RBI/2009-09/365
UCB Cir. 43/09.16.900/08-09 January 30, 2009

The Chief Executive Officers of all
Primary (Urban) Cooperative Banks

Dear Sir/Madam,

Guidelines for merger/amalgamation of UCBs

Please refer to our circular PCB.Cir.36/09.169.00/04-05 dared February 2, 2005 on the captioned subject. The extant guidelines inter alia provide that, where the net worth of the acquired bank is negative, the acquirer bank should protect the deposits of the acquired bank on its own or with upfront financial support from State Government.

2. In legacy cases pertaining to UCBs having negative net worth as on March 31, 2007, it has been decided that the Reserve Bank may also consider scheme of amalgamation that provides for payment to depositors under Section 16(2) of the Deposit Insurance and Credit Guarantee Corporation Act, 1961, financial contribution by the transferee bank and sacrifice by large depositors. The detailed guidelines for merger of UCBs in such legacy cases are given in Annex I. Further, guidelines have also been laid down for valuations of assets and liabilities of the transferor bank as detailed in Annex II. The additional incentives that may be provided to the transferee bank are listed in Annex III.

3. The guidelines contained in Annex I, Annex II and Annex III are in addition to the guidelines on merger issued vide our circular dated February 2, 2005.

4. The new guidelines may be placed before the Board of Directors of your bank for their information.

5. Please acknowledge receipt to the Regional Office concerned of Reserve Bank.

Yours faithfully,

(A.K. Khound)
Chief General Manager-in-charge.

Encl: As above

Annex I

Guidelines for merger of UCBs (having negative net worth) with DICGC support

The following guidelines are laid down for considering sanction of scheme of mergers of UCBs (having negative net worth) with DICGC support.

1. Eligibility

1.1 Mergers of UCBs with DICGC support may be considered by the Reserve Bank in legacy cases, i.e. in case of UCBs, whose net worth was assessed negative through statutory inspections with reference to their financial position as on March 31, 2007 or earlier.

1.2 The UCB to be merged should be registered either in a State, which has signed MOU with the Reserve Bank or under the Multi-State Cooperative Societies Act, 2002, where RCS concerned assures to order merger in public interest as provided under the respective State Cooperative Societies Act or where CRCS prepares a scheme of amalgamation under Section 18 of the Multi-State Cooperative Societies Act, 2002.

1.3 Merger proposals may be considered where the transferee bank complies with the prudential parameters post-merger.

2. Essential conditions

2.1 Audit-cum-Due diligence

The audit-cum-due diligence should be carried out in respect of the transferor bank with reference to the financial position as at the close of business of the day immediately preceding the effective date of merger. For this purpose, independent auditors (chartered accountants) may be appointed by the transferee bank with the concurrence of DICGC.

2.2 Valuation of assets & liabilities

The valuations of assets and liabilities of the transferor bank should be as per the guidelines given in Annex II. The assets should be grouped into two categories, viz. liquid or readily realizable (hereafter called as “readily realizable assets”) and non-readily realizable or bad and doubtful (hereafter called as “non-readily realizable assets”). The “readily realizable assets” are those, which are considered to be realizable and have fair market value; and “non-readily realizable assets” are those, which do not have fair market value.

2.3 Deposit coverage ratio

2.3.1 The scheme of merger should provide the proportion of deposits of the transferor bank, which will be paid by the transferee bank out of the ‘’readily realizable assets’’ of the transferor bank and from its own contribution, hereafter referred to as ”deposit coverage ratio”. The deposit coverage ratio shall not be less than 65%. Higher deposit coverage ratio may be insisted upon depending upon the RBI assessment.

2.3.2 The “deposit coverage ratio” may be worked out in the following manner:

(a) The amount due to preferred and secured creditors should be deducted from the “readily realizable assets”, to determine the “net readily realizable asset”. Similarly, the amount due to preferred and secured creditors should be deducted from the total outside liabilities to arrive at “net outside liabilities”.

(b) The sum of “net readily realizable assets” and the contribution to be made by the transferee bank would be available for distribution amongst the depositors and unsecured creditors for repayment of “net outside liabilities”.

(c) The ratio between “net readily realizable assets” (say x) plus the amount of contribution to be made by the transferee bank (say y) and the “net amount of outside liabilities” (say z), may be called the “deposit coverage ratio” [(say x + y) / z].

2.3.3 The difference between the “net outside liabilities” and “net readily realizable assets”, hereafter called the “uncovered gap” would be met through contribution to be made by the transferee bank, claim on DICGC and sacrifice to be made by the large depositors.

2.4 Claims on DICGC

DICGC may pay to the depositors to the extent and in the manner prescribed under Section 16(2) of the DICGC Act, 1961.

2.5 Deposit protection

The transferee bank shall pay to each of the depositors and unsecured creditors of the transferor bank, irrespective of the amount of his/her deposits as per the deposit coverage ratio(i.e. pro rata payment). After pro rata payment to the depositors and unsecured creditors by the transferee bank, the insured depositors would be paid the claim amount as and when received from DICGC to the extent and in the manner prescribed under Section 16(2) of the DICGC Act, 1961. The implication is that while all depositors having balance upto rupees one lakh would be repaid their deposits in full out of the ‘net readily realizable asset’, contribution from the transferee bank and DICGC, the depositors having deposits above rupees one lakh would be protected to the extent of rupees one lakh or as per the deposit coverage ratio, whichever amount is higher.

2.6 Sharing of the recoveries from “non readily realizable assets”

2.6.1 As per provisions of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 and the DICGC General Regulations, 1961, the transferee bank shall repay the amount paid by the Corporation out of recoveries made after making provision for expenses in respect of such realizations. Though the Corporation has priority in appropriation of recoveries out of non readily realizable assets, it may consider sharing the recoveries from the “non readily realizable assets” net of expenses with other stakeholders, keeping in view the financial contribution to be made by the transferee bank and the larger interests of the depositors.

2.6.2 The “non readily realizable assets“ would be held in a “Collection Account” for the purpose of meeting the repayment liabilities held in “Collection Account” in respect of (i) claims paid by DICGC, (ii) contribution made by the transferee bank, (iii) outstanding balance in the accounts of the depositors and other creditors and (iv) share capital.

2.7 Compliance with prudential parameters

Post-merger, the transferee bank should comply with the following prudential parameters:

i) The transferee bank should conform to the prescribed minimum CRAR.

ii) The net NPAs should normally be within a limit of 10%. However, where CRAR on consolidated basis remains much above the prescribed minimum, there could be some relaxation on this count.

iii) The operations of the transferee bank should remain profitable after merger

iv) The transferee bank should be in a position to comply with CRR/SLR on a consolidated basis.

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Annex II

Guidelines for valuation of property and assets & liabilities in case of mergers

The independent auditors (Chartered Accountants) appointed by the transferee bank with the concurrence of DICGC should value the property and assets and reckon the liabilities of the transferor bank in accordance with the following provisions :

1. Cash & bank balances

Cash & bank balances are to be reckoned at their book value unless there is reasonable doubt about the repayment of deposits by the banks with which such balances are held. In the latter case, the realizable value of the deposits may be ascertained and reckoned, taking into account the financial position of the bank concerned and the facts and circumstances relevant for such assessment.

2. Investments

i)Investments including Government securities shall be valued at the market rates prevailing on the day immediately preceding the date of merger or at the rate as prescribed by Reserve Bank of India under investment guidelines, provided that the securities of the Central Government such as Post Office Certificates, Treasury Savings Deposit Certificates and any other securities or certificates issued under the Small Saving Scheme of the Central Government shall be valued at their face value or the encashable value as on the date of merger, whichever is higher.

ii)Where the market value of any Government Security such as the Zamindari Abolition Bonds or other similar security in respect of which the Principal is payable in installments, is not ascertainable or is for any reason not considered reflecting the fair value thereof or as otherwise appropriate, the security shall be valued at such an amount as is considered reasonable having regard to the installments of principal and interest remaining to be paid, the period during which such installments are payable, the yield of any security issued by the Government to which the security pertains and having the same or approximately the same maturity and other relevant factors.

iii)Where the market value of any security, share, debenture, bond or other investment is not considered reasonable by reason of its having been affected by abnormal factors, the investment may be valued as per the extant valuation guidelines endorsed by Reserve Bank of India.

iv)Where the market value of any security, share, debenture, bond or other investment is not ascertainable, only such value, if any, shall be taken into account as is considered reasonable, having regard to the financial position of the issuing concern, the dividends paid by it during the preceding five years and other relevant factors and neither the transferor bank nor the transferee bank shall not question the said valuation as from the date of the merger.

3. Loans & advances

i)Where the going concern approach is adopted as in case of merger between two sound banks, the loans and advances, including bills purchased/discounted, etc. may be valued as per the prudential norms laid down by the Reserve Bank, as that would be just and fair valuation for both the banks as normally reflected in their balance sheets.

ii)Where the gone concern approach is adopted as in case of banks working under directions issued under Section 35A of the Banking Regulation Act, 1949(AACS) or in case of proposals involving sacrifice by the shareholders and/ or depositors, advances including bills purchased and discounted, book debts and sundry assets, will be scrutinized by the auditor and such assets including portions thereof, will be classified into two categories, namely 'Advances considered good and readily realizable'(In short, referred to as “readily realizable assets”) and 'Advances considered not readily realizable and/or bad or doubtful of recovery'(In short refereed to as “non-readily realizable assets”).

4. Furniture & fixtures

Furniture and fixtures, computer and all related hardware and peripherals etc. stationery in stock and other assets, if any, shall be valued at the written down value as per books or the realizable value as may be considered reasonable, whichever is lower.

5. Premises & immovable properties

Premises and all other immovable properties and any assets acquired in satisfaction of claims shall be valued at their market value.

6. Liabilities

Liabilities for purpose of this scheme shall include all contingent liabilities, which the transferee bank may reasonably be expected or required to meet after the said date of merger.

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Annex III

Incentives to transferee banks in case of mergers

The Reserve Bank may consider the following additional incentives to the transferee bank in case of mergers.

i) The transferee bank may be permitted to close down the loss incurring branches (net loss for last three years) of the transferor bank. The transferee bank, if need be, may be permitted to use these branch licences for opening new branches in the expanded area of operation of the transferee bank (i.e. the area of operations of the transferor and transferee bank put together). Similarly, shifting/relocation of the branches of the transferor bank may be permitted within the expanded area of operation of the transferee bank, subject to the condition that the existing clientele is provided banking facilities through the existing/relocated branches of the transferor/transferee bank.

ii) The transferee bank may be permitted to retain the facilities such as AD category I, etc. where higher level of CRAR at 12 % is required on an on-going basis, provided it maintains the benchmark CRAR of 9%.

iii) The loans and advances considered as ‘readily realizable’ may be treated as ‘standard assets’ in the books of the transferee bank for a period of six months from the effective date of merger for recovery purposes as the transferee bank gives full value to these assets upfront for meeting the liability to the depositors. However, no income on such assets would be recognized during this period on accrual basis. The extant asset classification norm would apply thereafter.

iv)The minimum entry point capital of Rs.50 crore may not be insisted upon in case of UCBs, which become multi-state on account of taking over another UCB registered outside the state, as some of the UCBs predominantly cater to a particular community.

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