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

# Investment Policy

Version 5.0

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# Contents

## 1. Introduction

The purpose of Investment Policy (“Policy”) is to establish a structured framework for investments in various financial instruments by Alpha Alternatives Financial Services Private Limited (“AAFSPL”/ “Company”). The Reserve Bank of India (RBI), though Master Directions, has advised for NBFCs to have a Board Approved Investment Policy.

## 2. Objective

The objectives of the Policy are –

- Establishing investment framework which is compliant with regulatory guidelines
- Providing an investment and trading framework for Commodities Absolute Return (CAR) and Equity Absolute Return strategies
- Providing a structured framework to meet short- term and long- term investment goals of the Company
- Achieving optimal risk – return balance while maintaining adequate liquidity
- Ensure prudent and balanced Asset Liability management

## 3. Investment Strategies

The Company is involved in the business of issuance of Market Linked Debentures (MLDs) in compliance with SEBI regulations. These are listed - rated MLDs having exclusive charge on assets managed under CAR or EQAR.

➢ **CAR:**

It is a combination of active, non-directional and directional strategies, investing in commodities derivative markets where instruments are liquid and traded on MCX and NCDEX exchanges. CAR book comprises of various trading strategies which can be clubbed in below broad categories:

▪ Option Strategies:

Active trading strategies in commodities options such as calendar spread, Option spreads, Volatility strategies

▪ Spread Trading:

Active trading between different contracts of the same or related underlying commodities - Calendar spread trading, parity trades

▪ Long / Short Strategies:

Long / Short positions in diversified basket commodities

▪ Arbitrage Strategies:

Spread trade between different securities of the same underlying like index arbitrage, Conversion reversion

➢ **EQAR:**

It is a combination of active, market non-directional and directional strategies, investing in underlying equity and equity derivative markets where instruments are liquid and traded on NSE or BSE exchanges. EQAR book comprises of various trading strategies which can be clubbed in below broad categories:

▪ Options Strategies

Active trading strategies in index and stock options such as Option Spreads, Volatility Trading, Index Dispersion, Calendar Spreads

▪ Special Situations

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

▪ Long / Short Strategies

Diversified basket of long stocks and short stocks

- Arbitrage Strategies

Spread trade between different securities of the same underlying such as Cash Futures Arbitrage, Index Arbitrage

CAR and EQAR strategies can have investment in Fixed Income instruments like Gsecs, Corporate bonds or other eligible securities which can be pledged with Equity and Commodity exchanges for trading in derivatives segment.

In addition, CAR and EQAR strategies can do short-term investment in Corporate Deposits and Commercial papers for efficient liquidity management,

- **Other:**

Apart from trading and investments in CAR and EQAR strategies, the Company can have investment book. Investments done by the Company shall be independent of investments made in CAR / EQAR strategies.

## 4. Structure:

- **Investment Committee:** The Investment Committee of the Company shall define broad level investment guidance for the investment teams of the CAR and EQAR strategies.

The Investment Committee of the Company has the following responsibilities:

- Defining broad level investment strategies of MLDs:
    - For EQAR: Options, Long-Short, Special Situations, Arbitrage
    - For CAR: Options, Long-Short, Spreads
- Establishing risk limits for CAR and EQAR strategies
- Evaluating various investment opportunities for the Company
- Defining guidelines for Investment policy
- Fixing criteria for classifying the investments into current and long-term investments
- Review of Investment portfolios of NBFC and CAR - EQAR strategies
- Approving pricing & valuation models for various complex financial instruments such as Options, OIS
- Approving disposal of investments made by the Company
- Identify all risks involved and evaluate risks

The Committee shall meet at least on a quarterly basis to discuss and review the investment decisions and financial performance of investments.

- **Investment Team:** The Investment teams of CAR and EQAR strategies shall actively look out for various trading and investment opportunities within the framework defined in Investment Policy.

The Investment Team of the Company has the following responsibilities:

- Research novel investment opportunities
- Evaluating and executing trading and investment opportunities
- Optimizing risk budgets across various trading positions
- Ensuring positions are withing regulatory limits
- Monitoring real time PnL of open positions through live dash boards
- Maintaining loss limits defined in risk frameworks

- **Back Office:**

The Back Office team is responsible for supporting the Investment team in discharge of its duties. It will be responsible for the following functions:

- Defining Single Order limits for each trading terminal as defined by Investment Committee (IC) or senior member of Investment Team appointed by IC
- Allocating margins for trading to each terminal
- Block the scrips for trading defined as banned scrips by Exchanges or Compliance, Risk or IC of the

Company

- Monitoring of terminal limits and exchange level limits
- Monitoring the margin utilization and sending alerts to the Investment Team
- Ensuring margin requirements are met in expiry dates of FnO contracts
- Live MTM monitoring and sending alerts to Investment Teams
- Keeping records of trade instructions given by investment team
- Reconciliation of trades between trading team and brokers contract notes
- Reconciliation of daily MTM calculations with broker`s report
- For Fixed Income OTC trades –
    - Trade confirmation with Agent / Broker
    - Issuing instructions to DP team for settlement
    - Reporting of Fixed Income OTC trades on exchange platform

➢ **Mid office:**

- Monitoring daily Gross and Net PnL of the strategies
- Monitoring daily, weekly, monthly and yearly performance of the trading strategies
- Sending alerts to Senior Management in case of breach in loss limits

➢ **Treasury:**

- Ensuring availability of funds to meet daily MTM requirements
- Settlement of Fixed Income OTC trades
- Pledge / un-pledge of eligible instruments used for trading in CAR and EQAR strategies

➢ **Risk Team:**

- Identifying the primary and secondary risk measures as per the trading strategies
- Defining risk framework and risk limits for trading strategies
- Preparing Risk policy which comprises of Risk parameters, risk thresholds and risk limits for trading strategies
- Monitor the risk parameters on end of day open positions
- Escalate the deviations to IC

➢ **Compliance Team:**

- Ensuring adherence to regulatory guidelines and regulatory limits
- Escalate the deviations to IC and senior management

➢ **Tech Team and IT Support:**

- IT support is of primary importance for smooth functioning of trading and risk management
- IT team shall drive the BCP testing to ensure the trading process is resilient to various events which can affect the trading and settlements
- Various tools and software used by trading team shall be evaluated at least annually as per Outsourcing guidelines issued by Reserve Bank of India.

## 5. Types of Instruments

| | **CAR** | **EQAR** | **NBFC`s Investment book** |
|---|---|---|---|
| Commodity FnO contracts tradable in MCX or NCDEX platforms | ✓ | û | ✓ |
| Equity FnO tradable in NSE or BSE platforms | û | ✓ | ✓ |
| Listed Equity shares | û | ✓ | ✓ |
| Unlisted equity shares (equity, warrants, preference, convertible or not) | û | û | ✓ |

| | | | |
|---|---|---|---|
| Equity: Mutual Funds and ETFs | û | ✓ | ✓ |
| Debt Mutual Funds, Liquid Funds | ✓ | ✓ | ✓ |
| Commodity ETFs | ✓ | û | ✓ |
| Equity IPOs/QIP | û | ✓ | ✓ |
| Investment opportunities arising from special situations such as open offer, merger, demerger, etc. | û | ✓ | ✓ |
| Gsecs, T-Bills, SDL | ✓ | ✓ | ✓ |
| Corporate Bonds, Primary issuance of Corporate Bonds | ✓ | ✓ | ✓ |
| Commercial deposits and commercial papers | ✓ | ✓ | ✓ |
| Interest Rate Derivatives include but are not limited to Interest Rate Swaps, Overnight Index Swaps. CBLO/TREPS based lending (for hedging the Interest Rate Risk) | ✓ | ✓ | ✓ |
| **Others -** | | | |
| ▪ Fixed Deposits / Recurring Deposits of Scheduled Commercial Banks | û | ✓ | ✓ |
| ▪ Units of AIFs, REITs | û | ✓ | ✓ |
| ▪ Portfolio Management schemes (equity or debt) | û | ✓ | ✓ |
| ▪ Other quasi equity/ quasi debt / hybrid instruments | û | ✓ | ✓ |
| ▪ Currencies and related derivatives (for hedging currency exposure) | û | û | ✓ |
| Any Other | With IC approval | With IC approval | With IC approval |

## 6. Process of Trading and Investment:

- Back-office team shall set the Single order limits, Exchange limits, MTM loss limits, Margin limits for each trading terminal
- The investment team shall actively evaluate unique trading strategies
- Back-office team shall block the scrips in banned period
- Post evaluation and finalization of trade, investment team passes the instructions to dealers to execute the trades
- Live margin utilization, PnL should be tracked by Investment teams and Back Office team
- The investment team should square off the positions which are entering into delivery confirmation period if delivery is not intended
- Timely alerts and Intimations should be sent to the Treasury to arrange for exchange and counterparty pay-outs
- Back office and MIS team shall involve in reconciliation of –
  - Trades with trading team and broker's report
  - Exchange pay-in outs with PnL report
  - Equity open positions with DP statement
  - GSecs and Fixed Income positions with DP statement

➢ Investment Evaluation: The following key parameters shall be considered while conducting Investment Evaluation

- Return generation profile under different scenarios
- Risk assessment
- Investment tenure
- Liquidity profile
- Counterparty assessment, if any
- Collateral diligence, if any
- Relevant Macro factors assessment

- Exit options
- Due diligence reports of external service providers, if any
- Overall Exposure before and after the transaction
- Portfolio level risk-return analysis before and after the investment
- Leverage requirement for the transaction

The IC shall meet as and when needed to evaluate any investment opportunity presented by the team. In case the IC needs an opinion of other external experts/consultants, the IC shall approach them and proceed as appropriate.

➢ Process to OTC deals:

- Corporate bond market in India is dominated by OTC trades. Following precautions should be taken to reduce the counter party risk –
    - All deals should be confirmed by dealer on recorded phone lines
    - Trade should happen via reputed agents / brokers
    - OTC trade should be reported and accepted by back-office team on exchange platforms

- Other OTC deals: The Company can enter OIS or other derivative deals with IC approval. IC approval notes should specify in detail -
    - Officials authorized for such deals
    - Transaction limits
    - Method of Mark-to-Market valuation and monitoring of derivative positions
    - Segregation of duties between the front office, middle office, and back office
    - Risk identification, measurement, and controls
    - Accounting policies and disclosure norms to be followed

## 7. Valuation methodology

➢ Valuation of Quoted Investments:

Listed / Quoted investments shall be valued at fair market value which is exchange traded closing price of the instrument. Thus, the following types of instruments shall be valued as perthe closing price of the instrument on exchange.

- Equity Shares or any compulsory convertible instruments
- Preference Shares
- GSecs, T-Bills, SDLs
- ETFs, Units of Mutual Funds

➢ Valuation of Option Derivatives:

The positions in Option derivatives can be in index options, stock options, and commodity options. These option contracts are actively traded on exchanges. Risk valuation of options involves calculation of implied volatilities and decomposition of option greeks.
Option contracts should be valued at the closing price of these contracts on stock exchanges. The market follows Black-Scholes model for pricing the options. The same model shall be followed to calculate implied volatilities and option greeks.

➢ Valuation of Un-quoted Investment:

- Equity Shares: Unquoted equity shares shall be valued at Cost or Break-up value, whichever is lower. However, AAFSPL may substitute Fair value for the Break-up value of shares, if considered necessary.
- Preference Shares: Unquoted preference shares shall be valued at Cost or Face value, whichever is lower. However, AAFSPL may substitute Fair value for the Break-up value of shares, if considered necessary
- Corporate Bonds and Government Securities: Investments in unquoted Government Securities or Government guaranteed bonds shall be valued basis independent valuation.

- Commercial Papers & Deposits: Commercial Papers/Deposits shall be valued at Carrying cost.

➢ Investment Classification:

- All investments made under CAR and EQAR strategies are of a trading nature. These should be classified as Financial Assets – Fair Value through Profit and Loss (FVTPL)
- Other Investments made by the Company can be classified as Financial – Fair Value through Other Comprehensive Income (FVOCI) or FVTPL depending on the nature of investment. The same shall be classified in respective investment notes.

## 8. Risk Monitoring:

The investment team is primary responsible for monitoring and mitigating the risk of its trading positions. The Risk team should independently identify the risks, define risk frameworks and risk limits and measure, monitor and highlight the risk positions.
Risk team shall formulate the risk framework which consists of primary risk parameters and methodology of measures of these parameters. The Risk team shall prepare the risk appetite of the Company and its investment strategies and define the risk limits accordingly. The risk framework shall be part of the Risk Management Policy.

Risk monitoring can be classified in three parts -

➢ **Intraday Live risk Monitoring:**

- The investment team will continuously monitor intraday P&L to ensure it remains within approved limits
- Sensitivity of derivatives positions, Greeks with respect to price changes in underlying instruments shall be tracked
- Real-time dashboards shall be developed which helps in monitoring MTM, margins, option greeks
- Positions built by the Investment Teams in CAR and EQAR strategies should have high liquidity

For trading positions, Intraday live risk shall be monitored vigilantly. Intraday risk monitoring shall cover –

- Margin utilization at exchange and at custody levels
- Span – exposure margin requirements
- Option exposure and OI limits
- Loss thresholds and MTM tracking
- Monitoring of single order limits
- Tracking user – terminal limits
- Block trading in banned scrips and scrips in restrictive list

➢ **Operational Risk:**

- Back-office team shall ensure that all trading terminals have single order limits, margin limits and loss limits established

➢ **End of Day open positions Risk Monitoring:**

- The Risk team should independently oversee end-of-day open position exposure
- Any breaches relative to established risk limits will be identified and promptly escalated to the Investment Committee or senior management for further review
- Risk models should measure the primary risk parameters and also conduct scenario analysis. There can be various primary risk measures depending on the strategy and underlying instrument. These can be but not limited to Opening Gap Risk, Value at Risk, Option Greeks, Duration, 01 PVBP, shift in yield curve, etc.

The Risk Management Policy shall bring out the primary risk vectors arising from trading and investment activities. These can include below but are not limited to :

| Risk | Description | Risk Measures |
|---|---|---|
| Market Risk | The risk that arises from market volatility and movement in prices of instruments | Opening Gap \| Scenario Analysis \| Stress Testing |

| | | |
|---|---|---|
| Credit Risk | Investment in corporate bonds have the default risk | Ratings and Concentration Limits |
| Regulatory Risk | The risk of breaching the regulatory exposure limits | Single group / issuer exposure limits |
| Interest Rate Risk | As majority investments are in Fixed Income instruments, changes in yields will have impact on bond valuations | Duration \| 01PVBP |
| Liquidity Risk | Risk of incurring losses while liquidating trading / investment positions | Days to liquidate the positions |
| Operational Risk | The risk of losses caused by failure in processes, systems or events that disrupt business operations | Terminal Limits \| Single Order Limits \| |

- AAFSPL shall invest in short dated – low risk and highly liquid instruments such as commercial papers, corporate deposits, FDs, money market instruments, liquid funds to meet the short-term liquidity needs,
- AAFSPL shall efficiently manage the funds such that the Company doesn't lose opportunity cost on any surplus funds and shall invest in FDs / liquid / overnight funds.

## 9. Management information system

Daily MIS reports and risk reports should be monitored daily. Any exceptions / breach in limits should be highlighted to senior management.
Any breach in MIS reconciliation, bank reconciliation, DMAT reconciliation should be escalated on priority.

Any breach in margin utilization limits, MTM requirements should be escalated immediately.

## 10. Exposure and Risk limits

The company is primarily into investment and trading activities through the recognized stock exchanges. Given the nature of business, the risk limits should be reviewed regularly and monitored tightly. The risk limits should be documented in detail in Risk Management Policy.

- In the Investment book, the Company shall maintain ceiling on concentration as under -
  - twenty-five percent of its Tier 1 capital to a single party; and
  - forty percent of its Tier 1 capital to a single group of parties
  - Investments in Gsecs, T Bills, Bonds, CPs, CDs, Money Market Instruments, MFs, AIFs shall be driven by the following limits:

| Nature of Investments | Limits |
|---|---|
| Government Securities (Central & State) including Treasury Bills (including Reverse Repo) | No Limit |
| Rated Corporate Bonds and Non-Convertible Debentures and Market Lined Debentures | Capped at 50% of Total Assets (With rating A and above) |
| Commercial Papers, Certificate of Deposits, and other Money Market Instruments | Capped at 50% of Total Assets |
| Units of Debt Mutual Funds (Liquid and Overnight funds) | No limit |
| Unite of AIFs | Capped at 15% of Total Assets |
| Any other instrument (with specific approval of the Investment Committee) | Capped at 15% of Total Assets |

Exposure means and includes both funds based and non -fund based facilities, including off-balance sheet exposure.

- For Trading book, the limits mentioned below shall be followed –
  - Overall Loss limits – 7.5 % of the assets for any day / month.
  - Duration Limits –For Fixed income book, portfolio duration should not be more than 5
  - Day to Liquidate – Derivatives positions in EQAR, CAR trading strategies should be highly liquid. Fixed income book should be able to liquidate within a month.

**11. Review -** The Policy shall be reviewed annually or earlier as needed.