CHAPTER- III

BANK MERGERS: REGULATORY REGIME IN INDIA

3.1. Introduction: Banks are unique as they not only accept and arrange large amounts of public funds in fiduciary capacity, but also leverage such funds through credit creation. Therefore, failure of a bank has a disastrous effect on depositors as it operates largely by the funds deposited by the public. Instability in the banking system has an adverse consequence on the economy. A perpetual justification of financial regulatory reform is the restoration of trust and confidence in the market for the financial products and services. Therefore, Banking Regulation is now an international activity. Basel

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303 “There is a substantial body of regulations in many countries around the world. That attempts to deal with moral hazard problem of banks. This prevent bank from taking certain actions, such as making certain investments or loans that are deemed to be risky” Lucian A Bebchuck and Holger Spamann, “Regulating bankers pay” 98 Georgetown Law Journal 247(2010).


305 Nafis Alam, ‘Does Banking Regulation affect banking efficiency? A survey of dual banking system’ 2012 Journal of International Banking Law and Regulation 231 “Banking regulations can generally be defined as the frameworks controlling the creation, operation and liquidation of banks in an economy. These regulations are put in place by Central Banks and finance ministries and the control is usually exerted through monitoring carried out by specialized banking supervisory authorities”.

306 Dr. Toussant Bouycee, ‘Automaticity in International Financial Regulation’, 2014 Journal of International Banking Law and Regulation 490 – “Where the author states that the modern regime for global regulatory bank capital standards developed by the Basel Committee on Banking Supervision (BCBS) is the powerful soft-law "Basel standards” or "Basel capital requirements”. From Basel I (1988), Basel II (2004), Basel 2.5 (2009), and most recently Basel III (2010) they are continuously upgraded to reflect new risks, to standardize bank capital and regulate its adequacy. Regulators can determine the particular financial risks (e.g. credit risks) that an institution faces and the appropriate level of loss absorbing capital by calibrating capital to those risks”.

Also in George Alexander Walker, “International Banking Regulation: Law, Policy and Practice” Kluwerlaw International (2001) at P.78 Author says that “Despite the creation of growing body of substantial supervisory and regulatory provision, Basel process remains fundamentally incomplete in the absence of any formal review and enforcement mechanism…”. He also says that “in the light of important and highly sensitive nature of the banking and financial service sectors within any economy it has to be accepted that it is very difficult, if not, impossible to agree any detailed series of comprehensive supervisory and regulatory rules which could be set out in an international treaty and
Committee on Banking Supervision and the International Organization of Securities Commission (IOSCO) has been central in forming international standards for banking regulation\(^{307}\). Member countries are bound to implement the same through their domestic legislation\(^{308}\). By 2018-2019, Basel- III\(^{309}\) norms has to be implemented by the banking companies\(^{310}\).

Banking system in India plays a key role as an instrument of social and economic change. The nationalization of private sector banks in 1969 and 1980 reflected the apparent need for state control\(^{311}\) to use banks as an instrument of growth so that public savings could be used for social and economic objectives\(^{312}\). In the context of financial services, absence of regulation and supervision can lead to deadlock. Banks are so linked to one another in the market place; they are liable to systemic risk because when one bank fails, there is a run on all the other banks. Continuing solvency of a bank depends on its customers retaining their confidence that their money is safe while it is to which all countries could then adhere. There is then a basic treaty or source of law vacuum in this area…” Also at P. 275, author states that in deed the development of bank and financial market control in most countries generally has often simply been one of attempting to respond to specific incidents of financial difficult as they arise rather than by attempting to construct any more complete and coherent programme of measures in advance”. This is also true of the position in India. Despite, the regulatory control exercised by Reserve Bank of India, more than 22 banks failed during 1960-2015. This shows that the existing regulatory regime is inadequate to control bank failures. Often Central Government and Reserve Bank of India, invoke section 45 and 36 AE of the Banking Regulation Act, 1949. There are strong regulations stipulated while a company obtain license to carry banking business, however, lack of continuous supervision lead to bank failures in India. Thus, Regulation and Supervision need to be strengthened and revived to avoid bank failures.

\(^{308}\) More than 28 countries are members of the Basel Committee on banking supervision.
\(^{309}\) Basel –III was in response to the financial crisis in 2007-08. It aims to strengthen bank capital requirements by increasing bank capital adequacy.
\(^{310}\) Capital adequacy norms prescribed for the banks by Basel committee is too high, thus there is a strong need for consolidation of small banks with larger public sector banks. Finance ministry has proposed for the larger banks in the public sector to acquire the smaller banks.( The Hindu Business Line, April 20, 2015)
\(^{311}\) An important method of control is under section 22 of the Banking Regulation Act, 1949, where every bank is required to hold a license from the Reserve Bank. This is to check the mushroom growth of banking companies.
with the bank\textsuperscript{313}. Regulation\textsuperscript{314} therefore can have a positive beneficial effect of breaking a deadlock by offering a guarantee that all participants will behave within certain standards\textsuperscript{315}. Bank supervision requires more of a safety and soundness approach, with supervisors closely monitoring the institutions financial condition and risk management practices, imposing capital requirements, and placing quantitative limits on risk exposure\textsuperscript{316}.

The number of banks in many countries is shrinking\textsuperscript{317} rapidly as larger banks absorb smaller banks and as large banks merge with one another\textsuperscript{318}. The factors those are primarily responsible for the recent pace of voluntary mergers\textsuperscript{319} and acquisitions\textsuperscript{320} in the banking industry includes technological progress\textsuperscript{321}, financial distress\textsuperscript{322} and


\textsuperscript{314} R. Glenn Hubbard, “Money, the Financial System and the economy” 2\textsuperscript{nd} Edn.,(1996) at Page 76, author states that first stage in the regulatory pattern is a crisis in the banking industry. Where if the depositors lose confidence in bank’s ability to use their funds wisely, a bank run would result as depositors tried to withdraw their funds. Second stage occurs when government steps into end crisis through regulation. Government generally intervenes when it perceives instability in the financial institutions and when political pressures make intervention advisable. Third stage is response by the financial system- A major regulatory intervention- deposit insurance. Fourth stage occurs with regulatory response. Regulators observe the impact of regulation on changes in the way that financial institutions do business. In particular, when financial innovation circumvents regulatory restrictions, regulators must adapt their policies and seek new authority as a regulatory response”.


\textsuperscript{317} State Bank of India proposed for the acquisition of its five associates (June, 2014)


\textsuperscript{319} Mergers and acquisitions lead to two formerly independent firms becoming a commonly controlled entity, but there are subtle differences between the two. While acquisitions refers to acquiring control of one corporation by another, merger is a particular type of acquisition that results in combination of both the assets and liabilities of acquired and acquiring firms. In merger only one organization survives and the other goes out of existence.

\textsuperscript{320} Ibid.,

\textsuperscript{321} Merger between Centurion Bank and Bank of Punjab (October 1, 2005). Both banks were given license under the new bank license policy, when Dr. Manmohan Singh, then finance minister of India. Both banks had good technological up gradation compared to other banks. On August, 2009 Lord Krishna Bank merged with Centurion Bank of Punjab. This enabled Centurion Bank of Punjab to strengthen its presence in south India. Later, Centurion
The integration of financial markets has blurred the distinction between activities such as lending; investment banking, asset management and Insurance. Consolidation would improve competitiveness of banks globally and also improve financial stability. In the Indian context, mergers and acquisitions provide a platform for a financially weak bank to gain strength by merging with a stronger bank. Motivation behind the mergers may not be increase in operating efficiency of banks but to prevent financial distress of weak banks.

Consolidation increases the efficiency of the banking industry and it eliminates the least efficient banks. Consolidation should benefit the economy as a whole, stimulating economic growth and improving access to credit and banking services. In the Indian context, multiplicity of laws and varied nature of banks slow down the growth of banking companies through mergers and acquisitions. Moreover, there is no uniformity in the merger provisions governing banking companies.

In this background, this chapter studies the regulatory regime governing banking companies in India. First part of the chapter addresses the Evolution of Banking Regulation in India. Secondly, it examines the rationales for separate legal regime for banks and it also analyses the motivations for consolidation in the banking sector.


Global Trust Bank with Oriental Bank of Commerce was due to the capital erosion. Global Trust bank was engaged in fraudulent practices and it was financing the brokers. GTB could not recover the money from them as there was insufficient security for the advances given by it.


Dario Focarelli et al. ‘Why do banks merge?’ 34 Journal of Money, credit and Banking 2002

Initially, Canara Bank agreed to acquire Amanath Co-operative bank (January, 2014) as per the scheme approved by RBI under Section 44A of the Banking Regulation Act, 1949. But it withdrew from the same stating that it would suffer huge financial erosion. [Matter is pending before the Karnataka High Court].

The number of banks merged during 1969-2015, was with the objective to save the weaker banks. Criticism leveled against it was that the licensing and supervision of these banks have been inadequate from the part of the bank regulators.

M.Jayadev&Rudrasensarma, ‘Mergers in Indian Banking: An Analysis’ accessed on 28th July 2011
Further it discusses the regulatory regime for bank mergers in India. It also critiques the categories of bank mergers and their governing statutes. Further, it compares between bank merger routes and its rationale for differential treatment to such banking institutions. The Chapter also gives importance to the substantial question of law, i.e. Merger of Non-Banking financial companies with the banking companies. It critically analyses the role of tribunal and RBI in the approval of such mergers. Further the chapter focuses on the Consolidation of the Regional Rural Banks (RRBs). Then; it examines the merger Laws of State Bank of India and Its Associates and the purpose of special treatment to State Bank of India and its associates, the law and procedure of such mergers. Finally, it critiques the law governing consolidation of Co-operative Banks, its legal nature, categories of co-operative banks, and the role of RBI in Regulating Co-operative Banks - it also provide the case studies on recent merger among co-operative banks.

3.2 Evolution of Banking Regulation in India

Bank merger laws cannot be studied without knowing the evolution of banking regulation in India. In the very early phase of commercial banking in India, the regulatory framework was somewhat diffused and the Presidency Banks were regulated and governed by the Royal Charter, the East India Company and the Government of India.

A detailed examination of the statutory recognition of special provisions for banking companies is discussed in chapter II.

V. Leeladhar, “Evolution of Banking Regulation in India – A retrospect on some aspects” www.rbidocs.rbi.org accessed on Aug 2009. “The roots of commercial Banking in India can be traced back to the early eighteenth century when the bank of Calcutta was established in June 1806. This was renamed as Bank of Bengal in January 1809 – mainly to fund General Wellesley’s Wars. This was followed by the establishment of bank of Bank of Madras in July 1843, as a Joint stock company through the reorganization and amalgamation of four banks (Viz., Madras Bank, the Carnatic Bank and Bank of Madras and Asiatic Bank). This bank brought about major innovations in banking such as use of joint stock system, conferring limited liability on the shareholders, acceptance of deposit from the general public etc. The Bank of Bombay was established in 1868. The three Presidency Banks were amalgamated in January 1921 to form the Imperial Bank of India which acquired the threefold role of a commercial Bank of a Banker’s bank and of a Banker to the Government. It is interesting here to note that merger of banks and consolidation in the Indian Banking system is not as recent phenomenon as is often thought to be and dates back to at least 1843”.

India of that time. Though the Company law was introduced in India way back in 1850\textsuperscript{331}, it did not apply to the banking companies. The banking crisis of 1913, however, had revealed several weaknesses in the Indian banking system, such as the low proportion of liquid assets of the banks and lending practices, resulting in large-scale bank failures\textsuperscript{332}. The recommendations\textsuperscript{333} of the Indian Central Banking Enquiry Committee (1929-31)\textsuperscript{334}, which looked into the issue of bank failures, paved the way for legislation for banking regulation in the country\textsuperscript{335}.

Though Reserve Bank of India, as part of its monetary management mandate, had, from the very beginning, been vested with the powers, under the RBI Act, 1934, to regulate the volume and cost of bank credit in the economy through the instruments of general credit control, it was not until 1949 that a comprehensive enactment, applicable only to the banking sector, came into existence\textsuperscript{336}. Prior to 1949, the banking companies, in common with other companies, were governed by the Indian Companies Act, 1913, which itself was a comprehensive re-enactment of the earlier company law of 1850\textsuperscript{337}. As there was no immediate prospect of a legislation dealing solely with the banking companies, Indian Companies Act was amended in 1936 and a separate chapter containing the provisions relating to banking companies was added to that Act. This Act, however, contained a few provisions\textsuperscript{338} especially applicable to banks. There were also a few \textit{ad hoc} enactments,

\begin{itemize}
\item \textsuperscript{331} Joint Stock Companies Act, 1850 (First legislation to govern the Indian companies)
\item \textsuperscript{332} Dr. Manmohan Singh, “Reserve Bank of India: Functions and Working” (1983) P.132.
\item \textsuperscript{333} “Report of the Banking Commission” at P.29 ‘Comprehensive banking legislation covering the organization, management, audit and liquidation of banks was recommended by the Indian Central Banking Enquiry Committee (1931).”.
\item \textsuperscript{334} A.J. Saunders, ‘Indian Central Banking Inquiry committee’, 42 The Economic Journal 32(1932) No 165 accessed at \url{http://www.jstor.org/stable/pdfplus/2223734.pdf}. See P.38 the Commission recommended for the promulgation of a Special Bank Act comprising the necessary provisions governing all banking institutions In India.
\item \textsuperscript{335} The Special address delivered by Shri .V.Leeladhar on ‘The Evolution of Banking Regulation In India – A retrospect on some aspects’ at the Banker’s Conference 2007 on Nov. 26,2007 accessed at \url{www.rbidocs.rbi.org.in} on Aug 2009
\item \textsuperscript{336} The Banking Regulation Act, 1949.
\item \textsuperscript{337} The Joint Stock Companies Act, 1850, (First legislation to govern Indian companies).
\item \textsuperscript{338} The amendments were mainly directed towards strengthening the capital structure of the banks by prescribing the minimum paid-up capital for new banks, maintenance of reserve fund and cash reserves, restrictions on the nature of
\end{itemize}
such as the Banking Companies (Inspection) Ordinance, 1946, and the Banking Companies (Restriction of Branches) Act, 1946, covering specific regulatory aspects.\textsuperscript{339} The Amendment of the Companies Act, 1936 was only an interim measure. In November 1939, the proposal for a comprehensive Banking Act was submitted to the Government of India by the Reserve Bank\textsuperscript{340}. But in view of the conditions prevailing in the country due to outbreak of war and divergence in the opinion received, the enactment of the legislation was held up.

In March 1949, a special legislation, called the Banking Companies Act, 1949, applicable exclusively to the banking companies, was passed; this Act was renamed as the Banking Regulation Act from March 1966. The Act vested in the Reserve Bank, the responsibility relating to licensing of banks, branch expansion, and liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. Important changes in several provisions of the Act were made from time to time, designed to enlarge or amplify the responsibilities of the RBI or to impart flexibility to the relative provisions, commensurate with the imperatives of the banking sector developments. It is interesting to note that till March 1966, the Reserve Bank had practically no role in relation to the functioning of the urban co-operative banks. However, by the enactment of the Banking Laws (Application to Co-operative Societies) Act, 1965, certain provisions of the Banking Regulation Act, regarding the matters \textit{relating to banking business}, were extended to the urban co-operative banks also. Thus, for the first time in 1966, the urban co-operative banks too came within the regulatory purview of the RBI\textsuperscript{341}.

\textbf{3.3 Rationale of Separate Legal Regime for Bank Mergers:} Banking regulation is necessary for public welfare. Following definition of a bank explains its status as a corporation and subordinate nature to the Government. \textit{“A bank is wholly a creature of statute, doing business by legislative grace and, the right to carry on a banking business

\textsuperscript{340} Ibid.
through the agency of a corporation is a franchise right depend on a grant of corporate powers by the state\(^{342}\). Regulation of the banking industry aims to achieve several goals\(^{343}\). First is maintaining bank solvency and thereby preventing bank failures. Another goal is to ensure liquidity of the banking industry, making sure that the banks honor their promise to redeem deposits for currency on demand. Third goal is to promote economic efficiency. There has always been a perceived need for special protection for depositors, in order to instill confidence, to avoid a run on a bank and to safeguard the depositors if a calamity does occur\(^{344}\).

The Essential basis for special treatment for banks and more specifically, of closer regulation and supervision of banking institutions all over the world, is premised on several reasons. Firstly, banks operate as a key stone of financial stability, since they accept public deposits are an instrument of monetary policy and have a significant role to play in the flow of cash. In this sense, banks constitute a form of public good\(^{345}\) and consequently, preventing the collapse in the banking system is vital to the welfare of the state. Thus, it is clear that it is a vital matter of state interest to ensure that the banking system is regulated and protected, to enhance the efficiency of the financial sector and also facilitate economic growth of the country.

The differential treatment of banking companies as opposed to non-banking companies was the subject of consideration by the Supreme Court in *Joseph Kuruvilla Vellikunnel v. Reserve Bank of India*\(^{346}\). In this case, Supreme court deduced the following distinctions between the two as the underlying rationale behind their differential treatment:

\(^{342}\) Black’s Law Dictionary, 9\(^{th}\) Edn., (2009) 165


\(^{344}\) Roy Goode, ‘1992:The Insolvency implications for Banks’ Published in “The Single Market and the Law of Banking” Ross Cranston(Ed.,) P.139,Lloyds of London Press Ltd(Publisher)

\(^{345}\) V. Leeladhar, ‘Evolution of Banking Regulation in India – A Retrospect on Some aspects’ www.rbidocs.rbi.org accessed on Aug 2009.[The special address delivered by Shri V. Leeladhar, Deputy Governor, Reserve Bank of India at the Banker’s conference (BANCON) 2007 on November 26, 2007 ]

\(^{346}\) AIR 1962 SC 1371(The case concerned with the Winding up of Palai Central Bank.)
1. A banking company cannot be compared to an ordinary company, because in the case of a banking company, the interest of the depositors is paramount.

2. The parliament intended the Reserve Bank to have a decisive voice in respect of certain matters pertaining to banking companies, due to the expertise of the bank with relation to banking matters.

3.4 Why Do Banks Merge?

The motivations and expected benefits of bank mergers particularly in the Indian scenario derive from the underlying forces operating in the forced and voluntary mergers. In the case of the former, the policy objective is consolidation of the financial sector and strengthening of the financial sector and consequently mergers are aimed at rescuing weaker institutions and bodies and protecting the interest of the depositors. In the case of the latter, it is competitive aspects that provide the incentive to spread and increase operations and customer bases.

The chief economic reason that encourages bank mergers may be roughly divided into cost reductions and benefits accruing from economies of scale, or access to new markets. Mergers are often assumed to improve the performance of banks in terms of profitability, by reducing costs incurred or by increasing revenues. Thus studies of post-merger accounting profits, operating expenses and efficiency ratios, relative to the pre-merger performance indicate an increase in profitability. However, further studies indicate that this may not always be so in cases where there is a large lag between the completion of merger and the realization of benefits, the results from it are

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347 M. Jayadev and Rudra Sensarma, ‘Mergers in Indian Banking, An Analysis’ 14(4) South Asian Journal of Management 2007(20-47) available at https://uhra.herts.ac.uk/dspace/bitstream/2299/3465/1/902962. The study reveals that when a bank has shown symptoms of sickness such as huge NPAS, and substantial erosion of net worth, RBI has intervened and merged the weak bank with a strong bank.

348 Ibid.

exactly opposite\textsuperscript{350}. Some studies indicate that the firms may benefit from diversification, particularly in the case of banks merging with NBFCs\textsuperscript{351}. In India, banks benefited substantial gains from mergers in the form of increased efficiency but it is limited for a very short term period\textsuperscript{352}. In terms of strategy, a bank may choose to undertake offensive or defensive mergers\textsuperscript{353}. Defensive mergers involve an effort to preserve what the bank considers its core activities, in the light of increased competition from external sources. Thus costs are eliminated by laying off workers and closing branch offices\textsuperscript{354}. Defensive mergers are beneficial because they enable the bank to declare bad debts and capital losses, and also diversify geographically. Offensive mergers, on the other hand, in an effort to actually expand the range of activities that the banks undertake\textsuperscript{355}. This could be done by entering new product market or by expanding the customer base or by expanding geographically. The factors that are considered in merging would include situational elements such as the number of competitors, the size of the capital market, the level of regional macro economic growth, and especially the regulatory regime\textsuperscript{356}. The national regulatory regime for banks largely influences the manner in which domestic and international mergers takes place.


\textsuperscript{351} Ibid.


\textsuperscript{355} Dario Focarelli etal. ‘Why do banks merge?’ 34 Journal of Money, credit and Banking 2002 (1047-1066) also in Fabrizio etal, ‘Measuring value creations in Bank Mergers and Acquisitions’ 2008 working paper available at www.ssrn.com

In the Indian Context, a survey by Jayden and Sensarma indicates that bank mergers voluntarily for variety of reasons. The chief of which are

1. Competitive Pressure: With policies of liberalization of markets, there has been an increase in the entry of private and foreign banks in Indian banking. Domestic banks accordingly face greater competition. Mergers consequently are a means of consolidating economic power and reducing cost to increase competitiveness.

2. Capital Account Convertibility: In the light of greater convertibility of Rupee, and easier access to capital that foreign banks possess, the creation of the larger bank is possibly the only means by which banks will be able to absorb the risks arising out of large scale lending, in the absence of risk management controls in India.

3. Capital Adequacy norms: The capital adequacy ratio of bank is an indicator of its stability, growth and financial solvency for the depositors of the bank. In cases where banks are deficit in capital, their ability to grow is constrained and one means of addressing such constraint is to merge with a bank with a greater capital base. One instance of an Indian Merger operating in this manner is that between Global Trust Bank and United Western Bank, where both the banks had substantial erosion in capital funds before the merger but were able to regain control subsequently through combined efforts.

4. Financial Inclusion: Financial Inclusion is the process by bringing low income groups under the cover of banking services by providing them access to

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357 Ibid.
359 Ibid.
banking at affordable prices. One mode of achieving such inclusion is the consolidation of banks to enable them to focus on untapped markets, and thereby increase penetration into rural and disadvantaged sections of the populace.

3.5 Regulatory framework for Bank mergers in India:

Globally, mergers and acquisitions have become the primary way in which banks expand, particularly in the case of banking firms which are entering financial markets. The commercial banks as a group form the preponderant part of the organized banking system and fall into four classes based on their method of establishment and pattern of ownership. These are banks in the public sector, banks in the private sector, foreign banks and regional rural banks. Public sector banks account for about 90% of the total banking business in India.

The diversity of banking institutions is inherent in the variety of conditions and circumstances obtaining in different regions of this country, and is the natural consequences of the historical circumstances. The differing requirements of people cannot all be provided by one set of institutions and all the various types of institutions have their place in the banking system.

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365 26 banks in the Public sector.
366 24 banks in the Private sector.
367 43 banks have place of business in India.
368 64 Regional Rural Banks.
The mergers and acquisitions regulations in the Indian Banking sector can be broadly placed as per the nature of the entities involved and of the mergers, into several categories, viz., (a) Voluntary amalgamation between private sector banks (b) Compulsory amalgamation of a private sector banks (c) Acquisition of banking companies by the central government in Part IIC of the Banking Regulation Act, 1949 (d) Merger between public sector banks (e) Merger of a Non-Banking Financial Company (NBFC) with a private sector bank (f) Merger among co-operative banks (g) Merger between Regional Rural Banks (h) Mergers of State Bank of India and its associates.

There are four categories of restructuring of Banking Companies under the Banking Regulation Act, 1949 (a) Voluntary Amalgamation (b) Compulsory Amalgamation (c) scheme of arrangement between banking company and its creditors (d) Acquisition of banking companies by the Central Government under Part-IIC of the Banking Regulation Act, 1949.

3.6 Jurisprudential basis for the recognition of special provisions for the restructuring of banking Companies under the Banking Regulation Act, 1949: Prior to 1960, the amalgamation of banks could be only in terms of section 44A of the Banking Regulation Act, 1949, on a voluntary basis. Voluntary amalgamation effected before 1960, however, where not encouraging the need for strengthening the banking system by eliminating small and weak banks. In order to accelerate the process of integration, additional statutory and regulatory powers for the reconstruction or compulsory amalgamation of banks were inserted by the amendment of the Act, 1960. Banking Companies (Second) Amendment Bill, 1960 proposed for the

370 S. 44A of the Banking Regulation Act, 1949
371 S. 45 of the Banking Regulation Act, 1949
373 Section 36AE to 36AJ of the Banking Regulation Act, 1949.
374 Section 44A and 44B was introduced by the Banking Companies (Amendment Act) 1950.
375 The year 1960 was one of the greatest stresses for the Indian banking system. Failure of two major banking companies one in Bombay, the Laxmi Bank, Akola and the Palai Central Bank in Kerala, were ordered to wind-up. Collapse of Palai Central bank sparked off controversy, especially in Kerala where it remained a major political issue for some time.
introduction of Section 45\(^{376}\) and Section 44A(7)\(^{377}\) to the Banking Regulation Act, 1949. The reason for introducing the bill was stated as “The procedure prescribed under the Banking companies Act, 1949 read with the Companies Act, 1956 for the liquidation of banking companies is somewhat elaborate, and in the absence of any provision in the law indicating the time schedule according to which certain payments may be made to the depositors, a great deal of hardship is caused to such depositors, who have to wait for considerably long period for realizing the sum due to them. It is proposed, in order to facilitate the expeditious payment of certain minimum amounts in such cases, that the procedure relating to the liquidation of banking companies should be suitably modified. The opportunity provided by these amendments has also been utilized to simplify the provisions of law relating to the grant of moratorium in respect of banking companies which may be experiencing difficulties and to facilitate the formulation and implementation of schemes of reconstruction or amalgamation of such companies\(^{378}\). J. Raman Nayar, in *Reserve Bank of India v. Palai Central Bank Ltd*\(^{379}\), held that ‘A bare perusal of section 38 of the Banking Companies Act and of the several provisions of the Reserve Bank Act and the Banking Companies Act shows that, while all the provisions are conceived in the interest of the depositors, each is intended for a slightly different situation so that there is a graded action according to the degree of evil, a remedy as it were, to suit the disease, a punishment to fit the crime, and in the last resort, when things are beyond redress and the danger to the depositors is imminent liquidation’\(^{380}\). Also by Justice Sha, in *R.C.Cooper v.Union of India*\(^{381}\), wherein he

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\(^{376}\) Compulsory amalgamation of banking companies. This section introduced declaration of moratorium by the Central Government as a prerequisite to restructuring of a weak bank either for amalgamation or for a scheme of arrangement.

\(^{377}\) Section 44A(7) of the Banking Regulation Act, 1949 permit the central government to amalgamate two or more banking companies in public interest. Section 44A was inserted in the year 1950.

\(^{378}\) [1960] 30 ComCas (Statutes) 157 - The Banking Companies (Second Amendment) Bill 1960- Statement of objects and reasons.

\(^{379}\) [1961] 31 ComCas.154 (Ker.)

\(^{380}\) Ibid.

\(^{381}\) AIR1970 SC 564 .One of the contention of the petitioner in this case was that the Central government is given unguided power to choose between Section 36AE of the Banking Regulation Act and Provisions of the Bank Nationalization ordinance, 1969 for the acquisition of banking companies. Court held that banking companies Act was amended in 1968 to insert section 36AE to the Banking Regulation Act, 1969, so as to give effect to the policy of “Social Control” over Commercial Banks in India [ Cited in AIR 1970 SC564.
stated the purpose of section 36AE\textsuperscript{382}-36AJ of the Banking Regulation as ‘that the Central Government is given power to acquire the business of any Bank if it failed repeatedly to comply with any direction issued by the Reserve Bank under certain specific provision in regard to any matter concerning the affairs of the bank and if acquisition of the Bank was considered necessary in the interest of the depositors or in the interest of the banking policy or for the better provision of credit generally or of credit to any particular section of the community or in a particular area’\textsuperscript{383}.

**Legislative intent behind the introduction of Section 45\&36AE in the Banking Regulation Act, 1949 and the enactment of Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 had different objectives. As seen earlier, year 1960 was one of the greatest stresses for the Indian banking system\textsuperscript{384}. Palai Central Bank, one of the largest banks in South India failed in that year. The failure of Palai Central Bank inaugurated a period marked by a number of banking panics in several parts of the country. The issue of speeding up the liquidation of banks came into focus. Thoughts then turned other ways of providing early and suitable relief to the depositors of the closed banks. There was consensus among officials of the bank, the Government of India and the State Bank that ‘immediate and suitable legislation’ was required to cut out of liquidation and rescue the failing banks in the interest of depositors\textsuperscript{385}. Applying for liquidation, not only intended to be harsh on depositors, it might also be unnecessary in circumstances where only the difficulty of realizing its assets immediately prevented a bank from meeting a panic withdrawal of deposits\textsuperscript{386}. An intermediate measure, such as declaration of ‘moratorium’ was appropriate so as to preserve the assets of the banking companies and withstand the panic of liquidation of banking companies. Moratorium and Consequent amalgamation of banking companies at the Central Government’s approval

\textsuperscript{382} Section 36 AE of the Banking Regulation Act, 1949 was inserted by the Banking Companies (Amendment Act), 1968 and it came into force on February, 1969. It confers the power to acquire the business of the banking companies in certain situations[It is discussed in this chapter under the title ‘acquisition of banking companies under Part-IIC of the Banking Regulation Act]

\textsuperscript{383} Ibid.,


\textsuperscript{385} Ibid at P.477

\textsuperscript{386} Id.,
could be achieved by the 1960 amendment to the Banking Companies Act. Immediately after the introduction of section 45, Reserve Bank ordered for the amalgamation of many small banks with larger banking companies. However, the 1960 amendment did not intend to do away with small banks and create only larger banking companies. In order to reduce consolidation at an unexpected speed and to control the same Central Government brought the 1961 amendment which inserted clause(4) to (9) to section 45. It laid down certain criteria such as ‘grossly mismanaged’, had failed to carry out bank directions or had lost a part of their deposits. Originally, Central Government could order for the amalgamation of financially weak banking companies only with the State Bank of India or with any of private sector banks. In 1984, Central Government brought an amendment to Section 45(15) of the Banking Regulation Act, which stated that ‘a subsidiary bank or a corresponding new bank’ can also be a banking institution for the purpose of section 45. A corresponding new bank is a bank which the Central Government has acquired either under the Bank Nationalization Act of 1970 or 1980.

Second route where, the Central government can acquire the undertaking of banking companies is under Section 36AE-36AJ of the Banking Regulation Act, 1949. It was introduced in the year 1968. It aimed at safeguarding the banking policy and to exercise ‘social control’ over banking companies. The policy of ‘social control over banks’ was introduced in response to the persistent complaints of the deficiencies of the banking system. Part-IIC of the Banking Regulation Act, 1949, may appear to be punitive in nature. This is because, Section 36AE gives power to the Central Government to acquire the banking business, if the banking company has failed to comply with its directions

387 “Report of the Banking Commission” P.31—“The Banking companies Act was amended to empower the Reserve Bank to apply to the Central Government for grant of moratorium to banks and sanction of the schemes for their reconstruction or amalgamation with another banking company”.


389 Section 45(15) introduced by the 1960 amendment Act read as “In this section, Banking institution means any banking institution and includes State Bank of India”.

390 “Report of the Banking Commission” [Available at NLSIU-Bangalore, Library]. This commission was constituted under the Chairmanship of R.G.Saraiya on Feb 3, 1969.
under Ss. 21\textsuperscript{391} or 35A\textsuperscript{392} of the Banking Regulation Act, 1949. The real objective is to ensure the compliance of banking policies of Reserve Bank of India.

### 3.7 Voluntary Amalgamation of Banking Companies:

Merger between two private sector banking companies is governed by Section 44A\textsuperscript{393} of the Banking Regulation Act, 1949. In this regard the Madras High court has held that the provisions of the Banking Regulation Act constitute a complete code in themselves on the amalgamation of banking companies\textsuperscript{394}.

S. 44A of the Banking Regulation Act, 1949 provides that no banking company shall be amalgamated with another banking company, notwithstanding anything contained in any law, unless the scheme for amalgamation has been placed in draft before the shareholders of both companies. Approval of the scheme is required by means of a resolution of two-thirds of the majority of the shareholders present in either company, in a meeting specifically called for the purpose of amalgamation\textsuperscript{395}. Once this scheme has been approved in due compliance with the requirements under S. 44A (2), it should be submitted to the Reserve Bank of India for sanction. Once sanctioned by the Reserve Bank, it is binding on all the shareholders and the companies. However S. 44 A (3) protects the rights of the dissenting shareholders who have either voted against the scheme or have given notice of such dissent in writing. Reserve Bank of India determines the value of shares to be paid to dissenting shareholders\textsuperscript{396}.

S. 44 A of the Banking Regulation Act, 1949 shows that it departs from the provisions of the Companies Act, 1956 in primarily two aspects, namely (1) the High court is not

\textsuperscript{391} Section 21 of the Banking Regulation Act, 1949 – ‘Power of RBI to Control advances by banking companies’.

\textsuperscript{392} Section 35A of the Banking Regulation Act, 1949 – ‘Power of Reserve Bank to give directions’.

\textsuperscript{393} Section 44A was inserted by the Banking Companies Amendment Act, 1950.

\textsuperscript{394} Bank of Madura, Shareholders Welfare Association v Governor, Reserve Bank of India and Others, (2001)105 ComCas. 663(Mad). (Wherein Bank of Madura was amalgamated with ICICI Bank. The main reason was to increase ICICI Banks presence in south India as Bank of Madura was many branches. However, employees did not have many advantages.)

\textsuperscript{395} Notice of Extraordinary meeting as is referred to above must be given to every shareholders of both the companies concerned in accordance with S. 44A(2)

\textsuperscript{396} S. 44 A(3) of the Banking Regulation Act, 1949
given the power to grant its approval to the scheme for merger of banking companies instead the Reserve Bank, which is the central bank of the country and supreme regulatory authority in banking supervision and (2) The Reserve Bank of India is also empowered to determine the market value of shares of the shareholders who has voted against the scheme of amalgamation. The banking Regulation Act enable the dissenting shareholder to obtain from the banking company concerned the market value of his shares as determined by the Reserve Bank of India under S. 44A(3).

In Bank of Madura Shareholders Welfare Association v. Governor, Reserve Bank of India397, it was held that if the shareholders were aggrieved that the market value of shares of both the companies had not been determined properly, it was always open to it to get the market value evaluated by the Reserve Bank of India and that the court would not go into the question whether the share exchange ratio adopted in the scheme was fair or not398.

3.8 Scope of S. 44-A of the Banking Regulation Act, 1949: The provision of Section 44A of the Banking Regulation Act, 1949 comes into play only if the transferor and transferee are both ‘banking companies’399 within the meaning of The Banking Regulation Act, 1949. Since Nationalized banks, Co-operative banks, Regional Rural Banks and State Banks of India are governed by the separate statutes, the merger provisions of the Banking Regulation Act and the Companies Act, 1956 is not applicable to it400.

397 Bank of Madura, Shareholders Welfare Association v. Governor, Reserve Bank Of India and Others (2001) 105 ComCas. 663 (Mad).
398 (2001)105ComCas.663 (Mad).
399 S. 5( c ) “ Banking company means any company which transacts the business of banking in India”
400 The Companies Act, 1956, Section. 616. Application of Act to Insurance, banking, electricity supply and other companies governed by special Acts.-The provisions of this Act shall apply- (a) to insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938; (b) to banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Companies Act, 1949; (c) to companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of [the Indian Electricity Act, 1910 or] the Electricity Supply 1948; (d) to any other company governed by any special Act for the time being in force, except in so far, as the said provisions are inconsistent with the provisions of such special Act; (e) to such body corporate, incorporated by any Act for the time
In *Bank of Baroda Ltd v. Mahindra Ugine Steel Company Ltd*[^401^], the issue in this case was whether the court could approve a scheme of amalgamation between Bank of Baroda and Mahindra Ugine Steel Company. The petitioners in this case had filed the application under Ss. 391-394 of the Companies Act, 1956. It was held by Justice P.D. Desai of the Gujarat High Court that the Bank of Baroda being a nationalized bank, it is governed by the provisions of the Bank Nationalization Act, 1970 & 1980, hence it will not be a banking company within the meaning of banking regulation Act, 1949. Therefore, the appropriate authority to sanction a scheme of amalgamation in this case is the High Court[^402^].

Similarly, provisions of the Banking Regulation Act, 1949, have no application if the merger is between a banking company and a Non Banking Financial Company (NBFC). In *ICICI Ltd v. In Re*[^403^], it was held that where though the transferee company was a banking company but none of the transferor companies were banking companies, the objection that the approval of the Reserve Bank of India had not been secured as required by the provisions of the Banking Regulation Act was not tenable.

Also in *IndusInd Enterprises and Finance Ltd v. IndusInd Bank Ltd*[^405^], the issue was whether prior permission of Reserve Bank of India is necessary for amalgamation of a scheme under the Banking Regulation Act, 1949. The case concerned with the merger between a banking company and a non–banking Company. Bombay High Court held that no prior sanction of RBI is necessary for the amalgamation of non-banking finance company with a banking company.

[^401^]: 1975 INDLAW GUI28962

[^402^]: The creditors in this case objected the scheme on the ground that the high court shall have no jurisdiction to entertain application for scheme of compromise under S. 44 B of the Banking Regulation Act, 1949. The court had to look into whether Bank of Baroda is a banking company within the meaning of the Banking Regulation Act, 1949.

[^403^]: The applicable laws for such merger is under Ss. 391-394^ of the Companies Act, 1956.

[^404^]: ICICI Ltd, 2002 (3) Comp Lj. 111 cited also in (2004) 119 ComCas.941(Bom)

[^405^]: 2003 (4) BomCR 482
Thus, Section 44A and 44B of the Banking Regulation Act, start with a non-obstante clause and these are express provisions in derogation of the Companies Act to the extent therein provided. S. 44B expressly provides that no High court shall sanction a scheme of arrangement of a banking company and its creditors unless the requisite certificate is issued by the Reserve Bank of India.

3.9 Procedure of Voluntary amalgamation between private sector banks: Section 44A of the Banking Regulation Act, 1949 deal with the voluntary amalgamation between two private sector banking companies. After the two banking companies have passed the necessary resolution proposing the amalgamation of one bank with another bank, in their general meeting, by a majority in number representing two thirds in value of the shareholding of each of the two banking companies, such resolution containing the scheme of amalgamation is submitted to the Reserve Bank for its sanction. If the scheme is sanctioned by the Reserve Bank, by an order in writing, it becomes binding not only on the banking companies concerned but also on other shareholders. Reserve Bank of India had issued guidelines in May 2005, which laid down various requirements for the process of such merger including determination of the swap ratio, disclosures, stages at which the boards will get involved in the merger process etc.

The policy objective of the RBI is to ensure that considerations like sound rationale for the amalgamation, systemic benefits and the advantage accruing to the residual entity are evaluated in detail. While sanctioning the scheme of Amalgamation, the RBI takes into account the financial health of two banking companies to ensure inter alia, that after the amalgamation, the new entity will emerge as a much stronger bank. In Bombay Gas Company Ltd. v. Hindustan Mercantile Bank Ltd., it was held that under Section 44A (4), of the Banking Regulation Act, the scheme is binding on all and, therefore, the alteration of the memorandum is not permissible.

Chapter-IV examines the role of Reserve bank in regulating bank mergers.

The Banking Regulation Act, 1949 S.44-A

See Annexure VI


[1980]50CompCas202(Cal)
3.10 Judicial treatment to Section 44A of the Banking Regulation Act, 1949-Various facets:

In Commissioner of Income Tax v. Trichy United Bank⁴¹² - Court held that Section 44A contemplates a scheme of amalgamation by means of a transfer of assets and liabilities from one existing company to another existing company. It might be that company law does not frown against a scheme of amalgamation under which all existing companies which are proposed to be merged may go out of existence, without exception, bringing into being an entirely new corporate unit to which the existing assets and liabilities of all the liquidated companies get transferred.

**RBI order under 44A amounts to conveyance:** In Chhatrapati Sambhaji Maharaj Sahakari Patsanstha Maryadit v. Assistant Registrar of Co-operative Societies,

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⁴¹² [1984]146ITR85 (Mad) N.V.Balasubramanian and S.Padmanabhan JJ., Brief Facts: Before 1965, there were three banking companies in Trichirapalli. They were the Woraiyur Commercial Bank Ltd., the Palakkarai Bank Ltd. and the Tennur Bank Ltd. In 1965, the first two banks amalgamated with the third. The amalgamation involved the transfer of all assets and liabilities of the first two banks to the third bank. With such transfer, the two transferor-banks were wound up and dissolved. The transferee-bank continued its existence, with the transferred assets and liabilities along with its own, but it emerged under a new name, the Trichy United Bank. The merger took place on June 24, 1965. Case Concerned with Income Tax assessments made on this transferee bank subsequent to the merger. Prior to the amalgamation, the three former banks were earning profits. But the profits were not distributed as dividends then and there. They were carried to reserves by each of the banks. Each bank was an independent Income Tax assesses. The profits earned by each, but credited to reserves, were assessed to Income Tax. Long after the merger of the three banks, the Trichy United Bank distributed dividends in the years 1968, 1969 and 1970. These dividends were distributed out of reserves. The bank claimed that in respect of these dividend distributions, it was entitled to relief under S. 236 of the I.T. Act, 1961. The claim was based on the footing that the dividends were distributed out of reserves and those reserves represented taxed profits up to March 31, 1960. In the said case, however, the scheme of amalgamation was by way of the undertaking of two existing banking companies to another existing banking company. The Woraiyur Commercial Bank and the Palakkarai Bank were the transferor companies and the amalgamation was effected by transferring all their assets and liabilities to the Tennur Bank. The Tennur Bank, which was the transferee-company, did not go out of existence. It remained the same, with its assets and liabilities considerably swelled by the augmentation of assets and liabilities, which stood transferred to it from the two transferor banks. Excepting for a change in the name from Tennur Bank to Trichy United Bank, which was also part of the terms of the merger, the court held that it could not find any discontinuity, or change in identity, of the original banking company which had earned the profits and had suffered Income Tax on those profits. It, therefore, follows that when those profits were subsequently distributed as dividends, the requirements of section 236 of the companies Act were fulfilled.
Satara, and Another\textsuperscript{413}, issue before the Bombay High court was Whether an order of RBI amounts to conveyance under Section 44A of the Banking Regulation Act for the purpose of Bombay Stamp Act, 1958? Court held that under Section 2(g)(iv) of the Bombay Stamp Act, 1958, every order made by the High Court under section 394 of the Companies Act, 1956, [in respect of amalgamation or reconstruction of companies; and every order made by the Reserve Bank of India under Section 44A of the Banking Regulation Act, 1949 in respect of amalgamation or reconstruction of Banking Companies;] by which property, whether movable or immovable, or any estate or interest in any property is transferred to, or vested in, any other person, inter vivos, and which is not otherwise specifically provided for by Schedule I of the said Act.

**Nature of assets after amalgamation:** Yet another case decided by the Bombay High Court under Section 44A of the B.R Act is in *L.M. Devare, Liquidator of Bank of Karad Ltd. (In Liquidation) v. The Commissioner of Income Tax*\textsuperscript{414}. The Court held that the assets and liabilities will not change their character after the amalgamation in the hands of the assessee. After the amalgamation also, the properties continue to be the stock-in-trade of the assessee business. As these properties were acquired in satisfaction of the

\textsuperscript{413} 2012 (5)BomCR773 decided by Abhay Sreenivas Oka J., The said case concerned with a transfer of land by the co-operative society to a bank as a security for payment of debt. The appellant in the said case argued that it amount to sale and thus Stamp duty is payable. But the court did not accept the said claim.

\textsuperscript{414} [1998]234ITR813(Bom), Dr.B.P.Saraf & A.Y Sakhare , JJ., Whether the profits earned out of the sale of the properties as a result of amalgamation is liable to tax under the Income Tax Ac? Facts: the Presidency Industrial Bank Ltd., Pune, was amalgamated with Bank of Karad. This amalgamation took place in pursuance of the scheme sanctioned by the Reserve Bank of India under Section 44A of the Banking Regulation Act, 1949. From the date of the amalgamation, all movable and immovable assets with liabilities of the bank stood transferred to the assessee. Immovable properties such as plots of land and buildings acquired by the bank from its debtors in satisfaction of the debts owed to it were also transferred to the assessee. The assessee sold these properties in the above assessment years and realized certain surplus. The Income Tax Officer treated the surpluses as profits arising out of the banking business and taxed the surpluses as the assessee business income by rejecting its contention that the surpluses represent capital gains, the assessee contended that these properties were non-banking assets and the surpluses realised on their sale cannot constitute business income. It was further submitted that buildings were let out by the bank on rent and after the amalgamation the same tenants continued to reside therein and income from these buildings had been assessed as property income.
debt from the debtor by the bank doing money-lending business, profits/income earned from the sale of these properties must be treated as business income taxable under the Act’.

3.11 Difference between Section 44A of the Banking Regulation Act, 1949 and Section 394 of the Companies Act, 1956: Though the swap ratio decided by the banking company was subject to question before the Madras High court in *Bank of Madura Shareholders Welfare Association v Governor, Reserve Bank of India* 415. The Court cited the difference between the amalgamation under section 394 of the Companies Act, 1956 and Section 44A of the Banking Regulation Act, 1949. It held that the provision contained in the Banking Regulation Act, viz., Section 44A regarding amalgamation of banking companies is a self-contained provision and a complete code on the amalgamation of banking companies. The scheme of amalgamation of two banking companies should contain in it the complete details regarding the proposed merger of the two companies. Court held that *section 44A of the Banking Regulation Act* shows that it departs from the provisions of the Companies Act, in two important aspects, namely, the High Court is not given the power to grant its approval to the scheme of merger of banking companies and the Reserve Bank of India is given such a power and, secondly, the Reserve Bank of India is also empowered to determine the market value of shares of the shareholder who has voted against the scheme of amalgamation or who has given such notice against the amalgamation in writing prior to the meeting of the company to the Presiding Officer concerned. The Banking Regulation Act enables the dissenting shareholder to obtain from the banking company concerned the market value of his shares as determined by the Reserve Bank of India, The provisions of Section 44A also enable the Reserve Bank of India to determine the market value of shares of the dissenting shareholder.

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415 (2001) 3 Comp LJ 212 (Mad), N.V. Balasubramanian J.
Share valuation during merger under Section 44A: The difficulty in arriving at share valuation was discussed in detail in *In Re: ICICI Ltd*[^416^], where a scheme was prepared for the amalgamation between ICICI Capital Services Ltd. and ICICI Personal Financial Services Ltd. with ICICI Bank Ltd. The petitioner and two other companies are the transferor companies and they are to be amalgamated with the ICICI Bank Ltd., the transferee company. Petitioners two main objection were. 1) The approval of the RBI was not sought for a scheme of amalgamation as the transferee was a banking company. 2) Valuation of shares was not arrived at properly. To the first question court held that the objection has no substance, in as much as, the provisions of section 44A come into play only in case the transferee and transferor, both the companies are Banking Companies. In the said case, though the transferee company is a banking company, none of the transferor companies arc banking companies. The objection did not sustain. While deciding that case court referred *Piramal Spg & Wvg. Mills Ltd*[^417^], and cited what was there as ‘that the valuation of shares is a technical matter which requires considerable skill and expertise. There are bound to be differences of opinion as to what the correct value of the shares of any given company is, simply because it is possible to value the shares in a manner different from the one which has been adopted in a given case, it cannot be said that the valuation which has been agreed upon is unfair’. Court thus held that ‘What is important is that all shareholders of both companies have unanimously accepted the valuation which has been arrived at by the auditors of the transferor and transferee companies, under these circumstances, the application cannot be rejected on the ground that the valuation of shares is unfair to the shareholders of the transferor-company’[^418^].

[^416^]: 2002(4)Bom CR450, D.K. Deshmukh Initially the case was filed before Gujarat High Court. See In Re: I.C.I.C.I. Bank Ltd., [2002]112 CompCas291 (Guj.). It came up before M.S. Sha. J., but that case was transferred to Bombay High court as the registered office of the company was in Bombay.

[^417^]: [1980] 50 Comp Cas.514

[^418^]: Also in *In re Grierson, Oldham & Adams Ltd*, [1967] 37 C. C. 357, has pointed out that the question of valuation is obviously one about which opinions may differ. It is possible in cases like this to criticize figures, offers and balance-sheets and argue about matters of fairness and unfairness. ‘Unless the person who challenges the valuation satisfies the court that the valuation arrived at is grossly unfair, the court will not disturb the scheme of amalgamation which has been approved by the shareholders of the two companies.'
3.12. Critical Appraisal of Section 44A:

The Experience of the RBI has been by and large satisfactory in approving the schemes of amalgamation of the private sector banks in the recent past and it had no occasion to reject any such scheme\textsuperscript{419}. Section 44A is not subject to much judicial scrutiny and therefore no doctrines or principles are evolved from it. Though Section 44A of the Banking Regulation Act, was inserted by the Banking companies (Amendment) Act, 1950, till date only seven\textsuperscript{420} bank mergers have taken place in India. This is due to the stringent policy of the Reserve Bank of India in approving bank mergers. Two key factors continue to discourage consolidation among private sector banks one is regulations, second, the corporate culture in the old private sector banks. RBI has the discretionary power in approving the voluntary amalgamation between two banking companies\textsuperscript{421}. Reasons to disapprove a merger scheme are not stated either in the 2004 guideline or under section 44A. Some mergers may generate anti-competitiveness. It would also have negative effects on the customers. From the regulatory perspective, RBI imposes conditions and restrictions through guidelines\textsuperscript{422} for amalgamation between voluntary banks in addition to the procedure laid down under the banking regulation Act, 1949. RBI’s policy is generally to encourage amalgamations only where it is satisfied that the scheme is in the interest of the depositors of the amalgamating banks and that the amalgamated group would be able to play a useful role in strengthening the banking structure in the areas of operation of these banks.

\textsuperscript{419} Majority of voluntary merger were between healthy banks similar on the lines suggested by the First Narasimham Committee Report.’TheNarasimham Committee Report: Some clarifications and ramifications’ http://www.iimahd.ernet.in/~irvarma/papers/WP1009.pdf accessed on 22\textsuperscript{nd} Nov2010.


\textsuperscript{421} At 1.1 of the Guidelines for the merger or amalgamation of Private Sector Banks , RBI/2004-05/462( May 11,2005)

\textsuperscript{422} Guidelines for the merger or amalgamation of Private Sector Banks , RBI/2004-05/462( May 11,2005) see Annexure VI
3.13 **Compulsory Amalgamation in Section 45** of the Banking Regulation Act, 1949: Insolvency of a bank can have disastrous effect on the depositors, the economy and on its various stakeholders. Section 45 of the Banking Regulation Act is aimed at rescuing financially weak private sector banking companies. Historical reasons states that the failure of many banks between 1934-1960, forced the government to come up with provisions for bank rescue. Section 45 of the Banking Regulation Act, 1949, involves two step processes. First step is, the RBI recommending to Central Government the imposition of moratorium on a bank, when the RBI has good reason to do so. Secondly, pursuant to the imposition of moratorium, if the RBI is satisfied it may restructure the bank or merge the banking company into another banking institution. Section 45 of the Act, provides for a bank to be reconstructed or amalgamated without the consent of its members or creditors, with any other banking institution as defined in sub-section (15) thereof.

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423 Constitutional Validity of S. 45 was challenged in *Shivkumar Tulsian and another v. Union of India and others* [1990]68 ComCas 720 (Bom), *State Bank of Travancore v. Elias Elias*, AIR 1971 SC 143 State Bank of Travancore v. General Secretary, Association of the state bank of employees and others 1978 II LLj.305 (Ker).

424 Two of the major bank failures in India attracted public outcry and political attention are the liquidation of Palai Central bank (Kerala) and Laxmi Bank (Bombay).

425 Section 45(6) states that the scheme prepared by the RBI shall be sent in draft to the banking company and also to the transferee bank and any other banking company concerned in the amalgamation. It further provides that the scheme so finalized by the Reserve Bank of India should be filed before the Central Government which may sanction the scheme with or without modifications.

426 In *Shivkumar Tulsian and others v. Union of India*, [1990]68 ComCas 720 (Bom), Court held that “Section 45 is a composite provision which provides an inseparable scheme with regard to moratorium, scheme of reconstruction or scheme of amalgamation. The mere fact that in a given case, the moratorium may come to an end without any further action, viz., a scheme of reconstruction or amalgamation will not necessarily show that the two sets of the provisions are independent of each other or have no nexus with each other and must be read as such”. In Palai Central Bank's case [1962] 32 Comp Cas 594, the Supreme Court held that even assuming that the power is unguided, the provision is not unreasonable as the power is conferred on an expert body which in the true sense is best able to decide whether it should or should not be exercised.
In *B.V. Abraham and others v. State Bank of Travancore*\(^{427}\), Kerala High court held that, it is to safeguard the interest of the depositors and creditors of the banking company that Section 45 of the Act has been introduced and the scheme of amalgamation is only a mode by which the compulsory winding up of a banking company is averted for the benefit of the creditors.

The question of whether a banking company is to be amalgamated with any another banking company is clearly a matter solely in the discretion of the Reserve Bank of India and no question can arise of the Reserve bank having to seek permission from High Court to exercise the powers conferred on it in this respect by Section 45 of the Banking Regulation Act. If the RBI does not issue certificate in writing that the scheme is not capable of being worked and is not detrimental to the interest of the depositors, then the court will be powerless to confirm the scheme\(^{428}\). In *Bhagvandas Garg v. Canara Bank Ltd*\(^{429}\), it was held that the scheme of amalgamation sanctioned by the Government of India under S. 45(7) of the Banking Regulation Act, 1949 is conclusive proof that the requirement of the section relating to amalgamation have been complied with and a true copy duly certified in writing by an officer of the central government shall in all legal proceedings be admissible in evidence to the same extent as the original scheme.

\(^{427}\) 1969 KLJ783. Kottayam Orient Bank was amalgamated with State Bank of Travancore under section 45 of the Banking Regulation Act, 1949. In pursuance of the sanction of the Reserve Bank of India, notices were issued to the members of the Kottayam Orient Bank Ltd., including the defendants in the several suits to pay the uncalled share amount. In view of the failure of the defendants to pay the amounts, shares were forfeited. Against which the suit was filed before the court.

\(^{428}\) In *Re, Chottanagpur Banking Association Ltd*, AIR 1959 Pat 288

\(^{429}\) [1981]51ComCas.38. G. Raghuntathamal Bank Ltd, amalgamated with Canara bank in pursuance of an order under section 45 of the Banking Regulation Act, 1949. As per the scheme of amalgamation bank was entitled to recover the uncalled amount from the shareholders of the transferee bank. Defendant failed to pay the call amount thus his shares were forfeited. Transferee bank also filed suit to recover the arrears of call money with interest. The suit was filed before the Munsif Magistrate. It was the contention of the defendant that Munsif Magistrate had no jurisdiction. This case discussed the Jurisdiction of civil court in a suit for recovery of money due from the shareholder. Nothing was discussed about the scope and ambit of section 45.
In *K.I. Shepherd v. Union of India*\(^{430}\), it was held that when a scheme is framed under Section 45 for amalgamation, judicial review is permissible to a very narrow extent. Particularly when a dispute or difference arising with regard to the equivalence of experience has been decided by the Reserve Bank of India, in exercise of its powers under the second proviso to Section 45 (5) (i), the High court in the writ jurisdiction cannot sit in appeal over such judgment. It can only interfere in extreme cases of arbitrariness or unreasonableness. In *Reserve Bank of India v. Francis*\(^{431}\), it was observed by the Kerala High court that the Scheme under S. 45 is supreme in its field. It has a statutory pre-eminence and prevails over the other laws in force. The scheme therefore cannot be treated merely as an executive or administrative act, but has the character and colour of a statutory enactment. The copies of the scheme have to be placed before both the houses of the parliament for legislative scrutiny in appropriate cases. The scheme in effect is a part of the Act itself\(^{432}\).

**Procedure of Compulsory Amalgamation of private sector Banks:** Under section 45 of the Banking Regulation Act, RBI has the power to force the merger of a weaker bank with a stronger Bank. The scheme is in public interest or in the interest of the depositors of the distress bank or to secure proper management of a banking company, or in the interest of the banking system\(^{433}\). In case of a banking company in financial distress, which has been placed under the order of moratorium, under sec 45 (2) of the Act, on an application made by the Reserve bank to the central government, the Reserve bank can, for the foregoing reasons, frame a scheme of amalgamation for transferring the assets and liabilities of such distressed bank to a much better and stronger Bank. Such a scheme framed by the RBI is required to be sent to the banking companies concerned, for their suggestions or objections, including those from the depositors, shareholders and others.

\(^{430}\) (1988)ILLJ162SC

\(^{431}\) 1987 (1) KLT 892- The case concerned with the suspension of business of Bank of Cochin and its amalgamation with the State Bank of India(SBI). Employees of the transferee bank contented that the scheme was arbitrary, unjust and unfair as it was in violation of Art.14 of the Constitution of India.

\(^{432}\) Ibid., “We have no hesitation in holding that the scheme under the Banking Regulation Act, 1949 is Law, providing for the amalgamation of two banking companies in the public interest and therefore protected under Art. 31 A of the Constitution of India”

\(^{433}\) S.45(2)-(15)of the Banking Regulation Act,1949
After considering the same, RBI sends the final scheme of amalgamation to the central government for sanction and notification in the official gazette. The notification issued for compulsory amalgamation also under s.45 of the Act is also required to be placed before the two houses of parliament.

Most of the amalgamations of the private sector banks in the post-nationalization era were induced by the Reserve Bank in the larger public interest, under Section 45 of the Act. In all these cases, the weak or financially distressed banks were amalgamated with the healthy public sector banks. The over-riding principles governing the consideration of the amalgamation proposals were: (a) protection of the depositors’ interest; (b) expeditious resolution; and (c) avoidance of regulatory forbearance.

Validity of the order of moratorium under Section 45: One of the earliest case in which the validity of the order of moratorium was challenged was in *Chawla Bank Ltd. v Reserve Bank of India and Ors*, the sole ground on which the moratorium order and the amalgamation scheme challenged was that they were in conflict with the order passed by the High Court under Section 153 of the Indian Companies Act,1913 sanctioning an arrangement agreed to by the shareholders and creditors of the Chawla Bank for the continuance of the said bank and for the satisfaction of its liabilities. The suggestion of the petitioners was that Section 45 of the Banking Regulation Act cannot operate to nullify orders that have been passed by the High Court in the jurisdiction conferred on it by the Companies Act. The Issue before the court was whether a scheme under Section 391 to 394 of the Companies Act, approved by the High court can be nullified by an order under Section 45 of the Banking Regulation Act, 1949? Court held that ‘that orders of moratorium and amalgamation schemes made under the Banking Regulations Act are to have effect notwithstanding any other law or any agreement, award or other instrument.

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434 V. Leeladhar, “Consolidation in the Indian financial sector”
435 [1970]40CompCas15 (All) and the case was decided by W. Broome, J. Chawla Bank Ltd. of Dehra Dun had filed a writ petition to challenge an order of moratorium issued by the Central Government under section 45(2), and an amalgamation scheme prepared by the Reserve Bank under Sub-section (4) of the same section for the amalgamation of the Chawla Bank with the New Bank of India.
Section 45 of the Banking Regulation Act thus expressly overrides Section 153 of the Companies Act, 1913, and the corresponding provision in Section 391 of the Companies Act, 1956; and arrangements or schemes enforced under these sections of the Companies Acts, can obviously not be put on a higher level than the sections of the Acts themselves and must also be deemed to be overridden by the provisions of Section 45 of the Banking Regulation Act. Court went on to say that the question of whether a banking company is to be amalgamated with any other banking institution is clearly a matter solely in the discretion of the Reserve Bank and no question can arise of the Reserve Bank having to seek permission from the High Court to exercise the powers conferred on it in this respect by Section 45 of the Banking Regulation Act.

In Ganesh Bank of Kurundwar Ltd and Ors v. Reserve Bank of India, Federal Bank Ltd., Ganesh Bank of Kurundwar Ltd. and Union of India, court held that the object of section 45 is to provide a relief to the depositors at the earliest where any such banking company lands into difficulty and is required to be either reconstructed or amalgamated with other banking institution. Surely, the decision is required to be taken at the earliest. This is because the moratorium will be running in the meanwhile. A personal hearing to all such affected interests would delay the decision. What is contemplated is that their suggestions and objections must be shown due regard. That can be obtained by receiving such suggestions and objections and RBI giving its comments thereon; According to the court that is sufficient by way of compliance with principles of natural justice.” Another case in which Section 45(2) challenged was in Bishop of Kottayam and Ors. v. Union of India (UOI), Wherein

436 [2006]131 Comp Cas614(Bom) H.L. Gokhale and Abhay Shreeniwas Oka, JJ. Ganesh Bank of Kurundwad Ltd, challenged the order of moratorium Imposed by central government based on the report submitted by RBI and its amalgamation with Federal bank Ltd.

437 AIR1986Ker126, case was decided by K. Bhaskaran, C.J. and V. Bhaskaran Nambiar J. In exercise of the powers conferred under Section 45(1) of the Banking Regulation Act, 1949 (Act 10 of 1949), the Government of India claimed moratorium on the Bank of Cochin from the close of business on the 27th of April, 1985 till 28th August, 1985. The petitioners used to receive foreign contribution through some of the branches of the Bank of Cochin and have registered themselves under Section 6 of the Foreign Contribution (Regulation) Act, 1976. They thus maintained accounts in some specified branches of the Bank. The petitioners were however, prevented from operating these accounts and
the court held that ‘moratorium’ contemplated under Section 45(1) of the Act is "in respect of a banking company" and not confined to banking business only. Moratorium, as the word signifies is a suspension of activity, a temporary ban on the performance of legal obligations. Section 45(3) of the Banking Regulation Act therefore enjoins that the Banking company shall not during the period of moratorium make any payment to any depositor or discharge any liabilities or obligations to any creditor, except as otherwise directed by the Central Government. The activity of the banking company is thus suspended and the bank cannot transact any banking business or engage in other forms of business. The fact that for certain types of business, a further authorization or permission is insisted under the foreign exchange does not affect the content of the power of moratorium sanctioned under Section 45 of the Banking Regulation Act and it does not authorize any business, banking or otherwise, during the operation of the moratorium. Thus, when the moratorium is in force, bank cannot transact business as an authorized dealer in foreign exchange under the Foreign Exchange Regulation Act also.

Further in *North East Finance Corporation Ltd. and Anr. v. Union of India (UOI) and Ors.* Court held that it was for the Reserve Bank to take proper action in the matter of Sikkim Bank Limited when it came to its notice that the affairs of the bank had been mismanaged and it was essential to act in the interest of the Sikkim Bank Limited, its depositors and the banking system as a whole. The creditworthiness of a banking institution is a matter of concern not only to a few but to the whole economy and one should not be surprised, if those who have mismanaged the affairs of a bank resulting in its unsatisfactory financial condition, should make allegations against withdrawing any amounts while the moratorium is in force. They have therefore filed writ petitions with two contentions (1) The moratorium ordered under Section 45(1) of the Banking Regulation Act cannot affect the authorization granted to the Bank under the Foreign Exchange Regulation Act, 1973 to deal in foreign exchange.(2) Assuming the power under the Banking Regulation Act extends to transactions and activities carried on by the authorized dealers of foreign exchange, the fundamental right guaranteed under Art 26(d) of the Constitution is violated.

438 MANU/SI/0002/1999 case decided by Ripusudan Dayal, C.J. and Anub Dev, J. (Sikkim High Court) the petitioners challenged the order of moratorium made by the Union of India in respect of the Sikkim Bank Limited on and also the scheme framed for amalgamating the said bank with the Union Bank of India.
those whose duty is to act in the matter. It thus held that the action taken was not bad on account of any mala fides on the part of the officers of the Reserve Bank of India. In *Bari Doab Bank Ltd. V. Union of India and others &Punjab Co-operative Bank Ltd. V Union of India and others*\(^439\), the main issue was whether the order of moratorium issued under Section 45 and proposed amalgamation of petitioner banks was justified. Court held that the significance of the Reserve Bank’s position as the central bank of the country needs no emphasis. As the central bank and as the primary regulator of the banking business, the Reserve Bank has been vested with very wide powers and is also charged with certain duties as reflected in the preambles to and the provisions of the two legislations referred to above. Section 45(1) of the Act requires the Reserve Bank to make an application to the Central Government for grant of moratorium. Court further held that the law is well-settled and the ‘function of the court is to see that lawful authority is not abused but not to appropriate to itself the task entrusted to that authority’. The provisions of section 45 of the Act are substantially complied with and it will not be open to the court to reappraise the material to arrive at a contrary conclusion as it is not the function of the courts to sit in judgment over such matters. The law is, therefore, very clear that the Reserve Bank which is described as the banker’s bank is empowered to regulate the banking system and certain regulatory functions have been assigned to it by the provisions of the Act. The question now arises as to whether the Reserve Bank has exceeded its brief and applied to the Central Government for an order of moratorium without application of mind when there was no good reason so to do. The Central Government duly considered the application made by the Reserve Bank of India and passed orders of moratorium in terms of sub-section (2) of section 45 of the Act. Court held that the Reserve Bank of India possesses the expertise to arrive at its finding which cannot be questioned under article 226. Decision of the single bench in *Bari Doab Bank Ltd. V. Union of India and others and Punjab Co-operative Bank Ltd. v. Union of

\(^{439}\) [1997]89CompCas438(Delhi) the case was decided by Chander Mohan Nayar, J., the general manager of respondent No. 2 advised the petitioner-bank to increase its paid-up capital to 10 crores by June 30, 1996, failing which the Reserve Bank of India will view the matter seriously. The facts revealed shortcomings in functioning of petitioner-banks. Thus the order of moratorium necessary in interest of public, depositors and banking system.
India and others was challenged before the division bench\textsuperscript{440} of the Delhi High court. Court confirmed the decision of the single bench and held that the Reserve Bank of India (RBI) is a body of expert and Courts cannot go into the expert opinion of Bank. Therefore, in the instant case, the opinion as to merge the Bari Doab bank with a bigger bank in the interest of the bank, its depositors and the policy of the RBI, cannot be interfered with. Purpose of declaring moratorium was stated by the court that moratorium by the Central Government followed by a scheme for amalgamation or reconstruction by the Reserve Bank is that, a proper atmosphere or situation is to be brought into being - for a short period not exceeding six months - so that a draft scheme could be brought in by the Reserve Bank, finalized after hearing objections or suggestions and laid before the Central Government for its sanction. This is why the moratorium imposes a stay of Commencement/continuation of all actions and proceedings against the company under section 45(2). The banking company is also not to make any payment to depositors or discharge any liability or obligation to the creditors. The stay or statutory injunctions stated above are intended to sub serve the main purpose of the Reserve Bank to examine the financial or other status of the bank and consider whether a draft scheme is necessary (a) in public interest, or (b) interests of depositors, or (c) in order to secure proper management of the banking company, or (d) in the interest of the banking system of the country as a whole. In other words, the moratorium for a maximum period of six months is to help in considering whether the bank is to be put under a scheme of reconstruction or amalgamation. Therefore, moratorium is a step which sub serves the main purpose of introduction of a scheme. While it is true that section 45(4) considers the introduction of a scheme during the pendency of the period of a moratorium, the existence of a moratorium is the first stage wherein conditions suitable for formulation of a scheme are introduced. In that sense, the existence of a moratorium is not an independent stage which is an end in itself. It is a means leading to an end. Therefore, the moratorium application under

\textsuperscript{440}[1997]89CompCas292(Delhi), it was argued before M. Jagannadha Rao, C.J. and Mannmohan Sarin, JJ.
section 45(1) and a moratorium order under section 45(2) are, to describe by analogy - an interlocutory stage anterior to but yet dependent on the result of the draft scheme and its finalization. In the event the scheme is finalized as per section 45(6) and approved by the Government under section 45(7), the scheme starts operating under its own mechanism and the moratorium simply lapses because it was intended only to create the necessary atmosphere for considering the introduction of a scheme. In case the scheme is withdrawn, the moratorium also lapses automatically. Yet another reason - as to why there can be no rule of natural justice at the pre-moratorium stage - is that if the financial stringency of the bank is given publicity by the Reserve Bank by a show-cause notice to the bank as to why moratorium should not be imposed, there could be a "run" on the bank, or the directors might fritter away or remove the assets of the bank or unduly prefer one creditor over another etc. Prior notice at that stage would therefore render the introduction of the scheme nugatory.

**Judicial Review under Section 45:** Scope of Judicial Review under section 45 of the banking Regulation was discussed in *Davis Kuriape v. Union of India*\(^{441}\). Court

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\(^{441}\) ILR 2002(1) Kerala 311  B.N. Srikrishna, C.J. and M. Ramachandran, J. Appellant had joined the services of the Bank of Cochin Ltd and promoted as junior office and later as the Grade II Officer in 1980 and Branch Manager in 1985. The Bank of Cochin Ltd. ran into financial difficulties, was hardly able to carry on its banking operation. Considering the overall public interest, the Government on India, in consultation with the Reserve Bank of India imposed a moratorium on the banking operations of the Bank of Cochin instead of winding up the Bank. Considering the interest of the public and depositors and large number of employees the Government of India in consultation with the Reserve Bank evolved a scheme for amalgamation of the Bank of Cochin with the State Bank of India. After the scheme was brought into force the State Bank of India took over the banking operations of the Bank of Cochin, took over its employees into appropriate grade assessing their length of service, qualifications, etc. This lead to dissatisfaction among the erstwhile employees of the Bank of Cochin and there was an agitation by them. Representation was made to the Reserve Bank of India. The Reserve Bank after considering the representations of the employees and the State Bank of India, decided that for the purpose of implementing the scheme, and deciding the equivalence of experience, every two years service in the Bank of Cochin would be treated as equivalent to one year service in the State Bank of India. Aggrieved by the decision, the employees filed Original Petition challenging the implementation of the scheme. It was contended that the scheme was illegal, that implementation of the scheme affects the employees adversely and that principles of natural justice had been violated. But the court overruled the contention of the Appellants and dismissed their appeals stating that Section 45 of the Banking Regulation Act, 1949 empowers the Reserve Bank of India to apply to the Central Government for suspension of business by a banking company and to prepare a scheme of reconstitution or amalgamation. Sub-section (5) of Section 45 enumerates several provisions which may be contained in any such scheme of amalgamation. The obligation of the transferee bank under the scheme
held that when a scheme is framed under Section 45 for amalgamation judicial review thereof is permissible only to a very narrow extent. Particularly when a dispute or difference arising with regard to the equivalence of experience has been decided by the Reserve Bank in exercise of its powers under the second proviso to Section 45(5)(i), the High Court in writ jurisdiction cannot sit in appeal over such Judgment. It can only interfere in extreme cases of arbitrariness or unreasonableness. As to the criteria adopted for judging the equivalence of experience in two different banks which are being amalgamated, the Reserve Bank being an expert body in banking operations would be the best judge. The High Court is neither equipped, nor capable of handling such a delicate task which requires expertise and deep knowledge of banking operations.

RBI is having the discretion to choose from the interested banks that is willing to acquire the assets and liabilities. There is no power given to the RBI to compel any bank to be a transferee bank. It means that if no banking company is ready to acquire the business of the ailing bank, then the only recourse is to order for the compulsory winding up. This is a dangerous situation. It is hereby suggested that in such cases Central government must acquire the business of such banking companies as under Section 36AE\(^{442}\) of the Banking Regulation Act, 1949.

3.14 Acquisition of Banking Companies by the Central Government under Part IIC of the Banking Regulation Act, 1949: In a welfare State, it is the constitutional obligation of the State to protect socially and economically weaker sections of the society against the exploitation by the corporations. The same prescription may not suit in all cases of sickness. Different types of actions with different procedures may have to be taken to deal with different situations. Whether in a given situation the banking company

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\(^{442}\) Power of Central Government to acquire undertakings of banking companies in certain cases.
should be acquired or should be amalgamated with another company or should be reconstructed, is a matter on which some strait-jacket formula cannot be prescribed. It has to be left to the decision of an expert body which is answerable to the Central Government.

Part-II C of the Banking Regulation Act, 1949 deal with the acquisition of the undertakings of banking companies by the Central government. Part IIC of the Banking Regulation Act was added at a time, when government decided to acquire the control of privately operated banking companies. It was in the year 1968 the Banking companies (Acquisition and transfer of undertaking) ordinance was issued and which became the Bank nationalization Act in the year 1969. It is to be noted that for the government to exercise the power to acquire the private banking companies Part -IIC was added.

Section 36AE does not confer *suo-moto* power to the Central government to acquire the business of a banking company. A report by RBI is essential and RBI is entitled to submit the report only if the banking company has failed to conform to its directions under section 21 or under Section 35A or if it was managed in a manner detrimental to the

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443 Section 36AE to 36 AJ, inserted by the banking companies (amendment)Act,1968.

444 Section 21: Power of Reserve Bank to control advances by banking companies.—

(1) Where the Reserve Bank is satisfied that it is necessary or expedient in the public interest (or in the interests of depositors) [or banking policy] so to do, it may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

(2) Without prejudice to the generality of the power vested in the Reserve Bank under sub-section (1) the Reserve Bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular, [as to—

(a) the purposes for which advances may or may not be made,

(b) the margins to be maintained in respect of secured advances,

(c) the maximum amount of advances or other financial accommodation which, having regard to the paid-up capital, reserves and deposits of a banking company and other relevant considerations, may be made by that banking company to any one company, firm, association of persons or individual,

(d) the maximum amount up to which, having regard to the considerations referred to in clause (c), guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, and

(e) the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.]
interest of its depositors. Considering the scope and ambit of Ss. 21 and 35-A of the Banking Regulation Act, 1949, it has been held by the Supreme Court in Central Bank of India vs. Ravindra and others\textsuperscript{446}, as follows “The power conferred by Ss. 21 and 35A of the Banking Regulation Act, 1935 is coupled with duty to act. Reserve Bank of India is prime banking institution of the country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions, having statutory force, in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally. Reserve Bank of India is one of the watchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would invite its policy decisions......." Main object of Part-IIC is to ensure that the banks would conduct its business in accordance with the provisions of the banking regulation Act, 1949, failing which the control over such banking companies would be transferred to central government. Part-IIC is a complete code by itself. Section 36 AE confers wide powers to the Central Government to acquire the business of the banking company. It states that Central Government may either vest itself with the acquired bank or transfer the same to any company constituted under any of its scheme. It also provides for setting up a tribunal to resolve the disputes

\textsuperscript{445} Every banking company shall be bound to comply with any directions given to it under this section.\]

\textsuperscript{446} [ 35A Power of the Reserve Bank to give directions. —

(1) Where the Reserve Bank is satisfied that—

(a) in the [public interest]; or

(aa) in the interest of banking policy; or

(b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or

(e) to secure the proper management of any banking company generally,

it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

(2) The Reserve Bank may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or cancelling any direction may impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.

\textsuperscript{446} (2002) 1 SCC 367]
arising as a result of acquisition of banking business in Part IIC. While preparing the scheme, Central Government needs to consult the Reserve bank of India. RBI is not the final authority in determining the acquisition of banking company by the central government; it is only a consulting agency. There is no provision in the Banking Regulation Act, 1949 to facilitate the voluntary acquisition of banking companies unlike Companies Act, 1956 & 2013, which deals with acquisition of shares of companies.

3.15 **Comparison between Section 45 and 36AE of the Banking Regulation Act:** In *North East Finance Corporation Limited and Another v Union of India and Others*[^447^], it was the contention of petitioners that S. 45 of the Banking Regulation Act is not constitutionally valid, since it confers unguided discretion to choose between the procedure and provisions of S. 45 on one hand and the provisions of 36AE to Section 36AG on the other. Further, an unguided discretion has been conferred on the Reserve Bank of India to choose between reconstruction and amalgamation in S. 45(4). Besides, S. 45 is more onerous than Sections 36AE to 36AG, both in procedure and substance. But the Court held that choice has to be exercised by some authority as to whether the situation called for acquisition or amalgamation or reconstruction and since choice has been left to be decided by an expert body, i.e. the Reserve Bank of India, the discretion cannot be said to be unguided and provisions of s. 45 cannot be said to be arbitrary.

3.16 **Comparison between Section 396[^448^] of the Companies Act, 1956 and Section 36AE of the banking Regulation Act, 1949:** Section 396 of the companies Act confers power to the central government to amalgamate two or more companies in the public interest. Such mergers need not undergo the route in Ss. 391-394 of the companies Act. The sole objective is to expedite the procedure as the merger is initiated by the central government in public interest. Power under section 36AE can be exercised by the Central Government to acquire undertakings of banking companies where the Central Government is satisfied that the banking company is not complying with the directions given by the Reserve Bank of India or the banking company is being managed in a

[^447^]: 2000 (1) CLC 46

[^448^]: Power of Central Government to provide for amalgamation of companies in public interest.
manner detrimental to the interest of the depositors. The principles for payment of compensation to the shareholders of the acquired bank and the method of computation of such compensation are provided in the Fifth Schedule to the Banking Regulation Act, 1949.

There is also a provision for constitution of a Tribunal by the Central Government for the purpose of fixing the compensation if the compensation offered is not acceptable to the shareholder. The power under section 36AE to acquire banking companies is to be exercised after giving the banking company a reasonable opportunity of showing cause against the proposed action.

Section 36AE provides for acquisition of banking companies, whereas section 396 deals with amalgamation of companies in public interest. A scheme under section 36AE the Central Government and RBI have different roles to play. Whereas under Section 396, Central Government prepares the scheme and the same is laid before both the houses of parliament. Section 396 does not mandate the Central government to take complete control over companies proposed for amalgamation in the public interest. But section 36AE states that the Central government shall acquire the control over such banking companies. Section 36 AE is attracted only, if the (1) the banking company has failed to act in accordance with the directions of the RBI relating to banking policy and (2) where the business of the banking company is managed in a manner detrimental to the interest of its depositors. Thus, the Central government has no suo-moto power to acquire the banking business, only if the banks failed to act in accordance with the directions of RBI and managed business detrimental to the interest of the depositors. But the power conferred to the Central Government under section 396 is in public interest.

3.17 Restrictions on Acquisition of shares or voting rights in Banking Companies:
Banking Laws (Amendment) Act, 2013 inserted section 12B to the Banking Regulation Act, 1949. It imposes cap on acquisition of shares or voting rights in the banking companies. Banks discharge their functions as the trustees of public money. If an

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449 ‘Except with the prior approval of RBI on an application being made no person shall acquire directly or indirectly by himself or acting in concert with any other person shares or voting rights if any held by him or his relatives five percent or more of the voting rights in such banking companies’. A bare perusal may reveal that the threshold limit
individual or company acquires more than five percentage of the total paid up share capital or voting rights, without the permission of the central government, it would be detrimental to the interest of the banking company and in turn prejudice the public interest. Voting rights or shareholding above five percentages may confer decisive voice to such shareholders and enable to control the banking business. If the control is vested in favor of such persons it would enable them the power to wield the decisions which may not be yielding to the public interest. Hence, it is justified on the part of the RBI to impose restrictions on the acquisition of shares of the banking companies.

Section 12B does not specify the ambit of its application. It is, to the Private sector banking companies or to the Public sector banking companies? By necessary implication it is to be understood that the application of the same is only to the private sector banking companies. Section 3 (2D) of the Banking companies (Acquisition and Transfer of Undertakings) Act, 1970, states that the “shares of every corresponding new bank not held by central government shall be freely transferable”. A proviso to the section 3(2D) states that if at any time an individual or company shall not hold more than twenty percent of the total paid up share capital of the company. The power to make notifications in that regard is vested with the central government. There are no corresponding provisions for the same under the State Bank of India Act.

An approval under Sub-section (1) of Section 12B may be granted by the RBI upon various criteria. Four grounds are stated such as ‘in the public interest’, ‘in the interest of the banking policy’, ‘to prevent the banking business being conducted in a manner detrimental or prejudicial to the banking company’, ‘in view of the emerging trends in banking and international best practices or ‘in the interest of the banking and financial system’. These are the usual reasons which RBI state for any matter relating to the banking companies. It is imperative to protect the Public interest and interest of the banking business and thus, it is required that the RBI must exercise control over the banks in India.

under SEBI (Takeover Regulations) 2011 for mandatory open offer requirement arises only after the acquisition of 24% or more of the shares or voting rights. But the ceiling imposed for the banking companies is too below the threshold permitted under the SEBI take over regulations'.
Increased coordination between RBI and central government would bring uniformity in determining the acquisition of shares or voting rights in banking companies (excluding the shares or voting rights exercised by the central government). It would be appropriate to include a chapter in the SEBI (Substantial Acquisition of shares and Takeovers), 2011, to govern the matters relating to acquisition of shares and voting control over in the banking companies. This would bring uniformity in the banking legislations pertaining to the acquisition of shares or voting rights in the banking companies.

3.18 Amalgamation of NBFCs\textsuperscript{450} with Banking Companies:

Commercial banks may be interested in merging with or acquiring non-bank financial firms for several reasons. External factors such as regulatory changes and bank capital adequacy requirements may force banks to expand their activities through acquisitions of nonbanks. Their internal desires to seek cost efficiency and to increase revenue or simply to maximize profit can also be determining factors. A bank with a nonbank subsidiary is able to offer a wider array of financial services to its customers beyond traditional banking services, thus enhancing its revenue and market value. Lastly, bank managers may have their own personal incentives for acquiring non-banks\textsuperscript{451}.

Chapter –III B\textsuperscript{452} of the Reserve Bank of India Act, 1934 confers powers to the Reserve bank to regulate the Non- banking companies and financial institution’s deposit taking business. In addition to the same, there are number of guidelines issued by RBI to regulate the working of Non-Banking Financial Companies. The latest among the same is the Revised Regulatory Guidelines for NBFCs issued in Nov 10, 2014\textsuperscript{453}.

In India, merger between banks and non-banking companies are sanctioned by High court under Ss. 391-394 of the Companies Act, 1956\textsuperscript{454}. There is no provision in the Banking Regulation Act that states that the banks need to get prior approval of RBI before

\textsuperscript{450} Non-Banking Financial Companies(NBFCs)
\textsuperscript{452} Section 45H to 45QB of the Reserve Bank of India Act,1934
\textsuperscript{453} Revised Regulatory Frame work for NBFCs. Available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/RRFNC101114F.pdf (See Annexure)
\textsuperscript{454} Corresponds to Ss.230-232 of the Companies Act,2013.
approaching the court. This is creating confusion for companies interested in merging with bank. By virtue of RBI’s power under Chapter IIIB, RBI regulate the deposit taking business of NBFCS. But it cannot be presumed that RBI can regulate all other issues relating to NBFCS. There were only few mergers between banks and Non-Banking companies\(^\text{455}\). Reserve bank of India has issued guide line and directions to be followed by banking companies in case of merger\(^\text{456}\) or acquisition\(^\text{457}\) between a bank and non-banking financial institutions. RBI direction on Acquisition of NBFCs states that ‘Prior written approval of the Reserve Bank would also be required before approaching the Court or Tribunal under Section 391-394 of the Companies Act, 1956 or Section 230-233 of Companies Act, 2013 seeking order for mergers or amalgamations with other companies or NBFCs’\(^\text{458}\).

The powers extended to the RBI under S.44A of the Banking Regulation, Act, 1949 do not extend to the voluntary amalgamation of an NBFC with a banking company. In such cases S.230-234 of the companies Act 2013\(^\text{459}\) will come into operation.

\(^{455}\) ICICI Bank with ICICI, Kotak Mahindra Finance Ltd with Kotakmahindra Bank, IDBI with IDBI Bank Ltd, ING and Vysya Bank Ltd


\(^{457}\) Annexure VII ‘Non-Banking Financial Companies(Approval of Acquisition or Transfer of Control)Directions,2014’. Available at [http://rbidocs.rbi.org.in/rdocs/notification/PDFs/CM376260514F.pdf](http://rbidocs.rbi.org.in/rdocs/notification/PDFs/CM376260514F.pdf)

\(^{458}\) Ibid.,3(iv) This now makes mergers and acquisitions relating to NBFCs (whether deposit accepting or not) subject to prior approval of the RBI. The policy rationale behind this approach is to ensure that the acquirer/ resulting entity following the merger/ acquisition is a “fit and proper person” that has the necessary qualifications to carry on the business of the NBFCs, and such that a transaction is not prejudicial to public interest or the interest of depositors. Interestingly, the RBI notification defines “control” as having the same meaning assigned to it in the SEBI Takeover Regulations. Therefore, any type of control over management and policy decisions of the company, whether through acquisition of shares or through other means such as shareholder agreements could fall within the purview of the RBI approval requirement. Hence, even acquisitions of minority stakes in NBFCs may be subject to scrutiny if they are accompanied by significant rights granted to acquirers/ investors through protective provisions such as board nominations, quorum rights, veto rights and the like that may be contained in shareholders’ (or similar) agreements or in the articles of association of companies. In other words, the approval requirement may be triggered not just for outright acquisitions or takeovers but also investments that are accompanied by significant protective rights to the investors.

\(^{459}\) Ss.230-234 of 2013 Act corresponds to Ss.391-394 of the 1956 Act.
Consequently RBI notified in June 2004\textsuperscript{460} that in such cases, the scheme should be approved by the RBI before it is submitted to the High Court for approval. Subsequently the joint parliamentary committee constituted by the RBI, formulated guidelines for voluntary mergers between banking companies\textsuperscript{461}. Similarly, provisions of the Banking Regulation Act, 1949, have no application if the merger is between a banking company and a non-banking financial company\textsuperscript{462}. In \textit{ICICI Ltd In Re}\textsuperscript{463}, it was held that though the transferee company was a banking company but none of the transferor companies were banking companies, the objection that the approval of the Reserve Bank of India had not been secured as required by the provisions of the Banking Regulation Act was not tenable.

Also in \textit{IndusInd Enterprises and Finance Ltd v. Indus Ind Bank Ltd}\textsuperscript{464}, the issue was whether prior permission of Reserve Bank of India is necessary for amalgamation of a scheme under the Banking Regulation Act, 1949. The case was concerned with the merger between a banking company and a non-banking company. Bombay high court held that no prior sanction of RBI is necessary for the amalgamation of non-banking finance company with banking company.

Based on this a proposal for guidelines between NBFCs and banking companies was mooted in April, 2005. These guidelines were issued in May 2005\textsuperscript{465}. Merger under the Companies Act and amalgamation of banking companies under Banking Regulation Act differ in various aspects. Under the mergers of companies there is a need to protect the interest of the investors whereas there is also a need to protect the interest of the depositors in case of bank mergers. The High Court is not given the power to grant its approval to the scheme of merger of banking companies and the RBI is given such a power. In other words it can be said that the High Court sanctions the scheme under the

\textsuperscript{460} Guidelines for the merger or amalgamation of Private Sector Banks, RBI/2004-05/462( May 11,2005) see Annexure VI

\textsuperscript{461} Ibid,

\textsuperscript{462} The applicable laws for such merger is under Ss. 391-394 of the Companies Act, 1956 or Section 230-234 of the Companies Act, 2013.

\textsuperscript{463} ICICI Ltd , 2002 ( 3 ) Comp Lj. 111 cited also in ( 2004) 119 ComCas.941( Bom.)

\textsuperscript{464} 2003 ( 4 ) BomCR  482

\textsuperscript{465} Ibid at point 3. Also see Annexure -VI
Companies Act, whereas the RBI has the final authority under the Banking Regulation Act for merger of banks. The RBI is empowered to determine the market value of the shares of the dissenting shareholders who have either voted against the scheme or who have given written notice of objection before the meeting of the banking company to the Presiding Officer concerned. The aggrieved shareholders of the amalgamating banking companies are entitled to such value of the shares as evaluated by the RBI. When an application is made by a banking company under Section 230 of the Companies Act, 2013, the tribunal has the powers to direct the RBI to make inquiry in relation to the affairs of the banking company and the conduct of its directors.\(^{466}\)

3.19 Amalgamation of Public sector Banks: One of the major tasks the Reserve Bank had to undertake was the building up of sound and adequate banking and credit structure on modern lines. To correct several undesirable practices and thus to protect the interest of the depositors wide powers were conferred on the Reserve Bank of India. To bring about a wider diffusion of banking facilities and changes in the pattern of bank lending, the scheme of ‘social control’ over the banks were initiated by the Government in 1967.\(^{467}\) Social control marked a transitory stage in the evolution of banking policy and it lead to the nationalization\(^{468}\) of 14 major banks in 1969.

In the case of public sector banks, i.e., nationalized banks, the statutory frame work differs wherein the provisions of the Banking Regulation Act do not apply. The amalgamation of public sector bank is governed by section 9(1)(c) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 & 1980, which is known as the Bank Nationalization Act\(^{469}\). It authorizes the central government to prepare a scheme of amalgamation in consultation with RBI for the transfer of one bank to another corresponding new bank.\(^{470}\)

\(^{466}\) Section 44B(2) of the Banking Regulation Act, 1949  
\(^{467}\) Dr. Manmohan Singh, “Reserve Bank of India: Functions and Working” (1983) P.6  
\(^{468}\) ‘The main objectives of the nationalization were to ‘control the heights of the economy and to meet progressively, and serve better, the needs of development of the economy in conformity with national policy and objectives’.  
\(^{469}\) Constitutional Validity of the 1969 Act was challenged in R.C. Cooper v. Union of India AIR 1970 SC 564  
\(^{470}\) S. 9(1) (C) Bank Nationalization Act.
The scheme framed under there will be placed before both the houses of parliament for approval.\textsuperscript{471} In \textit{Kurian v. State of Kerala},\textsuperscript{472} the Court observed that ‘a nationalized bank is a public institution. It falls within the meaning of the expression “State” for the purpose of enforcement of fundamental rights. It can be treated as a Government company within the meaning of Section 617 of the Companies Act, 1956\textsuperscript{473}. Purpose of bank nationalization was stated by the Supreme Court in \textit{All India Bank officers Confederation v. Union of India},\textsuperscript{474} as to render the largest good to the largest number of people. Object of Section 9 of the Act, which is regarding central government’s power to make a scheme for constitution of board of director, is to give the board (RBI) a truly representative character so as to reflect the genuine interest of the various persons and dealing with the bank as an industry and as a commercial enterprise. Further in \textit{Tarachand Vyas v. Chairman, Disciplinary authority},\textsuperscript{475} court observed that nationalized banks are the prime sources and pillars for the establishment of socio-economic justice for the weaker sections.

\subsection*{3.20 Consolidation of the Regional Rural Banks (RRBs)} – RRBs were established under the RRBs Act, 1976\textsuperscript{476} and were intended to create an institution mechanism to

\footnotesize{\textsuperscript{471} S. 9(6) Bank Nationalization Act
\textsuperscript{472} 1982 Cri LJ 780
\textsuperscript{473} Section 2(45) of the Companies Act, 2013.
\textsuperscript{474} AIR 1989 SC2045
\textsuperscript{475} (1999) 4 SCC565
\textsuperscript{476} S. 23A of the Regional Rural Banks Act, 1976-23A. Amalgamation of Regional Rural Banks.-(1) Notwithstanding anything contained in this Act, if the Central Government, after consultation with the National Bank, the concerned State Government and the Sponsor Bank, is of the opinion that it is necessary in the public interest or in the interest of the development of the area served by any Regional Rural Bank or in the interest of the Regional Rural Banks themselves, that two or more Regional Rural Banks should be amalgamated, that Government may, by notification in the Official Gazette, provide for the amalgamation of such Regional Rural Banks (hereafter in this Chapter referred to as the transferor Regional Rural banks) into a single Regional Rural Bank (hereafter in this Chapter referred to as the transferee Regional Rural Bank) with such constitution, property, powers, rights, interests, authorities and privileges; and with such liabilities, duties and obligations, as may be specified in the notification.

(2) Every notification issued under sub- section (1) shall indicate the date with effect from which the amalgamation shall become effective.

(3) Every notification issued under sub- section (1) may also provide for all or any of the following matters, namely:--}
deliver rural credit, using a form that would have local access and simultaneously access to the expertise of commercial banks. RRBS are jointly owned by the central and state governments.

(a) the continuance in service of all the employees of the transferor Regional Rural Banks (excepting such of them as not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947) are specifically mentioned in the notification) in the transferee Regional Rural Bank at the same remuneration and on the same terms and conditions of service, which they were getting or, as the case may be, by which they were being governed, immediately before the date on which the amalgamation takes effect;

(b) notwithstanding anything contained in clause (a), where any of the employees of the transferor Regional Rural Banks, not being workmen within the meaning of the Industrial Disputes Act, 1947 (14 of 1947) are specifically mentioned in the notification, or where any employee of the transferor Regional Rural Banks has by notice in writing given to the transferee Regional Rural Bank at any time before the expiry of a period of three months next following the date on which the amalgamation takes effect, intimated his intention of not becoming an employee of the transferee Regional Rural Bank, the payment to such employee of compensation, if any, to which he is entitled under the Industrial Disputes Act, 1947, and such gratuity, provident fund and other retirement benefits ordinarily admissible to him under the rules or authorizations of the concerned transferor Regional Rural Banks immediately before that date;

(c) the other terms and conditions for the amalgamation of Regional Rural Banks; and

(d) the continuance by or against the transferee Regional Rural Bank of any pending legal proceeding by or against any transferor Regional Rural Banks and such consequential, incidental and supplemental provisions, as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

(4) Every notification issued under sub-section (1) shall, as soon as may be after it has been made, be laid before each House of Parliament.

477. Sukanya Bose, ‘Regional Rural Banks: The Past and The Present Debate’ available at http://www.macrosan.org/fet/jul05/pdf/RRB_Debate.pdf visited on 20th June 2011. Recommendations to consolidate RRBS were first mooted by Chalapathy Rao Committee (Working Group TO Suggest Amendments to the RRBS Act, 1976) The Chalapathy Rao Committee (2002) had proposed that the government reduce the number of RRBS to around 40 from the present 196. Options for mergers could be mergers of RRBS following ‘one-sponsor bank approach’ or they could be amalgamated with their sponsor banks, and thereafter the RRBS could operate as ‘commercial entities’. The Vyas Committee II (June 2004), on the other hand, has forwarded a more logical solution. After weighing the various options for amalgamation, it decided that it could not consider the option of merger with the sponsor bank, as it would go against the rationale of the third channel for rural credit with a clear rural focus and regional orientation.” Instead, it recommended merger of RRBS so as to create a zonal bank for RRBS in the North-East and rural banks at state level for the rest of the country.
The Narasimham committee conceptualized the creation of Regional Rural Banks in 1975 as a new set of regionally oriented rural banks, which would combine the local feel and familiarity of rural problems characteristic of cooperatives with the professionalism and large resource base of commercial banks. Regional Rural Banks are regarded to be important financial institutions for overall economic growth of developing nations like ours. 62% of our nation’s populations are depended on agriculture sector to meet their livelihood. RRBs have been in existence for around three decades in the Indian financial scene. As a result of amalgamation, number of the RRBs has been reduced from 196 to 64 as on 31 March 2013. The restructuring and amalgamation of RRBs is at once both complex and delicate affair. It is complex as the multitude of the exercise is spread over different states, involving different sponsor banks with differences in performance of the merged entities. 478 The Reserve Bank of India (RBI) in 2001 constituted a committee 479

479. A number of committees have come out with different suggestions to address the financial non-viability of RRBs. For instance, the Working Group on RRBs (Kelkar Committee) in 1984 recommended that small and uneconomic RRBs should be merged in the interest of economic viability. In a similar vein, the Agriculture Credit Review Committee (ACRC, i.e. Khurso Committee), 1989 pointed out that ‘the weaknesses of RRBs are endemic to the system and non-viability is built into it, and the only option was to merge the RRBs with the sponsor banks. The Committee on Restructuring of RRBs, 1994 (Bhandari Committee) identified 49 RRBs for comprehensive restructuring. It recommended greater devolution of decision making powers to the Boards of RRBs in the matters of business development and staff matters. The Committee on Revamping of RRBs (1996) (Basu Committee) once again mooted the option of liquidation. The Expert Group on RRBs in 1997 (Thingalaya Committee) held that very weak RRBs should be viewed separately and possibility of their liquidation be recognized. Such RRBs might be merged with neighboring RRBs. In 2003 Chalapathy Rao Committee recommended that the entire system of RRBs might be consolidated while retaining the advantages of regional character of these institutions. As a part of the process, some sponsor banks may be eased out. The sponsoring institutions may include other approved financial institutions as well, in addition to commercial banks. The Group of CMDs of Select Public Sector Banks, 2004 (Purwar Committee) recommended the amalgamation of RRBs on regional basis into six commercial banks – one each for the Northern, Southern, Eastern, Western, Central and North – Eastern Regions. 479 A study of merger of banking institutions will not be complete without mentioning about the report of the Internal Working Group set up by the Reserve Bank under the Chairmanship of Shri A.V Sardesai (Sardesai Committee, 2005) in relation to Regional Rural Banks which were created as part of assisting in rural development under the Regional Rural Banks Act, 1976. The said Working Group had observed the following:
1. The Regional Rural Banks Act of 1976 does give powers to the Central Government to effect amalgamation of any two or more RRBs into a single RRB after consultation with the State Government, the National Bank and the Sponsor Bank.\footnote{479}

2. Amalgamation of two RRBs sponsored by the same bank will not affect the interest of the Sponsor bank or State Government and involve only the integration of the business of two banks. The area of operation will have to be redefined to cover that the both the erstwhile banks. Accordingly, this would be the easiest option available for merger of two or more RRBs.

3. Where RRBs sponsored by two different banks are sought to be merged within the same State, the shareholding of one of the Sponsor banks will have to be vested in the other under the Notification and the Directors appointed by that Sponsor bank will have to be withdrawn (as there is no provision for two Sponsor banks). The issue of any compensation to the outgoing Sponsor bank will have to be settled in consultation with the Sponsor bank and specified in the Notification. As the Central Government has only a duty to consult and concurrence of the Sponsor banks is not a statutory requirement, it will be open to the Central Government to decide the matter of compensation and provide for in the Notification, although it would be advisable to act on consensus to avoid any dispute or litigation.

4. RRBs, under Section 3 of the Act, are required to be established ‘in a State or Union Territory’ and operate within the local limits specified in the Notification. Consequently, the area of operation of a RRB has to be confined to a State and interstate RRBs are not envisaged. The State Government apart from holding 15% of the share capital has also the power to appoint two directors on the Board of a RRB. Further, in inter-state merger, the transfer of shares held by one State Government to the other will be involved, as the Act does not envisage more than one State Government to be the shareholder of a RRB. Hence, in the absence of specific provisions in the Act, the merger of RRBs located in two different States may not be envisaged under Section 23A. However, if a view is taken that Section 3 of the Act deals only with the initial establishment of RRB to be located in one State or Union Territory and that while exercising powers under Section 23A, the provisions of section 3 are not possible, it would be possible to merger two banks with contiguous areas of operation situated in different states. As the transfer of shares of one of the State Governments to the other becomes necessary, the shares may be transferred to/ vested in the State where the RRB has its headquarters. Further, the Directors appointed by the outgoing State Government will also have to be excluded from the merged entity. In that case, the two State Governments have to agree to the deal as in the absence of concurrency any Notification merging the banks might lead to dispute/litigation. In these circumstances, it would be advisable that the mergers may be limited to RRBs located within the same state.\footnote{479}

In pursuance of the recommendations of the Joint Parliamentary Committee (2002), the Reserve Bank of India (RBI) had constituted a Working Group to evolve guidelines for voluntary mergers involving banking companies. Subsequently, on May 11, 2005 following guidelines on merger and amalgamation, inter alia, were issued:

i. Draft scheme of amalgamation be approved individually by two – thirds of the total members of Board of Directors (BODs) of each of the two banking companies.

ii. Members of the BODs who approve the draft scheme of amalgamation are required to be signatories of the Deed of Covenants as recommended by the Ganguly Working Group on Corporate Governance.
under the Chairmanship of Dr. V S Vyas on ‘Flow of Credit to Agriculture and Related Activities from the Banking System’ which examined relevance of RRBs in the rural credit system and the alternatives for making it viable. The consolidation process thus was initiated in the year 2005 as an off-shoot of Dr Vyas Committee Recommendations. First phase of amalgamation initiated as per the Sponsor Bank-wise within a State in 2005 and the second phase was across the Sponsor banks within a State in 2012. The process was initiated with a view to provide better customer service by having better infrastructure, computerization, experienced work force, common publicity and marketing efforts etc. The amalgamated RRBs also benefit from larger area of operation, enhanced credit exposure limits for high value and diverse banking activities.

iii. Draft scheme of amalgamation be approved by shareholders of each banking company by a resolution passed by a majority in number representing two thirds in value of shareholders, present in person or by proxy at a meeting called for the purpose.

iv. Swap ratio be determined by independent valuers having required competence and experience; the Board should indicate whether such swap ratio is fair and proper.

v. Value to be paid by the respective banking company to the dissenting shareholders in respect of the shares held by them is to be determined by the RBI.

vi. Shareholding pattern and composition of the Board of the amalgamation banking company after the amalgamation are to be in conformity with the RBI’s guidelines.

vii. Where an NBFC is proposed to be amalgamated into a banking company in terms of Sections 391 to 394 of the Companies Act, 1956, the banking company is required to obtain the approval of the RBI before the scheme of amalgamation is submitted to the High Court for approval.

In the case of regional rural banks (RRBs), sponsor banks are being encouraged to amalgamate the RRBs sponsored by them at the State level. The Government of India (Ministry of Finance), after consultation with NABARD, the concerned State Governments and the Sponsor banks, issued nine notifications on September 12, 2005 under Section 23 – A of the Regional Rural Banks Act, 1976 providing for amalgamation of 28 RRBs into nine new RRBs sponsored by nine banks in six States, viz. Bihar, Gujarat, Karnataka, Maharashtra, Punjab and Uttar Pradesh. These amalgamations became effective from September 12; 2005. The ministry wants each RRB to have at least 400 branches. In 2011-12, RRBs opened 914 branches; they plan to open 1,845 branches in 2012-13. RRBs have been merged in Bihar, Karnataka, Madhya Pradesh, Odisha, Uttar Pradesh and Uttarakhand. UCO Bank, State Bank of Mysore, Central Bank of India, Bank of India and State Bank of India are the new sponsor banks.
3.21 Merger Laws of State Bank Group

The Rise of State Bank of India: The genesis of modern banking in the late nineteenth and early twentieth century in India\textsuperscript{480}, is associated with the development of foreign trade and organized commercial and industrial sectors. Foreign banks\textsuperscript{481} were the first to be established, principally at port towns like Bombay, Calcutta and Madras. The dominance of foreign banks in the early days was due to the preponderant share of foreign capital in organized trade such as tea and jute, shipping and insurance\textsuperscript{482}. In the year 1921 three presidency banks were amalgamated into one single entity known as the Imperial bank of India\textsuperscript{483}. Imperial bank\textsuperscript{484} was the first truly all-India bank as well as the biggest by far, offering banking services practically in all important business centers of the country. It also performed the role of a quasi central bank until 1935 and thereafter


\textsuperscript{481} Bank of Calcutta (1806), Bank of Bengal (1809), The Bank of Bombay (1840), Bank of Madras (1843)- All these banks were founded at the initiatives of the British in the three presidencies by the East India Company through Ban Charters.


\textsuperscript{483} On 20th December 1954, the Finance Minister announced in the Lok Sabha the decision of the Government of India to assume effective control over the Imperial Bank of India as a first step towards the setting up of a State Bank of India. This decision was taken by Government on the recommendations of the Committee of Direction of the All-India Rural Credit Survey, which had suggested among other measures, the creation of “one strong integrated State-partnered commercial banking institution with an effective machinery of branches spread over the whole country for stimulating banking development by providing vastly extended remittance facilities for co-operative and other banks and following a policy which would be in effective consonance with national policies adopted by Government without departing from the canons of sound business.” Following this announcement, the State Bank of India Act was passed by Parliament in May 1905, On the 1st July 1955 the State Bank of India came into being and the undertaking of the Imperial Bank of India, which was formed In 1921 by the amalgamation of the three Presidency Banks, was transferred to the new institution. Available at http://www.epw.in/system/files/pdf/1956_8/9/the_state_bank_of_india.pdf The state Bank of India , speech delivered at the first Annual General Meeting by John Mahthai, the Chairman on 29th Feb1956

\textsuperscript{484} The long association of the Imperial bank with Government of India as the custodian of government balances imparted to it a unique financial status and security and gave it a pre-eminent position in Indian Banking. Its status did not loose even after the creation of RBI in 1935.
functioned as the agent of RBI for transacting government banking business. Reserve bank of India acquired the controlling stake of imperial bank of in India in 1955 and from then it came to be known as the SBI and it is the agent of Reserve Bank of India in certain matters. State Bank of India provides increased banking facilities in rural areas.

**Central Government’s Control over the State Bank of India:** State bank of India is a public authority established for the purpose of discharging public functions. Being a public authority its functioning is controlled by central government. It is evident from the various provisions of the State Bank of India Act, 1955 that the central government exercises complete control over SBI particularly the public purpose which it is meant to serve, the extensive Government control over the bank including several matters of policy, appointment and removal, fixation of remuneration of particular officers of the Central board and the power of nomination and appointment of directors, the statutory audit subject to Government control, the obligation of the Bank to send returns to the Central Government, the obligation of the auditor also to forward audit reports to the Central Government, and the power of the Central Government to wind up the Bank. Section 18 of the State Bank of India Act, 1955 states that “in the discharge of its functioning including those relating to a subsidiary bank, the State Bank shall be guided by such directions in matters of policy involving public interest as the Central Government may, in consultation with the Governor of the Reserve Bank and the chairman of the State Bank give to it. The section further provides that "all directions given by the Central Government shall be given through the Reserve Bank and, if any question arises whether a direction relates to a matter of policy involving public interest, the decision of the Central Government thereon shall be final."

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486 Section 32 of the Reserve Bank of India Act, 1934 – State Bank to act as the agents of Reserve bank of India:

The nature of control Central Government exercise over the SBI was discussed in the case of *V. Ramaiah v. State Bank of India*[^1]488, the court held that the bank is largely state owned, several of its functions are controlled by Government, it has to obey the directive of the Government in vital respects, and even apart from its assets, and its bodies of management are partly governmental in composition. Under these circumstances, there can be no doubt that the State Bank of India is a 'Public authority' indisputably; it is an "authority" within the scope of Art.226 of the constitution of India. The court further stated that as per the direction of Central government, State bank of India has to discharge its public function.

**Acquisition of banking companies by State Bank of India:**

One of the structural weaknesses of the Indian Banking system at the time the State Bank came into being was the large number of small and often uneconomic banks[^2]. Amalgamation of these banks was one method by which certain degree of strength could be imparted to them. The State Bank of India included an enabling provision authorizing it to own and manage other banking institutions as subsidiaries and to acquire the business of other banking companies.

Section 35[^3] of the State Bank of India Act, 1955, allows the SBI to acquire the business of the other banking companies[^4]. Several of the private banks were acquired by SBI.

[^1]: AIR1964Mad335
[^3]: Section35. (1) **State Bank may acquire the business of other Banks.**— The State Bank may, with the sanction of the Central Government, and shall, if so directed by the Central Government in consultation with the Reserve Bank, enter into negotiations for acquiring the business, including the assets and liabilities, of any banking institution.(2) The terms and conditions relating to such acquisition, if agreed upon by the Central Board of the State Bank and the
following this route. SBI has acquired local banks in rescues. The first was the Bank of Behar, which SBI acquired in 1969, together with its 28 branches. Further it acquired National Bank of Lahore, which had 24 branches. In 1975, SBI acquired Krishna ram Baldeo Bank, which had been established in 1916 under the patronage of Maharaja Madhav Rao Sindia. Central government’s sanction is essential for the SBI to acquire the business of other banking companies and if shall so directed by the RBI in consultation with central government, SBI may acquire the business of other banking companies. It is important to note here that SBI do not enjoy autonomy in the acquisition of other banking companies unless approved by RBI and central government.

SBI has acquired not only the private sector banks but also State Bank of Indore under section 35 of the SBI Act, 1955. The validity of such acquisitions by SBI was challenged in the case of All India Bank officers Association v. State Bank of India the pleadings of the petitioners were mainly on two grounds first being that section 35(13) does not empower the SBI to acquire State Bank of Indore and therefore being ultra vires. The petitioners relied on S.35 (13) of the SBI Act which explained the meaning of “banking institution” includes any individual or any association of individuals whether incorporated or not, or whether a department of Government or a separate institution carrying on the business of banking. Secondly they contended that it is in violation of Article 14 of the Constitution of India, as it has applied the method of pick and choose and other similarly placed banks constituted under Section 3 of the 1959 Act have been left untouched. The court held that ‘a close scrutiny of Section 35(13) of the 1955 Act reveals that definition of banking institution is inclusive and it includes any individual or
directorate or management of the banking institution concerned and approved by the Reserve Bank, shall be submitted to the Central Government for its sanction and that Government may by order in writing (hereafter in this section referred to as the order of sanction) accord its sanction thereto.

491 The term ‘other banking companies’ not defined under the State Bank of India Act, 1955 nor under the State Bank of India Subsidiary Banks Act, 1959. However, it define the terms ‘new bank’, ‘existing bank’ and ‘corresponding bank’. In section 35(13) of the SBI Act, 1955 it says In this section “banking institution” includes any individual or any association of individuals (whether incorporated or not, or whether a department of Government or a separate institution), carrying on the business of banking]

492 V. Leeladhari, 'Consolidation in the Indian Financial Sector’ Available at http://www.bis.org/review/r080421d.pdf

any association of individual (whether incorporated or not, or whether a department of Government or a separate institution) carrying on the business of baking. Thus, if any individual or any association of individual, whether incorporated or not, is carrying on the business of banking the same shall fall within the purview of banking institution. Thus, in order to determine whether an institution is a banking institution within the meaning of Section 35 (13) of the 1955 Act, the test which is required to be applied is whether the institution is carrying on the business of banking or not. If it is carrying on the business of banking company it falls within the meaning of section 35(13) of the Act and thus SBI is empowered to acquire the business of any such banking companies  

Acquisition of banking companies by Associates of SBI: State Bank of India controls the working of Subsidiary State Banks. They are constituted under S. 3 of the State Bank of India (Subsidiary Banks) Act, 1959. They act as the agents of State Bank of India. Subsidiary banks of State Bank of India are regulated by the State Bank of India (Subsidiary Banks) Act, 1959 which made seven state banks associates of SBI. Currently it has five associate banks. The reason for enacting a separate legislation for regulating the associates of SBI was discussed by Justice Sujata V. Manohar in

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494 Ibid.,

495 State Bank of India was constituted under the State Bank of India Act 1955, for the purpose of taking over the undertaking and business of the Imperial Bank of India. The Imperial Bank of India was founded in 1921 under the Imperial Bank of India Act 1920. The Bank transacts general banking business of every description including, foreign exchange, merchant banking and mutual funds.


497 Section 36 of the State Bank of India (Subsidiary Banks)Act, 1959.- Subsidiary Banks to act as the agents of the State Bank of India.

498 The Object of the State Bank of India (Subsidiary Banks) Act 1959 is to provide for the formation of certain Government or Government associated banks as subsidiaries of the State Bank of India and for the constitution, management and control of the subsidiary banks so formed, and for matters connected therewith, or incidental thereto.


501 “Wherein it was stated that the future of certain major State-associated banks which are owned in part by the State Governments or with which such Governments have been closely associated, has been under consideration for some time. The question has recently been comprehensively re-examined, with particular reference to the necessity for making adequate and proper provision for the management of treasuries and sub-treasuries in the area served by these banks and the need for the expansion of these banks in these areas; and the view of the banks themselves have been ascertained. The management and the shareholders of the Bank of Bikaner, the Bank of Indore, the bank of Jaipur, the Bank of Mysore and the Travancore Bank have agreed to the proposal to reconstitute these banks as subsidiaries of the State Bank. The reconstitution on similar lines of the State Bank of Saurashtra, the Bank of Patiala and the State Bank of Hyderabad has also been agreed to. The scheme for reconstitution provides for the transfer to and vesting in the State Bank of India of the share capital of each of the banks which have accepted the proposals” 1997 Supreme court cases available at http://judis.nic.in/supremecourt/imgs1.aspx?filename=13754.

502 The State Bank of India (Subsidiary Banks) Act, 1959 Sec. 38 - Acquisition of business of other banks. -(1) A subsidiary bank may, with the approval of the State Bank, and shall, if the Reserve Bank, in consultation with the State Bank, so directs, enter into negotiations for acquiring the business, including the assets and liabilities of any other banking institution.

(2) The terms and conditions relating to such acquisition, if agreed upon by the Board of Directors of the subsidiary bank concerned and the directorate or management of the banking institution concerned and approved by the Reserve Bank, shall be submitted to the Central Government for its sanction and that Government may by order in writing (hereafter in this section referred to as the order of sanction) accord its sanction thereto. ...

(13) The provisions of this section shall apply in relation to the acquisition by one subsidiary bank of the business, including the assets and liabilities, of another subsidiary bank as they apply in relation to the acquisition by a subsidiary bank of the business, including the assets and liabilities, of any other banking institution.

503 AIR 1957 KER 47

504 The question in the said case was whether the State Bank of India is entitled to recover any sum due to the foreman in a chit fund transaction if defaulted by the subscriber to the chit fund. The court held that through acquisition certain contractual rights wouldn’t be vesting in the acquirer bank.
Bank of Travancore\textsuperscript{505}, Justice Thottathil Radhakrishnan, incidentally made a pertinent observation that the acquisition of business by Subsidiary state banks alone covered under Section 38 of the State Bank of India (Subsidiary Banks) Act, 1959, but for the amalgamation the Banking Regulation Act, 1949 need to be looked into.

- One of the lacunas in the provisions contained in section 35 and section 38 of the SBI Act and SBI (Subsidiary Banks) Act respectively do not specifically extend to the acquisition of the business of a public sector bank or a subsidiary of SBI or a banking company or RRB. To facilitate consolidation, it is necessary to expand the definition of banking institution contained in the SBI Act and SBI (Subsidiary Banks) Act to include the public sector banks\textsuperscript{506}.

- Secondly, both legislations fails to state the amalgamation of banking companies instead it only deals with acquisition of banking companies. The legal perception and procedure of amalgamation and acquisition are different, hence it is suggested that amalgamation between SBI and its associates and any other banking companies could be included so

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\textsuperscript{505} ILR2007(3)Kerala550, Judgement by J.Thottathil Radhakrishnan, writ petition was filed by the employees of the erstwhile Chaldean Syrian Bank Ltd. which was acquired by the State Bank of Travancore. On acquisition the Petitioner entered the service of the State Bank of Travancore. The Petitioners contended that the legal effect of their entry and continuity in the service of the Bank entitles them to tag along with and claim the previous service in the Chaldean Syrian Bank for the purpose of determining the length of the qualifying service for fixation of the pension payable to them under the Pension Regulation. The learned Single Judge referring to the Pension Regulation as well as the scheme of acquisition found the contention to be untenable. It stated that in a scheme of acquisition, the liability of the Bank to offer employment to the staff of Chaldean is left to the absolute discretion of the Bank and the terms and conditions of any such engagement are also matters left to the Bank to decide. It is not a case of merger or amalgamation of banks which are governed by provisions of the Banking Regulations Act, 1949. Regulation 20 of the Pension Regulations deals with employees of a Bank which becomes subject to a merger or amalgamation and which is permanently transferred to a service in the Bank from the bank which is subjected to merger or amalgamation. The concept of being permanently transferred from the service of one employer to the service of another is jurisprudentially different from the concept of an institution acquiring a business and taking any personnel as "new entrants" the provisions in Regulation 20 of the Pension Regulations regarding continuity of service apply only to situation where there is a merger or amalgamation and not where the Bank, under a Scheme, acquires the assets and liabilities of business etc. of another banking institution.

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that it would facilitate in protecting the interest of employees in such of the banking companies.

3.22 **Consolidation of Co-operative Banks**: Consolidation of Urban Co-operative Bank (UCB) is one of the most complex areas of bank mergers since the Regulation is under both, co-operative societies Act administered by the state Governments and the Banking Regulation administered by the RBI. The Task Force for Urban Co-operative Banks was constituted to resolve the complex issues emerging from UCB mergers.\(^\text{507}\)

**Co-operative movement in India**: The Indian cooperative movement, like its counterparts in other countries of the world has been established in distress. Based on the recommendations of Sir Frederick Nicholson and Sir Edward Law, the Cooperative Credit Societies Act was passed in 1904, paving the way for the establishment of cooperative credit societies in rural and urban areas on the patterns of Raiffeisen and Schulze Delitzch respectively.\(^\text{508}\) The Cooperative Societies Act of 1912 recognized the formation of non-credit societies and the central cooperative societies.

The Saraiya Committee that guided the Government in making policies for cooperative banks observed that the cooperative society has an important role to play as the most suitable medium for the democratization of economic planning. The first phase of co-operative bank development has started with the formation and regulation of cooperative society. The constitutional reforms which led to the passing of the Government of India Act in 1919 transferred the subject of “Cooperation” from Government of India to the Provincial Governments. In other words the subject matter with regard to “cooperation” was transferred from the Union list to the State list of the Constitution. The Government of Bombay passed the first State Cooperative Societies Act in 1925 which not only gave the movement, its size and shape but was a pace setter of co-operative activities and


\(^\text{508}\) History of cooperative bank in India; [online web] [http://www.rbi.org.in/scripts/publication.aspx](http://www.rbi.org.in/scripts/publication.aspx); accessed on 27/01/2014.
stressed the basic concept of thrift, self help and mutual aid.\textsuperscript{509} This marked the beginning of the second phase in the history of Co-operative Credit Institutions.

In view of the various expert committees set by the Government of India with a view to review the performance of the cooperatives in India, urban cooperative bank is the most appropriate bank that plays an important role in economic construction of the country. The Indian Central Banking Enquiry Committee (1931) felt that urban banks have a duty to help the small business and middle class people. The Mehta-Bhansali Committee (1939) recommended that those societies which had fulfilled the criteria of banking should be allowed to work as banks and recommended an Association for these banks. The Co-operative Planning Committee (1946) went on record to say that urban banks have been the best agencies for small people in whom Joint stock banks are not generally interested. The Rural Banking Enquiry Committee (1950), impressed by the low cost of establishment and operations recommended the establishment of such banks even in places smaller than towns.\textsuperscript{510} The real development of co-operative banks took place only after the recommendations of All India Rural Credit Survey Committee (AIRCSC), which were made with the view to fasten the growth of co-operative banks.\textsuperscript{511} This committee made a comprehensive study of the various problems involved in the rural credit and in its findings has stated that cooperative bank should be developed in all parts of the country for proper up liftment and up gradation of the country. Immediately after independence, the cooperative banks began to make remarkable progress in the various sectors of the economy. In the present date such banks has entered into several sectors like credit, banking, production, processing, distribution/marketing, housing, warehousing, irrigation, transport, textiles and even industries.

**Legal nature of co-operative banks:** Co-operative banking sector plays an important role by providing financial services to agricultural and allied activities, small scale industries and self employed workers. Since the network of co-operative banks is

\textsuperscript{509} Cooperative Banking in India; [online web] http://www.rbidocs.org.in; accessed on 27/01/2014.
widespread across different parts of the country, these institutions are considered as a potential instrument to bring people from far-flung areas under the formal banking network.\textsuperscript{512} Co-operative banks play an important role by providing banking services to the wider sections of the society, especially in rural and semi urban areas. Co-operative banks are co-operative societies\textsuperscript{513} engaged in the business of banking. In India Co-operative societies are covered under Schedule-VII, List II of Item 32. Section 48 of the Co-Operative societies Act, 1912 expressly bar the application of Indian companies Act to the co-operative societies. However if a co-operative society engages in the business of banking, it is governed by the central laws governing banking\textsuperscript{514} by virtue of item 45 of Schedule VII of List-I. Hence co-operative banks are subject to the control\textsuperscript{515} by the

\textsuperscript{512} ‘Developments in Co-operative banking’ http://rbi.org.in/scripts/PublicationsView.aspx?id=13939

\textsuperscript{513} The Banking Regulation Act, 1949, Part V, S.56 (cci) “co-operative bank” means a state co-operative bank, a central co-operative bank and a primary co-operative bank and S. 56 (cciia)- Co-operative society means a society registered or deemed to have been registered under any central Act for the time being in force relating to the multi sate co-operative societies, or any other central or state law relating to co-operative societies for the time being in force. S.56(cciia) is inserted by the Banking Regulation (amendment) Act 2004.

\textsuperscript{514} The Banking Regulation Act, 1949, S.3 read with Part V

\textsuperscript{515} Mukhul G.Asher, “Reforming governance and regulation of urban cooperative banks in India” 2007 Journal of Financial Regulation and Compliance. Available at http://login.westlawindia.com/maf/wlin/app/document wherein the author cites that Several committees that had examined the functioning of UCBs argued that this “duality of command” and the absence of clear-cut functional demarcation between the state governments/central government and the RBI had been the most serious of problems (RBI, 2004) of urban cooperative banking movement in India and suggested that such a scenario is not conducive for implementing regulatory measures with the required speed and urgency, besides impeding the effectiveness of the supervision. RBI had even proposed to set up a separate regulatory agency for the UCBs in the past (RBI, 2003). Indeed, separation of governance regulation from prudential regulation has resulted in greater discretion to managements of UCBs. To quote the Governor of the RBI:… since all the governance aspects of urban co-operative banks fall entirely within the jurisdiction of the State Governments, while only prudential aspects are in the RBI’s domain, it has been difficult to ensure effective co-ordination owing to the problems of dual control in the matters of governance which have a bearing on prudential regulation. Further, the market discipline in terms of shareholders’ influence on governance does not exist in regard to urban co-operative banks since they do not depend on equity markets for their funds. Moreover, the governance structure in the UCBs seems to be tilted in favor of borrowers, possibly undermining the interests of the depositors (Reddy, 2005). The RBI has been strengthening the regulation, governance and supervision of the cooperative banking structure in the country. Some of these measures are aimed at improving off-site surveillance, strengthening prudential guidelines on risk management, investment norms, capital adequacy and corporate governance and increased focus on the commercial viability of UCBs.
state\(^{516}\) and the central legislations\(^{517}\). The Co-operative banks in India is subject to the control by Central Government, Reserve Bank of India and the Registrar of co-operative societies. The Banking Regulation Act, 1949 put a bar on the application of the act to certain of the co-operative societies though they deal in financial matters\(^{518}\). The whole of the Banking Regulation Act, 1949 is not applicable to co-operative banks. The provisions of Banking Regulation Act governing amalgamation\(^{519}\) and takeover\(^{520}\) of banking companies are not applicable to co-operative banks. Co-operative societies governed by the Banking Regulation Act, 1949\(^{521}\) are regulated by Reserve bank of India. In addition to it the central government after consultation with the Reserve Bank of India passed the Banking Regulation (Co-operative societies) Rules, 1985.

\(^{516}\) Under state laws for incorporation, regulation and winding and under banking regulations for the business of banking.


\(^{518}\) Sec.3 of the Banking Regulation Act, 1949- Act to apply to co-operative societies in certain cases.—Nothing in this Act shall apply to—(a) a primary agricultural credit society; (b) a co-operative land mortgage bank; and (c) Any other co-operative society, except in the manner and to the extent specified in Part V.

\(^{519}\) Section 44A to 45 of the Banking Regulation Act, 1949, except sub-sections (1),(2),(3) of S.45, which relate to moratorium.

\(^{520}\) Section 36AE-36AJ of the Banking Regulation Act, 1949

\(^{521}\) Section 56 of the Banking Regulation Act, 1949. Act to apply to co-operative societies subject to modifications.—The provisions of this Act, as in force for the time being, shall apply to, or in relation to, co-operative societies as they apply to, or in relation to, banking companies subject to the following modifications, namely:—

(a) throughout this Act, unless the context otherwise requires,—

(i) references to a” banking company” or” the company” or” such company” shall be construed as references to a co-operative bank,

(ii) references to” commencement of this Act” shall be construed as references to commencement of the Banking Laws (Application to Co-operative Societies) Act, 1965 (23 of 1965) . For the purpose of regulating the banking business of certain co-operative societies and for matters connected therewith central government amended various provisions of the Banking Regulation Act, 1949 through the enactment of The Banking Laws (Application to Co-Operative Societies) Act, 1965 and the Reserve Bank of India Act, 1934\(^{521}\).
Categories of Co-operative banks in India: Co-operative banks are classified mainly into four categories. They are Scheduled Urban Co-operative banks\(^{522}\), Non-Scheduled Urban Co-operative banks\(^{523}\), State Co-operative banks\(^{524}\) and District co-operative banks\(^{525}\). The Urban Banks Department of the Reserve Bank of India is vested with the responsibility of regulating and supervising primary (urban) cooperative banks, which are popularly known as Urban Cooperative Banks (UCBs)\(^{526}\). The Banking Regulation Act, 1949 provides for banking business in the case of two types of co-operative societies: (1) Co-operative Bank, and (2) Primary Credit Society. Some aspects of urban co-operative banks are regulated under the Banking Regulation Act, 1949\(^{527}\). Keeping in view the

\(^{522}\) The SUCBs are listed in the second schedule of the Reserve Bank of India Act, 1934.

\(^{523}\) [http://www.rbi.org.in/commonman/English/Scripts/BanksInIndia.aspx#rrb](http://www.rbi.org.in/commonman/English/Scripts/BanksInIndia.aspx#rrb)

\(^{524}\) Ibid.,

\(^{525}\) Ibid.,


\(^{527}\) (i) Licensing of New Primary (Urban) Cooperative Banks: For commencing banking business, a primary (urban) cooperative bank, as in the case of commercial bank, is required to obtain a licence from the Reserve Bank of India, under the provisions of Section 22 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies).(ii) Licensing of Existing Primary (Urban) Co-operative Banks: In terms of sub-section (2) of Section 22 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), the primary (urban) cooperative banks existing in the country as on March 1, 1966, (when some banking laws were applied to UCBs), were required to apply to the Reserve Bank of India. They were given three months to obtain a licence to carry on banking business. Similarly, a primary credit society which becomes a primary (urban) cooperative bank by virtue of its share capital and reserves reaching Rs. one lakh (Rs.1,00,000) and above was to apply to the Reserve Bank of India for a licence within three months from the date on which its share capital and reserves reach Rs. one lakh. The existing unlicensed primary (urban) cooperative banks can carry on banking business till they are refused a licence by the Reserve Bank of India.(iii) Branch Licensing: Under the provisions of Section 23 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), primary (urban) cooperative banks are required to obtain permission from the Reserve Bank of India for opening branches.(iv) Statutory Provisions: The regulatory functions of Urban Banks Department relate to monitoring compliance with the provisions of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) by urban cooperative banks. These provisions include (a). Minimum Share Capital: Under the provisions of Section 11 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies), no primary (urban) cooperative bank can commence or carry on banking business if the real or exchangeable value of its paid-up capital and reserves is less than Rs. one lakh.(b). Maintenance of CRR and SLR: As in the case of commercial banks, primary (urban) cooperative banks are also required to maintain certain amount of cash reserve and liquid assets. The scheduled primary (urban) cooperative banks are required to maintain with the Reserve Bank of India an average daily balance, the amount of which should not be less than 5 per cent of their net demand and time liabilities in India in terms of Section 42 of the Reserve Bank of India Act, 1934. Non-scheduled (urban) cooperative banks, under the provision of Section 18 of Banking Regulation Act, 1949 (As Applicable to Cooperative Societies) should maintain a sum equivalent to at least 3
heterogeneity of this sector, the Reserve Bank proposed a multi-layered regulatory and supervisory approach specifically aimed at revival and strengthening of Urban Co-operative Banks in its vision document for UCB sector, 2005.528

The Role of RBI in Regulating Co-operative Banks: Reserve bank of India is conferred the power to license a co-operative society to carry the business in banking.530 In Mohammed Usman v. Co-operative societies the court held that, Reserve Bank of India is under an obligation to take prompt steps in violation of Banking Regulation Act for safeguarding public interest, for protecting banking policy and proper management of banking business in the co-operative banks. Further, in the Apex Co-operative Bank of Urban Bank of Maharashtra and Goa Ltd. v. The Maharashtra State Co-operative Bank Ltd, Supreme Court had to decide whether a Co-operative Society registered under the Multi State Act can be granted a License by the RBI to commence and carry on banking business. In the said case, R.B.I. granted license to a cooperative society registered under the Multi State Co-operative Societies Act to commence and carry on banking business. The court held that the RBI can give a license only to a state co-operative bank which has been so declared by a particular State. As the definition of co-operative societies in the NABARD Act is restricted to co-operative societies registered under State Acts and as the provision is for a State to declare a co-operative

per cent of their total demand and time liabilities in India on day-to-day basis. For scheduled cooperative banks, CRR is required to be maintained in accounts with Reserve Bank of India, whereas for non-scheduled cooperative banks, it can be maintained by way of either cash with themselves or in the form of balances in a current account with the Reserve Bank of India or the state co-operative bank of the state concerned or the central cooperative bank of the district concerned or by way of net balances in current accounts with public sector banks. In addition to the cash reserve, every primary (urban) cooperative bank (scheduled/non-scheduled) is required to maintain liquid assets in the form of cash, gold or unencumbered approved securities which should not be less than 25 per cent of the total of its demand and time liabilities in accordance with the provisions of Section 24 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies).

529 The existing licensing policy of RBI is broadly based on the recommendations of the Marathe Committee.
530 S. 22 of the Banking Regulation Act,1949- Licensing of banking companies
532 AIR2004SC141,
society as a "state cooperative bank" the license, which can be issued by the RBI, can only be in respect of that State. Merely because one State declares a cooperative society as a "state co-operative bank" would not enable the RBI to issue that society a license to carry on banking business in other States or in the rest of the country. In the said case the court found that the Apex Co-operative Bank of Urban Bank of Maharashtra and Goa Ltd, had not been declared a state co-operative bank in the State of Goa, RBI was wrong in granting license to it. It is clear from the said case that RBI does not enjoy autonomy in granting license to Co-operative societies to carry banking business. This is because the co-operative societies in India are subject to dual control by virtue of Schedule VII, List-I and List-II of the constitution of India. Apart from Part V of Banking Regulation Act, 1949 conferring powers to the RBI to regulate the banking functions of co-operative banks, RBI have also issued guidelines to the co-operative banks under S.22-30 of the Banking regulation Act, 1949. Supreme Court in Canara Bank v. P.R.N. Upadhyaya\(^{533}\) held that the circulars issued by the Reserve Bank of India have the force of law.

**Merger of co-operative banks: Law and Procedure** - Most of the States\(^{534}\) in India have enacted Co-operative Societies Act and it deals with provisions governing merger. Registrar of the co-operative societies supervises the merger\(^{535}\) scheme of co-operative

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\(^{533}\) AIR 1998 SC 3000 ,

\(^{534}\) The Karnataka State (Co-operative) societies Act, 1959, Sections 14A &14B. The Kerala State (Co-operative societies) Act, 1969, Section 14. The Maharashtra State (co-operative) societies Act, 1960 Section 17, 18A& Section 144-IA etc.

\(^{535}\) *Takeover of Bhubaneswar Urban Cooperative Bank by Cosmos Co-operative Bank:* Cosmos Bank, the country's second largest co-operative bank, has presence in six states. This Pune based Cosmos Co-operative Bank has take over Orissa's Bhubaneswar Urban Cooperative Bank (BUCB) in the year 2013. The decision to hand over Bhubaneswar Urban Cooperative Bank to Cosmos was to safeguard the interest of depositors and employees. The depositors were not able to get back their funds, while the employees were living in uncertainty. Hence, inorder to save both the interest of the employees and the depositors, the Bhubaneswar Cooperative bank was taken over. **Merger of Udhna Citizen Cooperative Bank and Kalupur Commercial Bank:** Surat’s Udhna Citizen Cooperative Bank and Ahmadabad’s Kalupur Commercial Bank merged with each other in year 2013. Kalupur Commercial Cooperative Bank was facing technical problem in completing the merger process, because of its status of multi-state cooperative bank. In view of this case, the Gujarat government tabled an amendment bill in assembly allowing multi state cooperative banks to merge with state cooperative bank was unopposed passed. This merger got approval from Reserve Bank in the same year. **Takeover of two cooperative banks by Saraswat Cooperative Bank:** Saraswat Cooperative Bank, country's
banks. Even though mergers/amalgamations of Co-operative banks come within the purview of concerned State Government, prior approval from the Reserve Bank is required for obtaining No Objection Certificate. The Reserve Bank, while considering proposals for merger/amalgamation, confines its approval to the financial aspects of the merger taking into consideration the interests of depositors and post-merger financial stability of the acquirer bank. The financial parameters of the acquirer bank post merger must conform to the prescribed minimum prudential and regulatory requirements invariably for the merger cases. Reserve bank of India has issued two guidelines\(^\text{536}\) on the issue of merger to the Co-operative banks in the year 2005 and 2009. RBI’s 2005 guideline allow co-operative banks to merge with any other co-operative banks or banks registered under the Multi-state co-operative societies Act. It also state the procedures of such merger as An application for merger giving the proposed scheme will have to be submitted by the banks concerned to the Registrar of Cooperative Societies/Central Registrar of Cooperative Societies (RCS/CRCS). The acquirer bank will also forward a copy of the scheme to the Reserve Bank along with the draft scheme, valuation report and other information relevant for consideration of the scheme of merger. The Reserve Bank

largest co-operative bank has its presence in five states namely Maharashtra, Goa, Gujarat, Madhya Pradesh and Karnataka. This bank had acquired two cooperatives namely Maharashtra State Annasaheb Karale Janata Sahakari Bank Ltd. (AKJSB) and Murgharajendra Sahakari Bank Ltd. (MRSB). It has been, however, declared during the preparation of the scheme that the shareholders of the transferor company or both the acquired banks shall not receive any shares post merger since both the acquired banks were loss making banking units which was rescued by Saraswat Cooperative Bank. **Takeover of Rupee Cooperative Bank by Saraswat Bank**

Saraswat Bank, the largest bank in the country has acquired Pune based Rupee cooperative bank in the year 2013. The main reason behind such acquisition was that the century old Rupee Co-operative Bank was put under directions by the Reserve Bank of India due to its weak financial position. According to the RBI directions, Rupee Co-operative Bank’s depositors are allowed to withdraw not more than Rs 1,000 of the total balance held in every savings bank or current account or any other deposit account. Further, without prior approval in writing from the RBI, the bank cannot grant or renew any loans and advances, make any investment or incur any liability — including borrowing of funds and acceptance of fresh deposits. The bank also cannot disburse or agree to disburse any payment, whether in discharge of its liabilities and obligations or otherwise, enter into any compromise or arrangement and sell, transfer or otherwise dispose of any of its properties or assets. However, the attractiveness of Rupee Co-operative Bank stems from its loyal customer base and the fact that most of the branches are owned by it.

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will examine the scheme with reference to the financial aspects and the interests of depositors based on the criteria/factors and convey its decision to the concerned State RCS and in case the acquirer is a multi-state cooperative bank, to the CRCS and the RCS of the State in which the acquired bank is situated. The registrars, being the authorities vested with the responsibility of administering the Acts, would ensure that the due process prescribed in the Statutes has been complied with before they seek the approval of the Reserve Bank. In addition to the guidelines issued in February 2005, the Reserve Bank issued another set of guidelines in January 2009 for merger/acquisition of UCBs having negative net worth as on end-March 2007. According to the new guidelines, the Reserve Bank would also consider scheme of amalgamation that provides for (i) payment to the depositors under section 16(2) of the Deposit Insurance and Credit Guarantee Corporation Act, 1961; (ii) financial contribution by the transferee bank; and (iii) sacrifice by large depositors. The process of merger/amalgamation requires the acquirer bank to submit the proposal along with some specified information to Registrar of Cooperative Societies/Central Registrar of Cooperative Societies and the Reserve Bank. The Reserve Bank examines the pros and cons of the merger scheme and places the same before an expert group for further screening and recommendations. If the proposal is found to be suitable Reserve Bank issues no objection certificate to the concerned Registrar of Cooperative Societies/Central Registrar of Cooperative Societies. Hence, from the above discussion it is clear that mergers among co-operative banks have taken place in considerable numbers in the recent days. Such mergers and amalgamations are helping the cooperative banks in creating a new environment for the shareholders as well as the depositors. However, as stated by the High Power Committee on Urban Cooperative Banks, consolidation of business through mergers, though create synergies for the cooperatives, yet the interest of the members should not to be forgotten. But as we have already seen, there has been complexity in the application of laws with regard to amalgamation or merger among cooperative banks. Therefore, it has been further

539 Ibid.,
recommended by the committee that in order to avoid controversies and confusions, some standard guidelines should be made by the Reserve Bank which has to be followed by all states of the country. Henceforth, it can be mentioned that though the merger and amalgamation schemes of cooperative banks are handled by the respective state cooperative legislations prevalent therein, yet such mergers should have some control by the centre as well. It is well known that in every scheme for merger, prior approval has to be taken from the Reserve Bank and this particular provision has been mentioned in every State Cooperative Societies Act of the states. But in addition to that some kind of supervision and regulation should also have to be there in a scheme of merger among cooperatives. Nevertheless, from the case studies referred above, it is evident that there has been considerable rate of mergers of cooperative banks are happening in the country without much confusion and difficulty.

3.23 Conclusion: The diversity of banking institutions and their governing statutes are no doubt unique to Indian banking sector. Diversity in governance and structure however, do not affect the nature of business of the banking. Ultimately, all banking companies are discharging commercial banking functions; therefore the bank merger laws of all the banking companies despite their governance should be uniform in nature. There are only subtle differences between the law and procedures governing merger between banking companies. Bank merger provisions confer power to prepare or sanction either to the Reserve Bank of India or to Central government or to both. In such a scenario, it is suggested that a chapter on merger laws applicable to all banking companies if, incorporated in the Banking Regulation Act, 1949 would be appropriate. It is also suggested that the said laws need not apply entirely to Regional Rural Banks and Co-operative banks. The state control over these banks should be retained.

Diversity of legislations and autonomy to one regulator in the banking sector creates overburden and confusion. It would be imperative if a single legislation or a chapter added for Bank mergers in the Banking Regulation Act. Because every banking company is entitled to exercise its right of corporate restructuring, it being a general requirement, the parent law governing banking regulation should deal with the same. It must also state a common procedure for all banking companies. In all bank mergers interest of
depositors is the main concern, thus a general provision stating a simple procedure would be appropriate to facilitate and expedite bank mergers.