

SECURITIZATION ASPECTS IN INDIAN BANKING SYSTEM

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ABSTRACT

Securitization has emerged globally as an important technique for bundling assets and segregating risks into marketable securities. Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations (or other non-debt assets which generate receivables) and selling their related cash flows to third party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). Securitization diversifies credit markets as it breaks the process of lending and funding into several discrete steps, leading to specialization and economies of scale. The Indian securitisation market evolved in the 1990s with the main objective of meeting the priority sector shortfall in the Indian banking system, both for scheduled commercial banks and foreign banks. For many non-banking finance companies (NBFCs) which act as an issuer in these transactions, securitisation has provided an alternative source of capital at a cheaper rate and played a crucial role in their growth.

Keywords: Security, RBI, Policy, Economy

INTRODUCTION

The Indian central Government announced the so-called Indradhanush Scheme in 2015, to recapitalize and revamp the functioning of public sector banks. Government has estimated that the additional capital needed over the next few years up to FY 2019 would be about Rupees1,80,000 crores, and has proposed a budgetary allocation of Rupees70,000 cores to recapitalize banks. Government expected that, “improved valuations coupled with value unlocking from non-core assets as well as improvements in capital productivity, will enable PSBs to raise the remaining Rupees 1,10,000 crores from the market”.

Given the magnitude of the NPA problem, capital infusion seems inadequate. Raising of Rupees1,10,000 crores from capital markets after stock market valuations rise due to improved productivity also seems unrealistic.

NPAs in Indian public sector banks (PSBs) have increased sharply over the last few years from 2.4 per cent in March 2011 to 11.8 per cent in September 2016. The substantive factors for this sharp increase in NPAs are the slowing down of economic growth, stoppage of large infrastructure projects (because of Supreme Court judgments banning iron ore and coal mining, for example), slower than projected acquisition of land and environmental clearances. These delays have lowered the capacity of borrowers to service their debt. Private Banks lend for shorter maturities and have mostly abstained from longer-maturity infrastructure lending. Despite this it is noteworthy that NPAs in private sector banks have remained less than 3 percent over the same period which raises serious questions about the quality of credit appraisal in PSBs and RBI's regulatory oversight. The shortcomings of debt recovery channels have compounded the problems of PSBs.

The Reserve Bank issued the first set of comprehensive guidelines applicable to banks, financial institutions and non-banking financial companies (NBFCs) on Securitisation in India way back in February 2006. The guidelines covered following aspects relating to Securitisation transactions:

- ❖ Broad definitions on important Securitisation related concepts such as Securitisation, SPV, bankruptcy remote, credit enhancement, first loss facility, liquidity facilities, service provider and underwriting facilities.
- ❖ Prescribed detailed 'true sale' criteria and criteria to be met by originators and SPVs. Some important criteria included that originators should not indulge in market making on securities issued by SPV, originators shall not invest in more than 10% of securities issued by SPV, securities cannot have any put option, etc.

LITERATURE

The Asia-Pacific securitization market (2015) has been promising in the recent times and continues to show a trend of development. There has been a growth in the Asian market's share in the global volumes, however a part of that is attributable to fall in the European market's share of securitization volumes as well. The collateral performance in the Asian countries has been strong despite the evident economic downturns. The Australian markets also continued to grow year on year. The issuers have been widespread and investors have been both onshore and offshore.

Loutskina, (2011) observed that there is also evidence that securitization has quantitatively increased the amount of credit granted making it less dependent on specific banking or monetary policy conditions.

According to Kane (2010) the crisis has shown that securitization is heavily dependent on markets' perceptions and could be subject to sudden bouts of illiquidity generated from investors' concerns. Namely the consequences of the increased participation in bank funding by financial markets' investors and the large increases in securitized assets, can led to acute liquidity crises.

OBJECTIVES

1. To discuss the significance of securitization in India
2. To analyze the performance of securitization in Indian banking with a focus on ABS and MBS.

HYPOTHESES

1. The magnitude of securitization is insignificant in India with reference to Indian banks.

METHODOLOGY

Towards the end of the objectives and hypotheses, the following methodology is adopted. To discuss the significance of the securitization and the problems associated with that in India, 50 sample respondents are selected from Hyderabad .

SAMPLE DESIGN

For the purpose of performance of Securitization in Indian banking two classes of securities are selected namely ABS and MBS. In order to reflect stakeholders views on the performance of securitization, 50 stakeholders are selected from the financial markets in Hyderabad district.

Age and improvement in liquidity position of the originator

Age (years)	Improvement in liquidity position of the originator		Total
	Yes	No	
30-40	3	2	5
	60.0%	40.0%	100.0%
	7.7%	18.2%	10.0%

40-50	12	7	19
	63.2%	36.8%	100.0%
	30.8%	63.6%	38.0%
Above 50	24	2	26
	92.3%	7.7%	100.0%
	61.5%	18.2%	52.0%
Total	39	11	50
	78.0%	22.0%	100.0%
	100.0%	100.0%	100.0%

Chi-Square=6.5,df=2, $p=0.039$, $r=-0.353$

Source: Primary data

Table-1 refers to the distribution of the sample respondents by their age and by their response about the benefits attributable to securitization with a focus on improvement in liquidity position of the originator. The correlation between the age of the sample respondents and their response about the benefits attributable to securitization with a focus on improvement in liquidity position of the originator is found to be negative ($r=-0.353$). The rejection of the null hypothesis with level of significance=0.05 and degree of freedom=2 which implies that the relationship between the age of the sample respondents and their response about the benefits attributable to securitization with a focus on improvement in liquidity position of the originator is found to be statistically dependent.

Composition and Potential tool for redistribution of risks for the originator

Composition	Potential tool for redistribution of risks for the originator		Total
	Yes	No	
Banker	23	10	33
	69.7%	30.3%	100.0%
	60.5%	83.3%	66.0%
Stock Analyst	12	0	12
	100.0%	.0%	100.0%
	31.6%	.0%	24.0%
Consultant for securitization	2	1	3
	66.7%	33.3%	100.0%
	5.3%	8.3%	6.0%
Stock investors	1	1	2
	50.0%	50.0%	100.0%
	2.6%	8.3%	4.0%
Total	38	12	50
	76.0%	24.0%	100.0%
	100.0%	100.0%	100.0%

Table-2 refers to the distribution of the sample respondents by their composition and by their response about the benefits attributable to securitization with a focus on potential tool for redistribution of risks for the originator. The correlation between the composition of the sample respondents and their response about the benefits attributable to securitization with a focus on potential tool for redistribution of risks for the originator is found to be negative ($r=-0.153$). The acceptance of the null hypothesis with level of significance=0.05 and degree of freedom=3 which implies that the relationship between the composition of the sample respondents and their response about the benefits attributable to securitization with a focus on potential tool for redistribution of risks for the originator is found to be statistically independent.

Age and High concentration among few players

Age	High concentration among few players		Total
	Yes	No	
30-40	4	1	5
	80.0%	20.0%	100.0%
	11.8%	6.2%	10.0%
40-50	9	10	19
	47.4%	52.6%	100.0%
	26.5%	62.5%	38.0%
Above 50	21	5	26
	80.8%	19.2%	100.0%
	61.8%	31.2%	52.0%
Total	34	16	50
	68.0%	32.0%	100.0%

	100.0%	100.0%	100.0%
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Chi-Square=5.9,df=2, $\rho=0.054$, $r=-0.224$

Table-3 refers to the distribution of the sample respondents by their age and by their response about the problems hindering securitization of nonperforming assets in their full scope and potential with a focus on high concentration among few players. The correlation between the age of the sample respondents and their response about the problems hindering securitization of non performing assets in their full scope and potential with a focus on high concentration among few players is found to be negative ($r=-0.224$). The acceptance of the null hypothesis with level of significance=0.05 and degree of freedom=2 which implies that the relationship between the age of the sample respondents and their response about the problems hindering securitization of non performing assets in their full scope and potential with a focus on high concentration among few players is found to be statistically independent.

DISCUSSION OF RESULTS

The problems hindering securitization of non performing assets in their full scope and potential are identified and arranged in the descending order of endorsement which include uneven cash flows, security receipts are backed by impaired assets without predictable cash flows, security receipts are with both debt and equity features, lack of appropriate legislation, capital scarcity for ARCs, lack of tax laws with regard to securitization, higher acquisition cost, absence of legal clarity on foreclosures, high concentration among few players and lack of enthusiasm among investors. It is further concluded that the securitization market in India, though in its infancy, holds great promise especially in the MBS area. While more complex securitization transactions and public issuance of securitized paper are still a distant dream, appropriate legislation and investor education can give the securitization market in India a much-needed thrust.

It is concluded that the problems hindering securitization of non performing assets in their full scope and potential are identified and arranged in the descending order of endorsement which include uneven cash flows, security receipts are backed by impaired assets without predictable cash flows, security receipts are with both debt and equity features, lack of appropriate legislation, capital scarcity for ARCs, lack of tax laws with regard to securitization, higher acquisition cost, absence of legal clarity on foreclosures, high concentration among few players and lack of enthusiasm among investors.

It is further concluded that the securitization market in India, though in its infancy, holds great promise especially in the MBS area. While more complex securitization transactions and public

issuance of securitized paper are still a distant dream, appropriate legislation and investor education can give the securitization market in India a much-needed thrust.

1. Proper legislation on securitization must be made in India and not merely in terms of guidelines.
2. Laws must be enacted in accordance with all the provisions of securitization act.
3. New players in the field of Asset Reconstruction must be encouraged.

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