

Draft Guidelines on Operations of Mortgage Guarantee Companies

Scope

1. These guidelines provide a framework for the registration of mortgage guarantee companies in India and the conduct of the business of mortgage guarantee in India.

Definitions

2. In these guidelines unless the context otherwise requires,
 - (a) "bank" means-
 - (i) a banking company; or
 - (ii) a corresponding new bank; or
 - (iii) the State Bank of India; or
 - (iv) a subsidiary bank; or
 - (v) such other bank which the Reserve Bank may, by notification, specify for the purposes of these guidelines; and
 - (vi) a cooperative bank as defined under the Banking Regulation Act, 1949 (10 of 1949);
 - (b) "banking company" means a banking company as defined in Section 5(c) of the Banking Regulation Act, 1949 (10 of 1949);
 - (c) "borrower" means any person who has been granted a housing loan by any creditor institution;
 - (d) "creditor institution" means a bank or housing finance company;
 - (e) "company" means a company registered under Section 3 of the Companies Act, 1956;
 - (f) "corresponding new bank" means as defined in clause (da) of Section 5 of the Banking Regulation Act, 1949;
 - (g) "default" means non-payment on the due date of any principal debt or interest thereon payable by a borrower to any creditor institution ;
 - (h) "guarantee" means a contract of guarantee as defined in the Indian Contract Act, 1872 (9 of 1872);
 - (i) "housing finance company" means a company which primarily transacts or has one of its principal objects, the transacting of the business of providing finance for housing, as defined in the National Housing Bank Act, 1987;

- (j) "housing loan" means any loan or advance granted to an individual for the purpose of construction/ repairs/ upgradation of a house or acquisition of a house or land or both house and land;
- (k) "mortgage guarantee" means a guarantee provided by a mortgage guarantee company for the repayment of a housing loan and interest accrued thereon up to the guaranteed amount to a creditor institution, on the occurrence of a trigger event;
- (l) "mortgage guarantee company" means a company which primarily transacts the business of providing mortgage guarantee;
- (m) "mortgage guarantee contract" means a tri-partite contract among the borrower, the creditor institution and the mortgage guarantee company, which provides the mortgage guarantee;
- (n) "National Housing Bank" means the National Housing Bank established under the National Housing Bank Act, 1987 (53 of 1987);
- (o) "net-owned-fund" shall have the same meaning as assigned to it under Section 45IA of the Reserve Bank of India;
- (p) "non-performing asset" means an asset or account of a borrower, which has been classified by a creditor institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by the Reserve Bank or the National Housing Bank as the case may be;
- (q) "Reserve Bank" means the Reserve Bank of India constituted under the Reserve Bank of India Act, 1934;
- (r) "securitization" means a process by which a single asset or a pool of assets are sold by a creditor institution to a bankruptcy remote entity and transferred from the balance sheet of the originator to that of the bankruptcy remote entity;
- (s) "trigger event" means classification of the account of a borrower as non-performing asset in the books of the creditor institution in accordance with the directions or guidelines issued by the Reserve Bank or the National Housing Bank, as the case may be;

Registration with the Reserve Bank of India

3. A mortgage guarantee company shall commence or carry on the business of providing mortgage guarantee after -
 - (a) obtaining a certificate of registration from the Reserve Bank of India; and
 - (b) having a net-owned-fund of one hundred crore rupees or such other higher amount, as the Reserve Bank of India may, by notification, specify.
4. Every mortgage guarantee company shall make an application for registration to the Reserve Bank of India in such form as may be specified by the Reserve Bank of India for the purpose.
5. The Reserve Bank of India, for the purpose of considering the application for registration, shall require to be satisfied that the following conditions are fulfilled;-
 - (a) that the mortgage guarantee company shall primarily transact the business of providing mortgage guarantee. A mortgage guarantee company shall be deemed to comply with the above when at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business;
 - (b) that the mortgage guarantee company is or shall be in a position to pay its liabilities arising from the contracts of guarantee it may enter into;
 - (c) that the mortgage guarantee company has adequate capital structure as stipulated in paragraphs 11 to 13 below and adequate earning prospects from mortgage guarantee business;
 - (d) that the general character of the management or the proposed management of the mortgage guarantee company shall not be prejudicial to the public interest;
 - (e) The Board of Directors should fulfill fit and proper criteria laid down by the Reserve Bank of India;
 - (f) The substantial shareholder should be an entity with well diversified shareholding

- (g) If a foreign entity which has received FIPB/FEMA approval is a significant investor in any company it should be a well diversified entity in its home country, should be regulated by home country financial regulator and a mortgage guarantee company and have a good track record of operating as a mortgage company. The foreign Direct Investment to be eligible should have prior approval of FIPB in addition the regulatory clearance;
 - (h) that the public interest shall be served by the grant of certificate of registration to the mortgage guarantee company to commence and to carry on the business in India.
 - (i) that the grant of certificate of registration shall not be prejudicial to the operation and growth of the housing finance sector of the country;
 - (j) that the mortgage guarantee company is compliant with the applicable norms for foreign investment in such companies; and
 - (k) any other condition, fulfillment of which in the opinion of the Reserve Bank of India, shall be necessary to ensure that the commencement of or carrying on the business in India by a mortgage guarantee company shall not be prejudicial to the public interest and the housing finance sector in India.
6. Reserve Bank of India may, after being satisfied that the conditions specified in sub paragraph 5 are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.
7. The Mortgage Guarantee Companies shall be under the regulatory and supervisory jurisdiction of the Reserve Bank of India.
8. Reserve Bank of India may cancel a certificate of registration granted to a mortgage guarantee company if such company-
- (a) ceases to carry on the business of providing mortgage guarantee in India; or
 - (b) has failed to comply with any condition subject to which the certificate of registration has been issued to it; or
 - (c) has failed to honour, in a timely manner, the claims arising from the contract of guarantee it has entered into or may enter into; or
 - (d) at any time fails to fulfill any of the conditions referred to in paragraphs 5 and 6; or

- (e) fails -
 - i) to comply with any direction issued by the Reserve Bank of India; or
 - ii) to maintain accounts, publish and disclose its financial position in accordance with the requirement of any law or any direction or order issued by the Reserve Bank of India; or
 - iii) to submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank of India.

Essential features of a mortgage guarantee

9. The essential features of a mortgage guarantee contract shall be as follows:
 - (a) it shall be a contract of guarantee under Section 126 of the Indian Contract Act, 1872;
 - (b) it shall be unconditional and irrevocable;
 - (c) it shall guarantee the repayment of the principal and interest outstanding in the housing loan account of the borrower, up to the amount of guarantee;
 - (d) the guarantor shall pay the guaranteed amount on invocation without any adjustment against the realisable value of the mortgage property;
 - (e) it shall be a tri-partite contract among the borrower, the creditor institution and the mortgage guarantee company, which provides the mortgage guarantee;.

10. The mortgage guarantee company shall not sell any product or indulge in any business which includes any features of an insurance contract or whereby it assumes any insurance liability.

Minimum Capital requirement

11. A mortgage guarantee company shall have a minimum net owned fund of Rs.100 crore at the time of commencement of business, which shall be augmented to Rs.300 crore within three years from the date of commencement of business.

Capital Adequacy

12. A mortgage guarantee company shall maintain twelve percent (12%) of its aggregate risk weighted assets as the minimum capital adequacy ratio or any other percentage that may be prescribed by the Reserve Bank of India for the purpose, from time to time.
13. A mortgage guarantee company shall maintain at least eight percent (8%) of its aggregate risk weighted assets as Tier 1 capital.

Prudential and accounting norms

14. The mortgage guarantee company shall be required to comply with various prudential guidelines including those relating to income recognition, asset classification, provisioning, classification and valuation of investments, and prudential exposures that are issued by the Reserve Bank of India from time to time.
15. The mortgage guarantee company shall also comply with all the relevant Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India from time to time.
16. No single guarantee or guarantee for a housing project shall exceed 10% of the company's Tier I and Tier II capital.

Acceptance of public deposits

17. Mortgage guarantee companies shall not accept public deposits.

Creation and maintenance of Reserves

18. **Contingency Reserves:** A mortgage guarantee company shall create and maintain a “Contingency Reserve” on an ongoing basis. The mortgage guarantee company:
 - (a) Shall appropriate each year **at least** forty percent (40%) of the premium or fee earned during that accounting year or twenty five percent (25%) of the profit (after provisions and tax), whichever is higher, to the Contingency Reserve;
 - (b) In case of inadequate profits, such appropriation shall either result in or increase the amount of carry forward loss;
 - (c) May appropriate a lower percentage of the premium or fee earned during any accounting year when the provisions made each year towards losses on account of settlement of mortgage guarantee claims exceeds thirty-five percent (35%) of the premium or fee earned during that accounting year;
 - (d) Shall ensure that the Contingency Reserve is **at least five percent** (5%) of the total outstanding mortgage guarantee commitments;
 - (e) Shall retain the amounts appropriated each year to the Contingency Reserve for a minimum period of seven (7) subsequent years which shall be eligible for reversal only in the eighth year;
 - (f) Shall utilize the Contingency Reserve only with the prior approval of the Reserve Bank of India;
 - (g) Shall show the amount of ‘Contingency Reserve’ as a separate line item on the liability side of the Balance sheet.

19. **Accounting of Unearned Premium:** A mortgage guarantee company shall account the premium or fee on the mortgage guarantee contracts as an income in the profit and loss account over the period of mortgage guarantee in accordance with the accounting standards issued by the Institute of Chartered Accountants of India. The amount of unearned

premium shall be shown as a separate line on the liability side of the Balance sheet.

20. **Provision for losses on invoked guarantees:** A mortgage guarantee company is exposed to a potential loss when its guarantee is invoked. Mortgage guarantee companies shall hold provisions for losses in respect of such invoked guarantees pending recovery of assets. The amount of provisions required to be held shall be equal to the contract-wise aggregate of 'amount of invocation' after adjusting the realisable value of the assets held by the company in respect of each housing loan where the guarantee has been invoked. In case the realisable value of the assets held in respect of any invoked guarantee is more than the amount of invocation, the excess shall not be adjusted against the shortfall in other invoked guarantees. In case the amount of provisions already held is in excess of the amount as computed above, the excess shall not be reversed. The amount of provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of Provision held for losses on settlement of invoked guarantees shall be shown as a separate line item on the liability side of the Balance sheet.
21. **Provision for 'Incurred But-Not-Reported (IBNR) losses':** A mortgage guarantee company is exposed to a potential loss when there is a default in a housing loan guaranteed by it. Mortgage guarantee companies shall hold provisions in respect of such defaulted housing loans where the trigger event is yet to occur or the guarantee is yet to be invoked. The potential loss to which the guarantee company is exposed to is referred to as 'Incurred-But-Not-Reported (IBNR) losses'. The amount of provisions required to be held shall be arrived at on an actuarial basis depending upon the estimates of loss frequency and loss severity for incurred but not reported losses which are derived from historic data, trends, economic factors and other statistical data in relation to paid claims, the provisions held for claims settled, risk statistics, etc. In case the amount of provisions already held is in excess of the amount as computed above, the excess

shall not be reversed. The amount of provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of Provision held for Incurred But-Not-Reported (IBNR) losses shall be shown as a separate line item on the liability side of the Balance sheet.

Requirement of maintaining Register of guarantees

22. Every mortgage guarantee company shall keep one or more registers in which shall be entered the particulars of guarantee provided by the company, namely,
- a. name and address of the borrower/co-borrower,
 - b. date and the amount of loan sanctioned to the borrower,
 - c. brief description of the property including the site/location of the property,
 - d. the nature of security available for the loan,
 - e. tenure of the loan,
 - f. amount of each installment and due date for the payment of each installment,
 - g. name and address of the bank or housing finance company to whom the guarantee has been provided,
 - h. date and amount of the guarantee, and
 - i. duration of the guarantee.

Mortgage guarantee company's obligations

23. The liability of the mortgage guarantee company in respect of a secured housing loan granted by a creditor institution where the mortgage guarantee company has provided a guarantee shall be as stipulated in the contract of guarantee entered into by and between the mortgage guarantee company, the creditor institution and the borrower.

24. On any day after a trigger event, the creditor institution, which has obtained a mortgage guarantee from a mortgage guarantee company, shall be eligible to invoke the guarantee against the mortgage guarantee company.
25. The mortgage guarantee company shall make good the guarantee liability without demur as and when a notice of demand for the payment of the guarantee liability in respect of the mortgage guarantee provided by it in favour of a bank or a housing finance company is received by it.
26. If a housing loan turns into a non-performing asset and the creditor institution prefers first to realize the loan by resorting to speedy recovery procedures prescribed in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the creditor institution, realizes some amount of the loan from the borrower, the liability of the mortgage guarantee company in respect of the loan, will stand reduced to that extent.
27. No mortgage guarantee company shall provide mortgage guarantee for a housing loan with 90% and above LTV ratio.

Due diligence to be exercised by a mortgage guarantee company

28. Before offering to provide a guarantee for the repayment of a housing loan, the mortgage guarantee company shall be required to be satisfied with amongst others, the following;
 - (a) that the loans are secured by a valid mortgage;
 - (b) that the creditor institution has verified title to the property, marketability of the property and credit worthiness of the borrower;
 - (c) that the creditor institution has verified the use of the land on which a residential house is constructed or proposed to be constructed out of the loan obtained from it;

- (d) that the creditor institution has verified and obtained a copy of the permission obtained by the borrower from the proper authorities for the purpose of construction of the residential house; and
- (e) that the loan granted by a creditor institution to a borrower is not more than 90% of the value of the property.

Prohibitions

- 29. A housing loan which is not secured by a valid mortgage of the house / flat that is or is proposed to be acquired shall not be eligible for a mortgage guarantee from a mortgage guarantee company.
- 30. **No commissions, rebates or inducements-** A mortgage guarantee company shall not pay commissions, rebates, or other inducements for referral of mortgage guarantee business to any person.
- 31. **Prohibition on guaranteeing mortgage originations of an affiliate** – A mortgage guarantee company shall not provide guarantees on mortgage originations of promoters, subsidiaries, associates, and affiliates including companies where the mortgage guarantee company has a material investment or interest of five percent (5%) or more.
- 32. **Investments:** A mortgage guarantee company shall not invest in notes or other evidences of indebtedness secured by a mortgage or other lien upon real property. This section shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contracts of sale are acquired in the course of the good faith settlement of claims under policies issued by the mortgage guarantee company, or in good faith disposition of real property so acquired.

Constitution of Audit Committee

- 33. A mortgage guarantee company shall constitute an Audit Committee consisting of not less than three non-executive Directors of the Board of the company, at least one of whom will be a chartered accountant.

Policy for grant of guarantee

34. The Board of Directors of a mortgage guarantee company shall frame a policy for the company for providing mortgage guarantee to creditor institutions. Such policy shall, inter alia, stipulate the following,-
- (a) the fee or premium chargeable for providing a mortgage guarantee based on specific identified criteria including the quantum of loan; LTV ratio; credit quality of the borrower; and credit appraisal / credit risk management skills of the bank or housing finance company,
 - (b) delegation of power for providing a mortgage guarantee and to enter into a contract of guarantee,
 - (c) delegation of power for taking a decision to make good the claims received from banks and housing finance companies, and
 - (d) delegation of power for initiating proceedings for the recovery of its dues from the borrowers.

Scheme of Mortgage Guarantee

35. For the purpose of providing mortgage guarantee, the mortgage guarantee company shall prepare a detailed scheme duly approved by its Board of Directors. The scheme shall contain matters, amongst others, the following;
- (a) the quality of a housing loan,
 - (b) the maximum portion of a housing loan granted by a bank or a housing finance company to a borrower, that may be covered under the contract of guarantee,
 - (c) the minimum and the maximum LTV ratio of a housing loan proposed to be covered under the contract of guarantee,
 - (d) the fee or premium or charge indicating the manner for the payment there of, payable by a borrower to the mortgage guarantee company in consideration for the contract of guarantee,
 - (e) the liability of the mortgage guarantee company as to whether the liability will be co-extensive with that of the borrower or otherwise, and
 - (f) the conditions governing the issue as to which party of the mortgage guarantee company or a bank/ housing finance company will be required to effect recoveries from the borrower after the mortgage

guarantee is invoked and the guarantee liability is made good by the mortgage guarantee company to the bank or housing finance company.

Counter-guarantee

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