Legislative Framework Governing Mergers and Acquisitions in India with Special Reference to Banking Sector

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Abstract

This article analyses the legislative framework governing mergers and acquisitions with a view to examine the existing legislative framework of bank mergers in India. The intrinsic linkage between banking sector and mergers and acquisitions has been significant, given the importance of both in the economy.

The article first establishes the extent of relation between banks and their consolidation by means of mergers and acquisitions, after which the terms 'merger' and 'acquisition' is conceptualized. Contemporary issues in bank mergers and acquisitions in specific economic jurisdictions is identified and the necessity of an understanding of legal framework in each jurisdiction to address is highlighted upon.

International perspectives are analyzed with the view of evaluating the Indian approach in comparison with other international approaches. This is done through a thorough analysis of case laws, statutes and scholarly literature. The position in the United States and the European Union is enumerated upon in detail. To conclude, the multiplicity of laws in the Indian framework is overburdening the banks as well as the regulatory authorities and there is a need to formulate a comprehensive legal framework addressing the various lacunas.

KEYWORDS: Banking, Financial institutions, India, mergers and acquisitions, legislative framework

Introduction

A bank is a financial institution that is authorized by the State to accept deposits and engage in the activities of lending and borrowing, by utilisation of the public money. Banks hold these funds in a fiduciary capacity and assist the nation in the process of creation and strengthening of credit. The banking system of a nation is central to its economy. The view that the strength of a nation's economy is synonymous with the

strength of its national banks[1] is aptly demonstrated by the strong economies of developed countries which house successful banks.[2]

The banking system in India has undergone multiple changes over the past few decades, both structurally as well as strategically, as a response to globalisation and in terms of regulation of the banking sector. Several reforms have been implemented by the Government in order to strengthen this sector. On the one hand, global banking has been advantageous to the customers and has blurred the boundaries between nations. However, it has also increased the risk of banking business. Although the primary function of banks is to assist the economy as well as the public, it is required that banks like other business entities and financial institutions are able to safeguard against risks and exploit the business opportunities available to them.[3] The economic turmoil in our neighbouring countries in the recent past has highlighted the importance of strong banking systems for sound economic growth.

The international banking scenario has witnessed major turbulence in the past few years in terms of mergers and acquisitions. The main causal factor behind this has been deregulation in the banking sector in the form of three strategies - dismantling of the interest rate controls, removal of barriers between banks and other financial intermediaries, and lowering of entry barriers.[4]

This has in turn led to disintermediation, investors demanding higher returns, price competition, reduced margins, falling spreads and competition across geographies compelling banks to figure out novel schemes to boost their revenues. Consolidation has proved to be an important tool for this and has now become a worldwide phenomenon, driven by apparent advantages of scale economies, geographical diversification, and lower costs through branch and staff rationalization, cross-border expansion and market share concentration.[5] The new Basel II norms have also led banks to consider mergers and acquisitions (herein after referred to as M&As).

Over the past few years, scholars and eminent figures in this field have constantly stressed on the need for several powerful central banks, to allow the Indian banking system to be in consonance with the global banking trends and to increase their competitiveness on an international plane. It is essential to strengthen the fragmented banking industry of the nation.[6]

Consolidation of banks has become a popular strategy over the past few decades. M&As in the banking sector have become the order of the day, globally as well in India, considering the numerous advantages that come along with a consolidation of banks. M&A activities facilitate banks in attaining growth at the strategic level in terms of size and customer base, in increasing their credit creation capacity and it also

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[1] In the words of President Woodrow Wilson: *"A great industrial nation is controlled by its system of credit."* – The New Freedom, 1913.

[2] Dario Focarelli, Fabio Panetta and Carmelo Salleo, *Why Do Banks Merge?,* Journal of Money, Credit and Banking, Vol. 34, No. 4, Ohio State University Press (2002).

[3] VG CHARI, BANK MERGERS AND ACQUISITIONS: IMPLICATIONS AND IMPEDIMENTS (Excel Books Pvt. Ltd. 2008).

[4] Supra note 3.

[5] Ibid.

[6] Supra note 2.

allows banks to reap the benefit of economies of scale through reduction of costs and boosting of benefits.

Theoretical and conceptual analysis of Mergers and Acquisitions

Prior to delving into the legislative framework, issues and challenges surrounding the consolidation of banks, it is necessary to have a well-defined picture of the import of the terms "mergers" and "acquisitions." In common terminology, a merger is the process whereby two or more entities come together to form one single entity. It is known as a *marriage of companies.*[7]The combining entities cease to exist in the eyes of law upon amalgamation and all the assets and liabilities of the combining entities vests ultimately in the newly formed entity.

In contrast to this, an acquisition or a takeover as is referred to in the statutes is a method of restructuring where one company is purchased and absorbed by the acquiring company. "It is a transaction or a series of transactions, whereby a company acquires control over the assets of another company either directly by becoming the owner of those assets or indirectly by obtaining the control of the management of the company."[8] The target company or the acquired company ceases to exist. The provisions governing the procedure of mergers and acquisitions are at variance with each other and the post-consolidation effects and results are also different for both the strategies.

Though the terms mergers or amalgamations, and takeovers or acquisitions are often used interchangeably with each other in common parlance, it is crucial to understand that they connote different meanings and processes in legal terminology. There exists no universal definition of these concepts. Hence, they are generally understood by the process and structures through which these deals are effectuated.

Mr. H.E. Hutcheon[9] has identified the following categories of financial activities of a company as an amalgamation, which stand true even today:

1. A sale of assets of one company to an existing company in consideration of the issuance of paid-up shares.
2. A sale of assets of two or more companies to a new company formed to carry on the businesses of the two companies.
3. A lease of the whole of the undertaking from one company to another.
4. The acquisition of shares of two or more companies by another company.[10]

Although the procedures for bringing a merger into effect may differ, the important aspect to be noted is that the result is the formation of a completely new entity. The previously operating companies are dissolved without having to go through the process of winding up of companies.

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[7]WEINBERG AND BLANK, TAKEOVERS AND MERGERS 1005 (Sweet and Maxwell, 4th Edition, 2010).

[8]Supra note5.

[9]Mr. H.E Hutcheon was the editor-in-chief of the Notes of Cases appearing in the journal: Advocate. He was also the secretary of the Vancouver Bar Association.

[10] H.E. Hutcheon, *Amalgamations,* 21 Advocate Vancouver 109 (1963).

On the other hand, in a takeover, the acquirer gains *control* over the target company and it is in a position to dominate the other. The aspect of control forms the root of the takeover or acquisition process.

Evolution of Bank mergers and acquisitions

Mergers and acquisitions have touched all segments of the financial sector. Consolidation has gripped the financial market and has blurred the boundaries between lending, investment banking, insurance related activities etc. Banks are increasingly venturing into other related financial activities through mergers and acquisitions. Banks, which were protected for a long time through restrictions and regulations, have now become active players in the M&A forefront. This has been prompted by deregulation and liberalization, beginning first with the US banking industry and slowly moving to other parts of the world.[11]

In the period 1996-2001, global bank mergers were valued at 1495 billion dollars, with the major industrial countries accounting for 66.6 per cent of the number and 88.1 per cent of the value.[12]Banking institutions aiming to expand their reach, services offered and their profits have undertaken the M&A route. Other specific requirements have also been to meet new capital adequacy standards and to ensure that they are protected against risks involved in the business of banking.

Legal and factual issues that arise in bank mergers and acquisitions can be summarized as below:

1. The mechanics of the merger and the legal techniques to be adopted for the same: it must be analyzed whether there is a need for a separate legislation or it can be governed by the general laws dealing with corporate acquisitions and amalgamations.
2. There is also a need to understand whether the laws of the specific jurisdiction impose any particular restrictions for the approval of bank mergers in the form of sanctions by regulatory authorities etc.
3. Private law considerations also arise in the aftermath of a bank merger such as those pertaining to bank confidentiality, private contracts etc.[13]

It is necessary to have an in-depth understanding of the legal framework in each jurisdiction so as to provide solutions to these considerations. This research aims to outline the contemporary issues in bank mergers and acquisitions in specific economic jurisdictions with a thorough analysis of case laws, statutes and scholarly literature.

One of the main problem areas concerning banking law today is the multiplicity and rigidity of laws governing the functioning of banks. Particularly in India, the number of compliances to be adhered makes bank mergers a cumbersome process. Therefore there is uncertainty with regards to the dominant role played by the Reserve Bank of India and its extensive powers. This again brings in the problem of whether an overcautious approach and prudential norms are after all necessary to safeguard the

[11]Focarelli, Panetta and Salleo, Supra note2.

[12] T.T Ram Mohan, *Bank Consolidation: Issues and Evidence,* Economic and Political Weekly, Vol. 40, No. 12, 1151 (2005).

[13]ROSS CRANSTON, PRINCIPLES OF BANKING LAW (Oxford University Press, 2nd Edition, 2002).

economy. Another issue that is highlighted is that the current practice of utilizing bank amalgamations to bail out weak banks must be done away with.

Legislative framework governing bank mergers and acquisition in the United States and the European Union

Position in United States:

The merger trend in the banking industry of the United States of America was triggered after the First World War in the 1920s.[14] It revolutionized the banking industry by creation of large banks, introduction of branch banking, strengthening of commercial banks and through the venturing of banks into trust businesses.[15] In the 1930s, bank mergers were mostly prompted by the failure of banks during that decade. Consolidation would aid in regulation of the economic failure of banks. On the other hand, in the forthcoming years, the bank merger trends were mostly oriented towards development of the banking industry as a whole for the purpose of availing economies of scale and for accumulation of profits.[16]

The instrumental factor that triggered this merger trend amongst banks was the passing of the Act of November 7, 1918. This legislation did away with the requirement of liquidation of one national bank in order to be amalgamated with another national bank that would ultimately take over its assets and liabilities. Thenceforth, any two national banks could consolidate through a contractual agreement, if so permitted by their charters and conditional upon the approval from the Comptroller of the Currency.[17] Subsequently, state banks were also allowed to merge with national banks following the same procedure.[18]This simplified the merger process to a great extent and encouraged more bank mergers.[19]

These uncomplicated procedures tremendously increased mergers of banks in the United States and resulted in solidification of the economy as a whole, especially from the 1980s onwards. This is unmistakably clear from data that suggests drastic concentration in the US banking industry. Five of the largest banks in the United States controlled 13.5% of the country's assets in 1980. This number increased by 30% in 1995 to 17.6% of the nation's total assets, and is still on a rise.[20]

Based on these tendencies, empirical studies have lent compelling support to the school of thought that suggests that mergers of banks with similar strategies and

[14] Eugene Nelson White, *The Merger Movement in Banking: 1919-1933,* The Journal of Economic History, Vol. 45, No. 2, 285 (1985).

[15] Charlotte P. Alhadeff and David A. Alhadeff, *Recent Bank Mergers,*The Quarterly Journal of Economics, Vol. 69, No. 4, 503 (1955).

[16]Supranote3.

[17]Supra note1 at 288.

[18] McFadden Act, 1927.

[19]12 U.S. Code § 215a - Merger of national banks or State banks into national banks: "…One or more national banking associations or one or more State banks, with the approval of the Comptroller, under an agreement not inconsistent with this subchapter, may merge into a national banking association located within the same State, under the charter of the receiving association…"

[20] Theresa Morris, *Bank Mergers under a Changing Regulatory Environment*, Sociological Forum, Vol. 19, No. 3, 436 (2004).

characteristics, especially strong banks, would result in an increase in the efficiency of the amalgamated entity and superior post-merger performance.[21]

The legislative structure governing the mergers of banks in the United States of America is quite complex, being closely intertwined with anti-trust laws and considerations of competition among banks. The Sherman Act[22] was enacted in 1890 in order to prohibit combinations that unreasonably restrained trade in the particular industry. Subsequently, the Clayton Act[23] of 1914 was passed to supplement the provisions of the Sherman Act. However, these statutes were inapplicable to the banking sector and therefore to bank mergers itself.

Owing to the causal factors that triggered a rise in the bank mergers and the concentration of banks, it was observed that there was a need to regulate the same as the existing law was inadequate and insufficient to govern bank mergers. It was required that there ought to be some means of dealing with a hierarchy of approvals for bank mergers and also to take into account effects on competition among banks as a result of the consolidation.[24] The Bank Merger Act of 1960[25] was thus passed to regulate bank mergers in the US economy.

The Act provides that for a merger among banks to be effectuated, prior approval must be sought from the Comptroller of the Currency, the Federal Reserve Board and/or the Federal Deposit Insurance Corporation depending on the types of banks amalgamating. These regulatory agencies must take into consideration the effect on competition and tendency towards monopoly as a result of the amalgamation, as well as the possible effects on banking factors.[26] Upon violation of these factors, a suit could be brought against the bank for indulging in anti-competitive behavior.[27]

In *United States v First National City Bank*[28] the district court had dismissed complaints by the Justice Department that the proposed mergers of banks were anti-competitive under the Clayton Act, stating that bank mergers could not be challenged under anti-trust provisions following the Bank Merger Act, 1966. However, the Supreme Court overturned the decision of the trial court and held that a suit for anti-competitive effects could properly be instituted against banks and the burden of proof would lie on the defendant to show that the anti-competitive effects, if any, were outweighed by the benefits to the interests of the community as a whole.[29]

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[21] Kannan Ramaswamy, *The Performance Impact of Strategic Similarity in Horizontal Mergers: Evidence from the U.S. Banking Industry,* The Academy of Management Journal, Vol. 40, No. 3, 713 (1997).

[22] 26 Stat. 209, I5 U.S.C. § 1-7.

[23] 15 U.S.C. § 12-27.

[24] Notes on: *The Federal Regulation of Bank Mergers: The Opposing Views of the Federal Banking Agencies and the Department of Justice Source*, Harvard Law Review, Vol. 75, No. 4, 756 (1962).

[25] Pub L. No. 86-463, 74 Stat. I29.

[26] David A Alhadeff, *Bank Mergers: Competition Versus Banking Factors,* Southern Economic Journal, Vol. 29, No. 3, 218 (1963).

[27] JAMES ELIOT MASON, THE TRANSFORMATION OF COMMERCIAL BANKING IN THE UNITED STATES: 1956-1991 (Routledge, 2011).

[28] 386 U.S. 361 (1967).

[29] Hsiu-Kwang u, Lawrence Connell and Jr, *Merger Myopia:An Economic View of Supreme Court Decisions on Bank Mergers*, Virginia Law Review, Vol. 59, No. 5, 867 (1973).

Subsequently, in *United States v Third National Bank* [30]the Supreme Court once again adopted the approach laid down in its previous judgments. The process to evaluate a merger was enunciated as a two-step process. The court would first appraise whether the bank merger violated the anti-trust laws. In the second step, the court would analyse whether the proposed merger would be able to better serve the financial needs of the community.[31]

An important characteristic viewpoint in this decision was that the court observed that a bank merger could not be justified only on the ground the merger was a necessary step to save a failing bank and thereby protecting the interests of the depositors. A merger of a strong bank with a weak one was not considered as a judicious method of bailing out the weak bank and thus, all other means of managing the issue had to be investigated before sanctioning an amalgamation.[32]

Another landmark judgment in the case of *United States v. Phillipsburg National Bank & Trust Co*[33] was also along the same line of thought. The Supreme Court herein rejected the merger of two banks in the Phillipsburg region on the justification that although the merger would be beneficial for the relevant geographical market delineated, it would increase the concentration of banks in the area. On the basis of these landmark decisions of the United States Supreme Court concerning bank mergers, it was observed that the Department of Justice became the predominant regulatory authority assessing mergers from an anti-competitive perspective.

It is the view of several specialists and scholars on the subject that this entanglement of laws governing mergers and the overriding power of the Department of Justice needs a re-look. Bank mergers must not be so narrowly scrutinized so as to be rejected on the grounds of concentration of banks or possible anti-competitive practices.[34] It has been widely recognized that there is a need for strong banks in the economy which can be achieved through measures of consolidation. The positive effects of bank mergers should be considered in more detail before unsystematically subjecting the mergers to an attack under the anti-trust laws.[35]

It has been opined that bank mergers must not be subjected to any standard stricter than the ones accorded to any merger of financial institutions under the Clayton Act, 1914. Deregulation in the commercial banking sector would encourage even small mergers, which is the need of the hour for the American economy.[36] It would do away with unnecessary litigation, costs and delays, and uncertainties in the banking sector.

Position in European Union:

Bank amalgamations in the EU had reached a progressive state as far back as in the 1920s. For instance, several reports of that particular time period suggest that merger trends among British banks had shifted from the absorption of local banks by bigger

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[30] 390 U.S. 171 (1968).

[31]Ibid. at 185.

[32]Supra note 19 at 868.

[33] 399 U.S. 350 (1970).

[34]Supra note 14 at 39.

[35]Supra note 19 at 884.

[36]*Commercial Bank Mergers: The Case for Procedural and Substantive Deregulation*, Harvard Law Review, Vol. 9, No. 8, 1934 (1982).

banks to amalgamations of two joint stock banks, possessing sufficient funds and credit creation capacities.[37] Hence, the motive was not to bail out weak structures in the economy by merging with healthy ones.

The banking systems of the member-states of the European Union are closely interconnected. It was popularly remarked that: "…Every time there is an attack on the banking system, every government in Europe is active, they intervene. . . . France is just like the others."[38] In fact, cross-border bank mergers among the EU member states have been identified as promoting efficiency and profitability of the consolidated structure and also increasing their geographical spread through a pan-European presence.

However, there are several hindrances to these amalgamations and concerns have been expressed regarding the lack of cross-border European bank mergers. The reason for this is in the form of multiplicity of laws, differing regulatory regimes and tax laws etc.[39]It has been opined that transparency in the merger review and approval process and other procedural regulations in the European Union could encourage the assimilation of the banking markets of the EU member states.[40]

The European Commission Merger Regulations, 1989 govern the procedural aspects of mergers of financial institutions among the European member-states. It lays down that the Commission has the exclusive powers to authorize concentrations that take place within the European Union, including those that take place in the banking sector. Concentration for this purpose means and includes:

a) the merger of two or more previously independent undertakings or parts of undertakings, or
b) the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings
c) the establishment of a joint venture[41]

The Commission must be notified with respect to concentrations above specified threshold limits with a Community orientation. In these matters, the national laws of the member states will not be applicable for the notification, approval and sanction of bank mergers.[42] However, Member States are allowed to take necessary steps to protect legitimate interests other than those that are taken into consideration by the EC Merger Regulations and which are compatible with the general principles and other

[37] 4 Federal Reserve Bulletin 954 (1918).

[38] Close advisor of French President Nicolas Sarkozy, after Societe Generale announced trading losses of almost 5 billion.

[39]Rudi Vander Vennet, Working Paper on: Cross Border Mergers in European Banking and Bank Efficiency (2002), *available at: http://www.ecri.eu/new/system/files/11+Vennet.pdf.*

[40] Matthias Kohler, Transparency of Regulation and Cross-Border Bank Mergers, International Journal of Central Banking, 39 (2009).

[41] Article 3(1) of the EC Merger Regulation ('Definition of concentration').

[42] Article 21(3) of the EC Merger Regulation.

provisions of Community law. Thus, under specific conditions, Member States may derogate from the exclusive powers of the European Commission.[43]

Thus, it is evident that the regulatory procedure governing mergers and acquisitions of banks in the European Union is a knotty process, particularly with respect to cross-border mergers and mergers involving the Community as a whole, based on the specified threshold limits.

Legislative framework governing Bank Mergers and Acquisition in India

Banking institutions, having been established as companies, were initially governed by the provisions of the Companies Act, 1956. The need was then felt to have a separate legal regime to govern merger activities of banking companies. This is primarily because banks, as opposed to companies, are the custodians of public wealth. It is essential to have stricter regulations in place to govern the functioning of banks. Hence, the Banking Regulation Act was brought into force in 1949. It established the structure for supervising the operation of commercial banks in India.[44] Provisions of this Act as well as several other legislations regulate the amalgamation of banks in India.

BANKING REGULATION ACT, 1949

A statute must be constitutionally valid in order to have the force of law.[45] The validity of the Banking Regulation Act, 1949 was questioned in *Shiv Kumar Tulsian and Another v Union of India*[46] wherein it was contended that employees' concerns in mergers and acquisitions of banks were neglected and thus the Act was violative of the fundamental rights of the employees, particularly with respect to Art. 14 and Art. 19 of the Constitution. However, the Bombay High Court upheld the constitutional validity of the Act:

> "*We are satisfied that the provision does not confer any arbitrary, unguided or untrammeled discretion upon the authorities…sufficient guidelines are to be found in the object and purposes of the Act. It can be granted from the other operative provisions of the Act*."[47]

A similar issue was raised before the High Court of Kerala in *Reserve Bank of India and Ors v Paul Francis Ambookan and Ors.*[48] The Central Government passed an order for moratorium on the Bank of Cochin and proposed its amalgamation with the State Bank of India. The draft scheme revealed that certain employees were denied employment in the transferee bank, namely the State Bank of India. Consequently, the employees filed a petition in court challenging the amalgamation as unjust, arbitrary and discriminatory. The learned judge, Mr. Justice Bhaskaran Nambiar held that:

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[43] Article 21(4) of the EC Merger Regulation.

[44] CLIFFORD GOMEZ, BANKING AND FINANCE: THEORY, LAW AND PRACTICE (PHI Learning Co, 1st Ed, 2011)

[45] Constitution of India, Article 13

[46] 1990 68 Com Cas 720 Bom

[47] *Shiv Kumar Tulsian,* 1990 68 Com Cas 720 Bom

[48] 1990 69 Com Cas 320 Ker

> "*…Scheme is statutory; it has the force of law and necessarily it is "law" for the purpose of Article 31A of the Constitution.*[49] *The protective umbrella of Article 31A of the Constitution of India saves the law from invalidation…*"[50]

The procedure for the voluntary merger of banks in the private sector in India is governed by Section 44A of the Banking Regulation Act, 1949. This provision broadly lays down that once two private sector banks have decided to merge, the resolution proposing the amalgamation must be ratified by both the banking companies in their general meeting, by a majority in number representing two-thirds in value of the shareholding of each of the two merging banks. Once this procedural requirement is completed, the resolution encompassing the scheme of amalgamation must be submitted to the Reserve Bank of India for its sanction and approval. Once the RBI sanctions the scheme, it becomes binding on the banking companies and all the shareholders and members involved.[51]

Despite being a self-contained code, the Reserve Bank of India deemed it necessary to evolve further guidelines for the voluntary merger of banks. A Working Group was constituted in 2002 for this purpose. In the view of the Reserve Bank of India:

> "*…amalgamations are normally decided on business considerations such as the need for increasing the market shares, synergies in the operations of businesses, acquisition of a business unit or segment etc.…considerations like rationale for the amalgamation, systemic benefits and advantages accruing to the residual entity are evaluated in detail…*"[52]

Hence, the RBI Guidelines for voluntary mergers of banks lay down provisions for the process of merger proposal, determination of swap ratios, disclosures to be made, stages at which Boards will get involved in the merger process and norms of buying or selling of shares by the promoters before and during the process of the merger.

The powers of the Reserve Bank under this provision does not affect the power of the Central Government to mandate a compulsory amalgamation of banking companies[53]

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[49] Article 31A (1) (c) of the Constitution saves laws "providing for the amalgamation of two or more corporations, either in the public interest or in order to secure the proper management of any of the corporations", from being challenged on the ground that they are inconsistent with, or take away or abridge any of the rights conferred by Article 14 or Article 19.

[50] *Reserve Bank of India,* 1990 69 Comp Case 320 Ker

[51] Banking Regulation Act, 1949, §44-A: "…amalgamation is approved by the requisite majority of shareholders…it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank…be binding on the banking companies concerned and also on all the shareholders thereof."

[52] RBI Circular Ref. DBOD. No. PSBS.BC. 89/16.13.100/2004-05

[53] Banking Regulation Act, §44-A (7): "Nothing in the foregoing provisions of this section shall affect the power of the Central Government to provide for the amalgamation of two or more banking companies 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."*

under Section 396 of the Companies Act, 1956 (correspondingly Section 230-234 of the Companies Act, 2013). [54]

As per the initial framework of the Act, banks could only be merged on a voluntary basis. However, gradually the need was felt for the Government to step in and take measures for strengthening the banking system. In view of this, the Act was amended to incorporate provisions to allow the Government to amalgamate banks so as to eliminate small and weak units that were detrimental to the functioning of the economy.[55] In the event that a banking company under financial distress has been placed under an order of moratorium by the Reserve Bank of India, the RBI may further make an application to the Central Government for the purpose of framing a scheme for forcing the merger of the weaker bank with a stronger bank. The objects behind this could be four-fold:

1. In the interest of the public;
2. In the interest of the depositors of the weaker bank;
3. To secure effective management of a bank; or
4. In the interest of the banking system as a whole.[56]

Apart from the voluntary and compulsory amalgamations, the Central Government is also vested with the power to acquire the undertaking of a banking company when there is a mis-management of its affairs or in the wider interests of banking policy at large. For this purpose, the Central Government must make the requisite orders after consultation with the apex banking institution, the Reserve Bank of India.[57]

BANKING COMPANIES (ACQUISITION AND TRANSFER OF UNDERTAKINGS) ACT, 1970

The procedure for amalgamation of a nationalized bank with any other nationalized bank or other banking institution is not governed by the provisions of the Banking Regulation Act, 1949. The BR Act only regulates the functioning of private sector banks in India. Amalgamation of public sector banks is provided for in a separate statute namely, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. Section 9 states that:

> "…*The Central Government may, after consultation with the Reserve Bank, make a scheme for carrying out the provisions of this Act…the reconstitution of any corresponding new bank into two or more corporations, the amalgamation of any corresponding new bank with any other corresponding new bank or with another banking institution, the transfer of the whole or any part of the undertaking of a corresponding new bank to any other corresponding new bank…*"[58]

[54] Companies Act, 1965, §396 (1): "Where the Central Government is satisfied that it is essential in public interest that two or more companies should amalgamate…it may provide for the amalgamation of those companies."
[55] TANNAN, *supra note* 6 at 440
[56] Banking Regulation Act, §45
[57] Banking Regulation Act, §36-AE: "…upon receipt of a report from the Reserve Bank, the Central Government may, after such consultation with the Reserve Bank as it thinks fit…acquire the undertaking of such company…"
[58] The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, §9(2)(c)

The merger of a public sector bank with the State Bank of India is also governed by the procedural requirements laid down under Section 9 of the Act. This is evinced from Explanation I appended to the provision which specifies that the applicability of the provision extends to the State Bank of India as well.[59] Hence, it is recognized that for amalgamation of public sector banks, there is a dual level of control that is with the Reserve Bank of India as well as the Central Government.

Despite the encouragement of bank mergers in the post-liberalisation period, it has been argued that the compulsory merger of public sector banks has been carried out in a way that has proven to be unfavourable to the common man.[60] Policy decisions of the Indian Government over the past decade have indicated that promotion of mergers among PSBs has become an issue of precedence, largely influenced by the views that such consolidation by increasing the size of the banks also increases its efficiency and its competitiveness in the international market place.[61] However, it is the view of certain economists and authors that this motive behind merger of PSBs has toned down the responsibility that these banks could have taken up and the part they could have played in extending loan facilities to small consumers, borrowers, and venture capitalists, among others.[62]

Conclusion:

One of the important questions for research framed in this study was to examine whether the existing legislative framework facilitates bank mergers in India. Through an in-depth investigation of the laws, it can be concluded that the multiplicity of laws in the Indian framework is overburdening the banks as well as the regulatory authorities. It has been clearly established that bank mergers are the need of the hour. It is necessary in order to protect the economy from inherent risks as well as to strengthen the existing structure. In terms of this, it is necessary that the legislative framework is such that it encourages and easily facilitates mergers and acquisitions of banks.

The current procedural laws are too many in number, pertaining to the different types of banks in the economy. There is also a requirement of approaching and obtaining sanctions from several regulatory agencies and bodies for approving a merger scheme, making the entire process very cumbersome. Though the need for consolidation of banks has been widely recognized, the Indian financial sector is being very conservative in its approach towards bank mergers. Prudential norms and guidelines have been adopted to ensure that the banking sector is protected from risks. However, the Reserve Bank of India has assumed a dominant role in sanctioning bank mergers.

There is a need to regulate the role played by the RBI and ensure that mergers in the economy are market driven rather than be forced by the Government. Several studies have suggested that the method of using mergers to bail out weak banks in the economy by amalgamating them with larger, stronger banks proves detrimental to the

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[59] The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, §9(2)(c): Explanation I: In this section, "banking institution" means a banking company and includes the State Bank of India or a subsidiary bank.

[60] Amiya Kumar Bagchi and Subhanil Banerjee, *How Strong are the Arguments for Bank Mergers?,* Economic and Political Weekly, Vol. 40, No. 12, 1181 (2005)

[61] Ram Mohan, *supra note* 13

[62] Amiya Kumar Bagchi and Subhanil Banerjee, *supra note* 30

health of the stronger bank and results in adverse effects to the economy itself in the long run. The second Narasimham Committee recommended that the mergers and acquisition in banking sector to be based on synergies and business specific complementarities rather than just being a method of bailing out of weak banks. This recommendation by the committee paved way for M&A of banks with other financial institution. But the powers of RBI remained intact even in the above case which needed an overlook not only from financial perspective but as well as from the competitive perspective in which competition commission of India (CCI) could have played better role.

Through a corresponding analysis of laws in the United States of America and the European Union, it is observed that although complicated in their own ways, there is no disadvantage of multiplicity of laws, statutes, rules and guidelines governing bank mergers. Additionally, mergers in these jurisdictions have been seen to be driven by market conditions and by advantages of economies of scale. Bank mergers to bail out weak structures in the economy have been discouraged since the origin of bank mergers itself. These observations must be incorporated into the Indian legislative framework as well.

The laws in the EU and the USA are entangled with the laws governing the individual states (in the case of the EU) and anti-trust laws and competition concerns (in the case of the USA). This has led to complexities in the banking regime. However, this issue has been tidily dealt with under the Indian banking laws by keeping bank mergers outside the control of the Competition Commission of India.

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