

A Study on Banks Asset Securitization Problems and Prospects

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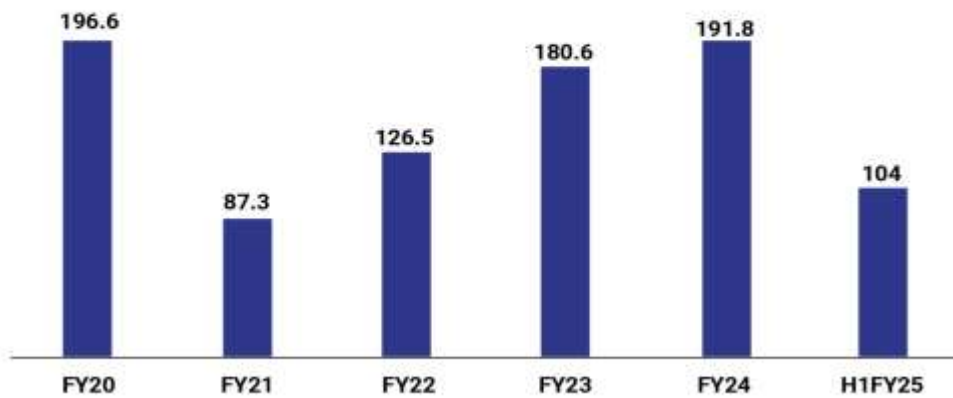
Abstract:

Asset Securitization is a process where debt products like home loans, auto loans, microfinance loans, and credit card debt are pooled and repackaged as interest-bearing securities. It basically works on the assumption that the probability of several assets defaulting is lower than the probability of defaulting for a single asset. A flaw in structuring the deal could be one of the contributory factors of a failed deal. It could also attract excessive abuse, which consequently will be catastrophic to the financial system. Thus, proper control and regulation of off balance sheet financing is inevitable. 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 Rupees 1,80,000 crores, and has proposed a budgetary allocation of Rupees 70,000 crores 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 Rupees 1,10,000 crores from capital markets after stock market valuations rise due to improved productivity also seems unrealistic. This has led to attempts being made by a few players to get into the Asset Backed Securities market as well.

Keywords: Demonization, SEBI, Guidelines, NPA's, RBI

Introduction:

Financial sector's primary role is intermediation between ultimate savers and ultimate investors. Initially, it was banks which were the intermediaries. As the financial sector evolved, other types of financial institutions came on the scene to undertake such intermediation directly, or between and among other intermediaries. A parallel development is the emergence of varieties of financial products, far removed from simple deposits and advances, delivering such intermediation. Securitization, as we all know, is among the latest of such intermediating product.

Securitization market volume (INR '000 crore)

Source: ICRA

A securitization transaction involves shifting the assets from the balance sheet of the originator to the balance sheet of an intermediary which could either be a Special Purpose Vehicle, SPV (a legal entity typically set as a trust to undertake a specific business purpose or activity) for non-stressed/standard assets, or an asset reconstruction company for stressed assets.

In the Indian market, the pooled assets are sold to the investors either in the form of pass-through certificates (PTCs), which are like bonds, for standard assets, or security receipts (SRs) for stressed assets. PTCs or SRs represent claims on incoming cash flows (like the principal repayments and interest) from such pooled assets.

PTCs vs DAs

Apart from PTCs, banks and financial institutions in India are allowed to enter Direct Assignment (DA) transactions to sell their loan books at a fixed interest rate to other banks or financial institutions. Such transactions do not involve an SPV or the issuance of PTCs.

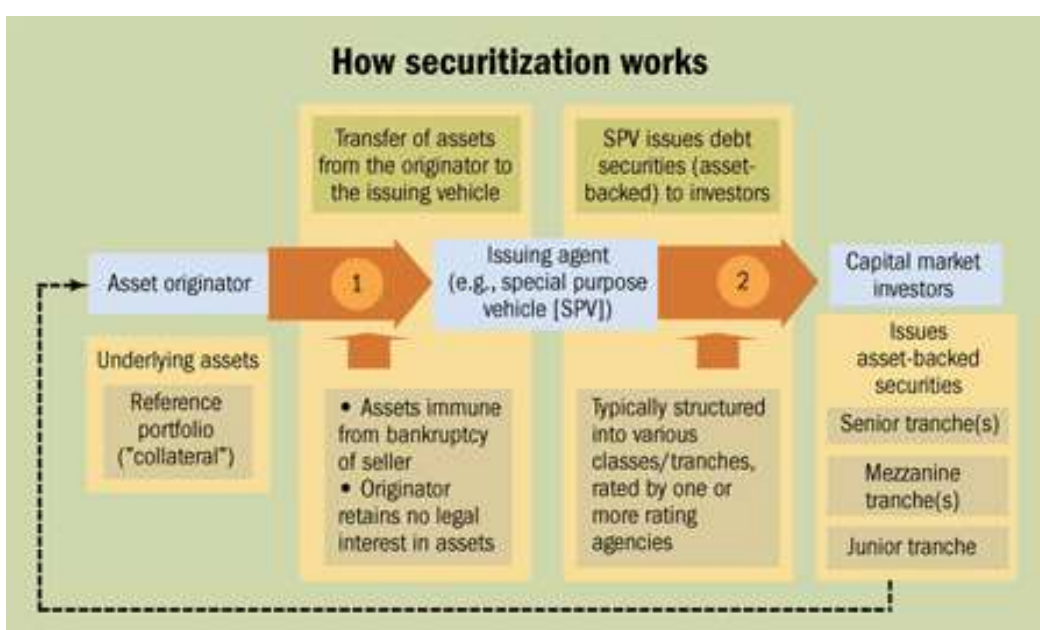
Over the last few years, the proportion of DAs compared to PTCs in retail loan securitizations has been reducing and continues to do so due to the expected fall in gold loan and mortgage securitizations as well as the rise in co-lending deals. PTCs are expected to gain a higher proportion due to the increasing share of asset classes like vehicle loans, microfinance, business loans, and personal loans in the securitization volume.

Literature:

Stefano Filomeni (2024) the reputational concerns of the originator in the market may invalidate the occurrence of a true sale. For instance, during the crisis Citigroup Inc. moved more than \$55 billion in dubious assets back on to its balance sheet as a signal of being directly accountable, should problems emerge related to the given securitization deal. This signal had the objective of maintaining a good reputation in the market that could ultimately lead to repeated securitization transactions.

Gopalan.R et. al (2023) explain In order to provide further impetus towards asset securitisation market operations and its stake-holders, the survey respondents recommended for 2 essential ‘make-overapproaches’. First towards – ‘Setting up Asset Securitisation - Centre of Excellence (CoE)’ at every Bank level, for ‘building product-expertise and evolve appropriate assetpricing-models’ for deal-pricing and pricing of PTC type of Securities & its derivative products such as Collateralised Debt Obligations (CDOs), Collateralised Loan Obligations (CLOs), Asset Backed Credit Default Swaps (ABCDs), Asset Backed Commercial Papers (ABCPs) etc., both from Credit product perspective as well Investment perspective for investing in PTC assets. The CoE may be assigned responsibility for cascading theoretical and practical knowledge on asset securitisation to middle and senior level managers of the Bank and build product competency for a wider section of banking professionals.

The Asia-Pacific securitization market (2018) 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. As per a report of BIS35, Consumer ABS volumes have recovered to above their pre-crisis peaks, however RMBS remains less than half its peak level and CMBS issuance has been dormant. In the past few years, the Japanese securitization market has been on a low key. Japan’s securitization annual issuances have fallen to a third of the 2006 levels.



Source: Seetharaman et.al (2018)

Solar City (2017) has completed its fourth successful securitization wherein bonds were backed by solar assets. The company had come up with its first securitization in November, 2016 amounting to US\$54 million. This was considered as a breakthrough in lowering the cost of capital for the solar industry. Also, recently AES Corp., a U.S. power producer, is in the news since it is planning to securitize its first portfolio of solar projects.

Loutskina, (2015) 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 (2014) 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.

Ashcraft *et al.* (2013) find evidence that ratings levels were less conservative around the *MBS* market peak of 2010-2011. The involvement of rating agencies should go beyond providing passive credit-quality certification and theoretically includes a more active approach over the economic cycle. This is crucial for our analysis as large part of our empirical analysis revolves around the issue of how rating changes of the underlying deals are determined.

Objectives:

1. To analyze the performance of securitization in Indian banking with a focus on ABS and MBS.
2. To explain the problems hindering securitization of nonperforming assets in their full scope and potential.

Hypothesis

1. Problems hindering securitization of nonperforming assets in their full scope and potential are insignificant.

Sample:

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.

Data Analysis:

Investor is ensured flexibility in structuring the timings of the cash flows

Response	Frequency	Percent	Cumulative Percent
Yes	37	74.0	74.0
No	13	26.0	100.0
Total	50	100.0	

Source: Primary data

The Above Table refers to the distribution of the sample respondents by their response about the benefits attributable to securitization with a focus on investor is ensured flexibility in structuring the timings of the cash flows. It is observed that 74 percent of the sample respondents have stated that investor is ensured flexibility in structuring the timings of the cash flows through securitization and 26 percent of the respondents did not endorse the same.

Age	Absence of legal clarity on foreclosures		Total
	Yes	No	
30-40	3	2	5
	60.0%	40.0%	100.0%
	8.6%	13.3%	10.0%
40-50	13	6	19
	68.4%	31.6%	100.0%
	37.1%	40.0%	38.0%
Above 50	19	7	26
	73.1%	26.9%	100.0%
	54.3%	46.7%	52.0%
Total	35	15	50
	70.0%	30.0%	100.0%
	100.0%	100.0%	100.0%

Chi-Square=0.378,df=2, p=0.828,r=-0.081

Source: Primary data

Table-1 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 absence of legal clarity on foreclosures. The correlation between the age of the sample respondents and their response about the problems hindering securitization of nonperforming assets in their full scope and potential with a focus on absence of legal clarity on foreclosures is found to be negative ($r=-0.081$). 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 nonperforming assets in their full scope and potential with a focus on absence of legal clarity on foreclosures is found to be statistically independent.

Age and Lack of tax laws with regard to securitization

Age	Lack of tax laws with regard to securitization		Total
	Yes	No	
30-40	3	2	5
	60.0%	40.0%	100.0%
	8.1%	15.4%	10.0%
40-50	15	4	19
	78.9%	21.1%	100.0%
	40.5%	30.8%	38.0%
Above 50	19	7	26
	73.1%	26.9%	100.0%
	51.4%	53.8%	52.0%
Total	37	13	50
	74.0%	26.0%	100.0%
	100.0%	100.0%	100.0%

Chi-Square=0.763,df=2, p=0.683,r=-0.011

Source: Primary data

Table-2 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 lack of tax laws with regard to securitization. The correlation between the age of the sample respondents and their response about the problems hindering securitization of nonperforming assets in their full scope and potential with a focus on lack of tax laws with regard to securitization is found to be negative ($r=-0.011$). 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 nonperforming assets in their full scope and potential with a focus on lack of tax laws with regard to securitization is found to be statistically independent.

Composition and Lack of tax laws with regard to securitization

Composition	Lack of tax laws with regard to securitization		Total
	Yes	No	
Banker	26	7	33
	78.8%	21.2%	100.0%
	70.3%	53.8%	66.0%

Stock Analyst	6	6	12
	50.0%	50.0%	100.0%
	16.2%	46.2%	24.0%
Consultant for securitization	3	0	3
	100.0%	.0%	100.0%
	8.1%	.0%	6.0%
Policy maker	2	0	2
	100.0%	.0%	100.0%
	5.4%	.0%	4.0%
Total	37	13	50
	74.0%	26.0%	100.0%
	100.0%	100.0%	100.0%

Chi-Square=5.74,df=3, $p=0.125$, $r=0.093$

Source: Primary data

Table-3 refers to the distribution of the sample respondents by their composition and by their response about the problems hindering securitization of nonperforming assets in their full scope and potential with a focus on lack of tax laws with regard to securitization. The correlation between the composition of the sample respondents and their response about the problems hindering securitization of nonperforming assets in their full scope and potential with a focus on lack of tax laws with regard to securitization is found to be positive ($r=0.093$). 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 problems hindering securitization of nonperforming assets in their full scope and potential with a focus on lack of tax laws with regard to securitization is found to be statistically independent.

Results:

it is concluded that the problems hindering securitization of nonperforming 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.

Conclusion:

1. Securitization has become a vital instrument for financial institutions over the last few decades. When banks participate in securitization activities, they remove the securitized assets, or pool of assets, from their balance sheets and sell them to a special purpose vehicle (SPV) that finances the purchase of the pool of assets by issuing ABS securities to outside investors in the market. Through this mechanism, the issuing institution can convert illiquid assets into marketable securities and is able to diffuse the associated credit risk among external investors. In this paper, I investigate the impact of securitization on the risk appetite of US BHCs during the period from 2001 to 2017. Based on a sample of 170 US BHCs, my results are supportive of the recourse hypothesis of securitization according to which securitization negatively affects the risk-taking by BHCs.
2. Loans outstanding of NPAs acquired have been increasing during 2010-2015. It is further observed that during the same period ARC acquisition cost as percent of loan outstanding has increased manifold. There is no significant difference between the performance of ABS and MBS modes of securitization of NPAs in Indian banking. YoY changes in securitization of NPAs through ABS and MBS and found that the degree of volatility in MBS mode of securitization is higher than that of ABS.
3. The problems hindering securitization of nonperforming 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.

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