

Benefits of Enforcement of Security Interest Aspect of the Securitization Act 2002

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ABSTRACT

There is large contribution made by the Public Sector Banks (PSB's) in Indian economy, such as agriculture, various industries, trade and employment and infrastructure. The performance of Indian Banks affects by increasing trends in deposits and credits. The public sector banks have high command in the economy due to Rs. 968749 crore as deposits and over Rs. 480681 crore as loans. The performance of the banks affected by the NPAs its shows the efficiency and profitability of the banks. Now a day's NPA increased in the alarming level in the bank due to the willful defaulting on the part of the borrowers. The asset quality is a main parameter to assess the overall performance and functioning of banks. The reduction in asset quality results increased the level of standard Assets. The Slowdown in economic growth and rapid credit growth are independently associated with higher levels of NPA. In this research an attempt is made to examine the benefits of enforcement of security interest aspect of the Act in recovering dues from the borrowers. Securitization is considered as a financial product and the bonds/debentures can be issued based on the future installments against the financial assistance already sanctioned and disbursed by the banks and financial institutions.

Keywords: NPAs, Security interest, ARCs, SARFAESI Act 2002

INTRODUCTION:

Now a day's debt securitization is used by the banks and FIs for enhancing the liquidity which is new in the market. It provides extended financial assistance to the borrowers for various purposes. The debt securitization makes available to these institutions the security papers against the financial assets which have been created out of the financial assistance sanctioned and disbursed by these institutions and in the case of a default by the borrowers the secured creditors can have recourse to either the securitization of the asset or the reconstruction of the same. The secured creditor has two rights under the Act. It can either transfer the Security Interest to ARCs or enforce the provisions of the Act on its own, without the intervention of the court. As per Section 35, the provisions of this Act override all other laws for the time being in force notwithstanding anything inconsistent therewith contained therein.

- 1) The Secured Creditor may require the borrower to give notice in writing to discharge his liabilities within 60 days from the date of the notice, if the borrower fails than the Secured Creditor can exercise all or any of the following rights under sub-section 13 (4) to recover his Secured Debt.
 - a. Take possession of Secured Assets of the borrower, including, by the way of lease, assignment or sale for realizing the Secured Assets.
 - b. Take over the management of the Secured Assets of the Borrower.
 - c. To manage the secured Assets the secured creditors also appoint any person as Manager.
 - d. Required any person who acquired the secured Assets whose money is due and payable to borrower and who to pay the same to the Secured Creditor, as is sufficient to repay the secured debt.

- 2) No Secured Creditor will be entitled to any or all of the above-said rights conferred on him u/s 13 (4) of the Act, if the financial Assets have been jointly financed by more than two secured creditors.
- 3) If the full amount of the secured creditors is not fully satisfied by the sale proceeds of the Secured Assets than the Secured Creditor can file an application with the Debt Recovery Tribunal or a competent Court of Law for recovery of the balance amount from the Borrower.
- 4) Secured Creditors have right against the guarantors or sell the pledged Assets without first taking any of the measures specified in clause (a) to (d) of sub-section 13 (4) in relation to the Secured Assets, under the Act.
- 5) In the following transactions the Act is not applicable.
 - a. Security Interest created in the Agricultural Land.
 - b. When due amount is less than 20% of the Principal amount and Interest thereon.
 - c. Any Security Interest for securing repayment of any financial asset not exceeding Rs. 1 lakh.
 - d. Pledge of Movable assets within the meaning of section 172 of Indian Contract Act 1872.

The need for the securitized asset and its transfer may be required by the originator to increase its liquidity and handle the non performing assets (NPAs) effectively.

The Act has been made effective from 21st June 2002, the date on which the first securitization and reconstruction of financial assets and enforcement of the security interest ordinance, 2002 was promulgated. This Act has been enacted to help Banks and FIs to tackle the NPA problem.

This Act can be broadly divided into four heads:

- ✓ Securitisation of assets
- ✓ Enforcement of security interest
- ✓ Setting up of Central Registry
- ✓ Establishment of an ARC

All ARCs (Asset Reconstruction Companies) or Securitisation companies, which are in existence at the commencement of the Act, shall make application for registration to RBI before the expiry of 6 months from such commencement. All ARCs are to be regulated and registered with the RBI. There will be a Central Registry and Central Registrar, to whom details of all individual transactions are to be reported, on an on-going basis.

ARCs are like the lenders and have all the rights same like lending banks. There are total 14 ARCs in India, some of them promoted by some banks coming together: the first ARC was ARCIL, which was sponsored by SBI, ICICI bank, IDBI bank and PNB. The main purpose for establishing ARCs under SARFAESI Act (Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Aspect Act) 2002 is to enable banks to clean up their balance sheets. The full time attention to realize a higher amount of recovery is given to the agency. ARCs must register under the sec 3 of Securitization Act 2002 and net owned funds of at least 2.00 crores or such other amount specified by the RBI.

LITERATURE REVIEW:

Kumar (2003) talked about need, process, summary and pros and cons of SARFAESI Act. Researcher analysed that this act empowered banks and financial institutions to directly enforce the security interest which pledged to them at the time of sanctioning the loan without going through the judicial process of DRT or civil court.

Alex Cowley and J. David Cummins (2005) the result of the study reveals 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. The credit is also managed with the help of the securitization process in which cash flow streams to be traded often involve contingent payments as well as more predictable components. 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 instruments. Moushumi Datta (2010) in his study outlined that securitization was a remedy to bad loans in the books and off balance sheet transaction. But need to be tackle what was the root of the whole evil of bad loans and NPAs. The whole process of giving loans, ensuring compliance and above all identifying bad loans disbursed and of course defaulters with stick punitive measures will go a long way in reducing bad assets. The limitations faced by him during his study were existing foreclosure laws were not lender friendly and the stamp duty on transfers of the securitized instrument was a major hurdle. Securitization is a process to reduce the impact of bad assets and offer a way out to the originator, but if the very causes of bad assets addressed, securitization will be a right tool for the one.

Pardeep Singh (2010) in his study found that the recovery of NPAs increased after the introduction of new mechanisms like debt recovery tribunal, one time settlement scheme and enactment of SARFAESI Act 2002. The formation of ARCs in India is one of the major steps which have been taken under the provisions of SARFAESI Act 2002. The result of the study concluded it is a big challenge for the public sector banks to maintain profitability and liquidity in a globalized environment with the growth of foreign banks and private banks. NPAs directly affect the profitability and liquidity of the banks, so it is essential to maintain the level of NPAs. The SARFAESI Act 2002 and ARCs play an important role in the recovery of the NPAs in the public sector banks.

Alper Kara, David Marqués-Ibáñez and Steven Ongena(2011) in their study found the relationship between securitization activity and lending standards effect. They explored the nexus between securitization and bank risk-taking by examining the pricing behavior of European banks when extending new loans after securitization. They found that banks more active at originating asset-backed securities were also more aggressive on their loan pricing practices. Macroeconomic factors also play an important role in explaining the impact of securitization activity on bank lending standards. They combined data from three different sources. Securitization data are obtained from Dealogic (Bondware) which is a private commercial data provider and completed with data from Standard and Poor's (S&P), a large private rating agency. They also look at individual deal-by-deal issuance patterns from euro-area banks originating the securities.

Nibedita Roy(2011) in his study found that increasing credit demand had led to decreasing the liquidity of the banks and the financial institutions. This has eventually created a mismatch between the demand and supply for finance. In this respect, when several conventional methods of obtaining a business loan are either undesirable or not possible, there is the option of securitization. The term securitization may be referred to as creation of security in any financial transaction which means a financial claim which is generally manifested in the form of a document and whose essential feature is marketability. Most previous literature in India is concentrated to the overall review of the securitization instruments not specific to the banking industry. The results of the study concluded that securitization leads to growth in performance, asset quality improvement, enhancement of loan portfolio and ultimately better risk management.

Vikrant Vig (2011) this paper showed the positive relationship between the greater creditor protection and expansion of the credit. Specifically, the paper exploits a quasi-natural experiment in India, the passage of a mandatory secured transactions law, the SARFAESI Act 2002, to investigate the effect of law on corporate debt structure. Prior to the SARFAESI Act, the slow and rigid judicial process created severe bottlenecks in the recovery of security interests. To liquidate the firm, secured lenders would have to go through a prolonged judicial process, during which the value of collateral considerably depreciated in value. The reform significantly increased the rights of secured creditors by allowing them to bypass the lengthy and judicial process and seize and liquidate the assets of the defaulting firm, thus improving the ability of lenders to access the collateral of the securities.

Dr. S. Muralindhar and N. L. Vijaya(2012) the result of primary data found that Securitization a Financial innovation provides an essential impetus for a more efficient allocation of capital and offers issuers more flexibility to create securities with distinct risk return profiles across the maturity structure to facilitate the unbundling, transformation and diversification of financial risks associated with various types of illiquid assets. Defaulting borrowers who were not responding previously started responding favorably and cash recoveries became a reality. It can be concluded that overall the Act has empowered the banks with additional powers for recovery and facilitated the reduction of NPAs of banks

OBJECTIVE OF THE STUDY:

To analysis the benefits of enforcement of security interest aspect of the Act in recovering of dues from the borrowers.

HYPOTHESIS OF THE STUDY:

Ho: (There is no significant difference between the mean values of Banks and regions wise benefits of enforcement of security interest aspect of the Act in recovering dues from borrowers.)

H1: (There is significant difference between the mean values of Banks and regions wise benefits of enforcement of security interest aspect of the Act in recovering dues from borrowers.)

To carry out the present study about the "An impact of security interest aspect of the Act 2002 on the recovering dues from borrowers in the Public Sector Banks" The relevant information has been collected with the help of the Structured Questionnaire (Appendix-I) from Assistant managers and loan managers working with public sector banks in Haryana.

Sample size:

The total Sample size is 200 respondents for the questionnaire. The target respondents will be the officers working in the various capacities (like Assistant manager, NPA department manager, credit officers) in public sector banks. The study is conducted Bank wise and Region wise. According to administrative purpose Haryana divided into four regions i.e. Ambala, Rohtak, Hisar and Gurgaon. 40 respondents of each selected bank will be taken from Haryana State (10 respondents from each 4 region).

Sampling Methods:

In proposed study Judgment sampling, multistage sampling and convenience sampling method used. Judgment Sampling (Selection of 5 public sector banks on the basis that according to the data 75% of the total NPAs covered by these banks.)

Multistage Sampling:

(Selection of divisions, selection of districts, Selection of Banks and Selection of Managers.)

Convenience Sampling:

used for selection of bank branches from the districts. All information collected for the purpose of the study has been arranged in cross sectional tables, depending upon the requirements of the analysis. The analysis part, responses of the total respondents has been tabulated. The tabulation encompasses absolute figures supported by simple percentage and subjected to statistical analysis through the use of Average, Standard Deviation, ANOVA.

ANALYSIS AND INTERPRETATION:

Table reflecting the effectiveness of security interest aspect of the Act (Bank wise and Region wise):

Table 1: Analysis of benefits of enforcement of security interest aspect of the Act

	ANOVA	Sum of Squares	df	Mean Square	F	Sig.
(a) Bank wise	Between Groups	.920	4	.230	.528	.716
	Within Groups	85.000	195	.436		
	Total	85.920	199			
Region wise	Between Groups	1.880	3	.627	1.462	.226
	Within Groups	84.040	196	.429		
	Total	85.920	199			
(b) Bank wise	Between Groups	.880	4	.220	.458	.767
	Within Groups	93.675	195	.480		
	Total	94.555	199			
Region wise	Between Groups	.415	3	.138	.288	.834
	Within Groups	94.140	196	.480		
	Total	94.555	199			
(c) Bank wise	Between Groups	.370	4	.093	.166	.955
	Within Groups	108.350	195	.556		
	Total	108.720	199			
Region wise	Between Groups	2.600	3	.867	1.601	.191
	Within Groups	106.120	196	.541		
	Total	108.720	199			
(d) Bank wise	Between Groups	4.020	4	1.005	1.923	.108
	Within Groups	101.900	195	.523		
	Total	105.920	199			
Region wise	Between Groups	.760	3	.253	.472	.702
	Within Groups	105.160	196	.537		
	Total	105.920	199			
(e) Bank wise	Between Groups	3.830	4	.958	1.835	.124
	Within Groups	101.750	195	.522		
	Total	105.580	199			

Region wise	Between Groups	.220	3	.073	.136	.938
	Within Groups	105.360	196	.538		
	Total	105.580	199			
(f) Bank wise	Between Groups	1.480	4	.370	.753	.557
	Within Groups	95.875	195	.492		
	Total	97.355	199			
Region wise	Between Groups	3.055	3	1.018	2.117	.099
	Within Groups	94.300	196	.481		
	Total	97.355	199			

Personally compiled through SPSS

Note: * significant at 5 percent.

Table 1 showed the analysis of benefits of enforcement of security interest aspect of the Act bank wise and region wise. According to the bank wise and region wise ANOVA table the f-values are insignificant at 5 percent in all the benefits. So, null hypothesis is accepted that no difference between the bank wise and region wise responses of the respondents. All the respondents says yes that delay in recovery are removed, create understanding between borrowers and lenders, lenders have given upper hand, minimize the cost of funding for borrowers and distressed credit problem is resolved with the help of the enforcement of security interest aspect of the Act.

CONCLUSION:

The stability and performance of the banks can be determined on the basis of its asset quality behaves during financial crises. Banks in India are efficient in comparison to banks in many other countries. This efficiency is relative and does not indicate the overall efficiency of Indian banking sector in the post - millennium period. The result of the data revealed that the asset quality of Indian PSBs affected by the financial crisis. So, that the period of credit boom followed by recessionary pressure resulted in decrease of asset quality. It is necessary for the Banks to diversify its activities and takes measures to improve its non-interest income (fee income, commission income etc). Out of the total income of the bank around 90% of total income is generated from interest income. This poses a challenge for banks. When asset quality decrease or NPA increases than the interest income generated also affected considerably, hence pose a major threat to the liquidity of banks. The effect can be reduced by the banks to diversify their activities and generate more non-interest based income.

All the borrowed funds should be so deployed remuneratively so that the cost of funds and service cost for such deployments of funds is fully recovered from the utilization of such borrowed funds and not only that but even a reasonable margin should remain available to Bank. The analysis of ANOVA table found that the f-value is insignificant at 5 percent in all the benefits. So, the null hypothesis is accepted that no difference between the mean scores of all the selected banks. All the respondents says yes that delay in the recovery is removed, creates understanding between borrowers and lenders, lenders have given upper hand, minimize the cost of funding for borrowers and the distressed credit problem is resolved with the help of the enforcement of security interest aspect of the Act.

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