CHAPTER 5

Housing Finance

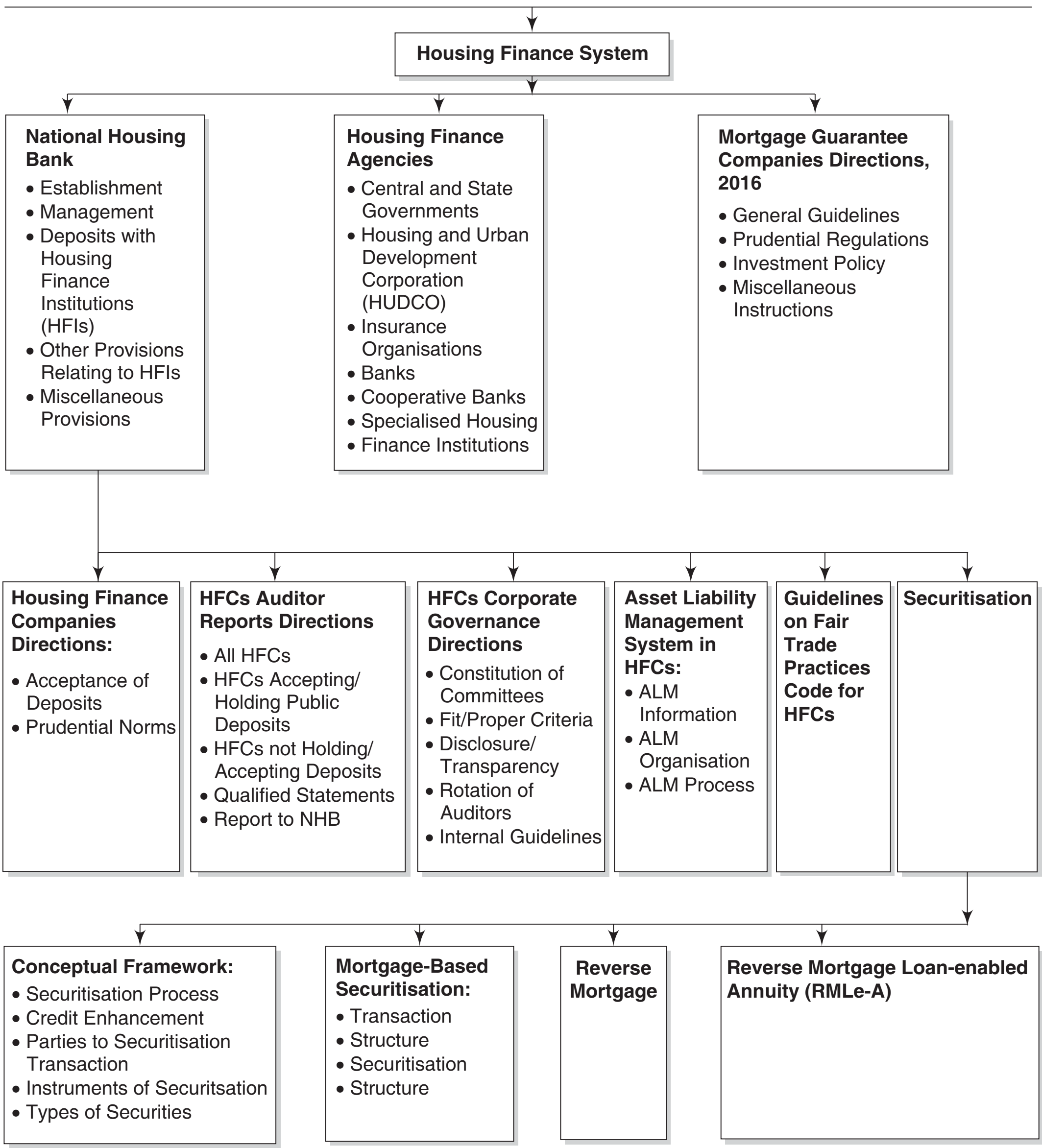
Learning Objectives

- Understand the profile of the National Housing Bank (NHB) as the apex housing finance institution.
- Discuss the three main elements—acceptance of public deposits, prudential norms, and auditors reports—of the NHB's directions relating to housing finance companies (HFCs).
- Review the NHB guidelines for extending equity support to HFCs.
- Explain the NHB guidelines for extending refinance support to HFCs.
- Discuss the main features of NHB's refinance scheme for HFCs.
- Discuss the framework for asset liability management in HFCs.
- Outline the main elements of Fair Practices Code for HFCs.
- Explain the concept of securitisation, securitisation process, credit enhancement, parties to securitisation transaction, assets characteristics and instruments of securitisation.
- Explain and illustrate mortgage-based securitisation.
- Understand the framework of reverse mortgage deals.
- Discuss the guidelines relating to reverse mortgage loan-enabled annuity (RMLe-A).
- Sketch the main agencies/institutions of the housing finance system.
- Examine the RBI directions for mortgage guarantee companies.

INTRODUCTION

The responsibility to provide housing finance largely rested with the Government of India till the mid-eighties. The setting up of the National Housing Bank (NHB), a fully owned subsidiary of the Reserve Bank of India (RBI) in 1988, as the apex institution, marked the beginning of the emergence of housing finance as a fund-based financial service in the country. It has grown in volume and depth with the entry of a number of specialised financial institutions/companies in the public, private and joint sectors, although it is at an early stage of development. **It is portrayed in Exhibit 5.1.** Sections 1-2 of the chapter profile the NHB and the other players in the housing finance system. The NHB housing finance companies (HFCs) directions and guidelines relating to **(i)** acceptance of deposits, **(ii)** prudential norms, **(iii)** directions to auditors, **(iv)** miscellaneous matters are comprehensively covered in Section 3. The asset liability management framework for the housing companies is covered in Section 4. Sections 5-8 discuss securitisation, mortgage-based securitisation and reverse mortgage respectively. **A comprehensive account of the NHB guidelines relating Fair Trade Practices Code for HFCs is given in Appendices 5-A on the website. The address is http://www.mhhe.com/khanfs9e.** Finally, the regulatory frame-work for mortgage guarantee companies is examined in Section 9. The main points are summarised in the last section.

Exhibit 5.1 Organisation of Housing Finance in India



NATIONAL HOUSING BANK (NHB)

The NHB was established in 1988 under the *NHB Act*, 1987, to operate as a principal agency to promote housing finance institutions (HFIs), at both local and regional levels, and to provide financial and other support to them. The HFIs include institutions, whether incorporated or not, that primarily transact or have as one of their principal objects the transacting of the business of providing finance for housing, either directly or indirectly. The main features of the NHB, as the principal/apex finance agency in India, are discussed below.

Establishment of the NHB and Its Capital

The NHB is a body corporate. It can establish offices/branches/agencies at any place in and, with the RBI's prior approval, outside India. Its authorised and paid-up capital is ₹350 crore, fully subscribed by the RBI. The authorised capital can be increased up to ₹2,000 crore by the Government in consultation with the RBI. The Board of Directors of the NHB may issue the increased authorised capital, on terms and conditions determined from time to time, to the RBI/Government/banks/public financial institutions (PFIs), housing finance institutions/other institutions, as approved by the Government. However, at least 51 per cent of its issued capital would be held by the RBI/Government/public sector banks/PFIs/other institutions owned/controlled by the Government.

Management

The general superintendence, direction and management of the affairs and business of the NHB is vested in its Board of Directors, which exercises all powers and executes all acts and things on its behalf. Subject to the provisions of the *NHB Act*, the Board, while discharging its functions, has to act on business principles, with due regard to public interest. In general, **(a)** the Chairman, if he is a whole-time Director or if he is holding offices both as a Chairman and a Managing Director (CMD) or **(b)** the MD, if the Chairman is not whole-time director or is absent, can also exercise these powers of the Board. The MD has to follow, in the discharge of his powers and functions, all directions given by the Chairman. In the discharge of its functions, the NHB is to be guided by the directions given in writing by the Government in consultation with the RBI, or by the RBI in matters of policy involving public interest.

The Board of Directors of the NHB consists of **(i)** a Chairman and a Managing Director (CMD), **(ii)** two directors from amongst experts in the field of housing, architecture, engineering, sociology, finance, law, management and corporate planning, or in any other field, special knowledge of which is considered useful to the NHB, **(iii)** two directors who are persons with experience in the working of institutions involved in providing finance for housing or engaged in housing development or have experience in the working of financial institutions/banks, **(iv)** two directors elected by shareholders other than the RBI/Government/other institutions owned/controlled by Government, **(v)** two directors from out of the RBI directors, **(vi)** three directors from amongst Central Government officials and **(vii)** two directors from amongst state governments' officials. The CMD an other directors, excepting the RBI's directors and those elected by the shareholders, are appointed by the Government in consultation with the RBI. The RBI nominates its directors on the NHB.

Business

Subject to the provisions of the *NHB Act*, the NHB is authorised to transact all/any of the following kinds of business:

- **(a)** Promoting, establishing, supporting/aiding in the promotion/establishment/ support of housing financing institutions (HFIs);
- **(b)** Making of loans and advances or rendering any other form of financial assistance, whatsoever, for housing activities to HFIs, banks, state cooperative, agricultural and rural development banks or any other institution/class of institutions notified by the Government;
- **(c)** Subscribing to/purchasing stocks, shares, bonds, debentures and securities of every other description;
- **(d)** Guaranteeing the financial obligations of HFIs and underwriting the issue of stocks/ shares/bonds/debentures/other securities of HFIs;
- **(e)** Drawing, accepting, discounting/rediscounting, buying/selling and dealing in bills of exchange/promissory notes, bonds/debentures, hundis, coupons/other instruments;
- **(ea)** Buying/selling, or otherwise dealing in any loans/advances secured by mortgage/charge of immovable property relating to banks/HFIs;
- **(eb)** Creating trust(s) and transferring loans/advances together with/without securities therefrom to HFIs for a consideration;
- **(ec)** Setting aside loans/advances held by the NHB and issuing/selling securities based upon them in the form of debt obligations/trust certificates of beneficial interest/other instruments, and to act as trustee for the holders of such securities;
- **(ed)** Setting up of mutual funds for undertaking housing finance activities;
- **(ee)** Undertaking/participating in housing mortgage insurance;
- **(f)** Promoting/forming/conducting or associating in promotion/formation/conduct of companies/mortgage banks/subsidiaries/societies/trusts/other associations of persons it may deem fit for carrying out all/any of its functions under the *NHB Act;*
- **(g)** Undertaking research and surveys on construction techniques and other studies relating to/connected with shelter/housing and human settlement;
- **(h)** Formulating scheme(s) for purposes of mobilisation of resources and extension of credit for housing;
- **(i)** Formulating scheme(s) for the economically weaker sections of society, which may be subsidised by the Government or any other source;
- **(j)** Organising training programmes/seminars/symposia on matters relating to housing;
- **(k)** Providing guidelines to HFIs to ensure their growth on sound lines;
- **(l)** Providing technical/administrative assistance to HFIs;
- **(m)** Coordinating with the Life Insurance Corporation of India, the Unit Trust of India, the General Insurance Corporation of India and other financial institutions, in the discharge of its overall functions;
- **(n)** Exercising all powers and functions in the performance of duties entrusted to it under the NHB Act or under any other law in force for the time being;
- **(o)** Acting as agent of the Central/State Government/the RBI or of any authority as may be authorised by the RBI;

(p) Any other kind of business which the Government may, on the recommendations of the RBI, authorise;
(q) Generally, doing of all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under the *NHB Act*.

Borrowing and Acceptance of Deposits For purposes of carrying out its functions, the NHB may:

(a) issue and sell bonds and debentures with or without the guarantee of the Central Government, in such manner and on such terms as may be prescribed;
(b) borrow money from the Central Government, banks, financial institutions, mutual funds and from any other authority or organisation or institution approved by the Government on such terms and conditions as may be agreed upon;
(c) accepting deposits repayable after such period and on such terms as may generally or specially be approved by the RBI;
(d) borrow money from the RBI **(i)** by way of loans and advances and, generally, obtain financial assistance in a manner specified by the RBI; **(ii)** out of the National Housing Credit (long-term operations) Fund established under Section 46-D of the *RBI Act*;
(e) receive, for services rendered, remuneration, commission, commitment charges, consultancy charges, service charges, royalties, premia, licence fees and other considerations of any description;
(f) receive gifts, grants, donations or benefactions from the Government or any other source.

The Central Government may guarantee the bonds and debentures issued by the NHB as to the repayment of the principal and the payment of interest at rate(s) fixed by the Government.

Loans in Foreign Currency The NHB may borrow in foreign currency from any bank/financial institution in India/abroad in such manner and on such conditions as may be prescribed in consultation with the RBI and with the prior approval of Government. The NHB may also provide guarantee as to payment of interest and other incidental charges, as well as repayment of the principal.

Assistance to Borrow Where any person/institution seeks any financial assistance from the NHB on the security of any **(i)** movable property belonging to him/institution or **(ii)** the property of some other person offered as collateral for such assistance, a written declaration would have to be executed in the prescribed form stating the particulars of the security/collateral security and agreeing that the dues relating to the assistance would be a charge on such property. Without prejudice to the rights of any other creditor holding prior charge/mortgage in respect of the specified movable property, the dues of the NHB would be a charge on the property. Such dues would also be a charge on any further immovable property offered as additional security if a fresh declaration in the prescribed form is executed. With the prior approval of the NHB, the above declaration may be varied/revoked at any time by the concerned person/institution. Such a declaration would be deemed to be a document registerable as an agreement under the provisions of the *Registration Act*, and unless registered, they would have no effect.

Amount/Security to be Held in Trust Any sum received by a borrowing institution in repayment/realisation of loans/advances financed/refinanced wholly/partly by the NHB, to the extent of the accommodation granted by it and remaining outstanding, would be deemed to have been received by it in trust and should accordingly be paid by the institution to the NHB. Similarly, where any accommodation has been granted by the NHB to a borrowing institution, all securities held/to be held on account of any transaction, in respect of which such accommodation has been granted, would be held by such an institution in trust for the NHB.

Power to Transfer Rights The rights and interests of the NHB in relation to any loan/advance made or any amount recoverable may be transferred by it wholly or partly in any form. Notwithstanding such transfer, the NHB may act as a trustee for the transferee in terms of Section 3 of the *Indian Trusts Act, 1882.*

Power to Acquire Rights The NHB has the right to acquire, by transfer/assignment, the rights and interests of any institution in relation to any loan/advance made/amount recoverable wholly or partly by the execution/issue of any instrument or by the transfer of any instrument or in any other manner in which the rights and interests in relation to such loan/advance may be lawfully transferred.

Exemption from Registration Subject to Section 17(1) of the *Registration Act*, 1908, **(a)** any instrument in the form of debt obligations/trust certificates of beneficial interest/other instruments, by whatever name called, issued by the NHB to securitise loans granted by HFIs/banks and not creating/declaring/assigning/limiting /extinguishing any right/title or interest to or in immovable property, except in so far as it entitles the holder to an undivided interest offered by a registered instrument, whereby the NHB has acquired the rights/interests in relation to such loans and in securities therefrom or **(b)** any transfer of the above instruments would not require compulsory registration.

Recovery of Dues as Arrears on Land Revenue Where any amount is due under an agreement to it acting as a trustee, or otherwise, in respect of the securitisation of loans of HFIs/banks, in addition to any other mode of recovery, the NHB may approach a state government for its recovery in the same manner as arrears of land revenue.

Power to Impose Conditions To protect its interests, the NHB may impose such conditions as it may think necessary/expedient in respect of any transaction entered into with any borrowing institution.

Power to Call for Repayment Before Agreed Period The NHB has the power to call for repayment before the agreed period of all obligations of institutions if **(a)** false/misleading information in any material particular was given in the application for loan/advance, **(b)** the borrowing institution has failed to comply with any of the terms of the agreement in the matter of the loan/advance, **(c)** there is reasonable apprehension that the institution is unable to pay its debts/proceedings, or its liquidation may be commenced, **(d)** for any reason due to which it is necessary to protect its interests.

Access to Records The NHB would have free access to all such records of the institution/person(s) availing of any credit facilities from it/the institution, the perusal of which may be necessary in connection with the provision of finance or other assistance to the institution/refinance of any loan/advance to such person by the institution. The institution/person concerned would be bound to comply with the NHB's requirement to furnish copies of such records.

Validity of Loans/Advances The validity of any loan/advance by the NHB cannot be questioned merely on grounds of non-compliance with the requirements of any other law/resolution/contract or any instrument relating to the constitution of the borrowing institution. However, a company/cooperative society cannot obtain any loan/advance if it is not empowered to do so by its constitution.

Prohibition on Loans Against Own Bonds/Debentures Loans/advances against the security of its own bonds/debentures, by the NHB, is totally prohibited.

Power to Inspect The NHB has the power to inspect the books/accounts/other documents of any institution to which it has made any loan/advance or granted any other financial assistance on its own or on direction from the RBI. A copy of the inspection report would be supplied to the institution concerned. Every officer/employee/other person(s) in charge of the whole/part of the affairs of the institution is duty bound to produce all books of accounts, other documents and any statement/information relating to the affairs of the institution, within the specified time, to the inspecting officer.

Power to Collect and Publish Credit Information To discharge its functions efficiently, the NHB may direct an institution at any time, to submit to its credit information in the specified form and within the time specified by it from time to time. Credit information refers to any information relating to **(i)** the amount of loans/advances/other credit facilities granted for housing purposes, **(ii)** the nature of security taken for them, **(iii)** the guarantees furnished and **(iv)** any information that which has a bearing on the borrowers' credit worthiness. The institution concerned is bound to comply with such direction under all circumstances. For similar purposes, the NHB may also collect credit and other information from the Government(s), local authorities, the RBI/banks and financial or other institutions specified by the RBI. If considered to be in public interest, the NHB may publish any credit/other information obtained by it in a consolidated/any other form.

Advisory Services The NHB is authorised to provide advisory services to the Government(s), local authorities/other agencies connected with housing in respect of **(a)** formulation of overall policies aimed at promoting the growth of housing and HFI, and **(b)** legislation relating to matters having a bearing on shelter, housing and settlement.

Deposits with Housing Finance Institutions

The provisions relating to HFIs, other than HFIs that are firms/incorporated association of individuals, receiving deposits are discussed below.

Registration and Net Owned Funds To commence/carry on business, every HFI set-up as a company should **(a)** obtain a certificate of registration from the NHB and **(b)** have net owned funds of ₹25 lakh or other such higher amounts as may be specified by the NHB from time to time. **Net owned funds** (NOFs) refer to **(a)** the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the HFI, minus accumulated balance of loss, deferred revenue expenditure and other intangible assets and **(b)** further reduced by the amount representing **(1)** investments in shares of subsidiaries/group companies/all other HFIs that

> **Net owned funds** refer to the **(a)** aggregate of the capital and free reserves minus accumulated losses, deferred revenue expenditure and other intangible assets less **(b)** the amount in excess of 10 per cent of **(a)**, investment in shares/book value of debentures, bonds, advances, deposits in group/subsidiary companies.

are companies and **(2)** book value of debentures/bonds/outstanding loans/advances (including hire purchase and lease finance) made to, and deposits with, subsidiaries and group companies to the extent such amount exceeds 10 per cent of **(a)** above.

While considering applications for registration, the NHB may satisfy itself by an inspection of the books of the applicant or otherwise that the following conditions are fulfilled:

- The HFI is/would be in a position to pay its present/future depositors in full as and when their claims accrue.
- Its affairs are not being/likely to be conducted in a manner detrimental to the interests of its present/future depositors.
- The general character of the management/proposed management of the HFI would not be prejudicial to the public interest/interest of depositors.
- It has adequate capital structure and earnings prospects.
- Public interest would be served by its registration.
- Registration would not be prejudicial to the operation and growth of the housing finance **sector in** the country.
- Any other condition fulfillment which, in its opinion, would be necessary to ensure that commencement/carrying on business would not be prejudicial to the public interest or the interests of the depositors.

On being satisfied about the fulfillment of the above conditions, the NHB may register a HFI, subject to such conditions as it may consider fit to impose.

Cancellation of Registration The registration of a HFI can be cancelled by the NHB if it **(a)** ceases to carry on business, **(b)** has failed to comply with any condition, subject to which the registration was issued, **(c)** at any time fails to fulfil any of the conditions laid down for grant of registration, discussed above, **(d)** fails **(i)** to comply with any direction issued by the NHB **(ii)** to maintain accounts in accordance with the requirement of any law/any order/direction issued by the NHB and **(iii)** to submit/offer for inspection its books of accounts/other relevant documents when so demanded by an inspecting authority of the NHB and **(e)** has been prohibited from accepting deposits by an order made by the NHB, which has been in force for at least three months. Any HFI aggrieved by the order/rejection of application for/cancellation of registration may appeal to the Central Government, whose decision would be final.

Maintenance of Percentage of Assets At least 5 per cent or such higher percentage (not exceeding 25 per cent), as specified by the NHB from time to time of deposits outstanding at the close of business on the last working day of the second preceding quarter (i.e., the period of three months ending on the last day of March, June, September and December) of a HFI should be invested in unencumbered approved securities valued at a price not exceeding their current market price. Included in the unencumbered approved securities are approved securities lodged by the HFI with another institution for an advance/any other arrangement to the extent to which they have not been drawn against/availed of/encumbered in any manner. Approved securities mean securities of any state government/the central government and bonds that are fully and unconditionally guaranteed as to their principal and interest by the Government. The HFls should also maintain in an account with a bank in India in term deposit or certificate of deposit free of charge or lien/deposits with or by way of subscription to bonds issued by the NHB, an amount which at the close of business on any day, together with the investments in the unencumbered approved securities, would not be less than 10 per cent or such higher percentage not exceeding 25 per cent as specified by the NHB from time to time of the deposits outstanding at the close of business on the last working day of the second preceding quarter. Every HFI may be required to furnish to the NHB with a return in a specified form/manner and period. On any shortfall in investment in unencumbered approved securities and deposits, the HFIs would have to pay a panel interest at 3 per cent per annum above the bank rate and if the shortfall continues in subsequent quarter(s), five per cent above the bank rate, within 14 days from the date on which notice issued by the NHB demanding payment is served, failing which the NHB may approach a civil court for direction, which would be enforceable in a manner as if it were a decree made by a court in a suit. However, if the NHB is satisfied that the defaulting HFI had sufficient cause for its failure, it may not demand the payment of penal interest.

Reserve Fund A reserve fund should be created by the HFIs by transfer of a sum not less than 20 per cent of their net profits every year, before payment of any dividend. While reckoning the limit of 20 per cent, any sum transferred by the HFI for the year, if any, to any Special Reserve Fund created and maintained by it under Section 36(1)(viii) of the *Income Tax Act* may be taken into account. Any appropriation of any sum from the reserve fund can be made only for purposes specified by the NHB from time to time and should be reported to it within 21 days from the date of withdrawal, which in any particular case and for sufficient cause may be extended by such further period as the NHB thinks fit or delay in submitting the report may be condoned. In case of HFIs, whose reserve fund together with the amount in share premium account is not less than its paid-up capital, however, the Government on the recommendation of the NHB and with due consideration of the adequacy of the paid-up capital and reserves, may make the requirement of transfer of 20 per cent of profit inapplicable for a specified period.

Issue of Prospectus/Advertisement If considered necessary in public interest, the NHB may by general/special order **(a)** regulate/prohibit the issue, by any HFI, of any prospectus/advertisement soliciting deposits from the public and **(b)** specify the condition subject to which it can be issued.

Determination of Policy and Issue of Directions If satisfied that **(a)** in public interest, **(b)** to regulate the housing finance system of the country to its advantage, **(c)** to prevent the affairs of any HFI being conducted in a manner detrimental/prejudicial to the interest of depositors/HFIs, the NHB may consider it is necessary/expedient, within the framework of Government policy, to determine policy and give directions to HFI(s) relating **(1)** to income recognition, accounting standards, provisioning for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off-balance sheet items and **(2)** to deployment of funds. The HFI(s) would be bound to follow the policy and the directions. In addition, it may give directions in particular as to **(i)** the purpose for which advances/other fund/non-fund based accommodation may not be made and **(ii)** the maximum amount of advance/financial accommodation/investment in shares and other securities that (having regard to its paid-up capital, reserves and deposits and other relevant considerations) may be made by the HFI to any person/company/ group of companies.

Collection of Information About Deposits and Issue of Directions The NHB may at any time direct the HFIs to furnish, in a form at intervals and within time specified by it, statements/information/

particulars relating to, or connected with, deposits received by them and in particular in respect of matters including credit rating, rate of interest payable and the period of deposits. For non-compliance with these directions, the NHB may prohibit the acceptance of deposits by a HFI. If required by the NHB, a HFI has to send, within the specified time, a copy of its annual balance sheet and profit and loss account/other annual accounts, on the last day of the year to which the accounts relate, to person(s) from whom it holds deposits more than an amount specified by it.

Furnishing of Statements All HFIs are required to furnish the statements/information/particulars called for in the form prescribed by the NHB and comply with any direction given to them in relation to acceptance of deposits.

Powers and Duties of Auditors of HFIs The auditors should enquire whether HFIs have furnished the NHB with the statements, information, or particulars relating to, or connected, with deposits received by them, as required under the provisions of the *NHB Act*. Except where satisfied on such enquiry about compliance, they should submit a report to the NHB giving the aggregate amount of deposits held by them. On being satisfied that it is necessary **(a)** in public interest or **(b)** in the interest of the depositors or **(c)** for proper assessment of the books of account, the NHB may issue directions to **(i)** any HFl/group of HFIs/housing finance companies or **(ii)** their auditors with regard to balance sheet, profit and loss account, disclosure of liabilities in the books of account or any other related matters. Where the auditor has made/intends to make a report to the NHB, as specified above, the contents of such a report should be included in his report under Section 27**(2)** of the *Companies Act*. In addition, the NHB, when it is of the opinion that it is necessary in public interest or in the interest of the deposits, may appoint an auditor(s) to conduct a special audit of the accounts of a HFI in relation to any transaction/ class of transaction for period(s) specified by it. The auditor's remuneration is fixed by the NHB after duly considering the nature and volume of work involved in audit, and the expenses of/ incidental to it would have to be borne by the concerned HFI.

Power of the NHB to Prohibit Acceptance of Deposits The NHB may prohibit any HFI from accepting any deposit on violation of provisions or failure to comply with any direction/order given by it in relation to the acceptance of deposits. In addition, it may, if necessary in public/depositors' interest, direct such a HFI not to sell, transfer, create charge/mortgage or deal in any manner with its property and assets without the NHB's prior written permission, for a period not exceeding six months from the date of the order.

Filing of Winding-up Petition On being satisfied that a HFI **(i)** is unable to pay its debt, **(ii)** has become disqualified in terms of registration and net owned funds requirements to carry on business, **(iii)** has been prohibited by the NHB from receiving deposits, by an order in force for a period of at least three months, **(iv)** continuing in business is detrimental to the public interest/interest of depositors, NHB may file an application for its winding-up under the *Companies Act*. The HFI would be deemed to be unable to pay its debt if it has refused/failed to meet any lawful demand made at any of its offices/branches within five working days and the NHB certifies in writing that such a company is unable to pay its debt. A copy of the application would be sent to the Registrar of Companies and all the provisions of the *Companies Act* relating to winding-up would apply to winding-up process initiated by the NHB.

Inspection To verify the correctness/completeness of any statements/ information/particulars furnished to the NHB or to obtain any information/particulars which the HFI has failed to furnish, on being called up, the NHB may conduct an inspection by its officer(s) (inspecting authority). Every Director/member of any committee or other body/any person for the time being vested with the management of the whole/part of the affairs of the HFI and accepting deposits and other officers/employees would be duty bound to produce to the inspecting authority all books, accounts and other documents in custody/power and to furnish any statement/ information related to the business of the HFI, required within the specified time. The inspecting authority may also examine them on oath.

Soliciting Deposits by Unauthorised Persons A person can solicit public deposits on behalf of a HFI either by publishing or by causing to be published any prospectus/advertisement or in any other manner only if **(a)** authorised in writing by the HFI and **(b)** the prospectus/advertisement complies with any order made by the NHB in this regard/any other provision of law for the time being in force and applicable to their publication.

Non-disclosure of Information Any information relating to a HFI **(a)** contained in any statement/return submitted by it or **(b)** obtained through audit/inspection or otherwise by the NHB should be treated as confidential and should not be disclosed. However, the non-disclosure stipulation does not apply to **(i)** any disclosure by the HFI with the prior approval of the NHB, **(ii)** publication by the NHB, in public interest, of any such information in a consolidated form without disclosing the HFI's/borrowers' name, **(iii)** disclosure by the NHB/HFI of any such information to any other HFI, in accordance with the practice and usage customary among them or as permitted under any other law and published accordingly. Yet, if satisfied that it is expedient in the public/depositors'/ HIF's interest or to prevent the affairs of the HFI being conducted in a manner detrimental to the depositors' interest, the NHB, may furnish/communicate, on its own/on being requested, any information relating to the conduct of business by any HFI to any authority constituted under any law. But no court/tribunal/other authority can force the NHB to produce/give for inspection any statement/other material obtained by it under any provision relating to deposit acceptance by HFIs.

Power to Exempt On being satisfied that it is necessary, the NHB, by notification, has the power to exempt any HFl/groups of HFIs from any/all provisions relating to acceptance of deposits, either generally or for specified period, subject to conditions, limitations/restrictions it may think to impose.

Overriding Power These provisions, relating to the acceptance of deposits by HFIs that are companies, would have effect notwithstanding anything inconsistent with them in any other law for the time being in force or any instrument having effect by virtue of any such law.

Power to Order Repayment of Deposits Unless renewed, deposits accepted by the HFIs should be repaid in accordance with their terms and conditions. On failure to repay, an officer with the NHB, authorised for the purpose by Government (ie authorised officer), on his own or on application of a depositor, if satisfied that it is necessary to safeguard the interest of the HFl/depositors or in public interest may, after giving it reasonable opportunity to be heard, direct the HFI to repay the deposit/part of it forthwith/within a specified time and subject to specified conditions.

Nomination by Depositors A depositor(s) may nominate, under Section 45-ZA of the *Banking Regulation Act, 1949* one person to whom, in the event of the death of the sole depositor(s), the amount of deposit may be returned by the HFI(s). The nominee would be entitled to all the rights of the depositor(s) to the exclusion of all other persons. If the nominee is a minor, the depositor(s) can appoint any person to receive the amount of deposit during the minority of the nominee. The payment to the nominee would constitute a full discharge of the HFI's liabilities in respect of the deposit.

Other Provisions Relating to HFIs

Recovery officers are officers of approved institutions appointed by the government in consulation with the NHB to act as trustees or otherwise in a transaction of securitisation of housing mortgage.

They relate to the appointment of recovery officers and appellate tribunals for recovery of dues of approved institutions.

Appointment of Recovery Officers The Government, in consultation with the NHB, may appoint **recovery officer(s)** from amongst officers of approved institutions, that is, a HFI registered with the NHB/bank/NHB acting as trustee or otherwise in a transaction of securitisation of housing mortgages undertaken by it/other institutions notified by the Government in consultation with the NHB. The local limits within which they would exercise their powers and perform their duties would also be specified by the Government.

Application to Recovery Officer(s) When any borrower (ie any person to whom any direct/indirect financial assistance has been given by an approved institution during the course of any house finance activity undertaken by it/for purchase, construction, repairs, extension or renovation of a residential house) defaults in repayment of any assistance/instalment or otherwise fails to comply with the terms of agreement, the approved institution, without prejudice to the provisions of Section 69 of the *Transfer of Property Act*, may approach the concerned recovery officer(s) for the sale of the property pledged/mortgaged/hypothecated or assigned to it as security for the dues, that is, the liability claimed as due, including interest, cost, charges and other amounts payable.

On receipt of the application by the approved institution(s), the recovery officer would send a written notice of demand in the prescribed form, calling upon the borrower to pay the specified amount within 90 days or to show cause as to why the relief prayed should not be granted. He may make an interim order by way of injunction/stay/attachment against the borrower to debar him from transferring/alienating or otherwise dealing with/disposing off the property pledged/hypothecated/mortgaged/assigned as security for the dues. The application made to the recovery officer should be dealt with by him as expeditiously as possible and endeavours should be made by him to dispose it off finally within six months.

Enforcement of the Order of the Recovery Officer If the borrower refuses/fails to comply with the order of the recovery officer(s) for the payment of the dues, within the specified time, the recovery officer(s) may take possession of the property and transfer it by way of sale/lease or otherwise in the prescribed manner. Such a transfer would vest all rights in/or to the property transferred in the transferee, as if the transfer has been made by the owner of the property. The Chief Metropolitan Magistrate/District Magistrate, within whose jurisdiction the property/other related documents are situated/found, would assist the recovery officer(s) in taking charge of property. The money received would be held by the recovery officer in trust to be applied, firstly, in the payment of costs/charges/expenses properly incurred by him, and secondly, in discharge of debts due to the approved institution(s) and the residual paid to the entitled person.

Establishment of Appellate Tribunals The Government would establish appellate tribunals (ATs) to be known as Housing Finance Institutions Debt Recovery Appellate Tribunals (HFIDRATs). They would exercise the jurisdiction, power and authority to entertain appeals against any order of the recovery officer(s). Till the establishment of ATs for any area, the ATs established under Section 8 of the Recovery of Debts Due to Banks and *Financial Institution Act, 1993*, functioning in that area would exercise such jurisdiction, powers and authority. The aggrieved party should file the appeal within 45 days from the date on which a copy of the order by the recovery officer is received by him in the prescribed form. However, the ATs may entertain an appeal after 45 days if satisfied that there was sufficient cause for delay. The ATs can confirm, modify or set aside the order appealed against. The appeal should be dealt with by them as expeditiously as possible and endeavours should be made to dispose it off finally within six months. The borrower's appeal would be entertained only on depositing 75 per cent of the due amount, determined by the recovery officer with the ATs, which may be waived/reduced for the reasons recorded in writing by it.

Procedures and Powers of ATs/Recovery Officers (ROs) The ROs and the ATs would not be bound by the procedure laid down by the Code of Civil Procedure but would be guided by the principles of natural justice and, subject to other provisions of the *NHB Act*/any regulations, they would have powers to regulate their own procedure, including the place(s) of their sitting(s). For discharging their functions, they would have the same powers as are vested in a civil court, under the Code of Civil Procedure, while trying a suit in respect of **(a)** summoning/enforcing the attendance of any person(s) and examining him on oath, **(b)** requiring the discovery and production of documents, **(c)** receiving evidence on affidavits, **(d)** issuing commissioner for the examination of witness(es)/documents, **(e)** reviewing its decisions, **(f)** dismissing an application for default/deciding it ex parte, **(g)** setting aside any order of dismissal of any application for default/passed by it *ex parte* and **(h)** any other prescribed matter.

Any proceeding before the ROs and ATs would be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purpose of Section 196 of the Indian Penal Code they would be deemed to be a civil court for all purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure.

Limitation The provisions of the *Limitation Act, 1963* would, as far as possible, apply to an application made to the ROs.

Bar of Jurisdiction Excepting the Supreme Court and High Court(s), no court/authority would have/be entitled to exercise any jurisdiction/powers/authority in relation to the matters pertaining to recovery of dues of HFIs/NHB.

Miscellaneous Provisions

Exemption from Tax The NHB would not be liable to pay income tax/any other tax in respect its income/profits/gains.

Penalties Whoever, in any return/balance sheet/other documents/information required/furnished by/ under/for purposes of any provision of the NHB Act, willfully makes a statement that is false in any material particular, knowing it to be false/omits to make a material statement, would be punishable with imprisonment for a term extending to three years and also liable to fine. In addition, failure to produce any book/account/document or furnish any statement/information would be punishable with fine up to ₹2,000 for each offence, and for continuing failure, with an additional fine up to ₹100 for every day during which the failure continues after the first such failure.

The penalty for contravention of the requirements of registration and net owned funds is **(i)** imprisonment for at least one year and up to five years and **(ii)** fine of not less than ₹1 lakh and up to ₹5 lakh.

An auditor who fails to comply with any direction given/order made by the NHB would be punishable with a fine up to ₹5,000. Any failure to comply with any order by the authorised officer, pertaining to repayment of deposits, would be liable to imprisonment up to three years as also a fine up to ₹5,000.

If any person other than an auditor **(a)** receives any deposits in contravention of/fails to comply with any direction given/order made by the NHB in relation to acceptance of deposits by HFIs, **(b)** issues any prospectus/advertisement in contravention of the provisions of the *NHB Act*, he would be liable to imprisonment up to three years and also fine up to twice the amount of deposit received/called for by the prospectus or advertisement.

The penalty for contravention of any other provision or default in compliance with any other requirement of the *NHB Act*/any order, regulation, direction made or given or condition imposed, would be a fine extending to ₹2,000 and further ₹100 for every day the contravention/default continues.

Offences by Companies Where any offence has been committed by a company under the NHB Act (ie a body corporate, including a firm or other association or persons) with the consent/ connivance of, or is attributable to any neglect on the part of, any Director (Partner)/Manager, Secretary or other officer of the company, he as well as the company would be deemed to be guilty and liable to be proceeded against and punished accordingly.

Power of the NHB to Impose Fine If the contravention/default in respect of the production of books/ accounts/other documents or furnishing of any statement/information is committed by a HFI that is a company, the NHB may impose a fine not exceeding ₹5,000. Where the contravention/ default relates to the requirement of registration with the NHB and net owned funds or acceptance of deposits or directions given by the NHB in respect of acceptance of deposits, a penalty not exceeding ₹5 lakh or twice the amount involved, if the amount is quantifiable, whichever is more, would be imposed. A further penalty of ₹25,000 per day would be imposed if the contravention/default is a continuing one. The penalty imposed by the NHB would be payable within 30 days failing which a further penalty may be levied on the direction of the principal civil court, specifying the sum payable by the HFI.

Power to Make Rules The Government may make/notify rules to carry out the provisions of the NHB Act, providing, inter-alia, for **(a)** qualifications for appointing as ROs, **(b)** salary/ allowances/other terms and conditions of service of the officers and other employees of the ATs

(c) salary/allowances/other terms and conditions of service of Presiding Officers of ATs, and
(d) procedure for investigation of misbehaviour or incapacity of the Presiding Officers of ATs.

Power of Board of Directors of the NHB to Make Regulations With the prior approval of the RBI and in consultation with the Government, the Board of Directors of the NHB may make/notify regulations not consistent with the NHB Act, to provide for all matters for which provision is necessary/expedient for the purpose of giving effect to the provisions of the *NHB Act*. In particular, they may provide, *inter-alia.*, for the following matters.

(a) Fees and allowances that may be paid to the directors for attending the meetings of the Board or its committees;
(aa) Manner in which directors would be elected.
(b) Times and places at which the Board may meet, and the rules of procedures that may be followed with regard to the transaction of business.
(c) Number of members that the Executive Committee may consist of, the functions that it may discharge, times and places at which it would meet and the rules of procedure that it may follow in the transaction of business.
(d) Manner and terms of issue and redemption of bonds and debentures.
(e) Manner in which, and the conditions subject to which the NHB may borrow in foreign currency.
(f) Form in which the statements, information, and so on are to be furnished;
(fa) Form of application to recovery officers and documents to be annexed;
(fb) Form in which notice of demand is required to be served on the borrower;
(fc) Manner in which property would be transferred;
(fd) The form in which an appeal can be filed with the Appellate Tribunal and the amount of fee required to be deposited with such appeal.
(g) Special fund, reserve fund and other funds to be created.
(h) Form and manner in which the balance sheet and accounts would be prepared and maintained.
(i) Duties and conduct, salaries, allowances and conditions of service of the officers and other members of staff of the NHB.
(j) Establishment and maintenance of provident fund and any other fund for the benefit of officers and other members of staff of the NHB;
  (i) Manner in which nomination may be made.
(k) Any other matter which is to be, or may be, prescribed.

NHB'S HOUSING FINANCE COMPANIES DIRECTIONS

The NHB had issued the Housing Finance Companies (HFCs) Directions in 1989 in public interest. It had also issued guidelines to them on prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, capital adequacy and concentration of credit/investments. The NHB Act was amended comprehensively in 2000 to enable the NHB to safeguard the interest of depositories and promote healthy and universal growth of HFCs in the country. In public interest and to regulate the housing finance system of the country to its advantage, the NHB issued consolidated directions in 2001 with a view to safeguarding the interest of depositors and promoting the healthy and universal growth of HFCs.

An HFC means a company incorporated under the *Companies Act* that primarily transacts/has as one of its principal objects the transacting of the business of providing finance for housing, whether directly or indirectly. These are in respect of matters relating to **(a)** acceptance of deposits by HFCs, **(b)** prudential norms to be observed by them, and **(c)** matters ancillary/incidental thereto. These directions have been issued exercising **(i)** the power conferred by Sections 30, 30-A, 31 and 33 of the NHB Act and **(ii)** all the powers enabling it in this behalf.

Acceptance of Public Deposits

Any HFC having NOFs of less than ₹25 lakh cannot accept public deposits. **NOFs** mean net owned fund (NOF) defined under Section 29-A (**discussed earlier**) of the *NHB Act*, including paid-up preference shares compulsorily convertible into equity capital. A public deposit means a deposit but does not include the following:

(a) Amount received from **(i)** the Central Government/a state government, **(ii)** any other source whose repayment is guaranteed by the Central Government or a state government, **(iii)** a local authority/any public housing agency (ie any authority constituted in India by/under any law engaged either for the purpose of dealing with and satisfying the need for housing accommodation/planning, development, or improvement of cities, towns and villages)/a foreign government/any other foreign citizen, authority, and person;

(b) Amount received from the NHB, Industrial Development Bank of India, Life Insurance Corporation of India, General Insurance Corporation of India and its subsidiaries, Small Industries Development Bank of India, Unit Trust of India, National Bank for Agricultural and Rural Development, Electricity Boards, Tamil Nadu Industrial Investment Corporation Ltd, National Industrial Development Corporation Ltd, ICICI Ltd, IFCI Ltd, IIBI Ltd, State Trading Corporation of India Ltd, Rural Electrification Corporation Ltd, Minerals and Metals Trading Corporation of India Ltd, Agricultural Finance Corporation Ltd, State Industrial and Investment Corporation of Maharashtra Ltd, Gujarat Industrial Investment Corporation Ltd, Asian Development Bank, International Finance Corporation, Japan Bank for International Cooperation (JBIC) or Kreditansalt fur Wiederaufbau (Kfw) or any other institution that may be specified by the NHB in this behalf;

(c) Amount received from another company;

(d) Amount received by way of subscription to any shares, stock, bonds, debentures, pending their allotment/calls in advance on shares, in accordance with the articles of association of the HFC, so long as such amount is not repayable to members under its articles of association;

(e) Amount received from a person who at the time of receipt of the amount was a Director of the HFC or amount received from its shareholders by a private HFC that has become a public HFC. However, the Director/shareholder, from whom the money is received, should furnish to the HFC, at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting from others;

(f) Amount raised by the issue of bonds debentures secured by the mortgage of any immovable property of the HFC/other asset compulsarily convertible into equity shares, provided that the amount does not exceed the market value of the immovable property/other assets;

(g) Amount raised by issuance of non-convertible debentures in accordance with the NHB guidelines with a maturity of more than year and having minimum per investor subscription at ₹1 crore and above;

(h) Amount brought in by the promoters by way of unsecured loan, subject to the conditions that **(i)** the loan is brought in pursuance of the stipulations imposed by the lending public financial institution (ie a public financial institution in terms of Section 4-A of the *Companies Act*/a State Financial or Industrial Corporation/bank/General Insurance Corporation/any other institution notified by the NHB) in fulfilment of the obligation of the promoters to contribute such finance, **(ii)** the loan is provided by the promoters themselves and/or by their relatives, but not from their friends and business associates and **(iii)** the exemption would be available only till the loan of the lending public financial institution is repaid;

(i) Any amount received from mutual funds;

(j) Amount received as hybrid/subordinated debt with a maturity period of at least five years provided there is no option for recall by the issuer during the period,

(k) Amount received from a relative of a director of a HFC.

(l) Amount received by issuance of commercial papers.

Restriction on Acceptance/Renewal of Deposits A HFC having a minimum credit rating of **A** (i.e. minimum investment grade) for fixed deposits from any one of the approved rating agencies, at least once a year as well as complying with all the prudential norms can accept/renew deposits upto five times of its NOF. A copy of the rating should be sent to the NHB. The five approved rating agencies in the country are the: **(i)** CRISIL, **(ii)** ICRA, **(iii)** CARE, **(iv)** FITCH and **(v)** Brickwork Rating. No HFC can have maximum deposits, inclusive of public deposits, together with the amount held by it under clauses **(iii)** to **(vii)** of sub-section 45I of the RBI Act as also loans or other assistance, from the NHB exceeding 16 times its NOF.

In the event of downgradation of rating to any level below **A** from the level earlier held by the HFC, it should **(i)** report the position within 15 working days to the NHB, **(ii)** with immediate effect stop accepting fresh public and **(iii)** reduce such excess deposits by repayment on maturity.

Period of Deposit The HFCs can accept/renew public deposits for a minimum period of 12 months and a maximum period of 120 months. They are prohibited from accepting public deposits repayable on demand/notice. Where a public deposit is in instalments, the period of such deposits would be computed from the date of receipt of the first instalment.

Joint Deposits Deposits may be accepted by HFCs in joint names with/without any of the clauses such as Either or Survivor(s), Number One or Survivor(s) and Anyone or Survivor(s).

Particulars in Application Forms Public deposits can be accepted/renewed by HFCs from the depositors, on the basis of a written application in the prescribed form, containing all the particulars specified in the NBFCs and MNBCs (Advertisement Rules) made under Section 58-A of the Companies Act as will as the particulars of the specific category of depositors, that is, whether the depositor is a shareholder/director/promoter of a HFC or a member of public or a relative of the director of the HFC. The application form should also contain the following:

(a) The credit rating assigned for its deposits and the name of the credit rating agency which rated the HFC.

(b) A statement to the effect that in case of any deficiency of the HFC in servicing its deposits, the depositor may approach the National Consumers Disputes Redressal Forum, the State Level Consumers Disputes Redressal Forum or the District Level Consumers Dispute Redressal Forum for relief.

(c) A statement to the effect that in case of non-repayment of a deposit/a part of it, according to the terms and conditions of the deposit, the depositors may make an application to the authorised officer of the NHB.

(d) A statement to the effect that the financial position of the HFC, as disclosed, and the representations made in the application form are true and correct and that the HFC and its Board of Directors are responsible for their correctness and veracity.

(e) A statement to the effect that the HFC is within the regulatory framework of the NHB. It must, however, be distinctly understood that the NHB does not undertake any responsibility for the **(i)** financial soundness, **(ii)** correctness of any of the statements or the representations made or opinions expressed **(iii)** and for repayment of deposit/discharge of liabilities of/by the HFC.

(f) The information relating to and aggregate dues from both fund and non-fund based extended to and the aggregate dues from companies in the same group/other entities or business ventures in which the directors and/or the HFC are/is holding substantial interest and the total amount of exposure to such entities.

(g) At the end of the application form, but before signature of the depositor, the following verification clause by the depositor should be appended: "I have gone through the financial and other statements, particulars/representations furnished/made by the housing finance company and after careful consideration I am making the deposit at my own risk and volition."

Introduction of Depositors Every HFC should obtain proper introduction of new depositors before opening their accounts/accepting deposits and keep on its records the evidence on which it has relied for the purpose. The introduction/identification may be done **(i)** by one of the existing depositors, **(ii)** on the basis of income tax permanent account number (PAN)/election identity card (ID)/passport/ration card.

Furnishing of Receipts to Depositors Every HFC should furnish to every depositor or his agent a receipt for every deposit that has been/may be received by it, duly signed by an officer entitled to act for the HFC on its behalf, stating the date of deposit, name of depositor, amount in words and figures, rate of interest payable and the date on which the deposit is repayable. However, if such receipt pertains to instalments subsequent to the first instalment of a recurring deposit, it may contain only name of the depositor(s), date and amount of deposit.

Register of Deposits HFCs are required to keep register(s) containing the following particulars:

(a) Name and address of the depositor/group of joint depositors
(b) Date and amount of each deposit
(c) Duration and the due date of each deposit
(d) Date and amount of accrued interest or premium on each deposit
(e) Date and amount of each repayment, whether of principal, interest or premium
(f) Date of claim made by the depositor
(g) Reasons for delay in repayment beyond five working days
(h) Any other particulars relating to the deposits

A register(s) should be kept at each branch in respect of deposit accounts opened by it and a consolidated register for all the branches taken together at the registered office of the HFC and preserved in good order for eight years following the financial year in which the latest entry is made of the repayment/renewal of any deposit of which particulars are contained in the register. However, if the HFC keeps its books of accounts [under Section 209**(1)** of the *Companies Act*] at a place other than the registered office, the register of deposits may also be kept at that place, subject to the condition that the HFC delivers to the NHB also a copy of the notice filed with the Registrar of Companies, within seven days of such filing.

Information to be Included in the Board's Report The report of the Board of Directors of a HFC, laid in a general meeting under Section 217**(1)** of the *Companies Act*, should include information/ particulars relating to the total number of accounts/amount of public deposit of the HFC that has not been claimed by the depositors/not paid by the HFC after due date for repayment. These should be furnished with reference to the position as on the last date of the financial year to which the report relates. If the amounts remaining unclaimed/undisbursed exceed rupees five lakh, a statement on the steps taken/proposed to be taken by the Board of Directors for their repayment should also be included in the report.

Ceiling on Interest and Brokerage and Interest on Overdue Public Deposits Any HFC cannot:

(a) invite/accept/renew **(i)** any public deposit on a rate of interest exceeding 12.5 per cent per annum payable/compoundable at rests not shorter than monthly rests, **(ii)** repatriable deposits from NRIs under NR(E) Account Scheme at a rate exceeding the rates specified by the RBI for such deposits with banks for 1-3 years.

(b) pay any broker, on public deposit collected by/through him, **(i)** brokerage, commission, incentive/any other benefit, by whatever name called, in excess of two per cent and **(ii)** expenses by way of reimbursement on the basis of relative vouchers/bills produced by him, in excess of 0.5 per cent of the deposit collected.

Payment of Interest on Overdue Deposit A housing finance company may, at its discretion, allow interest on an overdue public deposit/a portion of it from the date of maturity of the deposit, subject to the conditions that the **(i)** total amount of overdue deposit/a part of the deposit is renewed in accordance with other relevant provisions of these directions, from the date of its maturity till some future date and **(ii)** interest allowed is at the appropriate rate operative on the date of maturity of such overdue deposit, which would be payable only on the amount of deposit so renewed. However, where a HFC fails to repay the deposit along with interest on maturity, on the claim made by the depositor, it would pay interest from the date of claim till the date of repayment at the rate applicable to the deposit.

In regard to payment of interest on deposits which have been **(i)** seized or **(ii)** frozen till further clearance by Government authorities, the HFCs should obtain a request letter from the depositor on maturity indicating also the term for the renewal of the deposit. They should otherwise renew it for a term equal to the original term. New receipt is not required and only suitable note may be made in the deposit records. The rate of interest on the renewal deposit should be communicated to the depositors. The final repayment of the principal and accrued interest should be made only after clearance from the respective Government authorities.

General Provisions Regarding Repayment of Deposits A public deposit cannot be repaid within three months from the date of acceptance. The maximum interest payable on deposits repaid between 3–6 months would be 4 per cent for individual depositors and no interest in case of other depositors. In case of repayment after 6 months but before maturity, the payable interest would be 1 per cent lower than the applicable rate for the period for which the deposit has run or 2 per cent lower than the minimum interest at which the HFC accepts public deposits. Loan upto 75 per cent of the deposit may be given to a depositor after the expiry of three months (i.e. lock-in period) at a rate of interest two percentage point above the interest rate payable on the deposit. It is obligatory for every HFC to intimate the details of the maturity to the depositor at least fourteen days before the date of maturity. All deposits accounts standing in the credit of sole/first-named depositor in the same capacity should be clubbed and treated as one deposit account for the purpose of premature repayment or grant of loan by a problem HFC. However, in the event of the death of a depositor, public deposit may be paid prematurely to the surviving depositor(s) or nominee/legal heir(s) with interest at the contracted rate upto the repayment date.

For the purpose, HFCs are classified into two categories for the purpose of premature repayment of deposits: **(a)** Normally-run HFCs and **(b)** Problem HFCs. A **problem HFC** is one which **(i)** has refused/failed to meet within five working days any lawful demand for repayment of matured public deposits, or **(ii)** intimates the Company Law Board (CLB) under Section 58(AA) of the *Companies Act* about its default to a small depositor in repayment of any public deposit (including interest), or **(iii)** approaches the bank for withdrawal of the liquid assets/securities to meet deposit obligations, or **(iv)** approaches the NHB for any relief/relaxation/exemption from the provisions of the HFCs (NHB) Directions/Prudential Norms Directions for avoiding default in meeting public deposits/other obligations, or **(v)** has been identified by NHB to be a problem HFC either *suo moto* or based on the complaints from the depositors about non-repayment of deposit or on complaints from the lenders of the HFC about non-payment of dues. A normally-run HFC can permit premature repayment of deposit after the lock-in period (i.e. three months) at its sole discretion only and premature closure cannot be claimed as a matter of right by the depositors. The problem-HFCs are prohibited from making premature repayment of any public deposits/granting any loan against any deposit except in the case of the death of the depositor or in the case of tiny deposits upto ₹10,000 in entirety or to enable the depositor to meet expenses of an emergent nature upto ₹10,000. However, in the event of the death of the depositor, the public deposits may be paid prematurely to the surviving depositor(s)/nominees/legal heirs with interest at the contracted rate upto the date of repayment.

> **Problem HFC** is one which **(i)** has refused/failed to meet within five days any lawful demand for repayment of a matured public deposit, or **(ii)** intimates CLB about its default, **(iii)** approaches the bank for withdrawl of liquid amounts to meet deposit obligation, **(iv)** approches NHB for relaxation/ exemption from the provision of its direction or has been identified by the NHB to be a problem HFC

Renewal of Public Deposit before Maturity Where any HFC permits an existing depositor to renew his public deposit before maturity for availing the benefit of higher rate of interest, it would pay him the increase in the rate of interest, provided **(i)** the public deposit is renewed in accordance with the other provisions of these directions for a period longer than the remaining period of the original contract; **(ii)** the interest on the expired period is reduced by one percentage point from the rate which would have ordinarily been paid, had the deposit been accepted for the period for which such public deposit had run. Any interest paid earlier in excess of such reduced rate is recovered adjusted.

Safe Custody of Approved Securities Every HFC should entrust the unencumbered approved securities maintained by it in pursuance of Section 29-B of the NHB Act to a designated bank in the place where the HFC's registered office is situated. However, **(i)** it can entrust these securities to the designated bank at any other place, **(ii)** keep them in the form of constituents of a Subsidiary General Ledger Account with its designated bank, **(iii)** entrust them to the Stock Holding Corporation of India Ltd (SCHI), subject to NHB specified conditions, with the prior written approval of the NHB. Such securities should continue to be entrusted to the designated bank for the benefit of the depositors and not withdrawn/encashed/otherwise dealt with by the HFC except for repayment to the depositors. Nevertheless, the HFCs would be entitled to withdraw a portion of these proportionate to the reduction of their deposits, duly certified by its auditors. They can also substitute them by substitute securities of equal value to the designated bank before such withdrawal.

Creation of Floating Charge All HFCs accepting/holding public deposits should create floating charges on the assets invested by them in favour of their depositors in a manner prescribed by the NHB.

Employee's Security Deposit A housing finance company, receiving any amount in the ordinary course of its business, as security deposit from any of its employee(s) for due performance of his duties, should keep it in a joint account with the employee in a bank or in a post office on the conditions that **(a)** it would not withdraw the amount without the consent, in writing, of the employee and **(b)** the amount would be repayable to the employee along with interest, unless such amount/any part is liable to be appropriated by an HFC for the failure on the part of the employee for due performance of his duties.

Advertisement and Statement in Lieu of Advertisement

1. Every HFC soliciting public deposits should comply with the provisions Non-banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977 and also specify the following in every advertisement to be issued: **(a)** the actual rate of return by way of interest, premium, bonus or other advantage to depositors; **(b)** the mode of payment to depositors; **(c)** maturity period of deposit; **(d)** the interest payable on a specified deposit; **(e)** the rate of interest that would be payable to the depositor in case the depositor withdraws the deposit prematurely; **(f)** the terms and conditions subject to which a deposit would be renewed; **(g)** any other special features relating to the terms and conditions subject to which the deposits are accepted/renewed; **(h)** the information relating to the aggregate dues (including the non-based facilities) provided to/from companies in the same group or other entities or business ventures in which the directors/the HFC are holding substantial interest and the total amount of exposure to such entities; and **(i)** deposits solicited are not insured.
   Where a HFC displays any advertisement in electronic media even without soliciting deposits, it should incorporate a caption/band indicating the following:
   "As regards deposit taking activity of the company, the viewers may refer to the advertisement in the newspapers/information furnished in the application form for soliciting public deposits;

The company is having a valid registration certificate from the NHB. However the NHB does not accept any responsibility/guarantee about the present position as to the financial soundness of the company or for the correctness of any statement/representation made/opinions expressed by the company and for repayment of deposits/discharge of the liabilities of the company."

2. Where an HFC intends to accept public deposits without inviting or allowing or causing any other person to invite such deposits, it should, before accepting deposits, deliver to the office of the NHB for registration, a statement in lieu of the advertisement, containing all the particulars required to be included in the advertisement, pursuant to the Non-banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977 as also the particulars stated above, duly signed in the manner provided in the aforesaid rules.
3. A statement, delivered under **(2)** above would be valid till the expiry of six months from the date of closure of the financial year in which it is so delivered, or until the date on which the balance sheet is laid before an HFC in general meeting, or where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the *Companies Act*, whichever is earlier, and a fresh statement should be delivered in each succeeding financial year before accepting deposits in that financial year.

Full Cover for Public Deposits A full cover for public deposits accepted by the HFCs should be ensured at all times. For the purpose of computing the cover, assets should be valued at the lower of their book or market/realisable value and the value of secured/insecured debentures and other outside liabilities should be deducted.

Prior Approval for Acquisition/Transfer of Control of HFCs The prior written permission of the NHB would be required for **(a)** takeover/acquisition of control, by acquisition of shares/otherwise, **(b)** any merger/amalgamation of a HFC with another entity or of any entity with the HFC that would give the acquirer/another entity control or which would result in acquisition/transfer of more than 10 per cent shareholding (paid-up capital) of the HFC. Prior approval of the NHB would also be required before approaching the court/Company Law Tribunal seeking order for mergers/amalgamations with other companies/HFCs. These provisions are in addition to provisions of other law/regulations/directions.

Closure of Branches Any HFC accepting deposits can close its branch/office after publishing its intention in one national newspaper and in one vernacular newspaper in circulation in the relevant place as also advising the NHB ninety days before the proposed closure.

Prudential Norms

The NHB guidelines to HFCs on prudential norms for income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning requirements, capital adequacy and concentration of credit/investments are discussed below.

Income Recognition Income recognition should be based on recognised accounting principles. Income including interest/discount or any other charges on NPAs should be recognised only when it is actually realised. Any such income recognised before the asset became NPA should be reversed.

Where hire-purchase instalments/lease rentals are overdue for more than twelve months, income should be recognised only when they are actually received. Any such income (hire charges)/net **lease rentals** (i.e. gross lease rentals as adjusted by the lease adjustment account and as reduced by depreciation at the rate applicable under Schedule XVI of the *Companies Act*), taken to the credit of the profit and loss account before the asset become NPA, should be reversed.

Basis of NPA Classification A non-performing asset means:

> **NPA**
> means any credit facility which remains overdue for 90 days.

- An asset in respect of which interest has remained over due for 90 days.
- A term loan (other than to an agriculturist/a person whose income is dependent on the harvest of crops) inclusive of unpaid interest, when the interest is overdue for more than 90 days or on which interest amount remained past due for 90 days.
- A demand/call loan which remained overdue for more than 90 days or on which interest remained overdue for 90 days or more.
- A term loan to an agriculturist/a person whose income is dependent on the harvest of crops if the instalment if the principal/interest remains unpaid for **(a)** two crop seasons beyond the due date if the income of the borrower is dependent on short duration crop (i.e. crop season of upto one year), and **(b)** one crop season beyond the due date if the income of borrower is dependent on long duration crop having a crop season longer than one year.
- A bill of exchange that remains overdue for 90 days.
- The interest in respect of a debt/income on a receivable under the head “other current assets” in the nature of short-term loans/advances, which facility remained overdue for a period of 90 days.
- Any dues on account of sale of assets/services rendered or reimbursement of expenses incurred, which remained overdue for 90 days.
- The lease rental/hire-purchase instalment that has become overdue for a period of more than 90 days.
- An inter-corporate deposit in respect of which interest/principal has remained overdue for 90 days.
- In respect of loans/advances and other facilities (including bills purchased/discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facility becomes NPA. In the case of lease/hire-purchase, a HFC may classify such account on the basis of record of recovery.

Income from Investments Income from dividend on shares of corporate bodies and units of natural funds should be taken into account on cash basis. But when such dividend has been declared in the annual general meeting and the HFC’s right to receive payment is established, such income may be taken into account on accrual basis.

Income from bonds/debentures of corporate bodies and from Government securities/bonds may be taken into account on accrual basis if the interest on these instruments is predetermined, is serviced regularly and is not in arrears. Similarly, where the interest/repayment of principal is guaranteed by any Government, income on securities of corporate bodies/public undertakings may be accounted for on an accrual basis.

Accounting Standards Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI) should be followed in so far as they are not inconsistent with any of these directions.

Accounting for Investments The Board of Directors of HFCs should frame investment policy and implement it. The criteria to classify current and long-term investments should be spelt out in the investment policy. Investments in securities should be classified into current and long-term at the time of each investment. There should be no inter-class transfer on *an ad* hoc basis. Any inter-class transfer should be effected only at the beginning of each half year on April 1/October 1 with the approval of the Board of Directors. The transfer from current to long-term or *vice versa* should be scripwise at the lower of the market value and the book value. Depreciation, if any, in each scrip should be provided for and appreciation should be ignored. Depreciation in one scrip should not be set off against appreciation in another scrip at the time of each inter-class transfer even in respect of the scrips of the same category. The long-term investments should be valued in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI).

Quoted Current Investment Quoted current investments should, for the purposes of valuation, be grouped into the following categories: **(a)** equity shares; **(b)** preference shares; **(c)** debentures and bonds; **(d)** Government securities, including treasury bills; **(e)** units of mutual funds and **(f)** others. Quoted current investments for each category should be valued at cost or market value, whichever is lower. The investments in each category should be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation should be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost, the net appreciation should be ignored. Depreciation in one category of investments should not be set-off against appreciation in another category.

Unquoted Equity Shares in the nature of current investments should be valued at cost or break-up value, whichever is lower. Where the balance sheet of the investee company is not available for two years, such shares should be valued at one rupee only. The **"break-up value"** means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company. If the investee company is a loss making company, the earning value would be taken at zero.

> **Break-up value** means the equity capital and free reserves minus intangible assets and revaluation reserves divided by the number of shares outstanding.

Unquoted Preference Shares in the nature of current investments, should be valued at cost or face value or the net asset value, (ie the latest NAV declared by the concerned mutual fund in respect of that mutual fund), whichever is less. In case the net asset value is negative, or the balance sheet of the investee company is not available for two years, it should be valued at ₹1 per company.

Investments in Unquoted Government Securities or Government Guaranteed Bonds should be valued at carrying cost (ie book value of the assets and interest accrued but not realised).

Unquoted Investments in Units of Mutual Funds This, in the nature of current investments, should be valued at the net asset value declared by the mutual fund in respect of each particular scheme.

Commercial Papers These should be valued at carrying cost.

Unquoted Debentures Such debentures should be treated as term loans/other types of credit facilities depending upon their tenure for income recognition and asset classification.

Policy on Demand/Call Loans The Board of Directors of HFCs should frame and implement policy for demand/call loans, stipulating, *inter-alia*, the following: **(a)** A cut-off date within which the repayment of demand/call loan would be demanded/called up, **(b)** The sanctioning authority should record specific reasons in writing at the time of sanctioning of the loan if the cut-off date is stipulated beyond one year, **(c)** The rate of interest and payable at monthly or quarterly rests, **(d)** The sanctioning authority should record specific reasons in writing at the time of sanction if no interest is stipulated or a moratorium is granted for any period, **(e)** A cut-off date not exceeding six months for review of the performance of the loan, and **(f)** Such loan would not be renewed unless the periodical review has shown satisfactory compliance with the terms of the sanction.

Asset Classification The HFCs should classify their lease/hire purchase assets, loans and advances and any other form of credit into four broad groups: **(i)** standard assets, **(ii)** substandard assets, **(iii)** doubtful assets and **(iv)** loss assets. Broadly speaking, the classification of credit into these categories should be done taking into account the degree of well-defined credit weaknesses and extent of dependence on collateral security for realisation of dues. The above class of assets should not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

Standard Assets A standard asset is one in respect of which no default in repayment of principal or payment of interest is perceived and which does not disclose any problems nor carry more than normal risk attached to the business.

> **Substandard asset** is an asset classified as NPA upto one year.

Substandard Assets A **substandard asset (i)** is one that has been classified as NPA for a period not exceeding one year; **(ii)** in respect of which the terms of the agreement regarding interest and/or repayment of principal have been renegotiated/rescheduled, after release of any amount of loan or an inter-corporate deposit that has been rolled over, until the expiry of the one year of satisfactory performance under the renegotiated/rescheduled terms. However, where a delay in completion of a project is caused on account of factors beyond the control of the implementing agency, terms of the loan agreement relating to interest and/or principal may be rescheduled once before the completion of the project and such loans may be treated as standard asset subject to the condition that **(a)** the rescheduling is permitted only once by the Board of Directors of the concerned HFC and **(b)** interest on such a loan is paid regularly and there is no default. Similarly, where natural calamities impair the repaying capacity of a borrower, terms of the loan agreement regarding interest and or principal may be rescheduled and not classified as substandard. Their classification thereafter would be governed by the revised terms and conditions.

Doubtful asset is any asset that remains NPA beyond one year.

Doubtful Assets A **doubtful asset** means a term loan/leased asset/hire purchase asset/any other asset that remains a substandard for a period exceeding one year.

Loss asset is an asset that has been identified as loss asset to the extent not written off or is adversely affected by a potential threat of non-recoverability.

Loss Assets A **loss asset** is one that **(i)** has been identified as such by the HFC or internal/external auditors/the NHB to the extent it has not been written off, **(ii)** is adversely affected by a potential threat of non-recoverability due to the following: **(a)** non-availability of security in case of secured loans/advances, **(b)** erosion in the value of security, **(c)** insurance claim denied/settled in part, **(d)** fraudulent act on the part of the borrower, **(e)** debt becoming time-barred and **(f)** in-choate/defective documentation.

Loan to Value (LTV) Ratio Every HFC should grant loan upto ₹30 lakh and ₹30 and ₹75 lakhs to individuals with LTV ratio not exceeding 90 per cent and 80 per cent respectively. The LTV ratio should not exceed 75 per cent in case of loan above ₹75 lakh. For loans against collateral of gold jewellery, the ratio should not exceed 60 per cent.

Provisioning The HFC should make the following provisions against substandard, doubtful and loss assets, after taking into account the time-lag between an account becoming NPA, its recognition as such, the realisation of the security and the erosion in the value of security charged over a point of time.

Loans, Advances and Other Credit Facilities, Including Bills Purchased and Discounted
The provisioning requirements should be as under:

Loss Assets The entire assets should be written off. If they are permitted to remain in the books for any reason, 100 per cent of the outstandings should be provided for.

Doubtful Assets

(a) 100 per cent provision, to the extent to which the advance is not covered by the realisable value of the security to which an HFC has a valid recourse, should be made. The realisable value is to be estimated on a realistic basis;

(b) in addition, depending upon the period for which the asset has remained doubtful, provision to the extent of 25 to 100 per cent of the secured portion (ie estimated realisable value of the outstandings) should be made on the following basis:

Period for which the asset has been considered as doubtful	*Percentage of provision*
Up to 1 year	25
1 – 3 years	40
Over 3 years	100

Substandard Assets A general provision of 15 per cent of the total outstanding should be made.

Standard Assets **(a)** Standard assets in respect of housing loans at teaser/special rates (i.e. at comparatively lower rates in the first few years after which re-set at higher rates), 2 per cent on the total outstanding amount. The provisioning should be reset after one year at the applicable rates from the date on which the rates are reset at higher rates, **(b)** Standard assets in respect of commercial real estates, 0.75 per cent of the total outstanding for residential housing and 1 per cent in respect of all others, (c) Standard assets in respect of all other loans, a general provision of 0.40 per cent of the total outstanding amount. However, no provision need be made towards the portion of the housing loan guaranteed by the Credit Risk Guarantee Fund Trust for Low Income Housing. The amount outstanding in excess of the guaranteed portion should be provided for as per the provisioning requirement.

Note: Commercial real estate-residential housing (CRE-RH) would consist of loans to builders/ developers for residential housing projects (except for captive consumption) and would ordinarily not include non-residential commercial real estate. However, integrated housing projects comprising of some commercial space (e.g. shopping complex/schools) can also be classified under CRE-RH provided it does not exceed 10 per cent of the total floor space index (FSI) of the project.

Other commercial real estate would consist of loans to builders/developers/others for office building, retail space, multi-purpose/tenanted commercial premises, industrial/warehouse space, hotels, land acquisition/development/construction etc. Loans for third dwelling unit onwards to an individual will also be treated as CRE exposure.

Lease and Hire-Purchase Assets The provisioning requirements in respect of hire-purchases and leased assets should be as under:

Hire-Purchase Assets **(i)** In respect of hire-purchase assets, the total dues (overdue and future instalments taken together) as reduced by **(a)** the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges and **(b)** the depreciated value of the underlying asset should be provided for. The depreciated value of the asset should be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of 20 per cent per annum on a straight line method. In case of a second hand asset, the original cost should be the actual cost incurred for its acquisition.

Additional Provision for Hire-Purchase and Leased Assets **(ii)** With respect to hire-purchase and leased assets, additional provision should be made as detailed here.

- **(a)** Where any amounts of hire charges or lease rentals are overdue up to 12 months–*Nil.*
- **(b)** Where any amounts of hire charges or lease rentals are overdue for more than 12 months, but up to 24 months–10 *per cent of the net book value.*
- **(c)** Where any amounts of hire charges or lease rentals are overdue for more than 24 months, but up to 36 months–40 *per cent of the net book value.*
- **(d)** Where any amounts of hire charges or lease rentals are overdue for more than 36 months, but upto 48 months–70 *per cent of the net book value.*
- **(e)** Where amounts of hire charges/lease rentals are overdue for more than 48 months–*100 per cent of the net book value.*

(iii) On the expiry of a period of 12 months after the due date of the last instalment of hire purchased/leased assets, the entire net book value should be fully provided for. Net book value means: **(a)** in the case of hire purchase assets, the aggregate overdue and future instalments receivable as reduced by the balance of unmatured finance charges and further reduced by the provisions made as specified above; **(b)** in the case of leased assets, aggregate of the capital portion of overdue lease rentals accounted as receivable and the depreciated book value of the lease asset as adjusted by the balance of lease adjustment account.

Notes:

(1) The amount of caution money/margin money or security deposit kept by the borrower with the HFC, in pursuance of the hire purchase agreement, may be deducted against the provisions specified above under clause **(i)** if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security may be deducted only against the additional provisions stipulated under clause **(ii)** above.

(2) The amount of security deposit kept by the borrower with the HFC, together with the value of any other security available in pursuance to the lease agreement, may be deducted only against the additional provisions stipulated under clause **(ii)** above.

(3) Income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms should be made on NPAs on total outstanding balance, including the depreciated book value of the relevant lease asset, after adjusting the balance, if any, in the lease adjustment account. The fact that income on NPAs has not been recognised should not be taken as a reason for not making the provision.

(4) A sub-standard asset that has been renegotiated/rescheduled should be a substandard asset or continue in the same category in which it was prior to its renegotiation/reschedulement as a doubtful/loss asset. Necessary provision should be made as applicable to such cases till it is upgraded. In case an asset has been rescheduled on account of impairment of the repaying capacity of the borrower by natural calamities, any provisioning made prior to the rescheduling should neither be written back nor adjusted against any provisioning requirement that may arise in future.

(5) All financial leases attract the provisioning requirements as applicable to hire-purchase assets.

(6) The general provision of 0.40 per cent of the total outstanding amount of loan would not be reckoned for arriving at net NPAs.

(7) The provisions towards standard assets need not be netted from gross advances but shown separately as Contingent Provisions Against Standard Assets in the balance sheet.

Disclosure in the Balance Sheet The HFCs should separately disclose in their balance sheets the outstanding amount and the provisions should be distinctly indicated under separate heads of accounts and individually for each type of assets, such as **(a)** for sub-standard, doubtful and loss assets separately for housing and non-housing finance business along with total, and **(b)** for depreciation in investments. They should not be appropriated from the general provisions and loss reserves held, if any, by a HFC. Such provisions for each year should be debited to the profit and loss account. The excess of provisions, if any, held under the heads of general provisions and loss reserves may be written back without making adjustment against them.

Every HFC should disclose the percentage of outstanding loans granted against the security of gold jewellery to their outstanding total assets.

The HFCs should separately disclose in the **notes on accounts** to the balance sheet in the next annual report **(a)** details of penalty, if any imposed on the HFC by the NHB and **(b)** adverse comments, if any, on the HFC by the NHB in writing on regulatory compliances with specific communication to disclose them to the public.

Capital Adequacy Norms HFCs should maintain a minimum capital ratio consisting of Tier-I and Tier-II capital of at least 12 per cent of their aggregate risk weighted assets and of risk adjusted value of off-balance sheet items. The total of the Tier-II should not exceed 100 per cent of Tier-1 capital.

Tier-I capital means owned funds (ie paid-up equity capital, including preference shares that are compulsorily convertible into equity shares, free reserves, balance in share premium account and capital reserves representing surplus arising out of the sale proceeds of assets, excluding reserves created by revaluation of assets as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any, less investments in shares of other HFCs and in shares, debentures bonds, outstanding loans and advances, including hire-purchase and lease finance made to and deposits with subsidiaries and group companies in excess in aggregate of 10 per cent of the owned fund. Free reserves include the balance in the share premium account, capital and debenture redemption reserve and any other reserve shown/published in the balance sheet and created through an allocation of profits and excluding **(i)** a reserve created for repayment of any future liability/for depreciation in assets/bad debts, **(ii)** a reserve created by the revaluation of assets.

The **Tier-II Capital** includes the following:

Preference Shares Preference Shares other than those compulsory convertible into equity.

Revaluation Reserves Revaluation Reserves at discounted rate of 55 per cent.

General Provisions and Loss Reserves General Provisions and Loss Reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset, and are available to meet unexpected losses to the extent of 1.25 per cent of risk weighted assets.

Hybrid Debt means capital instruments that possess certain characteristics of equity as well as of debt.

Subordinated Debt **Subordinated debt** means a fully paid-up capital instrument, unsecured and subordinated to the claims of other creditors, free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the NHB. The book value of such an instrument should be subjected to discounting as provided below.

Remaining maturity of instruments	*Rate of discount*
Up to 1 year	100
1 – 2 years	80
2 – 3 years	60
3 – 4 years	40
4 – 5 years	20

Hybrid debt means capital instruments that possess characteristics of debt as well as of equity.

Subordinated debt means a fully paid-up capital instrument, unsecured and subordinated to the claims of other creditors, free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the NHB.

The discounted value of subordinated debt instruments should be limited to 50 per cent of the Tier-I capital.

On Balance Sheet Items—Weighted Risk Assets Degrees of credit risks expressed as percentage weightage should assigned to balance sheet assets. The value of each asset/item should be multiplied by the relevant risk weights to arrive at risk adjusted values of assets. The aggregate should be taken into account for reckoning the minimum capital ratio. The risk weighted assets should be calculated as the weighted aggregate of funded items, as detailed below.

Weighted Risk Assets: On Balance Sheet Items	*Weight (%)*
1. (a) Cash and bank balances, including fixed deposits and certificates of deposits with banks	0
2. Investments:	
(a) Approved securities	0
(b) Bonds of public sector banks and fixed deposits/certificates of deposits/bonds of public financial institutions	20
(c) Units of Unit Trust of India	20
(d) Mortgage backed security/receipt/other security evidencing purchase/ acquisition by HFC of an undivided right/title/interest in any debt/receivables originated by a HFC recognised/supervised by the NHB/a bank and secured by mortgage of residential immovable property	50
(e) Shares of all companies and debentures/bonds/commercial papers of companies other than in **(b)** above/units of mutual funds other than in **(c)** above	100
(f) Investments in innovative perpetual debt of other HFCs/banks/FIs	100
3. (a) Housing/project loans guaranteed by Government 0 (where guarantee has been invoked and the Government has remained in default for 90 days).	100
(b) Housing loans to individuals secured by mortgage of immovable property classified as standard:	
(i) Upto ₹ 30 lakhs with LTV ratio equal to/less than 80 per cent	35
(ii) Above ₹ 20 lakh but below ₹ 75 lakh with LTV ratio between 80 per cent and 90 per cent	50
(iii) Between ₹ 30 – ₹ 75 lakh with LTV ratio equal to or less than 75 per cent	35
(iv) Between ₹ 30 – ₹ 75 lakh with LTV ratio more than 75 per cent and equal to/less than 80 per cent	50
(v) Above ₹ 75 lakh with LTV ratio equal to/less than 75 per cent	75
(vi) Loans given for insurance of property/borrower, same as applicable to respective housing loans	
(c) Other housing loans	100
Note: Loan in **(b)** and **(c)** categories above are exclusive of any portion guaranteed by a mortgage guarantee company/credit risk guarantee trust fund.	
(ca) Any portion of loan in categories **(b)** and **(c)** guaranteed by a mortgage guarantee company, the risk weight would be related to its long-term ratings:	
(i) **AAA** rating	20
(ii) **AA** rating	30
(iii) Below **AA**/unrated (as applicable to unguaranteed portion)	
(cb) Any portion in **(b)(i)** and **(c)** guaranteed by credit risk guarantee fund	0
(d) **(i)** Fund/non-fund based exposures to commercial real estate residential buildings	75
(ii) Fund/non-fund based exposures to all other commercial real estates	100
(iii) Investment in mortgage based securities (MBS) and other securitised exposures	125
(e) Restructured housing loan, additional risk weight	25

4.	Current Assets:	
	(a) Stock on hire (see note 2)	100
	(b) Inter-corporate loans/deposits	100
	(c) Loans and advances fully secured by company's own deposits	0
	(d) Loan to staff	0
	(e) Other secured loans and advances considered	100
	(f) Bills purchased/discounted	100
	(g) Others (to be specified)	100
5.	Fixed Assets (net of depreciation)	
	(a) Assets leased out (net book value)	100
	(b) Premises	100
	(c) Furniture and fixtures	100
	(d) Other fixed assets (to be specified)	100
6.	Other Assets:	
	(a) Income tax deducted at source (net of provision)	0
	(b) Advance tax paid (net of provision)	0
	(c) Interest due on Government securities and approved securities	0
	(d) Others (to be specified)	100

Notes:

(1) Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.

(2) Stocks on hire should be shown net of finance charges, that is, interest and other charges recoverable.

(3) Assets that have been deducted from owned funds to arrive at Tier-I capital would have a weightage of "0".

(4) For being eligible for risk weight of 50 per cent, investment in mortgage-based security/receipt/other security referred to in item (**ca**) should fulfill the following terms and conditions:

(a) The assignment of debt together with the securities and receivables by the originating HFC/bank in favour of the trust/securitisation company under the *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2000* issuing such receipt/other security is complete and irrevocable.

(b) The trust/securitisation company is holding the debt together with the securities exclusively for the benefit of investors.

(c) The originating HFC/bank participating in the securitisation transaction as a seller/manager/ servicer/provider of credit enhancement or liquidity facilities **(i)** does not own any shares in the capital of the securitisation company or is the beneficiary of the trust, **(ii)** has not named the trust/securitisation company in such manner which implies any connection with it, **(iii)** does not have any director/officer/employer on the Board of the securitisation company unless the Board is made up of at least three members and there is a majority of independent directors and the nominee of the originating company has no veto powers; **(iv)** does not directly/indirectly control the trust/securitisation company, and **(v)** has not agreed to support any losses arising out of the securitisation transaction or to be suffered by the investors involved in it or agreed to bear recurring expenses of the transactions.

(d) Each securitised debt is a loan to an individual for the acquisition/construction of residential immovable property mortgaged in favour of the originating HFC/bank on exclusive basis.

(e) Securitised debt had investment grade rating at the time of assignment to the trust/securitisation company.

(f) Investors are entitled to call upon the issuer-trust/securitisation company to take steps for recovery in the event of default and distribute the net proceeds to the investors as per the terms of the issue of the receipt/other security.

(g) The trust/securitisation company undertaking the issue in which investment has been made is not engaged in any business other than the business of issue and administration of securitisation of housing loans.

(h) The trustees appointed to manage the issue is governed by the provisions of the Indian Trust Act.

Off-Balance Sheet Items **(A) General** The HFCs should calculate the total risk weighted off-balance sheet credit exposure as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure will be calculated by means of a two-step process: **(i)** the notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and **(ii)** the resulting credit equivalent amount is multiplied by the risk weight applicable, for example, zero per cent for exposure to Government, 20 per cent for banks and 100 per cent for others.

(B) Non-market-Related Off-balance sheet Items The credit equivalent amount in relation to a non-market related off-balance sheet item should be determined by multiplying the contracted amount of the particular transaction by the relevant credit conversion factor (CCF).

Item	*Item description*	*Credit conversion factor*
(i)	Undisbursed amount of housing/other loans	50
(ii)	Financial and other guarantees	100
(iii)	Share/debenture underwriting obligations	50
(iv)	Partly-paid shares/debentures	100
(v)	Bills discounted/rediscounted	100
(vi)	Lease contracts entered into but yet to be executed	100
(vii)	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the HFC.	100
(viii)	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawn down.	100
(ix)	Lending of HFC securities or posting of securities as collateral by HFC, including instances where these arise out of repo style transactions	100
(x)	Other commitments, for example, formal standby facilities and credit lines (including project loans) with an original maturity of:	
	up to one year	20
	over one year	50

(xi)	Similar commitments that are unconditionally cancellable at any time by the HFC without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness	0
(xii)	Take-out finance in the books of taking-over institution:	
	(a) Unconditional take-out finance	100
	(b) Conditional take-out finance	50
	Note: As the counter-party exposure will determine the risk weight, it will be 100 per cent in respect of all borrowers or zero per cent if covered by Government guarantee	
(xiii)	Commitment to provide liquidity facility for securitisation of standard asset transactions	100
(xiv)	Second loss credit enhancement for securitisation of standard asset transactions provided by third party	100
(xv)	Other contingent liabilities (to be specified)	50

Note: (i) Cash margins/deposits should be deducted before applying the conversion factor.
(ii) Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility, the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of HFC's on-balance sheet credit exposure. For example, a term loan of ₹100 crore is sanctioned for a large housing project which can be drawn down in stages over a three-year period. The terms of sanction allow draw down in three stages: ₹25 crore in stage 1, ₹25 crore in stage II and ₹50 crore in stage III, where the borrower needs the HFC's explicit approval for draw down under Stages II and III after completion of certain formalities. If the borrower has drawn already ₹10 crore under stage I, the undrawn portion would be computed with reference to stage 1 alone, that is, it will be ₹15 crore. If stage I is scheduled to be completed within one year, the CCF will be 20 per cent and if it is more than one year, the applicable CCF will be 50 per cent.

(C) Market Related Off-Balance Sheet Items

(i) The HFCs should take into account all market related off-balance sheet items (OTC derivatives and securities financing transactions such as repo/reverse repo/CBLO etc.) while calculating the risk weighted off-balance sheet credit exposures.

(ii) The credit risk on market related off-balance sheet items is the cost to an HFC of replacing the cash flow specified by the contract in the event of counterparty default. This would depend, among other things, upon the maturity of the contract and on the volatility of rates underlying the type of instrument.

(iii) Market related off-balance sheet items would include: **(a)** interest rate contracts, including single currency interest rate swaps, basis swaps, forward rate agreements, and interest rate futures; **(b)** foreign exchange contracts, including contracts involving gold, includes cross currency swaps (including cross currency interest rate swaps), forward foreign exchange contracts, currency futures, currency options; **(c)** credit default swaps; and **(d)** any other market related contracts specifically allowed by the NHB which give rise to credit risk.

(iv) Exemption from capital requirements is permitted for **(a)** foreign exchange (except gold) contracts which have an original maturity of 14 calendar days or less; and **(b)** instruments traded on futures and options exchanges which are subject to daily mark-to-market and margin payments.

(v) The exposures to central counter parties (CCPs), on account of derivatives trading and securities financing transactions (e.g. collateralised borrowing and lending obligations, repos) outstanding against them should be assigned zero exposure value for counterparty credit risk, as it is presumed that the CCPs' exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures.

(vi) A CCF of 100 per cent should be applied to the corporate securities posted as collaterals with CCPs and the resultant off-balance sheet exposure should be assigned risk weights appropriate to the nature of the CCPs. In the case of Clearing Corporation of India Limited (CCIL), the risk weight should be 20 per cent for other CCPs, it should be 50 per cent.

(vii) The total credit exposure to a counterparty in respect of derivative transactions should be calculated according to the current exposure method as explained below.

(D) Current Exposure Method The credit equivalent amount of a market related off-balance sheet transaction calculated using the current exposure method is the sum of **(i)** current credit exposure and **(ii)** potential future credit exposure of the contract. **Current credit exposure** is defined as the sum of the gross positive mark-to-market value of all contracts with respect to a single counterparty (positive and negative marked-to-market values of various contracts with the same counterparty should not be netted). The current exposure method requires periodical calculation of the current credit exposure by marking these contracts to market. **Potential future credit exposure** is determined by multiplying the notional principal amount of each of these contracts, irrespective of whether the contract has a zero, positive or negative mark-to-market value by the relevant add-on factor indicated below according to the nature and residual maturity of the instrument.

Credit conversion factors for interest rate related, exchange rate related and gold related derivatives

	Credit conversion factors (%)	
	Interest rate contracts	*Exchange rate contracts and gold*
One year or less	0.50	2.00
Over one year to five years	1.00	10.00
Over five years	3.00	15.00

(a) For contracts with multiple exchange of principal, the add-on factors are to be multiplied by the number of remaining payments in the contracts.

(b) For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. However, in the case of interest rate contracts which have residual maturities of more than one year and meet the above criteria, the CCF or add-on factor is subject to a floor of 1 per cent.

(c) No potential future credit exposure would be calculated for single currency floating/floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

(d) Potential future exposures should be based on '**effective**' rather than '**apparent notional amounts**'. In the event that the 'stated notional amount' is leveraged or enhanced by the structure of the transaction, the 'effective notional amount' must be used for determining potential future exposure. For example, a stated notional amount of USD 1 million with payments based on an internal rate of two times the lending rate of the HFC would have an effective notional amount of USD 2 million.

(E) Credit Conversion Factors for Credit Default Swaps (CDS) A CDS creates a notional short position for specific risk in the reference asset/obligation for the protection of buyer. This position should attract a credit conversion factor of 100 and a risk weight of 100. The add-on factor may be as 10 per cent (of notional principal of CDS) in relation to potential future exposure.

Restrictions on Investment in Real Estate and Engagement of Brokers

Investment in Land and Buildings Any HFC cannot invest in land/buildings, except for own use, more than 20 per cent of its capital fund (i.e. aggregate of Tier-I capital and Tier-II capital) on the condition that such investment in excess of 10 per cent of its owned fund should be made only in residential units.

Exposure to Capital Market ***Limit on Exposure*** The aggregate fund/non-fund based exposure of a HFC to the capital market should not exceed 40 per cent of its ***net worth*** (i.e. paid-up capital plus free reserves including share premium but excluding revaluation reserves plus investment fluctuation reserve and credit balance in profit and loss account less debit balance in profit and loss account, accumulated losses and intangible assets. Within the overall ceiling, direct investment in shares, convertible bonds/debentures, equity-oriented mutual fund units and all exposures to VCFs should not exceed 20 per cent.

Components of Capital Market Exposure The **capital market exposure** means all fund/non-fund direct/indirect exposure including: **(i)** direct investment in shares, convertible bonds/debentures, and units of equity-oriented mutual funds, **(ii)** advance against shares/bonds/debentures/other securities or clean basis to individuals for investment in instruments in **(i)**, **(iii)**, advances for any other purpose against instrument in **(i)** as primary security, **(iv)** advances for any other purpose to the extent secured by the collateral security of instruments in **(i)**, **(v)** secured/unsecured advances to brokers/guarantees issued on their behalf and market makers, **(vi)** loans sanctioned to corporates against the instruments in **(i)** or on clean basis for meeting promoters contribution, **(vii)** bridge loans to companies against equity flows/issues, **(viii)** underwriting commitments by HFCs, **(ix)** financing to brokers for margin trading and **(x)** all exposures to VCFs.

> **Exposure to capital market**
> means acquisition of shares, convertible debentures of corporates and units of equity-oriented mutual funds.

However, the following intems would be excluded from the aggregate (**40 per cent**) and direct investment (**20 per cent**) exposure: **(i)** Investments in own subsidiaries/joint ventures and those in unlisted shares and convertible bonds/debentures issued by infrastructure financial institutions/ other all-India financial institutions, **(ii)** Tier-I and Tier-II debt instruments issued by other HFCs,

(iii) Certificate of deposits of other HFCs, **(iv)** Preference shares, **(v)** Non-convertible bonds/debentures, **(vi)** Units of debt mutual funds and **(viii)** Shares acquired under a corporate debt restructuring (CDR) mechanism.

Computation of Exposure For computing the capital market exposure, loans/advances sanctioned and guarantees issued for capital market operation would be reckoned with reference to the higher of the sanctioned limit or outstanding.

Engagement of Brokers For engagement of brokers to deal with investment transactions, the HFCs should ensure that transactions should not be put through the broker's accounts. The brokerage on the deal should be clearly indicated on the notes/memorandum put up to the top management seeking approval for putting through the transaction and a separate account of brokerage paid broker-wise should be maintained. The role of the broker should be restricted to bringing the two parties to the deal together. On conclusion of the deal, the broker should disclose the counterparty and his contract note should be directly between the parties and the broker should have no role to play in the process. With the approval of their top management, HFCs should prepare a panel of approved brokers which should be reviewed periodically. Clear-cut criteria including creditworthiness, market reputation and so on should be laid down for their empanelment. Broker-wise details of deals and brokerage paid should be maintained. The HFCs should fix aggregate contract limits for each of the approved brokers. The aggregate upper contract limit for each broker should be five per cent of total transactions (purchases and sales). Specific reasons to exceed the limit should be recorded in writing and the Board should be informed *post facto*. The norm of five per cent would, however, not be applicable if the total annual transactions does not exceed ₹20 crore or dealings take place through primary dealers.

The auditors who audit the treasury operations should scrutinise the business through the brokers and include it in their monthly reports to the CEO of the HFC. The half-yearly review to the Board of Directors should cover the business put through individual broker(s) in excess of the limit. The HFCs should undertake securities transactions through stock brokers only on NSE/BSE/OTCEI.

Concentration of Credit/Investments The HFCs should not lend/invest more than 15 per cent of their owned funds to any single party/in shares of another company and more than 25 per cent to a single group of parties/in shares of a single group of companies. They should not lend and invest (loans/investments taken together) more than 25 per cent of owned fund to a single party and more than 40 per cent to a single group of parties. Within the overall ceiling, investment in the shares of another HFC (other than subsidiaries) should not exceed 15 per cent of the equity capital of the investee company.

Notes: **(a)** For determining these limits, off-balance sheet exposures should be converted into credit risks by applying the relevant conversion factors.

(b) The investments in debentures should be treated as credit and not as investment.

(c) The above ceiling on credit investments are applicable to the own group of the HFC as well as to the other group of borrowers/investee companies.

Partner in Partnership Firms No HFC should contribute to the capital of a firm (including limited liability partnerships) or become its partner. The prohibition will also apply with respect to association of persons, being similar to a firm.

Miscellaneous Matters

Opening of Branches Every HFC should inform the NHB in writing of its intention to open a branch/office. Opening of branches outside India is prohibited. Prior approval in writing of the NHB would be necessary to open a representative office outside India only for liasion work and undertaking market study and research. It cannot undertake any activity involving outlay of funds and no line of credit should be extended to it.

Loans Against Own Shares Prohibited No HFC should lend against its own shares.

Loans for Purchase of Gold The HFCs are prohibited from granting loan/advance **(a)** against bullion/primary gold/gold coins and **(b)** for purchase of gold in any form including primary gold/gold bullion/jewellery/coins, units of exchange traded funds (ETF) and gold mutual fund.

HFCs Failing to Repay Public Deposit Prohibited from Making Loans and Investments A HFC that has failed to repay any public deposit or part thereof, in accordance with the terms and conditions of such deposit, should not grant any loan or other credit facility by whatever name called or make any investment or create any other asset as long as the default exists.

Constitution of Audit Committee A HFC having assets of ₹50 crore and above, as per its last audited balance sheet, should constitute an Audit Committee consisting of not less than three non-executive Directors of the Board.

Accounting Year Every HFC should prepare its balance sheet and profit and loss account as on March 31 every year, with effect from the accounting year ending March 31, 2002.

Copies of Balance Sheet and Account Together with the Directors' Report to be Furnished to the NHB Every HFC should deliver to the NHB an audited balance sheet as on the last date of each financial year and an audited profit and loss account in respect of that year, as passed by it in the General Meeting, together with a copy of the report of the Board of Directors, laid before it in such meeting, in terms of Section 217**(1)** of the *Companies Act*, within 15 days of such meeting, as also a copy of the report and the notes on accounts furnished by its auditors.

Auditor's Certificate A HFC holding/accepting public deposits should furnish to the NHB, along with the copy of the audited balance sheet, a copy of the auditor's report to the Board of Directors and a certificate from its auditors to the effect that the full amount of liabilities to the depositors of the company, including interest payable thereon, are properly reflected in the balance sheet and that the company is in a position to meet the amount of such liabilities to the depositors.

Returns to be Submitted to the NHB Every HFC should submit to the NHB an annual return furnishing the information, specified in Schedule I of these Directions, with reference to its position as on March 31 every year, a half-yearly return furnishing the information, specified in Schedule II of these Directions, with reference to its position as on 30th September and 31st March every year and a quarterly return furnishing the information, specified in Schedule III, with reference to its position as at the end of every calendar quarter.

It should, within one month from the commencement of business, deliver to the NHB, a written statement containing a list of:

- **(a)** The names and official designation of its principal offices;
- **(b)** The complete postal address, telephone number(s) and fax number(s) of the registered/ corporate office;

(c) The names and office addresses of the auditors of the company;
(d) The names and the residential addresses of the directors of the HFC and
(e) The specimen signatures of the officers authorised to sign the returns on behalf of the HFC, as specified above.

Any change in the list referred to above should be intimated to the NHB within one month from the occurrence of such change.

Exemptions The NHB may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any HFC or class of HFCs, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as it may impose.

Interpretations For the purpose of giving effect to the provisions of these Directions, the NHB may, if it considers necessary, issue necessary clarifications in respect of any other matter covered herein and the interpretation of any provision of these Directions given by it should be final and binding on all the concerned parties.

AUDITOR'S REPORT DIRECTIONS, 2016

In addition to the report under Section 143 of the Companies Act on accounts of a HFC, the auditor should also make a separate report to its Board of Directors on the matters specified below. The auditor's report should include a statement on the following matters:

In Case of all HFCs

Whether the company **(i)** has obtained a Certificate of Registration (CoR) from the NHB, **(ii)** is meeting the required NOF requirement prescribed under Section 29-A of the NHB Act, including paid-up compulsorily convertible preference shares.

In Case of HFCs Accepting/Holding Public Deposits

Apart from the above matters, the auditor should include a statement on whether the **(i)** HFC has complied with Section 29-C of the NHB Act, **(ii)** public deposits accepted by it **(1)** together with other borrowings **(a)** from public by issue of unsecured non-convertible debentures/bonds, **(b)** from its shareholders (if it is a public limited company), and **(c)** which are not excluded from the definition of '**public deposit**' in the HFC (NHB) Directions are with the admissible limits, **(2)** in excess of the permissible quantum are regularlised in the prescribed manner, **(iii)** HFC is accepting/holding **public deposits** without minimum investment grade credit rating, **(ii)** the credit rating assigned for each of the fixed deposits schemes is in force, and **(iii)** aggregate outstanding deposits as at any point during the year have exceeded specified limit, **(iv)** HFC has defaulted in paying to its depositors the due interest and/or principal amount of the deposit; **(v)** total borrowings of the HFC are within the prescribed limits, **(vi)** HFC has complied with the specified prudential norms on income recognition, accounting standards, asset classification, loan-to-value ratio, provisioning requirements, disclosure in balance sheet, investment in real estate, exposure to capital market and engagement of brokers, and concentration of credit/ investments, **(vii)** capital adequacy ratio has been correctly determined and is in compliance with the prescribed minimum CRAR, **(viii)** has furnished to the NHB within the stipulated period the specified returns, **(ix)** has complied with the prescribed liquid assets requirement, **(x)** has furnished to the NHB within the stipulated period the return on statutory liquid assets, **(xi)** has complied with the specified requirements in the case of opening of new branches/offices or in the case of closure of existing branches/offices, **(xii)** has complied with the provision relating to prohibition of loans against own shares/for purchase of gold, **(xii)** violated any provisions contained under restriction on acceptance of public deposits, period of public deposits, joint public deposits, particulars to be specified in application form soliciting public deposits, ceiling on the rate of interest and brokerage and interest on overdue public deposits, renewal of public deposits before maturity.

In Case of HFCs Not Accepting/Holding Public Deposits

Apart from the above matters pertaining to all the HFCs, the auditor should include a statement on whether the **(i)** HFC has complied with Section 29-C of the NHB Act, **(ii)** Board of Directors of the HFC has passed a resolution for non-acceptance of any public deposits, **(iii)** HFC has accepted any public deposits during the relevant period/year, **(iv)** total borrowings of the HFC are within the prescribed limits, **(v)** HFC has complied with the specified prudential norms on income recognition, accounting standards, asset classification, loan-to-value ratio, provisioning requirements, disclosure in balance sheet, investment in real estate, exposure to capital market and engagement of brokers, and concentration of credit/investments, **(vi)** capital adequacy ratio submitted to the NHB has been correctly determined and is in compliance with the prescribed minimum CRAR, **(vii)** HFC has furnished to the NHB within the stipulated period the half-yearly return, **(viii)** HFC **(a)** has furnished to the NHB within the stipulated period the specified return on statutory liquid assets, **(b)** has complied with the prescribed requirements in the case of opening of new or closure of existing branches/offices, **(c)** complied with the provisions relating to prohibition of loan against own shares/for purchase of gold.

Reasons to Be Stated for Unfavourable/Qualified Statements

Where the statement regarding any of the above items is unfavourable/qualified, the auditor's report should also state the reasons. Where the auditor is unable to express any opinion, his report should indicate such fact together with the reasons.

Obligations of Auditor to Report to the NHB

Where the statement regarding any of the items is unfavourable/qualified, or in the opinion of the auditor, the HFC has not complied with: **(a)** the provisions of the NHB pertaining to miscellaneous matters, **(b)** HFCs (NHB) Directions; or **(c)** HFCs Issuance of Non-Convertible Debentures on Private Basis (NHB) Directions, it would be the obligation of the auditor to make a report containing the details of such unfavourable/qualified statements and/or about the non-compliance. The duty of the auditor would be to report only the contraventions of the provisions of NHB Act/directions/guidelines/instructions and the report should not contain any statement with respect to their compliance.

HFCs CORPORATE GOVERNANCE (NHB) DIRECTIONS, 2016

These directions are applicable to every non-public deposit accepting HFC with minimum assets size of ₹ 50 crore and all public deposit accepting/holding HFCs (i.e. **applicable HFCs**). The main elements of the directions are: **(i)** constitution of committees of the Board of Directors, **(ii)** fit/proper criteria, **(iii)** discloures/transparency, **(iv)** rotation of auditors, and **(v)** internal guidelines.

Constitution of Committees

The Board of Directors of the HFCs should constitute the following committees:

Audit Committee The audit committee should consist of at least three members of its Board of Directors. It must ensure that an information system audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the HFCs.

Nomination Committee The formation of a nomination committee should ensure '**fit and proper**' status of the proposed/existing directors.

Risk Management Committee To manage the integrated risk, all applicable HFCs should form a risk management committee, besides the asset liability management committee.

Fit and Proper Criteria

All applicable HFCs should:

(i) Ensure that a policy is put in place with the approval of its Board of Directors for ascertaining the fit and proper criteria of the directors at the time of appointment, and on a continuing basis. It should be on the lines of the prescribed guidelines discussed below: The importance of due diligence of directors to ascertain their suitability for the post by way of qualifications, technical expertise, track record, integrity, etc. needs no emphasis for any financial institution. The same guidelines *mutatis mutandis,* should be followed in case of HFCs also. While the NHB carries out due diligence on them before issuing CoR, the HFCs should put in place an internal supervisory process on a continuing basis. In order to streamline and bring in uniformity in the process of due diligence, the HFCs should ensure that the procedures mentioned below are followed and minimum criteria fulfilled by them before they are appointed on the Boards. The HFCs should undertake a process of due diligence to determine the suitability of the person for continuing to hold appointment as a Director on the Board, based on qualification, expertise, track record, integrity and other 'fit and proper' criteria. They should obtain necessary information and declaration from the proposed/existing directors for the purpose in the prescribed format. The process of due diligence should be undertaken by the HFCs at the time of these appointment/renewal. The Boards of the HFCs should constitute nomination committees to scrutinise the declarations. Based on the information provided in the signed declaration, the nomination committees should decide on the acceptance or otherwise of the directors. The HFCs should obtain annually as on March 31 a simple declaration from them that the information already provided has not undergone change and where there is any change, requisite details are furnished by them forthwith. Their Board of Directors must ensure in public interest that the nominated/elected Directors execute in the prescribed format the deeds of covenants.

(ii) Obtain a declaration and undertaking from the directors giving the specified additional information on the directors.

(iii) Obtain, in the specified format, a deed of covenant signed by them.

(iv) Furnish to the NHB a quarterly statement on change of directors, and a certificate from the managing director that the fit and proper criteria in selection of the directors has been followed within 15 days of the close of the respective quarter. The statement for the quarter ending March 31 should be certified by the auditors. If deemed fit and in public interest, the NHB may examine the fit and proper criteria of directors of any HFC irrespective of their asset size.

Disclosure and Transparency

All applicable HFCs should put up to the Board of Directors, at prescribed regular intervals, the following: **(i)** progress made in putting in place a progressive risk management system/policy and strategy followed; **(ii)** conformity with corporate governance standards, that is, in the composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions and so on. They should also disclose the following in their annual financial statements: **(i)** registration/licence/authorisation obtained from other financial sector regulators; **(ii)** ratings assigned by credit rating agencies and migration of ratings during the year; **(iii)** penalties levied by any regulator; **(iv)** information namely, area, country of operation and joint venture partners with regard to joint ventures and overseas subsidiaries and **(v)** asset-liability profile, NPAs and movement of NPAs, details of all off-balance sheet exposures, exposure to real estate/capital market, disclosure of complaints as also securitisation/assignment transactions and other specified disclosures.

Rotation of Partners of the Statutory Auditors/Audit Firm

All applicable HFCs should rotate the partner(s) of the chartered accountant firm conducting audit so that the same partner does not conduct audit continuously for more than three years. However, he will be eligible after an interval of three years. They should incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

Framing of Internal Guidelines

All applicable HFCs should frame their internal guidelines on corporate governance with the approval of their Board of Directors, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and publish it on their webs-site for the information of the various stakeholders.

GUIDELINES FOR EXTENDING EQUITY SUPPORT TO HFCs

The NHB has issued guidelines to HFCs for their growth on sound lines and to be healthy, viable and cost effective. These are available on the website. The website address is **http://www.mhhe.com/khanfs9e**.

GUIDELINES FOR EXTENDING REFINANCE SUPPORT TO HOUSING FINANCE COMPANIES

The NHB has issued Guidelines to Housing Finance Companies (HFCs) that are housing finance institutions within the meaning of Section 2**(d)** of the National Housing Act, 1987 for their growth on sound lines and to be healthy, viable and cost effective. They are applicable to such of those HFCs that desire to avail of refinance facilities from the NHB. These are available on the website. The address is **http://www.mhhe.com/khanfs9e**.

REFINANCE SCHEME FOR HFCs

The main provisions of the NHB's refinance scheme are available on the website. The address is **http://www.mhhe.com/khanfs9e**.

GUIDELINES FOR ASSET LIABILITY MANAGEMENT (ALM) SYSTEM IN HOUSING FINANCE COMPANIES

In the normal course, Housing Finance Companies (HFCs) are exposed to credit and market risks in view of the asset-liability transformation. With liberalisation in Indian financial markets over the last few years and growing integration of the domestic markets with external markets, the risks associated with the operations of an HFC have become complex and large, requiring strategic management. The HFCs are operating in a fairly deregulated environment and are required to determine on their own, interest rates on advances and deposits, subject to the ceiling on maximum rate of interest they can offer on deposits, on a dynamic basis. The interest rates on investment of HFCs in Government and other securities are also now market related. Intense competition for business involving both the assets and liabilities has brought pressure on the managements of HFCs to maintain a good balance amongst spreads, profitability and long-term viability. These pressures call for structured and comprehensive measures and not just *ad hoc* action. The managements of HFCs have to base their business decision on a dynamic and integrated risk management system and process driven by corporate strategy. The HFCs are exposed to several major risks in the course of their business-credit risks, interest rate risk, equity/commodity price risk, liquidity risk and operational risk. It is, therefore, important that HFCs introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.

The HFCs need to address these risks in a structured manner by upgrading their risk management and adopting more comprehensive Asset-Liability Management (ALM) practices than has been done hitherto. The **ALM,** among other functions, is also concerned with management of risks and provides a comprehensive and dynamic framework for measuring monitoring and managing liquidity and interest rate risks of an HFC that need to be closely integrated with the HFC's business strategy. It involves assessment of various types of risk and altering of the asset-liability portfolio in a dynamic way in order to manage risks.

> **ALM** involves assessment of various types of risks and altering the asset-liability portfolio in a dynamic way in order to manage risks.

This note lays down broad guidelines for HFCs in respect of systems for management of liquidity and interest rate risk which forms part of the ALM function. The initial focus of the ALM function would be to enforce the discipline of market risk management, namely, managing business after assessing the market risks involved. The objective of a good risk management system should be to evolve into a strategic tool for effective management of HFCs. **The ALM process rests on three pillars:**

- ALM Information System: **(i)** Management information systems and **(ii)** Information availability, accuracy, adequacy and expediency.
- ALM Organisation: **(i)** Structure and responsibilities and **(ii)** Level of top management involvement.
- ALM Process: **(i)** Risk parameters, **(ii)** Risk identification, **(iii)** Risk measurement, **(iv)** Risk management, and **(v)** Risk policies and tolerance levels.

ALM Information System

ALM has to be supported by a management philosophy that clearly specifies the risk policies and tolerance limits. This framework needs to be built on sound methodology with necessary supporting information system as the central element of the entire ALM exercise is the availability of adequate and accurate information with expedience. Thus, information is the key to the ALM process. These range from the sample Gap Statement to extremely sophisticated and data intensive Risk Adjusted Profitability Measurement methods. The systems existing in some of the major HFCs do not generate information in the manner required for ALM. Collecting accurate data in a timely manner will be the biggest challenge before the HFCs, particularly those lacking full-scale computerisation. However, the introduction of base information system for risk measurement and monitoring has to be addressed urgently.

The HFCs have heterogeneous organisational structures, capital base, asset sizes, management profile and geographical spread. Some of them have large number of branches and agents/brokers whereas some have unitary offices. Considering the present network of branches and the lack of (an adequate) support system to collect information required for ALM which analyses information on the basis of residual maturity and re-pricing pattern of liabilities and assets, it will take time for HFCs in the present state to get the requisite information. In respect of investment portfolio and funds management, in view of the centralised nature of the functions, it would be much easier to collect reliable information. The data and assumptions can then be refined over time as the HFC management gain experience of conducting business within ALM framework. The spread of computerisation will also help HFCs in accessing data.

ALM Organisation

Successful implementation of the risk management process would require strong commitment on the part of the senior management in the HFC to integrate basic operations and strategic decision making with risk management. The Board of Directors should have overall responsibility for management of risks and should decide the risk management policy of the HFC and set limits for liquidity, interest rate, exchange rate and equity price risks.

The Asset-Liability Committee (ALCO) consisting of the HFC's senior management including the Chief Executive Officer (CEO) should be responsible for ensuring adherence to the limits set by the Board of Directors as well as for deciding the business strategy for the HFC (on the assets and liabilities sides) in line with the HFCs budget and decided risk management objectives.

The ALM Support Groups consisting of operating staff should be responsible for analysing, monitoring and reporting the risk profiles to the ALCO. The staff should also prepare forecasts (simulations) reflecting the impact of various possible changes in market conditions on the balance sheet and recommend the action needed to adhere to HFCs internal limits.

The ALCO is a decision-making unit responsible for integrated balance sheet management from risk-return perspective including the strategic management of interest rate and liquidity risks. Each HFC will have to decide on the role of its ALCO, its powers and responsibilities as also the decisions to be taken by it. The business and the risk management strategy of the HFC should ensure that it operates within the limits/ parameters set by the Board of Directors. The business issues that an ALCO would consider will, *inter alia*, include product pricing for both deposits and advances, desired maturity profile, and mix of the incremental assets and liabilities, prevailing interest rates offered by other peer HFCs for similar services/product, etc. In addition to monitoring the risks levels of the HFC, the ALCO should review the results of and progress in implementation of the decision made in the previous meetings. The ALCO would also articulate the current rate view of the HFC and base its decisions for future business strategy on this. In respect of the funding policy, for instance, its responsibility would be to decide on the source and mix of liabilities or sale of assets. Towards this end, it will have to develop a view on future direction of interest rate movements and decide on funding mixes between fixed *vs.* floating rate funds, wholesale *vs.* retail funds, money market *vs.* capital market funding, domestic *vs.* foreign currency funding etc. Individual HFCs will have to decide the frequency of holding their ALCO meeting.

Composition of ALCO The size (number of members) of ALCO would depend on the size of each institution, business mix and organisational complexity. To ensure commitment of the top management and timely response to market dynamics, the CEO/CMD/President or the ED should head the Committee. The Chief of Investment, Credit, Resources Management or Planning, Funds Management/Treasury, International Business and Economic Research can be members of the Committee. In addition, the Head of the Technology Division should also be an invitee for building up of MIS and related computerisation. Large HFCs may even have sub-committees and support groups.

Committee of Directors The Management Committee of the Board of Directors or any other specific committee constituted by the Board should oversee the implementation of the ALM system and review its functioning periodically.

ALM Process

The scope of ALM function can be described as under:

- Liquidity risk management
- Management of market risks
- Funding and capital planning
- Profit planning and growth projection
- Forecasting and analysing what it scenario and preparation of contingency plans.

The guidelines contained in this note mainly address liquidity and interest rate risks.

Liquidity Risk Management Measuring and managing liquidity needs are vital for effective operation of HFCs. By assuring an HFC's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The importance of liquidity transcends individual institutions, as liquidity shortfall in one institution can have repercussions on the entire system. The HFC's

Liquidity has to be tracked through maturity or cash flow mismatches.

management should measure not only the liquidity positions of HFCs on an on going basis but also examine how liquidity requirements are likely to evolve under different assumptions. Experience shows that asset commonly considered to be liquid, such as government securities and other money market instruments, could also become illiquid when the market and players are unidirectional. Therefore, **liquidity** has to be tracked through maturity or cash flow mismatches. For measuring and managing net funding requirements, the use of a maturity ladder and calculation of a cumulative surplus or deficit of funds at selected maturity dates is adopted as a standard tool. **The format of the Statement of Liquidity is on the pattern of NBFCs discussed in Chapter 1 of the book**.

The maturity profile could be used for measuring the future cash flows of HFCs in different time buckets. The time buckets may be distributed as under:

(i) 1 day to 30/31 days (one month)
(ii) Over one month and upto 2 months
(iii) Over 2 months and upto 3 months
(iv) Over 3 months and upto 6 months
(v) Over 6 months and upto 1 year
(vi) Over one year and upto 3 years
(vii) Over 3 years and upto 5 years
(viii) Over 5 years and upto 7 years
(ix) Over 7 years and upto 10 years
(x) Over 10 years

The HFCs holding public deposits are required to invest a prescribed percentage of their deposits in approved securities in terms of liquid asset requirement under Section 29-B of the *NHB Act*, 1987. There is no such requirement for HFCs which are not holding deposits. Thus, various HFCs would be holding in their investment portfolio securities which could be broadly classifiable as 'mandatory securities' (under obligation of law) and other 'non-mandatory securities'. The HFCs holding deposits may be given freedom to place the mandatory securities in any time buckets as suitable for them. The listed non-mandatory securities may be placed in any one of the "1 day to 30/31 days (one month)", "over one month and upto 2 months" and "over two months and upto 3 months" buckets depending upon the defeasance period proposed by HFCs. The unlisted non-mandatory securities (e.g., equity shares, securities without a fixed term of maturity, etc.) may be placed in the "over 10 years" bucket, whereas unlisted non-mandatory securities having a fixed term of maturity may be placed in the relevant time bucket as per the residual maturity. The mandatory securities and listed securities may be marked to market for the purpose of the ALM system. Unlisted securities may be valued as per the prudential norms.

Alternatively, the HFCs may also follow the concept of trading book which is as under: **(i)** The composition and volume are clearly defined; **(ii)** Maximum maturity/duration of the trading portfolio are restricted; **(iii)** The holding period does not exceed 90 days; **(iv)** Cut-loss limit(s) is prescribed; and **(v)** Product-wise defeasance periods (i.e. the time taken to liquidate the position on the basis of liquidity in the secondary market) are prescribed. The HFCs which maintain such 'trading books' consisting of securities that comply with the above standards may show the trading securities under "1 day to 30/31 days, one month", "over one month and upto 3 months" and "over 2 months and upto 3 months" buckets on the basis of the defeasance periods. The Board/ALCO of the HFCs should approve the volume, composition, maximum maturity/

duration, holding/defeasance period, cut loss limits, etc., of the 'trading book'. The remaining investments should also be classified as short term and long term investments as required under the prudential norms.

A copy of the policy note recorded by the HFCs on treatment of the investment portfolio for the purpose of ALM and approved by their Board/ALCO should be forwarded to the NHB.

Within each time bucket there could be mismatches depending on the inflows and outflows. While the mismatches upto one year would be relevant since these provide early warning signals impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-30/31 days. The HFCs, however, are expected to monitor their cumulative mismatches (running total) across all time buckets by establishing internal prudential limits with the approval of the Board/Management Committee. The mismatches (negative gap) during 1-30/31 days, in normal course, should not exceed 15 per cent of the cash out flows in this time bucket.

While determining the tolerance levels, the HFC may take into account all relevant factors based on their asset-liability base, nature of business, future strategy, etc. The NHB is interested in ensuring that the tolerance levels are determined keeping all necessary factors in view and further refined with experience gained in liquidity management.

The Statement of Structural Liquidity on the pattern of the NBFCs discussed in Chapter 1 of the book may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. While determining the likely cash inflow/outflows, HFCs have to make a number of assumptions according to their asset-liability profiles. While determining the tolerance levels, the HFCs may take into account all relevant factors based on their asset-liability base, nature of business, future strategies, etc. The NHB is interested in ensuring that the tolerance levels are determined keeping all necessary factors in view and further refined with experience gained in liquidity management.

In order to enable the HFCs to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from one day to six months, HFCs may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes.

Floating exchange rate arrangement has brought in its wake pronounced volatility adding a new dimension to the risk profile of HFC's balance sheets having foreign asset or liabilities. The increased capital flows across free economies following deregulation have contributed to increase in the volume of transactions. Larger cross border flows together with the volatility may render the HFC's balance sheets vulnerable to exchange rate movements.

Interest Rate Risk The operational flexibility given to HFCs in pricing most of the assets and liabilities imply the need for the financial system to hedge the interest rate risk. **Interest rate risk** is the risk where changes in market interest rates might adversely affect an HFC's financial condition. The immediate impact of changes in interest rates is on HFC's earning (i.e. reported profits) by changing its Net Interest Income (NII). A long-term impact of changing interest rates is on HFC's Market Value of Equity (MVE) or net worth as the economic value of the assets, liabilities and off-balance sheet positions get affected due to variation in market interest rates. The interest rate risk when viewed from these two perspectives is known as 'earnings perspective' and 'economic value perspective', respectively. The risk from the earnings perspective can be measured as changes in the Net Interest Income (NII) or NET Interest Margin (NIM). There are many analytical techniques for

> **Interest rate risk** is the risk where changes in market interest rates might adverely affect financial condition of a HFC.

measurement and management of interest rate risk. To begin with, the Traditional Gap Analysis is considered to be a suitable method to measure the interest rate risk in the initial phase of the ALM system. It is the intention of NHB to move over to the modern techniques of interest rate risk measurement like Duration Gap Analysis. Simulation and Value at Risk over time when HFCs acquire sufficient expertise and sophistication in acquiring and handling MIS.

The Gap or Mismatch risk can be measured by calculating Gaps over different time intervals as at a given date. **Gap analysis** measures mismatches between rate sensitive liabilities and rate sensitive assets including off-balance sheet positions. An asset or liability is normally classified as rate sensitive if: **(i)** Within the time interval under consideration, there is a cash flow; **(ii)** Interest rate resets/reprices contractually during the interval; **(iii)** It is contractually prepayable or withdrawable before the stated maturities; and **(iv)** It is dependent on the changes in the bank rate by RBI.

> **Gap analysis** measures mismatches between rate sensitive liabilities and rate sensitive assets.

The Gap Report should be generated by grouping rate sensitive liabilities, assets and off-balance sheet positions into time buckets according to residual maturity or re-pricing period, whichever is earlier. All investments, advances, deposits, borrowings, purchased funds, etc. that mature/re-price within a specified time-frame are interest rate sensitive. Similarly, any principal repayment of loan is also rate sensitive if the HFC expects to receive it within the time horizon. This includes final principal repayment and interim installments. Certain assets and liabilities carry floating rate of interest that vary with a reference rate and, hence, these items get re-priced at pre-determined intervals. Such assets and liabilities are rate sensitive at the time of re-pricing. While the interest rates on term deposits are generally fixed during their currency, the tranches of advances are basically floating. The interest rate on advances could be re-priced any number of occasions, corresponding to the changes in PLR.

The interest rate gaps may be identified in the following time buckets:

- **(i)** 1 day to 30/31 days (one month)
- **(ii)** Over one month and to 2 months
- **(iii)** Over 2 months and to 3 months
- **(iv)** Over 3 months and to 6 months
- **(v)** Over 6 months and to 1 year
- **(vi)** Over 1 year and to 3 years
- **(vii)** Over 3 years and to 5 years
- **(viii)** Over 5 years and to 7 years
- **(ix)** Over 7 years and to 10 years
- **(x)** Over 10 years
- **(xi)** Non-sensitive

The various items of rate sensitive assets and liabilities and off-balance sheet items may be classified into various time-buckets.

The **Gap** is the difference between Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) for each time bucket. The positive Gap indicates that it has more RSAs than RSLs whereas the negative gap indicates that it has more RSLs. The Gap reports indicate that whether the institution is in a position to benefit from rising interest rate by having a positive Gap (RSA > RSL) or whether it is in position to benefit from declining interest rates by a negative GAP (RSL > RSA). The Gap can, therefore, be used as a measure of interest rate sensitivity.

> **Gap** is the difference between rate sensitive assets and rate sensitive liabilities for each time bucket.

Each HFC should set prudential limits on individual Gaps in various time buckets with the approval of the Board/Management Committee. Such prudential limits should have a relationship with the total assets, earning assets or equity. In addition to the interest rate gap limits, the HFCs may set the prudential limits in terms of Earnings at Risk (EaR) or Net Interest Margin (NIM) based on their views on interest rate movements with the approval of the Board/ALCO.

General

The classification of various components of assets and liabilities into different time buckets for preparation of Gap reports (Liquidity and Interest Rate Sensitivity) as is the bench mark. The HFCs which are better equipped to reasonably estimate the behavioural pattern of various components of assets and liabilities on the basis of past data/empirical studies could classify them in the appropriate time buckets, subject to approval by the ALCO/Board. A copy of the note approved by the ALCO/Board may be sent to the NHB.

The present framework does not capture the impact of premature closure of deposits and pre-payment of loans and advances on the liquidity and interest rate risks profile of HFCs. The magnitude of premature withdrawal of deposits during the periods of volatility in market interest rates is quite substantial. The HFCs should, therefore, evolve suitable mechanism, supported by empirical studies and behaviorual analysis, to estimate the future behaviour of assets, liabilities and off-balance sheet items to changes in market-variables and estimate the probabilities of options.

A scientifically evolved internal transfer pricing model by assigning values on the basis of current market rates to funds provided and funds used is an important component for effective implementation of ALM system. The transfer price mechanism can enhance the management of margin, i.e., lending of credit spread/the funding or liability spread and mismatch spread. It also helps centralising interest rate risk at one place which facilitates effective control and management of interest rate risk. A well defined transfer pricing system also provides a rational framework for pricing of assets and liabilities.

FAIR TRADE PRACTICES CODE FOR HFCs

While piloting the *Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act* in Parliament, the Finance Minister, by way of moderating the possible misuse of powers under the Act by banks/financial institutions, gave an assurance to bring out a Code of Fair Practices defining lenders liability to the borrowers in respect of loans and advances extended by them. As a follow-up, the RBI had prepared in 2006 the broad guidelines to be adopted by banks/financial institutions with the approval of their Board of Directors. The NHB has issued similar guidelines for the HFCs. **These are given in Appendix 5-A on the website. The website address is http://www.mhhe.com/khanfs9e.**

> **Securitisation** is the process of pooling and repackaging of homogeneous illiquid financial assets (debt) into marketable securities that can be sold to investors.

SECURITISATION

Concept

Securitisation is the process of pooling and repackaging of homogeneous 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 equipment loans but in some cases are unsecured, for example, credit card debt and consumer loans.

Securitisation Process

The securitisation process is listed below:

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 the 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 originator 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 the cash flows available in the asset pool. The proceeds from the sale of securities are used to pay the originator.
6. The SPV agrees to pay any surpluses 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 the SPV to repay funds to the investors in the securities.

Credit Enhancement

Investors in securitised instruments take 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 attempt to buffer investors against losses on the asset collateralising their investment. These losses may vary in frequency, severity and timing, and depend on the asset characteristics, how they are originated and how they are administered. 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 larger credit enhancer, credit enhancements correct the imbalance of information between the lender(s) and the borrowers. They are either external (third party) or internal (structural or cash-flow-driven).

Credit enhancement refers to the various means that attempt to buffer investors against losses on the asset collateralising their investment.

External Credit Enhancements They include insurance, third party guarantee and letter of credit.

Insurance Full insurance is provided against losses on the assets. This tantamounts to a 100 per cent guarantee of a transaction's principal and interest payments. The issuer of the insurance looks to an initial premium or other support to cover credit losses.

Third-Party Guarantee This method involves a limited/full guarantee by a third party to cover losses that may arise on the non-performance of the collateral.

Letter of Credit For structures with credit ratings below the level sought for the issue, a third party provides a letter of credit for a nominal amount. This may provide either full or partial cover of the issuer's obligation.

Internal Credit Enhancements Such form of credit enhancement comprise the following:

Credit Tranching (Senior/Subordinate Structure) The SPV issues two (or more) tranches of securities and establishes a predetermined priority in their servicing, whereby first losses are borne by the holders of the subordinate tranches (at times the originator itself). Apart from providing comfort to holders of senior debt, credit tranching also permits targeting investors with specific risk-return preferences.

Over-collateralisation The originator sets aside assets in excess of the collateral required to be assigned to the SPV. The cash flows from these assets must first meet any overdue payments in the main pool, before they can be routed back to the originator.

Cash Collateral This works in much the same way as the over-collateralisation. But since the quality of cash is self-evidently higher and more stable than the quality of assets yet to be turned into cash, the quantum of cash required to meet the desired rating would be lower than asset over-collateral to that extent.

Spread Account The difference between the yield on the assets and the yield to the investors from the securities is called **excess spread**. In its simplest form, a spread account traps the excess spread (net of all running costs of securitisation) within the SPV up to a specified amount sufficient to satisfy a given rating or credit equity requirement. Only realisations in excess of this specified amount are routed back to the originator. This amount is returned to the originator after the payment of principal and interest to the investors.

> **Excess spread** is the difference between the yield on the assets and the yield to the investors form the securities.

Triggered Amortisation This works only in structures that permit substitution (for example, rapidly revolving assets such as credit cards). When certain preset levels of collateral performance are breached, all further collections are applied to repay the funding. Once amortisation is triggered, substitution is stopped and the early repayment becomes an irreversible process. The triggered amortisation is typically applied in future flow securitisation.

Parties to a Securitisation Transaction

The parties to securitisation deal are **(i)** primary and **(ii)** others. There are three primary parties to a securitisation deal, namely, originators, special purpose vehicle (SPV) and investors. The other parties involved are obligors, rating agency, administrator/servicer, agent and trustee, and structurer.

Originator This is the entity on whose books the assets to be securitised exist. It is the prime mover of the deal, that is, it sets up the necessary structures to execute 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 the beneficial interest in the assets to the SPV.

> **Originator** is the entity on whose books the assets to be securitised exist.

SPV An issuer, also known as the SPV, is the entity, which would typically buy the assets to be securitised from the originator. An SPV is typically a low-capitalised entity with narrowly defined purposes and activities, and usually has independent trustees/directors. As one of the main objectives of securitisation is to remove the assets from the balance sheet of the originator, the SPV plays a very important role in as much as it holds the assets in its books and makes the upfront payment for them to the originator.

> **SPV** is the entity which would buy the assets to be securitised from the originator.

Investors The investors may be in the form of individuals or institutional investors like FIs, mutual funds, provident funds, pension funds, insurance companies and so on. They buy a participating interest in the total pool of receivables and receive their payment in the form of interest and principal as per agreed pattern.

Obligor(s) The obligors are the originators-debtors (borrowers of the original loan). The amount outstanding from an obligor is the asset that is transferred to an SPV. The credit standing of an obligor(s) is of paramount importance in a securitisation transaction.

> **Obligors** are the borrowers of the original loan.

Rating Agency Since the investors take on the risk of the asset pool rather than the originator, an external credit rating plays an important role. The rating process would assess the strength of the cash flow and the mechanism designed to ensure full and timely payment by the process of selection of loans of appropriate credit quality, the extent of credit and liquidity support provided and the strength of the legal framework.

Administrator or Servicer It collects the payment due from the obligor(s) and passes it to the SPV, follows up with delinquent borrowers and pursues legal remedies available against the defaulting borrowers. Since it receives the instalments and pays it to the SPV, it is also called the Receiving and Paying Agent (RPA).

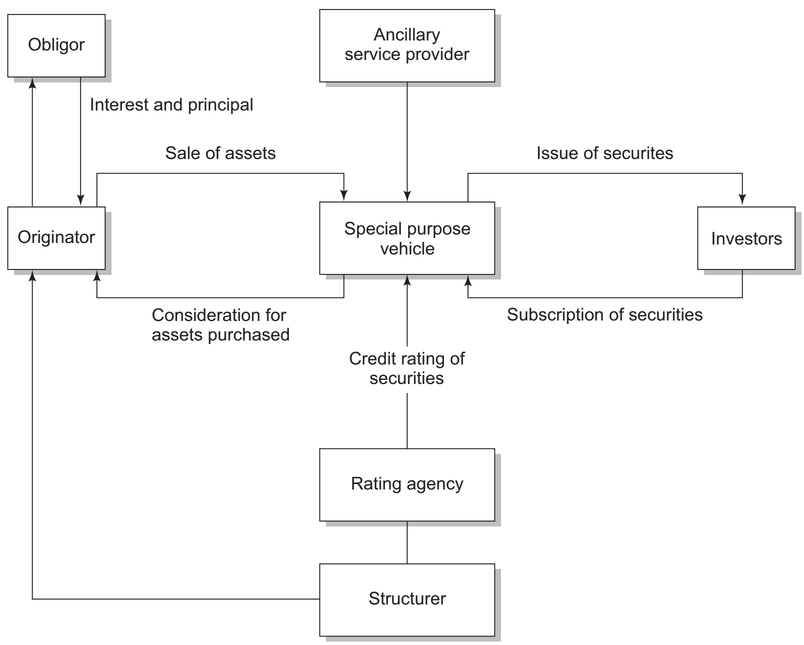
Agent and Trustee It accepts the responsibility for overseeing that all the parties to the securitisation deal perform in accordance with the securitisation trust agreement. Basically, it is appointed to look after the interest of the investors.

Structurer Normally, an investment banker is responsible as structurer for bringing together the originator, the credit enhancer(s), the investors and other partners to a securitisation deal. It also works with the originator and helps in structuring deals.

> **Structurers** bring together all the parties to a securitisation deal.

The different parties to a securitisation deal have very different roles to play. In fact, firms specialise in those areas in which they enjoy competitive advantage. The entire process is broken up into separate parts with different parties specialising in origination of loans, raising funds from the capital markets, servicing of loans and so on. It is this kind of segmentation of market roles that introduces several efficiencies securitisation is so often credited with. **The securitisation process is depicted in Fig. 5.1.**

Exhibit 5.2 Securitisation Process



Asset Characteristics

The assets to be securities should have the following characteristics.

Cash Flow A principal part of the assets should be the right to receive from the debtor(s) on certain dates, that is, the asset can be analysed as a series of cash flows.

Security If the security available to collateralise the cash flows is valuable, then this security can be realised by a SPV.

Distributed Risk Assets either have to have a distributed risk characteristic or be backed by suitably-rated credit support.

Homogeneity Assets have to relatively homogenous, that is, there should not be wide variations in documentation, product type or origination methodology.

No Executory Clauses The contracts to be securitised must work even if the originator goes bankrupt.

Independence from the Originator The ongoing performance of the assets must be independent of the existence of the originator.

Instruments of Securitisation

Securitisation can be implemented by three kinds of instruments differing mainly in their maturity characteristics. They are: **(i)** Pass through certificates, **(ii)** Pay through securities, **(iii)** Stripped securities.

Pass Through Certificates (PTCs) The cash flows 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. In other words, the cash flows are distributed on a pro-rata basis to the holders of the securities. The pre-payments occur when the holder of the underlying asset prepays the remaining principal before the final scheduled payment month. Any pre-payment is also proportionately passed on to the security holders leading to the quicker retirement of their underlying principal. Critical to pricing of pass through are the specific features of that particular collateral. All the securities are terminated simultaneously as the last payment on the pool leads to its complete amortisation. Some of the main features of PTCs are:

> **PTCs**
> involve distribution on pro-rata basis of cash flows to the holders of securities.

- They reflect ownership rights in the assets backing the securities.
- Pre-payment precisely reflects the payment on the underlying mortgage. If it is a home loan with monthly payments, the payments on securities would also be monthly but at a slightly less coupon rate than the loan.
- As underlying mortgage is self-amortising. Thus, by whatever amount it is amortised, it is passed on to the security holders with repayment.
- Pre-payment occurs when a debtor makes a payment, which exceeds the minimum scheduled amount. It shortens the life of the instrument and skews the cash flows towards the earlier years.

Pay Through Security (PTS) The PTS structure overcomes the single maturity limitations of the pass through certificates. Its structure permits the issuer to restructure receivables flow to offer a range of investment maturities to the investors associated with different yields and risks. The issuer of assets-backed debt are thus freed from the limitations imposed by the pass through structure which simply provides a conduit for sale of ownership interest in the receivables. By contrast, in a PTS structure, the issuer typically owns the receivables and simply sells the debt that is backed by the assets. As a result, the issuer of debt is free to restructure the cash flow from the receivable into payments on several debt tranches with varying maturities.

> **PTS**
> permits the issuer to restructure receivables flow to offer a range of investment maturities to the investors associated with different yields and risks.

A key difference between PTC and PTS is the mechanics of principal repayment process. In PTC, each investor receives a *pro-rata* distribution of any principal and interest payment made by the borrower. Because these assets are self-amortising assets, a pass through, however, does not occur until the final asset in the pool is retired. This results in large difference between average life and final maturity as well as a great deal of uncertainty with regard to the timing of the return of the principal. The PTS structure, on the other hand, substitutes a sequential retirement of bonds for the pro-rata principal return process found in pass through. Cash flows generated by the underlying collateral is used to retire bonds. Only one class of bonds at a time receives principal. All principal payments go first to the fastest pay trance in the sequence then becomes the exclusive recipients of principal. This sequence continues till the last tranches of bonds is retired.

Stripped Securities Under this instrument, securities are classifies as "Interest only" (IO) or Principally only (PO) securities. The IO holders are paid back out of the interest income only while the PO holders are paid out of principal repayments only. However, these securities are highly volatile by nature and are least preferred by the investors. Normally, PO securities increase in value when interest rates go down because it becomes lucrative to prepay existing mortgagor and undertake fresh loans at lower interest rates. As a result of prepayment of mortgages, the maturity period of these securities goes down and investors are returned the money earlier than they anticipated. In contrast, IOs increase in value when interest rates go up because more interest is collected on underlying mortgages. However, in anticipation of a decline in the interest rates, prepayments of mortgages declines and maturities lengthen. These are normally traded by speculators who make money by speculating about interest rate changes.

Types of Securities

The securities fall into two groups:

Asset Backed Securities (ABS) The investors rely on the performance of the assets that collateralise the securities. They do not take an exposure either on the previous owner of the assets (the originator), or the entity issuing the securities (the SPV). Clearly, classifying securities as 'asset-backed' seeks to differentiate them from regular securities, which are the liabilities of the entity issuing them. An example of ABS is credit card receivables. Securitisation of credit card receivables is an innovation that has found wide acceptance. Although the average tenure of credit available to a credit card holder is generally very short, it is revolving by nature. The lacuna of short tenor of the receivables is, hence, overcome by 'substitution', whereby collections are used for fresh purchases of receivables. Thus, a securitisable asset of marketable tenure comes into being. The structure in the case is generally 'Pay Through', since it is impossible to match the payment made by the card-holder with the payment to the investor.

> **ABS**
> are securities in which investors rely on the performance of the assets that collateralise the securities.

> **MBS**
> are securities backed by the mortgage loans.

Mortgage Backed Securities (MBS) The securities are backed by the mortgage loans, that is, loans secured by specified real estate property, wherein the lender has the right to sell the property, if the borrower defaults.

MORTGAGE-BASED SECURITISATION

Securitisation is a process of converting loans/future receivables into tradebale securities/assignable debt. This process involves packaging designated pools of loans and receivables and selling these packages to various investors in the form of securities which are collatarised by the underlying assets and their associated income streams. **Securitisation of mortgages** is the packaging of designated pool of mortgage loans originated by a primary

> **Securitisation of mortgages**
> is the packaging of designated pool of mortgage loans originated by a primary lending institution/housing finance company (HFC) and the subsequent sale of these packages to the investors in the form of securities which are collateralised by the underlying mortgages and associated income streams.

lending institution/housing finance company (HFC) and the subsequent sale of these packages to the investors in the form of securities which are collateralised by the underlying mortgages and associated income streams.

A typical process of securitisation involves sale of specific loans to a trust/special purpose vehicle (SPV) which in turn issues securities (e.g. promissory notes, participation certificates or other debt instruments) to the investors. The securities are rated by an independent rating agency. On the recommendation of the rating agency, additional credit support other than the obligation of the borrowers is provided in order that the instrument may receive the desired level of rating. Typically, the seller of the loans continues to service them. The excess cash flows (remaining after deducting the interest and principal and other obligations payable to the investors and other fees) accrue to the seller. The features of securitisation transactions include:

- Legal true sale of assets to a SPV with narrowly defined purposes/activities;
- Issuance of securities collateralised by the underlying assets by the SPV to the investors;
- Reliance by the investors on the performance of the assets for repayment rather than the credit of the originator (i.e. seller) or the issuer (i.e. SPV);
- Consequent to the above, 'bankruptcy remoteness" from the originator.
- Administration of the asset by the originator including continuation of relationship with the obligors (i.e. the borrowers of the original loans);
- Support for timely interest payments and principal repayments, *inter alia*, in the form of suitable credit enhancement.

Support to MBS has been a major policy initiative of the Government as manifested in the National Housing and Habitat Policy, 1998. It has enjoined upon the NHB to play a lead role in starting MBS and development of a secondary mortgage market in the country. In accordance with this role, it has been the NHB's endeavour to set up a conducive policy environment and operational mechanism for MBS. It placed the first ever MBS issue successfully in Indian capital market during August 2000. The first two pilot issues of MBS comprised 11,106 individual housing loans involving ₹135 crore, originated by two HFCs, namely, HDFC Ltd and LIC Housing Finance Ltd (LICHFL) in two separate tranches. Following the success of the first pilot issue, the NHB placed its next two pilot issues of MBS during May 2001, comprising 8,549 individual housing loans involving ₹138 crores originated by LICHFL and Canfin Homes Ltd (CFHL) in two separate tranches. The fifth issue of pilot MBS comprised of 4,526 individual loans amounting to ₹85 crore originated by CFHL. The MBS is illustrated in this Section with reference to the sixth issue of pilot MBS originated by the BOB Housing Finance Ltd (BOBHFL) in April 2003. They are available on the website. The website address is **http://www.mhhe.com/khanfs9e**.

REVERSE MORTGAGE LOAN (RML): OPERATIONAL GUIDELINES

The NHB guidelines are available on the website. The website address is **http://www.mhhe.com/khanfs9e**.

REVERSE MORTGAGE LOAN-ENABLED ANNUITY (RMLE-A)

The NHB guidelines are available on the website. The website address is **http://www.mhhe.com/khanfs9e**.

HOUSING FINANCE AGENCIES

The implementation of housing finance policies presupposes efficient institutional arrangements. Although there were a large number of agencies providing direct finance to individuals for house construction, there was no well established finance system till the mid-eighties in as much as it had not been integrated with the main financial system of the country. The setting-up of the National Housing Bank (NHB), a fully owned subsidiary of the Reserve Bank of India, as an apex institution was the culmination of the fulfillment of a long overdue need of the housing finance industry in India. The system has also been characterised by the emergence of several specialised financial institutions that have considerably strengthened the organisation of the housing finance system in the country. At present, there are about 320 housing finance companies, of which 26 are registered with the NHB and which account for 98 per cent of the total housing loan disbursed. A brief account of some of the institutions/agencies is given below.

Central and State Governments

Till the mid-eighties, the responsibility to provide housing finance rested, by and large, with the government. The Central and state governments indirectly support the housing building effort. The Central Government has introduced, from time to time, various social housing schemes. The role of the Central Government *vis-à-vis* these schemes is confined to laying down broad principles, providing necessary advice and rendering financial assistance in the form of loans and subsidies to the state governments and union territories. The Central Government has set up the Housing and Urban Development Corporation (HUDCO) to finance and undertake housing and urban development programmes, development of land for satellite towns, besides setting up of a building materials industry.

The Central Government provides equity support to the HUDCO and guarantees the bonds issued by it. Apart from this, both Central and state governments provide house building advances to their employees. While the Central Government formulates housing schemes, the state governments are the actual implementing agencies.

Housing and Urban Development Corporation (HUDCO)

Objectives HUDCO was established on 25th April 1970, as a fully owned Government of India enterprise, with the following objectives.

- **(i)** To provide long-term finance for construction of houses for residential purposes or finance or undertake housing and urban development programmes in the country.
- **(ii)** To finance or undertake the setting-up of new satellite towns.
- **(iii)** To finance or undertake the setting-up of the building materials industries.
- **(iv)** To administer the monies received, from the Government of India and other such grants, for purposes of financing or undertaking housing and urban development programmes.
- **(v)** To subscribe to the debentures and bonds to be issued by the state housing boards, improvement trusts, development authorities and so on, specifically for the purpose of financing housing and urban development programmes.

In brief, the principal mandate of the HUDCO was to ameliorate the housing conditions of the low income group (LIG) and economically weaker sections (EWS).

Resource Base The HUDCO was established with an equity base of ₹2 crore. Over the years, the equity base has been expanded by the Government. It has further been able to mobilise resources from institutional agencies like LIC, GIC, UTI, banks, international assistance (KfW, OECF, ODA, USAID), as well as through public deposits.

Form of Assistance The HUDCO extends assistance, benefiting masses in urban and rural areas, under a broad spectrum of programmes given below.

Housing Rural housing, cooperative housing, urban employment through housing and shelter upgradation.

Infrastructure Land acquisition, basic sanitation and environmental improvement of slums.

Consultancy Services Building centres for technology transfer, building materials industries and building technology.

Training Training in human settlements and technical assistance to all borrowing agencies.
Financial assistance from the HUDCO for these projects is made available to agencies that include state housing boards, rural housing boards, slum clearance boards, development authorities, improvement trusts, municipal corporations, primary cooperative societies and so on.

It follows a differential interest rate policy for various categories of households, with overriding emphasis on a concessional rate of lending for EWS and LIG families. Such a differential rate policy provides an incentive for the executing agencies to promote housing for the less privileged and help reduce the loan repayment by the families to bring it within affordable limits. The repayment period is 10—15 years.

Similarly, the lower the cost of the shelter unit, the higher is the HUDCO's loan component as part of the project cost. In case of EWS sites and services where the unit cost is ₹7,500 or below, the HUDCO finances the entire project cost.

Income category	*Extent of financing of the house cost (percentage)*
Economically weaker section (EWS)	90
Low income groups (LIG)	85
Middle income groups (MIG)	75
High income group (HIG)	60

Urban Infrastructure The HUDCO has also been entrusted with the responsibility of financing urban infrastructure projects with additional equity support provided by the Ministry of Urban Development, Government of India. The infrastructure projects cover sectors of water supply, sewerage, drainage, solid waste management, transport nagars/terminals, commercial and social infrastructure, roads/bridges, area development projects and so on.

The HUDCO plans to stress, in future, on expansion of urban infrastructure lending, housing delivery through expanded avenues including retail financing, increased consultancy assistance, services for projects in India and abroad, impetus to building, technology transfer initiatives and in-house research and training programmes with national/international working.

Insurance Organisations/Corporations

The LIC and GIC support housing activity both directly and indirectly. Besides subscribing to bonds of the HUDCO and state housing boards, LIC grants loans to the states for their rural housing programmes and to public sector companies for construction of staff quarters. Though the LIC has been granting loans directly to individuals, the thrust to housing finance was provided when, in June 1989, it promoted a subsidiary for the purpose, namely the LIC Home Finance Ltd.

The GIC supports housing almost exclusively, indirectly, by subscribing to bonds/debentures floated by the HUDCO and state housing boards. It has also set up a housing finance subsidiary called the GIC Housing Finance Ltd. in July 1990, to enable it to lend directly to individuals.

Commercial Banks

The trend of commercial banks lending to individuals for housing emerged in the wake of the report of the working group on the *Role of Banking System in Providing Finance for Housing Schemes*. (R C Shah Working Group, the RBI, 1978). They have been lending to the housing sector based on annual credit allocations made by the RBI. In terms of the RBI guidelines, scheduled commercial banks are required to allocate 1.5 per cent of their incremental deposits for disbursing as housing finance every year. Of this allocation, 20 per cent has to be by way of direct housing loans of which again at least half, that is, 10 per cent of the allocation has to be in rural and semi-urban areas. Another 30 per cent could be for indirect lending by way of term loans to housing finance institutions (HFIs), housing finance companies (HFCs) and public housing agencies for the acquisition and development of land and to private builders for construction. The balance 50 per cent is for subscription to the HUDCO, and the NHB bonds.

Cooperative Banks

The cooperative banking sector consists of state cooperative banks (SCBs), district central cooperative banks (DCBs) and primary urban cooperative banks (PUCBs). The first set of comprehensive guidelines for these cooperative banks were issued in 1984 by the RBI. Cooperative banks finance individuals, cooperative group housing societies, housing boards and others who undertake housing projects for the EWS, LIGs, and MIGs.

Specialised Housing Finance Institutions (HFIs)

There are certain institutions termed as 'Specialised HFIs', which cater only to the needs of the housing sector. They can further be classified as housing finance companies (HFCs) promoted in the public/joint/private sectors and cooperative housing finance societies. A lead player in the HFC category is the HDFC Ltd. It lends mainly for new residential housing to individuals, group of individuals and individual members of cooperative societies.

Besides the HDFC, a number of HFCs have been sponsored by banks such as the SBI Home Finance Ltd, Canfin Homes Ltd, Indbank Housing Finance Ltd, Citihome and so on.

RBI MORTGAGE GUARANTEE COMPANIES (MGCS) DIRECTIONS, 2016

A **MCG** means a company registered with the RBI which primarily transacts the business of providing **mortgage guarantee** for the repayment of outstanding **housing loan** (for construction/repair/upgradation or acquisition of a house/residential property or both) to a **credit institution** (bank/HFC) on the occurrence of a **trigger event** (i.e. classification of the account of the borrower as NPA in the books of the credit institution). The main elements of the Directions are: **(a)** general guidelines, **(b)** prudential regulations, **(c)** investment policy, and **(d)** miscellaneous instructions.

General Guidelines

The main elements of the general guidelines **(i)** registration with the RBI, **(ii)** other activities, **(iii)** features of mortgage guarantee, and **(iv)** funding operations are discussed below.

Registration A MGC should commence business after **(i)** obtaining a certificate of registration (CoR) from the RBI; and **(ii)** having a minimum net owned fund of ₹100 crore. The application for registration should be made in RBI-specified form. For considering the application for registration, the RBI should be satisfied that the following conditions are fulfilled: **(i)** the MGC **(a)** would primarily transact the business of providing mortgage guarantee, that is, at least 90 per cent of its business turnover/gross income is from mortgage guarantee business. **Business turnover** means total mortgage contract (i.e. tripartite contract among the borrower/creditor institution/MGC) entered during the year together with the volume of business arising out of specially permitted other activities undertaken during the year,**(b)** would be in a position to pay its liabilities arising from the contracts of guarantee it may enter into, **(c)** has adequate capital structure (discussed later) and earning prospects from mortgage guarantee business; **(ii)** the general character of its management/proposed management would not be prejudicial to the public interest; **(iii)** its Board of Directors does not consist of more than half of its total number of directors who are either nominees of any shareholder with substantial interest or associated in any manner with them or any of the subsidiaries of the shareholder with substantial interest if such a shareholder is a company; **(iv)** the MGC would **(a)** have a well diversified shareholding, **(b)** not be a subsidiary of any other company including a company registered outside India. No individual/association/body of individuals whether incorporated or not/partnership firm/company would, directly or indirectly, have any controlling interest in it; **(v)** the eligible foreign direct investment in the equity of the MGC should have the prior approval of Foreign Investment Promotion Board (FIPB). If the foreign entity which has received FIPB/FED approval is having substantial interest in the applicant MGC, it should be regulated by a home country financial regulator and should itself preferably be a MGC and have a good track record. However, this would not be applicable if the investor of a MGC is international financial institution; **(vi)** the public interest would be served by the grant of CoR to commence/carry on the business in India. The grant of CoR would not be prejudicial to the operation and growth of the housing finance sector of the country; **(vii)** the MGC is compliant with the applicable norms for foreign investment; and **(viii)** any other condition, fulfilment of which, in the opinion of the RBI, would be necessary to ensure that the commencement of/carrying on the business in India by a MGC would not be prejudicial to the public interest and the housing finance sector in India.

After being satisfied that the specified conditions are fulfilled, the RBI would grant the CoR subject to conditions which it may consider fit to impose. The MGC would be under the regulatory and supervisory jurisdiction of the RBI. It may cancel a CoR, if the company **(i)** ceases to carry on its business; or **(ii)** has failed to comply with any condition subject to which the CoR has been issued; **(iii)** has failed to honour, in a timely manner, the claims arising from the contract of guarantee it has entered into/may enter into; **(iv)** at any time fails to fulfil any of the above specified conditions; **(v)** fails to **(1)** comply with any direction issued by the RBI, **(2)** maintain accounts, publish and disclose its financial position in accordance with the requirements of any law/direction/order issued by the RBI, **(3)** submit or offer for inspection its books of account/ other relevant documents when demanded by the RBI.

Other Activities A MGC can take up any activity up to 10 per cent of its total assets. If it undertakes any other business within the permitted limit, the prescribed prudential norms for valuation of investments, asset classification and provisioning should be followed.

Essential Features of a Mortgage Guarantee The essential features of a mortgage guarantee contract should be as follows: It should be **(a)** a contract of guarantee, **(b)** unconditional and irrevocable and free from coercion/undue influence/fraud, misrepresentation, and/or mistake under the Indian Contract Act, **(c)** guarantee the repayment of the principal and interest outstanding in the housing loan account of the borrower, up to the amount of guarantee. The guarantor should pay the guaranteed amount on invocation without any adjustment against the realisable value of the mortgage property. It should be a tri-partite contract among the borrower/creditor institution/ MGC. It should not carry on insurance business.

Funding Options The MGCs would not **(i)** accept public deposits, **(ii)** avail external commercial borrowings.

Prudential Regulation

The MGCs would be required to comply with various prudential guidelines including those relating to **(i)** minimum capital, **(ii)** capital adequacy, **(iii)** income recognition, **(iv)** asset classification, **(v)** accounting year, **(vi)** concentration of credit/investment, **(vii)** creation/maintenance of reserves, **(viii)** accounting standards, **(ix)** accounting of unearned premium, **(x)** provisioning, **(xi)** disclosure in balance sheet, **(xii)** transaction in Government securities, **(xiii)** classification and valuation of investments and prudential exposures issued by the RBI.

Minimum Capital Requirement The MGC should have a minimum net owned fund of ₹ 100 crore at the time of commencement of business, which would be reviewed for enhancement after 3 years. It should maintain **(i)** a capital adequacy ratio consisting of Tier-I and Tier-II capital of not less than 10 per cent of its aggregate risk weighted assets of on balance sheet and of risk adjusted value of off-balance sheet items or any other percentage prescribed by the RBI, **(ii)** at least 6 per cent as Tier-I capital. The total of Tier-II capital should not exceed 100 per cent of Tier-I capital.

Income Recognition The MGCs should book income/dividend on **(i)** securities of corporate books/ public sector undertaking, **(ii)** shares of corporate bodies, **(iii)** Government securities/bonds/ debentures of corporate bodies, **(iv)** units of mutual funds on the same basis as are applicable to the HFCs (**discussed in the earlier Section**). Their income including interest/discount/other charges on NPA/NPA taken over from creditor institution on happening of trigger event should be recognised only on cash basis. It should account the premium/fee on the mortgage guarantee contracts as an income in the profit and loss account in accordance with the accounting standards issued by the Institute of Chartered Accountants of India (ICAI). The amount of unearned premium should be shown as a separate line on the liability side of the balance sheet. Income from any other business should be recognised as per income recognition norms prescribed for them.

Asset Classification/Accounting Year/Concentration of Credit/Investment The norms applicable to the HFCs (**discussed in earlier Section**) are applicable to the MGCs also.

Creation and Maintenance of Contingency Reserves A MGC should create and maintain a contingency reserve on an ongoing basis. It should appropriate each year at least 40 per cent of the premium/fee earned or 25 per cent of the profit, after provision and tax, whichever is higher, to the reserves. In case of inadequate profits, the appropriation would result in/increase the amount of carry forward loss. It may appropriate a lower percentage (24 per cent) when the provisions towards losses on account of settlement of mortgage guarantee claims exceeds 35 per cent of the premium/fee earned. It should **(i)** ensure that the reserves is built up to at least 5 per cent of the total outstanding mortgage guarantee commitments, **(ii)** retain the appropriate amount for a minimum period of 7 subsequent years, **(iii)** utilise the reserve without the RBI's prior approval solely for meeting and making good the losses suffered by the mortgage holders only after exhausting all other avenues and options to recoup the losses. In all other cases of its utilisation, its prior approval should be obtained, **(iv)** show the amount of reserve as a separate line item on the liability side of the balance sheet. However, it may be treated as **free reserves** for the purpose of net owned fund.

Accounting of Unearned Premium A MGC should account the premium/fee on the mortgage guarantee contracts as an income in the profit and loss account in accordance with the accounting standards issued by the ICAI. The amount of unearned premium should be shown as a separate line on the liability side of the balance sheet.

Provisioning Requirements relate to **(i)** losses on invoked guarantees, **(ii)** incurred but not-reported (IBNR) losses, **(iii)** mortgage guarantee assets.

Provision for Losses on Invoked Guarantee A MGC is exposed to a potential loss when its guarantee is invoked. It should hold provisions for losses in respect of the invoked guarantees pending recovery of assets equal to the contract-wise aggregate of **amount of invocation** after adjusting the realisable value of the assets held in respect of each housing loan where the guarantee has been invoked. In case the realisable value of the assets is more than the amount of invocation, the excess should not be adjusted against the shortfall in other invoked guarantees. In case the provision already held is in excess of the amount as computed above, the excess provision may be reversed after full recovery or closure of the invoked guarantee amount or after the account becomes standard. The provisions made each year should be shown as a separate line item in the profit and loss account. The provisions held for losses on settlement of invoked guarantee should be shown as a separate line item on the liability side of the balance sheet.

Provision for Incurred But-Not-Reported (IBNR) Losses A MGC is exposed to a potential loss when there is a default in a housing loan guaranteed by it. It should hold provisions in respect of them where the trigger event is yet to occur/guarantee is yet to be invoked. The potential loss to which it is exposed to is referred to as **IBNR losses**. The provisions required should be arrived at on an actuarial basis depending upon the estimates of loss frequency/severity derived from historic data, trends, economic factors and other statistical data in relation to the paid claims, the provisions held for claims settled, risk statistics and so on. In case of provisions already held in excess of the above amount, the excess should not be reserved. The provisions should be shown as a separate line item in the profit and loss account. The amount of provision held for IBNR losses should be shown as a separate line item on the liability side of the balance sheet.

Mortgage Guarantee Assets The provisions requirement in respect of mortgage guarantee assets classified as loss, doubtful, substandard and standard are the same as are applicable to the HFCs (**discussed in the earlier Section**).

Disclosure in the Balance Sheet Every MGC should separately disclose in its balance sheet the provisions without netting them from the income or against the value of assets. They should be distinctly indicated under separate heads of account separately for mortgage guarantee business and others and individually for each type of assets for bad and doubtful debts and depreciation in investments and made from the profit and loss account.

Transactions in Government Securities Every MGC may undertake transactions in Government securities through the CSGL account or its demat account only.

Investment Policy

Included in the investment policy are the **(i)** instruments, **(ii)** pattern of investments and **(iii)** accounting for investments.

Instruments A MGC should invest only in the following instruments: **(i)** Government securities, **(ii)** Government guaranteed securities of corporate bodies/public sector undertakings, **(iii)** Fixed deposit/certificate of deposits/bonds of banks/public financial institutions (PFIs), **(iv)** Listed and rated corporate debentures/bonds, **(v)** Fully debt-oriented mutual fund units, and **(vi)** Unquoted Government securities and guaranteed bonds. However, it may hold investments in quoted or unquoted equity shares of company or other unquoted investments acquired in satisfaction of its debt which should be disposed of within 3 years/period extended by the RBI, from the date of such acquisition.

Pattern of Investments A MGC should hold atleast 25 per cent of its total investment portfolio in Central/State Government securities. The remaining investments may be invested as its Board of Directors considers prudent, with a ceiling of 25 per cent in any one category, that is, listed and rated corporate bonds/debentures or debt-oriented mutual fund units and so on. Its Board of Directors may fix an appropriate sub-limit for individual investments within each category. The minimum investment grade rating assigned by the SEBI-registered rating agencies would be required for investment by it in bonds/debentures and debt-oriented mutual funds.

Accounting for Investments Quoted investments should, for the purpose of valuation, be grouped into the following categories **(1)** Government securities including treasury bills, **(2)** Government guaranteed bonds/securities, **(3)** bonds of banks/PFIs, **(4)** debentures/bonds of corporate, and **(5)** units of mutual fund. They should be valued at the lower of the cost or market value, except Government securities/guaranteed bonds/securities which may be treated as **held to maturity** (**HTM**) for the purpose of valuation. The MGC can effect the transfer of the Government security from **HTM** category to **AFS** (available for sale) category at the beginning of each half year, on April 1 or October 1, with the approval of its Board of Directors provided the principal amount is reinvested in another Government security. The investment classified under HTM need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period. However, if any security out of this bouquet is traded before maturity, the entire category will be treated as securities held for trade/AFS and will have to be mark to marked (MTM). The investments in each category should be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value is less than the aggregate cost, the net depreciation should be provided for or charged to the profit and loss account. If the aggregate market value exceeds the aggregate cost, the net appreciation should be ignored. Depreciation in one category of investments should not be set off against appreciation in another category. All other investments should be MTM.

Unquoted investments acquired in satisfaction of its debts should be valued as under: **(i)** units of mutual funds at the net asset value (NAV) declared by the mutual fund in respect of each particular scheme; **(ii)** equity shares at cost or breakup value, whichever is lower. However, the MGC may substitute fair value for the breakup value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, its shares would be valued at rupee one per company; **(iii)** preference shares at cost or face value, whichever is lower. Unquoted debentures should be treated as term loans or other type of credit facilities depending upon their tenure for income recognition and asset classification.

The MGCs with the approval of their Board should frame an investment policy in tune with these directions.

Miscellaneous Instructions

The main elements of the RBI instructions to the MGC are: **(i)** maintenance of register of guarantees, **(ii)** obligations, **(iii)** due diligence, **(iv)** information relating to change of address/ directors/auditors, **(v)** prohibitions, **(vi)** constitution of audit committees, **(vii)** policy for grant of guarantee, **(viii)** scheme of mortgage guarantee, and **(ix)** counter guarantee.

Maintaining Register of Guarantees Every MGC should keep register(s) to enter the particulars of guarantee provided, namely, **(a)** name and address of the borrower/co-borrower, **(b)** date and amount of loan sanctioned, **(c)** brief description of the property including its site/location, **(d)** nature of security available for the loan, **(e)** tenure of the loan, **(f)** amount of each instalment and due date for its payment, **(g)** name and addresses of the bank/HFC to whom the guarantee has been provided, **(h)** date and amount of the guarantee, and **(i)** duration of the guarantee.

Obligation of MGC Its liability would be as stipulated in the contract of guarantee entered into by and between the MGC/creditor institution/borrower. On any day after a trigger event, the concerned creditor institution would be entitled to invoke the guarantee. It should make good the guarantee liability without demur as and when a notice of demand for its payment is received by it. If a housing loan turns into a NPA and the creditor institution prefers first to realise the loan by resorting to speedy recovery procedures prescribed in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, and realises some amount of the loan from the borrower, the liability of the MGC will stand reduced to that extent. The LTV (loan to value) ratio for a MGC for loans below and above ₹ 20 lakh would be 90 and 80 per cent respectively.

Due Diligence Before offering to provide a guarantee for repayment of a housing loan, the MGC should satisfy themselves, *inter-alia*, that the **(i)** loans are secured by a valid mortgage, **(ii)** creditor institution has verified **(a)** title to/marketability of the property and creditworthiness of the borrower, **(b)** use of the land on which the house/residential property is/proposed to be constructed out of the loan obtained from it, and **(c)** obtained a copy of the permission obtained by the borrower from the proper authorities for the purpose of construction of the house/residential property, and **(iii)** loan granted by a creditor institution to a borrower is not more than 90 per cent of the value of the property.

Information Every MGC should communicate to the RBI within one month from the occurrence of any change in the **(a)** complete postal address, telephone/fax number(s) of its registered/corporate office; **(b)** names and residential addresses of its directors, and official designations of its principal officers, **(c)** names and office addresses of its auditors, and **(d)** specimen signatures of the officers authorised to sign on its behalf.

Prohibitions A housing loan which is not secured by a valid mortgage of the house/residential property that is/proposed to be acquired would not be eligible for a mortgage guarantee. The MGC should not **(i)** pay commissions/rebates/other inducements for referral of mortgage guarantee business to any person, **(ii)** provide guarantees on mortgage originations of promoters/subsidiaries/associates and related parties/subsidiaries/associates and related parties of the MGC including companies where it has a material investment/interest of 5 per cent or more of the shareholding, **(iii)** invest in notes or other evidences of indebtedness secured by a mortgage or other lien upon real property. No MGC should lend against its own shares.

Constitution of Audit Committee A MGC should constitute an audit committee consisting of at least 3 non-executive directors of its Board of Directors, at least one of whom should be a chartered accountant. It would have the same powers, functions and duties as laid down in the Companies Act.

Policy for Grant of Guarantee The Board of Directors of a MGC should frame a policy for providing mortgage guarantee to creditor institution stipulating **(a)** the fee/premium chargeable based on specific identified criteria including the quantum of loan, LTV ratio, credit quality of the borrower, credit appraisal/risk management skills of banks/HFC, **(b)** delegation of powers for **(i)** providing a mortgage guarantee and to enter into a contract of guarantee, **(ii)** taking a decision to make good the claims received from banks/HFCs and **(iii)** initiating proceedings for the recovery of its dues from the borrowers.

Scheme of Mortgage Guarantee The MGC should prepare a detailed scheme duly approved by its Board of Directors containing, *inter-alia*, the **(a)** quality of a housing loan, **(b)** maximum portion of a housing loan that may be covered under the contract of guarantee, **(c)** minimum/maximum LTV ratio of a housing loan proposed to be covered under the contract of guarantee, **(d)** fee/premium charge indicating the manner for their payment in consideration for the contract of guarantee, **(e)** its liability as to whether the liability will be co-extensive with that of the borrower or otherwise, and **(f)** conditions governing the issue as to which party of the MGC or bank/HFC would be required to effect recoveries from the borrower after the mortgage guarantee is invoked and the guarantee liability is made good by the MGC to the bank/HFC.

Counter-guarantee Whenever a MGC obtains counter-guarantee cover in respect of the housing loans guarantee by it from another MGC, the MGC and the counter-guarantee company should establish and maintain the required reserves in appropriate proportions in relation to the risk retained by the original MGC and ceded to be assuming counter-guarantee company so that the total reserves would not be less than the required reserves under Indian law. In case the counter-guarantee company is not regulated by the regulator(s) in India, the MGC guaranteeing the claim would hold the relevant reserves and provisions in respect of all the outstanding mortgage guarantee contract issued by it.

RECAPITULATION

- The responsibility to provide housing finance largely rested with the Government of India till the early eighties. The setting up of the NHB in 1988 as the apex/principal housing finance institution marked the beginning of the emergence of housing finance as a fund-based financial service in the country. With the entry of a number of specialised HFIs/HFCs/MGCs, it has grown in volume and depth.
- A diversified housing finance system has emerged in the country. The main components of the system are: **(i)** a large number of HFCs/HFIs, **(ii)** mortgage guarantee companies (MGCs) and **(iii)** the NHB.
- A diversified structure of HFCs/HFIs has emerged in the country. It comprises the HUDCO, insurance organisations, commercial and cooperative banks and specialised HFIs in the public, private and/or joint sectors such as HDFC, SBI Home Finance, Canfin Home, LIC Housing Finance, Indbank Housing Finance, Citihome, Dewan Housing Finance and so on.
- The NHB is the principal housing finance agency in the country. The part played by it in the supply of housing finance falls into three categories: **(i)** promotional **(ii)** regulatory and **(iii)** financial. The promotional role includes promotion of HFCs/HFIs, coordination with the Government and other agencies in securing necessary amendments to the existing laws to remove impediments in the housing sector and encouragement to participation of NGOs and social action groups in housing development. The regulatory powers exercised earlier by the RBI relating to HFCs are now the domain of the NHB. The MGCs are however, regulated by the RBI. The NHB regulates them through directions/guidelines. The financial support by the NHB to the HFCs is in the form of capital and refinance, promotion of loan-linked savings instruments and mortgage-based securitisation.
- The NHB is a body corporate. To carry out its functions, it may borrow money and accept deposits. It may also borrow in foreign currency. It may approach a state government for the recovery of its dues from HFIs/banks in the same manner as arrears of land revenue. To protect its interest, the NHB may call for prepayment before the agreed period of all obligations of the HFCs/banks. Loans/advances against the security of its own bonds by the NHB is totally prohibited. The NHB has the power to inspect the books/accounts/ other documents of any institution to which it has made any loan/advances/any other financial assistance. To discharge its functions effectively, the NHB has power to collect and publish credit information. It is authorised to provide advisory services to the Government/local authorities/other agencies in respect of formulation of policies to promote the growth of housing/HFIs, and legislation relating to matters having a bearing on shelter, housing and settlement.
- To commence/carry on business the HFCs should be registered with the NHB. They should have a minimum NOF of ₹25 lakh and satisfy conditions such as adequate capital structure and earnings prospects, registration is in public interest and would not be prejudicial to the operation and growth of the housing finance sector and so on. Their registration can be cancelled in specified circumstances. At least 5 per cent of the outstanding deposits of the HFCs should be invested in unencumbered approved securities. A reserve fund should be created by them by transfer of at least 20 per cent of their net profits every year. In public interest, it may regulate/prohibit soliciting of deposits by HFCs. It may also determine policy and issue directions to them. Similarly, it may collect information about deposits from them and issue appropriate directions. The auditors of HFCs are obliged to include in their report whether they have furnished the NHB with the statements/information/ particulars relating to, connected with, deposits received by them. The NHB may prohibit any HFC accepting deposits. It may

file an application for winding up of a HFC under the Companies Act. It may also carry out inspection of a HFC. On failure to repay a deposit, the NHB may direct it to repay the deposit.

- The Government in consultation with the NHB may appoint recovery officers for the recovery of dues of HFCs from borrowers who default in repayment of any assistance/instalment or fails to comply with the terms of the agreement.
- With a view to safeguarding the interest of the depositors and promoting the healthy and universal growth of the HFCs, the NHB has issued the **HFCs Directions**. These relate to **(i)** acceptance of deposits by HFCs, **(ii)** prudential norms to be observed by them and **(iii)** matters to be included in the auditors report by their auditors. The main elements of these directions are broadly similar to the RBI directions applicable to the NBFCs (**discussed in Chapter 1 of this book**).
- The ALM process rests on three pillars: ALM Information system, ALM organisation and ALM process. The main elements of the ALM information system are the **(i)** management information system and **(ii)** information availability, adequacy and expending. The ALM organisation consists of structure and responsibilities and levels of top management involvement. The ALM process comprises of risk parameters, risk identification, risk measurement, risk management and risk policies and tolerance levels. The NHB's guidelines relating to the ALM framework of HFCs are broadly similar to the RBI framework applicable to the NBFCs (**discussed in Chapter 1 of this book**).
- Securitisation is the process of pooling and repackaging of homogeneous 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 assets or pool of assets. the pool of assets collatorises securities.
- Investors in securitised instruments take 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 in terms of the various means that attempt to buffer investors against losses on the asset collateraising their investment. They are either external (third party) or internal (strucutural cashflow-driven). The external credit enhancements include insurance, guarantee and letter of credit. The internal credit enhancements comprise of credit tranching, over collaterisation, cash collateral, spread account and triggered amortisation.
- The parties to a securitisation transaction are the originator, SPV, investors, obligors, rating agency, servicer, trustee and structure.
- The instruments of securitisation are pass through certificates and pass through security. The securities fall into two groups: asset-based and mortgage-based.
- Reverse mortgage seeks to monetise the house as an asset and specifically the owners equity in the house. The major elements of the NHB's operational guidelines relating to reverse mortgage are primary lending institutions, eligible borrowers, eligibility and amount of loan, nature of payment, end-use of funds, period of loan, security, valuation of property, rights to recession, loan disbursement, settlement of loan, prepayment of loan, loan covenants, foreclosure, and counselling of borrowers.
- The main elements of the RBI MCG Directions are: **(a)** general guidelines, **(b)** prudential regulations, **(c)** investment policy, and **(d)** miscellaneous instructions.
- The main elements of the general guidelines relate to **(i)** registration with the RBI, **(ii)** other activities, **(iii)** features of mortgage guarantee, and **(iv)** funding operations.
- The MGCs would be required to comply with various prudential guidelines including those relating to **(i)** minimum capital, **(ii)** capital adequacy, **(iii)** income recognition, **(iv)** asset classifi-

cation, **(v)** accounting year, **(vi)** concentration of credit/investment, **(vii)** creation/maintenance of reserves, **(viii)** accounting standards, **(ix)** accounting of unearned premium, **(x)** provisioning, **(xi)** disclosure in balance sheet, **(xii)** transaction in Government securities, **(xiii)** classification and valuation of investments and prudential exposures issued by the RBI.

- Included in the investment policy are the **(i)** instruments, **(ii)** pattern of investments and **(iii)** accounting for investments.
- The main elements of the RBI instructions to the MGC are: **(i)** maintenance of register of guarantees, **(ii)** obligations, **(iii)** due diligence, **(iv)** information relating to change of address/directors/auditors, **(v)** prohibitions, **(vi)** constitution of audit committees, **(vii)** policy for grant of guarantee, **(viii)** scheme of mortgage guarantee, and **(ix)** counter guarantee.
- Reverse mortgage is a loan against residential mortgage for senior citizens who may not be eligible for any form of mortgage loan. Conceptually, reverse mortgage loan-enabled annuity (RMLe-A) seeks to monetise the owner's equity in the house. This involves senior citizen borrower(s) mortgaging thier house to a lender, who then makes periodic payments to the borrower(s) during the latter's lifetime. The borrower(s) need not repay the principal and interest to the lender during their life time, as long as they are alive and in occupation of the property. On borrower's death or on his leaving the house permanently, the loan along with accumulated interest is settled through sale of the house. After adjusting the principal amount of the loan and accumulated interest, surplus, if any, will go to the estate of the deceased. The borrower(s)/heir(s) can also repay or prepay the loan with interest during the currency of the loan or later and release the mortgage without sale of property without any prepayment charge. The annuity payments are sourced from a life insurance company by the lending institution on behalf of the borrowers. The lender makes periodic annuity payments to the borrower through his or her life time, on behalf of the insurance company. The maximum period of loan is the residual lifetime of the borrower.
- The main elements of the NHB's operational guidelines are **(i)** primary lending/annuity sourcing institutions, **(ii)** eligible borrowers, **(iii)** eligible amount of loan, **(iv)** nature of payment, **(v)** redemption reserves, **(vi)** period of loan, **(vii)** interest, **(viii)** security, **(ix)** valuation of property, **(x)** taxation, **(xi)** right to rescission, **(xii)** loan disbursement, **(xiii)** upfront charges, **(xiv)** service charges, **(xv)** settlement of loan, **(xvi)** prepayment of loan, **(xvii)** loan covenants, **(xviii)** title indemnity, **(xix)** foreclosure, **(xx)** payment adjustments, and **(xxi)** counselling of borrowers.
- The primary lending institutions **(PLIs)** are banks/HFCs, and the annuity-sourcing institutions are life insurance companies.
- The eligible borrowers are **(i)** seior citizen above 60 years of age, **(ii)** married couples as joint borrowers, and **(iii)** blood relatives of senior citizens who are joint owners. They should be clear owners of the self-occupied/acquired house. The house should be free from encumberances, have a minimum value of ₹5 lakh and residual life of at least 20 years.
- The maximum loan to value ratio would range between 60 and 75 for different age group of borrowers ranging between 60 and 80, with an upper limit discretion of 10 per cent.
- The nature of payment may be **(i)** periodic: monthly/quarterly/half-yearly/annual **(ii)** lump-sum, **(iii)** line of credit, **(iv)** any combination of the above.
- The PLIs may set aside a part of the loan as reverse mortgage redemption reserve to be used for settlement of the loan dues on the closure of the RML subject to a maximum of 5 per cent and 10 per cent of property value in case RML-A with and without return of purchase price respectively.
- The eligible end-use of funds are: **(i)** upgradation/renovation/extension/improvement/maintenance/insurance of house, **(ii)** medical purposes/increased hiring expenses/other consumption.
- The maximum loan disbursement tenure would be till the demise of the borrower.

- Fixed/floating rates may be fixed in the usual manner based on risk perception, loan pricing policy and so on.
- The RMLe–A should be secured by way of mortgage of house property.
- The market value of property should be determined through external approved valuers at least once every 5 years. In-house valuers may also be used subject to adequate disclosure of the methodology.
- While all payments under RML are exempt from tax, periodic annuity payments are taxable in the hands of the recipients.
- According to the right of rescission the senior citizens should be given upto 3 days to cancel the transaction after execution of documents and finalisation of loan.
- The PLI will make all the RMLe–A payments directly to bank account of the borrower.
- The PLIs can charge upfront one-time loan processing charge not exceeding the cost paid by the lender/charged to the lender by the providers of services such as appraisal/inspection, property verification/examination, survey and so on.
- The PLIs would be entitled to receive on-going service charges upto 1 and 1.5 per cent of loan in case of with/without return of purchase price respectively.
- The settlement of loan would be met by the proceeds from the sale of the house. The RMRR would be closed and the proceeds directly adjusted with the loan account. Any return from the insurance company would be used for partial settlement of the loan. However, borrowers would have the first right to settle the loan without sale of property. Any surplus would be passed on to the legal heirs/estate beneficiaries of the borrowers.
- The borrower should have the option to prepay the loan at any time during the loan tenure without penalty/charge.
- The PLI should obtain legal opinion for ensuring clarity on the title of the residential property
- The loan would be liable for foreclosure due to occurrences such as **(i)** the borrower has not stayed in the property continuously for one year or fails to pay taxes/maintenance/repair/insurance, **(ii)** the property is donated/abandoned by the borrower, **(iii)** changes in the property affecting the security of the loan, **(iv)** fraud/representation, **(v)** acquisition of the property by the Government and so on.
- The PLI should **(i)** observe/maintain high standard of conduct in its dealings and treat the senior citizens with special care, **(ii)** clearly and accurately disclose the terms of the RMLe-A, the valuation methodology, determination of eligible quantum of loan and so on.

REVIEW QUESTIONS

5.1 Write a brief note on the National Housing Bank as the apex housing finance institution in India.

5.2 Explain briefly the main features of NHB's directions to housing finance companies relating to:
- Acceptance of public deposits
- Prudential norms
- Auditors report

5.3 Explain the features of the corporate governance directions applicable to the HFCs.

5.4 What is securitisation? Discuss briefly the main features of securitisation.

5.5 **(a)** Define mortgage-based securitisation (MBS).
(b) Explain the process with reference to a MBS originated by the NHB recently.

5.6 What are the main features of RBI Directions relating to MCGs?