

## **Analysis of impact of Enactment of Securitization Act 2002: A case study**

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### **Abstract**

The financial system in India comprises of Commercial Banks including Public Sector, Private Sector and Foreign Banks, Co-operative Banks, Development Finance Institutions (DFIs) and various other institutions in the areas of Insurance, Mutual Funds and Government Securities. Commercial Banks are playing a very important role in the financial system and payment systems. Banks are 'special' as financial intermediaries critical for mobilizing public saving and for deploying them to provide safety and return to savers. The deployment of funds mobilized through deposits involves Banks in financing economic activity and providing a lifeline for the payment system. The introduction of economic reforms gives greater flexibility and autonomy to banks in increasing their profitability, productivity and efficiency. The RBI is the central bank of the India which is the Monetary Authority of the country. The Slowdown in economic growth and rapid credit growth are independently associated with higher levels of NPA upon analyzing the banking sector in India, it is evident that the NPAs still pose a significant threat to the banking sector. In this research an attempt is made to examine the impact of SARFASI Act 2002 on the level of non-performing assets of State Bank of Patiala seven years before and after the enactment of the Act.

**Keywords:** NPA's, banking sector, securitization act 2002, gross assets, net assets, capital adequacy, net profits to total assets

### **Introduction**

The health of an economy largely depends upon a healthy Banking system, which in turn depends upon a sound asset structure. The Bank has created Non- Performing Assets (NPA's), when the amount of bad and doubtful Assets increased in the banks. When the amount of the loan is due, they neither recover the capital nor earn income in real terms. Such NPA's affects the performance and profitability of the bank. For the health and financial soundness of banks in the international level the economic reforms were initiated. With the mutual consent and debate of the participants who reinforcing to the overall economy the economic reforms have undertaken. These reform measures substantiate the views that highlight the key role in economic development that could be played by a banking system free from the types of controls on interest rates and quantities that were Two decades had completed since the banking sector initiated measures to uplift the banking sector in line with international standards and to improve productivity and efficiency of banks. The need for the setting up an asset reconstruction company arise due to make the Assets off the balance sheet of the Banks and FIs with a view to develop a market for such assets was being felt, since long. Narasimham Committee 1 & 2 and the Verma Committee on restructuring of weak Banks has strongly recommended the setting up of Asset Reconstruction Companies (ARCs). For enhancing the liquidity of the Banks and FIs the term debt securitization is used which is new in the market. It provides extended financial assistance to the borrowers for various purposes. The enactment of the securitization Act, it was seen as a panacea to the entire problem of NPAs. Defaulting borrowers who were not responding previously started responding favorably and cash

recoveries became a reality. Now they are coming to the banks for settling their dues. The settlements are being reached as per RBI norms and banks' own recovery management policies. Cash recoveries have started pouring in. Where the borrowers have not responded to the 60-day notices, the banks have tightened the noose and have started procuring Seizure Orders from District Magistrates (DMs) or Chief Metropolitan Magistrates (CMMs).

### **Review of Literature**

Shakuntalamani (2001) highlighted in his paper the magnitude of NPAs in banks, reasons for increasing NPAs, the impact and the measures adopted for reducing NPAs in the banking system so far. The study was based on the secondary data. The data had been retrieved from the Report on the trend and progress of banking in India, various books and journals. The study found that the percentage of NPAs to gross advances had a downward trend over the year of study (1993 to 1999) which indicated better management techniques in banks. Further, legal framework, political interference, competition and liberalization were identified as reasons for mounting of NPAs. The study concluded that recovery efforts had been redoubled upon within the framework of the guidelines. Alex Cowley and J. David Cummins (2005) <sup>[1]</sup> in their study found that the Securitization is one of the most important innovations of modern finance. The securitization is a process which converts the illiquid assets into liquid assets by way of issuing securities in the capital market. It gives opportunity related to diversifying the risk by to invest in new classes of risk that enhance market efficiency. Securitization provides a recovery mechanism without the intervention of the court. In addition to facilitating risk management, securitization process

also reduces the liquidity risk in the financial markets by replacing untraded off balance-sheet assets with liabilities of tradable financial instrument.

Jain (2007) <sup>[2]</sup> stated that the problem is more acute in PSBs where the gross and net NPAs as on 31<sup>st</sup> march 2003 were at 9.4% and 4.5% higher than the overall figures for SCB sat 8.8% and 4.4%. The gross NPAs of PSBs as on March 2003 were Rs. 54086 crore, while the net NPAs is Rs. 24963 crore. An attempt was made to find out the reasons for the increasing level of NPAs and the prudential measures available for it. The debt recovery tribunals, Asset reconstruction companies, lok adults measures initiated by the RBI and Government of India. The attempt also examined the variations in the incidence of NPAs to various sectors, time periods, and the efficiency of the banks through univariate analysis of variance (ANOVA) technique. RBI study (1999) explained how the second phase of reform is helpful in the improvement of organizational efficiency and profitability of the banks is the reduction of NPAs.

Mei Cheng, Dan s. Dhaliwal and Monica Neamitu (2011) <sup>[3]</sup> in their study, they examined some of the consequences of asset securitization. The hypothesis of the study was the impact of the difficulty in estimating recourse on bank information uncertainty will be different for the banks that operate in a higher quality information environment. For testing the hypothesis they used two proxies for bank information uncertainty bid ask spreads and analyst forecast dispersion. Using a sample of bank holding companies, they investigated whether the difficulty in assessing the true extent of risk transfer, between securitizing banks and investors affects bank information uncertainty. They compared the information uncertainty levels between securitizing and non-securitizing banks. They found that greater information uncertainty (i.e., larger bid-ask spreads and analyst forecast dispersion). In addition, they found that this effect was mitigated for banks that operate in a higher quality information environment.

J. Rama Devi and Dr. B. Ramachandra Reddy (2014) <sup>[4]</sup> found that NPAs is a major problem for banking sector in indianite does not generate income for the banks. Today public sector banks give loans to different sectors, So that the most critical area in the improvement of the profitability of banks continues to be the reduction of non-performance assets (NPAs). The specific objectives of the study were to analyze the classification of loan assets in Public Sector Banks and to examine the causes and remedial measures to arrest. The study concentrated on PSBs only and study based on the secondary data. The amount of standard assets showed an increasing trend during the stated period. In the initial year 2004 the ratio of standard assets to total advances stood at 92.2 percent. It increased to 96.4 percent in 2013. Total advances of Public

Sector Banks is increased from Rs.6, 61,976 crore in 2004 to Rs.39, 428 crore in 2012. The Net NPAs to per cent of Net Asset ratios it was 1.3 per cent in 2004 and increased to 2.0 per cent in 2013. At last concluded that a large number of compromise proposals are being approved by banks with a view to reducing the NPAs and recycling the funds instead of resorting to expensive recovery proceedings spread over a long period.

### Research Methodology

Research methodology is a way to solve the research problem systematically. While designing the research work the following methodology will be adopted.

- **Sample selection:** The present study concentrates on the impact of enactment of Securitization act 2002. The selection of bank has been made on the basis of availability and uniformity of data. The case is as under: the name of the bank is state bank of Patiala.
- **Period of study:** In order to make a comparison of the impact of enactment of the Act, data for Seven years (1995-96 to 2001- 02) prior to enactment of act and data for seven years (2003-04 to 2009-10) after the enactment of act have been analyzed.
- **Data used:** The present study is based on secondary data published by the reserve bank of India, annual report of state bank of Patiala. Data have also been collected from the websites of various government and nongovernment agencies.
- **Statistical techniques:** Statistical techniques like arithmetic mean, standard deviation and t-test have been employed for the analyses of data. The statistical tools which have been employed in this study are presented as follows:
  - Mean or average value □ Standard deviation □ t-test
- **Objective of the study:** The objective of the study is to evaluate the effectiveness of the enactment of Securitization act 2002 on the NPAs of state bank of Patiala.
- **Hypothesis:** The present work is essentially based on secondary y sources; hence hypothesis is being tested by using published materials.
  - Let mean value before enactment of act be X1
  - Mean value after enactment of act be X2
  - Ho:**  $X1=X2$  Null Hypothesis: there is no difference in mean value of NPAs of state bank of Patiala before and after enactment of act.
  - H1:**  $X1\neq X2$  Alternate Hypothesis: there is difference in mean value of NPAs of state bank of Patiala before and after enactment of act.

## Analysis and Interpretation

**Table 1:** Selected Ratios of State bank of Patiala (in percent) (From year 1995-96 to 2001-02)

Year/Ratio	Net NPAs to Total Assets	Gross NPAs to Total Assets	Gross NPAs to Total Advances	Net NPAs to Total Advances	Capital Adequacy Ratio	Net Profit Ratio
1995-96	2.62	4.79	11.49	6.60	9.51	0.63
1996-97	2.57	5.24	11.32	5.88	11.25	0.68
1997-98	3.00	5.34	11.88	7.04	13.24	1.47
1998-99	3.65	6.61	13.98	8.23	12.47	0.93
1999-00	2.86	5.44	10.99	6.09	12.60	1.06
2000-01	2.35	4.85	9.66	4.92	12.37	1.12
2001-02	1.47	3.62	8.23	2.94	12.55	1.34
Mean Value	2.64	5.13	11.07	5.95	11.99	1.03
CAGR	-0.079	-0.039	-0.047	-0.109	0.040	0.114

*Source:* (RBI) Report on Trend and Progress of Banking in India, RBI.

**Table 2:** Selected Ratios of State bank of Patiala (in percent) (From year 2003-2004 to 2009-2010)

Year/Ratio	Net NPAs to Total Assets	Gross NPAs to Total Assets	Gross NPAs to Total Advances	Net NPAs to Total Advances	Capital Adequacy Ratio	Net Profit Ratio
2003-04	0.00	1.87	3.71	0.00	13.56	1.60
2004-05	0.60	2.07	4.13	1.23	14.21	0.91
2005-06	0.53	1.31	2.40	0.99	13.55	0.73
2006-07	0.50	1.10	1.80	0.83	12.38	0.77
2007-08	0.37	0.88	1.42	0.60	12.50	0.70
2008-09	0.40	0.80	1.30	0.60	12.60	0.80
2009-10	0.46	0.86	2.14	1.04	13.26	0.79
Mean Value	0.41	1.27	2.41	0.75	13.15	0.9
CAGR	-0.043	-0.105	-0.076	-0.028	-0.003	-0.096

*Source:* (RBI) Report on Trend and Progress of Banking in India, RBI.

**Table 3:** Analysis of State bank of Patiala (T-Test)

Ratios	SARFAESI Act	N	Mean	Std. Deviation	t	Df	Sig. (2-tailed)
Net NPAs to Total Assets	Before	7	2.6457	.66535	8.533*	12	.000
	After	7	.4086	.19617			
Gross NPAs to Total Assets	Before	7	5.1271	.89599	9.890*	12	.000
	After	7	1.2700	.51179			
Gross NPAs to Total Advances	Before	7	11.0786	1.79920	10.861*	12	.000
	After	7	2.4143	1.10345			
Net NPAs to Total Advances	Before	7	5.9571	1.68098	7.959*	12	.000
	After	7	.7557	.40533			
Capital Adequacy Ratio	Before	7	11.9986	1.24636	-2.148	12	.053
	After	7	13.1514	.68089			
Net Profit Ratio	Before	7	1.0329	.31389	.790	12	.445
	After	7	.9000	.31570			

*Note:* \* significant at 5 percent.

The result of State Bank of Patiala (Table-1) revealed that average of Gross NPAs to Total Asset, Net NPAs to Total Asset, Gross NPAs to Total Advances and Net NPAs to Total Advances of State Bank of Patiala during post Act period was lesser than that of pre Act period. Gross NPA to total Asset ratio of State Bank of Patiala was 4.79 in the year 1995-96 and then in the year 2009-10 declined up to 0.50. Gross NPA to total Advances ratio of State Bank of Patiala was 11.49 in the year 1995-96 and then in the year 2009-10 declined up to 2.14. Capital Adequacy ratio is 9.51 in year 1995-96 and increased up to 13.26 in the year 2009-10.

The table 3 highlighted that, the difference in mean values of Gross NPAs to total Assets (5.1271v/s1.2700,t-value9.890) and Gross NPAs to total Advances (11.0786v/s2.4143,t-value10.861) is significant at 5 percent concluding that bank

efficiency in assessing the credit risk and managing their NPAs. The table 3 also highlighted that difference in mean values of capital adequacy ratio (11.9986v/s 13.1514, t-value-2.148) and Net Profit to Total Assets ratio (1.0329v/s.9000, t-value .790) is insignificant at 5 percent which concluding that profitability will not significantly increased after the enactment of the Act.

It is clear from the table that average Capital Adequacy Ratio of state Bank of Patiala during post Act period was greater than that of pre Act period. The table also concluded that, the difference in mean score of capital adequacy ratio and net profit to total Assets ratio is not significant at 5percent; hence null hypothesis is accepted in last two cases. There is no significant difference between the pre and post Act period ratio of Capital Adequacy and net profit.

The result of the study also found that in all the ratios except Gross NPAs to total Assets marginal increase in the CAGR of post Act period with comparative to pre Act period.

### **Conclusion**

This study has provided the dimensions of credit risk and its effect on asset quality that banks and regulatory authorities might utilize in their decision making. NPA is closely related to the level of advances and this relationship is mediated and moderated by many bank specific and economy specific indicators. NPA can be reduced to a great extent if banks plan and implement strategies looking into the mediating and moderating nature of bank performance variables. The research has identified the variables, both micro and macro, that impact NPA of banks. Banks may benefit from the results of this study to revisit their approach to managing NPA of banks.

The present study analyzed the NPAs of State Bank of India during pre- Securitization Act and post-Securitization Act periods. The result of the study showed that there is a significant difference in the Net and Gross NPAs to total Assets and Advances ratios after the enactment of the Act. It means recovering of NPAs enhanced in the bank. The result of the study found that there is no significant difference in the Net profit to total Assets and Capital Adequacy Ratio after the enactment of the Act. It means no change in the profitability position of the Bank after the enactment of the Act. The results showed that null hypothesis is rejected in all cases expect Net profit to total assets ratio and capital adequacy ratio. It means there are significant differences in mean value of pre Act period and Post Act period. Net NPAs to Total Advance ratio have very decreasing trend. The result of study concluded that Securitization Act has significant impact on level of gross NPAs and Net NPAs of state bank of Patiala. After the introduction of the SARFAESI Act 2002 the level of Gross and Net NPAs decreased year by year in state bank of the Patiala.

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