

NEW RBI DIRECTIONS ON BANK ACQUISITIONS IN INDIA

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Introduction

Last month, the Reserve Bank of India (the “**RBI**”) introduced master directions (the “**Directions**”) and [guidelines \(the “**Guidelines**”\) for the acquisition and ownership of shares and voting rights in banking companies](#). The main aim of the Directions and Guidelines is to ensure that the ultimate ownership and control of banking companies remains well diversified.

The Directions read with the Guidelines are divided into four (4) chapters, out of which Chapters II and III deal with the substantive provisions. Chapter II deals with the requirements for acquisition and the procedure for obtaining prior RBI approval. Chapter III deals with continuous monitoring of major shareholders in accordance with the “Fit and Proper” (“**F&P**”) criteria specified in Annexure II thereof. Further, Chapter III provides instructions for due diligence, reporting, and submission of shareholding dilution plans, as also how to deal with a breach of Section 12(B)(1) of the Banking Regulation Act (the “**Act**”). The Guidelines also specify certain limits on shareholding and voting rights, and lock-in requirements.

Prior approval for acquisition

- The Directions read with Section 12(B) of the Act mandate prior RBI approval to attain a major shareholding status in a banking company through the acquisition of shares or voting rights. In this regard, “major shareholding” has been defined to mean an aggregate holding of 5% or more of the paid-up share capital or voting rights in a banking company by a person.
- The RBI may accept or deny the application for approval upon conducting due diligence of the applicant or may grant permission to acquire a lower shareholding. Further, the RBI may impose certain conditions on the applicant and the concerned banking company while granting approval.
- If the total shareholding or voting rights falls below 5% at any time after the acquisition, fresh RBI approval will be required to bring it back to 5% or more.
- Persons (other than existing major shareholders) who are from Financial Action Task Force (FATF) non-compliant jurisdictions are prohibited from acquiring major shareholding in banks. Moreover, any additional acquisition of shares or voting rights by such an existing major shareholder will require the RBI’s prior approval.
- At any time, the RBI may review the F&P status of holders of shares or voting rights who belong to FATF non-compliant jurisdictions and take appropriate legal measures to limit their voting rights.

Limits on shareholding

The Guidelines stipulate the following shareholding limits on the acquisition of shares or voting rights in a banking company.

- For non-promoters:
 - 10% of the paid-up share capital or voting rights of the banking company in case of natural persons, non-financial institutions, financial institutions directly or indirectly connected with large industrial houses, and financial institutions that are owned to the extent of 50% or more, or controlled, by individuals.
 - 15% of the paid-up share capital or voting rights of the banking company in case of financial institutions other than those mentioned above, supranational institutions, public sector undertakings, and the central or state government.
- For promoters:
 - 26% of the paid-up share capital or voting rights of the banking company after the completion of fifteen (15) years from commencement of business of the banking company.
 - prior to the completion of fifteen (15) years following the commencement of business, a higher percentage of shareholding may be allowed as part of the licensing conditions or the shareholding dilution plan approved by the RBI, which is required to be submitted within six (6) months from the date of the Directions.

The RBI may allow shareholding higher than the limits prescribed above (with or without conditions) on a case-to-case basis depending on circumstances such as relinquishment by existing promoters, supervisory intervention, etc.

Note, however, that as per Section 12(2) of the Act read with gazette notification dated July 21, 2016, no shareholder in a banking company can exercise voting rights on poll in excess of 26% of the total voting rights of all the shareholders of the banking company.

Lock-in requirements

The Guidelines specify certain lock-in requirements for shareholding and are classified as follows:

- Shareholding acquired up to or above 10% of the paid-up equity share capital of the banking company but less than 40% will remain under lock-in for the first five (5) years from the date of completion of the acquisition.

- In case of shareholding acquired up to or above 40% of the paid-up equity share capital of the banking company, the lock-in mandated for the first five (5) years will be applicable only on 40% of the paid-up equity share capital.

The locked-in shares cannot be encumbered in any manner. Promoter(s) and the promoter group are required to report to the banking company, within two (2) working days, the details of creation, invocation, and/or release of encumbrance on shares, which are not under lock-in.

Reporting requirements

- Banking companies are mandated to furnish to the RBI the details of the issued and allotted shares within fourteen (14) days from the date of completion of the allotment process.
- Banking companies are required to report the details of creation, invocation, and/or release of encumbrance of shares to the Department of Supervision, RBI, within thirty (30) days from the date of the event.

Continuous monitoring requirements

- Chapter III of the Directions read with the Guidelines requires banking companies to continuously monitor its major shareholders who have completed the approved acquisition. In addition, applicants for whom the concerned banking company has provided comments in Form A1 to the RBI in connection with an approval for acquisition, and those who have obtained such approval but are yet to complete the acquisition, also need to be monitored.
- Banking companies are required to establish a mechanism to obtain, on a continuous basis, information relating to any changes in the details furnished in the declaration submitted by the applicants (i.e., Form A), which may include any other development that may have a bearing on the F&P status of the applicant.
- Banking companies are mandated to examine any concerns regarding the F&P status of major shareholders and make an assessment based on the investigations conducted and information provided. Accordingly, reports are to be furnished to the RBI.

Conclusions

The Directions and Guidelines are applicable to all banking companies, including Local Area Banks, Small Finance Banks and Payments Banks operating in India, thereby increasing the scope of coverage. Previously, they were applicable only to Indian private sector banks. However, the Directions and Guidelines do not apply to foreign banks who have set up wholly owned subsidiaries or branch offices in India.

The increase in the limits of promoter shareholding from the erstwhile 15% to 26% is a welcome change. This move will enable promoters to infuse more funds, which will act as a crucial pivot for the expansion of banking companies as also work as a safety net to rescue banking companies in times of crises. The focus is now to do a qualitative test by assessing whether the F&P criteria is being met, as opposed to imposing excessively narrow investment limits by setting a low quantitative threshold.

The Directions and Guidelines have provided banking companies six (6) months to adopt these measures and comply with the specified requirements. The Directions and Guidelines have placed emphasis on the due diligence process and fulfilment of the F&P criteria during and after the acquisition process. These measures will ensure transparency and will have a positive impact on banks and other industry participants. Overall, there is a move to create a more trust-based domestic banking sector.