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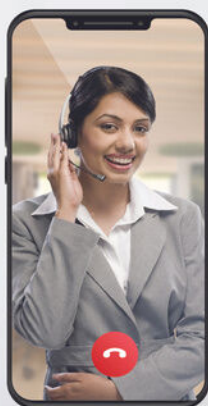
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Treasury & ALM in Banking

Managing the mismatch



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The 'SIB Students' Economic Forum' is designed to kindle interest in the minds of the younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is **Treasury and ALM in Banking**.

Ask most people what a bank does, and they will describe a branch. Deposits are collected. Loans are given. Cheques are cleared.

Ask a bank's Chief Financial Officer where the bank actually makes or loses money, and the answer is usually a different place: **the dealing room**.



Treasury and Asset-Liability Management, or ALM, sit at the point where every other department's decisions come together on one balance sheet.

Consider what that balance sheet looks like at the end of a good year.

- The bank has added several thousand crores of home loans running twenty years at a floating rate.
- It has funded that growth largely with fixed deposits of one to two years and with savings balances that can leave at any time.
- No single transaction in that set is unsound. Each loan was properly appraised. Each deposit was fairly priced. But taken together, they leave the bank with three exposures it never explicitly chose.

Funding mismatch: the money runs out before the loan does

The loans last far longer than the money funding them. Take a twenty-year home loan funded by a two-year deposit. When that deposit matures, the loan still has eighteen years to run. The bank must find the money again, and again after that, roughly ten times over the life of one loan. Each time, it is at the mercy of whatever deposit rates and market conditions happen to prevail on that day.

Repricing mismatch: rates change on different dates



The loans and the deposits change their rates on different dates. A home loan linked to the repo rate reprices within three months of a policy change, whether rates go up or down. A two-year fixed deposit does not reprice at all until it matures.

So a rate cut reaches the income side of the bank almost at once and the cost side only much later. In between, the margin shrinks. A rate rise does the same thing in reverse. This is the reason bank margins move even when nothing about the loan book has changed.

Liquidity mismatch: promises come due faster than dues come in

The bank has committed money to borrowers for twenty years while its depositors can ask for theirs back this week. Savings balances are legally payable on demand. Fixed deposits can be broken early. The loans, meanwhile, cannot be called back and cannot easily be sold. The bank's promises to pay can fall due much faster than its right to be paid.

The three are not interchangeable.

These overlap, but they are different problems. A bank can be comfortably funded and still lose margin to repricing. It can have a healthy margin and still be unable to pay out on a bad week. Each needs its own measurement, its own limits and its own decisions.

These exposures are not created by anyone in particular. They emerge from thousands of individual decisions taken across the branch network, none of which was made with the whole balance sheet in view. Somebody has to hold that view. That somebody is treasury.



This SEF explains what treasury does, how ALM works, what tools are used to measure the risks, and why all of this matters more today than it did ten years ago.

What Treasury does

Three separate jobs sit under the treasury roof. They often get confused with each other.

Job one: managing the bank's cash

Every day the bank must pay out money: deposit withdrawals, cheques, RTGS and NEFT settlements, cash reserve requirements, drawdowns on sanctioned limits. Money comes in and goes out unpredictably. Treasury has to make sure the bank never runs short. This is dull work, and it is also the job whose failure kills a bank fastest. A bad loan book takes years to become fatal. A cash shortage takes days.

Job two: managing the bank's investments



Indian banks must hold a minimum amount of government securities under the Statutory Liquidity Ratio. Most hold much more than the minimum. The investment book serves several purposes together. It meets the regulation. It acts as a cushion that can be sold or pledged for cash. It earns a return when loan demand is weak. And it can generate trading profits. Treasury decides what to buy, for how long, and in what mix.

Job three: absorbing the risks other departments create

Business units generate loans and deposits with all kinds of risks built in: fixed rates, foreign currency, deposits that can be broken early. Treasury absorbs these risks internally, then decides which to hedge in the market and which to carry. Treasury is also the desk that handles client business in forward contracts and swaps.

A fourth activity, *trading for the bank's own profit, is smaller in India than in global banks*. It still exists, and it still produces bad news when it goes wrong.

How the dealing room is organised

The dealing room is split into three parts:

1. The 'front office' does the deals.
2. The 'mid-office' independently measures the risk and checks that limits are being followed.
3. The 'back office' settles, confirms and accounts for the trades.

This split is not red tape. Almost every big trading loss in banking history happened because the wall between the person taking the position and the person checking it broke down.

ALM: the discipline of the mismatch

ALM is the framework that covers the whole balance sheet, not just the treasury book. Its subject is the mismatch that is built into banking itself.

Why the mismatch exists at all

Banks borrow short and lend long. Savings accounts are payable on demand. Fixed deposits last one to three years. But home loans run twenty years, project loans ten, and working capital keeps rolling over year after year. This conversion of short money into long money is genuinely useful for the economy. It is also risky. Part of what a bank earns is payment for carrying that risk.

The funding, repricing and liquidity mismatches described earlier are the three main forms this takes. A fourth applies to banks with international business.

Currency mismatch



Foreign currency assets funded by rupee liabilities, or the other way round, leave the bank exposed to the exchange rate. This matters for banks with significant trade finance, foreign borrowing, or NRI deposits, and it can interact with the other three: a currency hedge that needs rolling every three months is also a funding commitment.

What repricing looked like in practice

India saw the repricing mismatch clearly during the rate cuts of 2025. Loans linked to the repo rate repriced almost automatically within three months of each cut. Fixed deposits repriced only as they matured, which took one to two years. So income fell first and cost fell later. Banks with many repo-linked loans and few current and savings accounts felt the squeeze first and worst.

The point of ALM

ALM means measuring these mismatches, deciding how much of each the bank is willing to carry, and staying inside those limits. The important word is 'deciding'. A bank that has no view on its mismatch is not running zero risk. It is running

whatever risk its branches and business units happened to create, which is usually worse.

ALCO: where the decisions get made

The Asset-Liability Committee, or ALCO, is the body that owns this. In an Indian bank it usually includes the MD or a Deputy MD as chair, plus the heads of treasury, retail banking, corporate banking, risk, finance and often credit. It meets at least once a month, and more often when markets are unsettled.

ALCO's work is more specific than the phrase "balance sheet management" suggests. In practice it decides:

1. Deposit rates:

Card rates for each tenor, bulk deposit rates, and special schemes. This is the single most important decision most ALCOs make, month after month.

2. Lending rate benchmarks:

MCLR resets, the spread over the external benchmark, and the floor price below which no loan may be sanctioned.

3. Balance sheet mix:

How much growth in retail versus corporate, secured versus unsecured, and the CASA target the whole branch network will be measured against.

4. Investment book strategy:

Whether to buy longer-dated securities before an expected rate cut, or shorten up to protect against a selloff.

5. Limits:

How large a mismatch is acceptable in each time bucket, and what internal floors to keep above the regulatory minimum ratios.

6. Crisis triggers:

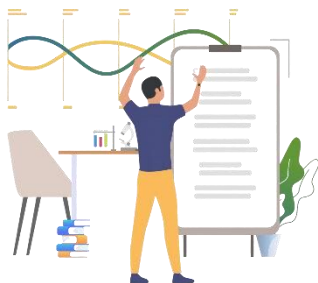
What the bank will do, and in what order, if funding conditions get worse.

A good ALCO takes decisions. A weak one is a reporting meeting where the treasurer shows thirty slides, everyone nods, and nothing changes. The difference is whether the committee sets a position for the months ahead or simply describes the position that has already built up on its own.

Measuring interest rate risk

There are two ways to look at this, and they answer different questions.

1. Looking at earnings: the gap statement



Sort the balance sheet into time buckets based on when each item next changes its rate: overnight, up to one month, one to three months, and so on. In each bucket, subtract the liabilities from the assets. What is left is the gap.

A positive gap means more assets than

liabilities reprice in that window. The bank gains when rates rise and loses when they fall. A negative gap works the other way. Multiply the cumulative gap by an assumed rate move, and you get a rough estimate of the effect on net interest income.

This method is rough, but useful, because it speaks the language management already uses: here is what happens to next year's NII if rates move by one percent. Its weakness is that it treats everything inside a bucket as identical, ignores the fact that different loans are linked to different benchmarks, and says nothing about what happens beyond the horizon you have chosen.

2. Looking at value: EVE

The second method treats the bank as a bundle of future cash flows and asks what those flows are worth today. Economic Value of Equity, or EVE, is the present value of the assets minus the present value of the liabilities. Because assets usually last longer than liabilities, a rise in rates normally reduces EVE.

This is the more complete measure. It captures the risk that rising rates quietly destroy the bank's value even while the reported profit still looks fine.

That is exactly what happened to Silicon Valley Bank in 2022. SVB held a large book of long-dated securities classified as held to maturity. Under the accounting rules, the fall in their market value never appeared in reported profit or capital. The loss was real. The accounts simply did not show it, until the bank was forced to sell and everyone found out at once.

The RBI's rules on Interest Rate Risk in the Banking Book require banks to run both measures under a set of prescribed scenarios, including rates up, rates down, and various changes in the shape of the yield curve. Under the Basel standard, a fall in EVE of more than 15% of Tier 1 capital in the worst scenario is treated as a warning sign for supervisors.

The assumptions do most of the work

Both measures depend heavily on assumptions about customer behaviour. This is where the real thinking sits.

Savings deposits can legally be withdrawn at any time. In practice, a large part of the balance stays for years. How large? The answer decides whether you place the savings book in the overnight bucket, which makes the bank look enormously exposed, or spread it over several years, which makes it look balanced. Banks estimate this "core" portion by studying how balances have actually behaved over time, and regulators examine those estimates closely.

The same applies elsewhere. A home loan has a twenty-year contract but a real life closer to seven or eight years, because borrowers prepay, refinance and sell property. Fixed deposits can be broken early, and customers break them more often when rates are rising. Cash credit limits are renewed every year but behave like long-term funding for the borrower.

Get these assumptions wrong and every number that follows is wrong. Worse, the assumptions tend to break down exactly when you most need them. Depositors become less loyal and borrowers change their behaviour under stress.

Managing liquidity

Liquidity is managed in two ways.

1. The structural view

The structural view lays out expected cash inflows and outflows across time buckets, from day one out to beyond five years. Negative gaps in the near buckets are subject to regulatory limits. The exercise forces the bank to face how much of its long-term lending is funded by short-term money that must keep being renewed.



2. The dynamic view

The dynamic view looks a shorter distance ahead but includes expected business growth, planned borrowings and known large flows.

On top of these sit two ratios from Basel III.

A. Liquidity Coverage Ratio: surviving thirty days

LCR asks whether the bank holds enough high-quality liquid assets to survive thirty days of severe stress. Each type of liability is assumed to run off at a set rate: retail deposits slowly, wholesale funding quickly. The minimum is 100%. The real discipline of the ratio is that it puts a visible price on unstable funding. Chase bulk deposits, and your requirement to hold liquid assets goes up.

The RBI has been tightening this framework, including higher assumed run-off for deposits held by customers with internet and mobile banking. This is a direct response to what happened in the US in 2023. Depositors with a phone can move money in hours, not days. SVB saw tens of billions of dollars leave in a single day, a speed that no older stress assumption had imagined.

B. Net Stable Funding Ratio: not being fragile in the first place

NSFR works over a full year. It requires that stable funding available exceeds stable funding needed. If LCR is about surviving a sudden shock, NSFR is about not building a fragile funding structure to begin with.

Everything beyond the ratios

A serious framework also includes watching intraday cash positions, limiting how much funding comes from any single counterparty or instrument, regular stress testing, and a Contingency Funding Plan.

The contingency plan matters most in the one situation where there is no time to write one. It should say, in advance, who has the authority to act, which assets get sold and in what order, and which credit lines get drawn. It has to exist before the crisis, not during it.

The investment book and its accounting

The RBI's revised rules on investment classification, effective from April 2024, bring Indian practice closer to global standards and change treasury's incentives.

Investments now fall into three categories, based on why the bank holds them:

1. **Held to Maturity:** For securities the bank intends to hold for their contractual interest and principal.
2. **Available for Sale:** For securities held both to earn interest and to sell when useful.
3. Fair Value through Profit and Loss: For everything else, with held-for-trading as a sub-category.

Three changes matter most. The old cap on how much could be held in HTM as a share of deposits has gone, but the classification now has to be justified by a genuine business model, and moving securities between categories is tightly restricted. AFS securities are marked to market, but the gains and losses go to a separate reserve inside equity rather than into the profit and loss account. That reduces swings in reported profit but makes capital more sensitive to rate moves. FVTPL positions go straight to the profit and loss account. And the old practice of ignoring gains while providing only for net depreciation is finished. Fair value now cuts both ways.

For an ALM practitioner, there is one point worth holding on to. Accounting does not change economics. A bond in the HTM category that has lost 15% of its market value has lost 15% of its value, whatever the books say. The classification decides only whether and when the loss becomes visible. Banks that manage the accounting instead of the economics are building the exact exposure that destroyed SVB.

Funds transfer pricing: the bank's internal price for money

Funds transfer pricing, or FTP, is how treasury buys money from the units that gather deposits and sells money to the units that lend. It is the least visible part of treasury and possibly the most powerful, because it decides how profitable each business looks, and therefore how every business head behaves.

Under a matched-maturity system, each transaction gets a transfer rate based on what money of that particular maturity and repricing pattern actually costs in the market on the day the deal is done. A five-year fixed rate loan is charged the five-year funding rate. A savings deposit is paid a rate reflecting how long the money really stays.

The effect is to take interest rate risk out of the branches and business units and move it into treasury, where it can be measured and managed as one single position. The branch earns a spread on lending and a spread on deposits. Treasury owns the mismatch. Each side is then held accountable only for what it can actually control.

Get FTP wrong and the incentives go wrong immediately. Charge too little for long-dated fixed rate lending, and the corporate desk will write a great deal of it, booking apparent profit while pushing an unpriced risk onto the bank. Pay too much for savings deposits, and the branch network will chase small accounts that look profitable on paper but are not. A surprising number of strategic mistakes can be traced back to an FTP curve that told everyone the wrong thing for years.

Liquidity cost belongs in FTP too. A five-year loan ties up stable funding and should be charged for it. Without an explicit liquidity charge, illiquid assets look cheaper than they are.

Why this matters more now

Several things have raised the stakes.

Margin pressure is now structural, not just cyclical

Linking loans to an external benchmark has made loan yields respond to policy rates much faster than deposit costs do. That asymmetry hurts banks every time rates fall. With the RBI having cut the repo rate through 2025 to 5.25% and held it there on a neutral stance into mid-2026, Indian banks have been absorbing this directly. The ones that coped best repriced deposits early and firmly, lengthened their investment book before the cuts arrived, and had a deep enough CASA base to cushion the transition.

Competition for deposits has grown

Households now have alternatives that barely existed a generation ago: mutual funds, direct equity, small savings schemes. Deposit growth has repeatedly lagged credit growth, which leaves treasury filling the gap with certificates of deposit and other market borrowings at rates well above the cost of CASA.

Deposits move faster than they used to

Digital banking has cut the time between a depositor's decision and the money leaving to a few seconds. Any stress assumption built on pre-digital behaviour underestimates how fast money can go, and regulators are adjusting their assumptions accordingly.

Rate volatility comes from outside

Crude prices, currency pressure from foreign investor flows, and disruption to trade routes all feed into inflation, which feeds into policy rates, which feed into the whole ALM position. A treasurer in Kochi is exposed to events in the Strait of Hormuz whether or not the bank holds a single dollar asset.

For the practitioner

The technical side of ALM can be learned: gap statements, duration, EVE, the ratio calculations. What is harder, and what separates an effective ALCO from one that merely complies, is **judgement**.

That means knowing which behavioural assumptions the whole model rests on, and stress-testing those specifically, rather than running the standard scenarios and filing the report. It means recognising where the accounting and the economics differ, and managing the economics. It means treating FTP as a strategic tool rather than a bookkeeping detail. And it means being willing to take a position, whether that is lengthening duration, repricing deposits ahead of the market, or accepting a

short-term hit to profit for a stronger structure, instead of drifting into whatever position the business units happen to create.

Banks fail for two reasons. They lend to people who do not repay, and they run out of money. Credit risk gets the committees, the attention and the arguments over provisioning. Liquidity and interest rate risk get one meeting a month and a set of returns. Yet the failures of recent years, from Silicon Valley Bank to Credit Suisse, were failures of funding and duration, not of credit. The risk lives on the balance sheet.

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