CONTRIBUTORS TO SUCCESS OF SECURITISATION ACT

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ABSTRACT

The Indian economy has also been affected by bad and doubtful assets of its banks and financial institutions. Although no exact data is available on the amount of NPAs in Indian context as estimates vary between Rs. 70,000 crore and Rs. 1,00,000 crore of our banks and financial institutions. The multiplicity of factors is responsible for the present status of NPAs in these financial institutions in India. The factors can be classified as originating, internal, external and other factors. Originating factors are inefficient management, unavailability of inputs and misappropriation of funds. Internal factors consist of financial problems, project appraisal deficiencies and project management deficiencies. Political interferences, lop-sided laws and government policies are under the category of external factors. Other factors are lack of good credit risk management system, inadequate preventive measures and inadequate post-disbursement supervision.

The Reserve Bank of India and the Government of India took number of measures from time to time like One Time Settlement Scheme (OTS), Debt Recovery Tribunals (DRTs), Lok Adalats, etc. to stem the rot, but fell short of the desired results and high expectations of the concerned people in particular and society in general. The government of India was critised and faced scathic attack from different quarters of the economy and the society. Obsessed with the criticism, the Government of India promulgated Securitisation Ordinance in June 2002 and enacted the full fledged Act in December 2002 entitled Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002. This is also known as SARFAESI Act 2002 or simply the Securitisation Act.

Securitisation Act

Managing financial services business is becoming more and more complex as the competition in the financial markets is becoming fierce. Gone are the old days when investors looked upon the banks as the first choice for depositing their savings and bankers had little anxiety over getting deposits. Nor the investors were concerned about the risk of fluctuating interest rates in the market. Thus, the investors swam in calm waters. But the developments of eighties have changed the scenario completely and investors are now facing a strong weather. Management of liquidity risk, credit risk, capital risk and interest rate risk has become the focal points in ensuring success in banking business.

Further, the capital adequacy regulations not only increase the cost of the resources for the institution but also places restriction on the asset expansion. Similarly, the illiquidity in the loans portfolio doesn't allow the banks to reduce the concentration of the bank's exposure on certain pocket of trade, business and industry and thus increasing the portfolio risk.

To tide over these problems some innovative solutions were required to be thought out in terms of making the illiquid loans portfolio some how liquid and saleable. The solution was found in the process of securitization of loans in the early seventies in the USA. The housing loan financial companies and saving and loan associations and few commercial banks, which had a sizeable exposure to the long-term housing loans built up by taking the help of short term sources have to think of this novel method to tide over liquidity constraints. The government agencies such as GNMA, FNMA and FHLMC came to the rescue of these institutions in popularizing the concept of securitization and in selling what are popularly called Mortgage Backed Securities (MBS). The concept took roots in the later half of the eighties in securitisation of other receivables such as vehicle loans, boat loans, credit card receivables and leasing rent receivables. Securitisation became popular in other developed countries and is gradually spreading to developing countries of world. Thus, securitisation of assets world over has become an important tool of asset-liability management of banks and financial institution to tide over the liquidity and other risks and also to supplement income by way of profit on sale of loans and recurring service charges of collection and remittance of principal and interest on securitised asset.

Although European and the American financial markets are recording billion of dollars worth of issues in the structured securitisation programmes undertaken by banks, financial institutions and finance companies, the Indian markets have yet to wake up the tremendous potential of securitization because of several impediments and constraints like absence of securitization markets, taxation issues, high stamp duties, accounting treatment, lack of legal framework (only in 2002 Securitisation Act has been enacted), etc. Securitisation came to the

Indian market in 1991, thanks due to the pioneering efforts made by Citi Bank but thereafter the issue has been few and far between and all of them on private placement bases. Presently, the ICICI Bank is a torchbearer for the institutions seeking securitisation. This bank is undertaking and experimenting the securitisation of different sorts like securitisation of existing assets, future receivables, sales tax revenues, small loan portfolios, etc. All the deals recorded in the Indian markets are asset-based securitization but very recently the mortgage-based securitization also started.

The non-performing assets of the banks and financial institutions have acquired the status of dangerous and calamitous problem all over the world. The survival of these institutions has been endangered as their viability and solvency are influenced by the NPAs. The main activity of such financial institutions i.e. lending activity gets adversely impacted due to the non recovery of the loan assets and interest on such assets influence the credit dispension process. As a consequence the profitability of such financial institutions also gets affected. This all results into greater need for funds by way of capital and extra provisions. Thus, the management of bad loans and keeping them at the lowest level is of paramount significance for the financial institutions as they are based upon public confidence.

The Indian economy has also been affected by bad and doubtful assets of its banks and financial institutions. Although no exact data is available on the amount of NPAs in Indian context as estimates vary between Rs. 70,000 crore and Rs. 1,00,000 crore of our banks and financial institutions. The multiplicity of factors is responsible for the present status of NPAs in these financial institutions in India. The factors can be classified as originating, internal, external and other factors. Originating factors are inefficient management, unavailability of inputs and misappropriation of funds. Internal factors consist of financial problems, project appraisal deficiencies and project management deficiencies. Political interferences, lop-sided laws and government policies are under the category of external factors. Other factors are lack of good credit risk management system, inadequate preventive measures and inadequate post-disbursement supervision.

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Securitisation originated and developed in U.S.A. and the markets for it have grown at a very rapid pace over the years in that country. U.K. is the second nation to make the best utilization of this concept. Other European countries have also realised the significance of securitisation and started enacting the legislations to assist the development of markets. In India, the concept of securitisation began in nineties when Citi Bank securitised a pool from its auto loan portfolio and placed the paper with GIC Mutual Fund. The volume involved was Rs. 16 crore. Then, various financial companies, housing companies, investing companies and banks followed the suit.

Securitisation in a broader sense indicates the process of disintermediation where in the borrowers bypass the traditional intermediatation process by accessing the investors' community directly in the money and capital markets through issuing their own securities. Securitisation as an innovation in the financial market covers the process of converting the contractual debt into tangible securities and selling them to the investors after proper packaging and underwriting the same.

The Securitisation Legislation in India deals with NPAs through Asset Reconstruction Companies and Enforcement of Security Interest besides the Securitisation. Considering all this and the significance of the securitisation in the recovery of NPAs of the banks and financial institutions, an effort is made to probe the impact of Securitisation Legislation in improving the financial markets, increasing the profitability and solvency of the banks and financial institutions through effective management of NPAs.

Success of Securitisation Act – Number of doubts and reservations were expressed about the chances of success of this legislation as it has come into application after storming odd weathers. An attempt is made from the bank respondents to ascertain the status of Securitisation Act 2002 from the respondent banks under consideration, Table 1 has been constructed.

TABLE - 1

Status of Securitisation Act 2002

Opinions	Respondents
(a) It has succeeded	51 (94.44)
(b) It has met the fate of previous legislations	—
(c) It has proved a bigger failure	—
(d) Can't say	03 (5.56)
Total	54 (100)

Source: Sample Survey

Figures given in parentheses represent percentages

A very vast majority (94.44 percent) has opined 'affirmatively' about the success of Securitisation Act. No one has responded to the options 'it has met the fate of previous legislations' and 'it has proved a bigger failure'. Only 5.56 percent of the respondents feigned ignorance about the success of Securitisation Act by responding to 'can't say' option.

It may be concluded on the basis of above analysis that Securitisation Act 2002 has succeeded in hitting the eye of bull.

Success Contributors - Considering the success rate of Securitisation Act as admitted by respondents, an idea struck to our minds to determine the contributors to the success of this Act. Table 2 deals with the contributors to the success of Securitisation Act.

TABLE - 2

Contributors to Success of Securitisation Act

Contributors	Respondents
(a) Legal wranglings of civil suits are not there	42 (77.78)
(b) Defining of financial instruments as security receipts	11 (20.37)
(c) Legal banking is there now	20 (37.04)
(d) To face the competition of banks and financial institutions of private sector	07 (12.96)
(e) Better yields	18 (33.33)
(f) Public sector biggies are plunging into markets	09 (16.67)
(g) Any other – fast method of recovery	03 (5.56)

Source: Sample Survey

Figures given in parentheses represent percentages

The analysis shows 'legal wranglings of civil suits are not there' was the main contributor to the success of Securitisation Act. This is followed by the 'legal banking is there now' and 'better yields'. Besides the above, the ‘defining of financial instruments as security receipts’ and ‘plunging of public sector biggies into markets’ have also contributed in the success of Securitisation Act.

It may be concluded that the direct recovery route from the borrowers is the biggest motivator for the banks. No doubt, there was hue and cry over violating the jurisdiction of law courts by this Act. This has also brought down the volume and number of NPAs accounts.

Research Design

As regards the size of the sample various public sector banks considered as earlier mentioned in scope of the study and data used sections. In all, study comprises 54 branches and offices of 21 banks operating at various levels. The 21 banks are Allahabad Bank, Andhra Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Central Bank of India, Corporation Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Oriental Bank of Commerce, Punjab & Sind Bank, Punjab National Bank, State Bank of India, State Bank of Patiala, Syndicate Bank, UCO Bank, Union Bank of India, United Bank of India and Vijaya Bank. 28 offices of the above mentioned banks operating at local level, 15 at regional level and 11 at zonal level were considered for study.

The views of the respondents to various aspects of the study have been dealt with from all the 54 branch offices at the different levels. The opinions expressed by respondents have been shown at local, regional and zonal levels for inter level comparison in respect of various aspects of the questionnaire for the study.

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