

CHAPTER VIII

RECENT DEVELOPMENTS

Securitization is a tested market oriented resource raising mechanism with enormous potential to integrate sectoral markets with the capital market. In the process, it has the capacity to enhance the ability of Banks & Financial Institutions for not only channelizing long term funds to housing sector but also in increasing competitive strengths in terms of improved efficiencies in both resource raising and deployment. During the year 2002-03, certain important developments took place in the field of securitization in terms of legislation as well as operational aspects which are discussed in this chapter.

SARFAESI Act, 2002

During the Winter Session 2002, Parliament enacted a law to regulate securitization and reconstruction of financial assets and enforcement of security interest of the banks and financial institutions known as “the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002)” (SARFAESI Act). The Act specifies the regulatory framework for a Securitization Company and Asset Reconstruction Company.

Definition of a Securitization Company

As per this Act a “Securitization Company means any Company formed and registered under the Companies Act, 1956 for the purpose of Securitization “ whereas “Securitization” is defined as “...acquisition of financial assets by any Securitization Company or Reconstruction Company from the originator, whether by raising of funds by such Securitization Company or Reconstruction Company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise”

The Act also defines a “Reconstruction Company” as “a Company formed and registered under the Companies Act, 1956 for the purpose of asset Reconstruction” whereas “asset Reconstruction means acquisition by any Securitization Company or Reconstruction Company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realization of such financial assistance”.

Registration of Securitization Company

The Act has made registration of a Securitization Company / Reconstruction Company compulsory with the Reserve Bank of India (RBI) and specific requirement of NOF. The RBI, before granting the certificate of registration, will have to ensure that the Company has not incurred losses in any of the three preceding financial

years, that it has made adequate arrangements for realization of financial assets required for the purpose of Securitization / Asset Reconstruction and will be able to pay periodical returns to the investors, that the Company is not having more than half of its directors nominated by or associated with the sponsor, that the Company will be complying with the Prudential Norms specified by the RBI.

The RBI, if it so decides on the basis of actual functioning of the Company within the periphery of certain specified parameters, may cancel a certificate of registration after giving adequate opportunity to such Company to fulfill the desired requirements. The Company, after cancellation of certificate of registration may file an appeal to the Central Government and shall be given a reasonable opportunity of being heard. An existing Company, even after rejection / cancellation of Certificate of Registration, will be deemed to be a Securitization / Reconstruction Company till the time it fulfils its obligations towards the investors.

The RBI, in the public interest or in the name of financial sector regulation, may frame policies / issue directions to all or any Securitization / Reconstruction Company.

Exemption from registration of Security receipts

Notwithstanding the provisions under the Registration Act, 1908, any security receipts issued by the Securitization / Reconstruction Company entitling the holder of the security receipt to an undivided interest afforded by a registered instrument or any transfer of such security receipts shall not require compulsory registration. This particular provision may go a long way in developing the secondary mortgage market in the country.

Other functions of Securitization Company

Any Securitization Company / Reconstruction Company registered with the RBI may, with the prior approval of the RBI, act as a recovery agent on behalf of any bank/ financial institution on payment of fees/ charges, or as a receiver if appointed by a court or tribunal.

Difference between securitisation under the SARFAESI Act, 2002 & General Law

	SARFAESI Act, 2002	General Law
Who Can transact securitisation business	Only Securitisation Companies	Any person
Registration	With RBI	No such requirement
What can be securitised	Financial assets of banks & FIs only.	No such restrictions
Who can be the investor	Only qualified institutional buyers	No such restriction

Nature of instrument which can be issued	Only security receipt	Normally PTCs are issued which represent undivided right of the holder in the financial asset.
Stamp Duty applicable on transfer of Mortgage Debt	Only as an agreement. The duty is nominal.	Depends on the place of transfer. To be charged as conveyance. Duty nominal in some States.
Stamp Duty on issue of security	To be stamped as receipt.	Depends on the place of transfer. To be charged as memorandum or record of the transaction.
Stamp Duty on transfer of security	Declared as security under SCRA – Can be dematerialised.	Not a security under SCRA – to be charged as conveyance.
Registration of issue and transfer of PTC	Not necessary	Not necessary in the case of securitisation by NHB.
Acquisition of rights in mortgage debts	Deemed vesting of rights on acquisition.	As per contract between the parties.
Notice to the obliger	Not necessary	Depends on the agreement between the parties.
Resolution of dispute	Arbitration Act applies	Depends on the agreement between the parties.
Enforcement of security interest	Under the Act, by the securitisation company itself.	Only by NHB under the NHB Act.
Trading	Being security can be traded in Stock Exchange	Can not be traded in Stock Exchange

As the procedure envisaged under the said Act for securitization of loans and for enforcement of security interest was cost effective and less cumbersome, NHB requested the Central Government to consider notifying housing finance companies registered with NHB as financial institutions for the purposes of the said Act, pending implementation of the provisions of NHB Act in the matter of enforcement of security through Recovery Officers.

Residential Mortgage Backed Securities: Trends in India

Mortgage securitization is by far the most complex form of securitization transaction as it is mainly dependent on the legal, tax, regulatory and market related environment. With each of the above aspects having direct linkage in structuring the transaction, the process is driven by a chain of factors and considerations involving the commercial, financial and the economic interests of the parties involved in the transaction. The process is thus largely dependent on policy environment for enabling its development on sound lines.

The process was embarked in India after detailed study of the successful securitization models world over, and research in the areas relating to legal, financial, regulatory and market environments. With the amendments to the National Housing Bank Act, 1987, (w.e. from June 12, 2000), NHB launched the first two RMBS in the Indian capital market during August 2000. With the issues, NHB enabled a platform for the HFCs, banks and other financial intermediaries to securitize their home loan portfolio. Following the launch, NHB completed seven RMBS transactions till 2002-03 involving home loan assets of 4 HFCs.

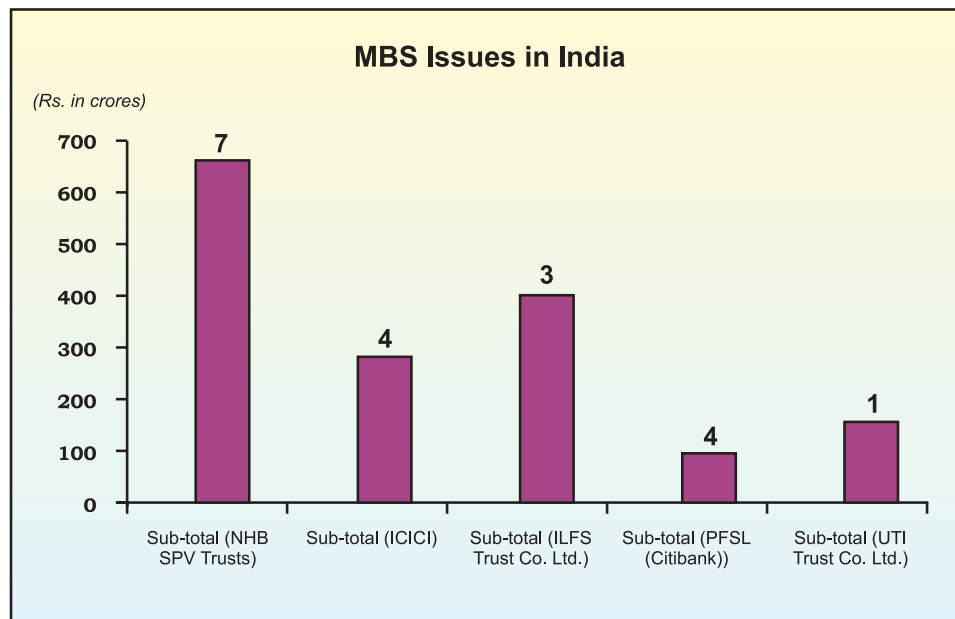
MBS Issues by NHB

Sr. No.	SPV	Date of Issue		Pool Size		Issue Size (Rs. crore)	MBS Pricing Structure (Premium /Par/ Discount)	MBS Coupon	Credit Enhancement	Rating (with Agency Name)
		Issue Open Date	Issue Close Date	No. of Loans	Principal Outstanding (Rs. crore)					
1	NHB Trust (NP1)	22-Aug-00	29-Aug-00	8329	88.32	59.7	Par	11.85% p.a.	A-B Structure & Guarantee of Rs.1.10 cr	AAA(So) by CRISIL
2	NHBSPV Trust (LP1)	22-Aug-00	29-Aug-00	2777	47.54	43.84	Par	11.85% p.a.	A-B Structure & Cash Collateral	AAA(So) by CRISIL
3	NHBSPV (LP2)	23-Apr-01	11-May-01	4292	74.22	46.84	Par	10.25% p.a.	A-B Structure & Collateral	AAA(So) by CRISIL
4	NHBSPV (CP1)	23-Apr-01	11-May-01	4257	63.4	44.85	Par	10.25% p.a.	A-B Structure & Cash Collateral	AAA(So) by CRISIL
5	NHBSPV (CP2)	12-Jun-02	28-Jun-02	4256	85.35	58.19	Par	8.90% p.a.	A-B Structure & Cash Collateral	AAA(So) by ICRA
6	NHBSPV (BP1)	21-Apr-03	29-Apr-03	3548	77.16	59.65	Par	6.89% p.a.	A-B Structure & Cash Collateral	AAA(So) by ICRA
7	NHBSPV (CP3)	24-Jun-03	2-Jul-03	2007	64.13	54.45	Par	6.25% p.a.	A-B Structure & Cash Collateral	AAA(So) by ICRA
Sub Total (NHB SPV Trusts)				29466	500.12	367.52				

There have also been initiatives in the field by other institutions such as ICICI Bank Ltd., Citibank, Housing Development Finance Corporation Ltd. and LIC Housing Finance Ltd. for securitizing their home loan receivables. Details of these transactions as available with NHB are given below:

Sr. No.	SPV	Date of Issue		Pool Size		Issue Size (Rs. crore)	MBS Pricing Structure	MBS Coupon	Credit Enhancement	Rating (with Agency Name)
		Issue Open	Issue Close	No. of Loans	Principal Outstanding (Rs. crore)					
1	ICICI HFC - Trustee	14-Jun-02	5-Jul-02	1354	30.13	35.04	Premium	9.05% p.a.	Cash Reserve: Rs. 4.57 crore; Overdue Receivable: Rs. 4.5 lakhs	AAA(So) by CRISIL & FITCH
2	ICICI HFC- Trustee	14-Jun-02	5-Jul-02	285	20.93	24.29	Premium	9.05% p.a.	Cash Reserve : Rs. 3.02 crore Overdue Receivable: Rs. 6 lakhs	AAA(So) by CRISIL & FITCH
3	ICICI HFC- Trustee	26-Nov-02	28-Nov-02	2836	91.05	106.60	Premium	8.00% p.a.	Cash Reserve : Rs. 15.97 cr Overdue Receivable: Rs. 37 lakhs	AAA(So) by CRISIL & FITCH
4	ICICI HFC- Trustee	6-Dec-02	9-Dec-02	3176	124.40	162.60	Premium	8.00% p.a.	Cash Reserve : Rs. 40.46 cr Overdue Receivable: Rs. 37 lakhs	AAA(So) by CRISIL & FITCH
Sub-total (ICICI)				7651	266.51	328.53				
5	ILFS Trust Company Ltd. Originator: HDFC	2-Sep-02	13-Sep-02	3294	75.2	55.15	Par		A-B Structure Union Bank of India Guarantee for Rs. 1.15 crore	AAA(So) by CARE & FITCH
6	ILFS Trust Company Ltd. Originator: LICHL	16-Dec-02	20-Dec-02	1773	186.93	229.03	Premium	6.5% to 7.6% p.a.	Cash Collateral: Rs. 40.25 crores	AAA(So) by CRISIL &

7	ILFS Trust Company Ltd. Originator: Dewan HFC	21-May-02	7-Jun-02	6713	146.78	158.40	Premium		Sub-pool of Rs. 28 cr Rs. 1.78 cr Corporate Undertaking	AAA(So) by ICRA
Sub-total ILFS Trust Co. Ltd.				11780	408.91	442.58				
8	PFSL-Citibank Originator: Citibank		1-Apr-01	125	14.27	14.27	Premium		Subordinate Cashflows & Cash Collateral	AAA(So)
9	PFSL-Citibank Originator: Citibank		1-Jul-01	200	25.36	25.36	Premium		Subordinate Cashflows & Cash Collateral	AAA(So)
10	PFSL-Citibank Originator: Citibank		1-Nov-01	160	18.36	18.36	Premium		Subordinate Cashflows & Cash Collateral	AAA(So)
11	PFSL-Citibank Originator: Citibank		1-Dec-01	300	33.74	33.74	Premium		Subordinate Cashflows & Cash Collateral	AAA(So)
Sub-total (PFSL (Citibank))				785	91.73	91.73				
12	UTI Trust Company Ltd. Originator: LICHFL	21-Mar-03	24-Mar-03	4667	151.86	202.96	Premium	7.50% p.a.	Cash Collateral: Rs. 50.38 cr	AAA(So) by CRISIL
Sub-total (UTI Trust)				4667	151.86	202.96				



Constraints for RMBS in the present Indian economic scenario

The case for evolving securitization as a mechanism to multiply resources for the housing sector in India is strong. In view of the complexities involved in RMBS transactions and in the process of an emerging policy environment, the task of development of secondary market for mortgages is a challenging one.

- Legal Issues pertaining to true sale complicating structuring of RMBS transactions
- High Stamp duty structures and registration charges in states
- Unclear tax environment.
- Absence of Accounting Standards for securitization (though ICAI has come out with Guidance Note)
- Lack of standardization in loan origination, underwriting, appraisals and documentation systems.
- Lack of depth in secondary market.
- Regulatory issues still emerging.

NHB's Efforts

As a nodal body, NHB has been engaged in sensitizing the policy environment for better appreciation of the issues associated with RMBS transactions.

- The high stamp duty structures in the various states except in Karnataka, Tamil Nadu, Gujarat, Maharashtra and West Bengal are a major deterrent in the RMBS markets presently, as the pool of housing loans to be securitized have to be chosen from these five states to prevent the risk of high stamp duties during registration. The revenue secretaries of the different states have been made aware that a reduction in the stamp duties will enable a wider coverage in the selection of the pool of housing loans for the purpose of securitization.
- NHB has commissioned a study to understand the behaviour of mortgages in the housing finance sector in India with the Administrative Staff College of India (ASCI). Further, a Working Group with representatives from the housing finance companies has also been formed to recommend measures for standardization in the residential mortgage finance sector. The reports are in the process of finalization.
- The Central Government (DEA) and Securities Exchange Board of India (SEBI) have been sensitized to consider classification of Pass Through Certificates (PTCs) as eligible securities under the Securities Contracts (Regulations) Act, 1956 to enable listing of the PTCs at the Stock Exchanges. Besides, NHB has also requested them to consider classification of Pass Through Certificates (PTCs) as eligible securities in the Investment Pattern of Pension/Provident/Superannuation Funds. This will help in the development of a secondary mortgage market in the country.

- NHB has initiated market making efforts to educate the originators and create investor awareness in the country. This will lead to the development of the necessary depth in the secondary mortgage market.

While the success of the MBS issues has significantly provided means to better understand and address various legal, regulatory, fiscal, accounting and other capital market related issues, the development of a secondary mortgage market in India will largely depend on the ability to design and launch market friendly products. NHB has been endeavoring to ensure proper direction for the development of secondary mortgage market.

Scope for Future Development

The process of development of secondary mortgage market has significant potential to benefit the banks and financial institutions in their capacities as both originators of home loans as also as investors in RMBS. While the banks and financial institutions are increasingly becoming active in the housing finance business in the present scenario, this mechanism seeks to enable the institutions to systematically enhance their volumes and compete effectively.