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HDFC BANK MERGER

Understanding the what and why of the $172 billion deal

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Background

Established in 1977, HDFC Limited is a Non-Banking Finance Company ("NBFC") and is publicly listed for trading on the Bombay Stock Exchange ("BSE") and the National Stock Exchange ("NSE"). HDFC Limited provides services related to housing finance providing mortgage facility to individuals and corporates for the construction or purchase of houses, rural development, real estate, etc. And as of March 2022, it is the largest housing finance company of India with a market capitalisation of about USD 57 billion, and having more than 15 subsidiaries under its brand in various fields such as venture capital, life and general insurance sector, asset management, etc.

HDFC Bank is a publicly listed banking company licensed by the Reserve Bank of India ("RBI") providing banking and finance related services. Established in 1994 post the liberalisation of the Indian Economy, it is the second largest bank in India by market capitalisation of approximately USD 107 billion handling operations across 3,188 cities and towns of the country.

HDFC Limited and the Bank had announced the successful completion of the merger with the necessary approval of the various Regulatory Authorities and other Government Agencies and its assent of its shareholders. This merger was announced back on April 4, 2022 (subject to the various approvals and consents) with a timeframe of approximately 15 to 18 months in mind. The Board of Directors of both these entities approved this merger in their annual meetings, which has become effective as of July 1, 2023.

What shall be affected by the merger?

The merger of the two entities may be considered as a win-win situation for the respective group of shareholders and its consumers and customers. Post the merger HDFC Bank is to become a 100% publicly owned entity, and the shareholders of HDFC Limited for every 25 shares held would receive 42 shares of the HDFC Bank, and the existing shareholders of HDFC Limited set to gain a 41% ownership in the HDFC Bank.

HDFC Investments and HDFC Holdings – wholly owned subsidiaries of HDFC Limited too shall be amalgamated with HDFC Bank, and hence forward shall cease to exist. The combined entity will integrate the two organisations' complementing qualities, allowing for a fulfilling customer relationship. HDFC Bank will also use the long-term mortgage connection to offer a variety of credit and deposit products made possible by superior insights across the client life-cycle. This will result in an improved value proposition and customer experience for all combined entity customers.

Why was a merger undertaken?

The merger has been rationalised for a variety of reasons, but the primary one is the favourable value created by the two businesses merging. While HDFC Limited provides a huge opportunity for the HDFC Bank to break into the housing loan segment, broaden its present consumer base, and benefit from its proficiency in low and efficient loan processing, it also provides a broad product portfolio, large distribution franchise, a solid funding capacity, and protection against unsecured loan exposure. The resulting merged HDFC Bank will have a market capitalisation of INR 12.8 Lakh Crores (about USD 160 Billion) and a greater balance sheet of INR 17.9 Lakh Crores (approximately USD 223.75 Billion).

This merger will result in the HDFC Bank becoming the fourth largest bank in the world by market capitalisation, where the combined entity shall be valued at around USD 172 Billion and have a customer base of more than 120 million. This merger shall give effect to the following outcomes:

- **Reduction in unsecured loans** This merger will reduce the bank's vulnerability to unsecured loans. Despite the low risk, the bank was aggressively expanding its credit card and personal loan portfolios due to the greater yield. Not only will the amalgamated business lower unsecured loan exposure, but it will also allow capacity to underwrite new loans.

- **Building a housing loan portfolio under the Bank** The merger of the two behemoths will enable the HDFC Group to create a highly competitive housing credit and loan portfolio on the banking platform. Currently, HDFC Bank makes a fee by selling HDFC Ltd home loans. This transaction would enable HDFC Bank to extend and build upon its housing loan's portfolio and spread out its existing consumer base.

- **Larger balance sheet** The merger will help in increasing the Bank's balance sheet by pooling in a large number of assets and resources making it the second largest bank of India after SBI with a market cap of approximately INR 12.8 Lakh Crores and a balance sheet of INR 17.9 Lakh Crores.

- **Low-cost funds** HDFC Bank is also India's largest private sector bank, with a massive customer base of approximately 6.8 crore people. The bank platform will offer a diverse low-cost funding base, particularly current and savings accounts (“CASA”). The bank will be able to offer more affordable housing options.

- **Cross-selling** HDFC Ltd has 445 service centre offices across the country that will be utilised to cross-sell the whole suite of banking products. The mortgage provider has a skilled workforce that only does house loans, giving the amalgamated firm a competitive advantage in the market.

The other major reason for going through with the merger was the introduction by RBI of the Prompt Corrective Action ("PCA") Framework which came into effect from October 1, 2022 which is a rigid system through which the RBI keeps tracks of Banks with poor financial performance. Essentially it allows the RBI to place restrictions on an entity such as placing a cap on the lending limit, stopping payment mechanisms offered, restructuring the operations, superseding the Bank's board of directors, etc.

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Regulatory and statutory approvals required

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For a merger of such a large scale regulatory and statutory approvals had been obtained from various government and other regulatory authorities. The scheme was governed through the lenses of both the Companies Act, 2013 (under sections 230-232) and the Banking Regulations Act, 1949 (undersection 44A). Hereinbelow is explained the process of approvals and consents that were required:

- **Approval of the Board of Directors** As per the Banking Regulations Act, 1949 for this merger a board resolution with two-thirds majority must be required from both the entities to continue forward with this scheme. As per the announcements made by HDFC Limited and HDFC Bank, their respective boards had approved such scheme on April 04, 2022.

- **RBI** Next, the most important of all, after receiving the boards approval the scheme was submitted with the RBI for their scrutiny and inspection. HDFC Bank had announced that the scheme had received a no-objection letter from the RBI dated July 04, 2022. For a merger of an NBFC with a banking company to be initiated, the amalgamation is required to be approved by two-third majority of the total board members of the bank and not just of those present and voting. Further, the banking company is required to obtain the approval of the RBI after the scheme of amalgamation is approved by its Board and the Board of the NBFC, but before it is submitted to the Tribunal for approval.

- **Under Companies Act, 2013** For any voluntary amalgamation of an NBFC with a banking company under sections 232 to 234 of the Companies Act, such scheme had to be approved by relevant Tribunal.

- **Stock Exchange** As per the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, all publicly listed companies who are entering into a scheme or amalgamation or merger have to file the draft scheme before the relevant stock exchanges prior to filing it with the Tribunal and get a no-objection letter for the same.

- **Competition Commission of India** The Competition Act, along with CCI (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011 prohibits a person or enterprise from entering into a 'combination' which causes or is likely to cause an 'appreciable adverse effect on competition'. Since this deal fell within the ambit of what was "Combination" and attracted the section 5(c)(ii) of the Competition Act, the deal was notified to the CCI on June 2022.

- **Securities and Exchange Board of India** Companies Act that the scheme be presented to the SEBI, who will then invite representations or comments against the said scheme within 30 days from the date of receipt of notice of meeting of creditors or class of creditors or members of class of members as ordered by the Tribunal, failing to put forward any comments will be presumed as SEBI has no objection to the scheme.

- **Insurance Regulatory and Development Authority** Since the subsidiaries of HDFC Limited are HDFC Life Insurance and HDFC General Insurance, the approval of IRDAI is required for this scheme. The ownership of HDFC Life Insurance and HDFC General Insurance will normally be transferred to HDFC Bank under the Scheme. As a result, before proceeding with the Scheme, HDFC Bank would need to obtain the requisite permissions from IRDAI. Post this scheme HDFC bank would hold in the HDFC Life Insurance and 50% in HDFC General Insurance. The RBI has been reacting negatively to banking businesses owning more than 30% of insurance companies, citing concerns that insurance is a capital-intensive business that could risk bank depositors' interests.

The merger of HDFC Limited and HDFC Bank can be considered as one of India's most historic and largest mergers ever. With HDFC Limited already at the forefront of home finance and HDFC Bank at the forefront of digital banking, the merger is expected to revolutionise the Indian housing finance and banking sectors. This scheme has not just resulted in HDFC Bank becoming the largest private sector bank in India but it has resulted it in becoming one of the largest banks in the world.

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