Covered Bonds,
a requirement

NOTICE: This document contains confidential, non-public company Information.
Further distribution of this document is strictly prohibited.

Contents

Background

- Indian Mortgage Industry is ~8% of GDP at INR 10.6 trillion
- Market dominated by a few players – top 10 players account for 75% of the market or 4 players account for ~56%
- HFCs/ NBFCs account for only ~37% of market of which top 4 account for 34% of the market
- Total 64 HFCs registered – assuming 50% not operational…30 HFCs account for 3% of market share i.e.an average of only INR 1000 –INR 1200 crores per HFC
- Why this huge gap between small players and large players
  - Is it on account of reach to end customers?
  - **Or is it access to funding options?**

Funding Options of HFCs

- Over all gearing of HFCs ranges between 7-8 times with a median capital adequacy of ~ 18%
- Alternate borrowing options for HFCs
  - NCDs / Commercial paper *(mainly large HFCs)*
  - Fixed Deposits
  - Bank Loans
  - NHB Refinance
  - Securitisation (off balance funding)
- Rating Profile of HFCs
  - Around 3-4 HFCs have a AAA rating and ~ 15 have a AA rating
- **Hence the borrowing cost (balance sheet funding) is high for most HFCs resulting in thin Net Interest Margins**

An alternative and less expensive source of funding is the "need of the hour"

Whether Covered Bonds meet the requirement

What are Covered Bonds

Covered Bond is a variant of mortgage backed securities, but is on the balance sheet of the issuer / originator

OR

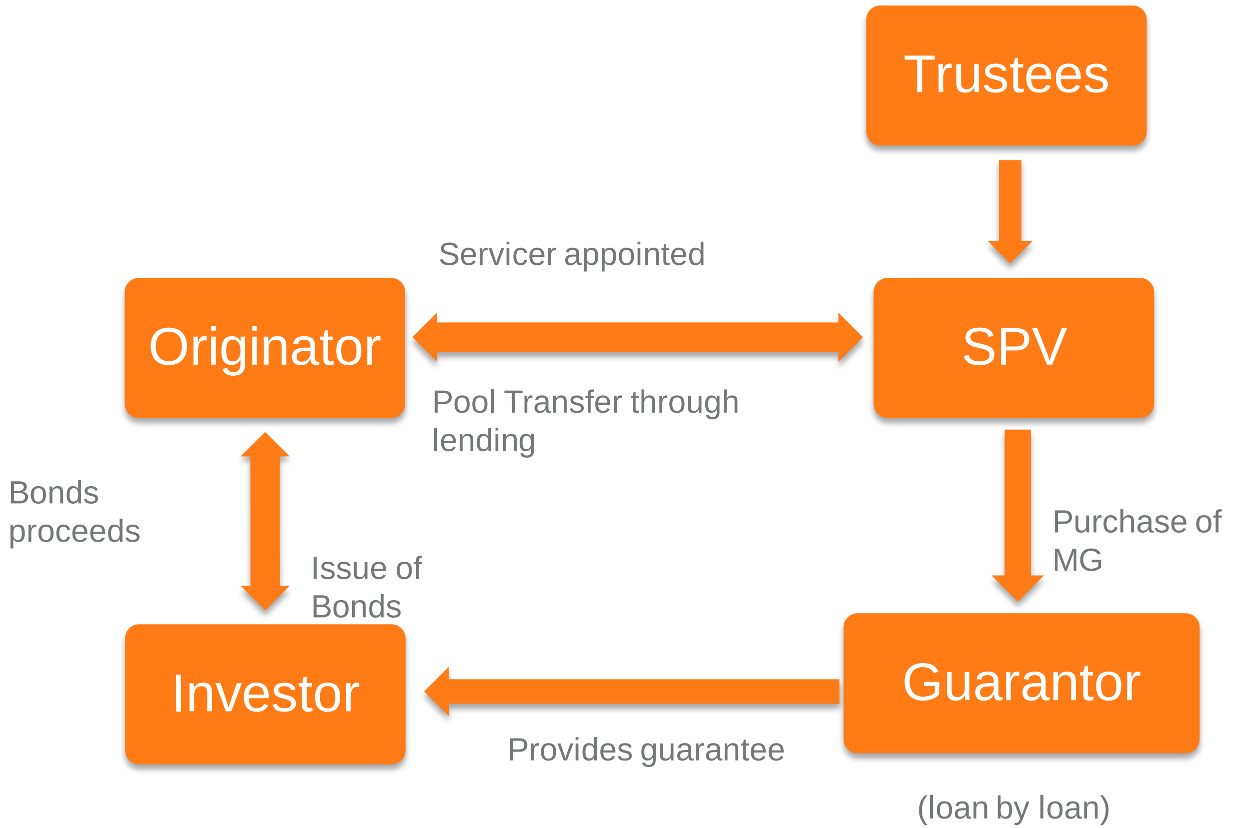
Covered Bond is a Corporate Bond with a recourse to an asset pool in case the issuer becomes insolvent

- Covered bond has a blend of both – Corporate Bond and Asset Backed Securities

- Have been in existence for more than 200 years
- Were mostly prevalent in the European nations
- Gained popularity in the US and other markets post GFC

- Currently no legislation protection in India

Typical Structure of Covered Bonds



How Covered Bonds help?

- Facilitate differential rating, hence can bring down cost of funding
- On balance sheet funding, improve leveraging
- Bankruptcy proof, hence will attract investors

What makes covered bonds attractive

- Benefits to the Issuer
  - Rating better than the rating of the issuer hence cost efficient
  - Balance sheet funding resulting is improving leveraging or no de-leveraging as in the case of securitisation
  - Alternate source of funding (likely to attract new investors)
- Benefits to the Investor
  - Dual recourse, in case of insolvency of issuer, has a fall back option on the asset pool
  - Cash flows not tied to the pool, hence investors not impacted by prepayments / balance transfers
  - Fixed repayment schedules
  - Issuer and Investor interest is aligned, as it is balance sheet funding
- Benefits to the economy
  - Bond Market development
  - Financial stability

How MG can help?

What is Mortgage Guarantee

- Mortgage Guarantee (MG) or more known as Mortgage Insurance (MI) in other countries, is a product designed to offer credit protection to lenders of home loans.
- The following additional benefits are inherent to the product:
  - Release of Regulatory Capital *(by reduced risk weight)*
  - Release of Economic Capital *(recognised by credit rating institutions)*
  - Lowering of credit enhancement (in securitisation transactions)
  - Improvement in return of Equity by
    - Expansion of books with same level of equity
    - Expanding the addressable market for a lender
  - **Better Delinquency Management**
  - **Second, independent review of the credit worthiness of mortgage loans**

How MG can Help?

- **By providing loan by loan guarantee on the underlying collateralized pool**
- **Efficient Collateralization**
- **Assistance in better delinquency management**

Sample Comparison

	Without MG	With MG
FD as Credit Enhancement	12%	6%
MRR	0%	4%
Pool Level Cover	0%	10%
Total Credit Enhancement	12%	20%

The approximate **Net Savings** to the originator in a securitisation transaction, on account of MG ranges between **2%-3%** of the pool size.