RBI/2010-11/31

DNBS (PD-MGC) C.C. No. 6 / 23.11.01 / 2010-11 **July 1, 2010**

The Chairman/CEOs of all Mortgage Guarantee Companies

Dear Sir,

Notification as amended up to June 30, 2010 – "Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008"

As you are aware, in order to have all current instructions on the subject at one place, the Reserve Bank of India issues updated circulars / notifications. The instructions contained in the notification No.DNBS (MGC) 4/ CGM(PK) - 2008 dated February 15, 2008 updated as on June 30, 2010 are reproduced below. The updated Notification has also been placed on the RBI web-site (http://www.rbi.org.in).

Yours faithfully,

(Uma Subramaniam)
Chief General Manager -in-Charge

RESERVE BANK OF INDIA
DEPARTMENT OF NON-BANKING SUPERVISION
CENTRAL OFFICE
CENTRE I, WORLD TRADE CENTRE
CUFFE PARADE, COLABA
MUMBAI 400 005

Notification DNBS(PD)MGC No.4 /CGM (PK) - 2008 dated February 15, 2008

The Reserve Bank of India, having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, it is necessary to issue the directions relating to the prudential norms as set out below, in exercise of the powers conferred by Section 45JA of the Reserve Bank of India Act, 1934 (2 of 1934) and of all the powers enabling it in this behalf, gives to every Mortgage Guarantee Company the directions hereinafter specified.

<u>Short title, commencement and applicability of the directions</u>

1. (i) These directions shall be known as the "Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008".

(ii) These directions shall come into force with immediate effect and shall apply to every Mortgage Guarantee Company which has been granted Certificate of Registration under the scheme of Registration of Mortgage Guarantee Companies by the Reserve Bank of India.

<u>Definitions</u>

2. (1) For the purpose of these directions, unless the context otherwise requires:

(i) “doubtful asset” means an asset which remains a sub-standard asset for a period exceeding 12 months;

(ii) “hybrid debt capital instrument” means capital instrument which possesses certain characteristics of equity as well as of debt;

(iii) “loss asset” means:

(a) an asset which has been identified as loss asset by the mortgage guarantee company or its internal or external auditor or by the Reserve Bank of India, to the extent it is not written off by the mortgage guarantee company; and

(b) an asset which is adversely affected by a potential threat of non-recoverability for reasons like erosion in the value of security or non availability of security or due to any fraudulent act or omission on the part of the borrower, etc.;

(iv) “Mortgage Guarantee Company” means as defined in paragraph 2(1)(l) of the Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008;

(v) (I) For the purpose of these directions ‘net owned fund’ means:

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the company after deducting therefrom-

(i) accumulated balance of loss;

(ii) deferred revenue expenditure; and

(iii) other intangible assets; and

(b) further reduced by the amounts representing-

(1) investments of such company in shares of-

(i) its subsidiaries;

(ii) companies in the same group;

(iii) all other non-banking financial companies; and

(2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with-

(i) subsidiaries of such company; and

(ii) companies in the same group,

to the extent such amount exceeds ten per cent, of (a) above.

(II) "subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956 (1 of 1956).]

(vi) ‘non-performing asset’ (NPA) in respect of mortgage guarantee asset means,

an asset acquired from the credit institution on the happening of trigger event which is straight away classified as non-performing asset and shall thereafter be classified according to the age of NPA;

(vii) “owned fund” means paid up equity capital, free reserves including contingency reserves maintained as per paragraph 18 of the Guidelines on Registration and Operations of Mortgage Guarantee Company, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any;

(viii) “standard asset” means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business;

(ix) “sub-standard asset in respect of mortgage guarantee asset” means an asset which has been classified as non-performing asset for a period not exceeding 12 months;

(x) "subordinated debt" means an instrument, which is fully paid up, is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of the mortgage guarantee company. The book value of such instrument shall be subjected to discounting as provided hereunder:

Remaining Maturity of the instruments	Rate of discount
(a) Upto one year	100%
(b) More than one year but upto two years	80%
(c) More than two years but upto three years	60%
(d) More than three years but upto four years	40%
(e) More than four years but upto five years	20%

to the extent such discounted value does not exceed fifty per cent of Tier I capital;

(xi) "substantial interest" means holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together in the shares of a company, the amount paid up on which exceeds ten per cent of the paid up capital of the company; or the capital subscribed by all the partners of a partnership firm;

(xii) "Tier I Capital" means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund;

Note;- Investment in shares of subsidiaries, companies in the same group and other NBFCs refers to that which has been acquired by the mortgage guarantee company in satisfaction of debt;

(xiii) "Tier II Capital" includes the following:-

(a) preference shares;

(b) revaluation reserves at discounted rate of fifty five percent;

(c) 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 and provisions made on standard assets, to the extent of one and one fourth percent of risk weighted assets;

(d) hybrid debt capital instruments; and

(e) subordinated debt,

to the extent the aggregate does not exceed Tier I capital;

(xiv) 'Turnover or business turnover' means the total mortgage guarantee contracts entered during the year together with the volume of business arising out of other activities undertaken during the year;

(2) Other words or expressions used but not defined herein and defined in the Reserve Bank of India Act, 1934 (2 of 1934) or Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008 contained in Notification DNBS(PD)MGC)No.3 /CGM (PK) - 2008 dated February 15, 2008 shall have the same meaning as assigned to them under that Act or that Directions. Any other words or expressions not defined in that Act or that Directions, shall have the same meaning assigned to them in the Companies Act, 1956 (1 of 1956).

<u>Income recognition</u>

3. (i) Income including interest/discount or any other charges on an asset which is NPA or on an asset which is NPA and is taken over from creditor institution on happening of trigger event shall be recognised only on cash basis.

(ii) A mortgage guarantee company shall account the premium or 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. The amount of unearned premium shall be shown as a separate line on the liability side of the balance sheet.

(iii) In respect of any other business undertaken by the mortgage guarantee company as specified in Section 45 I (c) of the RBI Act, 1934 within the permitted limit, income shall be recognised as per income recognition norms prescribed for such assets as contained in the "Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007".

Accounting standards

4. Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these directions as "ICAI") shall be followed insofar as they are not inconsistent with any of the provisions of these directions.

Asset Classification

5. (1) Every mortgage guarantee company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify its assets, loans and advances and any other forms of credit into the following classes, namely:

(i) Standard assets*;
(ii) Sub-standard assets;
(iii) Doubtful assets; and
(iv) Loss assets.

* Assets acquired under guarantee obligations will not be classified as standard assets.

(2) The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions as stipulated by the Bank from time to time, required for the upgradation.

Provisioning requirements

6. (1) **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.

(2) **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.

(3) Subject to what has been mentioned above, every mortgage guarantee company

shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against each class as provided hereunder :-

(4) **Mortgage guarantee assets**

The provisioning requirement in respect of mortgage guarantee assets shall be as under:

(i) Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for;
(ii) Doubtful Assets	(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the mortgage guarantee company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis; (b) In regard to the secured portion, provision is to be made on the following basis to the extent of 20% to 100% of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the asset has remained in doubtful category	**% of provision**
Up to one year	20
One to three years	30
More than three years	100

(iii) Sub-standard assets	A general provision of 10% of total outstanding shall be made.

For Standard Assets

Standard asset	Mortgage guarantee companies should make general provisions for standard asset on the following basis;

(a) Guarantee cover for residential housing loans beyond Rs. 20 lakhs at 1%;

(b) All other guarantee cover at 0.40%

Notes:

(1) The provisions on standard asset should not be reckoned for arriving at net NPAs.
(2) The provisions towards standard assets need not be netted from gross advances but shown separately as ‘Contingent Provisions against Standard Assets’ under ‘Other Liabilities and Provisions Others’ in the balance sheet.
(3) It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.

<u>Other Activities</u>

7. A mortgage guarantee company can take up any activity up to 10% of its total assets. If a mortgage guarantee company undertakes any other business as specified in 45I(c) of the RBI Act 1934 within the permitted limit, for which Prudential Norms are already prescribed and the same is contained in Notification No. DNBS. 193 DG(VL)-2007 dated February 22, 2007, as amended from time to time, the said norms for valuation of investments, asset classification and provisioning should be followed.

<u>Accounting year</u>

8. Every mortgage guarantee company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a mortgage guarantee company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the mortgage guarantee company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date.

Disclosure in the balance sheet

9. (1) Every mortgage guarantee company shall separately disclose in its balance sheet the provisions made as per paragraph 6 above without netting them from the income or against the value of assets.

(2) The provisions shall be distinctly indicated under separate heads of account separately for mortgage guarantee business and others and individually for each type of assets as under :-

(i) provisions for bad and doubtful debts; and

(ii) provisions for depreciation in investments.

(3) Such provisions for each year shall be made from the profit and loss account.

Constitution of Audit Committee by mortgage guarantee company

10. Every mortgage guarantee company shall constitute an Audit Committee, consisting of not less than three non-executive Directors of the Board of its company, at least one of whom will be Chartered Accountant.

Explanation I: The Audit Committee constituted by a mortgage guarantee company as required under Section 292A of the Companies Act, 1956 (1 of 1956) shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 292A of the Companies Act, 1956 (1 of 1956).

Transactions in Government securities

11. Every mortgage guarantee company may undertake transactions in Government securities through its CSGL account or its demat account:

Provided that no mortgage guarantee company shall undertake any transaction in government security in physical form through any broker.

Requirement as to capital adequacy

12. (1) Every mortgage guarantee company subject to the condition that the net owned fund shall be a minimum of 100 crore rupees or such other amount that Reserve Bank of India may specify from time to time, shall maintain, a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than ten per cent of its aggregate risk weighted assets of its on balance sheet and of risk adjusted value of off-balance sheet items. Of the required capital ratio, it shall maintain at least 6% of its aggregate risk weighted assets as Tier I.

(2) The total of Tier II capital, at any point of time, shall not exceed one hundred per cent of Tier I capital.

Explanations:

On balance sheet assets

(1) In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. Hence, the value of each asset/item requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. The aggregate shall be taken into account for reckoning the minimum capital ratio. The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:

Items of assets – **On-Balance Sheet items**	**Risk weight %age**
(i) Cash	0
(ii) Bank balances and claims on banks including fixed deposits and certificates of deposits.	20
(iii) Investments	
(a) Central Government and State Government Securities	0
(b) Bonds of banks	20
(c) Fixed deposits/certificates of deposits/ bonds of public financial institutions	100
(d) Shares of all companies *and debentures/bonds/commercial papers of all companies and units of debt oriented/money market mutual funds	100

(*As per paragraph 3(ii) of Mortgage Guarantee Companies Investment (Reserve Bank) Directions, 2008 shares of corporates can be acquired only in satisfaction of debt)

(iv) Current assets	
(a) Loans and advances	100
(b) Loans to staff, if fully covered by superannuities, benefits & mortgage of flats/houses	20
(c) Other loans to staff	100
(d) Other secured loans and advances	100
(e) Others (including net stock on hire, bills purchased and discounted, etc.)	100

(v) Fixed Assets (net of depreciation)

(a) Assets leased out (net book value)	100
(b) Premises	100
(c) Furniture & Fixtures	100
(d) Other fixed assets	100

(vi) 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	0
(d) Others	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) Assets which have been deducted from owned fund to arrive at net owned fund shall have a weightage of `zero'.

(3) While calculating the aggregate of funded exposure of a borrower for the purpose of assignment of risk weight, mortgage guarantee companies may net off the amount of cash margin/caution money/security deposits (against which right to set-off is available) held as collateral against the advances out of the total outstanding exposure of the borrower.

Off-balance sheet items

(2) In these Directions, degrees of credit risk exposure attached to off-balance sheet items have been expressed as percentage of credit conversion factor. Hence, the face value of each item requires to be first multiplied by the relevant conversion factor to arrive at credit equivalent value of off-

balance sheet item. The credit equivalent value of each item shall have to be again multiplied by the risk weight as applicable to the respective counterparties. The aggregate risk weighted value shall be taken into account for reckoning the minimum capital ratio. The credit equivalent value of the off-balance sheet items shall be calculated as per the credit conversion factors for non-funded items as detailed hereunder:

Nature of item	Credit conversion factor – Percentage
i) Financial & other guarantees	100
ii) Underwriting obligations in r/o capital investment such as shares/ debentures, etc	50
iii) Partly-paid shares/debentures	100
iv) Lease contracts entered into but yet to be executed	100
v) Other contingent liabilities	50

Note: Cash margins/deposits shall be deducted before applying the conversion factor.

Loans against Mortgage Guarantee Company's own shares prohibited

13. (1) No mortgage guarantee company shall lend against its own shares.

(2) Any outstanding loan against its own shares shall be recovered by the mortgage guarantee company as per the repayment schedule before grant of Certificate of Registration to it.

Concentration of credit/investment

14. (1) No mortgage guarantee company shall lend to

(a) any single borrower exceeding fifteen per cent of its owned fund; and

(b) any single group of borrowers exceeding twenty five per cent of its owned fund.

(2) Every mortgage guarantee company shall formulate a policy in respect of exposures to a single party / a single group of parties.

Notes :

(1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as explained above.

(2) The investments in debentures for the purposes specified in this paragraph shall be treated as credit and not investment.

(3) These ceilings shall be applicable to credit exposure by such a mortgage guarantee company to companies/firms in its own group as well as to the borrower company's group.

Information in regard to change of address, directors, auditors, etc. to be submitted

15. Every mortgage guarantee company shall communicate to Reserve Bank of India, not later than one month from the occurrence of any change in:

(a) the complete postal address, telephone number/s and fax number/s of the registered/corporate office;

(b) the names and residential addresses of the directors of the company;

(c) the names and the official designations of its principal officers;

(d) the names and office address of the auditors of the company; and

(e) the specimen signatures of the officers authorised to sign on behalf of the company.

Exemptions

16. The Reserve Bank of India 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 mortgage guarantee company or class of mortgage guarantee companies, from all or any of the provisions of these instructions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

Interpretations

17. For the purpose of giving effect to the provisions of these directions, the Reserve Bank of India may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these directions given by the Reserve Bank of India shall be final and binding on all the parties concerned.

(P. Krishnamurthy)
Chief General Manager-in-Charge