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Original Research Article

SPV/SPC COMPANY ROLE ON LOAN DEFAULTS OF A BANK & NPV RECOVERY

Mr. Sagar Kisunchand Mandal,

** Student (SYBAF), Matrushri Kashiben Motilal Patel Sr. College of Commerce & Science Padmakar Colony, Near Thakurli Railway Station, Cholegoan, Thakurli (East). 421201*

Abstract:

The purpose of this paper was to identifying the loan default rate and its impact on profitability, and Determining ways of reducing loan defaults in the way of SPV/SPC i.e. special purpose vehicle or special purpose company to frame a security to the bank for issued loans in the form of unsecured to the borrowers. Parties involved in the transaction of SPV and SPC.

According to Cox and Kendall, "securitization is the process where pools of individual loans, receivable or bad instruments are packaged in the form of securities, the credit status or rating of the securities are enhanced and distributed to the investors.

Key-words :- *SPV (Special Purpose Vehicle) , SPC(Special Purpose Company), NPA (Non-Performing Assets)*

Introduction:

A Bank is a primary unit of the Indian banking system. It is an institution that performs the functions of accepting deposits, granting bank loans, and making investments to earn profits. The rate of interest at which the commercial banks accept deposits is known as the" borrowing rate" and the rate at which banks lend out their reserves to investors is called the "lending rate".

Credit Score: A credit score is a numerical representation of a person's creditworthiness, based on their history of borrowing and repayment. Missed payments and bankruptcies can cause serious damage to a person's credit score.

Secured vs. Unsecured Loan: Unsecured loans don't involve any collateral. Common examples include credit cards, personal loans and student loans. Here, the only assurance a lender has that you will repay the debt is your creditworthiness and your word Secured loans require that you offer up something you own of value as collateral in case you can't pay back your loan, whereas unsecured loans allow you borrow the money outright (after the lender considers your financials).

What Is a Non Performing Asset (NPA)?

A non performing asset (NPA) refers to a classification for loans or advances that are in default or in arrears. A loan is in arrears when principal or interest payments are late or missed. A loan is in default when the lender considers the loan agreement to be broken and the debtor is unable to meet his obligations.

An amount due under any credit facility is treated as **"past due"** when it has not been paid within 30 days from the due date.

Non Performing assets (NPAs) are recorded on a bank's balance sheet after a prolonged period of non-payment by the borrower 90 days or more .

What Is a Special Purpose Vehicle (SPV)?

A special purpose vehicle, also called a special purpose entity (SPE), is a subsidiary created by a parent company to isolate financial risk. Its legal status as a separate company makes its obligations secure even if the parent company goes bankrupt. For this reason, a special purpose vehicle is sometimes called a bankruptcy-remote entity.

Parties involved in the process of SPV

1. **Originator**
2. **SPV**
3. **Investors**
4. **Obligor**
5. **Credit rating agency**
6. **Insurance company**

Review of Literature:

Loans defaults defined:

Loan default can be defined as the inability of a borrower to fulfil his or her loan obligation as at when due **(Balogun and Alimi, 1988)**

Causes of loan defaults:

Kohansal and Mansoori (2009). According to them a number of factors can cause loan defaults some of which Are;

1. Interest rate ceilings usually imposed by the government
2. Monopoly power in credit markets often exercised by informal lenders
3. Large transaction costs incurred by borrowers in applying for loans
4. Moral hazard problems

Ways for reducing loan defaults:

Kay Associates Limited (2005) cited by Aballey (2009) states that bad loans can be restricted by ensuring that Loans are made to only borrowers who are likely to be able to repay, and who are unlikely to become insolvent. Credit analysis of potential borrowers should be carried out in order to judge the credit risk with the borrower And to reach a lending decision.

Objectives:

The general objective of the study is to examine the effect of bad loans on the

1. NPAs effect on banks performance.
2. To examine how distribution of loans affect banks performance if banks give proper Attention.
3. How SPC/SPV convert illiquid assets to liquid assets from longer duration cash flows into shorter ones.
4. To know how SPC/SPV recovers loan amount

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Methodology:

Secondary data has been collected for research purposes from books and research journals and articles that are related to the research problem.

Scope:

1. To determine Decrease in overall credit rating of the bank
2. To determine Increase in cost of funds of banks due to NPAs
3. How effect on the Profitability of the Bank
4. Reduction in Bank's lending potential
5. To determine SPV role in banks.
6. To determine SPV process.

Conclusion:

An SPV is created as a separate company with its own balance sheet by a corporation in order to isolate financial risk. It may be used to undertake a risky venture while reducing any negative financial impact upon the parent company and its investors. Alternatively, the SPV may be a holding company for the securitization of debt. SPVs are also used by venture capitalists to consolidate a pool of capital to invest in a startup. SPVs have been used in the past by companies to hide financial losses.

References:

https://www.investopedia.com/search?q=Effects+of+loan+defaults+on+bank

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