed changes in the volume and composition of the portfolio against both, rising and falling interest rate scenarios.

ALM need to be proactive and be commensurate with the business cycle. Consideration has to be given to holding long term or short term assets/liabilities with fixed and variable interest rates. Addressing these issues should facilitate better interest sensitivity analysis as also spread and gap management.

Asset Management Strategy

Asset strategy management is the process through which organisations systematically approach the planning, production, organisation and maintenance of all their assets. For businesses, it entails taking a strategic approach to ensure that customers always receive the highest value. A vital component of asset strategy management is analysing the risk of external threats such as natural disasters and energy sources and the risk of downtime. With an effective asset management strategy, you can manage the impact or minimise the likelihood of such events. So, what's a bank or financial institution to do in order to stay profitable, or even afloat? Institutions can't with 100 percent certainty predict interest rate fluctuations. Yet, they have to lend funds and offer savings accounts as well as CDs with specific, set interest rates. Nevertheless, they may have to borrow short-term funds at much higher rates if interest rates spike. While a financial institution cannot altogether eliminate risks, there are a few key steps they can take to establish a sound asset liability management system.

Traditional asset strategy management handling

In the past, asset strategy management depended on manual inventory checks and paper logs. However, this method was disadvantageous in that:

Keeping track of previous accomplishments can be challenging. It is prone to human errors, which can lead to productivity loss if compounded over time. It can also lead to unforeseen machine outages. Paperwork may get mixed up, especially when multiple individuals are involved in record keeping.

Modern asset strategy management handling

In today's competitive business environment, the impact of robust asset management is prevalent in every sector of business. Strategic planners can use previous records to find out where they need to improve processes. Using sensors in the storehouse to ensure that raw materials are adequately stocked. Product developers can use collected data to build more durable and efficient assets in the future. Using the predictive maintenance approach to avoid potential future outages. Companies can build strong predictive algorithms through machine learning and use it to forecast repair expenditure. Through a connected manufacturing line, companies can build an effective asset strategy management that enables them to:

Reduce resource-consuming downtime: a data-driven and proactive asset strategy management will ensure that all working hours are well planned and managed

effectively.

Streamline processes: A well-defined asset management strategy will help to streamline processes while alerting you of any inefficiencies.

Providing key insights: Through asset management strategy, you can gain key insights that will fuel future innovation.

What are some Examples of Asset Management Strategies?

It is critical to choose the style of management that best meets your company's demands in order to manage your assets as efficiently as possible. Understanding the various forms of asset management is an important part of selecting a suitable solution. Here are several examples, along with descriptions of what they entail.

1. Digital Asset Management (DAM)

Digital asset management is a sector that is growing exponentially. It entails the effective organisation of content and digital material, as well as its processing and storage. Controlling access to goods such as intellectual property rights, construction blueprints and meeting recordings save stakeholders the expense of keeping numerous copies of these materials in storage. More significantly, consumers may be confident that they are better secured from natural disasters and water and fire damage. Having a solid digital asset management system permits for:

Accountability for digital asset access
Opportunities for reusing digital assets
Digital items and information are distributed instantly
Digital goods may be found quickly and easily without specialist knowledge
Brand consistency that works
Important data on which clients access digital items — who, what, when, and for how long — all of which is extremely valuable in building marketing strategies.

2. IT Asset Management (ITAM)

IT asset management includes both hardware and software management. It comprises tangible assets such as routers, computers and other IT equipment, as well as intangible assets such as licences, patents, software subscriptions (SaaS), and network infrastructure. IT asset management contributes to security, time and cost savings, and the establishment of a solid technical foundation for the future. It entails a system for storing, organising, accessing, and sharing data both online and in-house. It is useful to multiple kinds of service providers and companies.

3. Fixed Asset Management

Fixed assets refer to all the items an organisation uses to generate income. In most cases, they remain in their installation position for a long time. They include appliances, plumbing installations, in-place machinery and more. Fixed assets are commonly referred to as “property, plant, and equipment” or PP&E. Although fixed assets are major investments that usually serve the company for many years, they still require management. It may be in the form of producing data for a study, preventive maintenance, constant monitoring and more. Companies can achieve this through fixed asset management. By adding fixed assets to an asset management system or implementing one which is focused solely on PP&E, a company can get:

Information on who was using the asset and when, as well as which actions were performed

Lower maintenance costs

Real-time data streams on fixed assets in various locations

Pre-scheduled preventive maintenance

A record of assets that have been retired, lost, stolen, or recycled

4. Financial Asset Management

Financial asset management is a more conventional approach to asset management. It includes real estate holdings, investments, brokerage services and all intangible investments owned by an organisation. Here, asset management entails keeping track of market rates, tax obligations, and other financial commitments, such as loans, as well as accruing interest. Its main goal is to maximise profits while minimising risk.

5. Enterprise Asset Management

Enterprise asset management optimises, integrates and organises any infrastructure or physical assets owned by a company throughout its lifecycle. It entails inventory records, documentation of the condition of facilities and productivity. When shopping for an enterprise asset management system, look for one that has the following features:

The ability to generate customised and precise reports

Calculation and email creation in real-time

Visualisation of data

Customised formulae, charts, and productivity targets

6. Infrastructure Asset Management

The techniques involved in maintaining, upgrading and even eliminating these important utilities such as electricity, roads, water access, civil engineering, and

mass transport options are referred to as infrastructure asset management. In most cases, infrastructure asset management focuses on the end of a product's life cycle and the most efficient, cost-effective, environmentally responsible and safest ways to replace it.

Conclusion

Asset liability theory holds that when a bank simultaneously manages its assets and liabilities, it can then measure, monitor, and control the effects of changing interest rates on income, asset values, liquidity, and regulatory capital, thereby protecting the future viability of the bank. Virtually all financial institutions depend on asset liabilities management to stay afloat. In other words, financial institutions use ALM finance or ALM banking as their asset liability management system. Asset liabilities management is probably the key asset management technique that banks use today. In other words, a financial institution should practice asset liability management techniques, which show that they know their assets and liabilities; are keeping a close eye on any interest rate fluctuations; and are willing and able to revise interest rates on loans and deposits as the market – and national interest rate fluctuations – dictate. An effective asset and liability management (ALM) function is, therefore, crucial for organisations as it enables them to maximise return on capital, to address risks and to deal with rising competition.

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