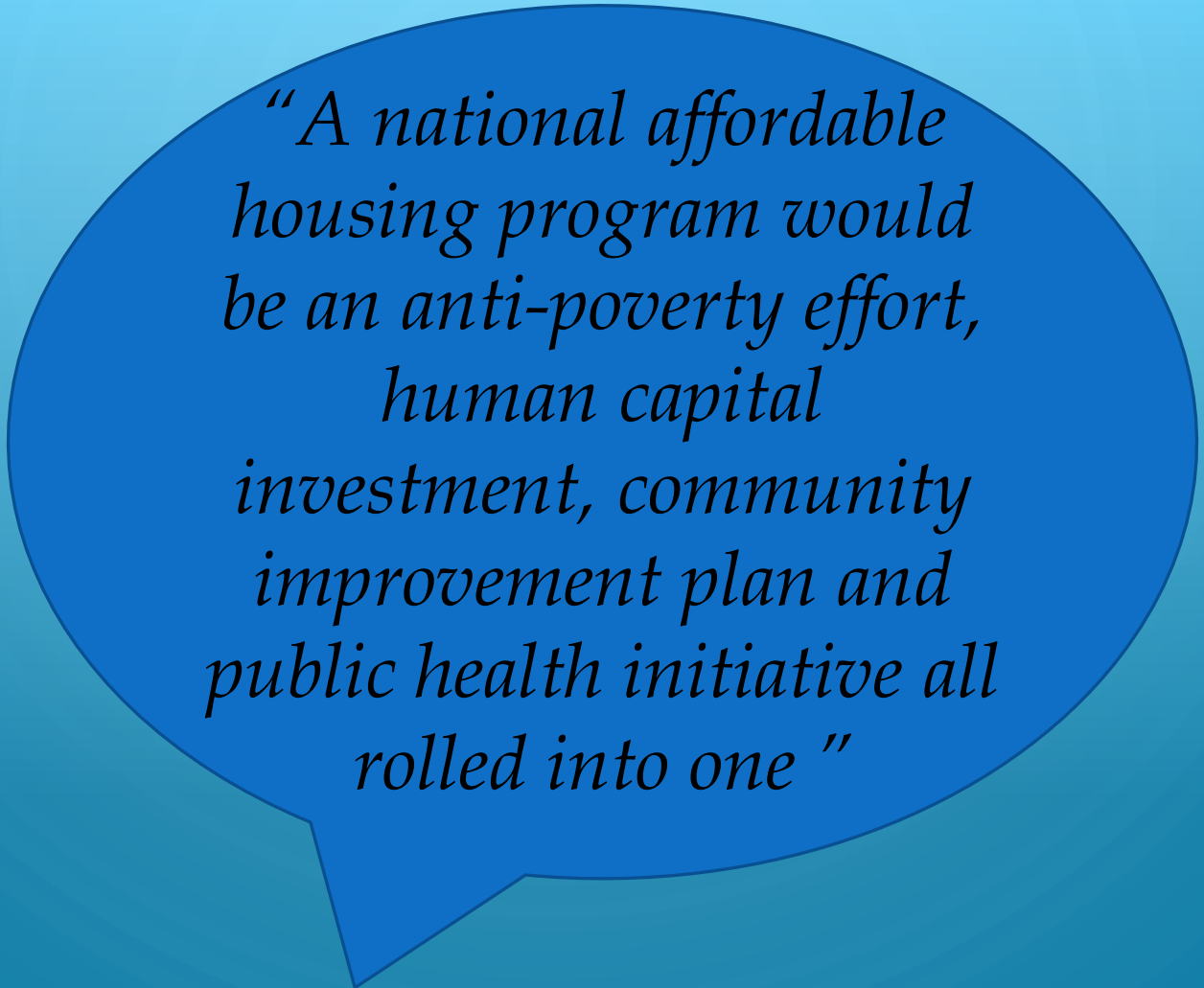


# **INDIA SECURITIZATION FORUM**

## **SECURITIZATION : AN ECOSYSTEM PERSPECTIVE**

**MAY 19, 2023**

**RV VERMA**



*“A national affordable housing program would be an anti-poverty effort, human capital investment, community improvement plan and public health initiative all rolled into one ”*

Desmond Matthew

# AFFORDABLE HOUSING

- GOVERNMENT POLICIES : CENTRE-STATE COORDINATION
- REGULATIONS AND PROMOTION
- MARKET INFRASTRUCTURE
- SUBSIDIES AND MARKET FUNDING : CROWDING IN THE PRIVATE INVESTMENTS
- ENHANCING INCLUSION AND AFFORDABILITY

# SUSTAINABLE FUNDING

- NEED FOR POLICY FRAMEWORK AND BUSINESS MODEL
- NHB'S REFINANCE
- SUBSIDIES UNDER PMAY (URBAN AND GRAMEEN)
- CGTFLIH (CREDIT GUARANTEE) AND SECURITIZE
- LEVERAGING MICRO HOUSING LOANS
- FUNDING DIVERSIFICATION FOR HFCs AND BANKS

# ACCESSIBILITY

- INCLUSIVE HOUSING : CENTRE/STATE PARTNERSHIP
- INCLUSIVE HOUSING FINANCE
- MASS HOUSING FOR EWS/LIG : GAPS IN POLICIES AND MARKET
- CHALLENGES AND OPPORTUNITIES
- MANDATE AND INCENTIVES
- REACH AND PENETRATION OF FINANCIAL SECTOR

# ROLE OF SECURITIZATION

- AN IMPORTANT INNOVATIVE MEANS FOR EXPANSION AND DEMOCRATIZATION OF CREDIT
- A PERENNIAL SOURCE OF FUNDING AND LIQUIDITY
- INCREASES ACCESS TO CAPITAL MARKET AND DIVERSIFIES RISK
- CONNECTS REAL ECONOMY WITH THE FINANCIAL AND CAPITAL MARKET
- SECURITIZATION : A MAJOR DRIVER OF FINANCIAL INNOVATION AND FINANCIAL FRAGILITY : ADAIR TURNER (Chairman, FSA, UK 2008-2013)

# SCOPE FOR SECURITISATION

## SECTOR PERSPECTIVE

- Capital Deficient Sector
- Growing Primary Market
- Shift towards Market-based Resource Mobilization
- Meeting Investors needs
- Creation of a Long-term Debt market through introduction of MBS
- MBS will integrate the housing market with the capital market

## LENDERS' PERSPECTIVE

- Liquidity Requirement
- Capital Relief
- Risk Dispersion
- Exposure Norms
- ALM Position
- Balance Sheet Management
- Leveraging Performance

## INVESTORS' PERSPECTIVE

- Exposure to the underlying mortgages
- Appreciating Assets
- Transparent Valuation
- Diversified Risk
- Range of Investment options
- Regulatory/Fiscal Incentives
- Liquidity through Trading
- Risk Mitigation through Mortgage Guarantee

## **BENEFITS OF SECURITISATION**

- Off balance sheet financing
- Alternative investor base-retail & institutional
- Sharing of risk
- Improves capital structure
- Better asset liability management
- Lower cost and positive impact on return on equity
- Reduce credit concentration
- Avoids interest rate risks



# FEATURES OF MBS MARKET

- Prudent lending with transparency
- Tracking the underlying assets
- Securitisation to induce greater discipline
- Promote growth with stability
- Role of Rating agencies
- Higher due diligence standards
- Proactive supervision of papers and the underlying cash flows
- Conforming Mortgages
- Standardized Pool Selection criteria
- Seasoning requirement
- Consistent performance
- High Collection efficiencies
- Consistent payments to Investors
- Servicer Audit
- SPV Audit
- Surveillance by Rating Agencies

# SUBPRIME MORTGAGES?

**Mortgage loans to high risk borrowers with low or uncertain incomes, low assets, high debt/ income and poor credit histories**

**Costly due to high risk : Low Doc/Low Income loans**

**Low origination and documentation standards; Originate – To - Sell**

# KEY PLAYERS IN THE GAME



**LENDERS WHO  
MADE LENIENT  
LOANS**



**HOME BUYERS  
WHO SOUGHT  
EASY  
MORTGAGES**



**WALL STREET  
UNDERWRITERS  
WHO TURNED  
THEM INTO  
SECURITIES**



**INVESTORS  
WHO WANTED  
HIGHER YIELDS**



**CREDIT RATING  
FIRMS**



# WHAT DROVE GROWTH?

**High demand for mortgages**

**Enhanced opportunity for borrowers to refinance**

**High LTV**

**Declining Interest Rates**

**Borrowing more attractive versus renting**

**Investors demand for MBS**

**Lenders and Investors- In pursuit of higher yields**



# WHAT DROVE GROWTH?

**High Liquidity**

**High Risk appetite**

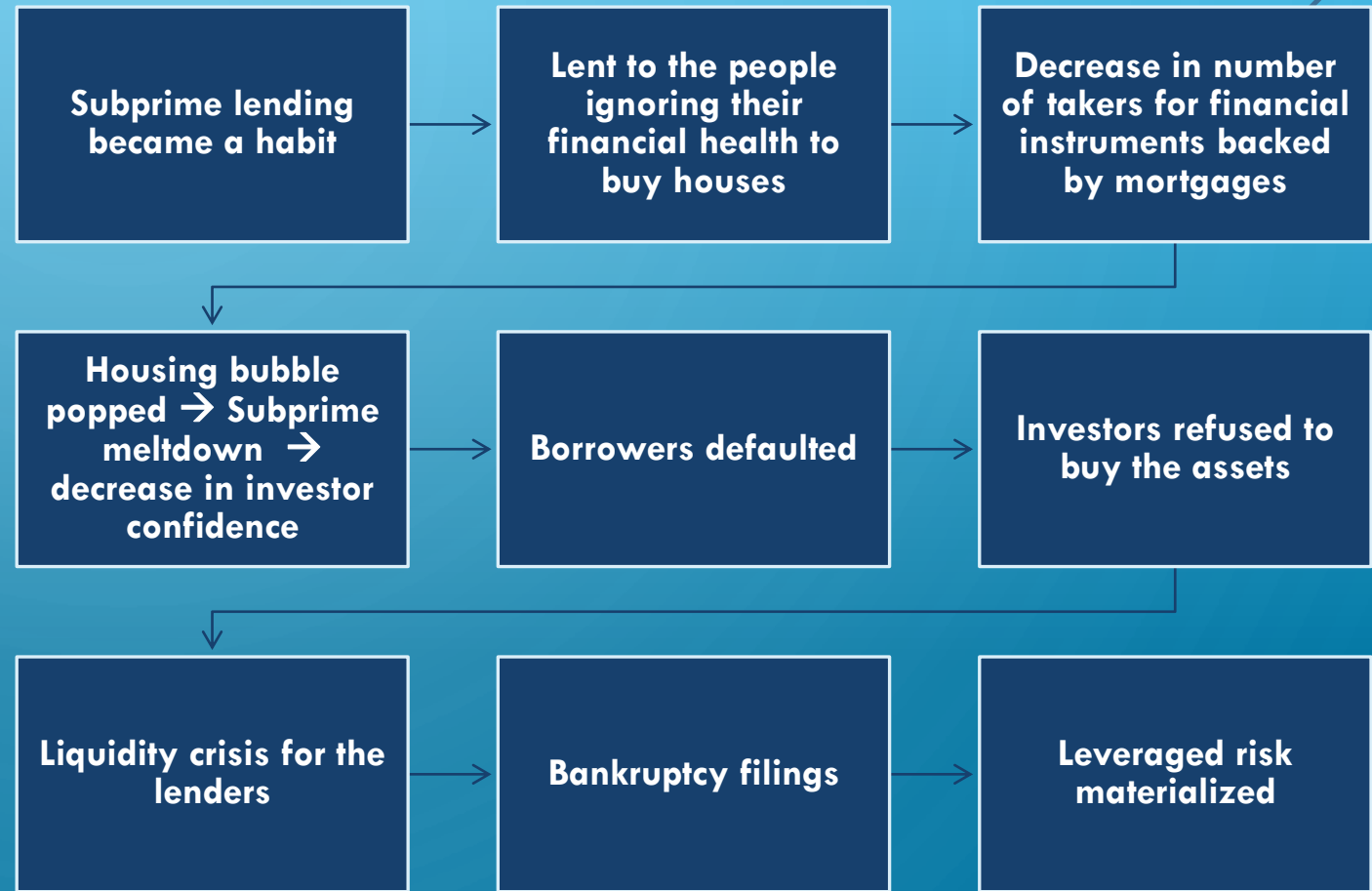
**Lenders- In search of business**

**Aggressive lending practices**

**Declining Interest rates**

**Rising property values**

# CHAIN REACTION- A SEQUENCE



# IMPACTS ON HOUSING MARKET

**Increased foreclosures**

**Distress sales**

**Prices declining**

**Interest rates moving-up**

**Resulting in higher defaults**

**Reverse conditions since 2004- rising interest rates and falling property prices**

**Precipitated the Crisis**

**Full circle**

# GLOBAL FINANCIAL CRISES CAUSES

- Poor underlying loan origination process
- Unprecedented issuance of complex and opaque securitized products
- Rating shopping resulting in upwardly biased ratings
- Highly accommodative monetary policy
- Deficient regulation
- Misaligned Incentives



# GFC : LESSONS

- Prudent lending with transparency
- Clear assessment and pricing of risk
- Securitisation is a good tool to be carefully used
- Regulating Rating agencies
- Promote growth with focus on stability
- Need for higher due diligence standards and transparency; borrowers, lenders and investors must clearly understand the product
- Supervisors need to be more alert and proactive

**“Securitization is both a tool for financial stability and a source of financial instability”**

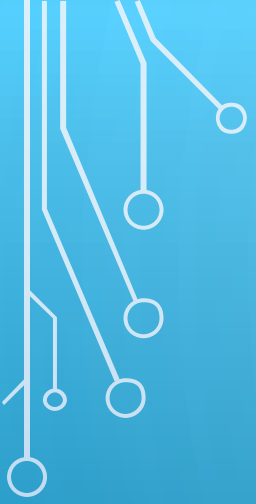
**Christine Lagard**

# POST GFC- REGULATORY RESPONSES

- Aiming for simple, transparent and standardized securitisation system
- Enhancing disclosure requirements to ensure better transparency
- Risk retention requirements
- Rating agency reforms
- Enhanced capital requirements
- Imposing due diligence obligations

*“ The best response to the housing bubble would have been regulatory, not monetary. Stronger regulation and supervision aimed at problems with underwriting practices and lender’s risk management would have been a more effective and surgical approach to constraining the housing bubble than a general increase in interest rates”.*

Ben Bernanke  
Chairman, Federal Reserve Board



# INDIAN MORTGAGE MARKET



- Loan to value ratio is moderate
- The Indian mortgage lenders, by and large conservative and cautious
- Well regulated market, Prudential Norms and Directions
- Proactive Regulation by Central Bank
- Prudent lending practices; originate- to- hold
- Close Monitoring of property prices and NPAs
- Complex innovative financial instruments are discouraged by Regulators



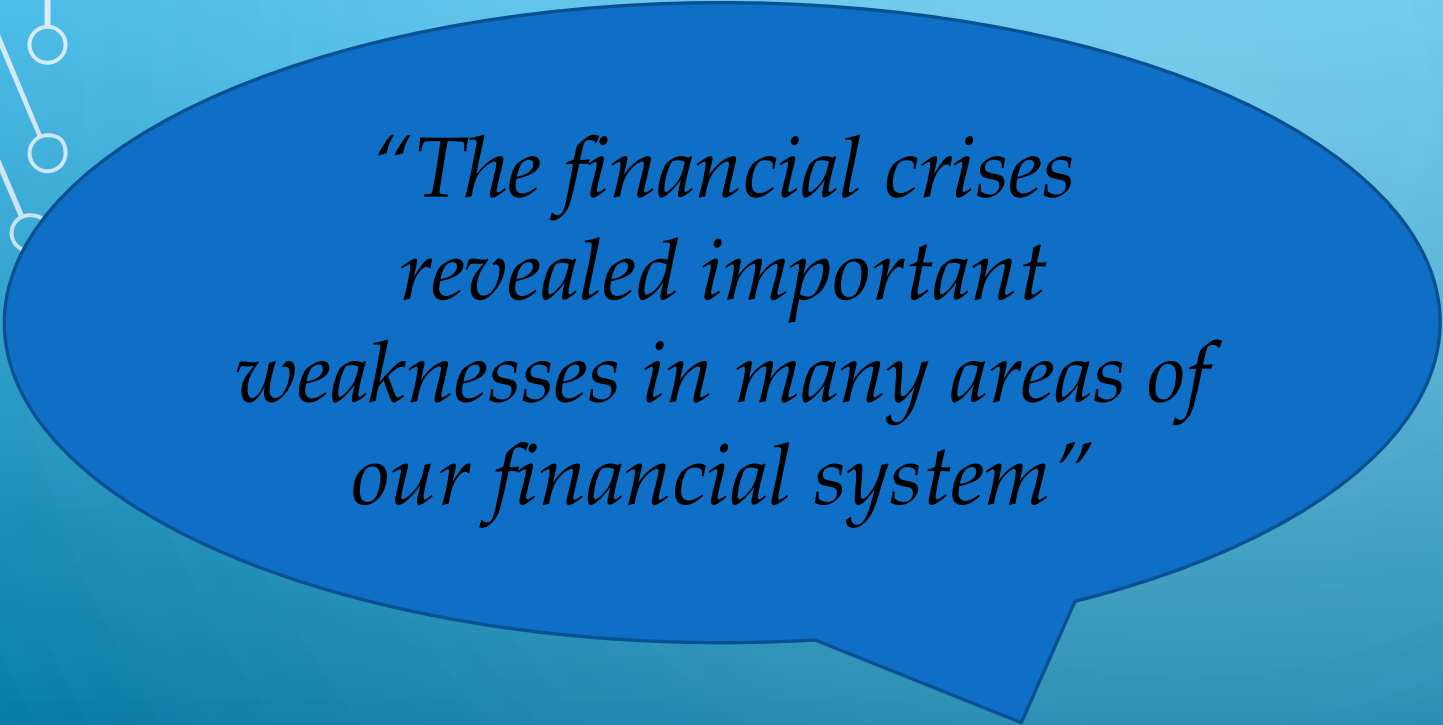
# STABILITY CHALLENGES

## CAUSES

- Overheating of the Market
- Property Price Bubble
- Oversupply of Credit
- Over supply of Housing
- Low Credit absorption capacity of the Sector
- Weak Underwriting Standards

## RESPONSES

- Monitoring Liquidity and prices
- Monitoring Price Trends and Valuation
- Regulatory Intervention (Counter cyclical) (Risk weights, LTV, Provisioning etc.)  
‘Macro and Micro prudential’
- Monitoring Housing starts, Housing stock vs Home Ownership
- Supply side Policy Distortions (Reforms)
- Regulations on Prudential Norms and close Supervision; Capacity building



*“The financial crises  
revealed important  
weaknesses in many areas of  
our financial system”*

Jerome Powell  
Chair of the Federal Reserve

# LOOKING AHEAD BEYOND DIRECT ASSIGNMENT AND PSLCS

- Need to revive the MBS market with lessons learnt
- Role for a dedicated secondary Mortgage Market Institution to act as Centralized Securitisation Vehicle
  - ❖ Bring discipline to the market
  - ❖ Prudent underwriting standards
  - ❖ Standardization in origination
  - ❖ Uniform and transparent Valuation
  - ❖ Conforming norms for securitisation
  - ❖ Access to long term Pension and Provident Funds

*Expansion in housing finance with Stability<sup>23</sup>*

“  
“Securitization has revolutionized  
the way that we finance everything  
from homes to cars to education,  
opening up new possibilities for  
Growth and Innovation”

Lawrence Summers



The background is a solid blue gradient. In the four corners, there are white line-art illustrations of circuit boards or neural networks, with lines and small circles representing nodes and connections.

***THANK YOU***