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'MERGERS IN THE BANKING SECTOR:REGULATORY FRAMEWORK & ISSUES'

UNDER THE GUIDANCE OF:

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CERTIFICATE

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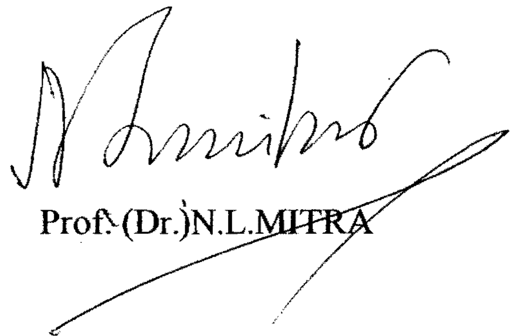

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DECLARATION

I, Nayeem Akhtar, do hereby declare that this dissertation ,titled," Mergers in the Banking Sector : Regulatory Framework and Issues" is the result of research undertaken by me in the course of my LL.M. Programme at National Law School of India University, Bangalore, under the guidance of Prof.(Dr.) N. L. Mitra.

This work is my original work ,except for such help taken from such authorities as have been referred to and acknowledgement has been made for the same.

I further declare that this work has not been submitted for any degree, diploma, fellowship at other university or institute.

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CHAPTER I: INTRODUCTION

Mergers and Acquisitions are not an unknown phenomenon in Indian Banking. In fact, the predecessor of State Bank of India, the Imperial Bank of India was born out of consolidation of three Presidency Banks way back in 1920. In fact there were several cases of bank failures, mergers and acquisitions which were reported in pre-independence period dating back to even early 19th Century. Proper regulation and control of banks and intervention by the regulator in the event of a crisis came into being with the passing of Banking Regulation Act in 1949. However, forced merger and amalgamation as a tool to provide relief to ailing banks besides protecting public and depositor confidence in banking system came into being only in 1960 when Section 45 inserted in BR Act. Panic created by the Nath Bank in the fifties and Laxmi bank and Palai Central bank in 1960 had prompted this legislative move. The first half of the sixties saw 45 forced mergers under section 45. In the post nationalization period also a number of mergers and acquisitions took place, most of them under Section 45. Interestingly almost all of them were amalgamations of failed private banks with one of the Public sector banks.

In the recent times, we have seen some M&A as voluntary efforts of banks. Merger of Times Bank with HDFC Bank was the first of such consolidations after financial sector reforms ushered in 1991. Merger of Bank of Madura with ICICI Bank, reverse merger of ICICI with ICICI bank, coming together of Centurion Bank and Bank of Punjab to form Centurion Bank of Punjab and the recent decision of Lord Krishna Bank to merge with Federal Bank are voluntary efforts by banks to consolidate and grow.

Consolidation fever has not been confined to the Scheduled Commercial Banks. We had 196 RRBs since 1989. We have over 2000 Urban Co-operative Banks in the country and failure of a number of these banks in the last few years has been a matter of great concern.

Thus we find that Liberalisation, Privatisation and Globalisation process has brought so many changes in the economic scene of the country. This process of economic reforms has brought competition not only from India but also from Overseas. In order to compete with these competitors, Indian corporate sector has tried to reorganise and restructure the companies by adopting various strategies. These strategies include Mergers, Acquisitions, Joint ventures, Spin off, Divestitures, etc.

ORIGIN OF BANKING IN INDIA

Banking in India originated in modern terms in the first decade of 18th century. Prior to that merchant banking instructions were existing in the country, to facilitate the vast trading requirements, that the country had with both east and west .The first bank[1], the Hindustan Bank was started in 1770 followed by the General Bank of India which came into existence in 1786. This was followed by Bank of Hindustan. Both these banks are now defunct. The first presidency bank came in existence in India which was known as "The Bank of Bengal" in Calcutta in June 1806. A couple of decades later, foreign banks like Credit Lyonnais started their Calcutta operations in the 1850s. At that point of time, Calcutta was the most active trading port, mainly due to the trade of the British Empire, due to which banking activity took roots there and prospered. The first fully Indian owned bank was the Allahabad Bank, which was established in 1865.

By the 1900s, the market expanded with the establishment of banks such as Punjab National Bank, in 1895 in Lahore and Bank of India, in 1906, in Mumbai - both of which were founded under private ownership. The Reserve Bank of India is the central bank of India. It formally took on the responsibility of regulating the Indian banking sector from 1935. .After India's independence in 1947, the Reserve Bank was nationalized and given broader powers.

The next significant milestone in Indian Banking occurred on July 19, 1969 when the Government of India nationalized the 14 largest commercial banks. A second nationalization of 6 more commercial banks followed in 1980. The purpose for the

[1] The Banking Law in Theory & Practice, S.N.Gupta; Universal Book Traders,2nd Edition,1992,Delhi,Pg.11

nationalisation was to control the heights of economy and to meet progressively, and secure better, the needs of development of economy in conformity with the national policy and objectives. After this, until the 1990s, the nationalised banks grew at a leisurely pace of around 4%, closer to the average growth rate of the Indian economy.

In the early 1990s the then Government of India embarked on a policy of liberalisation and gave licences to a small number of private banks, which included banks such as UTI Bank (the first of such new generation banks to be set up), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, started a new era for the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks.

With the growth in the Indian economy expected to be strong for quite some time-especially in its services sector, the demand for banking services-especially retail banking, mortgages and investment services are expected to be strong. M&As, takeovers, asset sales arc/e today some important issues that concerns the Indian banking industry.

Mergers and amalgamations play an important role in Indian banking industry. The present trend is based on the Narasimham Committee Reports of 1991 and 1988. They are helpful for larger players in the market as they give them the opportunity for fast expansion, efficiency and creation of better products, which benefits the customer and also for smaller and weaker players as it enables them to consolidate and face competition from larger players and survive for a longer run. The benefits of mergers and amalgamations are there for the economy too as healthy financial institutions would be able to finance India's march of global dominance. In the past, regulators to protect the interest of depositors of weak banks initiated mergers. But it is now expected that market led mergers may gain momentum in the coming years. The smaller banks with firm financials as well as the large ones with weak income statements would be the obvious targets for the larger and better run banks.

CLASSIFICATION OF THE BANKING INSTITUTIONS:

The banking system has three tiers. These are the scheduled commercial banks; the regional rural banks which operate in rural areas not covered by the scheduled banks; and the cooperative and special purpose rural banks.

Commercial banks are categorized as scheduled and non-scheduled banks, but for the purpose of assessment of performance of banks, the Reserve Bank of India categories them as public sector banks, old private sector banks, new private sector banks and foreign banks.

Scheduled and non Scheduled Banks

There are 93 scheduled commercial banks, Indian and foreign; 196 regional rural banks. In cooperative sector- nearly 2000 cooperative banks operate, which include non scheduled banks. In terms of business, the public sector banks, namely the State Bank of India and the nationalized banks, dominate the banking sector.

Scheduled Commercial Banks (SCBs) in India are categorized in five different groups according to their ownership and/or nature of operation. These bank groups are: (I) State Bank of India and its associates, (ii) Nationalized Banks, (iii) Regional Rural Banks, (iv)Foreign Banks and other(v)Indian Scheduled Commercial Banks(In the Private Sector)

Over the years the banking industry has experienced an unprecedented level of consolidation on a belief that gains can accrue through expense reduction, increased market power, reduced earnings volatility, and scale and scope economies. Reserve Bank being the Central Bank has been given power to Supervise and Regulate the function of Banks in such a way so as to protect the interest of investors and make the financial system of country strong. **Through this paper the researcher has tried to bring out factors which are kept into mind while going for a bank merger and what are advantages or disadvantages of such mergers. Researcher has focused on applicable laws in this regard and has referred relevant case laws to clarify nuances of law governing bank mergers and acquisitions.**

This paper has been divided into nine chapters which are as follows:

CHAPTER I:INTRODUCTION:

It deals with origin of Banking in India and classification of Banking Institutions

CHAPTER II:ESSENTIALS OF MERGER AND ACQUISITION AND BANKING INDUSTRY

It deals in detail definition of merger and acquisition, types of merger, benefits of megrgers and acquisitions. This chapter further throws light on merger waves that took place in world and analyse the factors which are responsible for bank mergers in Indian context.

CHAPTER III:LEGAL FRAMEWORK GOVERNING BANK MERGERS

This chapter is very important as far as this paper is concerned because it deals with laws governing bank mergers in India .Who is responsible for regulating bank mergers and what is procedure in this regard.

CHAPTER IV:EMPLOYMENT ISSUES IN BANK MERGERS

Bank mergers and acquisitions has generated several issues which need immediate concern. One such issue is impact of such mergers and acquisitions on employees of bank that is going to be merged. This chapter is dedicated to address the issues in this regard.

CHAPTER V:TAXATION ISSUES IN BANK MERGERS

Tax implication of merger and acquisition is another vital issue which must be kept in mind while going for bank mergers. This chapter enumerates tax benefit which banks may get due to mergers and acquisitions.

CHAPTER VI:COMPETITION LAW ISSUES IN BANK MERGERS

Competition law is emerging rapidly in India. This chapter deals with various provisions of Competition Act,2002 which govern anti-competitive impact of mergers and acquisitions.

CHAPTER VII:RESERVE BANK OF INDIA'S MERGER REVIEW PROCESS

Though bank mergers have become a frequent affair keeping in mind Bank's importance in economy of any country it becomes imperative to have a system whereby the activities of banks can be regulated and supervised. This chapter precisely states what is the role of Reserve Bank of India in a merger review process.

CHAPTER VIII:CASE STUDIES

In this chapter researcher has tried to analyse the impact of bank mergers and amalgamations through case studies.

CHAPTER IX:CONCLUSION AND SUGGESTION

Finally in conclusion part researcher has tried to give a clear picture of bank mergers and acquisitions in India and has given suggestions so that drawbacks of law can be removed.

RESEARCH METHODOLOGY

AIMS AND OBJECTIVES:

Aims and object of this paper is to analyse mergers and acquisitions in Indian Banking Industry and how it is affecting emergence and functioning of Banking Sector as a whole. Further, effort has been made to know motive behind such consolidation and trend across world in this respect.

Further, objective of this paper is to highlight issues and challenges Banking Industry is facing due to consolidation and what is the role of Reserve Bank of India as regulator.

SCOPE AND LIMITATIONS:

Scope of this paper is to analyse prevalent trend of mergers and amalgamations in Indian Banking Sector though reference has been given about merger activities in foreign countries also.

RESEACH QUESTIONS:

1. Why Mergers in Banking Industry? What is the driving force behind it and what are its advantages?

2. What is the Legal Framework governing Bank Mergers in India?

3. What are the powers vested with Reserve Bank of India with respect to Bank Mergers and its role in Merger Review Process?

4. What are the impact of Bank Mergers on Employees?

5. What are the Tax Implication of Bank Mergers?

6. Which all Competition Issues are involved in Bank Mergers?

7. Why Bank Mergers fail and what improvement can be made to make it successful?

METHOD OF ANALYSIS

Since Bank Mergers are gaining importance day by day and such activities are taking place across the world hence an analytical and critical method of study has been followed to fathom the implications of such mergers. The role of RBI has been critically studied and suggestions have been made to fill the regulatory gap with respect to bank mergers.

SOURCES OF DATA

The source of data is secondary in nature. Books, Articles and materials available on website have been used.

STYLE OF FOOTNOTING:

A uniform style of footnoting has been followed throughout.

CHAPTERII: ESSENTIALS OF MERGER AND ACQUISITON AND BANKING INDUSTRY

DEFINITIONS

The Oxford Dictionary defines a merger as a combining of two or more commercial organizations into one in order to increase efficiency and sometimes to avoid competition[2]

A *merger* is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. In a merger, the acquiring company assumes the assets and liabilities of the merged company. A merger differs from a *consolidation,* which is a business combination whereby two or more companies join to form an entirely new company. All of the combining companies are dissolved and only the new entity continues to operate[3]. In a consolidation, the original companies cease to exist, and their stockholders become stockholders 'in the new company. Despite the differences between them, the terms merger and consolidation, as is true of many of the terms in the mergers and acquisitions field, are sometimes used interchangeably. In general, when the combining firms are approximately the same size, the term consolidation applies: when the two firms differ significantly by size, merger is the more appropriate term. In practice, however, this distinction is often blurred, with the term merger being broadly applied to combinations involving firms of both different and similar sizes.

[2] The Oxford Dictionary for the business world, Oxford University Press, NY, 1993].
[3] in 1986 the computer manufacturers Burroughs and Sperry combined to form UNISYS

TYPES OF MERGERS[4]:

Various types of Mergers are as under:

1. Vertical Combination.
2. Horizontal Combination.
3. Circular Combination.
4. Conglomerate Combination; and
5. Concentric Acquisitions.

Let us now discuss in brief, the various types of Merger:

1. Vertical Combination

A company would like to takeover another company or seek its merger with that company to expand espousing backward integration to assimilate the sources of supply and forward integration towards market outlets.

The following are the main benefits, which usually accrue from the vertical combination to the acquirer company:-

- It gained a strong position because of imperfect market of the intermediary products, scarcity of resources and purchased products;
- Better control over the product specifications; and
- Strong supplier-buyer relationships.

2. Horizontal Combination

Horizontal combination is a merger of two competing firms which are at the same stage of industrial process. The acquiring firm belongs to the same industry as the target

[4] Dev Raj, Mergers And Amalgamations in Banking Industry, Rajat Publications, Delhi, Pp.10-12

company. The main purpose of such types of mergers is to obtain economies of scale in production by eliminating duplication of facilities, operations and broadening the product line. It will facilitate in reduction in investment, working capital, elimination of competition, concentration in product, reduction in advertising costs,, increase in market segments and exercise of better control on the market.

3. Circular Combination

Companies producing distinct products seeks amalgamation to share common distribution and research facilities to obtain economies by elimination of cost on duplication and promoting market enlargement. The acquiring company obtains benefits by Circular Combination in the form of economies of resource sharing and diversification.

4. Conglomerate Combinations

It is a amalgamation of two companies engaged in unrelated industries. The basic purpose of such types of amalgamations is utilisation of financial resources in a better way and to enlarge debt capacity through re-organising their financial structure so as to service the shareholders with increased leveraging and EPS, reducing average cost of capital and thereby raising present worth of the outstanding shares. The Conglomerate Combinations enhances the overall stability of the acquirer company and creates balance in the Company's total portfolio of diverse products and production processes.

5. Concentric Acquisitions

In concentric acquisitions the acquirer and target firms are related through the basic-technologies, production processes and markets.

BENEFITS OF MERGER AND ACQUISITION

Merger and acquisition activity results in overall benefits to shareholders when the consolidated post-merger firm is more valuable than the simple sum of the two separate pre merger firms. The primary cause of this gain in value is supposed-to tie the performance improvement following the merger. The search for post-merger performance gains has focused on improvements in any one of the following areas, namely efficiency improvements, increased market power, or heightened diversification.

Several types of efficiency gains may flow from merger and acquisition activity. Of these, increased cost efficiency is most commonly mentioned. Many mergers have been motivated by a belief that a significant quantity of redundant operating costs could be eliminated through the consolidation of activities. For example, Wells Fargo estimated annual cost savings of $1 billion 'from its 1996 acquisition of First Interstate[5].

Consolidation enables costs to be lowered if scale or scope economies can be achieved. Larger institutions may be more efficient if redundant facilities and personal are eliminated within the post-merger organization. Moreover, costs may be lowered if one bank can offer several products at a lower cost than separate banks each providing individual products. Cost efficiency may also be improved through merger activity if the management of the acquiring institution is more skilled at holding down expenses for any level of activity than that of the target.

In short any acquisition takes place with a number of motivations culminating in a positive synergy (2+2=5 relationship). This means that the performance of the combined company is more than the sum of the performance of erstwhile two independent companies. In short the motive behind merger may be enumerated as follows[6]:

- Taking advantage of awareness that a company is undervalued.
- Achieving growth more rapidly than by internal effort.

[5] Barton Crockett,"First Bank Claims Wells Overstates Deal Savings."American Banker(November 20,1995)

[6] Merger-Motives And Benefits,R.Rangarajan and D.G.Vaishnav,Banking Finance,Vol.15,Year 2002,Jan-Dec.,Issue 1-12,Pp.6-7

- Satisfying market demand for additional products/services.
- Avoiding risks of internal start-ups of expansion.
- Increasing earnings per share.
- Reducing dependence on a single product/service.
- Acquiring market share or position.
- Offsetting seasonal or cyclical fluctuations in the present business.
- Enhancing the power and prestige of the Owner, CEO, or Management.
- Increasing utilization of present resources, et., physical plant and individual skills.
- Acquiring outstanding Management or Technical Personnel.
- Opening new markets for present products/services.

WHY MERGER IN BANKS-BENEFITS

A merger involves a marriage of two or more banks. It is generally accepted that mergers promote synergies. The basic idea is that the combined will create more value than the individual banks operating independently. Economist refers to the phenomenon of the "2+2=5" effect brought about by synergy.

Economies of scale refer to the lower operating costs (per unit) arising from spreading the fixed costs over a wider scale of production and economies of scope refer to the utilization of skill assets employed in the production in order to produced similar products or services.

The resulting combined entity gains from operating and financial synergies. In a combined entity, the skill used to produce separate and limited results will be used to produce results on wider scale. Additional financial synergies refer to the effect of a merger on the financial activities of the resulting company. The cash flows arising from the merger are expected to present opportunities in respect of the cost of financing and investment.

Bank merger and acquisition activity may also encourage improved revenue efficiency a manner analogous to cost efficiency. Some recent deals, such as the proposed acquisition of Boatmen's Bancshares by NationsBank, have been motivated by potential gains in this area[7]. According to this view, scale economies may enable larger banks to offer more products and services, and scope economies may allow providers of multiple products and services to increase the market share of targeted customer activity. Additionally, acquiring management may raise revenues by implementing superior pricing strategies offering more lucrative product mixes, or incorporating sophisticated sales and marketing programs. Banks may also generate greater revenue by cross-selling various products of each merger partner to customers of the other partner. The result is supposed to be higher revenue without the commensurate costs, *i.e.,* improve 'profit efficiency. The latter term in general refers to the ability of profits to improve from any of the sources noted above, cost economies, scope economies or marketing efficiency. In a sense, it represents the total efficiency gains from the merger without specific reference to the separately tilled efficiency improvement areas.

Merger-related gains may also stem from increased market power. Deals among banks with substantial geographic overlap reduce the number of firms in markets in which both organizations compete. A related effect of in-market mergers is that the market share of the surviving organization in these markets C is raised. These changes market structure make the affected markets more vulnerable to reduced competition. The increased market power of the surviving organization may enable it to earn higher profits by raising loan rates and lowering deposit rates.

Finally, mergers may enhance value) by raising the level of bank diversification consolidation may increase diversification by either broadening the geographic reach of an institution or increasing the breadth of the products and services offered. Moreover, the simple addition of newly acquired assets and deposits facilitates diversification by increasing the number of bank customer's.

Greater diversification provides value by stabilizing returns. Lower volatility

[7] Kenneth Cline,"Nations Bank Sees Boatmen's Revenue Potential".American Banker(September 26,19960

may raise shareholder wealth in several ways. First, the expected value of bankruptcy costs may be reduced. Second, if firms face a convex tax schedule, then expected taxes paid may fall, raising expected net income. Third, earnings from lines of business where customers value bank stability may be increased. Finally, levels of certain risky, yet profitable, activities such as lending may be increased without additional capital being necessary[8].

MERGER WAVE AND BANKING INDUSTRY

The first merger wave started in approximately in 1897 and ended in 1904[9]. The Wave began during the economic recovery from the Depression of 1 893 in U.S.A. It featured mainly horizontal mergers that often resulted in monopolies or near monopolistic industry structures. The development of the infrastructure within the economy created conditions that allowed the "first merger wave" to prosper: Specially, the development of a transportation system through the growth of railroads allowed regional firms to compete in National Markets. This intensified competition, allowed companies to expand beyond their Regional borders. Better communications and increasingly specialised management helped firms to pursue expansion. Their growth was financed by increasingly aggressive investment bankers, such as J.R Morgan of Morgan Bank and Jacob Schiff of Kuhn Lobe & Company. These Bankers organised voting trusts to facilitate the recapitalisation of many failing businesses. The investment bankers helped to organise these failing enterprises into a smaller number of larger and more profitable firms.

SECOND MERGER WAVE : 1916 TO .1929

Approximately 70% of the merger in the Second Wave were horizontal combinations with the remainder being mostly vertical transactions.

Just as in the first wave of merger, investment Bankers played an aggressive role in providing the necessary capital to finance the Second Merger wave deals. Indeed, Capital within the investment Banking industry was concentrated in the hands of a relatively

[8] This is a key rationalization in favour of a move towards universal banking.
[9] Dev Raj,Mergers And Amalgamations in Banking Industry.,Rajat Publications,Delhi,p.12

small number of bankers who were more willing to lend to Industries that were more concentrated and had less competition. The Companies that expanded acquisition during this wave were able to take advantage of economies of scale and other productivity advantages that come from greater size of the Institution.

The second wave of merger came to an abrupt end in 1929 with the start of the Great Depression and the Collapse of the Stock Market in October, 1929[10]. With the exception of a small increase in the 1940s, the number of mergers and acquisitions remained at a low level until the late 1960s, when the Third takeover wave began. This wave, which is known as the conglomerate era, began in approximately in 1965 and ended in 1969. It followed a period of intense antitrust enforcement in the 1950s and 1960s, using the newly enacted Celler-Kefauver Act alongwith the other antitrust laws. This left expansion minded firms with no alternative but to expand into dissimilar lines of business. Such Companies included conglomerates like ITT, Gulf and Weston, LTV, Litton Industries, Textron and Teledyne.

The conglomerates took advantage of various "market inefficiencies" while playing the "P/E Game" and engaging in other accounting manipulations, which allowed the firms to demonstrate, rising accounting earnings without necessarily having a commensurate increase in shares outstanding. Some of these accounting manupulations became more difficult to pursue after the Tax Reform Act of 1969. This law, combined with a down turn in the Stock Market, helped to bring about the end to the conglomerate era in 1969.

While in the 1970s did not have a sufficient number of mergers to constitute a merger wave, it did feature a number of path-breaking deals with that set the stage for the type of hostile transactions that took place in the Fourth Merger Wave. The principal trend setting deal was the 1970 Inco-ESB merger, reputable Company. This deal was followed by two other trend-setting hostile takeovers in 1975—i.e. the takeover of Otis—Elevator by United Technologies and the takeover of Carlock by Colt Industries. Together, they paved the way for the marked increase in the number of large hostile

[10] Ibid,at P.13

takeover that took place in the following decade.

THE FOURTH MERGER WAVE : SINCE 1984

The fourth merger wave which started from 1984 onwards, covers the aggressive takeover tactics, leveraged buyouts and junk bond financing[11]. In sum, the fourth takeover wave was good for target shareholders but failed to yield clear benefits to acquiring firm shareholders.

Another, are where shareholders returns are a controversial issue is in the impact that takeover defenses have on shareholder wealth. This a particularly controversial area, since the use of some of these defenses, such as "litigation", "green mail" and "poison pills", do not require shareholder's approval. Other defenses, however, such as anti-takeover charter amendments, may require shareholder approval. Given the traditional inactive role that most shareholders play, as opposed to a more-interested management, it is difficult to successfully oppose management proposals to install preventive anti-takeover defenses.

The leveraged buyouts of the 1980s also featured a conflict between equity holders and bond holders. Bond holders saw the market value of their Bonds collapse as their ratings fell from high quality to low quality in response to the increased leverage brought on by the LBO.

[11] Ibid,at P.14

ARGUMENTS FOR BANK MERGER IN INDIA

1. **Size matters**:

This signifies the obsession with the idea that bigger banks would be able to perform in an efficient manner. Present day banking required a smaller number of very large banks rather than a pack of small banks. There are about 90 scheduled commercial banks, four non-scheduled commercial banks and 196 regional rural banks (RRBs). The State Bank and its seven associates have about 14,000 branches; 19 nationalized banks 34,000 branched; the RRBs 14,700 branches; and foreign banks around 225 branches. Therefore the idea of bank consolidation gains around from the fact of bigger banks performing in an efficient manner. But this may not always be true as assets size cannot always be termed to be the determining factor of bank performance. The following table drives home the point.

TABLE[12] : ASSETS SIZE AND PROFITABILITY IN TOP INDIAN BANKS

For the year 2003 – 04	Total Assets (Rs. Crore)	Ratio (Prof to assets) in%	Profitability Rank
State Bank of India	407815	0.90	28
ICICI Bank	125229	1.31	11
Punjab National Bank	102332	1.08	20
Canara Bank	99539	1.34	9
Bank of Baroda	85109	1.14	18
Bank of India	84860	1.19	17
Central Bank of India	63345	0.98	24
Union Bank of India	58317	1.22	14
Indian Overseas Bank	47322	1.08	19
Syndicate Bank	47223	0.92	27
UCO Bank	43798	0.99	23
HDFC Bank	42307	1.20	16

[12] The Economic And Political Weekly, March 2005

Oriental Bank of Commerce	419007	1.67	5
Indian Bank	39154	1.04	2
Allahabad Bank	34704	1.34	10
Bank of Maharashtra	32213	0.95	25
State of Bank of Hyderabad	30646	1.24	13
Corporation Bank	29154	1.73	2
Andhra Bank	27009	1.72	3
State Bank of Patiala	26897	1.60	6
United Bank of India	25843	1.22	15
Vijaya Bank	24071	1.71	4
State Bank of Travancore	24003	1.02	22
Dena Bank	22160	0.92	26

Thus the above Table shows that it is not always necessary to assess the performance of a bank by its size.

2. **Technology:**

Internet's emergence as a virtual channel for managing financial services offers many challenges and opportunities. As convergence reshapes the future marketplace, technology will become a competitive advantage offering many cost effective solutions. Banks will spend huge amounts on electronic customer management, trying to stay closer while reducing staff.

3. **Synergies from Bank mergers:**

There are obvious synergies to be obtained from bank mergers. This is due to the identical nature of the functions performed by various public sector banks. At times there

is not much difference in the functions being performed by two banks belonging to the public sector.

4. **Basel capital accord:**

The Base II Capital standards seek to improve regulatory capital standards via three broad and inter-related strategies. Or "pillars".

- Pillar 1 consists of minimum capital requirements-rules by which a bank calculates its minimum capital ratio and by which its supervisor assesses whether it complies with the minimum capital threshold.
- Pillar 2 addresses supervisory oversight. It embodies the concept that a well managed bank should seek to go beyond simple compliance with minimum capital requirements, to assess whether it has sufficient capital to support its risks.
- Pillar 3 seeks to complement Pillars 1 and 2, encouraging stronger market discipline of banking organizations. An important element here is requiring a bank to publicly disclose key measures related to its risk and capital positions.

For years there has been a call for a new way to measure corporate progress. The old model, focusing on financials, remains valuable, but it doesn't touch other vital organizational interests: customer feedback, internal processes, learning, hiring, innovation, and technology, also, managements and boards want to be able to see how well they are doing in achieving outcomes. It is easy to have measures and produce numbers, it difficult to select strategic ones from among

5. Increasing burden of NPAs:

One of the greatest challenges facing the Indian Banking Sector is the problem of Non-Performing Assets. Consolidation in the Banking Industry can help in reducing the mounting non-performing assets in Public Sector Banks and Private Sector Banks alike. Coming times may usher in large banking institutions, if the development financial institutions opt for conversion into commercial banking in the line with the recommendation of the second report of the Narsimhan Committee (1998). In India, one

of the largest financial institutions, ICICI, took the lead towards universal banking with its reverse merger with ICICI Bank. IDBI is also well on its way to transform itself into a universal bank. This may lead logically to promoting the concept of financial super market chain, making available all types of credit and non-funded facilities under one roof or specialized subsidiaries under one umbrella organization. The setting up of banks by financial institutions and non-banking financial companies and setting up of insurance, merchant banking, mutual funds, housing fiancé and investment companies either as subsidiaries or as joint ventures has brought into focus the need for consolidated supervision. The merger of ICICI with ICICI Bank has highlighted the benefit of such a strategy: it has helped blunt the risks posed by the large NPAs of the former.

Mergers and Acquisitions in Banking: International Experiences and Indian Evidence

The banking system in many emerging economies is fragmented in terms of the number and size of institutions, ownership, profitability and competitiveness of banks, use of modern technology and other related structural features. Very often, three or four large commercial banks co-exist with a large number of smaller urban and rural banks, or under the influence of the public sector. In general, few commercial banks, even larger ones, are listed on the stock exchange. Profitability varies widely, with some banks earning high returns but operating very inefficiently, and other banks competing fiercely for a narrow segment of the market. Likewise, while some commercial banks in the emerging economies are at the cutting edge of technology and financial innovation, many are still struggling with the basic operations such as credit risk assessment and liquidity management. Finally, recent banking crises have weakened banking systems in a number of countries, and banks in some countries remain on the brink of insolvency.

In this context, bank mergers have been considered as a possible avenue for improving the structure and efficiency of the banking industry. It is possible to categorise die motivations for bank mergers into four viz., cost benefits (economies of scale, organizational efficiency, funding costs and risk diversification), revenue benefits (economies of scope, enhancing monopoly rents), economic conditions (mergers after

crises or after the upswing of the business cycle); and other motives (private managerial benefits, defense against takeovers, etc.).

Cross-country experience of bank mergers is suggestive of significant cost and revenue benefits from bank consolidation. Market-driven consolidation is a relatively new phenomenon and has been mainly observed in Central European economies. In Hungary, for instance, some 40 institutions are presently competing in the retail and. corporate markets. At the same time, Belgium's KBC and ABN Amro merged their Hungarian operations to exploit market synergies. After the large number of bankruptcies of private banks, in Poland and Czech Republic, the number of commercial banks declined significantly, with no dominant bank in the corporate sector.

In other economies and especially in Asia, government-led consolidation has gained credence, motivated by the need to strengthen capital adequacy and the financial viability of many smaller banks affected by the 1997-98 crisis. The clearest example of this approach is Malaysia's Danamodal, a special purpose institution established with the twin objectives of recapitalising the banks and facilitating consolidation and rationalisation of the banking system. In Philippines, a range of incentives is being offered to the merging banks, including better access to rediscount facilities and temporary relief from certain prudential requirements. In Indonesia, four of the seven state banks existing before the crisis were consolidated into a new state hank (Bank Mandiri). In addition, eight private banks that had been taken over by the Indonesian Bank Restructuring Agency (IBRA) were merged during 2000 into a new institution.

In Latin America, bank mergers arose as a response to inefficient banking structures. In Argentina, bank consolidation has been driven largely by the domestic and external financial liberalisation launched in the early 1990s, and the progressive tightening of prudential regulations. Bank consolidation in Mexico, on the other hand, took place in response to the lack of capital after the 1995 banking crisis.

In view of the global phenomenon of consolidation and convergence, the Report of the Committee on Banking Sector Reforms (Chairman: Shri. M. Narasimham) had suggested mergers among strong banks, both in the public and private sectors and even with

financial institutions and NBFCs. The phenomenon of mergers in the banking sector is a relatively recent one in India. There was one merger in the early nineties, i.e., New Bank of India with Punjab National Bank.

There has been a spate of mergers in the recent past, viz., 20th Century Finance with Centurion Bank, HDFC Bank with Times Bank and ICICI Bank with Bank of Madura. The table below presents the number of mergers in the banking sector in India over the last three years as in Table 4.2

Table :*Mergers in Banking Sector in India: 1999 to 2001*

Name of the Merging Entity	*Name of the Merged Entity*	*Date of Merger*	*Post Merger Status (in per cent)*		
			CRAR	*Net NPA Ratio*	*Return on Assets*
20th Century Finance	Centurion Bank	January 1998	8.45*	4.67*	0.82*
Bareilly Corporation	Bank of Baroda	June 1999	12.10	6.95	0.85
Sikkim Bank	Union Bank of India	December 1999	11.42	7.97	0.29
Times Bank	HDFC Bank	February 2000	12.19	1.01	1.84
Bank of Madura	ICICI Bank	March 2001	11.57**	2.19**	0.82**

* As at end-March 1999.

** As at end-March 2001. All other ratios are as at end-March 2000.

What is important is that the systems for internal controls and risk management are put in place in order to take speedy decisions for offering a wide range of products

through multiple delivery channels. In the ultimate analysis, therefore, the success of consolidation efforts will depend on how effectively the banking industry is able to put in place firewalls against financial crises, while blending risks with returns.

CHAPTER III: LEGAL FRAMEWORK GOVERNING BANK MERGERS

Legal Categorization of banks

Legal categorization of banks is with reference to the statute under which they are constituted. They are classified as nationalized banks, banking companies, SBI and its subsidiaries, RRBs, Cooperatives and Multi-state cooperative banks.

Nationalized Banks

Nationalized banks are corporate bodies established by the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 and Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980. The total numbers of such banks is 19. These are predominantly owned and controlled by the Central Government. All these are constituted by an Act of parliament and governed by the aforesaid statutes.

By section 51 of the Banking Regulation Act, 1949 (BR Act), certain provisions of the BR Act are made applicable to these banks, however the provisions of the Companies Act do not apply to these banks.

Banking Companies

Although all private sector banks are companies registered under the Companies Act, 1956 and operating as banking companies after obtaining banking license from Reserve Bank of India such banks further grouped into following categories:

Old private sector banks

New private sector banks

Local area banks

All the above category of banks are banking companies except that their minimum share capitals are different.

In the matter of amalgamation /merger and winding up of banking companies, the concerned High Court will continue to have jurisdiction under the provisions of the Companies Act.

State Bank of India and its Subsidiaries

The State Bank of India is constituted under the State Bank of India Act, 1955 by transfer of the undertaking of the Imperial Bank of India to the State Bank of India and all the shares in the capital of Imperial Bank of India were transferred to the Reserve Bank of India. By section 51 of the Banking Regulation Act, 1949 certain of the said Act are made applicable to State Bank of India, but the provisions of the Companies Act do not apply. The subsidiaries of state Bank of India are constituted as subsidiary banks under State Bank of India (Subsidiary Banks) Act, 1959. The subsidiary banks are bodies corporate and are governed by the provisions of the above Act and the provisions of the Companies Act do not apply. Like other public sector banks, provisions of the BR Act, 1949 are made applicable to subsidiary banks by virtue of section 51 of the said Act.

Regional Rural Banks (RRBs)

Regional Rural Banks (RRBs) are constituted under Regional Rural Banks Act, 1976 (RRB Act, 1976). Section 6(2) of the RRB Act, 1976.

Such RRBs are bodies corporate governed by the RRB Act, 1976 and the provisions of the Companies Act do not apply. For the purpose of Income Tax Act or any other law for the time being in force relating to any tax on income, profits or gains, the RRB shall be deemed to be a co-operative society (section 22 of the RRB Act) and provisions of the companies Act do not apply to the RRBs. Provisions of Banking Regulation Act as specified under section 51 of the BR Act, apply to the RRBs to the extent specified therein.

Co-operative Banks

The definition of 'banking company' contained in the BR Act, 1949 as modified by section 56 of the Act includes co-operative banks within the definition of banking

company. While the provisions relating to regulation and supervision of the co-operative banks are contained in the BR Act, 1949 the status for such co-operative banks as co-operative societies are governed by the respective co-operative societies laws in force in various States under which the concerned co-operative bank may be registered as a co-operative society.

Multi-State Co-operative Banks

In the category of co-operative banks, there is a special category of co-operative banks having their area of operation in more than one States and such societies are registered under a central law viz. Multi-State Co-operative Societies Act, 2002.

COMPLIANCE WITH THE REGULATIONS OF BANKING REGULATION ACT,1949

There are two types of amalgamations of Banking Companies under the Banking Regulation Act,1949.These are:

A) Voluntary Amalgamation; and

B) Compulsory Amalgamation

A) VOLUNTARY AMALGAMATION[Sec.44A]

Section 44A of the Banking Regulation Act, 1949 provides that no banking company shall be amalgamated with another banking company notwithstanding anything contained in any law unless the scheme for the amalgamation has been placed in draft before the shareholders of each of the companies and approval obtained by way of a resolution passed by a majority in number "presenting two-thirds in value of the shareholders of each of the companies present either in person or by proxy at a meeting called and held for the purpose of amalgamation of the two companies,

Section 44A (2) provides that notice of every such meeting shall be given to every shareholder of each company as per the requirement of the Articles of Association. The notice will indicate the time, place and object of the meeting. The said notice shall be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality where the registered office is situated for each of the companies. The advertisement in newspapers ref-erred to above shall also be in one such newspaper in a language commonly understood in the locality.

Where a scheme is approved by the requisite majority of shareholders the same shall be submitted to Reserve Bank. of India for sanction and if sanctioned, shall be binding oh the companies and also all the shareholders. Section 44A(3) protects the dissentient shareholder who has voted against a scheme or who has given a notice in writing at or prior to a meeting of the company or to the presiding officer that he dissents from the amalgamation shall be entitled to claim from the banking company concerned in respect of shares held in that company their value as determined by Reserve Bank of India while sanctioning the scheme. The determination of value of shares by Reserve Bank of India to be paid to dissenting shareholders shall be final.

Section 44A(6), on the lines of section 394(2) provides that on sanction the properties of the amalgamated banking company along with the liabilities, by virtue of the order of sanction be transferred to and vest in the other company. Reserve Bank also enjoys powers to order in writing and direct that on such date as may be specified therein the amalgamated banking company, which by reason of the amalgamation will cease to function and the amalgamated company shall stand dissolved notwithstanding to the contrary contained in any other law.

Section 44A(6)(b) also provides that when Reserve Bank of India directs a dissolution of the amalgamating banking company a copy of the order directing such dissolution shall 'be transmitted to the Registrar before whom the banking company has been registered.

On receipt of such an order the Registrar shall strike off the name of the company. An order passed under section 44A(4) by Reserve Bank sanctioning a scheme shall be conclusive evidence that all the requirements of section 44A have been complied with. A copy of the said order and a copy of the scheme certified duly as true copy shall be submitted as evidence in all legal proceedings.

Amalgamation under section 396 of the Companies Act also possible

In terms of section 44A (7) provisions of sub-sections (1) to (6C) shall not affect the power of the Central Government to order amalgamation of two or more banking companies under section 396 of the Companies Act, 1956. However no such power shall be exercised by the Central Government except after consultation with the Reserve Bank.

While completing a scheme of amalgamation of banking companies, the Madras High Court in Bank of Madura Shan holders Welfare Association v. Governor, Reserve Bank of India and Others. 2001 105 Com Cases 663 (Mad) made the to a lowing observations while objections were raised in regard to a scheme:

(a) If the petitioner, the shareholders' welfare association, was realty aggrieved that the market value of shares of both the companies had, not been determined properly, it could get the market value of shares evaluated by the Reserve Bank of India and obtain the value of the shares from the banking company.

(b) The Court would not go into the question as to whether the share-exchange ratio adopted in the scheme of amalgamation was fair or not. Further the petitioner association had not proved that any of its members except the second petitioner was a shareholder of the transferor-bank.

(c) No materials were produced by the petitioner association before the Court to show that the third respondent had invited proxies from the shareholders in the capacity of an officer of the banking company and at the expense of the banking company Further, this

allegation against the third respondent had no connection or link with the question of determination of the validity of the scheme of amalgamation proposed by the boards of directors of the two companies

d) There were no materials to establish the insider trading with reference to the dealings in the company's shares and the calling for certain, particulars by the Bombay Stock .Exchange did not establish that there were certain violations.

(e) The question as to whether the third respondent had compelled the shareholders to give proxies had to be examined only by the Reserve Bank of India while considering the question of sanction to the scheme of amalgamation. Moreover neither the report of the chairman of the extraordinary general meeting showed that any shareholder had raised the protest that proxies were obtained by force or coercion, nor any shareholder had come forward before the court stating that proxies were obtained by force or coercion by the third respondent.

(f) No complaint had been made before the court by any shareholder that he was prevented from casting his vote freely either in favour of or against the scheme of amalgamation. Moreover, this was a matter for the Reserve Bank of India to examine,

(g) The explanatory statement sent along with the notice explained the salient features of the scheme of amalgamation, and the notice listed out various documents which were .kept open inspection at the registered office of the transferor-bank oh any working day except Sunday till the date of meeting between 10.00 a.m. and 4.00 p.m. and one such document was the valuation report of the chartered accountants. The petitioner association failed to produce any letter to show that any shareholder had made a complaint to the effect that he was not allowed to inspect the documents.

(h) The chartered accountants were expected to arrive at the market value of shares of both the companies and hence, it was desirable to appoint the same chartered accountants with the power to go through the books of account of both the banking companies and

evaluate the value of shares of both the companies. Hence the appointment of the chartered accountants of the transferee-bank could not be faulted.

(i) Since the majority of the shareholders had expressed their view in favour of the scheme of amalgamation, the earlier view expressed by the chairman of the bank to the effect that it was a strong institution, did not assume much importance. The shareholders being well acquainted with the statement of the chairman had exercised their votes in favour of the scheme of amalgamation.

(j) Since the requisite majority shareholders of the transfer-or-bank had accepted and approved the scheme of amalgamation, the question of the Court ordering a probe into the scheme of amalgamation did not arise.

(k) The conduct of the petitioner association clearly indicated that it was interested in the postponement of consideration of the amalgamation by the Reserve Bank of India on the ground that it had filed the writ petition seeking postponement of the extraordinary general meeting of shareholders. The petitioner association had failed to make out any primes, facie case for admitting the writ petition.

Scheme of compromise/arrangement between banking company and creditors requires sanction of High Court

Though the power to amalgamate banking companies is exclusive power of Reserve Bank of India under section 44A of the Banking Regulations Act, 1949, the legal position regarding sanctioning of a compromise or arrangement between a banking company and its creditors is different. In terms of section 44B of the Banking Regulations Act, 1949, the power to sanction a compromise or arrangement between a banking company and its creditor etc shall be made only by High. Courts However: High Court shall not sanction a scheme unless Reserve Bank of India certifies a scheme in writing as not being incapable

of being worked and as not being detrimental to the interests of the depositors of such banking company.

S. 44A covers banking companies only for the purpose of amalgamation of Companies. Petitioners being non-banking companies are not required to seek permission of the Reserve Bank. *In the matter of Scheme of Amalgamation of Industrial Enterprises & Finance Ltd., with Funds hid. Bank Ltd*[13] *and* Reserve Bank of India has power to determine the value of shares of dissenting shareholders. If the petitioner is not satisfied with the valuation of shares he can approach Reserve Bank for the same and court will not interfere with valuation or share exchange ratio adopted in the scheme.[14]Any opinion expressed by the court on the valuation of shares would foreclose the Reserve Bank's right and would prevent the Bank from exercising its power conferred by Statute.[15]But the provisions of Sec.44A are applicable only where transferor and transferee companies are Banking companies,[16] hence the provisions of this Section are not applicable in case of amalgamation of public sector banks or Nationalised Bank or State Bank of India with Banking company.

In short it can be summarized as follows:

- No banking company shall be amalgamated with another banking company, unless the shareholders of both the banking companies approve merger scheme in a meeting called for the purpose by a majority in number representing two-thirds in value of the shareholders of each of the said company.
- The approved scheme of amalgamation shall be sent to RBI for its approval.
- Any shareholder who has voted against the scheme of merger or has given notice in writing at or prior to the meeting shall be entitled to claim from banking company the value of the shares held by him as determined by the RBI while approving the scheme.
- Once the scheme of amalgamation is sanctioned by the RBI, the property and the

[13] 2003(4) Bom CR (OUCJ) 482.
[14] .Bank of Madura Shareholders Welfare Association V.Governor,Reserve Bank of India;(2001)105Comp.Cas.663(2001)3Comp LJ 212(Mad)
[15] DBOD NO.PSBS.BC.89/16.313.100/2004-05,May 11,2005
[16] ICICI Ltd.,In Re.,(2004)119Comp.Cas.941(Bom.)

liabilities of the amalgamated company shall become the property and the liabilities of the acquiring company.

- After sanctioning the scheme of amalgamation by the RBI, the RBI may further order the closure of acquired bank and the acquired bank stands dissolved from such a data as may be specified.

B)COMPULSORY AMALGAMATION[Sec.45]

Power of Reserve Bank of India to apply to Central Government for suspension of business and amalgamation.

Section 45(1) of the Banking Regulations Act, 1949, empowers Reserve Bank of India to apply to Central Government where there is good reason so to do for an order of moratorium in respect of a banking company. Section 45(2) empowers Central Government to make an order of moratorium for a total period not exceeding 6 months. Section 45(4) provides that Reserve Bank of India has power, while the banking company is under moratorium. Reserve Bank of India may prepare a scheme if it thinks it is necessary so to do in public interest or interest of depositors or to secure interest of the banking system of the country as a whole. Reserve Bank may prepare a scheme either for the reconstruction of the banking company or for the amalgamation of the banking company with any other banking institution.

Section 45(7) provides that any scheme referred to in subsection (4) including the scheme for amalgamation may be sanctioned by the .Central Government with or without modification. This power of the Central Government appears (o be similar t0 ie provisions of section 396.

Sec. 45 of the Banking Regulation Act empower the RBI to apply to the cent. Govt. for

supervision of business by a banking company and to prepare scheme of reconstruction or amalgamation.[17] In other words, S. 45 provides for a bank to be amalgamated compulsorily, without the consent of the creditors or members, with any other banking institution as defined v / sub sec. (15) therein.[18]

A compulsory amalgamation is generally resorted to when the financial position of the bank has become weak and urgent measures are required to be taken by the RBI in construction with central govt. to safeguard the interest of depositors.

U/S 45 (2), no prior opportunity is contemplated nor practicable and a moratorium is only a step leading towards consideration of introduction of a scheme and it is not an end in itself and the grounds for the moratorium are to be within the scope of the grounds relevant for introduction of a scheme.[19]

Imposition of Moratorium

The term 'moratorium' means that an activity is stopped temporarily for performing legal obligations. Thus, under moratorium, bank is not entitled to do any business[20].The RBI can exercise its power v/s. 45 for obtaining moratorium and subsequently framing banking company even where there is such financial difficulty, if grave defects in the management of the banking company are revealed on inspection and are serious differences between persons in management of the company.

Oral hearing was not an essential ingredient of natural justice in every case. The question had to be decided on facts of each case. Where the order of moratorium had to remain in operation for a limited period to complete the process u/s. 45 within 6 months, it was *held,* that grant of oral post-decisional hearing might unduly obstruct and delay the process and would defeat the very purpose of law[21].Further,while passing of order of moratorium, pre-decisional hearing is not necessary however post- decisional hearing is

[17] S. 45 of RBI Act, 1934.
[18] S. 45 (15).
[19] S. 45 (4).
[20] Bishop *of Kottayam* v. *Union of India,* AIR 1986 Ker 126.

9 *Punjab Co-operative Bank Ltd* v. *UOI,* 2001 (1) RCR (Civil) 154 (P&H-FB).]

sufficient[22].

RBI a banker's bank possessing expertise made an application to the central Government and on a careful consideration of the matter, the central Government passed Orders of moratorium u/s. 45(2). It was *held,* that no interference was permissible under Article 226 of the constitution. Opportunity of hearing to bankers was not necessary before passing an order of moratorium[23]. *[Bari Doab Bank Ltd.* v. *UOI,* AIR 1998 Del 95 : 1997 (3) AD 137 (Del).]

Hearing at the stage of moratarium.—

Oral hearing is not an essential ingredient of natural justice in every case. The question had to be decided on facts of each case. Where the order of moratorium had to remain in operation for a limited period to complete the process u/s. 45 within 6 months, it was *held,* that grant of oral post-decisional hearing might unduly obstruct and delay the process and would defeat the very purpose of law[24].

Effect of a moratorium.—

Where a moratorium was ordered by the Central Govt. u/s. 45(1) of the Banking Regulation Act, it was *held, that* the bank appointed as authorised dealer in foreign exchange could not act as such dealer during moratorium consequently, a person having foreign exchange account could not withdraw money from such account. Further, s. 45(3) forbidden the concerned bank from making any payment to any depositor or discharge any liabilities to any creditor except as directed by the Central Govt. Hence, the fact that FERA required further authorisation to transact business in foreign exchange would not affect the content of power of moratorium. Also observed, that secular activities of religious denomination allowed under article 26(d) of the constitution were subject to the moratorium sanctioned u/s. 45(1) of the Banking Regulation Act[25]. .

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[22] *Bari Doab Bank Ltd.* v. *Union of India,* (1997) 6 SCC 417 : 1997 (89) Comp Cas 462
[23] *Bari Doab Bank Ltd.* v. *UOI,* AIR 1998 Del 95 : 1997 (3) AD 137 (Del).]
[24] *Punjab Co-operative Bank Ltd* v. *UOI,* 2001 (1) RCR (Civil) 154 (P&H-FB).]
[25] *Bishop of Kottayam* v. *Union of India,* AIR 1986 Ker 126.

Post-decisional hearing.(Sec.45(2)—

Where after accepting the request of RBI, the Central Government imposed a moratorium against the bank restraining it from granting loans or advances and RBI prepared a draft scheme for amalgamation of bank in question with another bank. Objections to RBI and writ petition against orders were dismissed. SLP was also dismissed by the Supreme Court with the observation that the bank would be entitled for a post-decisional hearing. While passing the subsequent order of amalgamation, the Central Government considered the objections filed as aforesaid. Hence, there was no violation of natural justice principles on the ground of absence of giving fresh hearing to bank[26].

Sub. Sec. (6) provides that a scheme for amalgamation shall be sent in draft to all banking companies concerned, and the RBI may make suggestions and objections received from the said banking companies and from any member, depositors or other creditors of the company.

In Amrit Bank Ltd. & ors. Vs. U.O.I., it was observed that the RBI has been given very wide power of superintendence over banking companies with a view to safeguard not only the interest of the depositors but also the public interest. v/sec. 45(5) of the B.R. Act, it cannot be contended that the provisions of sec. 45 of the act can be resorted to only on the ground on which the high court could be moved v/s.7 of the act, usually, a banking company being temporarily unable to meet its liabilities.

Sec. 45(7) provides that the scheme, so finanlized by the RBI should be filed before the central government which may sanction the scheme with or without such modifications as it may consider necessary. It is to safeguard the interest of the depositors and creditors of a banking company that sec. 45 of the act has been introduced and scheme of amalgamation is only a mode by which the compulsory winding up of banking company is averted for the benefit of the creditors.[27]

In Bhagwandas Garg vs. Canara Bank Ltd.[28] It was held that the scheme of

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[26] *Punjab Co-operative Bank Ltd.* v. *UOI*, AIR 2001 P&H 1 : 2001 A1HC 29 (P&H-FB).]
[27] B.V. Abraham & ors. Vs. St. Bank of Travancore, (1970) 40 comp cases 252.
[28] (1981) 51 Comp. cases 38.

amalgamation sanctioned by the government of India v/ sec. 45 (7) of the B.R. Act is conclusive proof that the requirement of the section relating to amalgamation have been complied with.

Sub-section (8) and (9) of the B.R. Act makes the scheme binding on the banking company. The purpose of moratorium followed by a scheme of amalgamation it that, a proper atmosphere is exceeding six months, so that a draft scheme could be brought in by the RBI, finalized after hearing objections. In Bishop of Kottayam and Ors. V. V.O.I.[29] it was held that when the moratorium is in force, the bank cannot transact any business as authorized v/ the FERA.

Section 45 (10) helps in removing any difficulty that is likely to happen while giving effect to the scheme[30], *Goodland Plantation* v. *State Bank of Travancore.*

In Shiv Kumar Tulsian vs. V.O.I.[31] sec. 45 was challenged as violative of Art. 14 and 19 of the constitution. The court held that s. 45 related to the preparation of a scheme for amalgamation and reconstruction during and the order of moratorium was a condition precedent for preparing and sanctioning such a scheme. Hence, it does not confer arbitrary, uncontrolled discretion upon authorities and hence not violative of art. 14 and 19 the constitution.,*it has been established* that scheme of amalgamation of two banks is supreme in its field, and had a statutory pre-eminence to prevail over other laws. The scheme could not, therefore, be treated as a mere Executive or Administrative Act, but had the character and colour of a statutory instrument. The scheme is protected under Article 31A(l)(c) of the constitution and immune from challenge as violating Articles 14 and 19 of the constitution[32].

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[29] AIR 1986 Ker. 126.

[30] *Goodland Plantation* v. *State Bank of Travancore,* AIR 1965 Ker 297.

[31] 1990 (68) comp. cases 720 (Bom) at. Pg. 731-733.

[32] *RBI* v. *Francis,* 1987 (1) KLT 809 (Ker-DB), reversed in 1987 (2) K.LT 707 (SC).]

PROCEDURE FOR MERGER/AMALGAMATION OF DIFFERRENT KIND OF BANKS

a) Merger of private banks-

The Reserve of India has the power to sanction of merger of banking companies under section 44A of the Banking Regulation Act. Various steps for such a scheme are as under:

i. Draft scheme of merger has to be placed before shareholders of each banking Company and approved by the majority representing 2/3rd in value of shareholders of each banking company present and voting (including proxies)

ii. Notice of meeting to be given to shareholders of each banking company and notice of meeting to be published in two newspapers of the locality at least once in week for three consecutive weeks.

iii. Any dissenting shareholder to be paid value of shares held by as fixed by Reserve Bank of India while approving in draft scheme.

iv. On obtaining shareholders approval, scheme to be submitted to Reserve Bank of India for approval /sanction.

v. Reserve Bank of India to issue an order sanctioning the scheme. Consequences of such amalgamation scheme such as vesting of assets and liabilities in the transferee bank etc ensure as provided in sub-sections (6), (6A), (6B), (6C) of section 44A.

vi. Except the variations on account of requirement of sections 44A, other requirement for actual framing of the scheme will apply as stated in section on power of Acquisition or Takeover of banking Institutions (Section 4.1)

b) Merger of a private bank with a nationalized bank-

i. Since the definition of' banking institution ' under section 9 of the bank

nationalization Act includes a banking company, a scheme under section 9(2) (C) can be framed by the Central Government for the purpose of mergers of a banking company will corresponding new bank. All the requirement stated under section on power of Acquisition Takeover of banking Institution (Section 4.1) would apply in respect of such a scheme.

ii. If such a banking company to be merged with corresponding new bank is a listed company it would be necessary to comply with the requirement of the Listing Agreement.

iii. To protect the right of the shareholders of the banking company it will also be necessary to give an option to the shareholders of the banking company to accept the shares of the merged entity as per the swap ratio as fixed by the scheme or accept the shares of the merged entity as per the swap ratio as fixed by the scheme or accept the payment for shareholders. Since the merger scheme is to be framed under section 9(2) (C) of the Nationalization Act, there is no express statutory requirement for the purpose of obtaining the consent of the shareholders of the banking company for the mergers.

c) <u>Merger of nationalized banks-</u>

The following steps will need to be undertaken:

i. CMD's of the two Banks approach GOI and obtain clearance to proceed to evaluate proposal.

ii. The Central Government may then ask the Two CMD's to conduct a strategic due diligence to be able to further evaluate the logic of the merger.

iii. The CMD's would go back to GOI with the results of the strategic due diligence.

iv. If the proposal finds favor with the Central Government, it would then frame a draft scheme under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. The Central Government would

require valuation to be conducted by experts to work out the swap ratios. The experts so chosen should be requested to submit their report in a sealed cover directly to the Central Government. This is necessary so that persons connected with the corresponding new banks who are involved in the process are protected from any allegation that sensitive information was leaked or disclosed.

v. The Central Government would then place all the material before the Reserve Bank of India by way of consultation in terms of Section 9(1).After the Reserve Bank offers its comments and suggestions, if any, the draft scheme could be fine-tuned.

vi. The Government scheme so fine-tuned would be placed before the Boards of both Banks. At this stage, it would be necessary for listed entities to ensure that compliance with SEBI guidelines is ensured.

vii. The next step would be to publish the draft scheme in its final form in various newspapers across the country for the information of the investing shareholders and inviting them to make their suggestions, if any, in relation to the scheme. A reasonable period for not less than 21 to 30 days could be given for this purpose. Natural justice dose not entail personal hearing in all cases. This is particularly so in cases where a large body of persons are involved. In such cases natural justice is complied with if the persons concerned are given an opportunity for making suggestions or objections. It would be perfectly reasonable to give an opportunity of placing objection and suggestions in writing, which could then be considered by the Central Government in a fair and objective manner.

viii. Since the merger scheme is to be framed under section 9(2) (C) of the Nationalization Act, there is no express statutory requirement for the purpose of obtaining the consent of the shareholders of the banking company for the mergers.

ix. The treatment of transferee bank employees will need to be indicated by the GOI. It will be necessary to provide an option to workmen staff to continue in service on same terms and conditions or accept retrenchment compensation and other terminal benefits as may be payable under the rules, as governed by the Industrial Disputes Act 1947. As far as non-workmen employees are concerned the scheme may offer continuation initially for a specified period on same terms and conditions and from the date to be specified on terms that are applicable to such employees in the transferee bank. Those who do not accept the offer may be paid terminal benefits as per the rules applicable.

x. After all the suggestions that are received from minority shareholders are considered, the Central Government could proceed to notify the scheme. The effective date will need to be indicated in the notification.

xi. Thereafter the scheme would have to be placed before both the Houses of Parliament as provided in Section 9(6).

d) <u>Merger of a nationalized bank with State Bank of India (SBI)-</u>

i. In a corresponding new bank the controlling shares are held by the Central Government and respect of State bank of India, the controlling shares are held by Reserve Bank of India. Initiation of any proposal for merger of corresponding new bank with State Bank of India would therefore need approval of the Central Government as well as the Reserve Bank of India.

ii. Since the provision of section 9(2) (c) read with explanation I to section 9(5) of the Nationalization Act contemplate the merger of a public sector bank with State Bank of India, it would be permissible for the Central Government of formulate a scheme under section 9(2) (c) for the purpose of amalgamation of a corresponding new bank with State Bank of India.

iii. If the corresponding new bank has raised capital by issue of shares to public it will be necessary to make a valuation of shares and decide the swap ratio for shares of the state Bank of India. Provision will have to be made for payment of compensation in cash to the dissenting shareholders of the corresponding new bank, who do not dissenting shareholders of corresponding new bank, who do not accept the shares of the State Bank of India as per the swap ratio.

iv. In addition to the requirement stated above, the other requirement in the matter of formulation of the scheme under section 9 (2) (c) as stated earlier above will apply in respect of merger of a corresponding new bank with State Bank of India.

e) Merger of a nationalized bank with a subsidiary bank of State Bank of India

The position as stated earlier, in respect of merger of a corresponding new bank with State Bank of India shall apply in respect of merger of corresponding new bank with a subsidiary of State bank of India also. The only modification that may be required is that approval of State Bank of India in addition to Reserve Bank of India and the Central Government would be necessary for initiation of negotiation for merger, since the entire shareholding of a subsidiary bank vests in State Bank of India; expect the above modification, rest of the steps and applicable law will be the same as stated in 4.1 above.

f) Merger of a private bank with State bank of India or its subsidiaries

Although the State Bank of India has power to acquire any banking institution under section 35 of the State Bank of India Act, 1955 the definition 'Banking Institution' does not expressly include a banking company. It is therefore doubtful whether powers under section 35 of the State Bank of India Act, 1955 or under section 38 of the State Bank of India (Subsidiary Banks) Act, 1959 can be exercised for the purpose of such merger. As far as the power of the Central Government is concerned a scheme under section 9(2) (c) cannot be framed for the purpose of merger of a banking company with State Bank of India or subsidiary bank.

g) Merger/Amalgamation in the cooperative banking sector

As co-operative banks are under dual control, with both the RBI and the RCS (Registrar of Co-operative Societies) .for merger to take place the RBI must issue a no-objection certificate (NOC) to RCS. Amalgamation and mergers of co-operative banks falls under the purview of the RCS.

Reserve Bank of India will consider proposals for merger and amalgamation in the urban banks sector in the following circumstances:

1) When the networth of the acquired bank is positive and the acquirer bank assures to protect entire deposits of all the depositors of the acquired bank;

2) When the networth of acquired bank is negative but the acquirer bank on its own assures to protect deposits of all the depositors of the acquired bank; and

3) When the networth of the acquired bank is negative and the acquirer bank assures to protect the deposits of all the depositors with financial support from the State Government extended upfront as part of the process of merger.

The Reserve Bank also proposes that in all cases of merger/amalgamation, the financial parameters of the acquirer bank post merger will have to conform to the prescribed minimum prudential and regulatory requirement for urban co-operative banks. The realizable value of assets will have to be assessed through a process of due diligence. (See detailed guidelines in the annexure)

h) Amalgamation of Banking and Non-Banking Companies Position regarding

In the case of an amalgamation of a banking company with a non-banking company or vice versa apart from approval of their shareholders and that of the Reserve Bank of India, the sanction of High Court concerned should also be obtained as required under sections 391/394 of the Companies Act, 1956. A typical example of such a merger would be that of ICCI with ICICI Bank.

CHAPTER IV: EMPLOYMENT ISSUES IN BANK MERGERS

Pursuant to merger and acquisition many issues arises and one such issue is related to human resource,viz.rights of employees.The Banking Regulation Act,1949 provides certain provisions to address these issues which have been discussed in detail with case laws

Amalgamation of Banks And Right of employees.- In case of restructuring many issues arises and one such issue is rights of employees. It could happen that on amalgamation, the terms and conditions of the transferred employees were not the same as of original employees of the transferee bank. More often than not the terms and conditions of the transferred employees were inferior to that of the original employees of the transferee bank. To tackle this situation Second proviso was inserted in Sec.45(5)(i)to give a period of three years to the transferee bank to enable it to give to the transferred employees the emoluments and terms and conditions of service which were being given to the existing employees of the transferee bank. The use of the expression 'pay' or 'grant' in the Section seems to imply that the transferee bank was required to give something more than what the transferred employees were originally getting from the transferor bank. If the intention of the Legislature was that with the promulgation of the scheme there should be no difference in the conditions of pay, remuneration, etc. between the transferred employees and that of the existing employees of the transferee bank, then the protection contained in Sec. 45 (5) *(i)* would not have been there and, *secondly,* the second proviso would have clearly stipulated that on a scheme being promulgated, notwithstanding the provisions of Sec. 45 (5) *(i),* all the employees of the transferee bank including employees like the petitioner, will get same remuneration and will be entitled to the same terms and conditions of service. No such provision has been incorporated in the Act or in the scheme. Clause 12 of the scheme or the second proviso of Sec. 45 (5) *(i)* cannot be read as to take away the vested rights of the transferred employees which rights were that their remuneration as well as the terms and conditions of service were not to be adversely affected.[33]

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[33] *M.S. Jasra* v. *Governor, R.B.L, 1994 (3) Bank L.J.* 274 *at p. 279 (Delhi); Indian Bank* v. K. *Usha, (1998) 2 S.C.C. 663 at p.* 675 *(S.C.).*

Arrears of Salary is a liability to be discharged by the transferor Bank.—*In the instant case it* was contended by the learned counsel for the respondent that under the scheme, the assets and liabilities are to be taken over by the appellant Bank and, therefore, the employment of the appellant is one of the liabilities. Judicial review being one of the basic features of the Constitution, the appellant cannot be prevented to avail of the judicial review against the appellant Bank. As far as service conditions are concerned, in view of the specific provision in the scheme contained in paras. 3 and 10 of the notification arrears of salary is a liability to be discharged by the transferor Bank and not of the appellant Bank.[34]

Age of retirement according to rules of transferee bank.—*In* the case of *S.P. Dubey* v. *M.P.S.R.T.C. Corpn.*[35] the employees of a company were to superannuate at the age of 60 years. This company was taken over by the State Government. Assurance was given that the terms and conditions of the employees of the erstwhile company would not be adversely affected. The State Service Rules, however, fixed the age of superannuation at 58 years. The Supreme Court held that the transferred employees who were to retire at the age of 60 years would not be liable to retire at the age of 58 years and the State Service Rules were not applicable. It is submitted by Mr. Bhatt that the Supreme Court based its conclusion on the fact that there was an assurance given by the State Government that the retirement age of the employees of the erstwhile company would not be reduced. He submits that there is no such assurance in the present case. This submission cannot be accepted. While in *S.P. Dubey's* case there was only an administrative assurance that the retirement age would not be reduced, in the present case on the other hand, there is a statutory assurance contained in Sec. 45 (5) *(i)*. The assurance contained in this provision coupled with CI. 10 of the scheme gives a right to an employee like the petitioner to continue to remain in service till the age of 60 years. The ratio of the decision of the Supreme Court in *S.P. Dubey's* case is clearly applicable in the instant case as well.[36] Further court has held that pursuant to merger status,pay,seniority ,increments of employee will be protected.

[34] *Bank of Baroda v. Rajender Pal Soni, 1996 (1) Bank L.J. 218 at p. 221 (S.C).*
[35] *J.T.1990(4)S.C236.*
[36] *M.S. Jasra v. Governor R.B.I., 1992 (46) D.L.T. 665 at pp. 670,671 (Delhi): 1992 Lab. I.C. 564 (Delhi).*

Right of bank employees transferred to another bank.—The right of the employees of the banking company in the transferee bank on continuance of the service by virtue of such a provision in the scheme as provided in CI. *(i)* of thh-section (5) is merely that which is contained in the proviso there under, that is, that the transferee bank would treat them at par with its-own employees of ^responding rank or status subject to the qualifications and experience Respective of the earlier terms and conditions of service. In other words, if the Scheme provides for continuance of the services of the employees in the transferee hank then beyond a period of three years from the date on which the scheme is sanctioned by the Central Government, the transferee bank cannot discriminate between such employees and its other employees of corresponding rank or status. The only right of such an employee whose service is so continued is, therefore, to claim parity with the employees of the transferee bank itself of corresponding rank or status subject to equivalent qualifications and experience and no more. The right of such an employee is provided in the proviso to CI. *(i)* and not in the earlier enacting part of CI. *(i)* of sub-section (5) as claimed by respondent No. 1 and upheld by the High Court.[37]

When the employee is appointed on the same terms and conditions of service as were applicable to such employees immediately before the close of business on 27th April, 1985 and in accordance with the conditions of service and has been served with a charge-sheet by the transferor bank which has become extinct, it cannot be said that the charge-sheet served by the transferor bank lapses with its merger with the transferee bank. It would not be necessary to issue a fresh charge-sheet in the matter on the ground that the charge-sheet issued by the transferor bank has ceased to exist with the merger of the said bank with the transferee bank. This clearly means that the respondent continues to be in the service of the transferee bank for all intents and purposes including his liability, if any, to face the charge-sheet served on him by the transferee bank.[38]

Permission to judicial review of the scheme of amalgamation.—

When a scheme was framed u/s. 45 for amalgamation of two banks, it was *held,* that judicial review thereof was permissible only to a very narrow extent. Particularly when a dispute

[37] *The Chairman, Canara Bank, Bangalore v. M.S. Jasra, A.I.R. 1992 S.C. 1100 at pp. 1105,1106.*
[38] *Canara Bank* v. *Y.L. Sharma, 1991 (1) A.L.T. 446 at p. 451.*

regarding equivalence of experience had been decided by an expert body like RBI, the High Court could not sit in appeal, in its writ jurisdiction, over the decision of RBI. In the facts, the High Court observed that it was satisfied that the transferee bank and exercised the right of judging the equivalence of the employees of the transferor bank with the employees of the transferee bank, hence, appeal had to be dismissed[39]

Further,the Reserve Bank's decision that the qualifications and experience of the employees of the transferor Bank and of the employees of the transferee Bank of corresponding bank and status are same or equivalent is final. But no finality is attached to any decision of the Reserve Bank on any other matter like determining that the rank and status of an employee of the transferor bank did or did not correspond with the subordinate or clerical status[40]. Section 45 (5) (i) provides for the terms and conditions of service and remuneration. If the transferee bank does not offer the same rank or position to the employee in which he was in the transferor bank, then it would violate the provision of I the section. Under clause (ii) to the first proviso of section 45 (5) (i), the transferee bank I is not entitled to place an employee in a post of lower rank and status than the rank in the transferor bank; *State Bank of Travancore* v. *Bias Elias*[41].

It would be gross denial of the guarantee, if the employee is not given the rank and status which he had in the transferor bank, and the guarantee under clause (i) of Section 4(5) covers the terms and conditions of the service as well[42] .

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[39] *Davis Kuriapev. UOI,* 2002 (H) LLJ 87a(Ker-DB): 2002 (5) ALT 12 (DN-OHC)]

[40] Ibid

[41] AIR 1971 SC 143.

[42] Travancore v General Stores, 1978 (50) Com. Cas. 412

CHAPTER V:TAX ISSUES IN BANK MERGERS

Amalgamation v/ sec. 2 (1B7 of the I.T. Act.

The term amalgamation used in the I.T. Act refers only to amalgamation in relation to companies and not other amalgamations. In case where company 'A' amalgamates with and merge into company 'B' and the shareholders of company 'A' are allotted shares in company 'B' then question arose whether those shareholders are liable to pay tax under head 'capital gains [Kanga, Palkhiwala and Vyas, The law and practice of Income Tax; 9th Edition, Laxis, Nexis, New Delhi, 2004, p. 1138]? No such tax would be payable unless the amalgamation involves : -

(a) a transfer

(b) a sale

(c) an exchange

(d) a relinquishment of the asset, or

(e) the extinguishment of any right therein.

It is clear that such amalgamation doesn't involve any transfer or sale of the shares of company. Merger, doesn't involve an exchange.

Amalgamation – Tax benefits

Unabsorbed depreciation and post losses of amalgamating company :-

These benefits can b claimed provided the assesses is the same, but since amalgamation results in a different assessee, the right to carry forward these benefits would be lost due to amalgamation. However, s. 72A of I.T. Act provides certain exemptions.

In cases where '' takes over the assets of 'A' at a higher value than the written down value, then for tax purpose, the same value as applicable to A, before

amalgamation should be considered.

Benefits v/ sec. 80 HH, 80HHA or 80 J of the I.T. Act :-

The benefit could be enjoyed under these sections, by the new unit and not by the owner of the new unit. The problem relating to the carry forward of the benefit available t the amalgamated company and the scheme of amalgamation takes effect before the 8 year period contemplated by sec. 80J. The same would arise in case of sec. 80HH provided such amalgamation comes into effect before the 10 year period contemplated by s. 80HH. The amalgamated company an take over the new unit, and the benefit under sec. 80J would be continued to the new unit even after amalgamation. This benefit which is granted to the new business can be carried forward by the amalgamated company.

Treatment of bad debts :-

Where due to amalgamation, debts of the amalgamating company have been taken over by the amalgamated company and subsequently such debt or part of the debt becomes bad, such debt or part of the debt becomes bad, such debt will be allowed as deduction to the amalgamated company. The decision of the S.C. in CIT vs. Veerabhadra Rao, K. Koteshwar Rao & Co[43] is significant. In this case court held that the successor to the business is entitled to claim bad debts of the predecessor but where the transferor bank was merged with the transferee company and the income-tax, surtax liabilities were claimed as eligible for deduction as revenue expenditure. The Court held that the liabilities arose under an amalgamation scheme and not in the course of its business and therefore not deductible. Industrial Credit and Development Syndicate Ltd. v. CIT[44] following Dashmesh Transport Co. Pvt. Ltd. v. CIT[45].

[43] 1985) 1551 TR 152)
[44] (1992) 196.1TR 574 (Kar)
[45] 1980) 125 ITR 681 (P&H).

CHAPTER VI:COMPETITION LAW ISSUES IN BANK MERGERS

A good deal of the debate on competition effects from bank consolidation has been prepared in terms of the conflict between two competing hypotheses or paradigms. The structure conduct performance (SCP) paradigm, going back to Mason[46] and Bain[47], highlights reductions in competition and increase in market power through firm growth and concentration. In contrast, the efficient structure (ES) patadigm, related to Demsetz[48] and peltzman[49] rather emphasized that differences in market shares reflects superior efficiency of growing firms. The main idea behind these two paradigms is that a merger has two effects: first,it enlarges the market share of merged firm; second, it may lead to efficiency gains in terms of a reduction in the cost of the merged firm.The first effect leads to upward pressure on prices. The second effect tends to reduce prices.

As far as Indian legal regime with respect to competition is concerned the MRTP Act, which came into force on I June 1970, was the first substantive legislation in India aimed to regulating free and unfettered trade. The main object was to ensure that the economic system doesn't result in concentration of economic power to the common detriment for the control of monopolies and prohibition of monopoly and restrictive trade practices.

However after the economic reforms of 1990's, it was felt that the MRTP act had become obsolete and competition act was enacted.

It prohibit abuse of dominant position and anti-competitive practices. Sec. 4 enjoins that "No enterprise shall abuse its dominant position. "Dominant position" is the position of strength enjoyed by an enterprise in the relevant market which enables it to

[46] Mason, ES (1939): "practice & production policies of large –scale enterprises", American economic review, 29, 61-74)

[47] (Bain, JS (1956) : "Relation of profit rate to industry concentration", quarterly journal of economics, 65, 293-324)

[48] (Demsetz, H (1973) : Industry structure, market rivalry, and public policy, Journal of Law & Economics P. 16, 1-9)

[49] (Peltzman, s (1977), The gains and losses from industrial concentration", journal of law and economics, 20, 229-63)

operate independently of competitive forces prevailing in the market which enables it to operate independently of competitive forces prevailing in the market or affect its competitors or consumers or the relevant market in its favour. Dominant position is abused when an enterprise imposes unfair or discriminatory conditions in purchase or sale of goods or services or in the price in purchase or sale of goods or services. There is also abuse of dominant position when an enterprise limits / restricts production of goods / services or technical or scientific development, acts in manner which denies market access, prevails upon contracting parties to be contractually bound by acts which are not a part of the intent of the parties as well as by the use of dominant position in one relevant market t enter or protect another relevant market.

The competition act also is designed to regulate the operation and activities of "combinations" a term which contemplates acquisitions, mergers or amalgamations. Under the Competition Act, the key term for mergers is 'combination[50]'. S. 6(1) of the Act says that the no person or enterprise shall enter into a combination which causes or is likely to cause an 'appreciable adverse effect on competition' within the relevant market in India and such a combination shall be void. Thus the clause speaks only about the 'appreciable adverse effect on competition' and the dominant position of undertaking is not the sole criteria. Thus the focus is upon competition only. Therefore prima-facie, this clause seems to be closer to the US term (lessening the competition). However, like EU regulation, the Competition Act lays down the factors to be considered by the Commission while determining the effect of competition. The Act makes it mandatory for Commission to have regard to all or any of the following factors[51]:

a) Actual and potential level of competition through imports in the market;

b) Extent of barriers to entry into the market;

c) Level of combination in the market;

d) Degree of countervailing power in the market;

e) Likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;

f) Extent of effective competition likely to sustain in a market;

[50] Defined in S. 5 of Competition Act, 2002. This definition includes mergers.

[51] S. 20(4) of Competition Act, 2002.

g) Extent to which substitutes are available or are likely to be available in the market;

h) Market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;

i) Likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;

j) Nature and extent of vertical integration in the market;

k) Possibility of a failing business;

l) Nature and extent of innovation;

m) Relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;

n) Whether the benefits of the combination outweigh the adverse impact of the combination, if any.

CHAPTER VII:MERGER REVIEW PROCESS BY RESERVE BANK OF INDIA

Reserve bank of India has laid down guidelines for the process of merger proposal, determination of swap ratios, disclosures, the stages at which boards will get involved in the merger process and norms of buying and selling of shares by the promoters before and during the process of merger.

Reserve bank of India (RBI) in its capacity of the primary regulator and supervisor of the banking systems has information on the present functioning of all the banks in India, the RBI is the best suited to undertake the merger review process.

While undertaking the merger review process, RBI will need to examine the proposal for the merger from a prudential perspective to gauge the impact on the stability and the financial well being of the merger applicants and on the financial systems. In addition to the assessment of the proposed merger on the competitiveness and stability of the financial systems, RBI will also need to examine the implications on regional development, impact on society etc. as a result of merger since banks in India also have to fulfill have to fulfill various social obligations.

The RBI will need to examine the reasonableness of financial projection, including business plan and earning assumptions as well as the effect of the proposed merger on the merged entity's capital position. Finally RBI will have to consider potential changes to risk profile and the capacity of the merger applicants ' risk management systems, particularly the extent to which the level of risk would change as a result of the proposed merger and the merged entity's ability to measure, monitor and manage those risks.

It is further stated that Reserve bank is central bank of the country and acts as banker to the government. It plays an important role in the economy and financial affairs of India and one of its important function is to regulate the banking system in the

country[52]. Every banking company is bound to carry its business bank and the object of banking regulation act of the discharge this function RBI has been given power under the act. For example sec. 45 mandates the RBI to act in the interests of the banking system of the country as a whole". In Piara Lal Anand vs. S.B.I.[53] it was held that "the banking regulation act, at every turn makes the reserve bank the authority to sanction, permit, certify, inspect, advise, control, direct, license and prohibit. There is hardly any provision where the Reserve Banks judgement is not made final vis-à-vis a banking company except rarely where an appeal to the central government can lie."

Similarly v/ sec. 45 Reserve Bank can exercise its power for obtaining moratorium and safeguarding the rights of employees [s. 45 (5)(i)]as it has knowledge of entire banking structure of company as a whole and there is no apprehension that it will act arbitrarily.Thus,the most important function of RBI is to regulate and supervise the Banking system of country and while examining a merger deal it will keep in mind aims behind such mergers,its impact on financial system of country ,competitiveness in market and its socio-economic effects.Thus,we can say that Banking Regulation Act gives wide power of merger review to Reserve Bank of India.

[52] Canara Bank v. P.R.N. Upadhyaya; AIR 1998 SC 3000
[53] 1972 II LLJ, 495 (del)

CHAPTER VIII:CASE STUDY

Merger/Amalgamation of Global Trust Bank with Oriental Bank of Commerce- A Case Study:

The Reserve Bank had granted license to Global Trust Bank (GTB) Ltd. In September 1994 as a part of the policy to set up new private sector banks. The bank was promoted by a group of professionals led by Dr. Jayanta Madhab and Shri Ramesh Gelli, the then Chairman of Vysya Bank Ltd. with the participation of International Finance Corporation (IFC) and Asian Development Bank (ADB) as associates.

The financial position of GTB started weakening in 2002 due to very high exposure to capital market which had turned into problem assets. After it came to the notice of the Reserve Bank that the bank had incurred huge net loss in 2002, it was put under close monitoring. The bank was instructed to adopt a prudential policy of containing growth of risk weighted assets, to make maximum recoveries of NPAs, to reduce its high capital market exposure to the prudential limit, provide against impairment of assets out of the operating profits and to take immediate steps to augment the capital.

The bank reported some progress in making recoveries and also the attempts underway to have equity infusion. However, it was not able to finalize a programme of capital augmentation till June 2004 through domestic sources as advised. Later, the bank submitted in July 2004, a proposal received from an overseas equity investor fund for recapitalization of the bank. The proposal was not found acceptable by Reserve Bank on prudential and other considerations.

As the financial position of the bank was deteriorating progressively and the solvency of the bank was being seriously affected, the Reserve Bank had to place the bank under moratorium on July 24, 2004 to protect the interests of the large body of small depositors of the bank and in the interest of the banking system.

A firm proposal for merger of the bank was received from Oriental Bank of

Commerce (OBC). OBC's perception on the issue was examined by the Reserve Bank, keeping in view, its financial parameters, its retail network and synergies as well as strategic advantages. Taking into account the interests of OBC and depositors of GTB, as well as the bank's strengths and weaknesses, GTB was merged with OBC with effect from August 14, 2004 under the powers vested with the Reserve Bank under the Banking Regulations Act, 1949 through a scheme sanctioned by the Government of India.

FINANCIALS BEFORE AND AFTER

Oriental Bank of Commerce:

Company Profile:

Oriental Bank of Commerce (OBC) is a Delhi Based public sector bank with a Major presence in northern India. With the recent acquisition of the ailing erstwhile Global Trust Bank (GTB), OBC has expanded its presence in the Southern and Western India. The bank caters to the Corporate, Retail and the Agricultural sector With various loan and fee based products. It reaches out to its 8mn strong customer base through a network of 1121 branches and 396 ATMs.

At FY04, the bank held a market share of 2.2% and 2.4% in credit and deposit respectively of all the SCBs In India. The financial of the OBC given bellow before GTB merger. Just by seeing the number we can tell that financial condition of OBC bank is quit strong. There is a clear 50% increase in the net profit from 2003 to 2004 and maintaining 14% CAR (Capital Adequacy Ratio) is sign of financial soundness.

	OBC financial result as on 31 march 2004	All figure in crore	
		31.03.04	31.03.03
S.N	Particulars		
1	Interest Earned	3300.54	3304.27
2	Other Income	721.71	531.39

	(A) TOTAL INCOME (1+2)	4022.25	3835.66
3	Interest Expended	1844.74	2089.94
4	Operating Expenses	644.48	582.66
	(B) TOTAL EXPENDITURE	2489.22	2672.6
	(c) OPERATING PROFIT /LOSS (A-B)	1533.33	1163.6
	(D)Other provisions and contingencies	387.43	427.55
	(D)Other provisions and contingencies	387.43	427.55
	(E)Provision for Taxes	459.53	278.56
	(F)Net Profit/Loss(C-D-E)	686.07	456.95
5	Analytical ratio		
	Capital adequacy ratio (%)	14.47	14.04
	Earning per shares(in RS)	35.63	23.73

Global Trust Bank:

Global Trust Bank Ltd., (GTB) was placed under an Order of Moratorium on July 24, 2004. The option available with the Reserve Bank was to compulsory merger under section 45 of the Banking Regulation Act, 1949. Oriental Bank of Commerce (OBC) interest was examined by the Reserve Bank of India keeping in view its financial parameters, its retail network and its synergies as well as strategic advantages. GTB strongly present in western part of India having 1 million costumer and 1300 employees taken over by OBC.

If we see the financial of the GTB before to the merged with the OBC it is quite evident that Net profit was continuously deteriorating.

	OBC financial result as on 31 march 2004	All figure in crore	
		31.03.04	31.03.03
S.N	Particulars		
1	Interest Earned	354.19	539.59
2	Other Income	161.06	191.36

	(A) TOTAL INCOME (1+2)	515.25	730.95
3	Interest Expended	435.13	517.41
4	Operating Expenses	158.91	177.1
	(B) TOTAL EXPENDITURE	594.04	694.51
	(c) OPERATING PROFIT /LOSS (A-B)	-78.79	36.44
	(D)Other provisions and contingencies	708.19	309.09
	(E)Provision for Taxes	25.4	0.05
	(F)Net Profit/Loss(C-D-E)	-812.38	-272.7
5	Analytical ratio		
	Capital adequacy ratio (%)	0	0
	Earning per shares(in RS)	-66.94	-22.47

OBC after merger with GTB-

As per the scheme of amalgamation notified by the Government of India the erstwhile Global Trust Bank Ltd. (GTB) has been amalgamated with Oriental Bank of Commerce w.e.f. 14.08.2004.

It is observed that as per the scheme of amalgamation the valuation of Assets and the determination of Liabilities have been made by the Auditors nominated by the Reserve Bank of India and the assets are classified into Readily Realizable and Not Readily Realizable

The excess of liabilities over assets taken over amounting to Rs. 1225.72 crores has been debited to an account titled "Amalgamation Adjustment Account" and included under Other Assets. The Bank has decided to write off the intangible asset "Amalgamation Adjustment Account" equally over a period of five years commencing from the year ended March 31, 2005.

We can see the financial of the OBC after merger with GTB %CAR gown down significantly from 14 % in 2004 to 9% in 2005 and net profit gown up just up by just 10% in 2005 one should keep in mind that before merger this figure was 50%.

	OBC financial result as on 31 march 2004	All figure in crore	
		31.03.04	31.03.03
S.N	Particulars		
1	Interest Earned	3571.9	3300.54
2	Other Income	505.2	721.71
	(A) TOTAL INCOME (1+2)	4077.1	4022.25
3	Interest Expended	2048.22	1844.74
4	Operating Expenses	795.73	644.48
	(B) TOTAL EXPENDITURE	2843.95	2489.22
	(c) OPERATING PROFIT /LOSS (A-B)	1233.15	1533.33
	(D)Other provisions and contingencies	400.15	387.43
	(E)Provision for Taxes	72.19	459.53
	(F)Net Profit/Loss(C-D-E)	760.81	686.07
5	Analytical ratio		
	Capital adequacy ratio (%)	9.21	14.47
	Earning per shares(in RS)	39.51	35.63

The Detail of Asset and Liabilities Taken Over are as under

(Amount in crore)

Liabilities	Rs	Assets	Rs
Deposits	5187.87	Cash and Bank Balance	367.12
Borrowings	185	Balance with Banks	162.44
Other Liabilities and Provision	692.04	Investment	1808.9
		Advances	1712.97
		Fixed Assets	252.69
		Other Assets	534.87
		Excess of liabilities over assets taken over	1225.72
Total	6064.71	Total	6064.71
Contingent liabilities	2083.17		

The accounting treatment for the amalgamation is given on the basis of the purchasing method as per the accounting standards 14 'accounting of the amalgamation' issued by the institute of chartered accountants of the India. The prudential norms in respect of the investment and advances taken over have been applies on an ongoing basis.

Challenges in front of OBC after merger with GTB-

a) Recovery of the bad loans:

For OBC acquisition of GTB rather than a matter of choice, was a mandate from the Government. Standalone OBC had a gross NPL (non performing loan) ratio of 6.2% and amounting to Rs12.1bn less than GTB's Rs13.4bn. The bank had 100% provision coverage and As a result the incremental loan loss provision (LLP) was voluntary which was seen in OBC's LLP in the first quarter, which was zero. The bank could absorb EGTB's bad Loans and make provisioning without excessively straining its accounts. OBC is hoping for a recovery of 75-80% of the bad assets either through cash Recoveries or up-gradations and restructuring. The bank has upped its expectations From the earlier 65-70% on back of strong recovery during FY05. Although 75-90% Could be recovered, we feel even if 60-65% is recovered the acquisition cost could Fall significantly.

Table : GTB bad loan recovery progress

(Rs bn)	Dec – 04	Mar - 05
Cash Recoveries	1.0	2.0
Restructuring	3.6	4.1
Up gradation	0.5	0.6
Total	5.0	6.7
Settlements already approved	3.0	4.5
Criminal cases filed	3.0	9.8

Source : Company

OBC could very well achieve its earlier status of Zero NPA by the end of FY06, Provided it achieves its recovery targets and incremental slippages are kept under Control. This is possible as the bank has a good risk management system in place and with low NPA level can concentrate on faster recoveries.

b) Managing Human resources:

For any merger to successful it is very important to handle the issue of the human resources this fact is true with this merger. At the time of the merger it was announced that Oriental Bank of Commerce will retrain the staff of Global Trust Bank to enable them to carry out lending activities at branch level and attain three times more business from the acquired unit. It is fact that of the 1,300 staff of GTB, 160 has quit after the merger despite OBC offering job protection and retaining their high pay package.

At present, GTB branches are functioning as OBC branches following lifting of the The bank is also on a recruiting spree to bolster its manpower requirement for the increased number of branches and in view of expanding business by 30 per cent to Rs 80,000 crore in coming year.

c) IT implementation-

In this merger IT plays an important role because both bank GTB and OBC both enjoyed same IT platform before merger so in this merger there was no issue as far as the IT implementation is concerned. OBC has gained a significant amount just because both enjoys same IT platform.

This is the classic case of the merger in banks where in both bank gains significantly Oriental Bank of Commerce stands to gain about Rs 950 crore including Rs 300 crore in tax benefit, from this merger. On the other hand GTB regains this customers and credibility.

ICICI Ltd. and ICICI Bank Merger

The merger of ICICI Bank and ICICI Ltd is a case of a Developmental Financing Institution merging with a Commercial Bank and emerging into an Universal Bank. reflect new trends in the banking and financial services sector.

The merger between ICICI Bank and ICICI Ltd. pioneered the concept of Universal Banking in India. Taking the reverse merger route ICICI Ltd. Merged with its erstwhile subsidiary, ICICI Bank. The swap ratio has been decided at 2:1 that is 1 share of ICICI Bank for every 2 shares held in ICICI Ltd. It was also supposed to include merger of two ICICI subsidiaries, namely, ICICI Personal Finance Services Limited and ICICI Capital Services Limited with ICICI Bank.

At the time of merger, ICICI Ltd was holding (held) 46 per cent stake in ICICI Bank. In the case of merger, instead of extinguishing the shares, the company has decided to transfer the stake to a Special Purpose Vehicle (SPV) to be created in the form of a trust. Post merger, this was to form about more than 16 per cent of the total capital. This is an intelligent move by the company, as it would serve many purposes. First of all it is not prudent to extinguish capital in a scenario where the cost of raising capital itself is very high. Secondly, by doing so the bank would be able to safeguard its capital adequacy ratio. Thirdly, the plan is to divest the stake to a strategic partner few years down the line, which would fetch the bank considerable amount of cash. The shares would be transferred to the SPV at the price at which ICICI bought the shares i.e. Rs 12 per share.

Reason for Merger

1 Analysts say ICICI wanted to merge with its banking subsidiary to obtain cheaper funds for lending, and to increase its appeal to investors so that it can raise capital needed to write off bad loans.

- This merger was basically a survival, more for ICICI, as its core business didn't look too good and they needed some kind of a bank because only a bank has access to low-cost funds.
- Cheap Cash was another reason for merger.

Main Concerns

- A major concern in the road ahead to the merger was the reserve requirement

that a bank was supposed to maintain. At that time these requirements were not applicable to ICICI Ltd. A bank has to maintain a Cash Reserve Ratio of 5.5 per cent with RBI and Statutory Liquidity Ratio of 25 per cent. ICICI required a total of Rs.18,000 crore to fulfill this requirement. This was a huge amount and given the scenario of that time and it was difficult for the institutions to raise such an amount. The group planned to raise the required funds partly through ICICI and partly through ICICI Bank.

- Another issue was of fulfilling the priority sector lending requirement. This requirement at the time of merger was at 40 per cent i.e. 40 per cent of the lending was to be made to priority sectors.

Benefit to the Players

- The main objective of adopting the path of Universal Banking is that financial institutions are finding it increasingly hard to survive in a scenario of high cost of borrowing and decreasing spread with interest rates going down. Cost of borrowing for a financial institution through bonds is much higher than a bank, which can raise current and saving deposits. As per regulations, financial institutions cannot raise these deposits. Post merger it would be possible to do so.
- Also increasing disintermediation had made things increasingly difficult for ICICI Ltd. Some of the customers of ICICI Ltd. were in a position to access funds at much lower cost than from ICICI Ltd. and ICICI Ltd. could not afford to lend at that rate as its own cost of funds was high. Once converted into a bank, its access to cheap funds would enable it to lend at competitive rates.

ICICI Ltd. as a combined entity would be better equipped to handle issues arising from potential asset liability mismatches due to more stable deposit base.

- Post merger ICICI Bank would be able to significantly enhance its fee based income based on the strength of its balance sheet. Before the merger, ICICI Ltd. could not carry out certain activities as it was not a bank and therefore loses out on the fee based income. ICICI Bank on the other hand was constrained because of the limited size of its balance sheet. The sheer size of the balance sheet post merger would boost the fee based income.
- The high margin retail loan portfolio before the merger was with the various

subsidiaries. Post merger this was to be transferred to ICICI Bank.

The Negative Side of the Merger

- The assets quality of ICICI Bank, which has been its major strength, would be affected post merger. ICICI Ltd. had NPAs of 5.2 per cent for FY01 as against ICICI Bank's NPAs of 1.4 per cent.
- Before the merger, ICICI Ltd. could claim a deduction upto 40 per cent of its profits from its long term lending by transferring the amount to special reserve. Post merger, this benefit was to stand withdrawn in the case of incremental loans.
- Average cost of borrowing for ICICI Ltd. for financial year 2001 was 11.71 per cent. Its Gross yield was 13.54 per cent for the same period. Either way ICICI Ltd. would have to take a hit in the bottom-line in the initial years.
- By bringing down its loan portfolio and diverting these funds for the reserve requirement it would have to forego some of the interest spread.
- CRR would get a return of 6.5 per cent and amount in SLR would generate a return of about 9.5 per cent. Even in the case of fresh funds the cost of borrowing would be higher and the return on those funds would be less.

Some Financial Parameters at the time of Merger

Particular	ICICI Ltd.	ICICI Bank
MP at the time of merger (Rs.)	51	101
EPS (Rs.)	15.4	11.9
Book Value (Rs.)	102.8	65.5
MP/ Book Value	0.50	1.54
PE ratio	3.3	8.5

ICICI group has pioneered the concept of universal banking in India. IFCI Ltd is also in the process of merging with PNB. The concept of universal banking has found favour with many global players. Some of the international players, which have realized the benefits of universal banking are ABN-AMRO, Citigroup, HSBC, UBS etc. No doubt in the times to come the benefits of this will start flowing in.

Punjab National Bank and New Bank of India Merger

The case of Punjab National Bank and New Bank of India is a case of two Public Sector Banks merging together as a solution to protect a weak bank (New Bank of India) by merging with a healthy bank (PNB).

The first case (PNB-NBI) reflects the old thinking in the banking and financial services sector.

In year 1970 fourteen banks including PNB were nationalized. In 1980 six more banks including New Bank of India were nationalized. Both these banks were merged in 1993 by the Central Government. The New Bank of India was incurring losses and by the year 1991-92, its financial position had become so bad that its capital and deposits completely stood eroded. Punjab National Bank commenced its operations on April 12,1895 from Lahore with an authorized capital of Rs. 2 lakhs and working capital limit of Rs. 20,000/- . The Bank has more than 100 years of history and has faced many financial and other crises in the Indian financial system over these years.

New Bank of India was a comparatively small bank among the nationalized banks. It had around 600 branches all over the country with 12,400 employees and was having 2,500 crores of deposits and advances Rs. 970 crores. Whereas PNB was working with 3734 branches all over the country with total employees numbered 71,650. it was having total deposits of Rs. 25,280 crore and advances of Rs. 12,078 crore. This was the first case in the Indian History that one nationalized bank was merged with another nationalized bank. The basic reasons for this merger were as follows:

– The New Bank of India was in loss consecutively for last three years when merger took place on 4th September, 1993.
– Productivity per employee of New Bank of India was low.
– Work ethics of the union(s) workers was low.
– Only option left out was either liquidation or merger with another bank.

Since it was a small bank having its head office in Delhi and also with the similarities of work culture of Punjab National Bank whose head office also happened to be in

Delhi, Govt. of India under recommendations of Narasimham Committee report decided to merge New Bank of India with Punjab National Bank.

Financials of the PNB and NBI at the time of Merger (1992-93)

	PNB	NBI	PNB+NBI
Capital(In Crore)	187.84	68.69	256.53
No. of Shares	187842200	186000000	373842200
Reserves (Rs. in Crore)	360.94	8.43	369.37
Profits (Rs. in Crore)	38.01	(-)75.79	(–)37.382
Earnings per Share (Rs.)	2.02	(-) 4.07	(–) 1.01
Deposits (Rs. in Crore)	18241.31	2362.32	20603.63
Advances (Rs. in Crore)	9915.21	974.81	10890.02

The PNB and NBI merger has not been a marriage of convenience. It had the seeds of long-term detrimental effect to the health of PNB. The most ticklish problem which the amalgamated entity faced was the complete absorption of the sizeable NBI workforce into its own work-culture. The NBI was notorious for rampant indiscipline and intermittent dislocation of work due to fierce inter-union rivalries.

ICICI Bank and Bank of Madura Merger

The case study of ICICI Bank and Bank of Madura is a representative case of modern thinking in the banking industry, i.e., growth through the merger route.It reflect new trend in the banking and financial sector.

Bank of Madura (BOM) was a profitable, well-capitalized, Indian private sector commercial bank operating for over 57 years. The bank had an extensive network of 263 branches, with a significant presence in the southern states of India. The bank had total assets of Rs. 39.88 billion and deposits of Rs.33.95 billion as on September 30,2000. The bank had a capital adequacy ratio of 15.8% as on March 31,2000. The Bank's equity shares were listed on the Stock Exchanges at Mumbai and Chennai and National Stock Exchange of India before its merger.

ICICI Bank then was one of the leading private sector banks in the country. ICICI Bank had total assets of Rs. 120.63 billion and deposits of Rs. 97.28 billion as on September 30, 2000. The bank's capital adequacy ratio stood at 17.59% as on September 30, 2000. ICICI Bank was India's largest ATM provider with 546 ATMs as on June 30, 2001. The equity shares of the bank were listed on the Stock Exchanges at Mumbai, Calcutta, Delhi, Chennai, Vadodara and National Stock Exchange of India. ICICI Bank's American Depository Shares were listed on the New York Stock Exchange.

In February 2000, ICICI Bank was one of the first few Indian banks to raise its capital through American Depository Shares in the international market, and received an overwhelming response for its issue of $ 175 million, with a total order of USD 2.2 billion. At the time of filling the prospectus, with the US Securities and Exchange Commission, the Bank had mentioned that the proceeds of the issue would be used to acquire a bank.

As on March 31, 2000, bank had a network of 81 branches, 16 extension counters and 175 ATMs. The capital adequacy ratio was at 19.64% of risk-weighted assets, a significant excess of 9 % over RBI Benchmark.

ICICI Bank was scouting for private banks for merger, with a view to expand its assets and client base and geographical coverage. Though it had 21% of stake, the choice of Federal bank, was not lucrative due to employee size (6600), per employee business was as low as Rs. 161 lakh and a snail pace of technical upgradation. While, BOM had an attractive business per employee figure of Rs. 202 lakh, a better technological edge and a vast base in southern India as compared to Federal Bank.

While all these factors sound good, a cultural integration was a tough task ahead for ICICI Bank. ICICI Bank had then announced a merger with the 57 year old BOM, with 263 branches, out of which 82 of them were in rural areas, with most of them in southern India. As on the day of announcement of merger (09-12-2000), Kotak Mahindra group was holding about 12% stake in BOM, the Chairman BOM, Mr. K.M. Thaigarajan, along with his associates was holding about 26% stake, Spic group had about 4.7%, while LIC and UTI were having marginal holding. The merger was supposed to enhance ICICI Bank's hold on the south Indian market.

The swap ratio was approved in the ratio of 1:2- two shares of ICICI Bank for normal every one share of BOM. The deal with BOM was likely to dilute the current equity capital by around 2%. And the merger was expected to bring 20% gains in EPS of ICICI Bank and a decline in the bank's comfortable Capital Adequacy Ratio from 19.64% 17.6%.

Financials of ICICI Bank and Bank of Madura(Rs.In Crores)

Parameters	ICICI Bank 1999-2000	ICICI Bank 1998-1999	Bank of Madura 1999-2000	Bank of Madura 1998-1999
Net worth	1129.90	308 .33	247.83	211.32
Total deposits	9866.02	6072.94	3631.00	3013.00
Advances	5030.96	3377.60	1665.42	1393.92
Net Profit	105.43	63.75	45.58	30.13
Shrae Capital	196.81	165.07	11.08	11.08
Capital adequacy ratio	19.64%	11.06%	14.25%	15.83%

Gross less NPAs/gross advances	2.54%	4.72%	11.09%	8.13%
Net NPAs/net advances	1.53%	2.88%	6.23%	4.66%

The scheme of amalgamation was expected to increase the equity base of ICICI Bank to Rs. 220.36 crore. ICICI Bank was to issue 235.4 lakh shares of Rs. 10 each to the shareholders of BOM. The merged entity will have an increase of asset base over Rs. 160 billion and a deposit base of Rs. 131 billion. The merged entity will have 360 branches across the country and also enable ICICI Bank to serve a large customer base of 1.2 million customers of BOM through a wider network, adding to the customer base to 2.7 million.

The Board of Directors at ICICI Bank had contemplated the following synergies emerging from the merger:

Financial Capability: The amalgamation will enable them to have a stronger financial and operational structure, which is supposed to be capable of grater resource/deposit mobilization. In addition to this, ICICI will emerge as one of the largest private sector banks in the country.

Branch Network: The ICICI's branch network would not only increase by 263. but also increase its geographic coverage as well as convenience to its customers.

Customer Base: The emerged largest customer base will enable the ICICI Bank to offer other banking and financial services and products to the erstwhile customers of BOM and also facilitate cross selling of products and services of the ICICI group to their customers.

Tech Edge: The merger will enable ICICI Bank to provide ATM, phone and the Internet banking and such other technology based financial services and products to a large customer base, with expected savings in costs and operating expenses.

Focus on Priority Sector: The enhanced branch network will enable the bank to focus on micro finance activities through self-help groups, in its priority sector

initiatives through its acquired 87 rural and 88 semi-urban branches.

Managing Rural Branches: Most of the branches of ICICI were in metros and major cities, whereas BOM had its branches mostly in semi urban and city segments of south India. The task ahead lying for the merged entity was to increase dramatically the business mix of rural branches of BOM. On the other hand, due to geographic location of its branches and level of competition, ICICI Bank will have a tough time to cope with.

Managing Software: Another task, which stands on the way, is technology. While ICICI Bank, which is a fully automated entity was using the package, banks 2000, BOM has computerized 90% of its businesses and was conversant with ISBS software. The BOM branches were supposed to switch over to banks 2000. Thought it is not a difficult task, 80% computer literate staff would need effective retraining which involves a cost. The ICICI Bank needs to invest Rs.50 crores, for upgrading BOM's 263 branches.

Managing Human Resources: One of the greatest challenges before ICICI Bank was managing the human resources. When the head count of ICICI Bank is taken, it was less than 1500 employees; on the other hand, BOM had over 2,500. The merged entity will have about 4000 employees which will make it one of the largest banks among the new generation private sector banks. The staff of ICICI Bank was drawn from 75 various banks, mostly young qualified professionals with computer background and prefer to work in metros or big cities with good remuneration packages.

Managing Client Base: The client base of ICICI Bank, after merger, will be as big as 2.7 million from its past 0.5 million, an accumulation of 2.2 million from BOM. The nature and quality of clients is not uniform. The BOM has built up its client base over a long time, in a hard way, on the basis of personalized services. In order to deal with the BOM's clientele, the ICICI Bank needs to redefine its strategies to suit to the new clientele. If the sentiments or a relationship of small and medium borrowers is hurt; it may be difficult for them to reestablish the relationship, which could also hamper the image of the bank.

CHAPTER IX:CONCLUSION AND SUGGESTIONS

Mergers and amalgamations and acquisitions enable banking institutions to undertake business on a larger scale. Banking Institutions not only gain in size but are also able to focus more sharply on competitive strengths. Mergers and amalgamations internationally have produced financial conglomerates that are expected to maximize economies of scale and scope by bundling the production of financial services. The general trend has been towards universal banking where banks have undertaken traditionally non-banking activities such as investment banking, insurance, mortgage financing, securitization and other financial activities with greater ease arc on the increased the global experience can be looked in this field as an important benchmark that the Indian banking sector should follow. The fear that mergers and amalgamations would leave only a few large banking institutions which would prey upon the depositors and regulators alike and would exploit the markets for is sole goal of financial benefits is untrue and unfound. A study by McKinsey indicates that 61 per cent, of the acquisitions studied were failures. The reason for merger failures could be numerous. Some of the key reasons are:

- Acquirer generally overpays
- The value of synergy is over estimated ,
- Psychological banners
- Cultural incompatibility

With adequate supervision of central banking by authorities mergers and amalgamation between banking institutions would be beneficial to the depositors and would provide long-term economic benefits to the country. Adequacies of legal provisions are a necessity for successful completion and further development of merging institutions. Banking sector in a country is its backbone, and the backbone should be supported be adequate legal mussels. The law in Indian context relating to mergers and amalgamations of banking institutions are fairly clear and adequately implemented. The need is for a policy by which a clear picture can be drawn as to what the future of Indian banking industry should be like. A proper policy in this regard would enable the Reserve Bank achieve even higher levels of market transparency and consumer confidence. That intern would be of great benefit to the

nation as a whole by proving as fuel to the economic growth.

Based on the above the following recommendations are sought to be put forward for the merger of banks in *our* country:

I. A merger policy would go a long way in reducing the inefficiencies at the time of mergers and acquisitions. There has to be a consolidation policy in place which would go a long way in guiding future merger activities, the focus of any merger policy in India should be to preserve competition, promote efficiency, protect consumers and preserve economic efficiency. The core purpose of merger policy may be described as protecting the process of competition, which ensures the efficient allocation of resources.

II. A separate legislation dealing with bank mergers won't be out of place either. The enabling guidelines could be provided by the Legislature whereas the RBI could control the routine process with the help of its directives and guidelines.

Bring an Umbrella Act governing consolidation, in both private and public sector banks, in the form of a single composite banking law that could govern all State-owned banks, the State Bank of India and its seven associate banks, and ail the 30 private banks.

III. Strategic alliances and collaborative approach, as an alternative to mergers and acquisitions, could be attempted to reduce transaction costs through outsourcing, leverage synergies in operations and avoid problems related (o cultural integration. If consolidation is taken too far, it could lead to misuse of domirtant market positions. Rapid expansion in foreign markets without sufficient knowledge of local economic conditions could increase vulnerability of individual banks.

IV. A dispassionate analysis of the potential benefits and pitfalls involved is important before going ahead with a merger. Once the decision to go ahead is announced, the focus shifts to integration. This is a task which is under estimated by most companies. In the final analysis, it is the efficiency with which the integration process is managed that decides whether projected synergies • materially.

V. Merger risks are not just financial. A failed merger can disrupt work processes,

diminish customer confidence, damage the company's reputation and cause employees to leave. A big mistake most acquirers make is to lay too much stress on strategic, unquantifiable benefits of the deal. This results in overvaluation of the acquired company. Hence, lot of attention needs to be paid to these pre-merger and post-merger issues which would in turn help to make a merger or an acquisition a successful one, proving beneficial for all the various stakeholders of both the companies.

VI. There should be no blanket ban on corporate, but at the same time there should be sufficient safeguards to take care of stakeholder and depositor interest.

ANNEXURE

Narasimham Committee

The Narasimham Committee on Banking Sector Reform was set up in December, 1997. This Committee's terms of reference include; review of progress in reforms in the banking sector over the past six years, charting of a programme of banking sector reforms required making the Indian banking system more robust and internationally competitive and framing of detailed recommendations in regard to banking policy covering institutional, supervisory, legislative and technological dimensions. The Committee submitted its report on 23 April, 1998 with the following suggestions:

- Merger with strong banks, but not with the weak.
- Two or three banks with international orientation, eight to 10 national banks and a large number of local banks.
- Rehabilitate weak banks with the introduction of narrow banking
- Confine small, local banks to States or a cluster of Districts.
- Review the RBI Act, the Banking Regulation Act, the Nationalisation Act and the State Bank of India Act.
- Speed up computerisation of public sector banks.
- Review the recruitment procedures, and the training and remuneration policies of PSU banks.
- Depoliticisation of appointments of the bank CEOs and professionalisation of the bank Boards.
- Strengthen the legal framework to accelerate credit recovery.
- Increase capital adequacy to match the enhanced banking risk.
- Budgetary support non-viable for recapitalisation.
- No alternative to the asset reconstruction fund.

Khan Group

The Group was set up by the RBI in December, 1997, under the Chairmanship of Shri S.H. Khan, the then Chairman of IDBI. The Group was to review the role and structure of the Developmental Financial Institutions and the Commercial Banks in the emerging environment, and to recommend measures to achieve coordination and harmonization of Lending policies of financial institutions before they move towards Universal Banking. Some of the recommendations of this Group are given below:

i) A progressive move towards universal banking and the development of an enabling regulatory framework for the purpose.

ii) A full banking licence may be eventually granted to DFIs. In the interim, DFIs may be permitted to have a banking subsidiary (with holdings up to 100 per cent), while the DFIs themselves may continue to play their existing role.

iii) The appropriate corporate structure of universal banking should be an internal management/shareholder decision and should not be imposed by the regulator.

iv) Management and shareholders of banks and DFIs should be permitted to explore and enter into gainful mergers.

v) The RBI/Government should provide an appropriate level of financial support in case DFIs are required to assume any developmental obligations.

Verma Group

The Reserve Bank of India set up a Working Group on Restructuring Weak Public Sector Banks, under the Chairmanship of Shri M.S. Verma, former Chairman, State Bank of India, to suggest the measures for revival of weak Public Sector Banks. The group has gone deep into the issue and analyzed the problem fully and made specific suggestions. The summary report of this is given in the appendix to this unit. This group has identified some core principles for incorporation into the future restructuring strategies for weak banks. They are reproduced below from the report.

Future restructuring strategies for weak banks must incorporate the following core principles:

a) ***Manageable Cost***: The restructuring effort that is embarked upon has to be at the least cost possible. However, the fact that injudiciously chosen lower cost alternatives may lead to much higher costs in the long term must not be lost sight of.

b) ***Least Possible Burden on the Public Exchequer***: As far as practicable the cost of restructuring must come out of the unit being restructured. Even if its contribution to the cost of restructuring is not available upfront, it should be possible to recover this later, out of the value that can be created by the restructuring. The need to minimise the burden of such cost, preferably initially, but certainly finally is obvious and cannot be overstated. Any plan for restructuring which does not clearly result in value addition at the end of the exercise, is not worth attempting.

c) ***All Concerned must Share Losses***: The restructuring strategy as also the instruments employed in the implementation of this strategy have to make a clear statement about the manner in which the losses already incurred and to be incurred have to be shared. The principle of sharing of losses will have to remain fully operative in both operational and financial restructuring envisaged for a bank. Such a plan for sharing losses will include reduction in staff as well as all other administrative cost of operations.

d) ***Changes for Strong Internal Governance***: The internal governance of the banks and their operations at all levels has to be strengthened and fully sensitised to the needs of protecting against all foreseeable future problems. Restructuring always involves some amount of destabilisation in the organisation and during this period as also immediately after it, management and all its operatives have to make sure that the

intended benefits of the restructuring plans are not allowed in any way to be frittered away or lost due to delays and lack of diligence in its implementation

e) ***Effective Monitoring and Timely Course Corrections***: Individual restructuring plans are to be implemented by the banks concerned internally and their success will depend upon the quality of governance and organisational commitment to the proposed restructuring. However, for a successful restructuring it is important that there is an independent agency which will own it and in the process of driving it forth, constantly monitor its progress. This role can be played by the owner but such an arrangement has limitations because of the conflict of interests that are likely to arise in such cases and the lack of time and skill for the job, which the owner may suffer from. It will be more so when the ownership of the banks is with the government. For obvious reasons, this responsibility cannot be given to the regulator either. The regulator will no doubt have interest in the success of the restructuring programme but direct efforts on its part to ensure its implementation could result in conflict of interests. The objective can, therefore, be best achieved by an independent agency, which with the express consent of the owner shall have full authority over the restructuring process and be in a position to effectively monitor its progress. In this process, while this independent agency will monitor to ensure that the restructuring process remains on course, wherever necessary it shall also take steps to facilitate due implementation of the plan. Such steps by this agency may include devising corrective measures and ensuring that the banks concerned adopt these measures.

f) ***Ease of Implementation***: Above all there must be an all-round consensus on the process of restructuring, its modalities and timing. The process itself and all the attendant instruments and instrumentalities will have to be simple and easy to employ. While setting the core principles, which should govern any programme of bank restructuring is not so difficult, deciding upon precise modalities of restructuring, is indeed, quite a vexatious and difficult issue to settle. As can be learnt from international experiences various modalities and quite a few variations of each of these modalities have been tried with varying degrees of success. In their time and given socio-economic environment each of these options chosen had good logic behind them. While, therefore, they have their applicability and merit these are certainly not transplantable where the prevailing conditions are different.

THE BANKING REGULATION ACT,1949

Sec.5(b): **"banking"** means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.

Sec.5(c) :**"banking company"** means any company which transacts the business of banking [3] in India; Explanation: Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause;

Sec.5A : Act To Override Memorandum, Articles, Etc.- Save as otherwise expressly provided in this Act, (a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a banking company, or in any agreement executed by it, or in any resolution passed by the banking company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of the Banking Companies (Amendment) Act, 1959 (33 of 1959); and (b) any provision contained in the memorandum, articles, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the provisions of. this Act, become or be void, as the case may be.

Sec.44A [1] Procedure for amalgamation of banking companies.- (1) Notwithstanding anything contained in any law for the time being in force, no banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by the resolution passed by a majority in number representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a

meeting called for the purpose. (2) Notice of every such meeting as is referred to in sub-section (1) shall be given to every shareholder of each of the banking companies concerned in accordance with the relevant articles of association, indicating the time, place and object of the meeting, and shall also be published at least once a week for three consecutive weeks in not less than two newspapers which circulate in the locality or localities where the registered offices of the banking companies concerned are situated, one of such newspapers being in a language commonly understood in the locality or localities. (3) Any shareholder, who has voted against the scheme of amalgamation at the meeting or has given notice in writing at or prior to the meeting to the company concerned or to the presiding officer of the meeting that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the Reserve Bank, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank when sanctioning the scheme and such determination by the Reserve Bank as to the value of the shares to be paid to the dissenting shareholders shall be final for all purposes.

(4) If the scheme of amalgamation is approved by the requisite majority of shareholders in accordance with the provisions of this section, it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank by an order in writing passed in this behalf, be binding on the banking companies concerned and also on all the shareholders thereof. [2] 1 (6) On the sanctioning of a scheme of amalgamation by the Reserve Bank, the property of the amalgamated banking company shall, by virtue of the order of sanction, be transferred to and vest in, and the liabilities of the said company shall, by virtue of the said order be transferred to, and become the liabilities of the banking company, subject in all cases to [3] the provisions of the scheme as sanctioned. [4] (6A) Where a scheme of amalgamation is sanctioned by the Reserve Bank under the provisions of this section, the Reserve Bank may, by a further order in writing, direct that on such date as may be specified therein the banking company (hereinafter in this section referred to as the amalgamated banking company) which by reason of the amalgamation will cease to function, shall stand dissolved and any such direction shall take effect notwithstanding anything to the contrary contained in any other law. (6B) Where the Reserve Bank directs a dissolution of the amalgamated banking company, it shall

transmit a copy of the order directing such dissolution to the Registrar before whom the banking company has been registered and on receipt of such order the Registrar shall strike off the name of the company. (6C) An order under sub-section (4) whether made before or after the commencement of section 19 of the Banking Laws (Miscellaneous Provisions) Act, 1963 (55 of 1963) shall be conclusive evidence that all the requirements of this section relating to amalgamation have been complied with, and a copy of the said order certified in writing by an officer of the Reserve Bank to be true copy of such order and a copy of the scheme certified in the like manner to be a true copy thereof shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after the commencement of the said section 19), be admitted as evidence to the same extent as the original order and the original scheme. [5] (7) Nothing in the foregoing provisions of this section shall affect the power of the Central Government to provide of the amalgamation of two or more banking companies [6] 1 under section 396 of the Companies Act, 1956 (1 of 1956): PROVIDED that no such power shall be exercised by the Central Government except after consultation with the Reserve Bank. 44B . [1][2] Restriction on compromise or arrangement between banking company and creditors.- [3] (1) Notwithstanding anything contained in any law for the time being in force, no [4] High Court shall sanction a compromise or arrangement between a banking company and its creditors or any class of them or between such company and its members or any class of them [5] or sanction any modification in any such compromise or arrangement unless the compromise or FOOTNOTES: 1. Inserted by Act No. 20 of 1950. 2. Sub-section (5) omitted by Act No. 55 of 1963, with effect from . 1st. February, 1964. 3. Substituted by Act No. 55 of 1963, for the words "the terms of the order sanctioning the scheme", with effect from . 1st. February, 1964. 4. Inserted by Act No. 55 of 1963, with effect from . 1st. February, 1964. 5. Inserted by Act No. 37 of 1960. 6. The words "in national interest" omitted by Act No. 7 of 1961.

Sec.44B :Restriction on compromise or arrangement between banking company and creditors.- [3] (1) Notwithstanding anything contained in any law for the time being in force, no [4] High Court shall sanction a compromise or arrangement between a banking company and its creditors or any class of them or between such company and its members or any class of them [5] or sanction any modification in

any such compromise or arrangement unless the compromise or arrangement or modification, as the case may be, is certified by the Reserve Bank [6] in writing as not being incapable of being worked and as not being detrimental to the interests of the depositors of such banking company. [7] (2) Where an application under [8] section 391 of the Companies Act, 1956 (1 of 1956) is made in respect of a banking company, the High Court may direct the Reserve Bank to make an inquiry in relation to the affairs of the banking company and the conduct of its Directors and when such direction is given, the Reserve Bank shall make such inquiry and submit its report to the High Court. 45 . [1] Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution or amalgamation.- (1) Notwithstanding anything contained in the foregoing provisions of this Part or in any other law or [2] any agreement or other instrument, for the time being in force, where it appears to the Reserve Bank that there is good reason so to do, the Reserve Bank may apply to the Central Government for an order of moratorium in respect of [3] a banking company. (2) The Central Government, after considering the application made by the Reserve Bank under sub-section (1), may make an order of moratorium staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it thinks fit and proper and may from time to time extend the period so however that the total period of moratorium shall not exceed six months. (3) Except as otherwise provided by any directions given by the Central Government in the order made by it under subsection (2) or at any time thereafter, the banking company shall not during the period of moratorium make any payment to any depositors or discharge any liabilities or obligations to any other creditors. [4] (4) During the period of moratorium, if the Reserve Bank is satisfied that: (a) in the public interest; or (b) in the interests of the depositors; or (c) in order to secure the proper management of the banking company; or (d) in the interest of the banking system of the country as a whole, it is necessary so to do, the Reserve Bank may prepare a scheme- (i) for the reconstruction of the banking company, or (ii)for the amalgamation of the banking company with any other banking institution (in this section referred to as "the transferee bank") (5) The scheme aforesaid may contain provision for all or any of the following matters, namely: (a) the constitution, name and registered office, the capital, assets, powers, rights, interests, authorities and privileges, the liabilities, duties and obligations of the banking company on its reconstruction or, as the case

may be, of the transferee bank; (b) in the case of amalgamation of the banking company, the transfer to the transferee bank of the business, properties, assets and liabilities of the banking company on such terms and conditions as may be specified in the scheme; (c) any change in the Board of Directors, or the appointment of a new Board of Directors, of the banking company on its reconstruction or, as the case may be, of the transferee bank and the authority by whom, the manner in which, the other terms and conditions on which, such change or appointment shall be made and in the case of appointment of a new Board of Directors or of any Director, the period for which such appointment shall be made; (d) the alteration of the memorandum and articles of association of the banking company on its reconstruction or, as the case may be of the transferee bank for the purpose of altering the capital thereof or for such other purpose as may be necessary to give effect to the reconstruction or amalgamation; (e) subject to the provisions of the scheme, the continuation by or against the banking company on its reconstruction or, as the case maybe, the transferee bank, of any actions or proceedings pending against the banking company immediately before the date of the order of moratorium; (f) the reduction of the interest or rights which the members, depositors and other creditors have in or against the banking company before its reconstruction or amalgamation to such extent as the Reserve Bank considers necessary in the public interest or in the interests of the members, depositors and other creditors or for the maintenance of the business of the banking company; (g) the payment in cash or otherwise to depositors and other creditors in full satisfaction of their claim- (i) in respect of their interest or right in or against the banking company before its reconstruction or amalgamation; or (ii) where their interest or rights aforesaid in or against the banking company has or have been reduced under clause (f), in respect of such interest or rights as so reduced; (h) the allotment to the members of the banking company for shares held by them therein before its reconstruction or amalgamation whether their interest in such shares has been reduced under clause (f) or not, of shares in the banking company on its reconstruction or, as the case may be, in the transferee bank and where any members claim payment in cash and not allotment of shares, or where it is not possible to allot shares to any members, the, payment in cash to those members in full satisfaction of their claim- (i) in respect of their interest in shares in the banking company before its reconstruction or amalgamation; or (ii) where such interest has been reduced under clause (f) in respect of their interest in shares as so reduced; (i) the continuance of the

services of all the employees of the banking company (excepting such of them as not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947) are specifically mentioned in the scheme) in the banking company itself on its reconstruction or, as the case may be, in the transferee bank at the same remuneration and on the same terms and conditions of service, which they were getting or, as the case may be, by which they were being governed, immediately before the date of the order of moratorium: PROVIDED that the scheme shall contain a provision that:- (i) the banking company shall pay or grant not later than the expiry of the period of three years from the date on which the scheme is sanctioned by the Central Government, to the said employee the same remuneration and the same terms and conditions of service [5] as are, at the time of such payment or grant, applicable to employees of corresponding rank or status of a comparable banking company to be determined for this purpose by the Reserve Bank (whose determination in this respect shall be final); (ii) the transferee bank shall pay or grant not later than the expiry of the aforesaid period of three years, to the said employees the same remuneration and the same terms and conditions of service [6] as are, at the time of such payment or grant, applicable to the other employees of corresponding rank or status of the transferee bank subject to the qualifications and experience of the said employees being the same as or equivalent to those of such other employees of the transferee bank: PROVIDED FURTHER that if in any case under clause (ii) of the first proviso any doubt or difference arises as to whether the qualification and experience of any of the said employees are the same as or equivalent to the qualifications and experience of the other employees of corresponding rank or status of the transferee bank, [7] the doubt or difference shall be referred, before the expiry of a period of three years from the date of the payment or grant mentioned in that clause , to the Reserve Bank whose decision thereon shall be final; (j) notwithstanding anything contained in clause (i) where any of the employees of the banking company not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947) are specifically mentioned in the scheme under clause (i), or where any employees of the banking company have by notice in writing given to the banking company or, as the case may be, the transferee bank at any time before the expiry of one month next following the date on which the scheme is sanctioned by the Central Government, intimated their intention of not becoming employees of the banking company on its reconstruction or, as the case may be, of the transferee bank, the payment to such employees of compensation,

if any, to which they are entitled under the Industrial Disputes Act, 1947, and such pension, gratuity, provident fund and other retirement benefits ordinarily admissible to them under the rules or authorisations of the banking company immediately before the date of the order of moratorium; (k) any other terms and conditions for the reconstruction or amalgamation of the banking company; (l) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out. (6)(a) A copy of the scheme prepared by the Reserve Bank shall be sent in draft to the banking company and also to the transferee bank and any other banking company concerned in the amalgamation, for suggestions and objections, if any, within such period as the Reserve Bank may specify for this purpose; (b) the Reserve Bank may make such modifications, if any, in the draft scheme as it may consider necessary in the light of the suggestions and objections received from the banking company and also from the transferee bank, and any other banking company concerned in the amalgamation and from any members, depositors or other creditors of each of those companies and the transferee bank. (7) The scheme shall thereafter be placed before the Central Government for its sanction and the Central Government may sanction the scheme without any modifications or with such modifications as it may consider necessary; and the scheme as sanctioned by the Central Government shall come into force on such date as the Central Government may specify in this behalf: PROVIDED that different dates may be specified for different provisions of the scheme. [8] (7A) The sanction accorded by the Central Government under sub-section (7), whether before or after the commencement of section 21 of the Banking Law (Miscellaneous Provisions) Act, 1963 (55 of 1963), shall be conclusive evidence that all the requirements of this section relating to reconstruction, or, as the case may be, amalgamation have been complied with and a copy of the sanctioned scheme certified in writing by an officer of the Central Government to be a true copy thereof, shall, in all legal proceedings (whether in appeal or otherwise and whether instituted before or after commencement of the said section 21), be admitted as evidence to the same extent as the original scheme. (8) On and from the date of coming into operation of the scheme or any provision thereof, the scheme or such provision shall be binding on the banking company or, as the case may be, on the transferee bank and any other banking company concerned in the amalgamation and also on all the members, depositors and other creditors and employees of each of those companies and of the

transferee bank, and on any other person having any right or liability in relation to any of those companies or the transferee bank [9] including the trustees or other persons managing, or connected in any other manner with, any provident fund or other fund maintained by any of those companies or the transferee bank. (9) [10] On and from the date of the coming into operation of, or as the case may be, the date specified in this behalf in the scheme, the properties and assets of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and vest in, and the liabilities of the banking company shall, by virtue of and to the extent provided in the scheme, stand transferred to, and become the liabilities of, the transferee bank. (10) If any difficulty arises in giving effect to the provisions of the scheme, the Central Government may by order do anything not inconsistent with such provision which appears to it necessary or expedient for the purpose of removing the difficulty. (11) Copies of the scheme or of any order made under sub-section(10) shall be laid before both Houses of Parliament, as soon as may be, after the scheme has been sanctioned by the Central Government, or, as the case may be, the order has been made. (12) Where the scheme is a scheme for amalgamation of the banking company, any business acquired by the transferee bank under the scheme or under any provision thereof shall, after the coming into operation of the scheme or such provision, be carried on by the transferee bank in accordance with the law governing the transferee bank, subject to such modifications in that law or such exemptions of the transferee bank from the operation of any provisions thereof as the Central Government on the recommendation of the Reserve Bank may, by notification in the Official Gazette, make for the purpose of giving full effect to the scheme: PROVIDED that no such modification or exemption shall be made so as to have effect for a period of more than seven years from the date of the acquisition of such business. (13) Nothing in this section shall be deemed to prevent the amalgamation with a banking institution by a single scheme of several banking companies in respect of each of which an order of moratorium has been made under this section. (14) The provisions of this section and of any scheme made under it shall have effect notwithstanding anything to the contrary contained in any other provisions of this Act or in any other law or any agreement, award or other instrument for the time being in force. (15) In this section, "banking institution" means any banking company and includes the State Bank of India or [11] a subsidiary bank or a corresponding new bank. [12] Explanation : Reference in this section to the terms and conditions of

service as applicable to an employee shall not be construed as extending to the rank and status of such employee.

THE RESERVE BANK OF INDIA ACT,1934

Sec.45MC of the RBI Act,1934: Power of Bank to file winding up petition.- (1) The Bank, on being satisfied that a non-banking financial company- (a) is unable to pay its debt; or (b) has by virtue of the provisions of section 451A become disqualified to carry on the business of a non-banking financial institution; or (c) has been prohibited by the Bank from receiving deposit by an order and such order has been in force for a period of not less than three months; or (d) the continuance of the non-banking financial company is detrimental to the public interest or to the interest of depositors of the company, may file an application for winding up of such non-banking financial company under the Companies Act, 1956 (1 of 1956). (2) A non-banking financial company shall be deemed to be unable to pay its debt if it has refused or has failed to meet within five working days any lawful demand made at any to its offices or branches and the Bank certifies in writing that such company is unable to pay its debt. (3) A copy of every application made by the Bank tinder sub-section (1) shall be sent to the Registrar of Companies. (4) All the provisions of the Companies Act, 1956(1 of 1956) relating to winding up of a company shall apply to a winding up proceeding initiated on the application made by the Bank under this provision.]

Sec.45IA(4)(b) of The RBI Act,1934:The Bank, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:-- (b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;

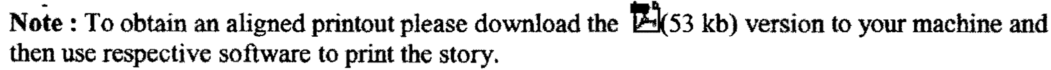
THE COMPANIES ACT,1956

Sec.394 Provisions for facilitating reconstruction and amalgamation of companies.- (1) Where an application is made to the [Tribunal] under section 391 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the [2] [Tribunal] - (a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies; and (b) that under the scheme the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme (in this section referred to as a "transferor company") is to be transferred to another company (in this section referred to as "the transferee company"); the [3] [Tribunal] may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provision for all or any of the following matters: - (i) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company; (ii) the allotment or appropriation by the transferee company of any shares, debentures policies, or other like interests in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person; (iii) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company; (iv) the dissolution, without winding up, of any transferor company; (v) the provision to be made for any persons who, within such time and in such manner as the [4] [Tribunal] directs dissent from the compromise or arrangement; and (vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out: [5] Provided that no compromise or arrangement proposed for the purposes of, or in connection with, a scheme for the amalgamation of a company, which is being wound up, with any other company or companies; shall be sanctioned by the [6] [Tribunal] unless the [7] [Tribunal] has received a report from the [8] [***] the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest: Provided further that no order for the dissolution of any transferor company under clause (iv) shall be made by the [9] [Tribunal] unless the Official Liquidator has, on scrutiny of the books and papers of the company, made a

report to the [10] [Tribunal] that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest.] (2) Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order; that properly shall be transferred to and vest in and those liabilities shall be transferred to and become the liabilities of the transferee company and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect. (3) Within [11] [thirty] days after the making of an order under this section, every company in relation to which the order is made shall cause a certified copy thereof to be filed with the Registrar for registration. If default is made in complying with this sub-section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to [12] five hundred rupees] . (4) In this section - (a) "property" includes property rights and powers of every description; and "liabilities" includes duties of every description; and (b) "transferee company" does not include any company other than a company within the meaning of this Act; but "transferor company" includes any body corporate, whether a company within the meaning of this Act or not.

Sec.396 Power of Central Government to provide for amalgamation of companies in [1] [public interest].- (1) Where the Central Government is satisfied that it is essential in the [2] public interest] that two or more companies should amalgamate, then, notwithstanding anything contained in sections 394 and 395 but subject to the provisions of this section, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution; with such property, powers, rights, interests, authorities and privileges; and with such liabilities, duties, and obligations; as may be specified in the order. (2) [3] The order aforesaid may provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and may also] contain such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government be necessary to give effect to the amalgamation. (3) Every member or creditor (including a debenture holder) of each of the companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as he had in the company of which he was originally a member or

creditor; and to the extent to which the interest or rights of such member or creditor in or against the company resulting from the amalgamation are less than his interest in or rights against the original company, he shall be entitled to compensation which shall be assessed by such authority [4] as may be prescribed and every such assessment shall be published in the Official Gazette] . The compensation so assessed shall be paid to the member, or creditor concerned by the company resulting from the amalgamation. [5] (3A) Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the [6] [Tribunal] and thereupon the assessment of the compensation shall be made by the [7] [Tribunal].] (4) No order shall be made under this section, unless - (a) a copy of the proposed order has been sent in draft to each of the companies concerned; [8] [***] [9] (aa) the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and] (b) the Central Government has considered, and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof. (5) Copies of every order made under this section shall, as soon as may be after it has been made, be laid before both Houses of Parliament.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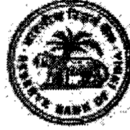

RESERVE BANK OF INDIA

Date: Feb 02, 2005

Guidelines for merger / amalgamation of Urban Co-operative Banks (UCBs)

(PCB).Cir. 36/09.169.00/04-05

February 2, 2005

The Chief Executive Officers of all Primary (Urban) Co-operative Banks

Dear Sir/ Madam,

Guidelines for merger / amalgamation of Urban Co-operative Banks (UCBs)

A copy of the guidelines for merger/ amalgamation of urban co-operative banks is enclosed for your information and necessary action. The guidelines may be placed before the Board of Directors of your bank.

Yours faithfully,

(N.S.Vishwanathan)
Chief General Manager

Guidelines for merger / amalgamation of Urban Co-operative Banks (UCBs)

With a view to facilitating consolidation and emergence of strong entities and providing an avenue for non disruptive exit of weak/unviable entities in the co-operative banking sector, it has been decided to frame guidelines to encourage merger/amalgamation in the sector.

2. Although the Banking Regulation Act, 1949 (AACS) does not empower Reserve Bank to formulate a scheme with regard to merger and amalgamation of co-operative banks, the State Governments have incorporated in their respective Co-operative Societies Acts a provision for obtaining prior sanction in writing, of RBI for an order, inter alia, for sanctioning a scheme of amalgamation or reconstruction.

3. The request for merger can emanate from banks registered under the same State Act or from banks registered under the Multi State Co-operative Societies Act (Central Act) for takeover of a bank/s registered under State Act. While the State Acts specifically provide for merger of co-operative societies registered under them, the position with regard to take over of a co-operative bank registered under the State Act by a co-operative bank registered under the Central Act is not clear. Although there are no specific provisions in the State Acts

or the Central Act for the merger of a co-operative society under the State Acts with that under the Central Act, it is felt that, if all concerned including administrators of the concerned Acts are agreeable to order merger/ amalgamation, RBI may consider proposals on merits leaving the question of compliance with relevant statutes to the administrators of the Acts. In other words, Reserve Bank will confine its examination only to financial aspects and to the interests of depositors as well as the stability of the financial system while considering such proposals.

Procedure for Merger

4. The procedure for merger either voluntary or otherwise is outlined in the respective state statutes/ the Multi State Cooperative Societies Act. The Registrars, being the authorities vested with the responsibility of administering the Acts, will be ensuring that the due process prescribed in the Statutes has been complied with before they seek the approval of the RBI. They would also be ensuring compliance with the statutory procedures for notifying the amalgamation after obtaining the sanction of the RBI.

5. An application for merger giving the proposed scheme will have to be submitted by the banks concerned to the Registrar of Co-operative Societies (RCS) / Central Registrar of Co-operative Societies (CRCS). The acquirer bank shall also forward a copy of the scheme to the Reserve Bank along with information as in Annexure I. The Reserve Bank will be examining the same with reference to the financial aspects and the interests of depositors based on the criteria/factors outlined in Annexure II and convey its decision to the concerned State RCS and in case the acquirer is a Multi-state Bank, to the CRCS and the RCS of the State in which the acquired bank is situated.

6. The State Acts also provide for compulsory amalgamation of the cooperative societies by the RCS. In such cases too, prior approval of RBI is necessary. The schemes received from RCS will be examined with reference to the financial aspects and the interests of depositors as well as the stability of the financial system, based on the criteria/factors outlined in Annexure II and decision conveyed to the RCS.

Annexure I

Information and documents to be furnished by the acquirer UCB along with the application of a Scheme of Amalgamation

1. Draft scheme of amalgamation as approved by the Board of Directors of the acquirer bank.

2. Copies of the reports of the valuers appointed for the determination of realizable value of assets **(net of amount payable to creditors having precedence over depositors) of the** acquired bank.

3. Information which is considered relevant for the consideration of the scheme of merger including in particular:-

a. Annual reports of each of the UCBs for each of the three completed financial years immediately preceding the proposed date for merger.

b. Financial results, if any, published by each of the UCBs for any period subsequent to the financial statements prepared for the financial year immediately preceding the proposed date of merger.

c. Pro-forma combined balance sheet of the acquiring bank as it will appear consequent on

the merger.

d. Computation based on such pro-forma balance sheet of the following:-

i. Tier I Capital

ii. Tier II Capital

iii. Risk-weighted Assets

iv. Gross and Net NPAs

v. Ratio of Tier I Capital to Risk-weighted Assets

vi. Ratio of Tier II Capital to Risk-weighted Assets

vii. Ratio of Total Capital to Risk-weighted Assets

viii. Tier I Capital to Total Assets

ix. Gross and Net NPAs to Advances

x. Cash Reserve Ratio

xi. Statutory Liquidity Ratio

4. Information certified by the valuers as is considered relevant to understand the net realizable value of assets of the acquired bank including in particular:-

a. The method of valuation used by the valuers

b. The information and documents on which the valuers have relied and the extent of the verification, if any, made by the valuers to test the accuracy of such information

c. If the valuers have relied upon projected information, the names and designations of the persons who have provided such information and the extent of verification, if any, made by the valuers in relation to such information

d. Details of the projected information on which the valuers have relied

e. Detailed computation of the realizable value of assets of the acquired bank

5. Such other information and explanations as the Reserve Bank may require.

Annexure II

Guidelines on merger/ amalgamation for UCBs

1. Reserve Bank of India may consider proposals for merger and amalgamation in the following circumstances:

(i) When the networth of the acquired bank is positive and the acquirer bank assures to

protect entire deposits of all the depositors of the acquired bank.

(ii) When the networth of acquired bank is negative and the acquirer bank on its own assures to protect deposits of all the depositors of the acquired bank.

(iii) When the networth of the acquired bank is negative and the acquirer bank assures to protect the deposits of all the depositors of the acquired bank with financial support from the State Government extended upfront as part of the process of merger.

2. In all cases of merger/ amalgamation the financial parameters of the acquirer bank post merger should conform to the prescribed minimum prudential and regulatory requirement for urban co-operative banks.

3. The realizable value of assets has to be assessed through a process of due diligence

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