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THE NEED FOR A CAG AUDIT

KANNAN NEELAMEGAN

CFA
Centre for Financial Accountability

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Author: Kannan Neelamegan

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Centre for Financial Accountability
R21, South Extension Part 2, New Delhi-110049
info@cenfa.org | www.cenfa.org

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Cost of Bank Mergers: The need for a CAG Audit

Public Sector Banks (PSBs) have played a significant part in the country's economic growth. The principles of nationalization also contributed to the social banking character of the PSBs. This scenario has been changing since implementation of the new economic policies in the 90s. Three decades down the line, the unabated policy changes have only cost the banks dearly.

Public Sector Banks have been saddled by non-performing assets (NPAs), that has become unmanageable mainly in the past five years. Apart from this, there has been a generalized credit crunch in the financial system due to stresses in the non-bank financial sector, especially following the collapse of Infrastructure Leasing & Finance Services (IL&FS).

In general, PSBs constitute more than 65% of total banking business of all SCBs (Rs.136 lakhs cr deposits and Rs.104 lakhs cr advances as of March 2020) and the Private sector covers 30% of the business leaving the balance of 5% to foreign banks and Small Finance banks. However, during the past five years PSBs in an average, share a very large portion of 85% total gross NPAs leaving 13% share to private sector and 2% to other sectors. Compounded Annualized growth (CAGR) of gross NPAs in the past five years is around 28%. It is also observed during the past 5 years, NPAs increased by 25% on an average basis as detailed below:

If Opening NPA's are based at 100, slippages are added at 67%, recoveries with up gradation only at 20 percent and whereas write-off is 22% resulting the cumulative NPAs to increase at 25 percent (100+67-20-22=125). It may be observed from the analysis that the Govt. aims to keeps the burden of certain sticky private banks on the PSBs entity and in a later stage easily converts the Public sector entity into Private entity (ex: IDBI,YES Bank etc). Further 100 percent provisions are made with the assurance and the strength of capital infusion leaving easy way to the major defaulters to enjoy the benefit of write-off and haircuts. Unhealthy prudential write-off is made which reduces the Advances folio as well as the Net NPAs.

The government had in the last 7 years come out with multiple 'solutions' for the NPA crisis. From bringing in the Insolvency Bankruptcy Code (IBC), attempting to bring in FRDI bill, putting banks through multiple Prompt Corrective Action (PCA), periodically changing provision requirement, Mergers of Banks and so on. This paper attempts to critically review the implementation of the mergers.

Bank Mergers:

Merger of banks is not new and have taken place before the current series of mergers proposed by this government. State Bank of India (then known as the Imperial Bank), the oldest and largest bank even today itself is a resultant of merger of all three presidency banks in 1921 – Bank of Bengal, Bank of Bombay and Bank of Madras. Since 1969 (Bank of Bihar merged with SBI) to Kotak Mahendra taking over ING Vysya bank in 2015 there have been many mergers and consolidation of banks, but they have been part of the efforts by the central bank to protect financial system and depositor's money. And most of these mergers have also been PSUs taking over failing or struggling private banks and cooperative banks.

It is to be noted that the new merger proposed since 2017 for the purpose of 'consolidation and growth' are different in their motive than those that have taken place earlier. The then Finance Minister late Mr. Arun Jaitley stated the government's objectives very clearly as he proposed the mergers – "India needs fewer and mega banks which are strong because in every sense, from borrowing rates to optimum utilisation, the economies of scale as far as banking sector is concerned are of great help"

Mergers and the Neo Liberal Agenda:

Bank merger in accordance with the new economic policies or the structural adjustment was implemented in 2017. It has been part of the banking reforms since 1990s. The second Narasimham committee report in 1991 had suggested a three tier banking system - three large banks with international presence, eight to ten national banks and a large number of regional and local banks. The 2017 model of mergers is a direct implementation of this policy. The push had consistently been for the merger of banks. In 2004, the Indian Banking Association (IBA) report suggested corporatization of PSBs to accelerate the process of consolidation.

In 2008, a Planning Commission Report also stated that given the fragmented nature of the Indian banking system and the small size of the typical bank, there was a need to encourage but not force consolidation of banks in India. Leeladhar Committee (2008) observed that there were adequate legal provisions available which encourage and promote consolidation within the PSBs through the merger and amalgamation route. In 2014, Nayak Committee further emphasized the importance of governance in PSBs and thus stated that the decision of a merger or an amalgamation in the PSBs must be through the respective boards of the banks keeping in view the synergies and benefits of merger.

It is in this backdrop that the 2017 merger of SBI with the associate banks and Bharatiya Mahila Bank took place. This was only the first of the series that was to follow. In the last three years however, the number of PSBs has been reduced steadily through mergers. First to 21 and then further down to 18 PSBs with the merger of erstwhile Dena bank& Vijaya bank with the merged entity of Bank of Baroda effective from 01/04/2019. Also, erstwhile IDBI public sector bank was again converted into the status of a private sector bank during the financial year 2018-19 now under the control of LIC with their major share capital.

As of now (01/04/2021), there are 12 Public Sector banks as detailed below:

1	State Bank of India-Group (after merger of all its Associate Banks& Bharatiya Mahila Bank)
2	Punjab National Bank (after merger of Oriental Bank of Commerce and United Bank of India)
3	Bank of Baroda (after Amalgamation of Vijaya Bank &Dena Bank)
4	Canara Bank (after merger of Syndicate Bank)
5	UNION bank (after merger of Corporation bank& Andhra Bank)
6	Indian Bank (after merger of Allahabad Bank)
7	Bank of India
8	Central Bank of India
9	Indian Overseas Bank
10	United Commercial Bank (UCO Bank)
11	Bank of Maharashtra
12	Punjab & Sind Bank

The Great Indian Merger:

Despite the resistance from unions the government went ahead with the merger of SBI with its associate banks and Bharatiya Mahila Bank in 2017. Later that year after the cabinet's in principle approval for mergers an Alternative Mechanism (AM) was constituted chaired by the then Finance Minister Arun Jaitley.

The Alternative Mechanism would receive scrutinize the proposals for amalgamation and direct banks to examine the proposals with inputs from RBI. The AM presents a report every three months to the cabinet and the final scheme of amalgamation will be approved by the Central Government and the houses of parliament. The framework clearly states that the decision regarding creating strong and competitive banks would be solely based on commercial considerations.

Following the three decade trail that starts from the Narasimham Committee report in 1991 to the merger of 10 banks and the proposal to disinvest two PSBs in the 2021 budget, it is clear that the merger was not proposed to strengthen the public banks. It was to create a few big banks as proposed in the Narasimham committee recommendations and also to clear the books of merged banks as a step towards privatization.

Though currently the government claims that the merger has been a success and that the merged banks are on a path to recovery, the process of merger and how it was implemented does raise some critical questions.

Did merger fulfill the following promises made?

- To have a robust banking system for a 5 trillion dollar economy.
- to build next-generation banks, big banks with the capacity to enhance credit
- Mergers would allow banks to have a lot more resources, and lending cost would come down
- No employee will lose their job

Any Banking reform, in general, has its own merits and demerits. It is more ideal to visualize the implications on the part of certain sensitive reforms before implementing the same. Wherever cost studies are to be made, they should get prioritized and made mandatory before implementation. **As the huge amount spent in this regard is public money, the Govt. has more responsibility and liability.**

The table below is the consolidation of SBI associate banks & Bharatia Mahila bank with prime SBI was made. It is observed that there are possible manipulations in the accounting procedure and it is believed that the performance of the associate banks are underestimated mainly by showing higher NPAs and thereby provisions apart from abnormal increase in wage.

Estimated cost of Merger in respect of SBI (Rs. in crore)							
SBI MERGER COST 2016-17 accounting as per published results	**As per SBI P&L 2015-16**	**As per SBI P&L 2016-17**	**SBI Expense Growth % during merger**	**Other non-merged banks P&L 2015-16**	**Other non-merged banks P&L 2016-17**	**Other non-merged banks growth % during merger**	**Estd merger cost involved for SBI**
Details	A	B	B over A=C	D	E	E over D=F	G=(C-F)%of A
Other Expenses	9116	11086	21.61	15908	17214	8.21	1222
Depreciation on bank's property	2161	2771	**28.23**	3527	3663	**3.86**	527
Rent, Taxes & Lighting	4772	5073	**6.31**	7584	8158	**7.57**	-60
Auditors' fees and expenses	280	305	**8.93**	621	648	**4.35**	13
Postage, telegrams, telephones, etc	678	829	22.27	1238	1361	9.94	84
Insurance	2275	2501	9.93	4732	5111	**8.01**	44
Estimated merger cost							**1830**

(Estimated merger cost excludes staff cost, computer system package cost and other capital cost). Data Source compiled from: www.rbi.org.in, Time series publications, statistical tables relating to banks in India

- It is observed that the growth in gross NPAs during 2016-17 was greatly reduced by the entire Public Sector Banks, in general. The growth in NPAs was at 29.26% in 2016-17 for all the 11 turn around Banks compared to last year level of 93.83%. Similarly the increase in Net NPAs was also minimal at 20.95% in 2016-17 compared to 92.22% in 2015-16. This was also being the position for the entire PSBs average at 26.91% compared to last year level of 93.91%.

- Excluding NPAs of Associates of SBI, the increase in gross NPA for the system was only at 19.97%. This being the case, how could the

Associate Banks gross NPA alone increase at 164.72% when compared to last year level of 50.41%. As per the annual report recently published by SBI for 2016-17 in page no.219, the following table illustrates the above.

(Rs. in crore)

Details	**2015-16**	**2016-17**	**Growth %**
Gross NPA for SBI Group	123416	179167	45.17
Gross NPA for SBI Standalone	98173	112343	14.43
Gross NPA for Associates	25243	66824	164.72
Gross NPA for PSBs	539950	685257	26.91

Data Source compiled from: https://www.sbi.co.in

- It appears that abnormal adjustments would have been made in finalizing the NPA position of Associate Banks alone. Due to this, the overall gross NPA ratio of Associate Banks as a whole was given a lethal blow of showing gross NPA Ratio at 20.19% compared to last year level of 6.55%.

- As such, the provisions for NPAs increased at the huge level of Rs.27565 Crores for the Associate Banks alone whereas the comparable provision for Associate Banks in 2015-16 was only at Rs. 8127 Crores. The increase at 239.18% is unbelievable.

- The Associate Banks as a whole have given a reasonable growth in operating profit at 8.66% in 2016-17compared to last year level of 12.05%.

(Rs. in crore)

Details in 2016-17	Gross NPA	NPA Provisions	Provision %
Provision for Gross NPA for SBI Group	179167	59811	33.38
Provision for Gross NPA SBI Standalone	112343	32246	28.70
Provision for Gross NPA for Associates	66824	27565	41.25

Data Source compiled from: https://www.sbi.co.in

- In general, when there is an increase in gross NPAs, there would be a fall in Net Interest Income (NII) growth. During the year 2016-17, the entire PSBs registered an average growth in NII was lower at 4.19% due to higher NPAs observed in the system. As a matter of fact, 10 PSBs have showed negative growth and almost all other banks showed a growth of less than 10%. But in the case of Associate Banks as a whole, the NII growth was observed significant at 27.42% and ranked first among all the PSBs in the particular parameter.

- Further, the staff cost for associate banks have been vouched more at Rs.9202 Cr in 2016-17 compared to Rs.5901 Cr in 2015-16 with an abnormal increase of 55.92% i.e, over by Rs.3301 Cr against a system average of 8% only.

- **As such we can conclude that the Associate Banks are merged on a compulsory and committed basis despite their reasonably a good performance. They were exhibited a false and unhealthy show of their performance.**

- ✧ Since larger provisions are made unreasonably, this could be easily reversed in the 1st quarter of current year or in the next quarters and the post merged SBI can exhibit higher profit in the coming period as against a poor show of Rs. 391Cr loss during 2016-17.
- ✧ It appears the provision adjustments and NPA classification is done on a committed/pressure basis which needs reclassification and reaudit especially by a Government Audit.
- ✧ **All this has been done so as to justify the Government that the merger plan is a successful process so as to continue for other banks.**

Amalgamation of BOB with Vijaya &Dena bank in FY2018-19

The same thing (as that of SBI) happened to BOB merged entity. A brief analysis on amalgamation of BOB with Vijaya and Dena bank has been made and also compared with earlier year position of BOB merged entity with reference to the performance of PSBs as a whole. As a result, the merged entity of BOB has shown Rs.8339 loss during 2018-19 compared to Rs.3628 cr of loss in the earlier period 2017-18 as accounted on the merged basis. It is observed that there are possible manipulations in the accounting procedure

- ✧ When the gross NPAs grew only at 3.49 percent (Rs.21138 cr in dec 2018 to Rs.21691 cr in Mar2019, how could NPA provisions increase at 142.65% in the same period for e-Vijaya and eDena entity?
- ✧ Salaries increased from Rs.2539 cr for nine months to Rs.4744 cr in March 2019 accounting for 12 months for e-Vijaya and eDena entity? It is estimated around Rs.1500 cr has been provided in excess.-
- ✧ Similarly operating expenses were shown abnormally higher at 56% increase for all the three individuals probably owing to merger cost?

- ✧ When the PSBs as a whole improved its growth in operating profit though marginally at 1.37% merged BOB entity showed negative growth at 1.04% for the full year as whole.
- ✧ When PSBs as a whole showed an improved ROA at -0.63% in 2018-19 compared to -0.80% in 2017-18, the merged BOB could impact only a decline in ROA to-0.82% in 2018-19 compared to -0.36% in 2017-18.

Why Banks are not audited by C&AG?

Given the discrepancies in how the mergers were implemented there is serious question on the claim that post-merger banks are performing better. There needs to be a CAG audit of the bank merger.

- ✧ The C&AG (Comptroller and Auditor General)of India has an independent authority under the article 148 to151 of the Constitution of India has been authorized to audit the accounts of the State and Central Govt, Defense, Posts & Telegraph, Railways, all commercial workings of both the governments etc .However, C&AG has not been authorized by the Govt. to audit the accounts of RBI& Nationalized banks. Now only pension payments alone made by the banks to employees are audited by C&AG as it is paid from the Consolidated Fund of India. **As the PSBs are strictly following the policies of RBI and guidelines of the Govt., it is common and ideal that bank accounts are also to audited by C&AG (other than RBI audits)**. As per DPC ACT 1971, the C&AG is conducting audit of all the accounts autonomous bodies funded by Govt of India/States (ex. Universities) and Govt companies and Corporations. (ex BHEL, Shipping Corporation, Port Trust ,IOC,EB etc). Similarly C&AG can very well audit all PSBs accounts. This will help the Managers to free from high level pressure and avert all misleading. The system may be further streamlined by giving more powers to the banks to recover willful default accounts so as to reduce the NPAs substantially.

“149. Duties and powers of the Comptroller and Auditor-General.—The Comptroller and AuditorGeneral shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made, shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States as were conferred on or exercisable by the Auditor-General of India immediately before the commencement of this Constitution in relation to the accounts of the Dominion of India and of the Provinces respectively. 1 [150. Form of accounts of the Union and of the States.—The accounts of the Union and of the States shall be kept in such form as the President may, 2 [on the advice of] the Comptroller and Auditor-General of India, prescribe.] 151. Audit reports.—(1) The reports of the Comptroller and Auditor-General of India relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament. (2) The reports of the Comptroller and Auditor-General of India relating to the accounts of a State shall be submitted to the Governor 3*** of the State, who shall cause them to be laid before the Legislature of the State.” (Source: The Constitution of India, Edition2020)

Conclusion:

Officially banks have not published accounting details or the cost involved in mergers. There are estimations that the cost of SBI merger alone is Rs. 1830 Cr. Further top three banks in the list of write offs are SBI, Union bank and PNB - all three have been merged. SBI has written off Rs. 34,402 Cr, Union bank Rs. 16,983 Cr and PNB Rs.15,877 Cr (July 2021) in last fiscal year alone.

The merger then leaves more questions than the Rosy picture that is being painted.

- What did it cost to merge 10 banks? Was there any cost analysis study or budget prepared before merging the banks that looks at the financial implications on banks?
- What was the additional expense incurred in implementing the mergers? Whether the Govt. has specifically allotted funds/subsidized/exempted from tax benefits for such merger expenses, Whether RBI has issued any guidelines for the damage done to the principle customers?

- What has been the write off of each of the merger banks? Is write offs the preferred way of reducing NPA?
- Where are the costs for mergers being adjusted? Through charges on customers? Reduction of interest rates?

Since RBI issues policies and have control on all PSBs under its guidelines, it is ideal that C&AG to audit those merged bank accounts as the entire huge money expended is only from the public money. RBI has over the years failed as a regulator to check the NPA, frauds, correctly address and bring a long term solution for the NPA crisis, these serious questions make ground for a **CAG audit on the Merger process**.

Centre for Financial Accountability (CFA) engages and supports efforts to advance transparency and accountability in financial institutions. We use research, campaigns and trainings to help movements, organisations, activists, students and youth to engage in this fight, and we partake in campaigns that can shift policies and change public discourse on banking and economy.

We monitor the investments of national and international financial institutions, engage on policies that impact the banking sector and economy of the country, demystify the world of finance through workshops and short-term courses and help citizens make banks and government more transparent and accountable, for they use public money.

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