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| **“Mortgage Guidelines”** |
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**State Bank of Pakistan**

**Infrastructure and Housing Finance Department**

**(IHFD)**

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# Preface

***A strong, well defined and prudent Regulatory regime has direct impact on the overall growth of a particular sector of the economy. Review of the existing prudential regulations reveals that there many areas and facets of housing finance sector that cannot be covered thoroughly in Prudential regulations primarily due to the nature of the document and needs some detailed analysis by SBP. Assessing and recognizing the need of through understanding of mortgage markets, IHFD to introduce a comprehensive set of mortgage guidelines for housing finance covering the lacking areas. In this lieu an outline has been prepared to draft Mortgage guidelines based on best international practices.***

***Every effort has been made to cover all the areas and facets of housing finance industry and we hope that this document will go a long way in stabilizing and nourishing the growth of this sector.***

# Chapter No .1 Definitions

1. “**Debt”** means the amount of money subject to a Mortgage that is owed to a Mortgagee as a result of Financing. Debt may include the cost of Financing, penalties, damages, expenses and other related liabilities.
2. **“Debtor”** means a Person owing a Debt.
3. **“Lender”** means a financial institution having a right to receive payment of a Debt under a Mortgage. A Lender may be incorporated within or outside Pakistan and transact the business of banking as defined under the law “**Banking Companies Ordinance 1962**” for Banks/DFIs by SBP.
4. **“Loan Agreement”** A written agreement to repay a loan. The agreement is secured by a mortgage, serves as proof of indebtedness, and states the manner in which it shall be paid. The note states the actual amount of the debt that the mortgage secures and renders the mortgagor personally responsible for repayment.
5. **“Mortgage” means written document evidencing the lien on a property taken by a lender as security for the repayment of a loan**
6. **“Mortgagor”** any person who applies for a loan secured by real estate/property/house and is responsible for repaying the loan (mortgage)
7. **“Mortgagee”** means a Lender in whose favor a Mortgage is created.
8. **“Mortgaged Property”** means Immovable Property charged to secure Debt.
9. **“Mortgage deed”** means the written document signed by the Mortgagor and Mortgagee that describes the Mortgaged Property, the terms of a Mortgage, and the duties and obligations of the parties.
10. **“Property”** means possessions or items capable of ownership and includes Movable and Immovable Property.
11. **“Movable Property”** means tangible items that can be physically moved from one location to another without changes in shape and substance and includes tangible things such as goods and intangible things such as Documents of title, accounts, securities, instruments, copyrights, trademarks and patents.
12. **“Immovable Property”** means tangible items that cannot be moved from one location to another without change in shape and substance. Land, homes and buildings are Immovable Property.
13. **“Registry”** means an office that registers a Document of Title and Mortgage transaction on Immovable Property and its related documents and keeps the records.
14. **“Document of Title”** means a written document prepared in accordance with the law that proves ownership of Immovable Property.
15. **“Default on Payment”** means **Failure of the borrower to honor the terms of the loan agreement and** inability to pay a Debt or its installment when due.
16. **“Default on Performance”** means failure to perform an obligation stated in the Loan Agreement.
17. **“Lien” means the lender’s right to claim the borrower’s property in the event the borrower defaults.**
18. **“Power of Sale”** means the right of a Mortgagee to collect the amount of Debt from the sale of the Mortgaged Property.
19. **“Notice”** means written information delivered regarding the Mortgaged Property to an office headquarters or place where the Person resides or operates. Reasonable means of receipt is required.
20. **“Person”** means a natural or juridical person.
21. **“Sale”** means to convey Immovable Property for a certain price that is subject to a Mortgage between a Mortgagor and Mortgagee.
22. **“Creation of Mortgage”** means creation and registration of a Mortgage in accordance with this Law.
23. **“Mortgagor’s Location”** means a Mortgagor principal place of business, if any, or his residence, if there is no place of business. A corporation is located where it was incorporated

# Chapter No .2 “Creation of Mortgage”

## Mortgage process

1. The lender should have a written description of all the steps involved in making a mortgage loan, from the initial contact with the client up to the signing of legal agreements, varying the terms of those agreements and up to redeeming the mortgage. This description should comprise a flow chart showing the steps involved and a written description of each of the steps.
2. Financial Institutions should have procedures in place to make sure that all staff that plays a material part in the process receives training to ensure that they understand and are familiar with it.
3. A clearly defined organizational structure should be in place and include responsibilities, accountabilities and roles in all aspects of the mortgage process.

## Structure of Mortgage Business Operation:

Where a decentralized model is adopted by Financial Institutions, it should be supported by regular audit checks and balances by Head Office to ensure compliance with policy.

Financial institutions need to demonstrate that capital and shareholder funds are being managed prudently and that adequate risk management controls are in place.

##

## Basic Parameters

Financial Institutions must follow the following as the basic eligibility criteria set by prudential regulations of Pakistan.

|  |  |
| --- | --- |
| **Category** | **Minimum Requirement** |
| Purpose | Purchase, construct/ build or renovate the house/apartment/Banglow  |
| Property location | With in Pakistan  |
| Debt Equity ratio  | 85:15  |
| Debt burden ratio  | 50 % of net disposable income |
| Minimum Reserve Requirement  |  |
| Time Period  | Based upon the internal policy of bank |

## Creation of Mortgage

Immovable Property may be used to create a Mortgage to secure some or all of a Debt.

A Mortgage is subject to the following specifications:

1. It may relate to more than one Immovable Property;
2. One or more Mortgages may refer to the same Immovable Property, however the second loan has to be given by the same lender who provides the first loan on property i.e only same institution can create another mortgage on the same property.
3. It can be created without delivering possession of the Mortgaged Property to the Mortgagee
4. It can be created on Immovable Property that is jointly owned as defined in the Law.
5. Once a Mortgage is created, failure to repay Debt on its specified date may lead to the sale of Mortgage Property in order to repay the Debt in accordance with the provisions of this Law.

## Conditions of Mortgage creation

A Mortgage can be created under the following conditions:

1. A Mortgage deed that provides an adequate description of the Property shall be signed both by Mortgagor and Mortgagee;
2. A Document of Title that demonstrates real ownership and good title over the Mortgaged Property shall be given to the Mortgagee by Mortgagor;
3. The Mortgagor and Mortgagee shall be bound to perform under a Loan Agreement.
4. Registration of the Mortgage should be recorded with the related Registration Authority.
5. Any amendment, cancellation or assignment of a Mortgage shall be registered in the Registry by Mortgagee.
6. Identification of Mortgagor, Mortgagee and Debtor should be stated in the Mortgage deed which will include name, father and grandfather’s name, address, date of birth etc.
7. The Mortgage deed is valid when it is singed by Mortgagor and Mortgagee, or their authorized representative, and the person who saw the Mortgage deed signed by the Mortgagor (name and date).
8. Subject to the provisions of this Law, the Mortgage deed may include other terms and conditions agreed upon by the parties that are not inconsistent with this Law.
9. Should a Mortgagor be unable to read or understand the Mortgage deed, the

## Property valuation

Lenders should ensure that a proper property valuation is done by a professional, reputable and the valuer approved by PBA

1. In assessing the profile of the Valuer, the lender should ensure that: a) the valuer is a competent professional and on the panel of PBA (Pakistan Bankers Association).
2. The Valuation Report presented to the lender should contain the following details:
3. Applicants name & address of the property, including the postal code.
4. Description of property/estimation of age
5. Dimensions/floor area
6. Number/type of rooms
7. Vacant or tenanted
8. Any extensions/Planning permission(obtained or required as the case may be)
9. Services like water, gas, electricity and/or other utilities, as available.
10. If under construction, stage reached/work & time to complete
11. Evidence of subsidence/landslide, if any
12. Rights of way across /through property.
13. Market value
14. Purchase Price
15. Reinstatement/replacement cost
16. Repairs identified
17. Recommendations
18. Signature/qualification/name of firm
19. Provides the lender with an independent assessment of the property that is being offered as security.
20. Highlights repairs required etc.
21. Forsee value of the property.

## Development of market based products

FIs should indulge themselves into launching new and innovative products that suit to diversified housing needs of customers. Products should be market oriented with fixed, variable and hybrid from of Mark up.

## Housing observatory

Financial Intuition should deploy at least two employees who can develop and maintain an internal housing observatory for the banks/FI. The developed employee should provide update market research on all the facets of housing finance and real estate.

## Revision in Existing Fee Structure:

All financial institutions should apply for Written approval before making a substantial changes in existing structure of fee/charges i.e. if the revision is made to the tune of Rs 5000 or above ).

# Chapter # 3 “Mortgage Documents and verifications”

## Engagement of Legal Advisor

Development of all documentation supplied in the Mortgage process should involve suitable **qualified legal** adviser(s)

## Requirements of loan agreement:

1. Loan Agreement should contain Name & Address of Customer, address of property being mortgaged, amount of credit advanced; period of the agreement; number of repayments; total amount repayable; cost of the credit; interest rate, and general conditions.
2. The Loan Agreement should be in writing and signed by a Mortgagor and Mortgagee and state the name of the Mortgagor(s), Guarantor etc.
3. A clear promise by the Mortgagor to repay the total amount of Debt subject to the Mortgage.
4. When, where and how repayment of Debt or a related installment should occur; and How any installment payments shall be applied to repayment of the Debt. If the Mortgagor is responsible for installment payments at certain dates in the future, the Mortgagee will attach to the Loan Agreement a schedule of such installment payments.

## Repayment Schedule and other Documents

Loan agreement should be supplemented with detailed repayment schedule, and other documents as and when required which may include; indemnity bond, guarantee form, General Power of Attorney etc besides that any other essential document as per banks internal policy.

## Requirements of Mortgage Loan Application form:

 The application formshould atleast include the following details:

1. Personal details, including postal/property addresses, CNIC, contact No. ,family members, references etc
2. Occupation and Income
3. Financial assets
4. Current Debt/Repayments
5. Bank Account Details
6. Current living accommodation
7. Details of property to be purchased/built, including postal codes
8. Amount of Loan required
9. Full costs of transaction
10. Full source of funds to cover the cost
11. Type of Mortgage required

## Tile Documents

The FI should obtain all the relevant title documents. Documents should be clear and free from all encumbrances and legal charges with proper details of ownership, area, demarcation and property value.

Tile documents that bank should acquire ,may vary from city to city , which normally includes

1. Lease/Sub-Lease/Sub-License
2. Sale Deed /Gift Deed/Exchange Deed
3. Permission to Assignment NEC / (Search Certificate)
4. Site Plan
5. Building Plan duly approved alongwith approval letter
6. Mutation/Transfer
7. Allotment Letter/Transfer order
8. GLR (General Land Register)
9. Akse Shajra duly demarcated
10. L-20 from Tehsildar(for rural property)
11. PT-1

## Other relevant Documents

Other documents that are required by FI should include CNIC, ECIB, property valuation, income certificates, employment letters, business details, bank statements, Income tax certificate and any other relevant document of a salaried person/self employed that can be consequential to overall mortgage process and ultimate lending decision.

## Legitimacy of Documents

All documents including offer letter should be legally binding, comply with consumer legislation, safeguard the customer and the bank and will stand in a court of law.

## Verifications:

FIs should verify the all the information provided in mortgage application form, title documents, CNIC. Verifications can be carried put through personal visits/ contacts /one to one interviews of the applicant etc. However banks can outsource verifications based upon the internal policy of FI.

##

## Combination of mortgage deed and loan agreement:

The Mortgage deed and Loan Agreement can be combined into one document provided the combined document fulfills the requirements of this Law.

# Chapter 4: Recovery and Auction

## Recovery procedures

1. In case of Default the Mortgagor and Mortgagee will exercise rights, duties and obligations arising from a Mortgage or a related agreement in accordance with existing guideline and regulation on recovery i.e. recovery ordinance 2001 or any other Law/regulation promulgated by SBP from time to time in this direction.
2. Upon Default on Payment or Default on Performance, the Mortgagee will send written Notice to the Mortgagor describing the Default and demanding that the Mortgagor remove such Default within the required time period.
3. In case the customer fails to comply with and reply to the initial legal letter, the FI will have to issue second and third legal notices to get the default settled.
4. However, under extreme measures, FIs can opt for auctioning the mortgage property, if all the efforts in default settlement proves fruitless and can sell/auction the Mortgaged Property under a Power of Sale through recovery ordinance 2001, without intervention by a court.

## Auction of Mortgage Property

FIs can choose to auction the property after full filling the following requirements and auction can take place at any time or place under commercially reasonable conditions. Also, the Mortgagee may elect to lease the Mortgaged Property to a third party or purchase the Mortgaged Property at a public sale.

1. Specific written Notice to the last known address of the Mortgagor
2. General notice by publication in the local language in at least one reputable daily newspaper with wide circulation in the village, city, district or province where the Mortgaged Property is located. Where such publication is not feasible, any other available means of general notice to the local public is acceptable.
3. The Notice for auction should include a description of the Mortgaged Property, unpaid amount of the Debt, the amount of the applicable expenses or, where the amount of the expenses has not been determined, a reasonable estimate;
4. A statement that, upon paying the due amounts, a Person responding to general or specific notice may buy or redeem the Mortgaged Property; and also the day, time and place of any public auction.

## Value of Purchase Price under a Power of Sale

1. The Mortgagee may not accept a price for the Mortgaged Property that is less than 75% of the value of comparable Immovable Property.
2. If the Mortgagee is unable to sell Mortgaged Property at a value indicated in the clause (1) of this article, the Mortgaged Property may be sold at a lesser value provided the Mortgagee:
	1. Holds at least two public auctions in accordance with this Law; and
	2. Establishes by documentation that neither auction produced a price as required under Clause (1) of this Article

## Utilization of sales proceeds through Auction

Funds received from Mortgaged Property through auction should be paid in the following order:

1. To pay reasonable expenses of the Mortgagee, including cost of insurance, taxes and costs for taking, holding, repairing or preparing the Mortgaged Property for sale or lease. Other expenses may include those stated in the Mortgage deed or Loan Agreement;
2. Payment of all Debt owed to the Mortgagee;
3. Payment of any remaining funds to the Mortgagor.

## Effect of auction on Mortgaged Property

1. A Power of Sale over Mortgaged Property in accordance with this Law terminates the Mortgage, and the Mortgagor’s interest in the Mortgaged Property.
2. A Person who occupies a Mortgaged Property, or any part thereof, under a lease will not be forced to vacate the Property until such lease expires. The Mortgagee or buyer of Mortgaged Property is allowed to negotiate compensation to the lessee to terminate such lease.
3. The Mortgagee shall give a written accounting of the following information to the Mortgagor upon request
	1. The amount of funds received;
	2. The amount applied to costs and expenses;
	3. The amount applied to the Mortgagee’s Debt;
	4. The amount of any funds paid to the Mortgagor

## Mortgagee Retaining Mortgaged Property

1. Should the Mortgagor fail to remove the Default on Payment or Performance within the specified time period, the Mortgagee may propose taking possession of the Mortgaged Property or a portion of it, in satisfaction of all or a portion of the Debt.
2. The Mortgagee should give written Notice of this proposal to:
	1. The Mortgagor;
	2. Any Mortgagee who, prior to the day on which such notice is given to the Mortgagor is registered in the Registry.
	3. Any objection to this proposal by Persons shown in clause (1) of this Article shall be sent to the Mortgagee within 15 (fifteen) days after receiving Notice.
3. If no objection is given, the Mortgagee is, at the expiration of period stated in clause (2), considered to have irrevocably elected to take the Mortgaged Property in satisfaction of the Debt as shown in the proposal and is entitled to hold or sell such Mortgaged Property free of any rights of the Mortgagor.

## Mortgagee as Attorney

1. Should a Mortgagee retain Mortgaged Property or execute a Power of Sale in accordance with this Chapter, the execution and registration of the Document of Title over Mortgaged Property may be performed by the:
	1. Mortgagor,
	2. Or Mortgagee, who is hereby deemed the duly authorized representative or agent to act on behalf of the Mortgagor;
2. The related Registry will accept and register documentation of sale and ownership executed by any of the Persons stated in clause (1) of this Article.

## Protection after Power of Sale

Upon sale of Mortgaged Property in accordance with this Chapter, a buyer

1. Acquires the Mortgaged Property free from the rights or claims of the Mortgagor.
2. May apply to the court to void a lease created after the date of the Mortgage if it appears to the court that such lease was created to adversely affect the value of the Mortgaged Property or to prejudice the rights and remedies of the Mortgagee.

##

## Right to Redeem Mortgaged Property

At any time before the Mortgagee executes the right to auction the Mortgaged Property, the Mortgagor may redeem the Mortgaged Property by paying all unpaid Debt to the Mortgagee and early payment charges (if any).

## Court Protection of Mortgagor

A Mortgagor may apply to the court, only on very solid ground and adequate evidence in order to stop auction proceedings on following grounds

- Default has not occurred,

- Notice of Default was not given or,

- Adequate time was not provided for the Mortgagor to remove a Default.

- All Debt was repaid or;

- No Mortgage exists;

# Chapter # 5: Risk Management

## Credit Policy

##

The lender should have a defined **Credit Policy** and in this Credit Policy it should refer to the parameters on which the lender carries out its mortgage lending activities. Primarily the Credit Policy should state that:

* 1. The policy is reviewed regularly to reflect business objectives and market conditions.
	2. Mortgage lending is based on ability to repay.
	3. The interest rate charged might vary, subject to nature of the product, to reflect the risks applying in a particular case that may include higher LTV ratios, higher debt burden ratio smaller loans or construction loans as opposed to purchase loans. But for each risk factor, the lender should set a ceiling above which it will not lend. Each bank in their policy documents should set out what the risk/reward ratio will be.
	4. The Interest rate charged to customers should be adequate to cover the bank’s cost of funds plus a suitable margin.
	5. Where the interest rate charged to the customer is variable; it should be linked to the relevant reference rate i.e KIBOR etc
	6. A policy not to deal with known risky (/fraudulent customers
	7. Explicit lending criteria.
	8. All lending decisions to be made on the basis of verifiable information and documentation provided rather than subjective judgment.
	9. It should set standards, which ensure that underwriters and account managers apply the policy initially at credit assessment stage and subsequently throughout the life of the mortgage.
	10. It should include expected lending skills standards, lending authorities, tiered discretions, training requirements and succession planning.
	11. It sets out policy on Arrears management, Repossessions, Loan Loss Provisions and Write-offs **EBRD STANDARDS**

## Loan Assessment

The lender should employ the following basic steps in critically assessing a loan application. Assess if:

* 1. Required information/documentation is in place.
	2. Application matches the standard criteria.
	3. Customer has the ability to repay.
	4. Customer has clean credit history.
	5. Property is suitable for mortgage.
	6. No legal or other impediments (age/bankruptcy etc).
	7. Costs and funds available match.

## Credit risk management

An approach to **Credit Risk Management** which will include the following:

* 1. Detailed data capture/verifying procedures.
	2. Detailed analysis/lending decisions.
	3. Realizable security.
	4. Proactive account management.
	5. General/Specific provisions in place.

## Arrears Management

Lenders should have an **Arrears Management Policy** for Mortgage Lending Risk Framework. This should be part of the overall Credit Policy and include specific provision for:

* 1. Well trained team/familiar with laws
	2. Clearly documented Process.

## Insurance Policies

1. **Life Assurance**: A Life Assurance policy on the life/lives of the borrower(s) to cover the outstanding principal for the term of the loan. The policy is to be assigned to the lender and its value will decrease in line with outstanding balance of the loan.
2. **Property Insurance:** lender should take comprehensive property insurance policy from reputable insurance companies before enhancing finances to the clients. The policy is to be in the joint names of the customer and the lender or the interest of the lender should be noted in the insurance policy, as the case may be.

#

# Chapter No 6: MIS & Accounts Management SUGGESTED BES

All the FIS should develop MIS and accounting systems that can generate comprehensive monthly/quarterly and yearly reports as per requirement. The systems that that have to be developed fall under the following categories.

## Mortgage Accounting System:

Comprehensive mortgage accounting system which would include the following functions within guidelines of Credit Policy:

* 1. Ability to .tag. Mortgages as belonging to a particular cover pool or as having been transferred to a particular SPV.
	2. Facility to use internal own bank Standing Orders/Direct Debits, if available.
	3. Facility to amend payments/notify customers when rates change.
	4. Facility to switch from variable to fixed rate and vice a versa.
	5. Facility to accept lump sum reductions/repay early.
	6. Facility to remove/add names to accounts.
	7. Management of account on death of a borrower.
	8. Facility to monitor/follow up arrears.
	9. Facility to carry out regular/annual reviews.
	10. Facility to provide statements to the customer.
	11. Systems should also have an adequate disaster recovery plan.

## Reporting:

Good reporting information which is accurate, timely and relevant. Monthly/Quarterly/Annual reports to be available by Branch/Area/Total Bank for:

* 1. Mortgage Book size/split by products (total value, total volume, average term, average interest rate, average LTV etc.)
	2. Share of National Mortgages (where available)
	3. Market Segments
	4. Portfolio share by sales channel
	5. Growth Profile
	6. Performance v Targets
	7. Applications v Approvals v Declines v Drawdowns
	8. Application Pipeline
	9. Arrears Profile (Split into 30, 60, 90 ,180 and 390 & above days)
	10. Maturity Profile
	11. Geographic Profile/Employer Profile
	12. Profitability
	13. Historic Data Retention
	14. Ability to produce reports as required by rating agencies and investors

##

## Monitoring Mortgage Account:

The following should be adhered to in order to ensure efficient monitoring of accounts:

1. Approvals are converted into drawdowns.
2. Security is in order before drawdown.
3. Repayments are up- to- date.
4. Premiums on Life Assurance policies are up to date
5. Premiums on Buildings Insurance policies are up to date.
6. Buildings Insurance Policies are index linked
7. Insurers report incidents of cancelled Life/Buildings Insurance policies.

# Chapter No. 7 “Relationship Management”

## Duties and obligation of mortgagor:

1. The Mortgaged Property should be free from other liens and encumbrance.
2. Stabilization and explanations of all rights, remedies, duties and obligations of parties and the remedies which arise from Default on Payment or Default on Performance
3. An understanding that Default on Payment or Default on Performance may result in the loss of any and all ownership and title rights in the Mortgage Property up to the extent of secured Debt;
4. A promise to keep Mortgaged Property, other than land, insured in a manner consistent with local standards; and promise to make reasonable repairs to Mortgaged Property
5. a clear statement that the Mortgagor has read and understands all the terms and conditions of the Mortgage deed;
6. To repay all Debt timely and in the agreed manner;

And unless otherwise agreed in writing or until all Debt is repaid, the Mortgagor

1. Will not sell Mortgaged Property without written consent of the Mortgagee;
2. Will not allow encumbrances or Liens filed against the Mortgaged Property;
3. Will allow inspection of the Mortgaged Property by the Mortgagee during business hours;
4. Will pay utilities, taxes and other public charges against the Mortgaged Property.

## Duties and obligation of mortgagee

Mortgagee should perform following

1. To provide Financing to the Mortgagor or perform any other agreed upon financial undertaking after written request from the Mortgagor
2. To apply repayment of the Debt in a manner consistent with the terms stated in the Loan Agreement; and
3. The Mortgagee will produce a written accounting of how payments are applied toward repayment of total Debt. Such accounting is required on a quarterly basis, unless there is agreement to do so on a more frequent basis.
4. The Mortgagee should provide a true copy of the signed Mortgage deed and Loan Agreement to the Mortgagor.
5. Consumer guides to process/products, relevant marketing material; Application Form(s). Letter(s) of Offer/Loan Agreement meeting legislative requirements, Mortgage Deed, Valuation/Property Appraisal Form and any other relevant material that can to facilitate the customer to make a convenient decision.
6. FIs through this law are bound to disclose all the relevant information of cost, procedures and policy of banking institution clearly. Clients should be guided and consulted to their best satisfaction level, even if it means involving a lawyer who explains the terms and conditions embodied in the loan agreement.
7. written confirmation of the key terms of the loan once the contract is signed and subsequent notification, at least on an annual basis, in cases where the structure of fees change (e.g., redemption penalties, statement fee, re-mortgage, early repayment charges etc.)
8. Annual statements to the borrower detailing the principal outstanding, repayments and interest payments made during the year and any penalty interest.
9. written notification of early repayment charge / arrears charges lender to have arrears / repossession policy or equivalent internal regulations