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# Legal Study on the Restructuring of Banking Companies and Protection of Banking Employees from the Impact

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## ABSTRACT

*The rising concern over the NPA and bad debt recovery of banks are making the banks weak. To reduce the number of Non-performing Assets in the banking sector, people started to prefer the way of mergers and acquisitions of banks. The weak banks can be merged/acquired by the strong banks, so that the interest of the depositors can be protected. The restructuring of banks not only protect the interest of the depositors but also increase the synergy, growth, economy of scale and other benefits. There are some adverse effects of the mergers/acquisition of the merger/acquisition of banks. The RBI and central government have made strenuous efforts to make the mergers/acquisition in banking sector feasible but it did not attain complete feasibility and complexities are still exist in the framework. This paper seeks to study on the different procedures of mergers/acquisitions of banks available in the statute and the protection given to the employees during the merger/acquisition.*

## I. INTRODUCTION

*“I sincerely believe that banking establishments are more dangerous than standing armies.”<sup>2</sup>*

The Indian banking system has the sufficient capacity and ability to pull through each and every arduous situation. In recent times, Banks and banking companies are reconstructed by means of mergers, acquisitions and amalgamations. Merger can be stated as the consolidation of two entities into one entity, Acquisition can be stated as the purchase of entire or portion of shares of one entity by another entity, and Amalgamation can be stated as the combination of two companies to form new company in which the old companies cease to exist. The restructuring of bank is not novel in India as the first merger of banks in India is the combination of the bank of Madras, bank of Bombay and bank of Bengal which resulted into Imperial bank of India and later renamed to State Bank of India.<sup>3</sup> Government of India have taken a revolutionary step by making fourteen commercial banks as nationalized banks in 1968, this step resulted in some

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<sup>2</sup> Letter from Thomas Jefferson to John Taylor (May 28, 1816), in the papers of Thomas Jefferson. Retirement series

<sup>3</sup> Ishwarya J, *A Study on Mergers and Acquisition of Banks and a Case Study on SBI and its Associates*, IJTRD, 22, 25th September 2019, <http://www.ijtrd.com/papers/IJTRD20776.pdf>

achievements and effects. The New Economic policy, 1991 paved a clear path for mergers in the country. The first merger between the nationalised banks was happened when the new bank of India was merged with the Punjab national bank, this merger was completed in the year 1994.<sup>4</sup> Recently, in 2019, Mega merger of nationalized banks have taken place in which 10 nationalised banks restructured into four banks. At present, there are 12 public sector banks, 22 private banks, 10000(approx.) registered Non-banking financial companies, 58 multistate cooperative banks, 1482 urban cooperative banks, 45 regional rural banks and other government banks like National Bank for Agriculture and Rural Development, National Housing Bank are there in the country.

The inception of the banking regulations can be traced down during pre-independence period where the presidency bank was governed by the Royal charter. After some years, banking companies were governed by the Indian companies act, 1913<sup>5</sup>, but the banking companies were treated like other companies. Then, Reserve Bank of India (hereinafter referred to as RBI) was founded and its powers are vested under the Reserve Bank of India act, 1934<sup>6</sup>. As an interim relief, separate chapter related to banking companies was added to the Indian companies act in 1936 by way of amendment. At last, a separate statute was brought in 1949, to govern the banking companies, which was Banking companies act, 1949. The Banking companies act, 1949 was renamed to the Banking Regulations act, 1949<sup>7</sup>. As we are discussing about restructuring of banks, the provisions related to arrangements, schemes and compromise plays an important role in the restructuring. The restructuring of banks is governed by various laws which gives various modes of the restructuring namely the Banking Regulations act, 1949, the Companies act, 2013<sup>8</sup>, the Securities and Exchanges Board of India act, 1992<sup>9</sup>, and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002<sup>10</sup>.

In general, when corporate restructuring takes place, the final restructure would bring the good impact as well as some bad impact. The restructuring has been considered as the way to break the implicit contracts. The mergers and acquisitions in banking field have made the employment contract void. It is not necessary that there should be mergers and acquisitions, sometimes in other forms of restructuring also results in the dreadful impact on employees. In most cases, the adverse impact can be in form of retrenchment, layoffs, reduction in salary or,

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<sup>4</sup> Id.

<sup>5</sup> The Indian companies act, 1913

<sup>6</sup> The Reserve bank of India act, 1934

<sup>7</sup> The Banking regulation act, 1949

<sup>8</sup> The Companies act, 2013

<sup>9</sup> The Securities and Exchanges Board of India act, 1992

<sup>10</sup> The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

differential treatment after the merger or acquisitions. When the restructuring itself happening for the best of the corporates, then it should include the employees as the part of such corporates. This paper is not only going to delve into the restructuring of the banks, effect on employees because of such restructuring but also delve into the question whether a cooperate bank can merge with private banks? and the current situation of the cooperative banks in India.

## II. SCOPE OF RESTRUCTURING OF BANKS

In present scenario, the restructuring is the most preferred way to maintain the market share and strength as this way is fast and efficient. The mergers and acquisition are not only to maintain the strength and position in market place but also to proliferate the market share in new market. Mergers and Acquisitions in banking sector is wide and dynamic as it can be witnessed from the previous bank restructurings. The routine of merging or acquiring of weak banks by strong banks is not novel and it is encouraged as it gives the stability to such weak banks. merger, there is a transfer of skills, products, and services between the two banking companies. The most important economic reasons for the bank merger are access to new market, benefit from the scale of economy and reduction at cost. Though there are many reasons for the restructuring of banks but there is no assured guarantee of success.

However, the mergers and acquisitions assure some needful benefits, such as Synergy, development in technology, wide reach, avoiding sickness situation, tax advantage<sup>11</sup>. When we talk about the synergy, the restructuring makes the banks to attain streamline gains through revenue synergy and cost synergy<sup>12</sup>. The development in technology allows the bank to give efficient competition to the other player in the market and it'll make the bank to good number of customers. Not every bank has branches in rural areas as they have potential to make loss but when there is a merger or acquisition, the merged entity or the acquired entity will have the reach in rural areas. The banks which are suffering from heavy bad loans are considered to be in state of sickness, the restructuring of bank can lead to avoid such sickness. The income tax benefits are provided for mergers, amalgamation and acquisitions in the Income tax act, this step promotes the financial synergy and stability of the company. Demerits also show up while we talk about the mergers and acquisitions in banking sector. Some of the demerits are lack of coordination in initial phase of post-merger or post-acquisition, Objectives can be changed by the acquired company, cultural problems, customers hesitation with new structure, and

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<sup>11</sup> Dr. Jyoti H. Lahoti, *An Experiential Study of Mergers and Acquisitions in Indian Banking Sector*, 5 IJRP 398, April 2016,  
[https://www.worldwidejournals.com/paripex/recent\\_issues\\_pdf/2016/April/April\\_2016\\_1461042504\\_\\_140.pdf](https://www.worldwidejournals.com/paripex/recent_issues_pdf/2016/April/April_2016_1461042504__140.pdf)

<sup>12</sup> Ishwarya J, *Supra* Note 2

importantly effect on the employees.<sup>13</sup> Low productivity, diminishing growth rate and less profitability can happen because of the traumatic event inside the organization which will be created out of the merger and acquisition. The restructuring of bank can make the employees feel bitter and even reduce the level of job satisfaction which has potential to result in failure.

### III. MERGERS OF BANKS

The occurrence of Mergers and acquisitions have become trend in contemporary times. Nevertheless, there are bewilderments when we think about the legal aspect of the merger and acquisitions. The banking sector is diversified as there are variety of circumstances prevailing in different part of the country. A single type of banking institution cannot fulfil the different requirements of the people; therefore, many different types of banking institutions were formed, the mergers and acquisitions can be done in all the type of banking institution.

In general, the banking companies get registered like other companies under the companies act, 2013. The companies act, 2013 governs the registration of the banking company but when the question arise about the governing of merger between banks, the companies act has no power to do that. The Banking Regulations act comes into action when there is a merger or acquisition between the banks. The Banking Regulations act will prevail if any provision of the Companies act, 2013 inconsistent with the provisions of Banking Regulation act, 1949. Further, the Banking Regulation act, 1949 provide a provision which clearly says that the Banking regulation act can override the memorandum and article of association if it is repugnant to the provisions of the Banking Regulation act.

As per the nature of the entities delved, the restructuring of the banks can be placed. The mergers and acquisitions in banking sector can be categorized as

#### 1. Volunteer amalgamation

The section 44A governs the volunteer amalgamation between two private banking companies. The Reserve Bank of India (Amalgamation of Private Sector Banks) Directions, 2016 also guides the amalgamation of private sector banks. The section 44A is limited to the banking companies.<sup>14</sup> This provision clearly states that the amalgamation between two banking will not take place unless the scheme for amalgamation has been put in draft before the shareholders of the both entities. The scheme has to be approved by the 2/3<sup>rd</sup> of board members. As per section 44A, the scheme has to be approved by the 2/3<sup>rd</sup> value the shareholders present in the meeting

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<sup>13</sup> RavikumarUndi and Basavaraj C.S, *A STUDY OF MERGERS AND ACQUISITIONS IN PUBLIC SECTOR BANKS IN INDIA*, 5 IJMR, November 2019, [https://eprajournals.com/jpanel/upload/427pm\\_7.EPRA%20JOURNALS-3765.pdf](https://eprajournals.com/jpanel/upload/427pm_7.EPRA%20JOURNALS-3765.pdf)

<sup>14</sup> The Banking Regulation Act, No. 44A of 1949

and the notice of this has to be given to the members of the amalgamating banks. After that, the scheme has to get sanction from the RBI which is binding on banks as well as on shareholders. The dissenting shareholders will get their value of share which will be determined by RBI. Further, the assets and liabilities are transferred to the acquiring bank. The property under asset includes both movable and immovable properties. It also says that, the central government has power to provide for the amalgamation between two banking entities under section 237 of the Companies act,2013 but only after the consultation with the RBI. When it comes to the share valuation during amalgamation under this section, the application cannot be rejected on the basis of the unfairness of valuation of shares to the shareholders of the transferor company when both banks shareholders accepted the valuation.

## **2. Compulsory amalgamation of private banking companies**

The Non-Performing Assets have full potential to lead a bank to insolvency, at such time, the depositors, the shareholders and economy will experience a disastrous effect. Section 45 of the Banking Regulations act, 1949<sup>15</sup> provides a platform to RBI to prepare scheme of amalgamation of a banking entity with other company. This section is not limited like section 44A, Section 45 is broad and the amalgamation of a banking company with other banking companies, public sector bank, State bank and its associate banks is possible. The process of compulsory amalgamation will be initiated when RBI apply to central government to enforce moratorium on the bank and draft a scheme for amalgamation which will be sent to the banking companies for suggestions. But the Banking Regulation (amendment) ordinance,2020<sup>16</sup>, gives power to the RBI to initiate scheme without imposing moratorium. After finalizing the draft, RBI will send the draft to central government for sanction and make notification in official gazette.

## **3. Restructuring of public sector banks**

The banking regulations act does not govern the amalgamation of public sector banks. The amalgamation of public sector banks takes place with help of the Bank Nationalization act or the Banking companies (Acquisition and transfer of undertaking) act, 1980. The section 9 of the act gives authority to the central government after consultation with RBI, to make and prepare a scheme for transfer of undertaking partly or fully, from a nationalized bank to another nationalized bank.<sup>17</sup> The scheme drafted by the central government requires the approval from parliament. When it comes to the State Bank of India, the State Bank of India act, 1955 allows

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<sup>15</sup> The Banking Regulation Act, No. 45 of 1949

<sup>16</sup> The Banking Regulation (amendment) ordinance,2020

<sup>17</sup> The Banking companies (Acquisition and transfer of undertaking) act, No 9 of 1980

the State Bank of India to enter into the negotiation for acquiring business which is involved in banking sector, with sanction of the central government after consulting with RBI. The Section 38 of the State Bank of India (Subsidiary Banks) Act, 1959 says that the subsidiary banks of the State Bank of India can also acquire business of other banks, only after consulting with the State Bank of India.<sup>18</sup> Neither section 35 of the State Bank of India act, 1959 nor section 38 of the State Bank of India (Subsidiary Banks) Act, 1959 talks about the consolidation.

#### **4. Amalgamation of Non-Banking Finance Company (NBFC) with banks**

The Section 44A of the Banking Regulations act, 1949 does not govern the amalgamation of NBFC with banks. There is not a single provision provided in the Banking Regulations act, 1949 which deals with the amalgamation of the NBFC with banks. This type of amalgamation is dealt under the section 232-234 of the Companies Act, 2013.<sup>19</sup> The Board of directors of the NBFC and banking company has to approve the amalgamation with 2/3<sup>rd</sup> majority. Once the scheme is approved by the board of directors of the NBFC and the Bank, the banking company requires RBI approval. RBI has sole authority to reject the scheme. In case, RBI approves the scheme, the scheme has to get approval from the tribunal.

#### **5. Merger of Cooperative banks**

The cooperative banks play a vital role in providing loans for agriculture, small scale industry and self-employed workers. The merger of cooperative banks is complicated area as the cooperative societies act is administered by the respective state government whereas as the banking regulations are administered by the Banking Regulations act, 1949. The Banking Regulation (amendment) ordinance, 2020 allows the RBI to regulate the cooperative banks but with some exemptions. The RBI, central government and registrar of cooperative societies have control of the cooperative banks. The merger of cooperative bank takes place, only between two cooperative banks from the same state, or a cooperative bank can be merged with the cooperative bank which is registered under the Multi state cooperative society act, 2002. The banks have to submit the drafted scheme for amalgamation/acquisition to the registrar of the cooperative societies/ central registrar of cooperative societies. Then, the drafted scheme along with relevant documents has to be submitted before the RBI. The RBI will convey its decision

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<sup>18</sup> The State Bank of India (Subsidiary Banks) Act, No 38 of 1959

<sup>19</sup> Gokul L. and Akshay Ramesh, RBI Repudiates The First Ever Merger Attempt Between The Bank And A NBFC, mondaq (Nov 9, 2019), <https://www.mondaq.com/india/financial-services/865582/rbi-repudiates-the-first-ever-merger-attempt-between-the-bank-and-a-nbfc#:~:text=Legal%20Provisions%20with%20respect%20to%20mergers%20in%20the%20Indian%20Banking%20Sector.&text=The%20RBI%20has%20discretionary%20powers,the%20Banking%20Regulation%20Act%2C%201949.>

to the Registrar of the cooperative society/ Central registrar of the cooperative societies after examining the schemes and relevant documents.

#### **6. Merger of Regional Rural banks (RRB)**

The Regional rural banks are created to serve the rural areas with banking and financial services. The government of India started the process of merger of RRB by amalgamating of RRB within the state by the sponsored bank of the RRB.

### **IV. LEGAL PROTECTION AND REMEDIES FOR EMPLOYEES**

The employees are the first one who will be affected by the merger or acquisition. The employees can be affected by any sort. During the restructuring of banks, approval from board of directors and shareholders is necessary according to the provisions which we dealt above. But these provisions are not demanding approval from the employees. The scheme of amalgamation which is drafted can not be objected by the employees. The employees of the company cannot be transferred forcibly under the scheme of transferring of undertaking. The continuance of employment should not be affected and employees of the transferor company are entitled to get the same remuneration followed with the same terms and conditions<sup>20</sup> of service of the transferee company. The amalgamating bank/transferred bank employees cannot get better conditions than the employees of the amalgamated bank/transferee bank employees. Also, the employees should not be adversely affected by the amalgamation of the banks.<sup>21</sup> When we talk about the protection of employees under the voluntary amalgamation, there is no such protection given under the section 44A of Banking Regulation Act, 1949. Section 44A is keen towards the process of voluntary amalgamation but did not talk about the employees' position during the transfer of business. As regard to section 45 of Banking regulations act, 1949, RBI has responsibility to take care the interest of the employees of the banks while preparing the scheme for amalgamation. Even while sanctioning scheme under section 44A, the RBI can ensure the interest of the employees. The trade unions also play a vital role. The employees union can show their disinterest of the merger which can be taken as consideration by the banks but, it does not stop the scheme.

When the employee is not treated equally after the merger, irrespective of the type of merger, can claim for compensation under Section 25FF of the Industrial disputes act.<sup>22</sup> Section 25FF is enacted to protect the interest of the workers during the transfer of undertakings. The notice and compensation have to be provided if there is going to be retrenchment, transfer of

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<sup>20</sup> The Banking Regulation Act, No. 45(5)(i) of 1949

<sup>21</sup> The Chairman, Canara Bank, Bangalore vs. M.S. Jasra and Ors., (1992) AIR 1100

<sup>22</sup> The Industrial Disputes Act, No. 22F of 1947

undertaking and closure. If employee got job in new company which is at the similar level, then he cannot claim compensation under this section. But in practical aspect, the compensation for employee under section 25FF bring up the debate on whether the employee is workmen under the definition provided under the section 2(s) of the Industrial Disputes act. During such type of debate, judicial pronouncement comes into action.

## **V. SUGGESTIONS/ RECOMMENDATIONS**

1. The employees should be given the right to object the scheme of restructuring of any kind.
2. Provision for the remedies to the employees should be added in the section 44A of the Banking regulations act, 1949 and in section 230 of the Companies act, 2013.
3. A special statue can be brought to protect the interest of the employees during the restructuring.
4. To eliminate the cultural difference after the merger/ acquisition, a committee can be appointed to review and propose a plan to overcome the cultural difference.
5. Provision for the compulsory amalgamation for urban cooperative banks and multi state cooperative banks has to be added in the Banking Regulations Act, 1949, therefore, RBI can save the interest of depositors of weak urban cooperative banks and multi state cooperative banks.
6. The state governments can consolidate all the weak state and district cooperative banks present in the state.
7. The government and RBI should go for rigorous reviews before amalgamating the weak bank with strong bank as the weak bank could cause adverse effect to the strong bank.
8. Number of public sector banks are being reduced over the years which can lead to unhealthy competition in the banking sector, so, RBI have to make a list of public sector banks which cannot be merged.
9. Intermittent training program/ workshop has to be conducted for the employees to get through the new environment after the merger.

## **VI. CONCLUSION**

The Mergers and Acquisition in banking sector plays an important role in the nation's economy and it is one of the ways to eliminate the non-performing assets from the banks. Indian banks are diversified and governed by distinctive statues but this diversity does not affect the sole nature of the banking business. This diversity nature in banking statues creates the confusion, complexity and overburden. When there is single statue which gives common procedures for

all types of restructuring in banking sector, can eliminate the confusion, complexity and overburden. RBI follows a strict discipline as it has rejected many merger proposals in the past, even some proposal of NBFC merger with bank also rejected by the RBI. This shows that the RBI has final authority over the mergers of banks. As regard to the employees during Mergers/Acquisitions, their position is vulnerable in the nature and in India, we don't have concrete laws which protects interest of employees especially in the course of Mergers/Acquisitions.

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