ROLE OF REGULATORS IN PUBLIC SECTOR BANKS IN INDIA: MERGER AND ACQUISITION

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ABSTRACT

Mergers and acquisitions (M&A) have become prevalent in the public sector banking domain in India, heralding significant transformations in the banking landscape. This paper provides a comprehensive legal analysis of M&A activities within Indian public sector banks. It examines the regulatory framework, legal provisions, and the implications of such transactions on stakeholders. Through a detailed examination of relevant laws, regulations, and judicial precedents, this analysis elucidates the intricacies involved in M&A processes in the public sector banking sector. It delves into the legal aspects governing various stages of M&A transactions, including due diligence, valuation, documentation, regulatory approvals, and post-merger integration. Furthermore, the paper discusses the impact of M&A activities on corporate governance, competition, and the overall stability of the banking sector. By critically assessing the legal framework, this study aims to provide insights for policymakers, regulators, and stakeholders to navigate the complexities of M&A transactions in Indian public sector banks effectively. Moreover, this analysis considers the socio-economic ramifications of M&A transactions in public sector banks, including their impact on employment, access to financial services, and the broader economy. It also explores the challenges and opportunities presented by M&A activities, such as managing cultural integration, addressing non-performing assets, and enhancing operational efficiency. By examining case studies and best practices, this study offers practical insights for policymakers and practitioners to facilitate smoother M&A transitions in the public sector banking sector. Ultimately, the paper underscores the importance of a robust legal framework in ensuring transparency, accountability, and sustainability in M&A transactions within India's banking industry.

Keywords: Mergers and Acquisitions, Public Sector Banks, India, Legal Analysis, Regulatory Framework, Corporate Governance, Competition, Banking Sector, Due Diligence, Post-Merger Integration.

LIST OF ABBREVIATIONS

Abbreviation	Full Form
&	and
AAEC	Appreciable Adverse Effect on Competition
AIR	All India Report
BR	Banking Regulation
CCI	Competition Commission of India
F&P	Fit and Proper
HR	Human Resource
IT	Information Technology
Ltd.	Limited
M&A	Mergers and Acquisitions
NPA	Non-Performing Assets
PSB	Public Sector Bank
RBI	Reserve Bank of India
SBI	State Bank of India
v.	Versus

LIST OF CASES

1. Himalayan Bank Ltd. v. Roshan Lal Mehra
2. Reserve Bank of India v. Peerless General Finance and Investments Co. Ltd.
3. Coal India v. Union of India.

SCHEME OF CHAPTERISATION

Chapter 1: Introduction

In this chapter, the researcher discusses the concept of mergers and acquisitions in the Banking sector and its relevance. Also, the main advantages that followed the adoption of this idea.

Chapter 2: The role of the Banking Regulation Act, 1949, and other regulations in Mergers and Acquisitions of PSBs

This chapter concentrates on the public sector banking sector's regulatory environment regarding mergers and acquisitions. It would entail a thorough examination of the supervision and approval functions performed by regulatory agencies including the Ministry of Finance and the RBI. In order to ensure that legal and regulatory obligations are fulfilled, this chapter can also go into detail about the compliance requirements that banks must follow during the M&A process.

Chapter 3: Conclusion

This chapter concludes the key observations made in the research paper.

CHAPTER 1: INTRODUCTION

In the current competitive environment, firms frequently employ mergers and acquisitions (M&A) as a strategy to expand their corporate reach, enter new markets, and get out of financial difficulties. In today's corporate world, the process of mergers and acquisitions has become increasingly significant. In light of the aforementioned argument, it is evident that India has a number of established regulations covering different forms of corporate restructuring. The Indian banking sector has also witnessed significant transformations in recent decades, marked by a series of mergers and acquisitions among the banks.

In the current state of the economy, small and medium-sized banks face a number of difficulties due to factors such as inadequate resources, antiquated technology, a lack of stability in their financial structures, and inefficient advertising. Their survival is in jeopardy if they don't adopt cutting-edge technologies, and competition from larger banks is inevitable. They may find relief and help in their revival as a result of their merger-based reorganisation. So far, bank mergers have kept failed financial institutions from going out of business.

In order to increase their market share and protect themselves from an aggressive takeover by a larger bank, smaller banks would sometimes merge with other smaller banks. The RBI supports the initiative since it will help the bank expand both its clientele and its physical footprint. As a result, the combined bank will have a much greater capacity to issue credit. A bank's resilience in the face of an ever-changing market is bolstered by a merger. By joining together, smaller banks can become more competitive in the domestic and global financial markets.

This trend has been propelled by various economic, regulatory, and policy considerations, with the aim of strengthening the financial stability and competitiveness of the banking industry. The integration of banks through mergers and acquisitions is a complex process that involves a multitude of legal, financial, and operational considerations.

This paper endeavours to provide a comprehensive legal analysis of mergers and acquisitions (M&As) in the public sector banks in India, examining the regulatory framework, challenges, and implications of such transactions. The study is particularly timely in light of the recent amalgamations of several PSBs and their far-reaching consequences on the banking landscape.

The RBI regularly modifies the procedures it follows for bank mergers and acquisitions, which necessitates a careful consideration of the concept as a whole. This paper is an attempt to achieve that goal. Even while achieving economies of scale might be one of the goals of this kind of consolidation, inadequate bank restructuring raises more important concerns. Therefore, the focus of this research paper is on the fundamental causes of the RBI, banks merger laws, and the prospects for M&A in the industry. It is envisaged that the findings of this study will offer valuable insights for policymakers, legal practitioners, scholars, and stakeholders in the banking sector.

RESEARCH PROBLEM

In the Indian banking industry, mergers and acquisitions can present a number of complicated and challenging legal issues. For a considerable amount of time, the banking industry has seen an increase in M&A activity. As a result, the primary research subject in this study is the problems and obstacles with the regulatory structure that governs mergers and acquisitions in India's public sector banks (PSBs).

This paper aims to provide a thorough legal analysis of mergers and acquisitions in Indian public sector banks by addressing these research issues and illuminating the complex legal structure, difficulties, and ramifications of these deals. The research findings will be a useful tool for researchers, politicians, legal professionals, and stakeholders in the banking industry, assisting in the formulation of future legal reforms and enabling informed decision-making.

SIGNIFICANCE OF THE STUDY

This study is significant because it has the potential to provide insightful information in a number of important areas, such as improving awareness of the legislative framework governing mergers and acquisitions in India's public sector banks. Its thorough study can act as a basis for future legislative changes and policy alterations pertaining to the banking industry. Professionals in the banking industry and professionals alike might gain from the thorough examination of the legal nuances of mergers and acquisitions. It can operate as a helpful guide and point of reference for people managing and carrying out these kinds of transactions.

The research assesses the degree to which the M&A legal framework in Indian PSBs conforms to global best practices. India may be able to embrace international standards when appropriate by using the benchmarking opportunities and insightful lessons that this comparison research can provide. The study's overall importance stems from its capacity to improve legal procedures, shape public policy, and add to the body of information about mergers and acquisitions in India's public sector banking industry. A broad spectrum of stakeholders, including legislators, solicitors, academics, and business experts, stand to gain from it.

To successfully traverse these legal issues, one must adhere to regulatory regulations, conduct in-depth legal study, and retain competent legal counsel. Furthermore, the laws and rules governing mergers and acquisitions in the banking industry may change; therefore, banks and solicitors must keep abreast of these developments and adjust accordingly.

REVIEW OF LITERATURE:

Several studies have been carried out to investigate the effects of mergers and acquisitions in the banking sector in India.

Shail Shakya (2014) provides an overview of M&A in the banking sector, followed by a discussion of the regulatory framework and the various types of regulation. The author then examines the strengths and weaknesses of consolidation through M&A, and the shareholder responses to such mergers. The methodology used in this paper is a qualitative analysis of existing literature and regulatory frameworks. The scope of the paper is limited to the Indian banking sector, and the limitations include the lack of empirical data on the subject. The findings of the paper suggest that while M&A can lead to economies of scale, it also poses challenges such as cultural differences and regulatory hurdles.

Profitability and financial analysis of banking mergers and acquisitions were studied by Azeem Ahmad Khan in 2011. The study's purview extends to analysing the effects of the merger on the debt equity ratio of the company and on the equity shareholders of the merged institution, as well as assessing the performance of the banks individually in terms of net profitability and return on capital employed. Author concludes that mergers and acquisitions significantly affect banks' financial performance and that there is a sizable gap between net profit margins before and after mergers.

Ishwarya (2019) examines the evaluation of M&A in the Indian banking sector over a specified time. The study employs financial indicators to evaluate the pre and post-merger financial performance of the merged banks. The State Bank of India and its Associates merger is examined, along with the benefits and drawbacks for both the banks and their staff. The report also examines the patterns in M&A activity in Indian banking. The author comes to the conclusion that while M&As have had some success in the Indian banking system, mergers between strong and distressed institutions should not be encouraged by the government or policy makers because doing so will negatively impact the stronger banks' asset quality. Some of the study's shortcomings include its disregard for the potential effects of variations in the accounting practices used by various businesses and its methodology's failure to account for the cost of acquisition in mergers. The paper doesn't have any legal focus on the study.

Aparna Pandey (2018) argues that M&A can be an effective strategy for banks to improve their operational flexibility and enhance their competitiveness in the market. The paper uses a qualitative research methodology, drawing on a range of academic literature and case studies from the Indian banking sector. The author acknowledges that the findings may not be generalizable to other countries. The paper concludes that M&A can be a viable strategy for banks, but that careful planning and execution are required to ensure success.

Indrani Patwari (2013) focuses on the laws and procedures governing bank mergers in India, with a comparative analysis of the Banking Regulation Act, 1949 and the Companies Act, 2013. The study examines the guidelines provided by the RBI for bank mergers, as well as the impact of merger announcements on shareholder wealth in Indian private sector banks. The author also discusses the issues and evidence surrounding bank consolidation in India. The author has limited the scope of the paper to two acts, the Banking Regulation Act, 1949, and the Companies Act, 2013.

OBJECTIVES OF THE STUDY

1. To understand the evolution of M&A in the public sector banks in India
2. To evaluate the challenges associated with the process of M&As in the public sector banks.
3. To examine how legal provisions safeguard the interests of shareholders.
4. To discuss the issues arising out of public sector banks merger and acquisitions.

RESEARCH QUESTIONS

1. What are the specific legal provisions and regulatory guidelines governing mergers and acquisitions in the public sector banks of India?
2. What are the primary legal challenges and potential conflicts that may arise during the process of merging and acquiring public sector banks with other private or public sector banks in India?
3. What are the effects of public sector bank mergers on the competition in India?

SCOPE AND LIMITATION OF THE STUDY

The research will only look at mergers and acquisitions involving Indian public sector banks. The research will examine the laws, rules, and guidelines that control mergers and acquisitions in the public banking industry. It will include a review of laws, court decisions, and industry-specific regulations. A comparative review of the regulatory frameworks for mergers and acquisitions in Indian public sector banks and worldwide best practice in the public sector banks will be a part of the study. This will shed light on possible areas for improvement as well as areas of alignment.

Private sector mergers and acquisitions will not be covered by the study. The exclusive focus would be on Indian public sector banks. The conclusions and suggestions of the study will depend on the legal environment that existed at the time of the investigation. The investigation will be supported by case law, existing literature, and regulations. Although they might not be fully discussed, outside variables like political, economic, or world developments that could affect mergers and acquisitions in public sector banks will be addressed. The parameters that the study will work inside are established by these scope and constraints, guaranteeing a targeted and contextually appropriate analysis of the legal concerns.

RESEARCH METHODOLOGY

The researcher intends to employ the doctrinal method in carrying out the study. When performing the research, the researcher will primarily use secondary sources like books, journals, and articles in addition to a few main data sources like laws and regulations. Authorised websites will serve as the basis for the data used in the study.

CHAPTER 2: THE ROLE OF BANKING REGULATION ACT, 1949, AND OTHER REGULATIONS IN MERGERS AND ACQUISITIONS OF PSBs

REGULATION OF M&A IN THE BANKING SECTOR:

According to Section 44A[1] of the Banking Regulation Act, 1949, no bank may merge until the planned merger has been approved by two-thirds of the shareholders of each merging bank.[2] After upon, it is sent to the RBI for approval. However, as of right now, attendance at the specific public meeting called to assess the program—whether in person or by proxy—is mandatory. It is stated clearly in Section 2A[3] of the Banking Laws (Amendment) Act of 2011 that no banking company is governed by the Competition Act. As previously required only by the Companies Act of 1956, Chapter XV of the Companies Act of 2013 stipulates that any proposed merger involving a bank and a non-banking firm must first receive approval from the HC and subsequently the RBI in order to proceed. The main law governing M&As in India is the Competition Act of 2002. This law was mainly passed to control mergers and acquisitions (M&As) and to prohibit anti-competitive behaviour. The stringent criteria of the M&A clause do not apply to any bank that complies with a loan or investment agreement; however, the combination must be reported to the CCI within seven days.[4] In 2017, the government decided not to require CCI authorization for bank mergers that had been nationalised. The intention was to facilitate a speedy consolidation of the PSU banking industry. The 10-year exception was announced at a time when a number of academics and government officials were discussing the necessity of banking sector consolidation, particularly among state-run banks.

[1] Banking Regulation Act, 1949, s 44A.
[2] M.J.Aslam, "Legal Aspects of Bank Lending" (1st ed ALH, 2010)
[3] Banking Regulation (Amendment) Bill, 2011, s 2A.
[4] Samir R Gandhi et al, "Merger Control in India: Overview", Thomson Reuters Practical Law (September 19, 2022),https://uk.practicallaw.thomsonreuters.com/0-501-2861?transitionType=Default&contextData=(sc.Default)&firstPage=true

THE BANKING REGULATION ACT 1949:

The banking industries are merged under the BR Act of 1949, rather than the Companies Act of 2013. When it comes to banking, the BR Act is the law of the land, but the Companies Act of 2013 is in charge of the registration of financial institutions. Using the rules of the BR Act, which regulates the behaviour and affairs of banks, the RBI acts as a "match-maker"[5] to facilitate the merger of weak banks with strong banks. Unless otherwise mentioned in the Act, its provisions are in addition to the Companies Act of 1956 and other recently established laws. Therefore, it is important to stress that a company engaging in banking activity in accordance with Section 5(b)[6] of the Act would be subject to the provisions of both the Companies Act and the BR Act. If there is a dispute between the terms of the companies Act and the BR Act, the BR Act requirements will apply to banking firms.

In addition, if a provision in a company's memorandum or articles of incorporation is in conflict with the BR Act's provisions, the BR Act's provisions shall govern. If the provisions of the BR Act are violated by any agreement the firm executes or any resolution passed by its Board of Directors, the agreement or resolution will be null and void and of no force or effect.11 The consolidation of the financial institutions is governed by Part III, Sections 44A, 44B[7], and 45[8] of the Act. These sections detail the steps required to merge two financial institutions into one. The acquiring and merging of banks under various acts can be broken down into three distinct types: voluntary private sector bank amalgamations, obligatory private sector bank amalgamations, and private sector bank mergers.

PUBLIC SECTOR BANKS MERGER:

s empowered to prepare or make a scheme, in consultation with the Reserve Bank, for the transfer of an undertaking from a "corresponding new bank," i.e., a nationalised bank, to another "corresponding new bank," or for the transfer of all or part of any banking institution to a "corresponding new bank" under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980[9], also known as the Bank Nationalisation Act.[10] The plan for a merger of public sector banks must be presented to both Houses of Parliament for approval

[5] Ramanujam, S., *"Mergers et al: Issues, Implications and Case Law in Corporate Restructuring",* LexisNexis: Butterworths Wadhwa, Nagpur, 3rd Edn. (2012), p.306

[6] Banking Regulation Act, 1949, s 5(b).

[7] Banking Regulation Act, 1949, s 44B.

[8] Banking Regulation Act, 1949, s 45.

[9] Nationalised Bank Scheme 1970, available at: http://www.pnbindia.in/Upload/En/Nationalised%20bank%20scheme%201970.pdf.

[10] Banking Companies (Acquisition And Transfer Of Undertakings) Act, 1980, s 9(1)(c).

by the Central Government. So far, this process has resulted in only one merger, between the Punjab National Bank and the defunct New Bank of India due to the latter's dire financial straits. However, problems with the two companies' smooth integration led to a less-than-ideal post-merger experience.

The Acts of 1970 and 1980 on Banking Companies (Acquisition and Transfer of Undertakings) have the following goals:

"to provide for the acquisition and transfer of the undertakings of certain banking companies, having regard to their size, resources, coverage and organisation, in order further to control the heights of the economy, to meet progressively and serve better, the needs of the development of the economy and to promote the welfare of the people, in conformity with the policy of the state towards securing the principles laid down in clauses (b) and (c) or Article 39[11] *of the Constitution and for matters connected therewith or incidental thereto."*

Resizing PSBs is obviously necessary to help them achieve the goals of the nationalisation acts. This will help them become more competitive, increase their ability to cover more ground, diversify their product offerings, and more efficiently use resources.

Sections 9(2)(c)[12] and 9(6) of the aforementioned Act include the pertinent provisions pertaining to the merging of these institutions. They are as follows:

Section 9(2)(c): The Central Government may create a plan that could include the following, after consulting with the RBI:

(a) The splitting up of any matching new bank into two or more companies,

(a) Combining any corresponding new bank with another banking institution or with another corresponding new bank, or

(c) The transfer of the entire undertaking or any portion of it from one corresponding new bank to another corresponding new bank or financial institution, or the transfer of the entire undertaking or any portion of it from one banking institution to another corresponding new bank.

Moreover, in accordance with Act Section 9(6):

[11] Indian Constitution, art 39.
[12] Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, s 9(2)(c).

"Every Scheme made by Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session for a total period of 30 days,(which may be comprised in one session or in two or more successive sessions, and if before the expiry of the session immediately following the session or the successive sessions aforesaid) both Houses agree in making any modification in the scheme or both Houses agree that the scheme should not be made, the scheme shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that scheme."

AN ALTERNATIVE CONSOLIDATION MECHANISM FOR PSBS:

In principle, the Cabinet has approved the Public Sector Banks' amalgamation via an Alternative Mechanism. It would make nationalised banks' consolidation easier, resulting in the creation of powerful, competitive banks.

The applications submitted by banks seeking approval in principle to create merger plans will be presented to the Alternative Mechanism. Every three months, a report on the proposals approved by the Alternative Mechanism will be forwarded to the Cabinet.

Alternative Mechanism has the authority to order banks to review merger proposals. RBI will provide input to the Alternative Mechanism prior to granting in-principle approval.

The Alternative Mechanism will create its own process for evaluating bank merger bids, with general guidance from the Nationalisation Acts, including the Banking Companies (Acquisition and Transfer of Undertakings) Acts of 1970 and 1980.

The Central Government will approve the final plans, which will then be presented to both Houses of Parliament.

SALIENT FEATURES:

The following are the key components of the Framework for Approval for Public Sector Bank Consolidation:

1. Only commercial factors would inform the decision to establish robust and competitive banks.
2. The Bank Boards must be the first to propose the idea.

3. The suggestions that Banks submitted for initial approval to create
4. Plans for consolidation must come before the Alternative Mechanism.
5. Following approval in principle, the Banks will act in compliance with the law and SEBI's directives.
6. The Central Government will announce the final plan after consulting with the RBI.

MERGERS OF PSBS:

Several meetings have taken conducted on the subject of bank mergers and consolidation in India since the Narasimham report's proposal. As with previous conversations, the rising number of nonperforming assets (NPAs) affecting public sector banks started the current round of debate.

Since the SBI and Bank of Behar merged in 1969, there have been very few bank mergers driven by the desire for development and consolidation. The majority of bank mergers prior to the 2015 merger between Kotak Mahindra Bank Ltd and ING Vysya Bank Ltd were the result of the central bank's attempts to protect the financial system and depositors' funds.

The only time two PSBs merged was in 1993, when Punjab National Bank (PNB) bought New Bank of India. The RBI used Section 45 of the BR Act, 1949 to compel the merger since the New Bank of India's liquidity was in jeopardy. PNB was a strong bank with a history of success before the merger, but afterward it ran into a variety of problems. It took PNB supposedly at least five years to get over the merger's effects.

MERGER OF SBI:

The Associate Banks of SBI, sometimes known as the "seven sisters," were established before independence by princely republics to serve their respective regions. These institutions became Associate banks under SBI after the State Bank of India (Subsidiary Banks) Act was passed by the Indian government in 1959.[13]

With the assent of the central government and after consulting with the RBI, the SBI Act of 1955 gives the SBI the authority to negotiate the purchase of the assets and liabilities of any financial organisation.[14] SBI's central board, the relevant bank's board, and the RBI's board must all agree the acquisition terms and conditions before they can be forwarded to the central

[13] Economic & Political Weekly (EPW), 22 July 2017.
[14] State Bank of India Act, 1955, s 35(1).

government for final approval.[15] The federal government can greenlight any acquisition plan, and those plans will go into force on the day they were given the go-ahead.

The SBI Act's acquisition provisions are quite broad and apply to any individual or group of individuals engaged in banking activities. This refers to the person or group of people doing banking operations. SBI has the authority to purchase the business of any individual engaged in banking activities. It should also be legal to purchase any corporate engaging in banking activities, provided that the corporate complies with applicable laws.[16] Such an acquisition impacts the property rights and rights of numerous other stakeholders in the organisation being purchased. Therefore, in order to minimise the risk of a stakeholder challenging the acquisition action, the authorities for acquisition must be expressly and explicitly specified by legislation. Additionally, unambiguous legislative requirements must inform stakeholders of their rights. Nationalised banks are free to combine with other nationalised banks or with other financial establishments. a bank, SBI, or a subsidiary, for example. It is not possible to combine an NBFC with a nationalised bank.[17]

A merger of any two banking firms may be approved by the RBI under Section 44A of the BR Act with the consent of each company's shareholders equal to one-third of its total worth. The Companies Act still requires the approval of three-quarters of the shareholders in order for a banking company to merge with a new bank, even though Section 44A does not apply in this case. Additionally, public sector banks would be subject to the RBI's voluntary merger guidelines as appropriate.

- **State Bank of Saurashtra and SBI merger (2008)**

The State Bank of Saurashtra amalgamated with the SBI initially in 2008.[18] Consolidation of SBI with affiliates was actively studied when the banking sector was opened to international banks in 2009 in order to strengthen its expertise vis-à-vis entry of foreign banks. The Bank of Saurashtra was selected initially because it would strengthen SBI's already-limited presence in the Saurashtra region, was smaller than other partners, and was entirely controlled by SBI.

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[15] State Bank of India Act, 1955, s 35(2).

[16] Suresh Kumar, "Impact of Bank Mergers on the Efficiency of Banks: A study of merger of Bharat Overseas Bank with Indian Overseas Bank", International Journal of Academic Research in Business and Social Sciences December 2013, Vol. 3, No. 12 ISSN: 2222-6990, DOI: 10.6007/IJARBSS/v3- i12/427.

[17] Mallick Inderajit "Does the Future of Indian Public Sector Banks lie in Merger and Acquisition?" available at http://ssrn.com/abstact1403103.

[18] Atmadip Ray & Sangita Mehta, 'State Bank of Saurashtra to be merged with SBI' (*The Economic Times*, 26 August 2007) <https://economictimes.indiatimes.com/industry/banking/finance/banking/state-bank-of-saurashtra-to-be-merged-with-sbi/articleshow/2310997.cms?from=mdr> accessed 10 October 2023.

- **State Bank of Indore and State Bank of India (2010)**

Following a similar procedure with State Bank of Saurashtra, it was the second merger of an associate bank with SBI.[19] In August 2010, the State Bank of India formally amalgamated with the State Bank of Indore.

- **Bharatiya Mahila Bank and Associate banks join into SBI (2017)**

State Bank of India, the country's largest bank, was once designated as a systemically significant financial institution. The bank's expansion has continued with the April 2017 merger with five partner banks and the Bharatiya Mahila Bank.[20] Thanks to the merger, SBI has become one of the world's top 50 banks in terms of total assets.

RBI REGULATIONS:

The situation involving *Reserve Bank of India v. Peerless General Finance and Investments Co. Limited*,[21] the Supreme Court ruled that the RBI regulates the banking industry in India and that the RBI is a vital component of the country's financial affairs and economy. The banking industry has benefited greatly from two regulatory duties of the RBI, which have raised the bar for Indian banking standards by creating a solid foundation and streamlining operations.

The Banking Regulation Act, 1949 distinguishes between two categories of mergers:

1. Compulsory, and
2. Wilful amalgamations

The RBI has initiated a forced merger to protect the depositors of a failing bank. A high proportion of non-performing assets, the use of junk, or a fall in net worth are all indicators of a bank's vulnerability.

In such a situation, the RBI must intervene and force the weaker banks to merge with the more robust ones. The BR Act, 1949 establishes procedures that are applicable solely to involuntary

[19] 'State Bank of Indore merger with SBI to begin by Aug 26' (*The Economic Times*, 28 July 2010) <https://economictimes.indiatimes.com/industry/banking/finance/banking/state-bank-of-indore-merger-with-sbi-to-begin-by-aug-26/articleshow/6229264.cms?from=mdr> accessed 10 October 2023.
[20] 'After associate banks, now Bharatiya Mahila Bank to also merge with SBI' (*The Economic Times*, 21 March 2017) <https://economictimes.indiatimes.com/industry/banking/finance/banking/after-associate-banks-now-bharatiya-mahila-bank-to-also-merge-with-sbi/articleshow/57736246.cms?from=mdr> accessed 10 October 2023.
[21] Reserve Bank of India v. Peerless General Finance and Investments Co. Limited, 1987 AIR 1023.

mergers of private sector banks. Any regional rural bank must adhere to the Regional Rural Banks Act of 1976.

The Reserve Bank of India's Part in the Coerced Merger of Private Sector Banks Section 45 of the BR Act of 1949 allows the RBI to request a suspension of a banking company's operations from the Central Government of India so that the company can create a reconstruction or amalgamation plan. Its goal is to allow the bank to be merged with another institution without the approval of the bank's shareholders or creditors. In order to safeguard the interests of the various shareholders and form an adequate bank managing committee to develop the merger or amalgamation plan, the RBI must issue a moratorium. Additionally, the RBI's finalised programmes must be submitted to the Indian Central Government, which has the last say on whether or not any changes should be made.

Bank mergers fall under the purview of state high courts, as demonstrated by a fascinating case heard by the High Court of Allahabad. In this case, the petitioner challenged the validity of a plan prepared by the Reserve Bank of India (RBI) under Section 45(4)[22] and an order of moratorium passed by the Central Government under Section 45(2)[23] of the Banking Regulation Act, 1949, on the grounds that a previous High Court order under Section 153[24] of the Companies Act had approved a plan by the bank's c The appellant argued that Section 45 lacked jurisdiction to reverse the High Court's rulings since that authority was delegated to it by the Companies Act. Since the court found that the appeal's reading of Section 45 was at odds with the provision's express statement that it applied regardless of other legislation, the appeal was denied. When it comes to challenging the RBI's amalgamation plan decisions, the High Court's jurisdiction and the judicial review mechanism are severely limited.

In the case of *Himalayan Bank Ltd. v. Roshan Lal Mehra*,[25] the Supreme Court elaborated on the separation of powers under the Banking Regulation Act, 1949 between the High court and the RBI. A petition was filed by a bank that was already operating under an approved amalgamation plan under Sections 45M[26] and 45B[27] of the Banking Regulation Act, and it was determined that the High Court had the authority to issue orders under Sections 392[28] read with

[22] Banking Regulation Act, 1949, s 45(4).
[23] Banking Regulation Act, 1949, s 45(2).
[24] Companies Act, 2013, s 153.
[25] Himalayan Bank Ltd. v. Roshan Lal Mehra, AIR 1961 P H 550.
[26] Banking Regulation Act, 1949, s 45M.
[27] Banking Regulation Act, 1949, s 45B.
[28] Companies Act, 2013, s 392.

Section 391[29] of the Companies Act. In each case, the Court made it quite apparent that the merger plan was not meant to be a substitute for liquidation but rather a complementary strategy.

NEW RBI GUIDELINES REGARDING BANK ACQUISITIONS:

The RBI introduced the master directions and guidelines for the acquisition and ownership of shares and voting rights in banking companies. Ensuring that the ultimate ownership and control of banking organisations remain adequately diversified is the primary goal of the Directions and Guidelines.

There are four chapters in the Directions read with the Guidelines, with Chapters II and III addressing the substantive provisions. The prerequisites for acquisition and the process for securing prior RBI permission are covered in Chapter II. Chapter III pertains to the ongoing surveillance of significant shareholders, adhering to the "Fit and Proper" (F&P) standards outlined in Annexure II. Furthermore, Chapter III offers guidance on how to do due diligence, report, and submit shareholding dilution plans. It also explains how to handle a violation of BR Act, Section 12B(1)[30]. The Guidelines also outline lock-in rules and specific restrictions on voting and shareholder rights.

- **Prior authorization for the acquisition**

In accordance with the Directions and Section 12B of the Act, obtaining major ownership status in a banking firm through the purchase of shares or voting rights requires prior clearance from the RBI. In this context, "major shareholding" refers to a person's cumulative ownership of 5% or more of the voting rights or paid-up share capital in a banking company.

After performing due diligence on the applicant, the RBI may approve, reject, or allow the acquisition of a smaller ownership. Additionally, before approving a request, the RBI may place restrictions on the applicant and the relevant banking institution.

After the acquisition, if the total shareholding or voting rights drop below 5% at any point, new RBI permission will be needed to raise it to 5% or above.

It is forbidden for anyone from Financial Action Task Force (FATF) non-compliant states to acquire a significant stake in banks, with the exception of current substantial shareholders.

[29] Companies Act, 2013, s 391.
[30] Banking Regulation Act, 1949, s 12B(1).

Furthermore, the RBI's prior approval will be needed for any further shares or voting rights that such an existing large shareholder wishes to acquire.

The RBI may, at any time, evaluate the F&P status of shareholders or voting rights holders who are residents of countries that do not comply with the FATF and may take appropriate legal action to restrict their voting rights.

- **Shareholding restrictions**

The following shareholding restrictions on the purchase of shares or voting rights in a banking firm are outlined in the Guidelines.

1. Regarding non-promoters:

10% of the paid-up share capital, or voting rights, of the banking company in the case of natural persons, non-financial institutions, financial institutions connected to large industrial houses directly or indirectly, and financial institutions controlled or owned by individuals to the extent of 50% or more.

15% of the fully paid-up share capital, or voting rights, of the banking corporation in the case of supranational organisations, public sector projects, the federal or state governments, and other financial institutions not specifically included above.

2. For Promoters:

After the banking company has been in existence for fifteen years, the minority shareholder must own 26% of the company's fully paid-up share capital or voting rights. Within six months of the date of the Directions, a plan must be submitted to the RBI for approval that will allow a greater percentage of shares to be held until the business has been operating for fifteen years.

The RBI may, in individual cases, relax the aforementioned restrictions on foreign ownership of shares (with or without limitations) based on considerations such as the involvement of regulators, the sale of shares by existing company promoters, etc.

As a reminder, Section 12(2) of the Act, when read with the gazette announcement dated July 21, 2016, states that no shareholder in a banking company may exercise more than 26% of the total voting rights of all shareholders in the banking company on a poll.

- **Lock-in specifications**

The Guidelines are categorised as follows and include specific lock-in requirements for shareholding:

A five-year lock-in period will apply to any shares acquired up to or exceeding 10% of the banking company's paid-up equity share capital, but fewer than 40% will be subject to lock-in.

Only 40% of the paid-up equity share capital of the banking company will be subject to the lock-in requirement for the first five years if shareholdings are acquired up to or above that amount.

There can be no encumbrance on the locked-in shares. Within two working days, the promoter(s) and the promoter group must report to the banking company the specifics of the creation, invocation, and/or release of encumbrance on shares that are not locked in.

- **Requirements for ongoing monitoring**

Banking companies are required by Chapter III of the Directions read with the Guidelines to keep a close eye on their major shareholders who have completed the approved acquisition. Furthermore, those applicants who have received acquisition approval and those who have not yet completed the acquisition but for whom the relevant banking company has submitted comments in Form A1 to the RBI should also be kept under observation.

Banking institutions must set up a system for continuously obtaining information about any modifications to the information provided in the declaration that applicants submit (i.e., Form A). This information may include any other development that could impact the applicant's F&P status.

Banking institutions are required to look into any complaints about the F&P status of significant shareholders and provide an evaluation based on the data they have collected and the investigations they have carried out. Reports must therefore be submitted to the RBI.

CHAPTER 3: CONCLUSION

The public sector banking industry in India has experienced a notable shift in the M&A environment in recent times. They are subject to a complicated legal framework that encompasses a number of banking regulations, company laws, and regulatory requirements. Adherence to these legislative provisions is crucial in guaranteeing the legitimacy and seamless implementation of mergers. The government has actively embraced M&A as a strategic instrument to address the many difficulties faced by public sector banks, working with regulatory bodies like the RBI.

The Narasimham Committee Reports, which were published in 1991 and 1998, were crucial in determining how bank mergers in India developed. These papers established the groundwork for important banking sector reforms, such as the encouragement of mergers to increase banks' capacity and efficiency. However, some major recommendations of the Narasimham Committee, like merging of strong banks with strong banks. have been ignored which has led to some troublesome scenarios for some PSBs. Banks with huge NPAs are being merged with strong banks which affects the working and financials of the well performing banks.

The Ministry of Finance and the RBI have also played a crucial role in coordinating these consolidation initiatives. They have created policies, evaluated the combining companies' financial standing, and guaranteed that prudential standards are being followed. Their proactive approach has protected stakeholders' interests while supplying the regulatory framework required for mergers to be effective.

Although mergers have brought about a number of benefits, such as increased competitiveness and operational efficiency, they have not been without difficulties. It has been shown that integrating IT systems, HR, and operational procedures is a complex and resource-intensive process. To maintain asset quality, careful risk assessment and provisioning are also necessary for the management of NPAs during mergers. Reduced competition and market dominance are two other possible drawbacks of consolidation that have come to light.

It is crucial to emphasise that bank mergers in India have significant effects on financial inclusion and the overall economy; they are not just financial transactions. In order to effectively serve rural and underprivileged communities, public sector banks are essential, and merger success shouldn't impede attempts to promote financial inclusion. Mergers certainly appear to be a viable solution given the country's declining international status and the unanticipated rise in NPAs and bad loans. However, it has also led to an unparalleled rise in bank concentration at the market level, potentially affecting the competitiveness of banks. The exemption of the Banking sector from CCI approval for mergers and acquisitions may have some adverse effect. Nonetheless, the government ought to keep a careful eye on abuses of power and anti-competitive mergers in the banking industry. At this time, the government must also approve crucial merger laws that apply to PSBs and private banking institutions alike.

In conclusion, the merger and acquisition process in the Indian public sector banking sector is indicative of the government's resolve to help these banks overcome obstacles and become more competitive. Notwithstanding ongoing difficulties, the changing environment presents chances to enhance the banking industry, boost productivity, and eventually support India's goals for financial inclusion and economic progress.