Alpha Alternatives Financial Services Private Limited
(Formerly Known as Provincial Finance and Leasing Co Private Limited)

Risk Management Policy

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Applicable to: Alpha Alternatives Financial Services Private Limited ("AAFSPL") (Formerly Known as Provincial Finance and Leasing Co Private Limited ("PFLCPL")

BACKGROUND & LEGAL FRAMEWORK

Risk Management is a key aspect of the "Corporate Governance Principles and Code of Ethics" which aims to improvise the governance practices across the Company's activities. The Management of NBFCs have to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. NBFCs are exposed to several major risks in the course of their business-credit risk, interest rate risk, market risk, liquidity risk, operational risk etc. It is therefore important that NBFCs should introduce effective risk management policy that addresses the issues relating to various business risks. Riskmanagement policy and processes will enable the Company to proactively manage uncertainty and changes in the internal and external environment to limit negative impacts and capitalize on opportunities.This policy document has been prepared in line with the RBI guidelines.

GENERAL PROVISIONS

This Policy represents the basic standards of Risk Assessment to be followed by the Company. Changes in the Policy will become effective upon approval by the Board of Directors of the Company.

OBJECTIVE & PURPOSE OF POLICY

The main objective of this policy is to ensure sustainable business growth with stability and to promote a pro-active approach in reporting, evaluating, and resolving risks associated with the business. To achieve the key objective, the policy establishes a structured and disciplined approach to Risk Management, in order to guide decisions on risk related issues.

THE SPECIFIC OBJECTIVES OF THE RISK MANAGEMENT POLICY ARE:

- To ensure that all the current and future material risk exposures of the company are identified, assessed, quantified, appropriately mitigated, minimized and managed i.e. to ensure adequate systems for risk management.
- To establish a framework for the company's risk management process and to ensure its implementation.
- To enable compliance with appropriate regulations, wherever applicable, through the adoption of best practices.
- To assure business growth with financial stability.

DISCLOSURE IN BOARD'S REPORT

Board of Directors shall include a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in theopinion of the Board may threaten the existence of the company.

<u>RISK MANAGEMENT</u>

Risk management is a business facilitator by making more informed decision with balanced risk-reward paradigm. The Company shall follow a disciplined risk management process and has been taking business decisions, ensuring growth and balancing approach on risk reward matrix.

There are following risks associated with our business which are detailed as under:

Market Risk

Market Risk is the risk on account of exposure in capital markets and exchange traded commodities whichwould include price risk, exposures in derivative instruments, etc.

Operational Risk

Risks inherent to business operations including those relating to client acquisition, service delivery to clients, business support activities, information security, physical security and business activity disruptions.

Interest Risk

Interest rate risk is the risk where changes in market interest rates might adversely affect an NBFC's financial condition. The changes in interest rates affect company in some way. The immediate impact of changes in interest rates is on company's earnings (i.e. reported profits) by changing its Net Interest Income(NII). As such the Company is also in the business of and making investments in Fixed income securities, debentures and other instruments that may be fixed or floating rates, interest rate risk may have a major impact on the company.

Liquidity risk

Liquidity risk refers to the potential that the Company may encounter difficulty in meeting its short-term financial obligations, primarily due to an imbalance between its liquid assets and liabilities. In other words, it's the risk that the Company may not have enough readily available funds to cover its immediate cash needs, leading to financial distress or inability to fulfill customer/other financial obligations

Credit Risk

Credit risk is the risk that the Company will incur a loss because its counterparties fail to discharge their contractual obligations. The Company's exposure to credit risk is influenced mainly by cash and cash equivalents, loan assets and other financial assets. Based on business environment in which the Company operates, a default on a financial asset is considered when the counter party fails to make payments withinthe agreed time period as per contract.

Information Technology Risk:

Phishing Attacks: Cybercriminals attempt to deceive individuals into providing sensitive information through fraudulent emails, messages, or websites.

Malware Infections: Malicious software, such as viruses, worms, and ransomware, can infect systems, steal data, or disrupt operations

Data Breaches: Unauthorized access to sensitive data, whether through hacking, insider threats, or accidental disclosure, can lead to significant financial and reputational damage.

Insider Threats: Employees, contractors, or partners may intentionally or unintentionally compromise security by abusing privileges, mishandling data, or engaging in malicious activities.

Third-Party Risks: Dependence on third-party vendors or service providers introduces additional security risks, such as supply chain attacks or data breaches through external systems.

System Vulnerabilities: Weaknesses in software, operating systems, or network configurations can be exploited by attackers to gain unauthorized access or disrupt operations.

Risk Mitigation

Market risk

The Company assesses and reviews its exposure in capital markets and exchange traded commodities on a continuous basis. Further, for management of such risk, the company makes the required diversification in its investment portfolio for equity exposures. Further, it monitors its derivative exposure closely and therisk on the same is managed by adopting hedging strategies for the same.

Interest Risk

The company manages this risk on NII by pricing its loan products to customers at a rate which covers interest rate risk. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or

Net Interest Margin (NIM). Measurement of such risk is done at the time of deciding rates to be offered to customers and at the time of making investments in Fixed income and Debt instruments. Once interest rate risk is measured, lending rates are finalized. Given the interest rate fluctuation, the company has adopted a prudent & conservative risk mitigation strategy to minimize interest risk by matching liability with that of assets.

Operational Risk

Any eventuality arising from the act relating to people, technology, infrastructure, process, regulatory non-compliance and external factors, which can give rise to some type of loss in the organisation, is termed as Operational Risk. Therefore, the Company responsible shall prudently keep continuous watch and shall gather the symptoms/warning signals to manage Operational risk.

Liquidity risk

The Company employs various strategies and tools to manage liquidity risk effectively. The liabilities raised shall always be for longer term vis a vis the assets. The Company shall maintain liquid high-quality assets, that can be liquidated at shorter notice, to meet any unforeseen liquidity requirements.

Credit Risk

Credit risk shall be managed using a set of credit norms and policies. The Company shall have defined rolesand responsibilities for originators and approvers. All credit exposure limits shall be approved by authorized persons as per delegation of matrix.

- There shall be a structured and standardized credit approval process to ascertain the credit worthiness of the borrower.
- The Company shall develop internal evaluation team to make credit decisions mor erobustand in line to manage collateral risk.
- The Company shall follow a process of time-to-time revisiting the credit policy andprocesses, on the basis of experience and feedback.
- The Company shall regularly review the credit exposure and ensure prudently and that the exposures are within the comfort zones.

Information Technology Risk

- **Phishing Attacks**: Implement email filters, conduct employee training on identifying phishing attempts, and utilize multi-factor authentication to reduce the risk of unauthorized access.
- **Malware Infections:** Install and regularly update antivirus and anti-malware software, maintain strong firewalls, and educate employees on safe internet browsing habits.
- Data Breaches: Encrypt sensitive data, restrict access to confidential information based on user roles, and implement robust access controls and monitoring systems.
- **Insider Threats**: Implement role-based access controls, monitor user activities for suspicious behavior, and enforce strict data protection policies, including employee training on security best practices.
- **Third-Party Risks**: Perform due diligence on third-party vendors, including security assessments and contractual obligations for data protection. Monitor and audit third-party access to sensitive systems and data regularly.
- **System Vulnerabilities**: Apply security patches and updates promptly, conduct regular vulnerability assessments and penetration testing, and implement intrusion detection and prevention systems.

Responsibility

Responsibility for risk management is shared across the organisation.Key responsibilities include:

- Controlling the risks through a formal program is necessary for the well-being of the organization and everyone in it. The services the organization provides, the safety of the workplace and other benefits all depend to an extent on our ability to control risks.

- The Board is responsible for satisfying itself annually, or more frequently as required, that management has developed and implemented an effective risk management framework. Detailed work on this task is delegated to the Audit Committee, and reviewed by the full Board.
- The Audit Committee shall assists the Board in overseeing the group's risk profile and is responsible for overseeing management's actions in the identification, management and reporting of material business risks.
- The head of investment shall be responsible for the investments strategies execution and monitoring risk.

Over the counter derivatives

The Company shall also deal in over-the-counter derivatives such as interest rate swaps, interest options/futures, non-INR currency forwards plain vanilla and structured. These instruments shall dynamically be used to hedge the underlying interest rate and currency risk, if any. However, such trades shall also be dealt with in anticipation of an underlying transaction and for short-term opportunities.

These OTC derivatives shall be executed with RBI registered banks and other financial institutions.

The Company shall execute International Swaps and Derivative Association (ISDA) and Credit Support Annex (CSA) documents with these counterparties before dealing in OTC instruments.

The Company shall lay down prudent risk management guidelines for the OTC instruments encompassing:

i. **Risk Identification, Measurement, and Control: thorough process for risk identification, risk measurement techniques and risk controls**

ii. **Designation of authorized officials and clear Procedures** to undertake OTC derivative transactions, within specified transaction limits and also for revaluation and monitoring of derivative positions by authorized officials.

iii. **Separation of Duties:** Clear separation of duties between the front office, middle office, and back office

iv. **Risk Measurement and Information Systems: E**mploy sound risk measurement procedures and advanced information systems to ensure comprehensive internal controls and audit procedures.

v. **Accounting Policy and Disclosure Norms:** Established accounting policies and disclosure norms for derivative transactions.

vi. **Mark-to-Market of the Portfolio:** Guidelines for appropriate accounting process for mark-to-market valuations.

vii. **Risk & other Data Reporting:** Institutionalize processes for reporting data., ensuring oversight and risk mitigation

viii. **Quarterly Review and Annual Audit**: Quarterly review of operations and an annual audit of transactions to ensure compliance with RBI regulations and other statutory guidelines.

Business Risk Principles

The Company intends to run a multi-strategy absolute return product, where capital and risk are dynamically allocated across a combination of active, market non-directional strategies. These shall be low-medium risk strategy which aims to generate a consistent returns, with very low downside volatility and a target of generating positive returns every quarter.

This is an all-weather strategy where the Company wants to take a lot of small risk across several strategies and sub-strategies. The strategy has a low correlation with the market, and the Company target's to achieve the returns irrespective of market cycles.

In the derivatives book the company shall endeavour to be active in most liquid indices and the top 200 stock futures and options. Target portfolio shall be such that 90%-95% of the book can be liquidated in maximum 2-3 trading session.

Brief description of strategies

<u>Option Strategies:</u>

Active trading strategies in index and stock options.
Strategies: Option Spreads, Volatility Trading, Index Dispersion, Calendar Spreads

<u>Special Situation:</u>

Trades based on events driven by corporate restructuring.
Strategies: Open Offer & Buyback, Delisting, Mergers & Acquisitions, Demerger, IPO

<u>Long / Short Strategies:</u>

Diversified basket of long stocks and short stocks
Tight stop losses and tightly controlled market exposure

<u>Arbitrage Strategies:</u>

Trade the spread between different securities of the same underlying.
Strategies: Cash Futures Arbitrage, Index Arbitrage

1. A few examples of the sub-strategies that the Company shall run include the following:

<u>Option Strategies:</u>

Option Implied Volatility v/s Market Volatility

- Trade between the implied volatility priced in the options v/s expected market volatility.
- Buy/ sell options and continuously hedge the delta as the underlying market moves.
- Normally, trade both the call & put options, so that a one-way move doesn't hurt.

<u>Trade Example</u>

Nifty Futures trading @ 18700 → **Sell 18600 & 18500 puts** → **Hedge any residual Delta continuously**

Option Ratio Spreads

- Trade between options of different strikes of the same underlying
- Normally, trade both the call & put options, so that a one-way move doesn't hurt.

Trade Example

Bank Nifty Futures Trading @ 44500 → **Buy 44400 put & sell 44200 puts Buy 44600 call & sell 44800 calls** → **Hedge any residual Delta continuously as the underlying moves**

Index Dispersion

- Trade between index options and the basket of stock options
- Trying to capture the relative mispricing of volatilities between index options and stock options

Trade Example

Sell Bank Nifty Futures At-The-Money Options → **Buy a basket of at-the-money stock options of the Bank Nifty constituents.** → **Hedge any residual Delta continuously as Nifty**

Special Situations:

Open Offers

- Mandatory/ voluntary offer by promoter/shareholder to buyout minority shareholders
- Normal timeline: 3-4 months

Trade Example

- **Open offer of sugar mill company, triggered by new promoter taking control**
- **Offer to buy about 29% equity**

Buyback

- Company offers to buys back shares from existing shareholders.
- Normal timeline: 2-3 months

Trade Example

- Cash rich IT services company, which wanted to **return excess cash** to shareholders
- **Buyback of about 7% shareholding at a 25% premium to market price**

Delisting

- Voluntary option used by promoters to take the company private.
- Normal timeline: 3-4 months

Trade Example

- The company's core business is specialty injectable drugs.
- The delisting price discovered through reverse book building was Rs. 400 which was accepted by the acquirers
- We can make an absolute return of 4.1% over the course of 86 days with an XIRR of 50%

IPO

- Voluntary option used by corporates to raise funds for change in capital structure/Increase in working capital.
- Normal timeline: 7-10 days

Trade Example

- A government owned entity handling online ticketing, tourism and catering for trains
- Due to its attractive valuation, we expect
- the subscription in the QIB segment
- to be more than 50-60x. We can allocate maximum available capital for the IPO

Long-Short strategies:

Technicals

- Team went long Nifty as well as Bank Nifty
- NBFC's gave lots of breakouts along with volatility expansion (+)
- RSI + MFI trades were a mixed bag

Pairs - Long Short

- As market provided direction, pair trades were reduced significantly
- Large cap IT (-) against midcap IT (+)

Results

- This bucket continues to remain very active
- RE/NBFC's/Banks/Financials - all gave opportunities
- Should continue to be an active bucket this month

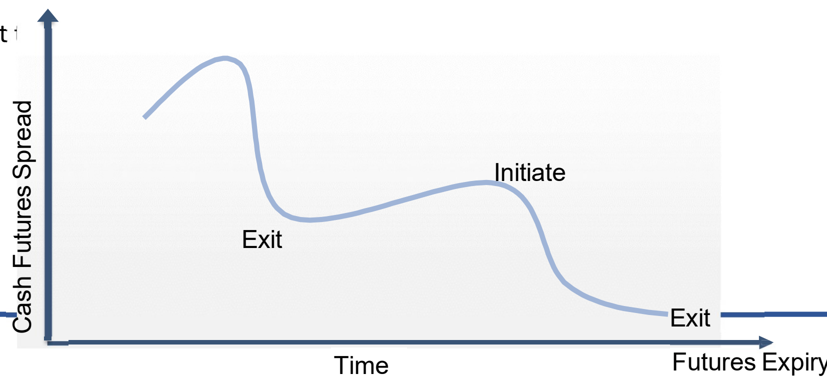
Sector Rotation/Relative Strength

- The team saw strength in Nifty and played sectors they thought would outperform
- FMCG/PSE/AUTOS/INFA (+)
- IT/NBFC/RE (+)
- Used Nifty to hedge their long positions

Arbitrage Strategies:

Arbitrage

- Taking advantage of the spread between different securities of the same underlying: -
  - **Cash Futures Arbitrage**: - Arbitrage between the underlying stock and stock futures, eg Reliance stock vs Reliance futures
  - **Index Arbitrage**: - Arbitrage between the index futures and the basket of stock futures; eg Nifty futures vs basket of 50 stock futures
- In today's market conditions, the static arbitrage opportunities are rarely available, but there are significant



Board of Directors Meetings and Review

The Board of Directors, Investment committee and or Risk management committee in their meetings, will oversee the implementation of the risk framework, risk system and review its functioning periodically.

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