



HDFC Pension Fund Management Limited (Formerly known as HDFC Pension Management Company Limited)

Risk Management Policy Version 1.7

Owner Department: Risk Management

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1. Introduction

Risk is an inherent aspect of business and has the potential to disrupt achievement of organizational goals and objectives. Risk management underscores the fact that the survival of an organization depends heavily on its capabilities to anticipate and prepare for changes rather than reacting to changes. The objective of risk management is not to prohibit or prevent risk taking activity, but to ensure that the risks are consciously taken with full knowledge, clear purpose and understanding so that it can be measured and mitigated. It also helps to prevent unacceptable loss that may cause the company to fail or materially damage its competitive position.

HDFC Pension Fund Management Limited ('HDFC PFM') aims to use a structured Enterprise Risk Management ('ERM') approach to manage and mitigate various risks faced by the organization, thereby enabling management to take informed decisions and improve the probability of achieving its strategic and operational objectives.

Vision: Promote Risk Management as a continuous process and contribute to the creation, optimization and protection of enterprise value by managing business risk as we create value and trust in the market place.

Mission: Create comprehensive approach to anticipate, identify, prioritize, manage and monitor our business risks. And to put in place policies, processes, accountabilities, reporting and enabling technology to execute the approach successfully.

The principles of ERM in HDFC PMC would be derived and guided by the Risk Management Policy of the parent company. These principles would be interpreted and adapted to suit the organization structure, objectives and principles adopted by HDFC PMC.

2. Objective

ERM would be a fundamental part of daily operations in HDFC PMC. This would stem from our commitment to various stakeholders of minimizing risk, and would work towards ensuring that we deliver more than we promise. The practices would thus be integrated into governance and routine operations across all verticals of the organization. All these practices would be designed to address one or more of these risk management objectives defined below -

1. Protect the interests of all the stakeholders
2. Ensure all regulatory mandates are met as laid down by different regulatory authorities, thus ensuring that the company operates within the required regulatory framework which enables ethical practices and good corporate governance
3. Enhance risk response decision within the organization through proactive identification of risks and establishing alternate risk responses ranging from risk avoidance, reduction, sharing, and acceptance.
4. Provide a clear and strong basis for informed decision making at all levels of the organization; develop and inculcate a risk-based decision making culture across all levels of the organization

5. Assist the organization in designing lean yet effective processes, which enable working with optimum efficiency and cost containment

3. Scope

Risk Management Policy in HDFC PMC would

- i. Lay out the tone of the Risk Management Strategy in the organization
- ii. Govern all the Risk Policies for the organization
- iii. Set up ERM implementation plan for the organization

Risk Management Policy would also act as a reference document for the following:

- i. To determine the overall level of risk embedded within the processes and activities
- ii. Outline the ERM governance structure, principles, and guidelines for risk identification, control, and monitoring
- iii. Outline the roles and responsibilities regarding the ERM practices of board members, staff members and associated vendors

Compliance to Risk Management Policy would be mandatory for all the departments, employees, external (third) parties/ agents of the organization. Prior approval from Chief Risk Officer would be taken for exceptions/ non-compliance of the Risk Management Policy. The Board will review the Risk Policy on a half-yearly basis.

4. Policy Statement

- i. Promote Risk Management as a continuous process and contribute to the creation, optimization and protection of enterprise value by managing business risk as we create value and trust in the market place*
- ii. To provide clear and strong basis for informed decision making at all levels of the organization. Develop and inculcate risk-based decision making culture across all levels of the organization*
- iii. To continually strive towards strengthening the Risk Management System through continuous learning and improvement*

5. Risk Management Framework

5.1 Risk Governance

Risk Management in HDFC PMC would be governed by the Risk Management Committee of Board. Risk management governance committee would meet minimum 4 times in a year and would hold the primary responsibility of setting up risk culture within the organization. Risk Management team would be responsible to translate the management's risk management vision to set up robust enterprise wide risk management practices across all levels of HDFC PMC and would work towards creation, optimization and protection of enterprise value by managing business risk to create value and trust in the market place. Risk management governance committee would provide its required support to risk management team for implementation of risk management practices. It would also ensure phased implementation of the Enterprise Risk Management Framework and align it with the growth of the organization. Risk Management Governance Committee would take adequate measures in terms of insuring risks as and when deemed necessary.

5.2 Risk Tolerance

Risk tolerance would be defined for each risk. HDFC PMC would ensure to conduct its business within defined risk tolerances.

5.3 Type of Risks

- a. Market Risk
- b. Credit Risk
- c. Operational Risk
- d. Compliance Risk
- e. Liquidity Risk
- f. Strategic Risk
- g. Information Security Risk
- h. Other material risks

a. Market Risk

Market Risk is the risk of losses in investment positions arising from movement in market parameters.

The various market risk factors include -

- Interest rate risk- Risk of upside/ downside movement of interest rates adversely impacting HDFC PMC assets and liabilities
- Equity risk- Risk of downside movement in the prices of equity holdings of HDFC PMC, which may have adverse impact

b. Credit Risk

Credit risk is defined as the possibility of losses associated with diminution in the credit quality of borrowers or counterparties, and includes loss on account of deterioration in the value of investments on account of change in credit worthiness or rating of the issuer / investment.

This risk would include-

- Credit default risk- Risk of default of the borrower, which may hinder HDFC PMC's ability to recover its investment with the borrower
- Credit spread risk: Risk on account of adverse credit spread movement in the investment portfolio (corporate bonds)
- Concentration risk- Risk of higher loss due to concentrated investments by HDFC PMC in a single counterparty, entity, Industry or sector
- Settlement risk: Risk of loss due to counterparty's failure to perform its obligation under a contract at the settlement date.

c. Operational Risk

Operational Risk is the risk of direct/indirect loss due to inadequate or failed internal processes, people, systems or external events.

d. Compliance Risk

Compliance Risk is the risk arising from non-adherence and/or failure to meet regulatory/ legislative/ judiciary guidelines and procedures.

e. Liquidity Risk

Liquidity risk is the risk of loss due to the inability to liquidate investment positions or honor claims of subscribers on a timely basis due to lack of sufficient funds as and when required. The liquidity risk also leads to risk of asset liability mismatch since funds available for redemptions request may fall short of the previous day's AUM.

Market Liquidity Risk: Inability to liquidate investment positions at or about the desired economic price due to market environment

f. Strategic Risk

Risk associated with an organization's mission and future business plans. This risk includes failure to achieve plans for new business lines, expanding existing services, investment objectives, mergers and acquisitions, and enhancing infrastructure.

g. Information Security Risk

It is the business risk associated with the use of digital platforms and adoption of IT within HDFC PMC leading to information security related risks e.g. information leaks, business downtime, financial and reputational loss via inadvertent disclosure, hacking, confidentiality breaches, malware attacks, advanced persistent threats, denial of service attacks etc.

h. Other material Risks

The following risks could potentially have adverse consequences for the business. Examples of such risks are:

- Risks arising out of subsidiary actions/contagion effect of regulatory action on Group companies
- Reputation risk

5.4 Risk Treatment in HDFC PMC

HDFC PFM would adopt bottom-up and top-down approach for risk treatment. Risk in the Company would be identified, analyzed, assessed, prioritized, planned for actions, monitored & reported on predefined intervals.

Risk Identification

HDFC PMC would have a formalized comprehensive risk identification process in place. The process would detail the methodology, areas and stakeholders involvement, and would cover all the business functions within the organization.

Analysis and Assessment

Risk analysis and assessment in HDFC PMC would be jointly done by the various functional units and Risk Management team for the risk profiling exercise. Risk Management team would also independently conduct risk analysis and assessment exercise as and when required/ requested by the Board and Management.

Risk assessment would follow prioritization of risks which would be ranked as levels defined below -

- High (Red)
- Medium (Amber)
- Low (Green)

Based on the levels of risks defined, HDFC PMC would create a Heat Map for its top risks. The risks would be mapped on basis of Severity and Occurrence as per defined parameters. The heat map would be reviewed by the Board at least once a year.

In HDFC PMC, adequate internal controls environment would be established and implemented to control risk source exposure. Multiple strategies would be deployed for mitigation of risk which would be categorized as:

- Risk avoidance: HDFC PMC would not engage in activities that would promote an environment which would be perceived as unhealthy
- Risk transfer: HDFC PMC would transfer risks where exposure could be passed to third parties at an acceptable cost
- Risk mitigation: HDFC PMC would ensure that it has adequate risk control measures in place for the risks which are necessary to perform business operations
- Risk acceptance: HDFC PMC would accept the residual risks which it perceives could provide competitive edge in the market and maintain appropriate reserves for these risks from the shareholders funds

Plan of action

Risk identification, analysis and assessment would follow with plan of action to reduce the impact of the risk. This plan of action would be formulated by the functional units in co-ordination with the Risk Management team.

Risk Management team would also provide recommendations as and when required/ requested.

The plan of action would have defined timelines. Functional units would communicate the defined timelines and updates of the plan of action implementation status periodically to risk management team.

Control Implementation

Plan of action would detail controls to be implemented along with the timelines. Risk Management team would track control implementation status periodically.

Risk Management team would update Board, Management and functional units of the control implementation status on a periodic basis.

Risk monitoring & Reporting

Risk monitoring would be a continuous activity in HDFC PMC. The risk owners would monitor activities and processes to determine the accuracy and effectiveness of the measures taken to treat the risk.

- **Internal Monitoring:** Risk profiles and key risk indicators would be reviewed on a continuous basis at all levels by the risk management team. Risk Management team would also ensure involvement of appropriate party for implementation of efficient processes. Audit team shall perform IT System Audit to test the operating effectiveness of key IT controls in areas such as Access to programs/data, Information Security etc.
- **External Assurance:** External assurance would be provided to senior management through means of internal audit. Risk Management team would ensure timely & effective communication of appropriate information to the Board and respective stakeholders. Business functions would ensure that appropriate risk/ incident information is proactively provided to risk management team effectively and timely.

6. Roles and Responsibilities

6.1 Risk Management Committee

- Determine the strategic direction of the organization; for creating the environment and structure for risk management to operate effectively
- Review and approve the Risk Management Policy to be implemented in HDFC PMC
- Review and approve Risk tolerances
- Review the Corporate Risk profile on a quarterly basis
- Monitor the significant risk exposures, as well as the potential financial and other impacts from such risks
- Review and approve requisite policies relating to Risk Management framework
- Review and approve plans/programs relating to Risk Management including, but not limited to, the Coordinated Disaster Recovery and Business Continuity Plan
- Monitor the effectiveness of risk management programs
- Initiate corrective actions with management in any area of risk as deemed appropriate by the committee
- Ensure and monitor compliance to all regulations and observations by the authority

- Review performance of funds v/s benchmark & peers and ensure optimal risk adjusted returns to subscribers
- Review the liquidity of investments in all schemes and assess the risk of being unable to liquidate the portfolio in due time, thus incurring significant losses
- Review the stop loss breaches and assess the impact of decision to hold/exit the respective securities
- Review the credit profile of corporate papers in schemes A and C
- Review the concentration of exposures in all investment schemes, and assess the impact of adverse movements in equity and bond markets through scenario analysis
- Evaluate and obtain adequate insurance cover against risk of damage to various fixed assets, cyber security risk & Investment operations risk after considering the severity & likelihood of all such risks

6.2 Chief Risk Officer

The Chief Risk Officer would have overall responsibility of risk management in HDFC PMC. He would be responsible for communication of all the material risk related information to the Risk Management Committee of the Board in relation to setting and controlling the risk exposure.

6.3 Functional units

Identification of Risks:

- The functional heads would have a primary responsibility of identifying and managing the risk on day to day basis
- They would own the functional risk profiles and take responsibility of updating it on a annual basis
- Would coordinate with the Risk team and aid in identifying 'Key Risks & mitigants' which impact their respective department

Review & Analysis

- The functions would review the risk profile on a periodic basis
- Controls would be tested by the Audit team basis the audit calendar for each function
- The functional heads would provide data as and when required for analysis and monitoring perspective

Awareness

- The head of the function would ensure that there is adequate risk awareness amongst all team members of the function

6.4 Risk Management Team

Enterprise Risk Management framework

- Hold the primary responsibility of setting up the Risk Management framework and practices
- Create a risk oriented culture within the organization
- Ensure risk assessment of the critical or material projects and processes.

Implementation of Risk Management Practices

- Coordinate with the department/s to identify key risks and metrics
- Ensure adequate controls are in place to mitigate the risks

- Track and review the key risks on a continuous basis
- Ensure that all risks are within the defined tolerance levels
- In case of deviations, would ensure that departments take adequate steps to mitigate the risk
- Create and maintain a repository of Operational Losses occurring within HDFC PMC

Investment Risk framework

- Tracking of market parameters to help gauge the systemic risk as well as market volatility.
- Monitoring Duration risk is risk associated with the sensitivity of a bond's price to a one percent change in interest rates. The higher a bond's duration, the greater its sensitivity to interest rates changes
- Tracking of ratings for the instruments and counterparties so as to take informed decision w.r.t. limits, as well as valuation of instruments. It also helps in identifying idiosyncratic risk.
- Monitoring financial risk (market, credit, fund performance and liquidity risk) and presenting to the Risk Management Committee of the Board,
- Independently monitoring the credit limit review process mentioned in the Investment Policy, and presenting it in the Risk Management Committee in case of significant changes in credit exposure – both on an overall portfolio level and individual scrip level.

Reporting

The Risk Management team would hold the primary responsibility of risk reporting to the Chief Risk Officer. The Risk Management team would report trends on the implementation of action plans relating to the risk framework and any actionable requested by the Committee.

Risk Management framework would also encompass requisite controls to manage external / internal fraud occurrences. HDFC Pension Fund Management Limited would also have a Business Continuity Management ('BCM') plan aligned to Risk Management Policy which would further lay down guidelines for BCM implementation, monitoring and reporting program.

7. Authority Matrix

7.1 Authorities

The Risk Management Committee would retain authority to approve the Risk Management Policy and Stop Loss Policy.

The Board of Directors could delegate to the Managing Director and CEO, the authority to revise risk profiles of business functions deemed to meet minimum standards of Risk Management Policy whenever there is a change in risk profiles. The Managing Director and CEO, in turn, could delegate it to the respective function head. However all changes would be approved by the Risk Management Committee before these become a part of the process.

Any change in the risk profile would be made in consultation with Risk Management team and a formal sign-off from the Chief Risk Officer is to be obtained before presenting to the Risk Management Committee.

The Chief Risk Officer would be authorized to:

- Ask for any information necessary so as to allow the consolidated Risk Management report to be completed within the deadline
- Seek confirmation from the Risk Management Committee, functional heads and Risk Management team, on an annual basis, that all risk policies meet minimum standards of Risk Management Policy and other Risk policies

7.2 Limitations

Any system of risk management can only provide reasonable and not absolute assurance against material mis-statement or loss or regulatory breakdown. The extent to which a risk is limited must be balanced against the cost of associated controls, impact and likelihood of that risk.

The Enterprise Risk Management Framework is a dynamic process and would be reviewed and aligned with the growth of the organization

7.3 Terms of Reference

- Reviewing the associated framework on a quarterly basis; risk management processes and practices of the Company on an annual basis
- Ensuring the appropriateness of measures taken by the company to achieve prudent balance between risks and rewards in both ongoing and new business activities
- Evaluating significant risk exposures of the Company and assessing Management's action to mitigate the exposure in a timely manner
- Coordinating activities with Audit Committee in instances where there is any overlap with Audit activities
- Reporting to the Board on a periodic basis
- Setting the risk/reward objectives and assess policyholder expectations
- Quantifying the level of risk exposure and assessing the expected rewards and costs associated with the risk exposure
- Assessment of the risks for the critical or material projects and processes and suggesting the mitigating factors and providing sign off.
- Formulating and implementing optimal Asset Liability Management strategies and meeting risk/reward objectives. The strategies would be laid down both at product level and enterprise level
- Laying down the risk tolerance limits
- Monitoring risk exposures at periodic intervals and revising ALM strategies, where required

8. Employee's Code of Conduct

All employees of the Company are required, as part of their contracts of employment, to abide by the company's code of conduct, so as to enable the Company to ensure that there is no conflict of interest between transactions of employees and the Company and interest of the policyholders and stakeholders.

8.1 Objective

The purpose of the policy is to specify minimum guidelines and ensure that:

- All personal securities transactions are conducted in such a manner so as to avoid any actual or potential conflict of interest vis-à-vis investment transactions by HDFC PMC.
- Key Personnel should not take undue advantage of any price-sensitive information that they may have in the course of working with HDFC PMC
- The interests of the subscribers are not adversely affected.
- To guide employees in maintaining a high standard of probity that one would expect from an employee in a position of responsibility.

8.2 Investments Covered

- These guidelines cover transactions for purchase or sale of any securities in the primary or secondary market, made in the name of employee, immediate family members either individually/jointly and/or as a member of HUF or as a nominee.

A complete description of the Code of Conduct and Employee Dealing Policy is part of the Compliance function and the reference may be made to the complete document for all the details regarding specific restrictions, safe-guards, approvals and disclosures.

9. Credit Limits Review Process

Credit Limits review process is part of the Investment Policy and Investment team handles the same. The investment committee shall monitor the following credit risk parameters at each of their meetings:

- a) Exposure and the approved limits for each issuer
- b) Rating wise exposure for various funds
- c) Any approvals/limit changes since the previous meeting
- d) Any significant credit development for any of the holdings since the previous meeting

Risk team will be independently monitoring the Credit Limit Review Process and would report to the Risk management Committee in case of significant changes in the credit exposure – both on an overall portfolio level and individual scrip level.