Chapter 7
The Concept of Securitisation
Securitization is a process of pooling and repackaging of homogenous illiquid financial assets into marketable securities that can be sold to investors. The process leads to the creation of financial instruments that represent ownership interest in, or are secured by a segregated income producing asset or pool of assets. The pool of assets collateralises securities. These assets are generally secured by personal or real property such as automobiles, real estate, or equipments loans but in some cases are unsecured, for example credit card debt and customer loans.

Reserve Bank of India, in its Guidelines on Securitisation, has defined securitisation as a process by which assets are sold to a bankruptcy remote special purpose vehicle (SPV) in return for an immediate cash payment. The cash flow from the underlying pool of assets is used to service the securities issued by the SPV. Securitisation thus follows a two stage process. In the first stage there is sale of single asset or pooling and sale of pool of assets to a 'bankruptcy remote' special purpose vehicle (SPV) in return for an immediate cash payment and in the second stage repackaging and selling the security interests representing claims on incoming cash flows from the asset or pool of assets to third party investors by issuance of tradable debt securities.
If the assets are secured by real property such as automobiles or real estates, then these are called mortgage backed securities. Here the lender has the right to sell the property if borrowers default. If the assets are credit card receivables than these are unsecure and the investor has to rely on the performance of the assets that collateralise these securities. These are known as assets backed securities. Securitization of credit card receivables is an innovation that has found world wide acceptance.

**Securitization Process:**

The securitization process involves following steps:-

1. Asset are originated through receivables, leases, housing loans, or any other form of debt by a company and funded on its balance sheet. The company is normally referred to as the “originator.”

2. Once a suitably large portfolio of assets has been originated, the assets are analysed as a portfolio and then sold or assigned to a third party, which is normally a special purpose vehicle company (“SPV”) formed for specific purpose of funding the assets. It issues debt and purchases
receivables from the originator. The SPV is owned by a trust / the originator.

3. The administration of the asset is then subcontracted back to the originated by the SPV. It is responsible for collecting interest and principal payments on the loans in the underlying pool of assets and transfer to the SPV.

4. The SPV issues tradable securities to fund the purchase of assets. The performance of these securities is directly linked to the performance of the assets and there is no recourse (other than in the event of breach of contract) back to the originator.

5. The investors purchase the securities because they are satisfied that the securities would be paid in full and on time from cash flow available in asset pool. The proceeds from the sale of securities are used to pay the originator.

6. The SPV agrees to pay any surplus which, may arise during its funding of the assets, back to the originator. Thus the originator, for all practical purposes, retains its existing relationship with the borrowers and all of the economies of funding the assets.

7. As cash flow arise on the assets, these are used by SPV to repay funds to the investors in the securities.
History Of Securitization

Securitization has evolved from its tentative beginnings in the late 1970s to a vital funding source. Securitization only reached Europe in the late 80's, when the first securitizations of mortgages appeared in the UK. This technology only really took off in the late 90's or early 2000's, thanks to the innovative structures implemented across the asset classes, such as UK Mortgage Master Trusts, Insurance-backed transaction or even more esoteric asset classes such as lottery receivables for the Greek government.

As the result of the credit crunch, precipitated by the subprime mortgage, the market for bonds backed by securitised loans was very weak in 2008 unless the bonds were guaranteed by a federally backed agency. As a result, interest rates are rising for loans that were previously securitised such as home mortgage, student loans, auto loans and commercial mortgages. However, in India, the concept of mortgage backed securitization is almost new. It got impetus with financial reforms initiated by Government of India towards the end nineties.
Credit Enhancement

Investor in securitised instrument takes a direct exposure on the performance of the underlying collateral and have limited or no recourse to the originator. Hence, they seek additional comfort in the form of credit enhancement. It refers to the various means that attempts to buffer investors against losses on the asset collateralising their investment. The credit enhancements are often essential to secure a high level of credit rating and for low cost funding. By shifting the credit risk from a less known borrower to a well known, strong and large credit enhancer, credit enhancements correct the imbalance of information between the lenders and the borrowers.

The credit enhancer can either be external or internal. The external credit enhancer includes insurance, third party guarantee and letter of credit. Since any of these services will be provided by the third party, a fee is to be paid to it for the service received. The internal credit enhancement may include a number of measures. The most popular is credit trenching which means that the Special Purpose Vehicle Company (SPV) issues two or more tranches of securities and establish a pre-determined priority in their servicing, where by first losses are borne by the holders of subordinate tranches. The holders of other tranche i.e. senior class debt are at
comfort. The securities belonging to the subordinate tranche may be known as “B” class securities whereas securities belonging to senior class may be known as “A” class securities. Other method of credit enhancement is over-collateralisation which means that the originator sets aside assets in excess collateral required to be assigned to the Special Purpose Vehicle (SPV) Company.

**Parties To Securitisation Transaction**

There are three primary parties to a securitisation deal. The first is the originator. This is the entity on whose books the assets to be securitised exist. It is the prime mover of the deal. It sells the assets on its books and receives the funds generated from such sale. In a true sale, the originator transfers both the legal and beneficial interest in the assets to the SPV. The scheduled commercial banks and the housing finance companies, which lend for the housing, are originator in securitisation transaction.

The second party to securitisation transactions is SPV. It is the entity, which buys the assets to be securitised from the originator. A SPV is typically a low-capitalised entity with narrowly defined purposes and activities and usually has independent directors or
trustees. It holds the assets in its books and makes the upfront payment for them to the originator.

The third party to the securitisation transaction are investors who may be individuals, financial institutions, mutual funds, provident funds, pension funds, and the insurance companies. These investors buy a participating interest in the total pool of receivable and receive their payments in the form of interest and principal as per agreement.

The other parties to a securitization transaction are obligors, rating agency, administrators or servicers and agents and trustees. The obligors are the borrowers of the original loan. Rating agency would assess the strength of the cash flow and mechanism designed to ensure full and timely payment. The administrator and servicers is responsible for collecting the payment and passing it to SPV. Generally, the originator acts as a administrator or servicers. The agent and trustee are responsible to look after the interest of the investor.

**Instruments Of Securitization**

Securitization can be implemented through different kinds of
instruments which differ mainly in their maturity characteristics. The first instrument is Pass Through Certificates. These reflect ownership rights in the assets backed by securities. The cash flow from the underlying collateral are passed through to the holders of the securities in the form of monthly payment of interest, principal and pre-payments. The cash flows are distributed on a pro-rata basis to the holders of pass through certificates. The pay through security is another instrument of securitization which overcomes the single maturity limitation of the pass through certificates.

**National Housing And Habitat Policy 1998 And Securitization**

The Government of India has announced its support to the securitization so that the primary lending institutions can convert their illiquid assets in liquid and get resources to boost their lending operations. The National Housing and Habitat Policy, 1998 was a major policy initiative of Government of India to give support to mortgage backed securitization. It enjoined upon the National Housing Bank to play a leading role in starting mortgage backed securitization and develop a secondary market in the country. National Housing and Habitat Policy, 2005 announced that foreign financial institutions will be permitted to invest in Residential Mortgage Backed Securitization (RMBS). Further, higher rates of
Stamp duty on securitization is a major hurdle in the process of securitization as it makes the process a costly affair. The policy recognised it and it was stated that the stamp duty on the RMBS would be rationalised. It will be either reduced or waived on the lines of the Gujarat, Maharasthra, Tamil Nadu, Karnataka and West Bengal. The central Government announced that it would incentivise the State Governments to undertake such reform oriented measures. Further, the Policy stated that regulatory measures will be favourable for the banks and HFCs to engage them in RMBS both as originator and investor. The National Urban Housing and Habitat Policy, 2007 further emphasised the importance of RMBS as an innovative financial tool and reaffirmed the commitment of Government of India to develop the mortgage backed securitization market and secondary mortgage market. The Eighth and Ninth Five Year Plans have also focused on the need to augment larger resources for the housing sector through assets securitisation.

**Amendment In National Housing Bank Act, 1987**

The National Housing Bank Act, 1987 was amended in 2000 to make NHB eligible to enter into securitization market. The NHB (amendment) Act, 2000 was passed by Parliament with the object of providing NHB greater regulatory powers over the HFCs, increased
scope of mobilization of additional resources for the housing sector through the introduction of mortgage backed securitization and creation of a secondary market. Under the amendment, NHB has been authorized to purchase, sell, or otherwise deal in any loans or advances secured by mortgage or charge on the immovable property relating to scheduled banks or HFCs. NHB has also been allowed to create trusts and also to act as a trustee. To facilitate transfer of securities while undertaking this function, NHB has been exempted from compulsory registration under the Registration Act both at the time of issue of securities by NHB and at the time of their transfer by the investors. Further, in order to instill confidence among the investors in the securities issued by NHB, the Bank acting as a trustee or otherwise in the transaction relating to securitization of loans has been authorized to recover the dues as arrear of land revenue.

Recognizing the role of mortgage backed securitization (MBS) in linking the housing sector with the capital market and pursuant to the credit policy announcements of April 2002, the Reserve Bank of India issued guidelines in May 2002 for investments by banks in MBS. In terms of the RBI guidelines, investments by banks in MBS backed by the mortgages of housing finance companies recognized and supervised by National Housing Bank, will carry risk weightage of 50 per cent for the purpose of capital adequacy and shall qualify
for inclusion in the annual housing finance allocation stipulated for the banks by the RBI.

In the Union Budget for the year 2005-06, the Hon'ble Finance Minister announced that the definition of eligible securities in the Securities and Contracts (Regulation) Act, 1956 would be amended to cover securitized mortgage debt. The Securities and Contracts (Regulation) Act, 1956 has been amended. This is expected to facilitate listing of RMBS in stock exchanges and improve its tradability.

**NHB Policy Measures On RMBS**

In accordance with the role assigned to it by National Housing and Habitat Policies, and Reserve Bank of India and the amendment in the NHB Act, 1987, it has been the endeavour of the National Housing Bank to set up a conducive policy environment and operational mechanism for mortgage backed securitization transactions in India. It set up a Working Group to suggest modalities for widening the investor base in MBS, improving the quality of assets, creating liquidity for trading in such assets and other related issues. NHB has developed operational systems and behavioral models of MBS as an on-going exercise based on the experiences
drawn from its previous issues. Frequent MBS issuances are expected to spur the secondary market activity in the MBS products paving the way for a vibrant and deep secondary mortgage market in the country.

The Bank also formulated an RMBS Policy, so as to ensure minimum level of standards and unambiguity in the RMBS issues brought out by it. The Policy details the entire gamut of activities to be taken up by NHB and also sets forth guidelines for the same.

The Bank assumes the responsibility of the Trustee for RMBS issues to ensure transfer, payment and timely servicing to the investors in the PTCs. The Bank also has the mandate to invest in its own issues of RMBS. Recognizing the dual role required to be played by the Bank, i.e. of a Trustee as well as an investor, the Bank set up a Committee, “RMBS Trust Supervision Committee”, under the Chairmanship of a retired High Court Judge to supervise the activities of the Trust periodically in respect of MBS issues where NHB is interested in capacities other than that of trustee, so as to ensure that the interest of investors is duly protected.

NHB has also initiated the process of introducing Credit Enhancement measures such as guaranteeing the senior portion of
the RMBS and Financial Support for subordinate RMBS by way of refinance etc. to facilitate more MBS issues by HFCs and Banks. At the Bank's initiative, RBI has advised Banks and Financial Institutions that the risk weight on investment by Banks and Financial Institutions in RMBS originated by another Bank would attract a risk weight of 50 per cent. Earlier, this concession was available only to RMBS issues originated by HFCs regulated and supervised by NHB.

With a view to facilitate the development of secondary mortgage market and bring about standardization in the primary home loan market, NHB has commissioned the Administrative Staff College of India (ASCI) to undertake a study with the main objective to understand, analysis and assess the credit and prepayment risks in the housing finance sector. NHB has also constituted a Working Group with representatives from the housing finance companies to recommend measures for standardization in the primary residential mortgage finance sector. NHB has also entered into an Agreement with the Asian Development Bank (ADB) and Housing Development Finance Corporation Ltd. (HDFC) for undertaking a study for development of a Secondary Mortgage Institution in India along similar lines as the Fannie Mae in USA.
The NHB initiated steps to setup a Mortgage Credit Guarantee Corporation as early as 2003-04. But it could not come into existence. Now it is expected that this institution will be setup by March 2012. NHB is also looking to set up a separate credit enhancement company. The housing finance regulator has formed separate working groups to look at credit enhancement and covered bonds.

It is clear that NHB has taken measures to develop market for securitization and initiated policy measures for widening the investor base in mortgage based securitization; improve the quality of assets and creating liquidity for trading in such assets. The NHB will learn from its experiences and further take measures for a vibrant and deep secondary mortgage market in the country.

Issues Related To Mortgage Backed Securitization

To Treat Mortgage Backed Securitization As Security

To develop the MBS in the Indian market, it was urgently required that Mortgage Backed Securities should be treated as security under the Securities & Contracts (Regulation) Act, 1956 in order to include securitized mortgage debt under the definition of eligible securities. This was needed
to facilitate listing of RMBS on Stock Exchanges and hence make them tradeable which is expected to provide the desired moment for development of secondary market for RMBS. This would sustain the pace of growth of the Indian housing finance system and ultimately benefit the home loan borrowers.

- **Reduction In Stamp Duty On Securitized Instruments**

  The higher rates of stamp duty on the securitized housing loan portfolio are a major hurdle in the development of RMBS market. Bank has taken up the matter relating to rationalization of stamp duties in respect of instruments of securitization and is following up with the respective State Government authorities in this regard. Issue related to reduction of stamp duty or waving of stamp duty has been raised in the National Housing and Habitat Policy and by Reserve Bank of India. As a result of the measures taken by NHB, the stamp duty on instruments of securitization of housing loans or assignment of debt with underlying securities in Delhi was reduced to 0.1 per cent of the amount of securitized loans, subject to a maximum of rupees one lac. This is expected to provide a major fillip to the mortgage
backed securitization transactions through the increased supply of residential mortgages originated in the State of Delhi.

**Slow Progress**

The concept of RMBS has not picked up the desired speed. Housing loans were securitised under the scheme up to 2006-07 and thereafter no securitisation has been made till June 2011. The reasons for slackness are not clear. Neither the annual reports of NHB mention any reason for the same. RMBS scheme is a very high profile scheme of NHB which it wanted to pursue vigorously so that greater degree of liquidity is provided to illiquid housing loan portfolio of the HFCs and Scheduled Commercial Banks. In the initial phase, a good tempo was build up but later on the performance is nil.

**Mortgage Credit Guarantee Corporation**

A mortgage guarantee company provides credit guarantee to housing finance companies and banks on behalf of home loan borrowers. The guarantees are invoked in case of default by home loan borrowers. The Mortgage Credit Guarantee Company (MCGC) was conceived in India to facilitate rural penetration of housing
finance. The company would guarantee the loans given by a housing finance company, thereby protecting it against defaults. Such a guarantee company would also help develop the market for mortgage-backed securities (MBS), or home loan securitization. These guarantee companies play an important role in developed country like USA and U.K. where guarantee or insurance is mandatory in cases where the loan given was more than 80 per cent of the value of the property. The borrower had to bear the cost of the insurance.

Recognizing the need for a Mortgage Credit Guarantee Company, National Housing Bank initiated step to create the company as early as in 2003-04. It entered into talks for collaboration with Canada Mortgage and Housing Corporation (CMHC), United Guarantee (UG), International Finance Corporation (IFC) and Asian Development Bank (ADB). During the year 2003-04, term sheet was also finalized with the partners. But the corporation could not be setup. During 2005-06, the Chairman of NHB confirmed “We are still perusing it adding that the proposal was not dropped”. The delay in setting up the mortgage credit guarantee company was on account of some concept selling because there was no such a final product in the market. Further, the problem was partly in the difficulty that MCGC would have in recovering dues after it has paid a claim.
As reported in Sept.2011, the Chairman of NHB is of the view that Mortgage Credit Guarantee Corporation will take off by March 2012. The technical partner would be a US-based mortgage insurance entity named Genworth Financial and would pick up 36 per cent stake in the proposed joint venture. All the shareholder, technical services and subscription agreements have been executed among the partners as of February 3, 2012. The US based entity is expected to approach the Foreign Investment Promotion Board (FIPB) for foreign investment approval. Asian Development Bank (ADB) and International Finance Corporation (IFC) will each take a 13 per cent stake. NHB, as the lead partner, will hold 38 per cent stake in the proposed venture. The Chairman of NHB is of the view that mortgage guarantee will ensure softening of interest rates as well as more credit availability for retail home loan borrowers. The guarantee fee will be the main source of revenue for the proposed company which has been named India Mortgage Guarantee Company. The guarantee fee could be either fully borne by the borrower or shared between that borrower and the lender.

The initial paid-up capital of the venture will be Rs 120 crore. The proposed mortgage guarantee company would be a non-banking finance company (NBFC). Current regulations require mortgage
guarantee companies to have a minimum paid up capital of Rs 100 crore.

The Progress Of RMBS

The progress of Mortgage Backed Securitization Scheme can be measured in terms of various parameters like number of tranche issued, number of housing loan portfolio securitized and the amount involved. This has been shown by the table 7.1 given below:

Table 7.1

Progress of RMBS Scheme

<table>
<thead>
<tr>
<th>Year Ending</th>
<th>No. Of Tranche</th>
<th>Cumulative Tranche</th>
<th>Individual Housing Loan Account</th>
<th>Cumulative Housing Loan Account</th>
<th>Amount (Rs.Crore)</th>
<th>Cumulative Amount (Rs.Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2001</td>
<td>4</td>
<td>4</td>
<td>19655</td>
<td>19655</td>
<td>273</td>
<td>273</td>
</tr>
<tr>
<td>June 2002</td>
<td>1</td>
<td>5</td>
<td>4526</td>
<td>24181</td>
<td>87</td>
<td>360</td>
</tr>
<tr>
<td>June 2003</td>
<td>0</td>
<td>5</td>
<td>0</td>
<td>24181</td>
<td>0</td>
<td>360</td>
</tr>
<tr>
<td>June 2004</td>
<td>5</td>
<td>10</td>
<td>10935</td>
<td>35116</td>
<td>303.92</td>
<td>663.92</td>
</tr>
<tr>
<td>June 2005</td>
<td>3</td>
<td>13</td>
<td>2892</td>
<td>38008</td>
<td>99.33</td>
<td>763.25</td>
</tr>
<tr>
<td>June 2006</td>
<td>0</td>
<td>13</td>
<td>0</td>
<td>38008</td>
<td>0</td>
<td>763.25</td>
</tr>
<tr>
<td>June 2007</td>
<td>1</td>
<td>14</td>
<td>801</td>
<td>38809</td>
<td>98.95</td>
<td>862.2</td>
</tr>
<tr>
<td>June 2008</td>
<td>0</td>
<td>14</td>
<td>0</td>
<td>38809</td>
<td>0</td>
<td>862.2</td>
</tr>
<tr>
<td>June 2009</td>
<td>0</td>
<td>14</td>
<td>0</td>
<td>38809</td>
<td>0</td>
<td>862.2</td>
</tr>
<tr>
<td>June 2010</td>
<td>0</td>
<td>14</td>
<td>0</td>
<td>38809</td>
<td>0</td>
<td>862.2</td>
</tr>
<tr>
<td>June 2011</td>
<td>0</td>
<td>14</td>
<td>0</td>
<td>38809</td>
<td>0</td>
<td>862.2</td>
</tr>
</tbody>
</table>

Source: Compiled from Annual Reports of NHB
Graph 7.1
Progress of RMBS Scheme

Cumulative Amount (Rs. Crore)
The Scheme of RMBS was launched in 2000-01 where two separate tranche of housing loan portfolio were securitized by NHB. The first two pilot issues of MBS comprised 11106 individual Housing Loans involving Rs.135 crore originated by two HFCs namely HDFC Ltd and LIC Housing Finance Ltd. Following the success of the first two pilot issues, the NHB placed its next two pilot issues of MBS during May 2001 comprising 8549 individual housing loans involving Rs.138 crores originated by LIC HFL and Canfin Homes Ltd. In total fourteen issues of MBS have been securitized. These involve 38809 individual housing loans with a loan amount of Rs.862.20. No tranche of MBS has been securitized after the year 2006-07.

Further, a few HFCs, Banks and HF Institution promoted by Banks and insurance companies have participated in the scheme. These are LIC HF Ltd, Canfin Homes Ltd, BOB Housing Finance Ltd, Dewan Housing Finance Corporation Ltd, Birla Housing Ltd and Andhra Bank. The scheme has not been much popular due to its legal and structural complexities.

**Performance Of The Pool Of Housing Loan Securitized**

The performance of the securitized pool housing loan mortgage
backed securities has been quite good. In the initial phase, the issue got an overwhelming response from the investor community which mainly comprised of institutional investor. The respective originators of the RMBS have also been appointed as Service and Paying Agents (S&P Agents) to ensure that collections in respect of each of the pool of securitized loan are satisfactory and the same is distributed to the respective pass through certificate holders and service providers.

Further the NHB has acted as trustee in all these tranches of securitized pool. So it has acted as Special Purpose Vehicle Trust (SPV Trust) working as a trustee for RMBS issues, the NHB has assured transfer, payment, and timely serving to the investors in the Pass Through Certificates. Further, NHB has also initiated the process of introducing Credit Enhancement measures such as guaranteeing the senior portion of RMBS and final support for subordinate RMBS by way of Refinance to facilitate more issues by HFC.

The operation of the RMBS has ensured the yield to class A Pass through Certificate which is consistent with that indicated at the time of issue. The average collection efficiency in each of the subscribed pool ranged between 95-99 per cent. The total collection from the pools were adequate to service not only the scheduled
payment but also contributed to substantially to the residual income of the holders of subordinate RMBS.

Some of RMBS pool launched earlier are in the process of redemption. Five Mortgage Backed Securitization transactions amounting to Rs. 358.85 crore have been redeemed successfully in the year 2008-09 and the SPV trust have been closed. One Mortgage Backed Securitization transaction was redeemed during 2010-11. One more MBS transaction involving a sum of Rs.72.16 crore was fully redeemed and SPV trust was closed successfully. Hence only seven Mortgage Backed Securitization transactions are in operation which will be completed very soon.

**Concept Of Reverse Mortgage Scheme**

 Reserve mortgage scheme is a home loan product designed basically for the senior citizens. Under this scheme senior citizens can convert their fixed assets i.e. residential home into an income channel without liquidating their equity in case of any requirement. The reserve mortgage scheme involves two parties i.e. bank-the lender and the senior citizen-the borrower. The borrowers pledge their home property to the lender. In return of the home property pledged, the borrower gets a lump sum money or periodic payments say
monthly or quarterly spread over life time of the borrower that can be utilized by the borrower to add to his income existing by way of pension or interest or rent income so that in the old days when the flow of income falls, he do not suffer because of paucity of income. He enjoys the shelter of his property and simultaneously gets a regular flow of income from his property without disposing of the same. During the life time, the borrower need not repay the loan and the interest thereon. However, he is required to pay property tax and insurance and maintain the house in a condition so that the value of the house does not fall due to ill maintenance of property. After the death of the second of the spouses, the legal heir of the property can repay the loan along with the accrued interest to the bank, and the bank will release the pledged property to the legal heirs of the deceased. Alternatively, the bank can sell the property, recover all the dues and if any excess, will pay to the legal heirs of the deceased. If the senior citizen wants to get released the property during his life time, he can do so by making the payment to the bank. If the senior citizen needs to mortgage the same property again in his lifetime, he can do so and get the benefits of Reverse Mortgage Scheme again.

The reserve mortgage scheme operates in a manner opposite to that of the typical mortgage home loan scheme of the bank. In the home loan scheme bank grants lump sum money to the borrower at
the time of mortgage and monthly payment starts from the borrowers to the bank immediately which includes payment of interest plus the principal. This is known as equated monthly installment (EMI). The property is pledged in favour of the bank and released when full payment of loan plus interest is paid to the bank by the borrower. So in typical mortgage scheme, which we generally see in the market, where people take home loans from the bank, the flow of funds starts from borrower to bank and in Reverse mortgage scheme, the things are vice versa. That is why it is called Reverse Mortgage Scheme.

The Reserve Mortgage Scheme originated in U.K during the Great Depression of 1929. It is known there as life time mortgage. However it is more popular in USA. American of 62 years old or more can take the benefit of the scheme. In India, National Housing Bank (NHB) has conceptualized the Reverse Mortgage Loan (ML) product, exclusively for house owning senior citizens. Pursuant to the announcement made in the Union Budget speech of the Hon’ble Finance Minister on February 28, 2007, NHB notified Operational Guidelines for Reverse Mortgage Loan (RML) in May 2007 after extensive consultation with the Housing Finance Companies (HFCs) and Banks. Further, NHB drafted model formats of the loan documents for use by the HFCs and Banks under RML. The Hon’ble
Finance Minister in the Union Budget Speech for the year 2008-09, made two major announcements relating to the proposed amendments to the Income Tax Act. These are: (i) a new sub-section (xvi) to Section 47 of the Income Tax Act providing that reverse mortgage would not amount to “transfer” and (ii) insertion of a new sub-section (43) under Section 10 of the Income Tax Act to the effect that the stream of payments received by the senior citizen under RML notified by the Central Government would not be “income”, as they are in the nature of the capital receipts. These two amendments exempt the receipts in the hands of senior citizen from income tax and have made the scheme more beneficial for the senior citizen.

Launch Of Reverse Mortgage Loan Enabled Annuity (RM LeA)

The reverse mortgage Scheme introduced in the year 2007 had two major limitations. First the stream of income to the senior citizen was limited to a maximum of 20 years. What happens if a senior citizen remains alive beyond 20 years? From where he will get the monthly flow of payment because the bank will stop it after 20 years. And secondly in the event of adverse movements in property prices, the Banks/HFCs had the discretion to cease to make further payments to the senior citizen borrowers, at any given point of time. However, the Senior Citizen shall not make any repayment and may continue
to occupy the house as owners. Because of these two reasons the scheme did not become popular and the Ministry of Finance has to make amendments in the scheme.

NHB conceptualized an extended RML scheme ensuring assured life-time annuity for the senior citizens from a life insurance company. Further the scheme provides an option for married couple—both husband and wife—to be joint borrowers for availing the periodic annuity payments throughout their life time i.e. the payments shall continue to flow till the demise of the last surviving borrower. The new scheme was launched by NHB in association with Star Union Dai-ichi Life Insurance Company Ltd., (SUD Life) and Central Bank of India (CBI) in December 2009. The SUD Life has obtained necessary approval from Insurance Regulatory and Development Authority (IRDA) for introducing the annuity part of the RML product in India. This scheme is a significant improvement over the initial RML scheme (2007) which limited the loan disbursement tenure to a fixed term of twenty years causing uncertainties to the senior citizen borrowers. The new scheme will now facilitate the senior citizen borrowers to receive assured life-time payments i.e. even after completion of the fixed term of 20 years, in accordance with the announcement in Budget 2007-08. NHB has also
formulated operational guidelines for new RML enabled Annuity product.

**A Review Of Progress**

The Lending bank under Reserve mortgage scheme has to be careful enough to decide the amount of loan because there is a risk that the amount of outstanding loan may exceed the value of the property at the time of death of borrower. So if there is a short fall in the value of property over a period of time, the bank will have to bear the loss. This may happen due to a number of factors like a higher amount of loan than warranted by the value of property, fall in the value of property in the years to come, longer life of the borrower than expected and a rise in rate of interest in the later years. So the bank has to decide the amount of loan carefully. Various considerations like the value of property, condition of property, location of property, expected changes in the rate of interest, the age of the borrower and the cost of repairs the property may demand in the years to come should be taken care of. Normally the loan amount is around 65 to 70 percent of the market value of the property. Once the loan is granted, the lending bank will reassess the value of property from time to time and if it finds that the value has increased
substantially, the borrower can be given the option of increasing monthly installments.

The Reverse mortgage scheme, though in its infant stage, has huge potential market in the future. It can serve as a substitute of social security for the senior citizens who have strong preference for their own house. They have ready equity for mortgage and are eligible to borrow under Reserve mortgage scheme. In the times of rising inflation and fall of the joint family system the need for social security has assumed more importance for most of the Indians. However the Reserve mortgage scheme has more potential in metropolitan cities than small towns. Further the level of education among the senior citizens in towns and metropolitan cities and awareness of the scheme could be other factors which can create the market for Reserve mortgage scheme in big towns. However, it has been observed that the commercial banks are not taking enough interest in the scheme.

The researcher has undertaken a survey of the senior citizens residing in the NCR region. Eighty senior citizens were contacted by the researcher with a structured questionnaire for the purpose. All these eighty senior citizens were owner of residential properties and were living their houses. Out of these eighty senior citizens, only
sixty four filled up the questionnaire and the remaining 16 did not respond. Twenty five per cent of the respondents were found to be pension holders and twenty percent of the respondents were getting their income from rent and bank interest. Remaining twelve percent reported that they depended on their sons and daughters. Forty three per cent of the senior citizen reported that they are still doing jobs or business or engaged in consultancy or any other gainful activity and were getting income from there. Forty per cent of senior citizen reported that they knew about the scheme. So lack of awareness about the scheme was found as a major hurdle in the way of scheme.

Forty five per cent of the respondent reported that their present income is enough and that they do not require any additional flow of income. Twenty nine of the respondents did not give any response that weather their income was sufficient or not. Twenty six per cent of the respondents required additional flow of income. Ten senior citizens applied for loan and out of these only four could get loan sanctioned. The application of remaining 6 could not be considered for a number of reasons like lack of clear title, non compliance of formalities as required by the bank and lack of persuasion by the senior citizen borrowers. It was reported to the researcher by two applicants that they still hoped to get the loan though the bank has taken more than enough time. Out of the four borrowers under
Reverse Mortgage Scheme, two reported that loan was granted to them in normal routine and remaining two reported that the bank took undue time and were not friendly to the borrower. Further, it was reported by the all the borrowers that loan sanctioned by the bank was less than the loan applied by them. It was 60 to 90 per cent of the loan applied.

A study of State Bank Of India, Secundrabad, Andhra Pradesh conducted by Mr. N. sravanthi shows that during the period October 2007 to February 2009, 29 loan applications for a loan amount of Rs.4.90 crores were forwarded by the branches to the regional office and out of these only 11 applications were sanctioned a loan amount of Rs.2 crore. The all India figures for the first year show that only 150 people borrowed under the scheme. As on 30 June, 2011, 23 commercial banks and 2 housing finance companies had launched Reverse Mortgage Loan Scheme and a sum of Rs.1740 crore was sanctioned to 8903 senior citizen borrowers. Lack of clear title over the property was the major reason cited by State Bank of India office for rejecting applications. The bank officer having conservative outlook hesitate to sanction loan. The time horizon is too long and longer the time period greater will be the risk. Added to that is uncertainty. The Reverse Mortgage Scheme is little bit more risky for the banks compared to mortgage loan scheme for the reasons cited.
earlier. The amount of loan plus interest may exceed the realizable value of property. Further, the repayment of loan plus interest will be feasible at the time of death of the borrower and spouse and not earlier.

**Counseling Centre**

The NHB, as an apex institution in the field of housing finance in India is taking steps to implement the scheme and popularize it among the senior citizen of the country. NHB has launched counseling programme for senior citizen to popularize the scheme of RML. Under the programme, the concept is explained to the senior citizens and their doubts are removed. The NHB has adopted a partnership approach with reputed NGOs to operate the programme. During the year 2010-11, NHB organized and conducted 16 seminars for the senior citizens, in various cities of the country.

Further, the NHB has taken initiatives to setup the counseling centers for senior citizen on Reverse Mortgage Loan Scheme. Up to June 2010, seven counseling centers has been setup in the cities of New Delhi, Chandigarh, Hyderabad, Chennai, Kolkata and Bengaluru. During the year 2010-11, three more counseling centers were opened, increasing the total number to 10. These three centers
were opened at Lucknow, Mumbai, and Ahmadabad.

Not only the seminars are being organized and the counseling centers are setup, NHB is taking steps towards capacity building among the commercial banks and HFCs for implementing the scheme. NHB is arranging training programmes and seminars for the personnel of these institutions. The Bank is eager to spread the concept of RML Scheme for senior citizen in Tier II cities as well.

The Senior Citizen Scheme has a huge potential in the Indian context and this needs to be tapped by banks and housing finance companies and supervision and mentorship of National Housing Bank.

To conclude, it can be observed that the Reserve Mortgage scheme is a boon to the senior citizens who have residential property in their names and need additional flow of regular income in their old age. The National Housing bank, Reserve Bank of India and the Government of India have been taking the steps to make the scheme more beneficial and popularize it among the senior citizens. The stream of income in the hands of senior citizen is exempted from Income Tax. Further, the modified Reserve Mortgage loan enabled annuity scheme is friendly to senior citizens as the stream of income
is not limited to twenty years and there is no fear of reduction in the amount of monthly payment. But in spite of the best efforts of NHB and the Govt. of India loaning under the RMS has not picked up yet. It is because of some technical problems like lack of clarity of title over the property. Further, the banks find that loaning under RMS is more risky compared to the ordinary home loan scheme. As the scheme serves a very important socio-economic purpose and opens a new channel of loaning for the banks, the bank should adopt a liberal attitude for loaning under the scheme.

Conclusion

The process of securitization involves a lengthy and cumbersome procedure with a lot of legal formalities. It involves a number of stake holders like originators, Special Purpose Vehicle Company, and the investors. These are primary stake holders. With the amendment in National Housing Bank Act, 1987 and Securities and Contracts Act 1956, the ground for the Residential Mortgage Backed Securitization has been cleared. The NHB has completed only 14 tranche of RMBS till June 2011. The portfolio was of the size of Rs. 862.20 crore and 38809 housing loans were covered in these 14 tranche. The scheme of residential securitization ran successfully till 2006-07. In all the tranche NHB acted as Trustee and special vehicle
company to ensure that the operation run smoothly and timely payments are ensured. The originators were appointed as administrator and servicer to collect the timely payments of interest, payment of the principal and repayment so that these proceeds can be transferred to the SPV which in turn could pass on these benefits to the holders of the Pass through Certificates. It has been observed that all the securitized transactions performed well as far as collection and recovery is concerned. Further the yield to class a pass through certificates has also been consistent with that indicated at the time of issuances. However, it is a matter of concern that no securitization transaction has taken place after 2006-07. The National Housing Bank should probe the causes behind it so that the securitization of housing loan portfolio of the banks and the housing finance companies gets liquidity. Further, the conceptualization and implementation of reverse mortgage scheme for senior citizens is a landmark in the history of financial products and the NHB should ensure that the scheme is popularized among the senior citizens living in towns and small cities as well and that legal hurdles are removed.