

Dr. Harsh vardhan committee on the development of housing finance securitisation market

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Home loans suffer from a structural asset-liability management challenge for the lenders due to mismatch in the maturity period of home loans (typically, long term maturity) and funding sources for HFCs (typically, short term maturity). To overcome this, HFCs raise funds by pooling the home loans to issue securities backed by these loans. This is known as securitization.

What is the current status?

Currently, securitization is done through:

- The direct assignment (DA) method, or The pass-through certificates (PTC) method. Both involve the pooling of loans and selling them to a third party, thereby transferring the credit risk. However, in the case of securitization through PTC, the pooled loans are sold through an intermediary, set up as a special purpose vehicle.
- The Committee observed that the growth in the securitization market has been dominated by DA transactions (PTC transactions were just a quarter of total transactions in 2019).
- The Committee noted that securitization done through the DA route involves customized, bilateral transactions which keeps the details of transaction (such as valuation, pool performance, and prepayment) in private domain. This inhibits other participants (such as mutual funds, insurance, and pension funds) from participating. Further, these transactions have very little

standardization.

- Another major challenge associated with securitization is the added transaction cost which arises from legal and regulatory requirements, uncertainty in taxation, and accounting standards.

Recommendations of the committee

In view of these challenges (mentioned above), the Committee made these recommendations:

- Government-sponsored intermediary: The committee recommends that an intermediary should be set up through the National Housing Bank to promote housing finance securitization. It will be responsible for market-making and standard-setting.
- Standardization: To improve standardization, specific standards should be set up for loan origination, loan servicing, loan documentation, and loan eligibility for securitization. Further, standard formats should be established for data collection and aggregation for housing loan related data.
- The regulatory treatment for DA and PTC should be distinct from separate guidelines. Guidelines on securitization should only apply to PTC transactions. DA transactions should not be treated as securitization as it does not involve the issuance of securities. Further, PTCs issued in mortgage-based securitization should be mandatorily listed if the securitization pool is over Rs 500 crore.
- Regulatory treatment should be different for mortgage-backed securitization and asset-backed securitization. Further, the central government can exempt mortgage-based transactions from stamp duty. Mortgage loans can also be exempted from registration since they are essentially movable assets, unlike the underlying assets.
- Bankruptcy remoteness: Currently, securitization

transactions are bankruptcy remote, which means that in the event the originator of loans becomes insolvent and undergoes bankruptcy, the securitized pool of assets is excluded from the assets of the originator during the liquidation process. The Committee recommended that any law for resolving bankruptcy of financial firms should ensure that assets underlying a securitization transaction are bankruptcy remote, to ensure that investors are not discouraged from participating in securitization transactions