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PERFORMANCE ASPECTS INFLUENCED BY SECURITISATION—AN EMPIRICAL STUDY

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Abstract:
Securitization has emerged globally as an important technique for bundling assets and segregating risks into marketable securities. The concept of securitisation has emerged from the need of introducing innovative financial products which will facilitate in enhancing the availability and circulation of funds in the market. The technique of securitisation used the logic of utilizing an existing item in the balance sheet for optimum utilization of the resources available, comparable with recycling of products. This led to the emergence of a unique financial technique that can bring revolution in the financial market and can effectively provide solutions to many unanswered questions.

Keywords: Marketable securities, Asset backed funding, Structured instrument.

1. INTRODUCTION

Securitisation has emerged globally as an important technique for bundling assets and segregating risks into marketable securities. The concept of securitisation has emerged from the need of introducing innovative financial products which will facilitate in enhancing the availability and circulation of funds in the market. The core activity of the banks, financial institutions and non-banking financial companies (NBFCs) is to provide credit and such credits are backed by deposits accumulated by such institutions. But the growing credit requirements in the market urged the banking institutions to engineer a technique which could facilitate collection of funds to meet the growing demands. The bud of securitisation stemmed from this disequilibrium between demand and supply of funds. Moreover, a rise in the number of investors over the years has reduced the average size of investment per investor and has fuelled the development of such asset-backed funding, which could convert financial assets in the balance sheet of the originator viz. loans and receivables, into liquid, easy to understand and homogeneous products. Furthermore, investors also stress on the aspect of liquidity of their investment. Investment in banks involves a fixed time period (from a few months to may be a year) which made the financial analysts and researchers innovate a marketable instrument that would cater to the ever-changing requirements of the investors. Also, securitised instruments have come into being because of the urge to create a secondary market in mortgage financing. Risk management is yet another catalyst for the emergence of securitisation. In short, the securitisation mechanism is the result of increasing demands for credit.

The technique of securitisation used the logic of utilizing an existing item in the balance sheet for optimum utilization of the resources available, comparable with recycling of products. This led to the emergence of a unique financial technique that can bring revolution in the financial market and can effectively provide solutions to many unanswered questions. It is a part of the broad sector of *structured finance* which means a type of financing technique where the financial instruments are designed according to the requirements of the investors. The term 'securitisation' refers to a method of financing by issuing such financing instruments where the financier does not look at the riskiness of the entity concerned but instead, tries to align the financing to the specific cash accruals (i.e. money receivable from the assets in the balance sheet underlying the instruments) of the financier/originator. Thus, securitisation, in a true sense, is a *structured financial instrument*. That is, securitisation provides an alternative to the organizations to mobilize funds directly from various investors through the issue of different certificates/marketable instruments. Thus, securitisation mechanism helps the organizations in utilizing their idle assets in the balance sheet which can be re-utilized for the purpose of funding requirements of the institution. The concept of securitisation has always drawn the attention of the analysts and the researchers since its initiation in India. Although this innovative mechanism has been applied in India in scattered items of assets in various organizations, but gradually, the tool became more restricted to the banking and financial institutions. Accordingly, this paper concentrates on the position of securitisation in the Indian banking industry and makes an attempt to identify the parameters that are influenced as a result of introduction of the innovative mechanism of securitisation. The identification of such parameters behind securitisation will enable one to assess the future prospect of the mechanism in our country. But a conceptual understanding of the securitisation mechanism is necessary before turning to empirical analysis. So, the remainder of the paper is organized as follows. *Section 2* specifies the conceptual overview of securitisation. *Section 3* lays down the literature review. *Section 4* specifies the objective of the study. *Section 5* narrates the sample selection and research methodology. *Section 6* puts forth the analysis and findings. Finally, *Section 7* concludes the paper.

2. CONCEPTUAL OVERVIEW OF SECURITISATION

Securitization at its simplest is a secured borrowing, whereby a company borrows against an asset or group of assets. It is the process of creating a financial instrument by combining other financial assets and then marketing them to investors. In other words, securitisation can be defined as one of the off-balance sheet financing techniques, which consists of first choosing some assets (receivables, inventories, buildings, consumer loans, mortgages, etc) based on the quality of the collateral they offer or their level of risk. To reduce risk, the assets are then grouped into a special purpose company (termed as Special Purpose Vehicle/SPV) so as to pool risks and take advantage of the law of large numbers. The SPV buys the assets and finances itself by issuing securities to outside investors. The basic technique requires the rights on the receivables to be transferred to the SPV which then takes the necessary steps to complete the securitisation transaction, on behalf of the originator, by issuing securities on the basis of the underlying receivables. The process of securitisation comprises of three parties—originator (it is the entity that is responsible for originating a securitisation transaction), SPV (it is the entity which acts as a catalyst to the securitisation transaction formed to hold the securitised assets transferred by the originator) and investors (they are the parties who purchase the securities issued by the SPV and may be in the form of institutional investors like FIs, mutual funds, provident funds, pension funds, insurance companies, etc.).

In a nutshell, it may be stated that the whole concept of securitisation has emerged in order to achieve the following objectives—

i) to remove the applicable financial assets and related indebtedness (financing costs) from the seller's balance sheet;

ii) to attain funding at lower costs than available through alternate means of financing as a result of isolating the assets from potential bankruptcy risk of the originator; and

iii) to improve the originator's liquidity, by means of converting idle assets into source of funds and expanding the range of investors available to the originator.

Thus, from the above discussion it is clear that securitisation has emerged due to a vacuum created between the need and the availability of funds in the financial market and can bestow a number of advantages on the to the organizations introducing it and also to the related parties involved in the securitisation transaction. In India, the concept of securitisation is also prevalent and accordingly for the purpose of the study an effort has been made to identify the various types of work that has been done in the various countries relating to securitisation. Accordingly, the next section lays down the brief abstract of the works that has been done in different areas.

3. LITERATURE REVIEW

Over the years, various attempts have been made by the researchers to evaluate the different aspects of securitised instruments and examine the justifiability of its introduction in the financial markets. *Pamela Lipkin (July 1992)* stated that as real estate values continue to deteriorate and liquidity evaporates, the crisis in thrift institutions, banks, and insurance companies worsens. Consequently, there arises an unquestioned need for creative products to serve as non-traditional sources of financing, which has been very well solved by securitisation of real estates. *Steven L. Schwarcz (January 1995)* showed how companies can use asset securitisation to gain direct and indirect benefits. More importantly, he demonstrated that securitisation can enable certain companies to achieve a genuine reduction in financing costs by providing access to lower cost capital market funding. He also explored potential innovative uses of this financing technique. *Tamar Frankel (1997)* stressed on cross-border securitisation. He specified that while international transactions are usually designed and completed in one country the parts of cross-border securitisation are designed and completed in more than one country. This form of financial intermediation consists of several discrete stages designed and executed in different countries, and then linked to form a desired intermediation scheme. *Thomas Hugh (August 1999)* attempts to conduct tests of stockholder and bondholder wealth changes due to the securitization of non-government guaranteed assets during the years 1991–1996. He finds that securitization is significantly wealth creating device for stockholders, adding 5% per transaction to the excess returns of the stock. According to him securitization is not wealth destroying for bondholders. The effects on stockholders are larger for manufacturers than for banks and finance companies. Securitizations from corporations with poorer credit standing are subject to larger gains for asset sellers. A comparative advantage in asset origination and servicing rather than wealth appropriation from bond holders explains the gains from securitization. *Filip Henzler (April 2004)*, inferred in his case-study named “Pine Street I LLC: a case study in securitisation” that securitisation transactions can better accommodate the specific requirements of both the seller (i.e. originator/SPV) and buyer (i.e. investors). *Elena Loutskina (November, 2004)* conducted an extensive study to show that by allowing banks to substitute cash and securities for loans, securitisation reduces the sensitivity of bank lending to the availability of the external sources of funds and thus reduces the need for the monetary authority to affect bank lending through open market operations. *Kenneth C. Kettering (2008)* focuses on the financing technique referred to as "securitization," a close cousin of secured lending that has grown to enormous size since its origin more than two decades ago. He considered two points. One is a critique of the legal foundations of securitization, which includes a perspective on aspects of fraudulent transfer law that are well established historically but have been neglected in recent decades. The other is exploration of the implications of this product growing so vast despite its dubious legal foundations. In that regard, his article explored two points of legal sociology that apply to new financial products generally. The first is that a product can become so widely used that it cannot be permitted to fail, notwithstanding its dubious legal foundations. The second is that the debt rating agencies have become de facto lawmakers, because it is their decision to give a favorable rating to a financial product the credit quality of which depends on a debatable legal judgment that allows the product to grow too big to fail. He made a normative assessment of securitization from a pragmatic perspective, concluding that legislative action is appropriate to ratify the product's object, with constraints.

In Indian context, *Suhas Ketkar and Dilip Ratha (March 2001)* suggested that developing countries cannot obtain low-cost, long-term loans during financial crises. Thus, securitisation of future flow receivables can help investment-grade public and private sector entities in these countries obtain credit ratings higher than those of their governments and raise funds in international capital markets. *Vinod Kothari and Abhishek Gupta (August 2004)* studied the development of mortgage-backed securities market in India and examined the relevance of securitisation, both agency-backed securitisation (i.e. MBSs issued by government sponsored agencies which promote mortgage secondary markets) and private label securitisation (i.e. mortgage backed issues securitised by non-agency financial institutions) over the development of housing refinance market in India. The research conducted till date in India has focused on theoretical aspects mostly with little emphasis on empirical research. Also, none of the empirical studies conducted so far focused on the impact of securitisation on the Indian Banking Industry, the sector affected most by securitisation. Hence, in view of this research gap the present study assumes significance in Indian context.

4. OBJECTIVE OF THE STUDY

The study aims at examining different parameters that are influenced as a result of introduction of the securitisation mechanism and to understand the impact of such parameters on the performance of the banking industry in India.

5. SAMPLE SELECTION AND RESEARCH METHODOLOGY

The redefinition of the term "securities" and the establishment of Securitisation and Reconstruction of Financial Assets and Enforcement of Security (SARFAESI) Act, 2002 subsequently have paved the way for full-fledged implementation and practice of securitisation in India, especially by the banks, financial institutions and NBFCs from 2000 onwards. Accordingly, a sample comprising those Indian banks and NBFCs (henceforth institutions), that have initiated and undertaken securitisation on a more or less continuous basis and at least for a period of 3 years over the period 2022-2023 to 2024-2025 [as per information available in Credit Rating Information Services of India Ltd. (CRISIL) website (*www.crisil.com*)] has been selected to determine the factors that are influenced by the initiation of the securitisation mechanism in the Indian banking sector. The sample and the collected securitisation information (i.e. volume of securitisation in Rs. million) are restricted by the availability of data in the *structured finance* list of commentaries under the main heading of *ratings* in CRISIL website. Accordingly, the sample comprises 12 institutions, of which 9 are banks viz. *HDFC Bank Ltd., Kotak Mahindra Bank Ltd., HSBC Ltd., Standard Chartered Bank, Axis Bank Ltd., Bank of America, Yes Bank Ltd., CitiBank N. A. and ICICI Bank Ltd.* (in the banking institutions category) and 3 are NBFCs viz. *Kotak Mahindra Prime Ltd., Shriram Finance Ltd. and Poonawalla FinCorp. Ltd.* The sample is then analyzed graphically by comparing securitisation volume vis-à-vis certain selected parameters. The analysis has been done keeping in mind the three broad factors of *profitability, liquidity and risk management*.

First of all, in order to ascertain the impact of securitisation on profitability, two parameters have been considered viz. *Interest Income as percentage of Total Assets and Net Profit/Loss as percentage of Total Assets*. Securitisation helps in increasing the interest earned by an institution by enhancing the funds available for loans and advances. Moreover, it also aims at reducing the dependence of the institutions on deposits and other borrowed funds. Thus, on one hand the mechanism helps to increase the interest income, and at the same time it tries to increase the overall net profit of the institution by limiting the interest expended. Thereafter, in order to examine liquidity as a consequence of securitisation, two variables have been considered. One is the *Quick ratio* also known as *Liquidity or Acid Test Ratio*, which measures the ability of a company to pay off its short-term obligations from its most liquid current assets, i.e. current assets excluding inventories. The other ratio is *liquid assets to demand deposits*. It signifies how much cash is available to the institution in order to pay-off its demand deposits i.e. an account balance which can be withdrawn on demand, i.e. without prior notice. In case of both the parameters, higher ratios signify that the institution has enough liquid assets needed to pay off its debts. In case of certain sample institutions (both banks and NBFCs) which do not take demand deposits, the latter parameter has been changed to *liquid assets/total assets*. The higher the ratio, the more the total assets are composed of liquid assets which is a clear sign of enhancement in the liquidity. The liquidity analysis vis-à-vis securitisation trend for two sample institutions is shown below. Lastly, the risk management aspect is measured in terms of *net worth*. Risk management refers to identification of risks in order to control and minimize the impact of unfortunate events. This controlled risk undertaken by the institution is ultimately reflected in an increase in their net worth. Net worth (sometimes called net liabilities) refers to the total assets minus total outside liabilities of an institution. Though the risk management issue has not been directly addressed, but an attempt has been made to make an indirect assessment of the level of risk management. Annual accounts data of the above-mentioned variables for the sample institutions over the period for which information on securitisation volumes are available have been extracted from the CMIE Prowess database and the RBI website (*www.rbi.org.in*). The selected broad issues are then framed into three null hypotheses *(as shown in table-1)* and are analyzed on the basis of simultaneous comparison of the securitisation volumes vis-à-vis the various chosen financial performance indicators through graphs and charts. A satisfaction index is also constructed hypothesis-wise across sample units after compiling results. The null hypotheses are rejected (i.e. theory accepted) based on total satisfaction count across all sample banks and NBFCs (henceforth institutions) being greater than 50%. In other words, the hypotheses whose satisfaction count is 50% or less than 50%, in those cases the null hypotheses are accepted.

TABLE-1 LIST OF NULL HYPOTHESES

Sl. No.	*Null Hypotheses*	*Selected Parameters*
Hypothesis 1	Securitisation does not enhance the institutions' performance ratios.	Interest Income as %-age of Total Assets, Net Profit/Loss as percentage of Total Assets
Hypothesis 2	Securitisation mechanism does not favourably influence the liquidity position of the sample institutions.	Liquidity Ratio (Quick Ratio), Liquid Assets to Demand Deposits
Hypothesis 3	Securitisation does not help the institutions in better risk management.	Net Worth

A summary of the findings conducted on the basis of methodology, as discussed above, is presented in the next section.

6. ANALYSIS AND FINDINGS

The analysis results of all the sample institutions to examine each of the 3 hypotheses are given in *table-2*. The sample graphs and charts leading to the following results are given in *Annexure-A.*

TABLE-2: OVERALL HYPOTHESES SATISFACTION INDEX

Hypothesis	***Private Sector Banks***					***Foreign Banks***				***NBFCs***			***Total Count (%)***
	HDFC Bank Ltd.	*Kotak Mahindra Bank Ltd.*	*Axis Bank Ltd.*	*Yes Bank Ltd.*	*ICICI Bank Ltd.*	*HSBC Ltd.*	*Standard Chartered Bank*	*Bank of America*	*Citibank N.A.*	*Kotak M.. Prime*	*Shriram Finance Ltd.*	*Poonawalla Fincorp Ltd.*	
1.	√	√	√	√	√	√	X	X	X	√	X	√	**66.67**
2.	√	√	√	√	√	√	√	√	√	√	√	√	**100**

3.	√	√	√	√	√	√	√	√	√	√	√	√	**100**
Result	100	100	100	100	100	100	66.67	66.67	66.67	100	66.67	100	

Note: (√) => Rejection of null hypothesis and acceptance of theory
(X)=> Acceptance of null hypothesis and rejection of theory

It may be observed from the summary analysis that *hypothesis 2* (securitisation mechanism does not favourably influence the liquidity position of the banking institutions) and *hypothesis 3* (securitisation does not help the institutions in better risk management) are the hypotheses which reflect a 100% satisfactory index. Four institutions out of the total sample have accepted the null *hypothesis 1* (securitisation does not enhance the institutions' performance ratios) which ultimately leads to a 66.67% overall satisfaction index. Thus, what appears from the above findings is that the introduction of securitisation in the various sample institutions from the Indian banking industry had a positive impact on their financial performance, liquidity ratios and net worth when these institutions are compared with the respective chosen parameters for each of the hypothesis individually.

7. CONCLUSION

Securitisation is as necessary to the economy as any organized markets are. Securitisation in India has been in existence since early 1990s, though essentially as a device of bilateral acquisition of portfolios of finance companies. The first securitisation deal took place in 1991 when Citibank raised Rs. 16 crore from GIC Mutual Fund by securitising some of its auto loans. Since then, a variety of deals have been undertaken. Moreover, it is needless to mention that securitisation of loans, advances and receivables is mostly applicable to banks, financial institutions and non-banking financial companies (NBFCs), where such assets form a major component in the balance sheets, and as such in order to facilitate such organizations to allocate capital more efficiently, access diverse and cost effective funding sources and better manage business risks in an efficient manner, the concept of securitisation of loans and receivables has emerged. The analysis results point to the fact that securitisation improves the liquidity position, the risk management ability and the performance parameters of the sampled institutions. In other words, it may be said that the institutions and organizations which want to improve its liquidity, performance and risk management should opt for securitisation mechanism. However, the significance of securitisation may have been captured better if the analysis were done for a longer time period. Hence, a long run analysis of the effect of securitisation is necessary to realize the full potential of this innovative financing mechanism in India.

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