

THE 2020 PSB MERGERS & THEIR IMPACT

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INTRODUCTION

In any country, banking is one of the most vital structures because this promotes economy and enables cash flow and easy flow of other monetary resources. Merging of banks is a common practice, because they are usually for various reasons such as increasing market share, diversifying products and services, reducing competition, achieving economies of scale, and improving financial performance.¹ Usually mergers are governed by the Companies Act, 2002 but those between banking entities are governed by Banking Regulation Act, 1949. It provides guidelines and regulatory oversight for bank mergers, including approval from the Reserve Bank of India, and ensures the protection of depositors' interests.² Mergers under this act are either voluntary in nature or via means of compulsory amalgamation as result of order of RBI.³ However, wrt of Public Sector Banks (PSBs), which is regulated by Section 9(1)(c) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980, allows the central government to appoint new directors for the merged banks to ensure effective management and operation.⁴

Competition laws have been enacted in every economy to ensure fair competition in the market. Similarly, India has the Competition Act, 2002 promotes fair competition, prohibits anti-competitive agreements and abuse of dominant market position, and regulates mergers and acquisitions to ensure the protection of consumer interests. It regulates mergers and acquisitions to ensure that they do not have an adverse impact on competition and provides for the assessment of such transactions by the Competition Commission of India.⁵

While antitrust laws are crucial for maintaining fair competition across all industries, there are some industries that are excluded from these laws due to reasons such as national security, public interest, and cost reduction.⁶ By the section 54, the Central Government can exempt certain enterprises or agreements from the application of the Competition Act for a specified period if it deems necessary in the interest of national security or public interest, if arising from international obligations, or if the enterprise performs a sovereign function on behalf of the government.⁷ The Indian Government, exercising its power of exemption, issued a notification on August 30, 2017, exempting all mergers and

¹Sugata Banerjee, 'Rivisiting Bank Mergers: Does Size Matter?' (2017) 52 Economic and Political Weekly.

²Joseph Vellikuneel v. Reserve Bank of India, AIR 1962 SC 1371.

³Section 44A, Banking Regulation Act, 1949.

⁴Section 9(1)(c) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.

⁵Section 6(1) Competition Act, 2002.

⁶S.R. Khemani, Application of Competition Law: Exemptions and Exceptions (United Nations Conference on Trade and Development, 2002).

⁷Section 54 Competition Act, 2002.

amalgamations between public sector banks from the purview of Sections 5 and 6 of the Competition Act, 2002 for ten years.⁸ The GoI implemented the mega merger of ten PSBs into four large PSBs with effect from April 1, 2020, with the goal of giving the PSBs the required financial standing to combat the rising non-performing assets and to make Indian banks competitive internationally.⁹

By the RBI circular, post the announcement by the finance minister, the amalgamation of PSBs was declared. Ten PSBs amalgamated into four banks which was to bring the total number of PSBs in India down to twelve.¹⁰ As per the mega merger plan, Syndicate Bank into Canara Bank; Andhra Bank and Corporation Bank into Union Bank of India; Oriental Bank of Commerce and United Bank of India merged into Punjab National Bank; and Allahabad Bank into Indian Bank.¹¹

It is an unprecedented move to exempt PSB mergers from the application of the competition law. Such a large-scale merger could harm the banking sector's competitive environment, and if the merger's goals are not met, the consequences could be disastrous for the Indian banking sector.

WHY PUBLIC SECTOR BANKS ARE EXEMPTED

The threat of non-performing assets has been steadily growing in the Indian banking industry over the years, and most of it is held by PSBs in India.¹² In the pre-amalgamation period, most of the PSBs were facing a tough time financially as well as strategically to cope up with such a huge amount of NPAs vis-à-vis their own financial standings, the RBI Financial report in June 2018 revealed that eleven public sector banks may experience a worsening of their Gross NPA ratio from 21.0 per cent in March 2018 to 22.3 per cent.¹³ While gross NPA in March 2020 declined to 8.5 per cent of Scheduled Commercial Banks. Post the amalgamation, the RBI Financial report in July 2020 revealed that:

“Network analysis reveals that total bilateral exposures among entities in the financial system declined marginally during 2019-20; with the inter-bank market continuing to shrink and with better capitalisation of public sector banks (PSBs), there would be reduction in contagion losses to the banking system under various scenarios in relation to a year ago.”

⁸ Ministry of Corporate Affairs, ‘Gazette of India’ (30 August 2017) <https://egazette.nic.in/WriteReadData/2017/178385.pdf> accessed 3 April 2023.

⁹ Reserve Bank of India, ‘RBI/2019-20/197’ (30 March 2020) <https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/NT1978026F148C28D4BED9EADCAD322C41289.PDF> accessed 1 April 2023.

¹⁰ ‘Merger of 10 Public Sector Banks into 4 to Come into Effect from Apr 1: FM’ (Business Standard, 4 March 2020) https://www.business-standard.com/article/pti-stories/banks-merger-to-come-into-effect-from-apr-1-says-sitharaman-120030400934_1.html accessed 1 April 2023.

¹¹ Reserve Bank of India (December 2020), Bank Branch Statistics, retrieved from <https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#14..>

¹² Non-Performing Assets: Challenges and Solutions (Lok Sabha Secretariat, 2018) https://loksabhadocs.nic.in/Refinput/New_Reference_Notes/English/Non-Performing.pdf accessed 1 April 2023.

¹³ Reserve Bank of India, ‘RBI releases Draft Directions on Issuance and Operation of Prepaid Payment Instruments (PPIs) in India’ (Press Release, 17 March 2021) https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=44305 accessed 1 April 2023.

In other words, in order to solve the problem of rising NPAs, the central government's policy favoring bank mergers implies increased efficiency of the merged banks through economies of scale and scope.¹⁴ Since the central government's mega merger plan was going to have a significant effect on the competition environment in the Indian banking sector, an exemption under the Competition Act, 2002, was necessary. Otherwise, the Competition Commission of India would have required compliance. To put it plainly, massive consolidation of PSBs would not be legal under the Competition Act of 2002 without an exemption. Furthermore, the lack of financial capabilities to solve the issue of NPAs was also having a negative impact on the overall financial standing and accounts of the PSBs. It was through this mega merger that the central government planned to create larger banks through which the global competitiveness of the Indian banks could be improved. For instance, after the mega mergers, the Punjab National Bank became the second largest public sector bank in India having a total of 12,736 branches in India after the largest number of branches being held by State Bank of India, over 22,000 branches.¹⁵ The objectives behind different mergers and amalgamations are frequently the desire for expansion, profitability, a stronger balance sheet, and a larger customer base. These are also the main factors pushing PSB mergers forward, giving them a chance to fight on a global scale in the future. A 550 billion rupee capitalization plan was also used to support the merger of these significant PSBs in 2019, which emphasises the clear intention of the central government to ensure that the PSBs recover their financial competitiveness. Furthermore, it should be mentioned that the authority to exempt under Section 54 of the Competition Act, 2002 can be used for either public interest or security of the state, as well as for agreements and commitments made on an international level or for businesses carrying out sovereign duties. The banking industry is crucial to every nation's economy because it meets the financial needs of businesses and the economy as a whole through its fundamental functions of lending loans and keeping the deposits of its customers, even though the central government does not issue any statement of object and reason when exercising its power to exempt a business. Based on the circumstances and intention with which the mega merger was proposed in 2019 for the public sector banks.¹⁶

Since banks are crucial to a nation's economy, the better it is for the banks' financial situation. However, in recent years, Indian banks, particularly public sector banks, have struggled with their financial stability due to an excess of non-performing assets (NPAs) and a lack of financial and managerial resources to sustain themselves. This has a direct impact on the economy because it prevents the banks from performing even their most fundamental function of making loans, as it should ideally. Therefore, it is thought that mergers will help them regain their financial strength and give them a globalized base, both of which will have a

¹⁴Sugata Banerjee, 'Rivisiting Bank Mergers: Does Size Matter?' (2017) 52 Economic and Political Weekly.

¹⁵Mahesh L Chaudhary, Abhishek Wadhawan, Jalaj Pandey and Ved Thakur, 'Exemption of Public Sector Banks Mergers in India From Competition Act, 2002 : Determining the Rationale, Implications and Issues' (2021) 11 GJLDP (October) 161.

¹⁶Ravi Sharma and Shashi Sharma, 'Banking Sector in India: An Overview' (2014) Global Journal of Commerce and Management Perspective, 37-39.

beneficial effect on the economy. As a result, the entire act of waiver from the provisions of the Competition Act, 2002 for merger can be said to have been done for general interest.

INTERNATIONAL PERSPECTIVE

It is frequently argued that the financial sector has its own regulator and that the regulator of the financial sector, not the competition authority, should have the authority to decide on matters of competition within the sector because the financial sector has its own needs and demands that the competition authority cannot fully comprehend. One group of nations in this respect are those in which the competition authority is permitted to apply the law of competition to the financial sector. For instance, in Mexico, all sectors, including the banking industry, are subject to the Federal Law on Economic Competition. According to Article 27 of the Credit Institutions Law, any merger of banks in Mexico needs approval from the Ministry of Finance and Public Credit (Mexico), which makes the decision after consulting with Banco de Mexico and the National Banking and Securities Commission. There are no exemptions established in this regard, but the Federal Competition Commission's (Mexico) opinion and decisions are final with regard to the competitive aspect of bank mergers.¹⁷ On the other hand, a different group of nations are those where the competition authority serves as a consultative agency when bank mergers occur in the financial sector. In Chile, banks and financial institutions are required to notify the Bank Superintendence before merging, and the Bank Superintendence may ask the competition authorities for their opinion on a proposed merger between the banks and its impact on the banking industry's competition. However, this type of consultation with the office is not required and is occasionally not even followed by the authorities.¹⁸ Furthermore, in Italy, the provisions of the competition law apply to banks, but the Central Bank of Italy is responsible for enforcing them. In such instances of a bank merger, the competition authority is only required to advise the Central Bank on the aspect of the bank merger and its impact on the competition.¹⁹

Finally, there is a third group of nations where the competition body has no responsibility. For instance, the Superintendence of Commerce and Industry is the body mandated by Columbian law to oversee the correct implementation of the country's competition laws throughout the economy; however, this body lacks the authority to enforce those laws in the financial sector. Therefore, neither the general competition authority nor the Superintendence of Commerce and Industry has the authority to regulate the competition in the financial sector in Columbia as it is not covered by the general competition legislation of the nation.

¹⁷David Biggar and Adam Heimler, 'An Increasing Role for Competition in the Regulation of Banks' (2006) Subgroup 1, ICN, Bonn.

¹⁸OECD/IDB, 'Competition Law and Policy in Chile: A Peer Review' (OECD Publishing, 2004).

¹⁹David Biggar and Adam Heimler, 'An Increasing Role for Competition in the Regulation of Banks' (2006) Subgroup 1, ICN, Bonn.

The examination of the three types of international experiences regarding the influence of the competition authority on the financial sector, particularly the mergers of banks in the respective jurisdictions, indicates that all nations have some mechanism in place whereby the competition law aspects are also taken into consideration during bank mergers, either through the competition authority or the regulatory authority of the financial sector of the country. As the provisions of the antitrust laws are made with the intention to ensure proper competitive forces and practises within industry, it is pertinent and interesting to note that generally speaking, the countries do not grant complete exemption to any bank mergers from the application and scrutiny of the applicable competition law.

IMPACT OF MERGER

Impact post-merger, can be assessed on the following 3 bases:

1. economic performance of the country
2. post-merger accounting profits, operating expenses, and efficiency ratios
3. merger gains in terms of stock price performance

On the first issue, as per the RBI's Financial Stability Report,²⁰ the net non-performing assets have dropped to a 10-year low of 1.3% and gross NPA ratio fell to a seven-year low of 5.0 per cent in September 2022 of scheduled commercial banks. As per RBI's Financial Stability Report, the net non-performing assets have dropped to a 10-year low of 1.3% and gross NPA ratio fell to a seven-year low of 5.0 per cent in September 2022 of scheduled commercial banks. 5.53 per cent in December 2022. It cannot be definitively stated that this improvement is solely due to the merger. On second issue, the expansion of the banks' capital bases was one of the merger's key objectives. By doing so, the acquirer banks would be better able to offer larger loan amounts and a wider range of products, such as mutual funds and insurance, in addition to the more conventional loans and deposits. CRAR average of PSU as of 31st March 2022, is 15.56%, which is a significant improvement from 2020, which was around 12%. The study also looks into the key financial indicators like return on equity (RoE), provisioning coverage ratio (PCR), credit cost, and slippage ratio (SR).

²⁰Reserve Bank of India, 'RBI announces measures to improve functioning of Asset Reconstruction Companies' (Press release, 22 June 2021) https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54955 accessed 1 April 2023.

| Parameters | UBI | | Canara | | PNB | | Indian Bank | |
|-------------|--------|-------|--------|-------|--------|-------|-------------|-------|
| | FY 20 | FY 22 | FY 20 | FY 22 | FY 20 | FY 22 | FY 20 | FY 22 |
| RoE | -17.06 | 7.94 | -6.78 | 15.0 | -18.65 | 5.96 | 3.4 | 10.52 |
| SR | 7.91 | 2.93 | 4.28 | 1.75 | 4.84 | 3.90 | 6.0 | 3.63 |
| Credit Cost | 3.15 | 2.0 | 2.83 | 1.40 | 3.22 | 1.91 | 3.35 | 2.15 |
| PCR | 78.21 | 83.61 | 76.95 | 84.17 | 79.40 | 81.60 | 78.17 | 87.38 |
| CRAR | 12.01 | 14.52 | 12.96 | 14.90 | 12.33 | 14.50 | 14.06 | 12.53 |

Further, a DPN, a letter of pledge, and an accept delivery letter are three documents that, after the merger, customers find to be more layered in processing, sanction, and disbursement. Additionally, each of these documents is subject to a distinct stamp duty, which places an additional burden on small borrowers. Several times, checks were returned for “want of funds” when the accounts had enough money in them to pay the check, and the customer was charged penalties. Fixed deposit (FD) quarterly interest payments were not paid by the deadlines. The payment of loan installments tied to deposit interest was impacted by this failure. Despite the auto-renewal requirement, there have been instances where matured FDs were not renewed; when personal issues were raised, the banks requested the impacted parties to provide letters, but these letters were not quickly responded to. Data integrity was impacted during the transfer of client information from Merged Banks to Amalgamated Banks. To their surprise, depositors discovered that their relationships with the nominees differed from what had been initially stated: a spouse became a “other,” a boy became a daughter, and so on. Account holders’ addresses were not properly transferred to Amalgamated Banks’ database. Standing orders and requirements for regular interest payments were not followed.²¹

On 3rd issue, with respect to, stock market performance they still have been over shadowed by private peers. With biggest bank players still being HDFC, IndusInd and Kotak.

²¹Sucheta Dalal, ‘The PSB Mega-Mergers Integration: Still a Work in Progress - Part 1’ (2021) Moneylife, <https://www.moneylife.in/article/the-psb-mega-mergers-integration-still-a-work-in-progress-part1/63284.html> accessed 1 April 2023.

CONCLUSION

The exemption made it possible for the mega mergers to take place effectively without any interference from the Indian Competition Commission regarding their impact on the banking industry's competitive environment. This strategy, however, is different from those used internationally, where nations do not completely exempt any bank mergers from the application and examination of the relevant competition law because the antitrust laws' provisions are meant to ensure proper competitive forces and practices within the industry.

As a result, the mega merger of the PSBs appears to have been successfully completed, and the achievement of the stated goals appears to be on the correct track with better financial outcomes. To celebrate the achievement would be premature, though, as the financial data being examined only covers the first& second year following the merger. The sustainability of the combined banks depends on how well they manage problems like managing cultural diversity, rationalizing physical infrastructure and human resource management, and synchronizing IT infrastructure and business processes among the combined banks. Furthermore, it is crucial to maintain effective communication and collaboration among the employees of the combined banks to ensure long-term success.