

Innovative Practices in Banking – A Case of Reverse Mortgage: Prospects and Issues

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ABSTRACT

Reverse Mortgage Loan (R.M.L) is a financial facility specifically made for the Senior Citizens, which seeks to monetize their housing equity into an income stream, yet allowing the ownership and residence in the same house. Banks have a significant and dynamic role in the economic development of a developing country. They help in mobilising savings of people through network of branches to channelize them into productive loans and investments. In the recent couple of decades, India has witnessed a drastic improvement in the banking industry driven by forces of global business environment, rapidly changing technology and digitalization, changes in consumer tastes and preferences, intense competition from large number of competing banks, and changing governance and regulatory norms. The dynamic business environment has forced banks to go for research and development and given rise to innovations in product designing and delivering customer services. Realising this fact that innovation and improvement in customer services are the key factors for their survival and growth, banks have become customer oriented by adopting and implementing innovative strategies with a number of initiatives and services in order to stay profitable in the market, deliver better customer services and building better relationship with customers focussing on customer satisfaction. One of such initiative schemes from innovative banking practices adopted by the modern banks in India is Reverse Mortgage. This paper attempts to explore the prospects and issues of Reverse Mortgage Loan as a product to satisfy the needs of senior citizens. In the Indian context, changing demographic trends like ageing population, socio economic conditions like increasing nuclear families, rising standard of living, growing housing and realty sector, continual growth in regulatory support, etc bring huge market potential for it. Primary Lending Institutions (PLIs), which include Commercial Banks and Housing Finance Corporations, have incredible opportunity to tap untapped -

niche market of Reverse Mortgage, which acts as an additional value added service to the senior citizens need for cash. This would result in a win – win situation for both the elderly people and the lenders.

Keywords: Reverse Mortgage, Senior Citizens, Innovative Practices, Monetizing Housing Equity, Primary Lending Institutions, Niche Market.

I. Introduction:

Banks have a significant and dynamic role in the economic development of a developing country. They help in mobilising savings of people through network of branches to channelize them into productive investments. They offer various credit facilities to individuals, agriculture, trade and commerce, industries, and governments. They are just like blood vessels in a human body, which circulate sufficient blood to each part of the body. Banks supply money through their network of branches to each sector of the economy. Thus, banks meet the credit requirements of all types of people and business, and play important role in shaping the economic development a country.

In the recent couple of decades, India has witnessed a drastic improvement in the banking industry driven by forces of global business environment, rapidly changing technology and digitalization, changes in consumer tastes and preferences, intense competition from large number of competing banks, and changing governance and political system. In addition to this, the Union Government and the Reserve Bank of India have been implementing many regulative norms for banks to ensure that every person has access to banking services. Financial inclusion has become priority to the government and a challenge to banks. They cannot ignore any customer belonging to any segment in their market, and if they do so, they may have to bear the huge cost in the future. The dynamic business environment has forced banks to go for research and development and given rise to innovations in product designing and delivering customer services. Realising this fact that innovation and improvement in customer services are the key factors for their survival and growth, banks have become customer oriented by adopting and implementing innovative strategies with a number of initiatives and services in order to stay profitable in the market, deliver better customer services and building better relationship with customers focussing on customer satisfaction. One of such initiative schemes from innovative banking practices adopted by the modern

banks in India is Reverse Mortgage. This paper attempts to explore the prospects and issues of Reverse Mortgage Loan as a product to satisfy the needs of senior citizens.

II. Objectives:

This study has been undertaken with the following objectives

- To explore the concept and mechanism of Reverse Mortgage
- To know the role of the National Housing Bank (NHB) and the current position of Reverse Mortgage in India
- To assess the benefits of Reverse Mortgage to lenders
- To analyse the future prospects of Reverse Mortgage in India
- To ascertain the issues concerned with Reverse Mortgage

III. Research methodology:

This work is exploratory in nature and purely based on secondary data. The various journals and magazines, research papers and websites have been referred to collect the necessary data for this study.

IV. The Concept of Reverse Mortgage:

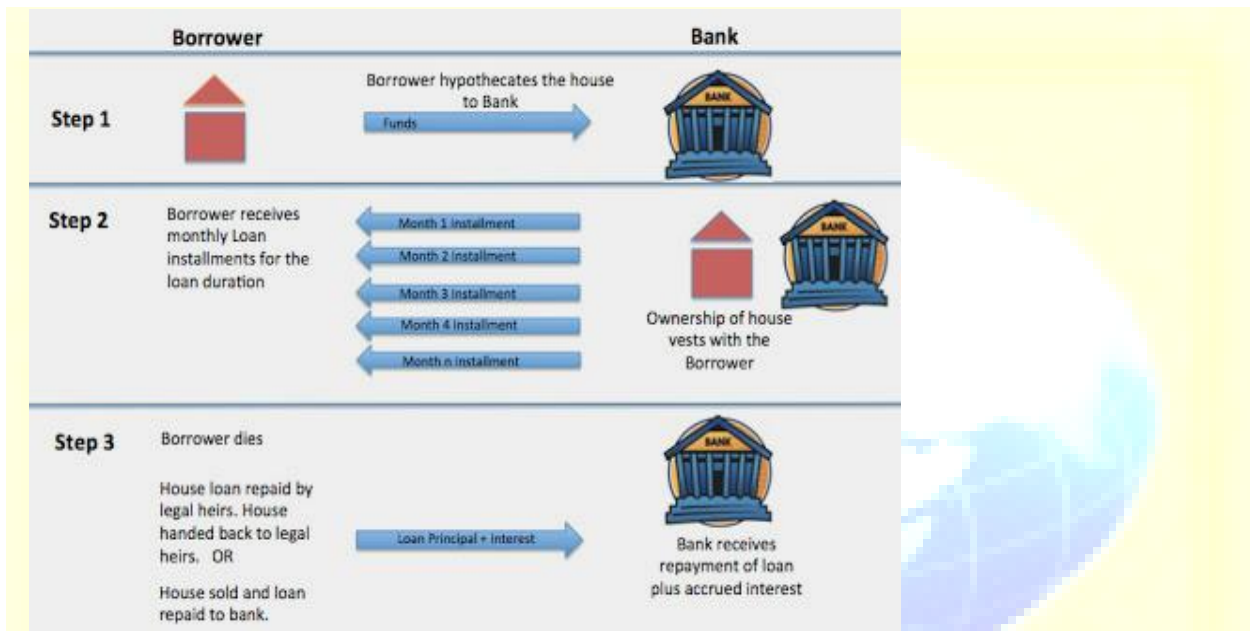
Reverse Mortgage Loan (R.M.L.) is a financial facility specifically made for the Senior Citizens, which seeks to monetize their housing equity into an income stream, yet allowing the ownership and to be the resident in the same house. As most of them do not have regular stream of income and large part of their savings is tied up in the form of a house property, the Reverse Mortgage is of a great help to them if they exhaust their cash savings. The whole idea here is entirely opposite to a regular mortgage loan and therefore it is called Reverse Mortgage.

V. Mechanism of Reverse Mortgage:

Reverse Mortgage is a kind of financial agreement between a reverse mortgage lender and an 'Equity Rich – Cash Poor' senior citizen, where the former makes periodic payments against the value of the mortgaged house to the latter for a fixed tenure. The amount a senior citizen may receive under reverse mortgage is determined based on the value of the property, the age of the borrower and the prevalent rate of interest and the transaction will be structured in such

a manner so that the loan amount will not exceed the value of the house over the life of the loan. As the borrower goes on receiving cash advances, the amount of the debt secured through the Reverse Mortgage increases over time. The borrower can opt for a monthly, quarterly, annual or lump sum payments at any point as per his discretion. Regular income received from such reverse mortgage can be used to meet medical expenses, pay utility bills and so on. Often, the lenders require that there can be no other liens against the house. Any existing liens must be paid off with the proceeds of the reverse mortgage.

Figure 1: The Mechanism of Reverse Mortgage



Source: 1: www.insight.banyanfa.com

The unique aspect of this mechanism is that the borrower does not required to repay the principal as well as accumulated interest as long as he/she continues to live in the house. Again, they can never owe more than the realisable value of their house as the repayment liability remains pegged to the market value of the house at the time of recovery of the loan. After the death of the borrower, the lending institution recovers the mortgage amount that it already lent along with accumulated interest thereon by disposing the house. Any amount in excess will be paid to the legal heirs of the borrower. If the legal heirs wish to retain the house property, they will be given preference to repay the loan before the disposal of the same. Yet another positive feature of reverse mortgage is that it is a non – recourse loan and therefore protects all assets of the borrower except the house that is being used as collateral.

VI. The Role of the NHB and Current Position of RML:

Reverse Mortgage is in its infancy stage in India and has a little history of about eight years. Dewan Housing Finance was the first institution in India to offer Reverse Mortgage scheme in 2006 viz., 'Saksham'. Reverse Mortgage Scheme was formally launched in India by the Ministry of Finance in the Union Budget 2007 – 08. The National Housing Bank (NHB) was given the task of drawing up the guidelines for its operation in India. The NHB issued the final operational guidelines for the same in May 2007. It plays the role of promoter, regulator, as well as instructor by issuing continual guidelines to the Primary Lending Institutions (PLIs) i.e., Commercial Banks and Housing Finance Institutions, who are the service providers. It also does refinance to the PLIs to the extent of amount actually disbursed by them to the borrowers, and takes guarantee for regular payment to the borrowers' availing the loan. On the par with countries like USA, UK, Australia where counselling for RML is mandatory, the NHB has, till date, opened 15 RML Counselling Centres across major cities in India. These counselling centres are at Ahmedabad, Bengaluru, Bhopal, Bhubaneswar, Chandigarh, Chennai, Delhi (two centres), Hyderabad, Kolkata, Lucknow, Mumbai, Nagpur, Pune and Patna. These centres are being run by the NHB in association with eminent Non-Government Organisations (NGOs) working for the elderly. The NHB regularly conducts counselling programs and seminars for elderly citizens to generate awareness and educate them to enable them to take informed decision for availing this loan. It has also been working towards building capacities in the PLIs by way of its training programs and seminars for the personnel of these institutions. In 2009, the NHB in association with Star Union Dai-ichi Life Insurance Company Limited (a joint venture of Bank of India, union Bank of India and Dai-ichi Life Japan) and Central Bank of India, launched a new scheme called Reverse Mortgage Loan enabled Annuity (RMLeA). This is an extension of RML, which ensures assured lifetime RML enabled annuity payment to the borrower by enabling the PLI to source annuity payments from a life insurance company. During 2013-14, the NHB has organised and conducted five seminars and one workshop for the senior citizens in various cities of India.

As of now, many commercial banks and housing finance corporations have come up with Reverse Mortgage schemes in India. As per The NHB Annual Report 2012-13, 24 Scheduled Commercial Banks, and 2 Housing Finance Corporations have launched this scheme and Rs. 1711 crores have been sanctioned to 7519 senior citizens since its inception. The above figure indicates that a very small percentage of senior citizens seem to have taken the advantage of this scheme.

The following is the list of Primary Lending Institutions offering Reverse Mortgage loans in India.

Table 1: Primary-Lending Institutions in India

Primary Lending Institutions offering Reverse Mortgage loans in India	
1. Allahabad Bank	14. Oriental Bank of Commerce
2. Andhra Bank	15. Panjab National Bank
3. Bank of Baroda	16. Punjab and Sind Bank
4. Bank of India	17. State Bank of Bikaner and Jaipur
5. Canara Bank	18. State Bank of Hyderabad
6. Central Bank of India	19. State Bank of India
7. Corporation bank	20. State Bank of Mysore
8. Dena bank	21. State Bank of Patiala
9. Dewan Housing Finance Limited	22. State Bank of Travancore
10. IDBI Bank	23. Syndicate Bank
11. Indian bank	24. UCO Bank
12. Indian Overseas Bank	25. Union Bank of India
13. LIC housing Finance Limited	26. Vijaya Bank

Source: 2: Minutes of SLBC Karnataka

The Conditions for availing Reverse Mortgage Loans prevailing in India are:

1) Eligibility norms:

- Nationality - Indian
- No. of borrowers – Single or jointly by married couples
- Age criteria – first borrower 60 years and 58 years for the spouse
- Residence – self acquired and self occupied residential property in India with clear title
- Encumbrance – free from any encumbrances
- Residual value of the property – at least 20 years

2) Determination of Eligible Amount of Loan:

- The amount of loan will depend on market value of residential property, as assessed by the PLI, age of borrower(s), and prevalent interest rate.
- The amount of loan as proportion of Assessed Value of Property will be up to 60% or as decided by the PLI

3) Nature of payment:

- Periodic or Lump-sum or Committed Line of Credit or any combination of these as agreed upon

4) Eligible End Use of Funds:

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- Any genuine purpose other than for speculative, trading and business purposes
- 5) **Period of Loan:**
 - Maximum 20 years or lifetime in case of RMLeA
 - 6) **Rate of Interest:**
 - 11% to 15% as fixed by the PLI
 - 7) **Security:**
 - By way of mortgage of Residential Property, in a suitable form, in favour of the PLI. Commercial property will not be eligible for RML
 - 8) **Valuation of the Property:**
 - At such frequency and interval as decided by the PLI, which in any case shall be at least once every five years
 - 9) **Processing fees:**
 - As per the discretion of the PLI
 - 10) **Pre payment of the Loan by Borrower/s:**
 - Have the option to prepay at any time during the tenure. There will be no prepayment penalty
 - 11) **Provision for Right to Rescission:**
 - Minimum of three days from the date of execution of the contract or as fixed by the PLI

VII. Benefits of Reverse Mortgage to the Lenders:

The benefits that accrue to the lenders because of Reverse Mortgage are:

I. A niche market and huge market potential:

Though it is a niche market to banks, still it gives many opportunities. Banks can leverage their existing market position and can extend their leadership position, differentiate product with that of competitors, expand their quality services into the new segment and so on.

In India, there is huge potential for RML because of changing demographics and other factors [points are discussed at the later part of the paper]. Thus, banks can tap such potential of the market, which will not only benefit them but also the economy.

II. Financial inclusion:

Banks usually cannot ignore the criteria of sufficient income before providing services to customers and that is the reason why many senior citizens in India remain excluded from banking services, as they have no or low income. Since RML does not require any income criteria, banks can easily extend this service to senior citizens seeking financial support from them.

III. Additional source of revenue:

The revenues from Reverse Mortgage Loans will add to the existing earning capacity of banks and thereby enable them to increase profitability.

IV. No/lower risk of default:

Banks will have no/lower rate of risk of default on Reverse Mortgage Loans, as loans are secured by way of mortgage and also senior citizens are committed to their contracts and none of them expects unhappiness and difficulties at that age from any legal disputes. Thus, it will not have relative effect on Non-Performing Assets, which has now become cumbersome to banks.

V. Addition to loan portfolio:

New age banks are always seen committed to deliver value to customers by innovation and new initiatives with a wide variety of financial assistance and services. Reverse Mortgage Loan will be an addition to this endeavour of banks.

VI. Regulatory support:

The Government along with the RBI and the NHB continuously extend their regulatory support to banks to popularise a novel product like Reverse Mortgage by many ways. The Govt. has come with necessary tax provisions with regard to RML. The NHB has been conducting counselling and seminars for senior citizens to create awareness. It also conducts workshops and training programs to personnel of banks (PLIs) for building capacity among them. The NHB also refinances to the lenders to extent of amount disbursed by them to the borrowers of RML.

VIII. Future Prospects of Reverse Mortgage:

Prevailing socio economic and demographic conditions in India clearly indicate that there is huge market potential for Reverse Mortgage in the future.

1. Demographic changes:

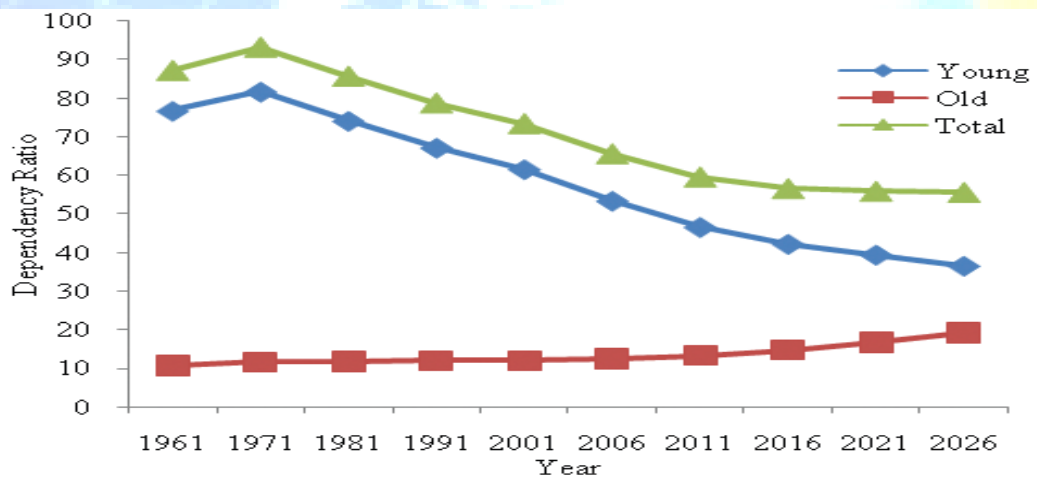
- According to the 2001 Census, the total number of older persons in India was approximately 70.6 million and is expected to cross 173 million by 2026, the life expectancy at birth is projected to increase to 69.8 years (from 61.6 years in 1996) for males by 2021-25 and 72.3 years (from 62.2 years in 1996) for females, and the total fertility rate (TFR) declined to 3.2 per women in 2001 and is expected to drop further.

Table 2: Population projection

Year	1981	1991	2001	2011	2026
Total population	683	846	1029	1219	1400
No. of senior citizens	43	57	71	103.8	173
% of senior citizens	6.5	6.7	7.4	8.7	12.4

Source: 3: Census data 2001

Figure 2: Dependency ratio of India for 1961 - 2026



Source: 4: Census data 2001

Thus, census data show that India is ageing with a shift of young age structure to an older. It will have important implications for the economy and to elderly as the need for socio economic support increases for elderly. There is decreasing number of working age persons and increasing number of elderly and that implies increase in old dependency ratio i.e., increase in economic burden on each working person. Thus, the demographic changes show that there is a need for improvements in socio economic security for elderly.

2. Lack of Social Security Schemes:

- In India, only 10% of the working population has social security coverage after retirement. However, Indian Govt. has implemented a number of pension schemes for providing financial security, a significant portion of the working population remains out of pension systems.

3. Changing family system:

- There are significant changes taking place in the family system in India. Nuclear families taking place of joint families, many children moving abroad or new cities in search of jobs while a few no longer feel to take care of their aged parents, increasing inter generational gaps and similar factors have brought new dimensions in the life of elderly.

4. No significant Bequeath motive:

- Suppose elderly homeowner has no children or if their children settled far away have no intention of coming back, then there will be no significant bequeath motive of leaving property to one's heir which otherwise might become a hurdle while going for RML.

5. Lower income in relation to desired standard of living:

- Many households in India are short of sufficient income to meet their desired standard of living because of poor employment, rising prices of commodities and so on. This could also mean that less amount of savings among such households, which would make their retired life inadequate of sufficient finance to meet old age costs.

6. Financial independence:

- Reverse Mortgage is an attractive option to those elderly who want financial independence even at their old age. Money received from RML could supplement their pension, which would enable them to lead financially self-sufficient life with desired standard of living during old.

7. Improvements in housing sector

- Indian housing sector has a good pace of growth. It is expected to accelerate further as recent budget announcement included significant tax concessions for construction of houses and there is declining rate of interest for housing. Thus, improvements in investments in housing sector along with socio economic changes will boost market for Reverse Mortgage in India in future.

Thus, it is clear that, there is huge potential for Reverse Mortgage in India in the future. The survey by Hansa Research Group commissioned by the NHB (2006-07) shows the following results:

Table 3: Potential market for RML.

	Population of senior citizens	Owning houses	Intention to Mortgage House (%)	Estimated population	Potential* (Rs. in Crores)
India (Metros)	44,54,000	38,67,000	21	8,12,070	81,207
Chennai	1,37,000	1,06,000	9	9,540	954
Delhi	3,17,000	2,97,000	29	86,130	8,613
Mumbai	3,83,000	3,43,000	24	82,320	8,232

Source: 5: The NHB report on Trend and progress on Housing India 2012-13. *assuming average loan size Rs. 10 lakhs

IX. Reverse Mortgage – Issues and Concerns:

International experience on Reverse Mortgage reveals that, RML has certain inherent issues, which in many countries have become bottlenecks for its success. In the Indian context, various issues concerned with Reverse Mortgage are discussed below:

1. Strong bequeath motive:

Many of the earlier studies conducted across India reveal the fact that, traditional elderly Indians are having strong feeling to leave their property to their heirs even though their financial condition has become critical. This kind of typical mentality of elderly may become opposing point to go to RML.

2. Psychological factors:

For many of potential borrowers, it may become hard to digest to going back to debt at old age against mortgage of house, who might have taken lifetime in building their dream house.

3. Complexity in pricing:

The eligible amount of loan under RML depends on – market value of the housing property as assessed by the lender, age of the borrower/s, and prevailing rate of interest. Therefore, lenders need to be careful at the time valuation of the property and fixing the price. Any adverse happening in the future may pose risk of loss to him. At the same

time, borrowers need to be careful in respect of the valuation, any under valuation and pricing will make elderly suffer financial losses.

4. Huge cost of origination of contract:

There is much processing or origination cost of the contract like mortgage insurance, appraisal fee, documentation charges etc., to be borne by the borrower. Though it can be financed out of loan amount, it decreases available cash to the borrower.

5. Condition on use of funds:

The amount received by the borrower can be used for maintenance of the property, meeting medical costs or for any other genuine purposes. However, it cannot be used for trading, business, or speculative purposes.

6. Poor marketing by lenders in India:

Although RML was launched in 2007 in India, primary lending institutions have shown lack of interest in promoting the loan. According to reports, many of the elderly people in India still unaware of this product and associated advantages of it. PLIs seem less interested of aggressive marketing about the loan due to unknown reasons.

7. Poor packaging:

Lack of aggressive promotions and poor packaging of RML have made RML unattractive to elderly. In addition, the loan has not been clearly explained and adequately made available to the potential borrowers.

8. Risk factors for lenders:

Lenders face many risks from Reverse Mortgage, which might have made them not to go aggressively about promoting the loan. Risks due to uncertainties with regard to longevity, interest rates, and appreciation of home value are critical to lenders since there is absence of public policy support to them.

- **Mortality Risk**

Mortality or longevity risk arises when the borrower/s live longer than the expected. In such a case, the lender has to pay the instalments, if any, until the death of the borrower/s or property is vacated permanently, and recovery of the loan is delayed which may again pose market risk to the lenders. In addition, since RML is expected to improve substantially the income and thereby standard of living, would it not itself result in increased life expectancy, in turn posing more mortality risk.

- **Interest Rate Risk**

There is significant interest rate risk to the lender since the contract is made for long period and rate of interest may move in any directions in the future. Again, it cannot be fully diversifiable within RML portfolio and hence, the lender may have to account for risk premium by offering conservative deal to the borrower. Accrued interest can be recovered only at the time of unforeseen maturity of the loan.

- **Market Risk**

Reverse Mortgage is a non – recourse loan and therefore, the lender can only recover the amount due from sale proceeds of mortgaged house. He has no right to claim unrecovered portion of the loan from other assets or heirs. This risk become critical if house property value does not increase on par with rising cost of the lender.

- **Moral Hazard Risk**

Duty of maintenance of the housing property lies with the borrower under a RML. Decreasing housing equity during the tenure of the loan may not have any incentive to him to maintain the property and in some cases; the borrower/s may become physically incapable of maintaining the property. As an addition to this risk, RML has a criss-cross aspect, whereby the cost maintenance would be borne by the borrower whereas its benefits would be accruing to the lender.

- **Early Redemption Risk**

Borrower/s under RML has an option to repay the loan at any time. Suppose a borrower goes for early redemption of the loan, he would go only when he has some benefits. It could mean that the situation might be an adverse to the lender.

In addition to the above factors, RML could involve third parties in origination of the contract, periodical valuation of the property and maintenance of the property. Payments made to them simply raise the cost of the contract to be borne by the borrower. There is also greater scope for fraud as the elderly borrowers cannot manage every aspect of the transaction due to physical incapability.

X. Conclusion:

Reverse Mortgage looks like a promising proposition conceptually. In the western countries, although it took many years to get attention of the market, it became very popular and a strong financial option available to the elderly people after retirement. There is a well-

established Reverse Mortgage market with a large number of lending institutions. However, India is a different market for Reverse Mortgage. Changing demographic trends like ageing population, socio economic conditions like increasing nuclear families, rising standard of living, growing housing and realty sector, continual growth in regulatory support, etc bring huge market potential for it. Primary Lending Institutions have incredible opportunity to tap untapped - niche market of Reverse Mortgage, which would result in a win – win situation for both the elderly people and the lenders.

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