Amalgamation of Three Public Sector Banks

The government has proposed the amalgamation of Bank of Baroda (BoB), Dena Bank and Vijaya Bank.

- This was decided at the meeting of a ministerial panel called Alternative Mechanism, an approval framework for proposals to merge state-run banks.

Why Amalgamation?

- One of the reasons for choosing these three banks was that the two stronger ones will be able to absorb the weaker entity.
- The amalgamation is part of the government's efforts to consolidate the banking industry with a focus on overcoming the bad loan crisis. Public sector banks are suffering from Non Performing Assets, in FY18, the banking system has reported a net loss of Rs 40,000 crore because of the sharp rise in NPAs.
- India has a target to meet the Global Basel III capital norms by March 2019. The move is a part of the steps to meet the norms.
- With amalgamation announcement, the government is moving closer to implementing the Narasimham Committee (1998) recommendation on structural reforms. The committee recommended the merger of Indian banks as it will have a "multiplier effect" on the economy.
- The Government of India has majority stakes in 21 public sector banks and owns more than two-thirds of banking assets in India. Having several government-owned Banks, doing the same business, and competing for same customers is not sensible. It also meant a lower return on the capital employed by the government which has competing demands for funds, and growing competition.
- With the increase in GDP, it is necessary for India to have globally stronger financial institutions.

The "New Bank"

- The New entity after amalgamation will have a total business of ₹14.8 trillion, with capital adequacy rating at 12.25%, and net non-performing loans 5.71%.
- The number of employees will be more than 85,000 and branches will be close to 9,500.

Impact of Merger

- It will consolidate and strengthen the banking industry, given the fact that amalgamated bank would be the third-largest after State Bank of India and ICICI.
- BoB and Dena Bank have a strong presence in Gujarat. Dena Bank is also strong in Maharashtra and part of Chhattisgarh. Vijaya Bank is strong in South. The duplication of work can be avoided. Their accounts can be easily merged. The three banks operate on the same core banking platform, Finacle, this also eases up technology integration to a large extent.
- There is also a significant overlap among public sector banks in terms of branches, mode of operation and clients. Mergers can bring down costs through economies of scale and address the problem of fragmentation.
- Global network strength of Bank of Baroda will be leveraged to enable customers of Dena Bank and Vijaya Bank to have global access.
- Dena Bank's strength in MSME will further augment the strength of the other two to position the amalgamated bank for being an MSME Udyamimitra

Challenges

- **Is the big bank a solution?**
    - Former RBI Governor has warned that while creating large bank one might end up with a big weak bank. Further, Dena Bank is under the RBI’s Prompt Corrective Action framework (PCA) due to its huge bad loans and weak financial ratios,
    - The first amalgamation in the public sector banking was when New Bank of India- a weak public sector bank – was merged with Punjab National Bank in the mid-80s, the latter took a long time re-stabilize itself.
    - The same was the case when the erstwhile Global Trust Bank (a private sector bank) was merged with Oriental Bank of Commerce (a public sector bank) in 2004.
- **Shareholder Interest**
    - For investors, the merger of the Bank of Baroda with a weaker PSB, Dena bank is a concern. A complex merger with a weaker and under-capitalized PSB would put the bank’s recovery efforts on the backburner. While the merger is positive for shareholders of Dena Bank, it is negative for Bank of Baroda and Vijaya Bank
    - The merger also sends out poor signals about banking governance, here a dominant shareholder in the form of the government is dictating critical moves which will impact the minority shareholders.
- **Interest of Employees**
    - There is a concern among employees that amalgamation may lead to rationalization of bank branches, many branches of these banks operate in the same neighborhoods. If branches will be shut down there are fears that staff will be laid off.

Way Forward

- Creation of large banks to meet the requirements of the economy is the necessity. But, it is more important for the government to address the core issue impacting the Banking Sector, that is, of Governance, the new amalgamated entity will have the same staff of Dena Bank who have driven it to its present condition.
- The Government can consider the recommendations of the PJ Nayak Committee, 2014 on Governance of PSB which advocated for restricted government interference in bank administration. Protection of Banks from political interference is the real challenge, without governance reform, any other measure to tackle the crisis of bank may not turn out to be useful.

Basel III Norms

- Basel III norms aim at making most banking activities more capital-intensive and promoting a more resilient banking system by focusing on four vital banking parameters viz. capital, leverage, funding and liquidity.
- The Reserve Bank of India has extended the timeline for implementation of the Basel III capital regulations by March 31, 2019.

Amalgamation vs. Merger

- The key difference between a merger and an amalgamation is that a merger is a union of two or more enterprises whereby the assets and liabilities of one are vested in the other, with the effect that the former enterprise loses its identity.
- An amalgamation is a coming together of two-three corporate entities where the assets and liabilities of all of them are vested with a new entity, with the effect that all of them lose their identities to form a new entity.

Narasimham Committee, 1998

- The merger of major banks which will have 'multiplier effect' on the industry.
- Improve the strength of the Indian banking system the committee recommended to raise capital adequacy norms.
- Review of functions of boards to adopt a professional corporate strategy to check the imbalance between government control over the banks in the form of management and ownership, and bank

autonomy.

PJ Nayak Committee, 2014

- Conversion of PSBs into Companies as per the Companies Act.
- Formation of a Bank Investment Company (BIC) under the Companies Act and transfer of shares by the central government in PSBs to the BIC.
- BIC should be given the controlling power of boards of PSBs.
- Proportionate voting rights to all shareholders and reduction of government shareholding to 40%.

Prompt Corrective Action (PCA)

- PCA norms allow the RBI to place certain restrictions such as halting branch expansion and stopping dividend payment. It can even cap a bank's lending limit to one entity or sector.
- Other corrective actions that can be imposed on banks include special audit, restructuring operations and activation of the recovery plan. Banks' promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA.
- The provisions of the revised PCA framework became effective from April 1, 2017, based on the financials of the banks for the year ended on March 31, 2017. The framework will be reviewed after three years.
- When is PCA invoked?
    - The PCA is invoked when banks breach certain regulatory requirement like minimum capital, return on asset and quantum of non-performing assets.

Capital Adequacy Ratio (CAR)

- CAR is the ratio of a bank's capital in relation to its risk-weighted assets and current liabilities.
- The Basel III norms stipulated a capital to risk-weighted assets of 8%. However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian public sector banks are emphasized to maintain a CAR of 12%.

Tier 1 Capital

- Tier 1 Capital is the core measure of a bank's financial strength from a regulator's point of view. It is composed of core capital, which consists primarily of common stock and disclosed reserves.