Merger of NBFCs with Banking Company

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Abstract: NBFCs have been playing a complementary role to the other financial institutions including banks in meeting the funding needs of the economy. The main aim of this paper is to understand the concept of NBFCs and to understand their role in Indian financial market. The paper deals with the various regulations related to the merger of a Non-banking finance company with banking company and also analyze the case study related to the merger between NBFC and banking company.

Introduction

The financial system of any country is consists of financial market, financial intermediation and financial instruments. Inter-relationship between these three is part of the system where financial system implies to close connected and complex inter-linked institutions, agents, practices, transactions etc. in the economy.

Financial intermediaries are broadly include-

- Banks
- NBFCs

At present times, financial system of most of the countries is not just limited to the traditional banking institutions but it also includes the Non-Banking Financial Institutions such as insurance companies, market makers, mutual funds and other financial service providers. NBFCs have emerged as an alternative to mainstream banking. Besides, they have proved to form an integral part of Indian Financial System and have commendable and creditable contributions towards Government’s agenda of financial Inclusion. Their role in filling the gap by offering credit to retail customers in underserved and unbanked area has been proved successful to some extend and should not go unnoticed.

Indian Financial system has also noticed growth in emergence of various NBFCs. They have proved an accepted importance in evolution of competitive, vibrant and dynamic financial system. Their capability to encompass risk, adapt to changes and meet such demands which are usually avoided by the bigger market players has been the important success factor for their business and led to uniform practice and level playing field for NBFCs in India is indispensable.

Their role has been well recognized and strongly advocated by all Taskforces and different expert Committees set up by Indian Government and RBI. It is a recognized fact that many unbanked borrowers avail credit from NBFCs and use their track record with NBFCs to become bankable borrowers. Thus, NBFCs act as channels and have promoted the Government’s agenda on Financial Inclusion.

The merger and acquisition is a recognized way of inorganic growth of the any company. The same goes with the banking sector. With the recognition of the role of NBFCs in financing India’s growth in recent past, the banks decided to merge with these institutions for further growth in their business.

What are NBFCs?

The financial sector in any economy consists of several intermediaries. In general, the intermediaries apart from banks which offer financial services may be broadly said as Non-banking Financial institutions.

Non- Banking Financial Company is defined as Section 45I-(f) "non-banking financial company" means-

(i) a financial institution which is a company;
(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending Tiny manner;
(iii) such other non-banking institution or class of such institutions, as the bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

Role of NBFC in Financial market

These institutions play a significant role in the financial market offering a wide variety of services. It is recognized by the RBI that its roles and
functions are of extreme importance they include the development in sectors like the transport and infrastructure, they provide a substantial employment generation and help in broadening economic development. The NBFCs also help in financing the economically weaker sections as well.

According to a speech given by the Executive Director of Reserve Bank of India, P.Vijaya Bhaskar explained that NBFCs play an important role in the economy. Its been observed that it has been growing over the past few years, statistics had shown that even when the country’s Gross Domestic Product was growing at a snail pace of 6.3% in 2010-2011, the NBFC growth rate was at 25.7%. This thus, implies that the NBFC is contributing much and much more to the economy with every passing year.

As compared to Banks, the NBFCs are always preferred more than the Banks in term of loan financing since NBFC offer much cheaper loans to customers, therefore, they would prefer NBFCs to Banks. They are more profitable in comparison to the banks. The loan that is lent to customers by NBFCs is so much higher as compared to banks.

In addition to this, they also contribute much to the lending of infrastructure projects. Because infrastructure projects have high risk therefore, it makes it difficult for the banks to lend to infrastructure projects but the NBFCs do not take this into consideration but they contribute much in lending to infrastructure projects.

NBFCs offer their services not only to the urban areas but also to the rural areas as well. They provide services in the form of loans and lending to the rural poor, giving them an affordable financing for housing projects.

The NBFCs prominent business would consist of variety of activities, these would include hire-purchase finance, equipment leasing, etc. They have provided financial solutions and financial services especially to the weak and poor section of the society. Through the activities provided by the NBFC, it is clear that they have met the financial needs of the people thereby improving the economy.

It has been said that NBFC is the most affordable financial services in matters of providing loans and insurance services in India. This shall also include micro financing.

Difference between Banks and NBFCs

There is a vast difference between the Banks and Non-Banking Financial Companies. The difference in these two institutions shall consist of their organization, performance, functions, role, etc. Banks and Non-banking Financial Companies are no doubt financial institutions performing different functions. The first and foremost difference between the two is with regards to Deposit Taking. We are very well versed with the fact that a bank’s primary function is in taking of deposits. Acceptance of deposits and issuing of those deposits on demand is a key ingredient that makes up a Bank. On the other hand an NBFC cannot accept demand deposits. Unlike the banks where issuance of cheques on demand is available the NBFC cannot perform such activities.

Banking company which is a financial institution shall provide the financial services this shall include the banking services of acceptance of deposits that are repayable on demand. The term “Bank” has not been defined particularly, but it can be derived from the definition of the term banking which has been defined and given under Section 5(b) of the Banking Regulation Act, 1949. The definition clearly defined the term banking to mean the “accepting for the purpose of lending or investment, of the deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, or otherwise.”

Banking company which have been given under Section 5(c) of the Banking Regulation Act, 1949. This definition which defined banking company shall mean “any company which transacts the business of banking”. Once we study and analyze the functions of these two institutions we will understand that they are different from each other. For banking companies their functions shall include:

- Acceptance of deposits of which are repayable on demand
- Lending of these deposits or investing them. The Bank can lend these deposits to its customers
- Apart from these there are a variety of provisions of other financial services provided by banks.

The terms “deposit” and “public deposits” have been defined under section 45-I(bb) of the RBI Act, 1934 and Paragraph 2(1)(xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 respectively. Deposits shall include any receipt of money in a way of deposits or loans or in any other
The importance of strong banking system is without any doubt important for sound economic

Further, Public Deposits have been defined as a deposit (as the definition under 45-I(bb) of RBI Act, 1934. But this shall exclude the amount which has been received from the Central/State Government or any other source where that payment is guaranteed by the Government. Those amounts which have been receive from any financial institutions, amount received from shareholders by the private company and the amount received from the directors or relative of the director of an NBFC. It shall also imply those amount which has been brought in by the promoters by way of unsecured loan, those amount received form a mutual fund, amount received by issuance of commercial paper.

It has been stated earlier that NBFCs do not accept public deposits. But it maybe noted that NBFCs who hold COR that is, a valid Certificate of Registration which has been given the authorization of accepting public deposits can hold/accept public deposits. Although these NBFCs are accepting public deposits, should and must have a minimum stipulated NOF (Net Owned Fund) by complying with the directions issued by the bank. For acceptance of deposits, the NBFCs have to follow a certain norm which has given ceiling criteria on the acceptance of public deposits. They have to maintain a specific Net Owned Fund.

Registration:

A Non-Banking financial Company cannot carry on business or commence its business without obtaining a Certificate of Registration from the Bank and without having a Net Owned Fund of 200 Lakh INR (by the end of March 2017). Although the minimum Net Owned Fund for companies that were already in existence since before April, 1999 can be retained at 25 Lakh INR. This has been elaborated under Section 45-1A of the RBI Act, 1934. There are other types of NBFC which are exempted from this registration with the RBI. These would include Housing Finance Companies (regulated by National Housing Bank), Chit Companies regulated by Chit Funds Act, 1982, Insurance Companies registered under the Insurance Regulatory and Development Authority, Venture Capital Funds and Merchant Banking Companies who are registered under the SEBI.

For any company to be registered under the Reserve Bank of India, the company need to be incorporated with/under the Companies Act, 1956 if it so wants to be registered under the RBI. The company needs to get itself registered under Section 3 of the Companies Act, 1956.

On the other hand banks are incorporated under the Banking Regulation Act, 1949. Their main function is to accept deposits of money. For Foreign Investments Banks are allowed up to 74% FDI. They are required by the RBI to maintain reserve ratios in the form of Statutory Liquidity Ratio and Cash Reserve Ratio which are currently at 21.5% and 4% respectively. Whereas in the case of an NBFC it is allowed up to 100% on FDI and it is also not mandatory for it for maintain any reserves as such.

To sum up, we can conclude that the difference between both the NBFC and the Banks can be summed up in the following points:

- Bank is a financial institution that the Government has been incorporated and given the authority for providing banking services. For this banks need to hold a license to carry forward their banking services however in the case of an NBFC it does not need such license, it functions more like a bank but it is not a bank. The reason is it does not usually accept deposits of money.

- Incorporation of an NBFC is under the Companies Act, 1956 whereas a bank is registered under the Banking Regulation Act, 1949.

- For banks the deposits which they accept are repayable on demand whereas for NBFCs such deposits are not allowed to be accepted by them.

- FDI is allowed up to 100% in case of NBFC. Whereas for banks (i.e., only Private Sector Banks) are allowed FDI of not more than 74%

- It is required that banks maintain their CRR and SLR whereas the NBFCs are not required to maintain those reserve ratios

Merger between Banking Company and NBFCs

The importance of strong banking system is without any doubt important for sound economic
growth of any country. It is important to improve the comprehensiveness and quality of the banking system to bring effectiveness and efficiency in the performance of the real sector in India. With time the banking industry has changed and been transformed from a highly protected and regulated situation to competitive and deregulated one as a result of which banking and non-banking companies came close and led to trend towards consolidation to attain meaningful balance sheet size and market shares in the face of intensified competition.

Indian banking industry has seen a lot of action with respect to M and A’s with consolidation as a key to competitiveness being the driving force. Some of the benefits of consolidation are like increase size and economies of scale, greater geographical penetration, increased bargaining power, enhanced market image and brand name, as well as other synergies.

In context of consolidation in Indian Banking Sector, the second Narasimham committee report (1998) had suggested merger among strong banks in both public as well as private sector and even with financial institutions and NBFCs.

The regulation related to the merger between banking companies and NBFCs is different than that of two banking companies. The merger between banking company is regulated under Banking Regulation Act, 1949. Where section 44A provides for voluntary amalgamation between banking companies and section 45 is related to the compulsory amalgamation between banking companies with approval of RBI.

The merger between banking company and NBFCs is not governed under banking regulation act, 1949 as it provide framework for merger between two banking companies. The regulation for amalgamation of NBFCs with banking company is regulated under Companies Act, 1956. Section 391 to 394 of the Companies Act is concerned with the Merger between companies.

NBFCs are companies which are registered under companies Act, 1956. Therefore provisions related to amalgamation of companies under Companies Act, 1956 are applicable on Non-Banking Financial Companies.

Section 394 of the companies act, 1956 provides provision related to voluntary amalgamation of a company with any two or more companies with the permission of the tribunal (High Court).

Voluntary amalgamation under section 44A of Banking Regulation Act, 1949 is available for merger of two banking companies. In case of an amalgamation of any banking company with a non-banking financial company, the merger would be covered under the provision of section 391 to 394 of the Companies Act, 1956.

In 2002, RBI constituted a working group to evolve guidelines for voluntary merger involving banking companies in pursuance of the recommendations of the Joint parliamentary Committee. Under these recommendations it stated that “where an NBFC is proposed to be amalgamated into a banking company in terms of the provision of sections 391 and 394 of the companies act, 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.”

Subsequently, in pursuance of the recommendation of the joint parliamentary committee (JPC), a working group was constituted by RBI to evolve guidelines for voluntary merger of banking companies. Based on the recommendations of the group and in consultation with the government, it was proposed in the annual policy statement of April 2005 to issue guidelines on merger and amalgamation between private sector bank and NBFCs. The guidelines were to cover the process of merger proposal, determination of swap ratios, disclosures, norms for buying/ selling of shares by promoters before and during the process of merger and the Board’s involvement in the merger process.

The merger of an NBFC with a banking company would be subject to satisfaction of the board of the banking company on certain parameters such as

- Whether the NBFC has violated or is likely to violate any of the norms issued by RBI or SEBI.
- If so, it need to ensure that these norms are complied with the Know Your customer (KYC) norms for the accounts which will become accounts of the banking company after amalgamation.
- If the NBFC has availed of credit facilities from any bank or financial Institution (FI), then the consent of that bank or FI concerned for the proposed merger or amalgamation would be needed.

In addition to this, in May 2014, RBI has also issued guidelines in relation to merger and amalgamation of NBFCs which are known as “Non-Banking Financial Companies (Approval of Acquisition or Transfer of Control) Directions 2014.” According to which “the prior written permission of RBI shall be required for any
takeover or acquisition of control of a NBFC, whether by acquisition of shares or otherwise.”

The bank were advised that in case where an NBFC is proposed to be amalgamated with a banking company, the banking company should obtain the approval of the RBI after the scheme of amalgamation is approved by its board but before it is submitted to the High Court for approval.

The RBI further said any merger or amalgamation of an NBFC with another entity or any merger or amalgamation of an entity with an NBFC which would result in acquisition or transfer of shareholding in excess of 10 per cent of the paid up capital of the NBFC, would also need its approval. The regulator said its prior written approval would also be required before approaching the court or tribunal seeking order for mergers or amalgamations with other companies or NBFCs.\[11\]

Before issue of these guidelines, the NBFCs were not needed to have any prior approval of RBI in case of any amalgamation. Only High Court’s approval was needed as per companies act, 1956.

Case Study

Merger between ASHOK LEYLAND and INDUSIND BANK

IndusInd Bank Ltd. (IBL) and Ashok Leyland (AL) have entered into an agreement according to which IndusInd Bank was to provide channel finance facilities to Ashok Leyland’s dealers.

The board of directors of the Ashok Leyland Finance Ltd (ALFL) has given an in-principle approval to the plan to merge the company with IndusInd Bank, another group company. The non-banking finance company (NBFC) has formed a committee to assist them in the process.

The committee was formed with the purpose look at how to proceed with the merger proposal and then advise the board. It will look at all the issues including the structure of merger, swap ratio and valuations. Valuations and other ground works are expected to be completed in a month’s time. And if the board will be satisfied with it then the merger exercise will be completed.

IndusInd Bank had come up with a proposal to consolidate the businesses of both the entities sometime bank. The board of the bank had cleared the proposal and had also appointed Ambit Corporate Finance Pvt Ltd, an independent firm of consultants, to evaluate all the relevant aspects of the proposed consolidation.\[11\]

The Reserve Bank of India (RBI) has approved the merger of Ashok Leyland Finance (ALF) with IndusInd Bank. The merger was also approved by the high courts.

The merger led to a dilution in the stake of the promoters, Hindujas, fall to 31.3%, while Chennai-based vehicle manufacturer Ashok Leyland took a 15.6% in the bank.

Ashok Layland sold shares worth rs. 299 crore in indusind bank through an open market transaction. It sold 32,63,923 shares or 0.55 percent stake in the bank.

The merger was a result of the growth strategy. ensure that post-merger the bank continues to be in compliance with the legal provisions contained in the Banking Regulation Act `49 and other relevant statutes and also the regulatory prescriptions of the Reserve Bank of India.

Conclusion

NBFCs role in the Indian economy has been tremendous over the years. We have noticed and seen that NBFC has emerged as game changer in the market. With services like Housing Financing the NBFCs have formed such an intrinsic and integral part in the Government’s goal of Financial Inclusion. NBFCs has helped in broadening the economic aspect and development and has definitely helped the economically weaker sections of the economy. There has been a growth in size of the NBFC mainly because people prefer the...
NBFCs to Banks as they provide loans which are much cheaper and more profitable as compared to banks. An analysis and study on the difference between the NBFC and the Banks. While both are financial institutions, they vary from each other in terms of their role, functionality, performance, etc. The only difference is in issuance of cheques on demand whereby banks can perform such activities but NBFC cannot do so. While NBFC has to be incorporated under the Companies Act, 1956 as a company and has to obtain a Certificate of Registration from the Reserve Bank of India Act, 1934.

Also, the merger between Banking Company and NBFC has been analyzed taking into consideration the mergers of both. In simple terms, merger means the merging or coming together of two entities into one. With the coming of the Narasimham Committee Report (1998) suggested the merger among the strong merger between the banks whether public or private and also with NBFCs. The regulation related to merger between banks and NBFC is different between two banking companies. The amalgamation of an NBFC with a banking company is given under Companies Act, 1956 from Sections 391 to 394. Each section differs one from the other. In the year 2002, there was a recommendation that came out which was a result of the Joint Parliamentary Committee stating that if an NBFC wasn’t to be amalgamated with a banking company it needs to obtain the approval of the RBI before submission of the scheme to the High Court concerned. RBI has issued guidelines with relation to the merger and amalgamation of all NBFCs, for any takeover or acquisition of control of an NBFC there shall be a written permission of the RBI. There has to be a written approval which needs to be submitted before approaching court or tribunal while seeking for mergers and amalgamations with any company.

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