

MORTGAGED BACKED SECURITIZATION IN BANGLADESH: A TENTATIVE GUIDELINE

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Bangladesh Bank
Motijheel, Dhaka-1000
Bangladesh

Preface

This Guideline has been prepared by a committee set up by the Bangladesh Bank. Comments were received from various quarters. While preparing this guideline on Asset / Mortgage Backed Securities, the committee consulted the regional guidelines including India, Pakistan and Sri Lanka. Moreover, best practices around the developed market has also been reviewed and taken into consideration while recommending medium to long-term policies initiative to develop the overall bond market in Bangladesh. Banks and non-bank Financial Institutions in Bangladesh can follow this as tentative guideline to develop Asset/Mortgage backed Securities in Bangladesh. This guideline should be used in consistent with other prudential norms and guidelines circulated by the Bangladesh Bank. In addition to these, Banks/Financial Institutions may use their own appraisal and control procedures in line with the objectives of their organizations. This tentative guideline revised after getting feedbacks while implementing this by the Banks/Financial Institutions and from other interested parties.

Bangladesh Bank acknowledges with gratitude, the contributions of the Committee Members and other who provided valuable comments at various stages of preparation of this document.

TABLE OF CONTENTS

1.0	INTRODUCTION AND OBJECTIVE OF THIS PAPER	1
1.1	Objectives	1
1.2	Terms of Reference	1
2.0	MORTGAGE BACKED SECURITIES-CONCEPT AND SCOPE	2
2.1	Definition of Mortgage-Backed Securities (MBS)	2
2.2	Evolution of Mortgage Backed Securities (MBS)	2
2.3	Typical Flowchart of an MBS showing Parties Involved.....	3
2.4	General features of Mortgaged Backed Securities.....	4
2.5	Types of Mortgage Backed Securities.....	4
2.5.1	Pass-throughs or Participation Certificates (PCs).....	4
2.5.2	Strips.....	5
2.6	Risk Assessment of Mortgage Backed Securities.....	5
2.6.1	Market Risk.....	5
2.6.2	Credit Risk	6
2.6.3	Prepayment Risk	7
2.7	Typical Issuer of Mortgage Backed Securities	7
2.8	Scope of MBS in Bangladesh.....	8
2.8.1	Benefits to issuers	8
2.8.2	Benefits to investors	9
2.8.3	Benefits to borrowers.....	9
2.8.4	Benefits to mortgage industry.....	9
3.0	Economics of MBS	10
3.1	General Economics	10
3.2	MBS can Reduce the Funding Cost of the Originators	11
3.3	MBS will provide Alternative Investment Tools for Institutional Investors...	12
3.4	Reasons for Promoting MBS for the Development of Capital Market.....	13
4.0	WORKING MODEL FOR MBS: Tentative MBS STRUCTURE	14
4.1	Overview of the MBS transaction	14
4.2	Entering into Memorandum of Agreement	15
4.3	Acquisition of the housing loans by the issuer	15
4.4	Consideration for the assignment.....	15

4.5	Registration of Deed of Assignment and payment of stamp duty	15
4.6	Issue of Zero Coupon Bond/Pass Through Certificates	15
4.7	Schedule of payouts	16
4.8	Pool servicing.....	16
4.9	Monthly procedure	16
4.10	Surrender of Bond before last payout.....	16
4.11	Default Management and enforcement of mortgages.....	17
4.12	Treatment of prepayment and Changes in terms of the loans.....	17
5.0	WAYS OF CREDIT ENHANCEMENT	18
5.1	Concept of Credit Enhancement	18
5.2	Various Ways of Credit Enhancement.....	18
5.2.1	Overcollateralisation	18
5.2.2	Cash Collateral	19
5.2.3	Limited Guarantee/Undertaking by the Originator	19
5.2.4	Creation of Various Class of Investor.....	19
5.2.5	Third Party Credit Enhancements	19
6.0	LEGAL ISSUES IN MBS	20
6.1	Assignment of Equitable mortgage.....	20
6.2	Borrower's Consent for Securitization	20
6.3	Separation of the debt from the security	20
6.4	Enforcement of mortgages in the case of default.....	21
7.0	THE MORTGAGE POOL AND STRUCTURING THE CASH FLOW	22
7.1	Pool Selection	22
7.2	Cash Flow Modeling	23
8.0	PARTIES TO THE TRANSACTION.....	24
8.1	Various Parties to the Transaction	24
8.2	The Need for an SPV.....	24
9.0	ACCOUNTING TREATMENT OF MBS.....	26
10.0	TAX ISSUES FOR THE DEVELOPMENT OF MBS.....	27
10.1	Off-Balance Sheet Treatment and Acceptance of Assignment.....	27
11.0	Draft Guidelines on Assets Backed / Mortgage Backed Securities.....	28
12.0	CONCLUSION.....	31

1.0 INTRODUCTION AND OBJECTIVE OF THIS PAPER

1.1 OBJECTIVES

All over the World Housing development plays a significant role in the economic development of every country. Most of the economists believe that housing sector can work as a locomotive in any economy as significant number of direct and indirect backward linkages can help any government to achieve some of its major objectives such as employment generation, GDP growth, besides, providing housing solution to its citizen. However, the growth of the sector is linked with the growth of housing finance. But housing finance segment lacks long term source of funding and thereby cannot offer very long term financing. Also they face asset liability mismatch.

Mortgage Backed Securities (MBS), a relatively new product can contribute significantly in overcoming the availability of long-term fund for housing finance companies.

The objective of this paper is to provide conceptual understanding of Mortgage Backed Securitization (MBS) as well to provide a working model for future MBS issuance in Bangladesh.

1.2 TERMS OF REFERENCE

- Definition and scope of Mortgage Backed Securitization in Bangladesh
- Assess the economics of Mortgage Backed Securitization under current market conditions
- Provide working model for Mortgage Backed Securitization in the light of existing legal, tax accounting and market conditions in Bangladesh
- Study the feasibility of the model under current market condition
- Provide ways of credit enhancement and suggest alternative models depending on the variation of credit enhancement
- Identify the existing impediments (specifying legal, tax and accounting treatment) and provide work plan to overcome the issues
- Roles and responsibilities of the Securities and Exchange Commission (SEC) and Bangladesh Bank (BB) to oversee the establishment of Mortgage Backed Securitization infrastructure by PFIs, Servicing and Asset Management, Custodial and Paying Agency arrangements and report on regulatory best practice for securitization
- Advise PFIs on recommended practice for the private/public issue of debt secured on specific assets of the issuer (Mortgage Backed Securities)

2.0 MORTGAGE BACKED SECURITIES-CONCEPT AND SCOPE

2.1 DEFINITION OF MORTGAGE-BACKED SECURITIES (MBS)

Securitisation is a process whereby commercial or consumer credits are packaged and sold in the form of financial instruments. A typical process of securitisation involves sale of specific loans to a Trust or to a Special Purpose Vehicle (SPV). The SPV or Trust in turn issues securities (promissory notes, participation certificates or other debt instruments) to the investors. The securities are rated by an independent credit rating agency. Sometimes, on the recommendation of the credit rating agency, additional credit support other than the obligation of the borrowers is provided in order that the instrument may receive the desired level of rating. Typically the seller of the loans continues to service them. The excess cash flows (remaining after deducting the interest and the principal and other monies payable to the investors), and other fees accrue to the seller.

Mortgage-backed securities (MBS) are debt obligations that represent claims to the cash flows from pools of mortgage loans, most commonly on residential property. Mortgage loans are purchased from banks, mortgage companies, and other originators and then assembled into pools by an entity. The entity then issues securities that represent claims on the principal and interest payments made by borrowers on the loans in the pool, a process known as securitization.

Mortgage-backed securities exhibit a variety of structures. The most basic types are pass-through participation certificates, which entitle the holder to a pro-rata share of all principal and interest payments made on the pool of loan assets.

2.2 EVOLUTION OF MORTGAGE BACKED SECURITIES (MBS)

The first pass-through mortgage security was issued in 1970 in United States of America. The development of the Collateralized Mortgage Obligation (CMO) in 1983 expanded the market for mortgage securities by appealing to investors with various investment time frames and cash-flow needs.

As a result of increasing investor interest in these investments, the mortgage securities market is one of the largest financial markets in the world. Total volume of outstanding mortgage securities exceeded \$7.2 trillion at the end of 2003.

2.3 TYPICAL FLOWCHART OF AN MBS SHOWING PARTIES INVOLVED

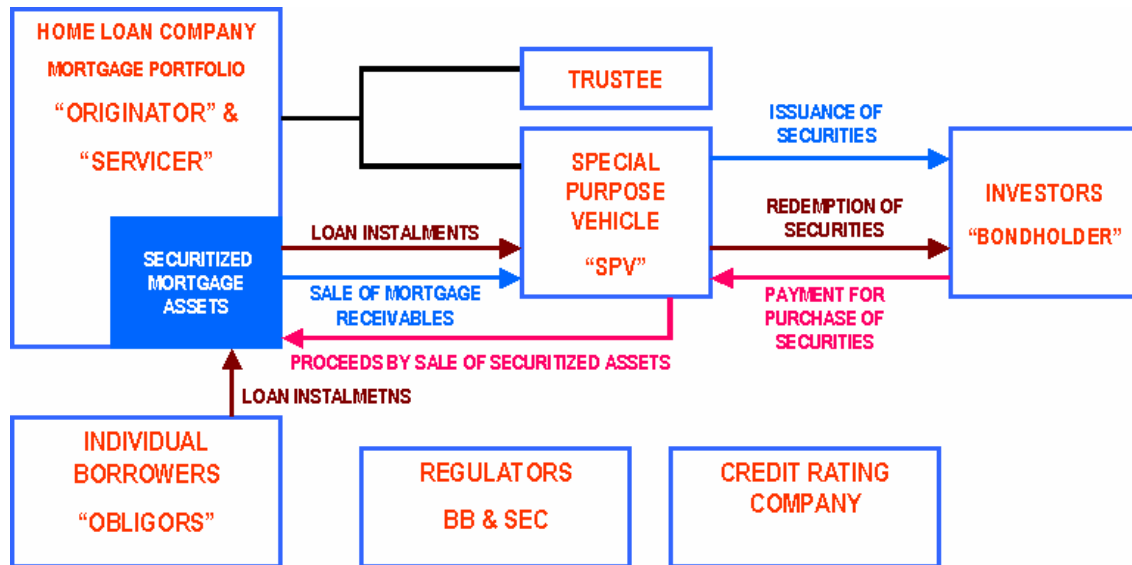


Figure: A simplified flowchart of MBS and principal parties involved

- The Home Loan Company has been providing home loan to various individuals, called the Borrowers or Obligors, and is entitled to Loan Instalments from time to time from such transactions. The Home Loan Company is the Originator of the transaction.
- Under the Home Loan Agreements, Home Loan Company is entitled to receive Loan Instalments the Obligors.
- Now the Home Loan Company is desirous to sell its beneficial interest in Loan Instalments (Receivables) from its mortgage loans under a securitisation transaction.
- Home Loan Company will be selling the receivables to a Special Purpose Vehicle (SPV). This SPV is to be formed for the sole purpose of acquisition of the receivables, issuance of Securities against these receivables and payment to the Security Holders.
- Home Loan Company may act as the Servicer and will be collecting the Loan Instalments from the Obligors and passing it to the SPV for subsequent payment to the Security Holders. The role of Servicer may be done by a third institution as well.
- For the purpose of facilitating the securitisation of the receivables, a Trustee, is appointed for preserving the benefit of the Bondholders as beneficiaries.
- A credit rating agency may be involved in the transaction for rating the securities to be issued.

- The transaction requires the permission of the Bangladesh Bank and Securities and Exchange Commission for fiscal incentive declared by the government, if the issue is zero coupon bond. More SEC approval is required for debt/capital issue under capital issue rules and public issue rules.

2.4 GENERAL FEATURES OF MORTGAGED BACKED SECURITIES

Features of securitisation transactions include:

- Absolute sale of assets to an SPV with narrowly defined purposes and activities
- Issuance of securities collateralised by the underlying assets by the SPV to investors
- Reliance by the investors on the performance of the assets for repayment - rather than the credit of their Originator (the seller) or the issuer (the SPV)
- Consequent to the above, “Bankruptcy Remoteness” from the Originator and the Issuer

Apart from the above, the following additional characteristics may generally be noticed:

- Administration of the assets by the Originator, including continuation of relationships with Obligors (the Borrowers of the original loans)
- Support for timely interest payments and principal repayments in the form of suitable credit enhancements
- Formal rating from one or more rating agencies. For achieving a target rating may require offering the required level of credit enhancements.

2.5 TYPES OF MORTGAGE BACKED SECURITIES

2.5.1 PASS-THROUGHS OR PARTICIPATION CERTIFICATES (PCs)

As the name suggests, the issuer or servicer of pass-through securities collects the monthly payments from the homeowners whose loans are in a given pool and “passes through” the cash flow to investors in monthly payments which represent both interest and repayment of principal. Most pass-through mortgage securities are issued and/or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac in the USA and carry an implied AAA credit rating. The remainders are privately issued and generally rated AAA or AA. The payments of principal and interest on pass-throughs are considered secure; however, the cash flow on these investments may vary from month to month, depending on the actual prepayment rate of the underlying mortgage loans. At issuance, the stated maturity of pass-through securities may have different maturity depending of the remaining tenure of the pooled assets.

Most pass-throughs are backed by fixed-rate mortgage loans; however, adjustable-rate mortgage loans (ARMs) are also pooled to create the securities.

2.5.2 STRIPS

Stripped mortgage securities, first introduced in 1986, are created by segregating the cash flows from the underlying mortgage loans or mortgage securities to create two or more new securities, each with a specified percentage of the underlying security's principal payments, interest payments or a combination of the two. For example, the cash flow on an 8 percent pass-through security might be redistributed to create one new security with a 10 percent coupon and another security with a 6 percent coupon.

Securities may be partially stripped so that each investor class receives some interest and some principal. When securities are completely stripped, all the interest is distributed to one type of security, known as *interest-only (IO)*, and all the principal distributed to another, known as *principal-only (PO)*. These securities may be custom-made to suit individual portfolio needs, depending on which portion of the cash flow the investor wants.

2.6 RISK ASSESSMENT OF MORTGAGE BACKED SECURITIES

2.6.1 MARKET RISK

Mortgage securities are often priced at a higher yield than Treasury and corporate bonds of comparable maturity, but their opportunities for profit (and loss) are also greater. They may be sold at par, or at a premium or a discount to their face value. As with other fixed-income securities, mortgage securities' prices fluctuate in response to changing interest rates: when interest rates fall, prices rise, and vice versa.

Interest rate movements have an additional impact on mortgage securities because they affect prepayment rates, which in turn affect yields. When interest rates decline, prepayment speeds generally accelerate, because homeowners may refinance their mortgages at a lower interest rate and thus reduce their monthly obligation. Rising interest rates may decrease the assumed prepayment speed. The impact on yield will depend on whether the security was purchased at a premium or a discount. Investors who may wish to sell their mortgage securities prior to maturity should take care to understand how the direction of interest rates might affect the value of their holdings.

Mortgage securities also have implied call and extension risks. The implied call risk means that investors may have their principal returned to them sooner than expected, because of accelerated prepayment speeds. In this case, investors may be forced to reinvest the returned principal at lower interest rates. On the other hand,

the life of the security may turn out to be longer than anticipated, because prepayment rates are slower, creating an implied extension risk. In this scenario, investors might miss an opportunity to earn higher prevailing rates of interest on their principal.

In general, before investing in a mortgage security, investors should consider the expected performance of that security if interest rates should rise, fall or remain the same.

2.6.2 CREDIT RISK

Essentially, in MBS, like in any other defaultable mode of investment, the basic risk is risk of default, or credit risk. Mortgage-backed securities are not guaranteed by either the originator or the trustees – the credit support has to come from the credit enhancements, which are put in place at the inception of the transaction. There is no continuing credit support, and it would be foolhardy to think that any of the parties would do anything to bail out a transaction potentially into a default.

This risk, analytically, is no different from risk of plain corporate bonds. In case of plain corporate bonds, the bond-holders' primary source of comfort is the existence of equity in the corporation. To the extent the equity is not wiped out due to losses, the bond holder is protected. As equity is wiped out, the bonds will get into a default.

What equity does to corporate finance, credit enhancements do to a securitisation. Credit enhancement is the economic equity of a securitisation.

Investors need to understand that in structured finance transactions, the computation of the size of the credit enhancement is based on the rating agencies' stressed default scenarios. Each and every factor that contributes to the credit of the portfolio – excess spreads, prepayment rates, contraction of the excess spread over time, delinquencies, are stressed, stretched, and the ability of the transaction to withstand the stress is analyzed. The size of the credit enhancement itself is a function of the desired rating.

Investors need to look at the following factors to understand the inherent credit risk:

- The rating of the issue that they are buying
- The rating rationale and the factors that the rating agency has/has not considered in giving its rating;
- Was excess spread a major factor in determination of the credit enhancements? Excess spread itself is a function of the weighted average rates of return from the pool over time, and rising prepayment rates might compress the excess spread.
- Extent of concentrations in the pool
- Assumptions of recovery rates, delays in case of foreclosure
- Other assumptions made by the rating agencies.

2.6.3 PREPAYMENT RISK

One of the most commonly misunderstood risks in MBS investing is the risk of prepayment. Since mortgages tend to prepay (obligors exercise a prepayment option), the prepayments are passed over to investors. Thus, investors get a part of the principal before scheduled maturity, and hence, lose their coupon to the extent they are prepaid.

A degree of prepayment speed is always estimated in any MBS investing, and hence, the expected maturity is computed, but if the actual prepayment speed is higher than that estimated, it introduces a **maturity contraction risk** to the investment; if the actual prepayment speed is slower than that projected, it introduces **maturity extension risk**. In general, neither of the two risks affect the yield of the investors from the given investment – but they have a bearing on the reinvestment returns. Therefore, in a falling interest rate scenario, a contraction risk results into reinvestment risk. In a rising interest rate scenario, extension risk becomes a loss of opportunity. Ironically, in a portfolio of fixed rate mortgages, falling interest rates will be generally associated with increasing prepayment speed, and rising interest rates will slow down prepayment speeds.

When interest rates decline, the prepayment risk is contraction risk: investors' principal will be returned to them sooner than expected primarily because the mortgage holders refinance their loans or sell the houses or pay off their mortgages early for some other reason. In a rising rate environment, mortgage investors are concerned about extension risk: slower prepayment speeds can cause their principal to be tied up longer, forcing them miss opportunities to invest at higher rates.

2.7 TYPICAL ISSUER OF MORTGAGE BACKED SECURITIES

In USA, the majority of mortgage securities are issued and/or guaranteed by an agency of the U.S. government, the Government National Mortgage Association (Ginnie Mae), or by government-sponsored enterprises (GSEs) such as the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Ginnie Mae is a government-owned corporation within the Department of Housing and Urban Development. Fannie Mae and Freddie Mac are chartered by Congress, but owned by stockholders. These agencies buy qualified mortgage loans or guarantee pools of such loans originated by financial institutions, securitize the loans (i.e., place them in a pool and issue securities representing fractional undivided interests in the pool) and distribute the securities through the dealer community. They also provide different levels of guarantees to investors.

Some private institutions, such as subsidiaries of investment banks, financial institutions, and home builders, also package various types of mortgage loans and mortgage pools. The securities they issue are known as “private-label” mortgage securities, in contrast to “agency” mortgage securities issued and/or guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac.

In India, Pakistan and Sri Lanka, so far, the “private label” securities have been issued.

2.8 SCOPE OF MBS IN BANGLADESH

A vibrant secondary mortgages market in Bangladesh will benefit all the stakeholders in the mortgage chain. This includes issuers, investors, borrowers and mortgage finance industry as a whole. It will also improve the housing situation and socio-economic situation in the country. The introduction of MBS can improve housing affordability, increase the flow of funds to the housing sector and better allocate the risks inherent in housing finance. It will also benefit lot of other industries that depend upon housing sector in one way or the other.

In recent years, mortgage-financing market in the Bangladesh has been growing significantly. Four specialized financial institutions and a quite a good number of commercial banks have either started their mortgage financing business or contemplating to commence near soon. However, the major challenge for this operation remains with the availability of long term funding. A developed MBS market can really play a catalytic role in the development of overall economic scenario of the country. The related benefits of a vibrant market can be summarized below:

2.8.1 BENEFITS TO ISSUERS

- Reduction in cost of funding
- Creates a diversified source of funding
- Capping of credit risk – the risk in case of securitisation transactions is capped to the extent of credit enhancements provided by the originator
- Elimination of asset liability mismatches, both in terms of maturities and interest risks
- Increase in liquidity and funding appetite by creating an additional avenue
- With more efficient use of owned capital, the issuer is enable to create higher effective leverage – which promotes RoE, hence market capitalization.

2.8.2 BENEFITS TO INVESTORS

- Attractive rate of return on investment in a highly-rated instrument, with excellent track record of rating resilience and recovery rates
- Portfolio diversification
- Socially responsible investing
- Ability to buy tranches, if available that matches their appetite
- Alternative to investment in government bonds and corporate bonds

2.8.3 BENEFITS TO BORROWERS

- Reduction in cost of mortgage finance, in the long run
- Greater availability of funds
- Availability of funding for lower income groups
- Creation of formalized credit scoring systems which ultimately result into a decentralized, formula-driven approach to mortgage origination and makes the process extremely fast
- On a higher level of development, integrating the origination process with the securitisation process, whereby the mortgage originator matures into a mere originator-cum-servicer, for a much smaller agency cost, and therefore, much lower lending costs.

2.8.4 BENEFITS TO MORTGAGE INDUSTRY

- Specialization of mortgage related service providers leading to reduction of costs and improvements in efficiency
- Lender access to alternative funding sources
- Improved sustainability of longer term housing funding through long term debt market with reforms of contractual savings institutions like pension funds and insurance companies
- Potentially larger investor-base
- Lenders able to broaden target market, through risk sharing
- Long term debt market funding can help smooth housing cycles
- Improved standardization and supervision of real state loans, improve transparency and security for borrowers and lenders

3.0 ECONOMICS OF MBS

3.1 GENERAL ECONOMICS

There is dearth of housing facilities in Bangladesh. Inadequate availability of housing finance partially contributed to this shortage. Out of the total outstanding housing loans, the share of NCBs and government owned HBFC is more than 50%. Over the last couple of years the share of FIs like Delta Brac Housing Finance Corporation Limited (DBH), National Housing Finance & Investment Limited (NHFI) and Industrial Development Leasing Company of Bangladesh Limited (IDLC) has been growing. However, the growth rate of housing finance by the private sector specialized Financial Institutions over the last three years was remarkably high in comparison to the growth rate of housing finance extended by the NCBs and HBFC. Besides, the Non-Performing Assets (NPAs) of private sector players are significantly lower than the state owned organizations. This fact has also been supported in a recent study on “Housing Finance Reforms in Bangladesh” conducted by the World Bank. All these facts support that the role of participating FIs is significant in ensuring a vibrant, competitive, and sustainable housing finance market in Bangladesh.

Though the participating FIs are very important parts of housing finance market, they have been operating with constraints and in an uneven playing field. Unlike the housing finance companies of the developed market, these FIs do not have access to adequate long term funding sources. FIs mainly depend on credit line from commercial banks as a source of their funds. Maturity of these credit lines is normally within 3 to 4 years and cost is normally not below 12%. That means, FIs are using costly shorter maturity credit lines to finance their long term assets for a period of 15 to 20 years. It exposes the FIs not only to a big mismatch of asset liability position but also to interest rate risk. FIs are allowed to take deposit with a maturity of more than a year. But till date these deposits contribute only a small part of FIs total fund requirements. Because of government regulations at least 75% of the deposits of the state-related entities go to NCBs, which offer relatively lower rate. From the depositors' side commercial banks, nationalized or private, enjoys greater credibility over the FIs as the commercial banks have implicit government support. Branch net work of the commercial banks also put them in an advantageous position over FIs for collecting deposits. Because of all these reasons FIs need to offer higher return to attract deposits. All these resulted in higher cost of funds for the participating FIs.

The following wordings from the recent World Bank Study on Housing Finance in Bangladesh also depicts this “high cost” issue.

“When different sources of finance are considered, the institutions that the more dynamic and professional in this field (housing finance) are also the ones that suffer from a severe handicap in the average cost of funds (data at June 30, 2003):

NCBs: 4.6%

BHBFC: 4.8%

PCBs: 7.2%

Specialized housing finance companies: 12%”

Higher cost of funds makes it difficult for the FIs to be competitive in housing finance and to play an effective role to make this sector a vibrant one and to stimulate the economic development of the country.

In this backdrop, mobilization of long term fund through issuance of MBS is a suitable option for the participating FIs for several reasons:

MBS shall allow the participating FIs to raise funds on long term basis and thus to reduce the mismatch between the maturities of assets and liabilities. Matching of assets and liabilities also reduce FI's exposure to interest rate risk;

3.2 MBS CAN REDUCE THE FUNDING COST OF THE ORIGINATORS

Mobilization of funds through MBS shall reduce FI's cost of fund. Securitization reduces the extent of risk capital or capital requirement for a given volume of asset creation. As equity is the costliest source of funding, lower equity requirements contributes to reduced cost. Besides, through securitisation structure it is possible for an “MBS Issue” to attract a rating, which is higher than the rating of the originator or FI. This higher rating allows the originator to borrow at a lower rate.

Our arguments as to why securitisation must result into reduced weighted average cost of funding run as under:

Let us compare two broad forms of funding – on-balance sheet and off-balance sheet, the latter by way of securitisation. We assume that both are fixed income, debt-type sources.

The on-balance sheet funding is characterized by the following:

- The rating of the funding method, say, bonds or loans, is driven by the rating of the mortgage originator.
- The lender/investor will be concerned with the bankruptcy or default risk of the mortgage originator, which in turn is affected by all the several risks affecting the business of the originator.
- There are capital adequacy considerations – therefore, for every on-balance sheet funding raised, there has to be an equity component required.
- The off-balance sheet funding or securitisation is characterized by the following:
 - The rating of the transaction is independent of the rating of the originator – this is because the transaction isolates the assets from the bankruptcy risks of the originator altogether and therefore, ratings are asset-based;

- The perceived risks of the investors are based on the rating – the senior class in securitisations will typically carry an AAA rating. Thus, investors invest in mortgage-backed securities at far lower spreads than if the originator were to issue on-balance sheet bonds.
- Securitisations typically carry capital relief. The originator is expected to put in first loss support to the transaction, but the extent of the same may be expected to be lower than the element of equity in on-balance sheet financings. This is due to the fact that with isolation of the assets, investors in a securitisation transaction are not affected by other entity-wide risks of the originators' business. Investors are concerned only with asset-based risks of the isolated pool – therefore, the credit enhancements required to support such risks at an AAA-rating confidence level are considerably lesser.

Thus, the rating independence creates a rating-arbitrage – the transaction gets a better rating than the originator. The isolation of assets creates a leverage-arbitrage – the transaction gets higher effective leverage than an on-balance sheet funding. The combined effect of the two arbitrages is to bring down the cost of funding for the originator.

3.3 MBS WILL PROVIDE ALTERNATIVE INVESTMENT TOOLS FOR INSTITUTIONAL INVESTORS

MBS is a long-term investment instrument. In Bangladesh there is shortage of long term paper. As such MBS would probably be able to attract funds from investors like insurance companies, pension funds, and many individuals who have appetite and desire for long term investment opportunities with easy liquidity option.

Based on the structuring enhancement, investors find it less risky and simple to invest in MBS rather than depositing the funds with the FIs.

However, absence of a Treasury Yield Curve makes it difficult for the FIs to price the MBS. Besides, existing investors of the bond market who are mainly commercial banks have appetite to invest in MBS with a maturity of not more than five years. As such market for MBS with a maturity of 10 to 20 years is not yet tested.

At present income from Zero Coupon Bonds (approved by Bangladesh Bank and SEC) is tax exempted, where as income from coupon bonds taxed at as high as 45%. As such tendency is to issue the bonds in the form of Zero coupon. Practically there is no much difference in terms of cash flow between these two types of bonds. However, to have the tax benefit issuers are in favor of Zero Coupon Bonds and in the Zero coupon structure only fixed rate can be used.

3.4 Reasons for Promoting MBS for the development of Capital Market

The Asian crisis in 1997 has clearly depicted the importance of a vibrant long bond market for the sustainable economic development of the country. Many studies advised the emerging corporate market to develop a deep and well functioning bond market to reduce systemic risk and to ensure economic development. Financing long term assets with short term funding pose a great threat for the overall economy. Securitization could play a vital role in development of overall bond market and hence ensure a growth of robust mortgage financing market with active participation of more efficient segment of the market.

4.0 WORKING MODEL FOR MBS: TENTATIVE MBS STRUCTURE

4.1 OVERVIEW OF THE MBS TRANSACTION

The transaction involves the assignment of retail housing loans \ receivables from the originator to the SPV. The loans, repayable in Equated Monthly Instalments ('EMIs'), will then be packaged and offered to the investors as Zero Coupon Bond/Pass Through Certificates (ZCB/PTCs) by a Special Purpose Vehicle (SPV). The housing loans which constitute the receivables to be securitised, will be held by the Special Purpose Vehicle and declared for this purpose by THE TRUSTEE. The entire process of acquisition of the housing loans and declaration of trust (described in detail hereunder) would be legally effected on or before the deemed date of allotment of the ZCB/PTCs.

The structure of the transaction has been diagrammatically represented below:

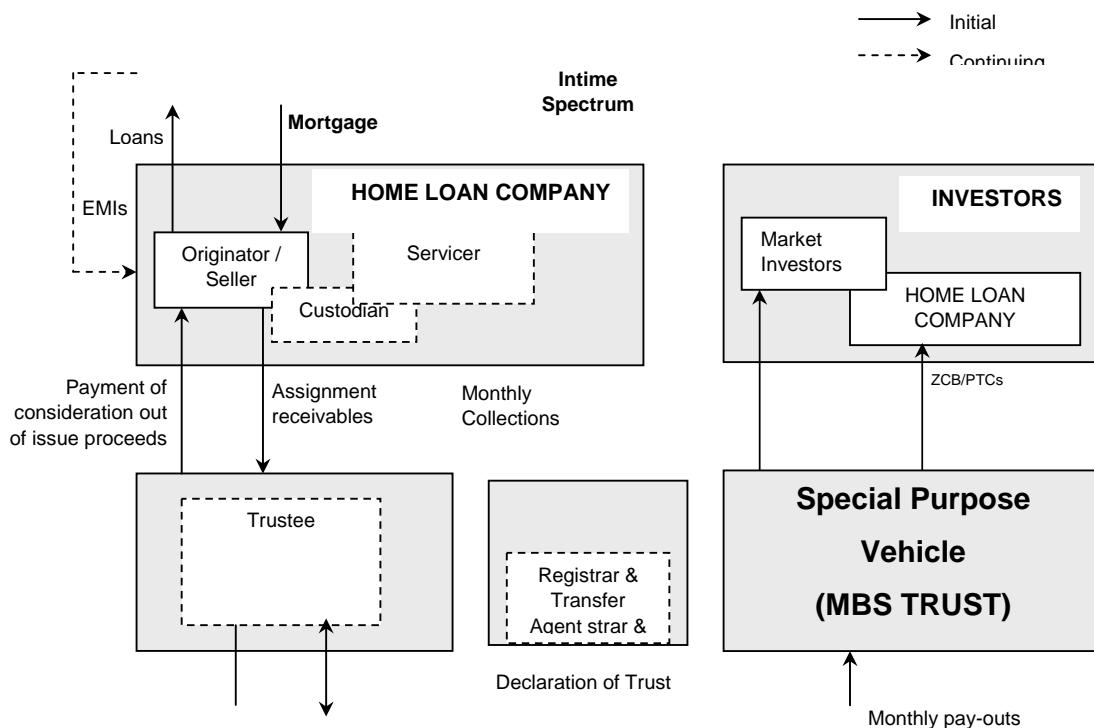


Figure: Overview of MBS Transaction

* The underlying mortgages continue to remain with the originator and will be held in trust for and benefit of the Issuer and the ZCB/PTC Holders.

4.2 ENTERING INTO MEMORANDUM OF AGREEMENT

The originator and THE TRUSTEE as Trustee for the issuer will enter into a Memorandum of Agreement (on any date on or prior to the deemed date of allotment.), to entitle the Issuer to complete all necessary formalities to securitise the said housing loans.

4.3 ACQUISITION OF THE HOUSING LOANS BY THE ISSUER

On or before the Deemed Date of Allotment, the Issuer would acquire the amount of balance principal of those housing loans outstanding and identified to fulfil the pool requirements (under a Deed of Assignment). There will be absolute transfer of all risks and benefits in the housing loans to the issuer (through the Deed of Assignment); the housing loans will be selected for securitization in accordance with certain predetermined pool selection criteria.

4.4 CONSIDERATION FOR THE ASSIGNMENT

The consideration for the pool would be the aggregate balance principal of the housing loans being acquired, recorded as outstanding in the books of the originator as on the cut-off date. However, generally, THE TRUSTEE will not purchase any overdue EMIs or penal interest/out-of-pocket expenses outstanding in the originator's books as on the cut-off date. The proceeds from the issue of ZCB/PTCs will be utilised to make payment of the consideration for purchase of the housing loans.

4.5 REGISTRATION OF DEED OF ASSIGNMENT AND PAYMENT OF STAMP DUTY

The Deed of Assignment will be registered with the sub-registrar of a district in which one of the properties is located, in accordance with the provisions of the Transfer of Property Act, 1882 and the Bangladesh Registration Act, 1908.

4.6 ISSUE OF ZERO COUPON BOND/PASS THROUGH CERTIFICATES

Once the housing loans have been declared as property held in trust, THE TRUSTEE in its capacity as Trustee for the Issuer will issue Zero Coupon Bond/Pass Through Certificates ('ZCB/PTCs') to investors.

4.7 SCHEDULE OF PAYOUTS

The actual repayments to the investor will be as per a scheduled cash flow pattern. This payment schedule may however change on account of prepayments/changes in terms of the loans including change in rate of interest on the loans and reschedulements in the underlying pool. In case of prepayments and term changes, the amounts payable to the investor will change. A revised repayment schedule will be generated every month and will be circulated to investors. It is to be noted that the tenure of the bond is hence subject to defaults (over and above the credit enhancements), prepayments of the underlying loans, if any, changes in the terms of the loans including reschedulements and changes in the rate of interest on the loans.

4.8 POOL SERVICING

The Trustee (THE TRUSTEE) will appoint the originator as the Servicing Agent ('Servicer'), as per the Memorandum of Agreement to be executed on or before the Deemed date of Allotment, for the receivables held by the Trust.

4.9 MONTHLY PROCEDURE

The Trustee will open a separate bank account for the collection and payment related with bond transaction with an Authorised Bank. The originator will collect the Equated Monthly Installment (EMI) payments from the Borrowers in the same manner as it collects payments against its existing loans, but in its capacity as the Servicer. The Servicer would provide collection details for a particular month to the Trustee (THE TRUSTEE) within certain days of the month subsequent to the next month.

The Servicer will deposit the total monthly collections from the Borrowers into the 'Collection & Payment Account' on or before the Payout Date, failing which the Servicer will be, usually, required to pay penal interest at the pass through rate for the period of delay.

The Trustee may pay through post-dated cheques ('PDCs') drawn on the Collection & Payment Account, for the monthly payouts to the bondholders as per the amortization schedule.

4.10 SURRENDER OF BOND BEFORE LAST PAYOUT

The right to receive the last payout is subject to the bondholder surrendering the certificate. Upon receipt of the certificate, the Trustee will cancel the same and make the last payout. The Trustee will stand fully discharged on the date of such cancellation. In the event that any investor holds the bond in dematerialised form

then such investor shall provide a letter in writing authorising the Trustee to cancel the bond as per the procedure prescribed for the same by the Depository.

4.11 DEFAULT MANAGEMENT AND ENFORCEMENT OF MORTGAGES

The originator will administer the housing loans given to the Borrowers, in its capacity as the Servicer.

While the housing loans will be legally transferred to the SPV, the originator will continue to physically hold the mortgage documents in respect of the housing properties, obtained as security on the loans given, in the capacity of a custodian to the issuer. The Trustee (THE TRUSTEE) would empower the originator to enforce the mortgage securities where required, and institute or cause to institute and file suits and all other legal proceedings as may be necessary, to recover the dues from defaulting borrowers.

The Borrowers will not be intimidated of the transfer of the housing loans to the issuer.

4.12 TREATMENT OF PREPAYMENT AND CHANGES IN TERMS OF THE LOANS

Usually the borrowers are permitted to prepay their housing loans in full or in part, and may be charged a prepayment penalty for the same. The originator as the Servicer may exercise the mortgage on the underlying property on default by any Borrower and recover the outstanding amounts by sale of the property. Such prepayments and foreclosures in the securitised receivables pool are passed on entirely to the bondholders until it is fully amortized. In case of senior and subordination class bonds are issued, the prepayment and foreclosure has the effect of accelerating the repayment to senior class holders, thus reducing the effective tenure of the bond. After the senior class has been fully amortised, prepayments and foreclosures will be passed on to the subordinated bondholders.

In case of any reschedulements of loans or change in the terms of the loan, the maturity profile of the cashflow of the pool may change. This would consequently result in a change in the repayment schedule of the bondholders.

5.0 WAYS OF CREDIT ENHANCEMENT

5.1 CONCEPT OF CREDIT ENHANCEMENT

One of major concerns of MBS investors is the credit risk which could arise from the pooled assets. In other words, the borrowers may not pay the principal as well as the interest on time and/or may not pay the installments at all. In such completely bad cases, investors run the risk of losing their money. To mitigate this kind risk, credit enhancement plays significant role in securitization.

Credit enhancement is a process through which the investors get extra comfort regarding the safety of their investment. It ensures that the risks associated in the transaction are shared among the various entities in the transaction.

5.2 VARIOUS WAYS OF CREDIT ENHANCEMENT

In USA, the mortgage backed securities are mostly based on the guarantee issued by the relevant government agencies. Therefore, other credit enhancement is required. The similar model is being practiced by some other countries as well. However, in other countries several credit enhancement ways are being followed. The type and extent of credit enhancement would be required depends on the particular market environment, past track record of the issuer, specific asset class and target investor class. However, every credit enhancement increases the cost of the originator; however, complementary benefit comes through higher rating which brings the funding cost down.

Credit Enhancement could be from the originator and from third party. In advanced market credit enhancement could be structural. If the originator provides the credit enhancement, change in rating of the originator may also affect the bond. On the other hand, third party guarantee may also affect the bondholder with a downgrading of the guarantee provider by the rating agency.

5.2.1 OVERCOLLATERALISATION

In such case, the originator assigns a higher value of receivables to the SPV. The collection from excess receivables is retained by the SPV until the final payment to the bondholders. This type of credit enhancement is common in markets where credit insurance is not available.

5.2.2 CASH COLLATERAL

Cash deposit or cash collateral is contributed by the originator to the SPV for credit enhancement either in the form of cash or subordination, which provides additional comfort for the investors. It may be liquid cash in the form of a risk free investment and can also be retained as security instead of transferring the same to the SPV

5.2.3 LIMITED GUARANTEE/UNDERTAKING BY THE ORIGINATOR

Sometimes, the originator may provide a limited guarantee to the extent of 5%-10%, depending on the market conditions and investors requirement. The structure envisages a credit enhancement for the transaction to be made available upfront in the form of a non-funded undertaking by the originator. In the event that the collections from the pool during any month is less than the Monthly Payouts to the bondholders due to defaults or delays by the Borrowers, the originator will unconditionally deposit such amount (subject to the outstanding value of the Undertaking) into the 'Collection and Payout Account' on being demanded by the Trustee. The Undertaking thus functions as a liquidity cum credit support.

However, the securitization transaction may not qualify for an off-balance sheet treatment for the originator.

5.2.4 CREATION OF VARIOUS CLASS OF INVESTOR

Another form of credit enhancement is to create various classes of investors such as senior, junior and subordinated securities. The receivables are used first to pay the claims of the senior bondholders and they have the claim over the entire cash flow. On the other hand, the subordinated bondholders claim comes at last, after satisfying the claims of senior and junior bondholders. They assume the highest risk. This kind of classification offers securities to various types of investors. Quite often, the originator itself subscribes the subordinated portion of the transaction taking the residuary risk in the portfolio.

5.2.5 THIRD PARTY CREDIT ENHANCEMENTS

There are various third party credit enhancement tools available which includes third party corporate guarantee, letters of credit, bank guarantee, monoline insurance, pool insurance & guarantee from multilateral agencies etc.

6.0 LEGAL ISSUES IN MBS

6.1 ASSIGNMENT OF EQUITABLE MORTGAGE

Since equitable mortgage is allowed for banks and financial institutions, only in case of housing finance, assigning the receivables to SPV, keeping the mortgage documents with the originator may not be an issue. The same has been in practice in the securitised bond issuance in Pakistan & India.

6.2 BORROWER'S CONSENT FOR SECURITIZATION

Mortgage securitization is based on the principle that a mortgage is a right of property and can be sold with or the consent or knowledge of the mortgage. Further, according to the general principles of law, a right arising from agreement can be freely assigned by the beneficiary unless the agreement specifically states otherwise or unless the beneficiary is prevented by law from assigning the right. In principle, the law will allow a lender to assign the right to receive repayment of its loan to a third party without the borrower's consent. However, obligation under an agreement cannot be transferred by the party on whom they have been imposed without the consent of the party to whom they are owed.

Although strictly speaking there is no need to obtain the borrower's consent in a mortgage securitization, it is desirable to secure his general consent at the time the loan documents are executed, by including a suitable provision in the loan agreement, This, if done, would take care of the securitization of housing loans made in the future.

The Issuer will have no legal consequences of not giving of such notice will have no effect so long as the originating institution is the Servicer in the transaction of securitisation. However, such notice would be necessary if Servicer is an institution other than the originating institution either initially or any time during the tenure of the bond.

6.3 SEPARATION OF THE DEBT FROM THE SECURITY

As per Bangladesh law, the debt can be separated from the security for the purpose of transferability as well as enforcement and the debt alone can be transferred without the security and such transfer would be a valid transfer which would not affect continuance of the security, with the result that the original mortgagee would be entitled to enforce the security in case of default in payment of the debt.

6.4 ENFORCEMENT OF MORTGAGES IN THE CASE OF DEFAULT

It is advisable that the Servicer, on behalf of the trustee, under the provisions of the Securitisation agreement shall enforce the debts in case of default, and file suits and all other legal proceedings as may be necessary to recover the dues from the defaulting Borrower. In such case, the Servicer will be reimbursed all the costs for enforcement of such debts out of the pool receivables.

7.0 THE MORTGAGE POOL AND STRUCTURING THE CASH FLOW

Before deciding about the MBS issuance, one should understand the nature of housing finance and its long term recovery period. In Bangladesh, particularly long term appetite for the investors is very limited, partly because of efficient liquidity mechanism and partly because of more unpredictability of cash flow because of long term nature. Therefore utmost care should be taken while selecting the pool for the securitization. The receivables to be securitised consist of a pool of retail housing loans, each of which is secured by mortgage charge on the property financed in part through the loan.

7.1 POOL SELECTION

General pool selection criteria could be, as follows;

- Loan Category: Housing Loans
- Borrowers in the pool to be individuals
- EMIs are not past due for more than two months.
- Loans are free from any encumbrances/charge on the date of selection
- The originator has not obtained any refinance with respect to these loans
- The loans should be secured by first exclusive mortgage charge on the property financed in part through the loan

A more detailed pool selection criteria has been provided in the annexure no. II.

Some common ratios and distribution of the portfolio could be as follows;

(a) Loan to Value Ratio

	No of contracts %	% of Principal outstanding
< = 50%		
>50% < = 60%		
>60% < = 70%		
>70<= 80%		
Total	100.00%	100.00%

(b) Installment to Income Ratio

	No of contracts %	% of Principal outstanding
< = 30		
> 30 , < = 35		
> 35 , < =40		
> 40 , < =45		
> 45 , < =50		
> 50		
Total	100.00%	100.00%

(c) Loan Size-wise Distribution

Loan size	No of contracts %	Principal outstanding (Rs. Cr)	% of Principal outstanding
< = 500,000			
> 500,000, < = 1,000,000			
> 1,000,000, <=2,000,000			
> 2,000,000			
Total	100.00%		0.00%

More criteria may include geographic, borrower occupation, area-wise distribution in Dhaka, loan size wise and remaining maturity wise etc.

7.2 Cash Flow Modeling

Structuring the cash flow is very important for the securitization transaction. Any rating of the issuance will analyze the cash flow situation thoroughly before providing the final score. Ensuring sufficient cash in to match the cash out and timing of the cash flow plays a vital role in designing the product.

The asset, the cash flow model and securitization structure are very much interrelated. The objective of the cash flow model is to ensure that all the cash inflow and outflow has been considered and also to look into sensitivity of the cash flow under certain stressed scenario. Cash unavailability may occur from default, irregular payment and sometimes structural flaw which failed to take into consideration of all cash flow or made calculation error in the model.

8.0 PARTIES TO THE TRANSACTION

The transaction involves the assignment of retail housing loans from Housing Finance Company (the originator) to the issuer. The loans, repayable in Equated Monthly Instalments ('EMIs'), will then be packaged and offered to the investors as Zero Coupon Bond/Pass Through Certificates (ZCB/PTCs). The housing loans, which constitute the receivables to be securitised, will be held by a Special Purpose Vehicle in the nature of a trust (the issuer).

8.1 VARIOUS PARTIES TO THE TRANSACTION

Party	Description
Originator	The one who intends to securitize
The Obligor	The borrower who obliges to pay back the loan amount & interest
The SPV	Conduit created for holding the receivable & issuing securities
The Trustee	The party responsible for ensuring that the entire transaction is carried out for the benefit of the investors
Legal Advisor	Legal counsel who draft the legal documents and provides all other legal support to complete the transaction
Rating Company	The company which rates the transaction
Investors	The investors who buy the securities issued by the SPV

8.2 THE NEED FOR AN SPV

The basic aim in securitization is to ensure that the asset transferred to the Special Purpose Vehicle (SPV) is not affected against any claim to the originator. It provides comfort to the investors of the bond by way of ensuring that the originators rating down gradation will not affect them, nor the bankruptcy of the originator can take away their right to receive the cash flows from the pooled assets. To achieve this goal, usually the scope of work of the SPV is limited only to hold the title of the receivable, issue debt and collect money from the investor, subsequently receive money from the originator and service the bondholders. The overall objective is to create an SPV which is bankruptcy remote and insolvency proof.

SPV can be formed in different from depending on the jurisdiction of the country. These include a company, Limited partnership and a trust. Considering the capital

requirement, filing requirement with RJSC, tax issue, various reporting requirements, complex system of winding up, the corporate form is not recommended in Bangladesh. In many countries, trust form has been very popular in securitization.

All the earlier Asset Backed securitization in Bangladesh was done with an SPV formed as trustee under the Trust Act.

9.0 ACCOUNTING TREATMENT OF MBS

The real benefits of serialization would accrue to the FI only if it could remove the securitized assets from its balance sheet under either of the two foregoing methods.

No statutory provision or guiding principal throws any light on this matter. In England, it is generally accepted that an asset has been sold for accounting purposes when all significant risks and benefits arising out of its ownership have been transferred by the originator to the buyer. Thus, in England, assets whose ownership, with its attendant risks and reward, has been substantially and materially transferred after securitization should be kept off the balance sheet.

The US statement of Financial Accounting Standard No.77, Pertaining to the removal of assets from the balance sheet, requires the transferred to surrender control of the future economic benefits embodied in the receivables, and inhibits the transferee from requiring the transferred to repurchase the receivables sold. In India, the relevant legislation (the companies Act of 1956) requires the concerned entity to show all its assets and liabilities on its balance sheet.

No standards or guidelines in this regard have been laid down by the Institute of Chartered Accounts of Bangladesh (the professional accounting body in Bangladesh). The matter is therefore left to the professional judgment of the auditor, who will have to justify the necessity of off-balance-sheet treatment for the assets securitised to give a true and fair view in the originator's accounts.

Under the first method of securitization, since the loan portfolio and the related mortgage are sold or transferred by the FI to the SPV, the attendant and rewards pass to the SPV and, therefore, there is no doubt that securitized asset can be removed from the balance sheet of FI.

Under the second method, the FI transfers all beneficial of economic interest in the loans to the MBSs holders and merely retain a formal legal interest in them. Further, in securitization, the relative loan assets on the balance sheet of the HFI are replaced by the money received by it, representing the proceeds arising out of the sale of the beneficial interest in the loans. It is also relevant to mention here that since the securities are issued without recourse to the FI, no fresh liability arises to the FI in that account. For these reasons, it is felt that even assets securitized under the second method could be given off-balance-sheet treatment. The transaction could be given appropriate disclosure in a note to the accounts. However, the matter is not entirely beyond question.

However, the Institute of Chartered Accountants should adopt the relevant accounting standard to provide a clear cut guideline on various aspects of securitization transaction. In the absence of such guideline confusion may arise specially with regard to off-balance sheet treatment, timing of recognition of capital gain on account of assignment of receivable and residual income/loss recognition.

10.0 TAX ISSUES FOR THE DEVELOPMENT OF MBS

In Bangladesh, the SPV has been declared income tax and VAT exempted if it is formed for the purpose of securitization. Also for zero coupon bond, the incomes of investors are completely tax exempted. This could be extended further, by including all securitized bond irrespective of zero coupon bond or not.

10.1 OFF-BALANCE SHEET TREATMENT AND ACCEPTANCE OF ASSIGNMENT

We are yet to see the tax treatment of interest income on the housing loan which will be assigned to the SPV. Since the assignments will be done on equitable basis, it might not get the off-balance sheet treatment from the tax authority and hence, the originator may continue to pay tax on interest income on the assigned assets. Subsequently, the investor might also be required to pay income tax on their interest income, which will result in double taxation.

11.0 DRAFT GUIDELINES ON ASSETS BACKED SECURITIES / MORTGAGE BACKED SECURITIES

1. The guidelines on Securitisation of Assets are applicable to banks and financial institutions. These guidelines come into force from January, 2008. The reference to Originator / Investor / Service Provider in the guidelines would include all the above institutions.
2. Securitisation is a process by which Assets are sold to a special purpose vehicle (SPV) in return for a sale consideration. The sale consideration is funded by the SPV by issue of one or more class of Securities to investors. The cash flow from the underlying pool of assets is used to service the Securities issued by the SPV.
3. For enabling the transferred assets to be removed from the balance sheet of the originator in a securitisation structure, the isolation of assets or 'true sale' from the originator to the SPV is an essential prerequisite. In case the assets are transferred to the SPV by the originator in full compliance with all the conditions of true sale given below, the transfer would be treated as a 'true sale' and originator will not be required to maintain any capital against the value of assets so transferred from the date of such transfer. In the event of the transferred assets not meeting the "true-sale" criteria the assets would be deemed to be on the balance sheet of the originator and accordingly the originator would be required to maintain capital for those assets.
 - a) The sale should result in a legal separation of the assets from the originator. The assets should stand isolated from the originator, after its transfer to the SPV and the SPV should obtain the unfettered right on the assets free of any restraining condition.
 - b) The SPV shall have no recourse to the originator, except to the extent of the credit enhancement provided by the originator.
 - c) There shall be no obligation on the originator to re-purchase the assets or substitute assets held by SPV or provide additional assets to the SPV at any time except those arising out of breach of warranties or representations made at the time of sale. An option to repurchase fully performing assets at the end of the securitisation scheme where residual value of such assets has, in aggregate, fallen to less than 15% of the original amount sold to the SPV ("clean up calls") can be retained by the originator.
 - d) Provision of certain services (such as credit enhancement, liquidity facility, underwriting, asset-servicing, etc.) and assumption of consequent risks/ obligations by the originators as specifically allowed in these guidelines would not detract from the 'true sale' nature of the transaction.

- e) Investment by the Originator in part or whole of a Class of Security would not detract from the 'true sale' nature of the transaction, subject to such investments not exceeding 50% of such Securities issued.
 - f) An opinion from the originating bank's Legal Counsel should be kept on record signifying that: (i) all rights, titles, interests and benefits in the assets have been transferred to SPV; (ii) originator is not liable to investors in any way with regard to these assets other than liability for certain permitted contractual obligations for example, credit enhancement/ liquidity facility;
 - g) The SPV should be entirely independent of the originator. The originator should not have any ownership interest in the SPV and should not act as the trustee for the transaction.
 - h) The banks/FIs can securitize their assets relating to loans, lease financing, mortgage financing, toll financing, auto loans and credit card receivables. Other assets may also be securitized with prior approval from the Bangladesh Bank
 - i) The securitizing bank/FIs shall ensure that there are no impediments (contractual or otherwise) that prevent the transfer of the assets, or the rights in relation to such assets, to an SPV and all the necessary consents have been obtained. The transfer of assets should not contravene the terms and conditions of any underlying agreement governing the assets.
 - j) The securities issued by the SPV shall compulsorily be rated by a rating agency registered with SEC or any reputed international credit rating agency and the asset pool should be awarded a minimum credit rating of A or equivalent and such rating at any time shall not be more than 6 months old.
4. Credit enhancement facilities include all arrangements provided to the SPV that could result in the Service Provider absorbing losses of the SPV or its investors. Such facilities may be provided by both originators and third parties. The credit enhancement can be provided in any form of credit support including a guarantee, cash reserve or investment in Subordinate Securities. The entity providing credit enhancement facilities should ensure that the following conditions are fulfilled:
- a) The facility is limited to a specified amount and duration.
 - b) Credit enhancement facility should be provided only at the initiation of the securitisation transaction.
 - c) The credit enhancement can be split in the form of a first loss and a second loss facility.
5. A liquidity facility may be provided to help smoothen the timing differences faced by the SPV between the receipt of cash flows from the underlying assets and the payments to be made to investors. A liquidity facility should meet the following conditions:

- a) The documentation for the facility must clearly define the circumstances under which the facility may or may not be drawn on.
 - b) The facility should be capable of being drawn only where there is a sufficient level of non-defaulted assets to cover drawings, or the full amount of assets that may turn non-performing are covered by a substantial credit enhancement.
 - c) The repayment on the liquidity facility should have a priority of claim over the cash flows from the underlying assets, over the senior most investor
6. Exposure norms for investment in the securitized bond - the counterparty for the investor in the securities would not be the SPV / originator but the underlying assets in respect of which the cash flows are expected from the obligors / borrowers. These should be taken into consideration when reckoning overall exposures to any particular borrower/borrower Group, industry or geographic area for the purpose of managing concentration risks. In case of Residential Mortgage Backed Securities, Auto loan and Credit Card Receivable securitization, borrowers/obligors of the underlying assets need not be considered for calculation of concentration to any particular borrower / borrower Group, Industry or geographical area for the purpose of managing concentration risks.
7. The Originator should not account for any upfront profit on sale of the assets unless the profit exceeds the Credit Enhancement provided by the Originator. The calculation of the profit would be as follows:
 (Sale Consideration) less (Book Value of assets) less (Estimated Servicing Expenses) less (Transaction Expenses).
8. Disclosures
- i) Investor should be informed in writing that their investments do not represent deposits or other liabilities of the originator, servicer, SPV or the trustee, and that they are not insured;
 - ii) the trustee / originator / servicer / SPV does not guarantee the capital value of securities and/or performance of the securities issued, or collectability of receivables pool; and
 - iii) their investments can be subject to investment risk, including prepayment risk, interest rate risk, credit risk, possible delays in repayment and loss of income and principal invested.

The originator should make the following disclosures, as notes to accounts, presenting a comparative position for two years:

- (i) total number and book value of loan assets securitised;
- (ii) sale consideration received for the securitised assets and gain/loss on sale on account of securitization.

12.0 CONCLUSION

Housing industry plays a very vital role in economic development of any country, in USA this industry is termed as the locomotive of the whole economy because its' spiraling down impact across the various sectors of the economy. Housing finance plays catalytic role in the overall development of the sector. It has been observed across the globe that development of housing finance has direct positive impact on the development of housing industry.

In Bangladesh, Housing penetration as a percentage to GDP is less 1.0% compared to 3% in India, 54% in United Kingdom and 51% in USA. More than 70% of the population the Dhaka metropolitan city lives in rented house. One of the reason that housing industry did not grow in Bangladesh was lack of financing facility for long term. Although recently some specialist housing finance company is actively operating in the market, but mismatch in asset and liabilities remains an area for concern. It is, in this backdrop Mortgage Backed Securities can play a significant role for mobilizing long term funds for the housing finance institutions.

With the issuance of few Asset Backed Securities, major issues related with formation of SPV, SPV formation fee, conveyance on assignment of receivable, tax and VAT status of SPV has already been addressed and the major obstacles of securitization have been removed. For mortgage backed securities, equitable assignment of receivables against loans having equitable mortgage could be one of the issue. However, in India the issue did not create any problem.

The major issue for issuance of MBS would be absence of appetite of investor, particularly for long term securities. Ideally MBS would for 10-15 years tenure and if there is not sufficient buyer, it might take some time to be a successful issue in Bangladesh. Even government Treasury bond for long term is not widely invested.

All major commercial banks and financial institutions may form one housing finance company which will buy the housing loans from the originators and can arrange issuance of MBS. Thus good originator of housing loans can concentrate only on quality asset booking and servicing of the same.

ANNEXURE-I

STEPS INVOLVED IN STANDARD MORTGAGE BACKED SECURITIZATION TRANSACTION

Securitisation process can be perceived as a two-stage process.

First stage: Transfer of mortgage debt from the primary lending institution (Originator) to a Special Purpose Vehicle with or without the underlying security.

Second stage: The mortgage debt so acquired will be converted into tradable debt instruments (say in the form of Pass Through Certificates) without any recourse to the originator or the SPV.

The transaction involves:

- a) Assignment and Transfer of a pool of housing loans along with or without the underlying mortgages, from the primary lending institution to SPV.
- b) Securitisation of Mortgage Debt: On acquiring the pool along with the underlying mortgages, an express declaration of trust will be made by the trustee in respect of the mortgage debt. Once the assets have been declared property of the SPV, it will issue securities to the investors.

STEP NO. 1

- **Authorisation for securitisation by originator:** Originator to obtain authorisation from its relevant internal highest authority for securitization its pool of home loans.

STEP NO. 2 - SELECTION OF POOL OF LOANS Pool should be selected based on certain criteria

STEP NO. 3 (In case of involvement of Rating Agency & Auditor) DUE DILIGENCE & RATING OF THE MORTGAGE POOL

- Supply Pool Information to Rating Agency
- Commencement of Rating Process
- Award of Rating by Rating Agency
- Appointment of Auditors for Due Diligence Audit of Mortgage Pool
- Verification of Mortgage Pool by Auditors for certifying Due-diligence
- Completion of Due Diligence Audit and Certification by Auditors

STEP NO. 4- Preparation of Offer Document or Information Memorandum

STEP NO.5 - Trust Deed formation and agreement with Trustee

STEP NO. 6 - Obtaining approval from Bangladesh Bank and Securities and Exchange Commission (SEC)

STEP NO. 6

- ISSUE OPENS
- RECEIPT OF APPLICATION MONEY BY SPV
- ISSUE CLOSES

STEP No. 7

ISUANCE OF BOND TO THE INVESTOR BY THE SPV

STEP No. 8

DOCUMENTATION

- Execution of:
 - Deed of Assignment
 - Deed of Trust
 - Subscription agreement
 - Servicing and Paying Agency Agreement
 - Power of attorney
 - Any other Document(s)

OTHER ACTIVITIES

- SUBMISSION OF MONTHLY MIS REPORTS TO TRUSTEE.
- AUDIT REPORTS TO BE SUBMITTED TO THE TRUSTEE.
- PERIODIC INSPECTION AND AUDIT BY SPV TRUST

ANNEXURE-II

ALTERNATIVE SELECTION PROCESS OF POOL OF HOUSING LOAN

The pool of housing loans would be selected by the originator from its existing housing loans based upon a 'pool selection criteria'.

PROBABLE ELIGIBILITY CRITERIA FOR HOME LOANS TO QUALIFY FOR SECURITISATION

The home loans should satisfy the following standards for being considered for selection in the Mortgage Pool offered for securitization. However, generally, it is something for the rating company to decide while rating, there should not be any eligibility assigned by the regulator. A company can securitize even the bad assets if there is a market for such investors.

- The borrower should be individual(s).
- The home loans should be current at the time of selection/securitization.
- The home loans should have a minimum seasoning of 12 months.
- The loan should not have overdues outstanding for more than two months, at any time throughout the period of the loan.
- Initially, the pool of housing loans may comprise only fixed interest rates.
- The Borrowers have only one loan contract with the originator.
- The loans should be free from any encumbrances/charge on the date of selection/securitization.
- The Loan Agreement in each of the individual housing loans, should have been duly executed and the security in respect thereof duly created by the borrower in favour of the originator.

The Pool selection criteria may be modified by the issuing organization depending on the investors' and regulators' preference.

ANNEXURE-III

DOCUMENTS NEEDS TO BE EXECUTED FOR MBS ISSUANCE

1. Creation of Special Purpose Vehicle (SPV)
2. Agreement with the Trustee
3. Assignment of Receivables from Housing Loans
4. Registration of Assignments of Receivables
5. Subscription Agreement with the Bond Subscriber
6. Obtaining consent from Existing Lenders for curving out Securitized Assets
7. Permission from Bangladesh Bank, in case of Zero Coupon Bond and SPV.
8. Permission from Securities & Exchange Commission (SEC)
9. Servicing Agreement

Banks create commercial mortgage-backed securities by taking a group of commercial real estate loans, bundling them together, and selling them in a securitized form as a series of bonds. They typically organize each series into tranches, also called segments. The bonds are ranked from the highest-rated and lowest-risk (senior issue) to the lowest-rated and highest-risk (junior issue). Investors pay more for senior issue CMBSs than junior issue due to the reduced risk. The senior issue is first in line to receive principal and interest payments, while the most junior issues will be the first to A mortgage-backed security (MBS) is a type of asset-backed security (an 'instrument') which is secured by a mortgage or collection of mortgages. The mortgages are aggregated and sold to a group of individuals (a government agency or investment bank) that securitizes, or packages, the loans together into a security that investors can buy. Bonds securitizing mortgages are usually treated as a separate class, termed residential; another class is commercial, depending on whether the underlying asset is Residential mortgage-backed securities (RMBS) are a debt-based security (similar to a bond), backed by the interest paid on loans for residences. The interest on loans such as mortgages, home-equity loans and subprime mortgages is considered to be something with a comparatively low rate of default and a comparatively high rate of interest, since there is a high demand for the ownership of a personal or family residence. Investors are attracted to this kind of security also want to be protected from the risk of default inherent with individual loans of this kind. This risk is mitigated by pooli