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Research

M&A Lab

HDFC–HDFC Bank:
Merger of Giant HDFC Twins!

August 2022

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Merger of Giant HDFC Twins!

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Asia-Pacific
Most Innovative Law Firm: 2016
Second Most Innovative Firm: 2019
Most Innovative Indian Law Firm: 2019, 2017, 2016, 2015, 2014

Asia Pacific
Band 1 for Employment, Lifesciences, Tax, TMT:
2021, 2020, 2019, 2018, 2017, 2016, 2015

Tier 1 for Private Equity, Project Development: Telecommunications Networks:
2020, 2019, 2018, 2017, 2014

Deal of the Year: Private Equity, 2020

Asia-Pacific
Tier 1 for Dispute, Tax, Investment Funds, Labour & Employment, TMT, Corporate M&A:
2021, 2020, 2019, 2018, 2017, 2016, 2015, 2014, 2013, 2012

Asia-Pacific
Tier 1 for Government & Regulatory, Tax: 2020, 2019, 2018

Ranked
'Outstanding' for Technology, Labour & Employment, Private Equity, Regulatory, Tax:
2021, 2020, 2019

Global Thought Leader — Vikram Shroff
Thought Leaders, India — Nishith Desai, Vaibhav Parikh, Dr. Milind Antani
Arbitration Guide, 2021 — Vyapak Desai, Sahil Kanuga

Fastest growing M&A Law Firm: 2018

Asia Mena Counsel: In-House Community Firms Survey:
Only Indian Firm for Life Science Practice Sector: 2018

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Prologue

Touted as the mother of all M&A deals[1], the merger of HDFC Limited with HDFC Bank is seen as the biggest transaction in India's corporate history. This Deal is valued at approximately USD 40 Billion. This mega-merger in the banking sector is expected to shake up the Indian financial services sector.

Closely observed, one finds that there are changes occurring in the competitive landscape for banks, and an increase in the prominence of M&A among banks seeking to close the market-share gap with the (soon to be merged) HDFC Bank (for e.g. SBI, which is a close competitor in terms of housing finance), acquisition of Citibank India's consumer business by Axis Bank Limited, etc.

NBFCs aiming to get a banking license might find it easier to merge with a bank and enter the market. Banks benefit by getting access to the high-margin products of the NBFCs. Further, the ongoing harmonisation of the regulatory regime of NBFCs and banks have propelled many past and potential mergers in this sector.

This Deal will facilitate HDFC Bank to tap into the large customer base of HDFC Limited's housing portfolio and result in HDFC Bank becoming the 2nd largest bank in India by market capitalization. On the other hand, the merger will also benefit the entire housing finance sector due to increased access to its customers using HDFC Bank's network. The said Merger will also provide for increased PSL lending and a higher credit growth in the Indian market since it will allow HDFC Bank to underwrite big ticket loans and sustain large exposures owing to its large balance sheet post-merger. HDFC Bank, post-merger will benefit from the positive synergies and economies of scale through wider outreach, larger balance sheet, broader range of products and access to common pool of resources.

1 Available at: https://www.vccircle.com/hdfc-bank-hdfc-merge-in-mother-of-all-m-a-deals

Glossary of Terms

Abbreviation	Meaning / Full Form
ADRs	American Depositary Receipts
Board	Board of Directors
BR Act	Banking Regulation Act, 1949
BSE	Bombay Stock Exchange
CASA	Current Account and Savings Account
CCI	Competition Commission of India
CA 1956	Companies Act, 1956
CA 2013	Companies Act, 2013
Competition Act	Competition Act, 2002
CRR	Cash Reserve Ratio
Deal	The all-stock acquisition of (i) HDFC Investments and HDFC Holdings by HDFC Limited, and (ii) HDFC Limited by HDFC Bank, through the Scheme under which each shareholder of HDFC Limited will be allotted shares of HDFC Bank as per the Share Exchange Ratio
FDI	Foreign Direct Investment
HDFC General Insurance	HDFC ERGO General Insurance Company Limited
HDFC Investments	HDFC Investments Limited
HDFC Holdings	HDFC Holdings Limited
HDFC Life Insurance	HDFC Life Insurance Company Limited
HDFC Limited	Housing Development Finance Corporation Limited
HDFC Bank	HDFC Bank Limited
HFC	Housing Finance Company
INR	Indian Rupees
Implementation Agreement	Implementation Agreement executed between HDFC Limited and HDFC Bank.
ITA	Income Tax Act, 1961
Listing Regulations	SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
MSMEs	Micro, Small & Medium Enterprises
NCDs	Non-Convertible Debentures
NCLT	National Company Law Tribunal
NBFC	Non-banking financial company
NHB	National Housing Board
NSE	National Stock Exchange of India Limited
NSE INX	NSE International Exchange
NYSE	New York Stock Exchange
Parties	HDFC Investments, HDFC Holdings, HDFC Limited and HDFC Bank
RBI	Reserve Bank of India

1. Glossary of Terms

Abbreviation	Meaning / Full Form
ROC	Registrar of Companies
RBI Amalgamation Directions	Master Direction – Amalgamation of Private Sector Banks, Directions, 2016
Scheme	Composite Scheme of Amalgamation of (i) HDFC Investments and HDFC Holdings into the HDFC Limited; and (ii) HDFC Limited into HDFC Bank
SEBI	Securities and Exchange Board of India
SLR	Statutory Liquidity Ratio
SEBI Schemes Circular	SEBI Master Circular No. SEBI/HO/CFD/DIL1/CIR/P/2021/0000000665 dated November 23, 2021.
Share Exchange Ratio	42 fully paid-up equity shares of face value of INR 1 each of HDFC Bank for every 25 fully paid-up equity shares of face value of INR 2 of HDFC Limited
Takeover Code	SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011
Tribunal	National Company Law Tribunal
USD	United States Dollar

Details of the Deal

A. Parties

i. HDFC Limited

HDFC Limited is a deposit taking housing finance company registered with NHB and its shares are listed on BSE Limited and National Stock Exchange of India Limited.

Established in 1977, HDFC Limited is India's largest housing finance company. Established as the first specialized mortgage company in India, over the period of 45 years, HDFC Limited is a pioneer in the business of providing housing finance and mortgage facility to individuals and corporates for the purchase and construction of residential houses, real estate, rural housing, etc. HDFC Limited is registered with the RBI as a Non-Banking Finance Company - Housing Finance Company (NBFC-HFC).

As of March 31, 2022, the market cap of HDFC Limited is INR 4,333 Billion (approx. USD 57 Billion) and gross outstanding loan book stands at INR 6,539.02 Billion (approx. USD 86.15 Billion) with an average loan term of 12 years[1]. With over 15 subsidiaries across India and overseas, HDFC Limited is a financial conglomerate which operates in various segments such as life and general insurance, asset management, venture capital, realty, education, etc. with over 464 operating branches across the country. Currently, HDFC Limited has 100% public shareholding comprising of foreign portfolio investors, financial institutions, banks, mutual funds, etc. and is listed on the NSE and BSE.

ii. HDFC Bank

HDFC Bank is a banking company licensed by the RBI under the provisions of the Banking Regulation Act, 1949. The equity shares warrants and NCDs issued by the HDFC Bank are listed on BSE and NSE and the ADRs issued by HDFC Bank are listed on NYSE.

Established in 1994, HDFC Bank is one of the first banks to receive in-principle approval from RBI to set up a private sector bank as a part of RBI's scheme of liberalization of the Indian banking industry.[2]. HDFC Bank undertakes business of providing financial and banking services including wholesale banking, retail banking and treasury operations. HDFC Bank is the second largest bank in India after State Bank of India with a market cap of approx. USD 107 Billion (as on 31 March 2022)[3] and a banking network of 6,342 branches in 3,188 cities and towns.

As on 30 June 2022, HDFC Bank's advances aggregated to approx. INR 13.68 Lakh Crores (approx. USD 171 Billion), deposits aggregated to approx. INR 15.59 Lakh Crores (approx. USD 194.875 Billion) and CASA deposits aggregated to approx. INR 7.34 Crores (approx. USD 917.5 Thousand).[4] HDFC Bank's total net profit as of March 2022 was INR 36,961.3 Crores (approx. USD 4.62 Billion).[5] After the implementation of the

1 Investor presentation dated 13 May 2022. Available at: https://www.hdfc.com/sites/default/files/2022-05/HDFC_13_May_2022.pdf

2 https://v1.hdfcbank.com/aboutus/general/default.htm#:~:text=The%20Housing%20Development%20Finance%20Corporation,Indian%20Banking%20Industry%20in%201994

3 https://www.hdfc.com/sites/default/files/2022-05/HDFC_13_May_2022.pdf;

4 https://www.bseindia.com/xml-data/corpfiling/AttachLive/ff088955-f247-4504-94e6-e9c8c407281f.pdf

5 Integrated Annual Report 2021-22 as on 31 March 2022. Available at: https://www.hdfcbank.com/content/bbp/repositories/723f-b80a-2dde-42a3-9793-7ae1be57c87f/?path=/Footer/About%20Us/Investor%20Relation/annual%20reports/pdf/HDFC-Bank-IAR-FY22-21-6-22.pdf

Scheme, HDFC Bank's market share is expected to improve from 11% to 15%[6] and it will be one of the most valuable banks in the world.

iii. HDFC Investments

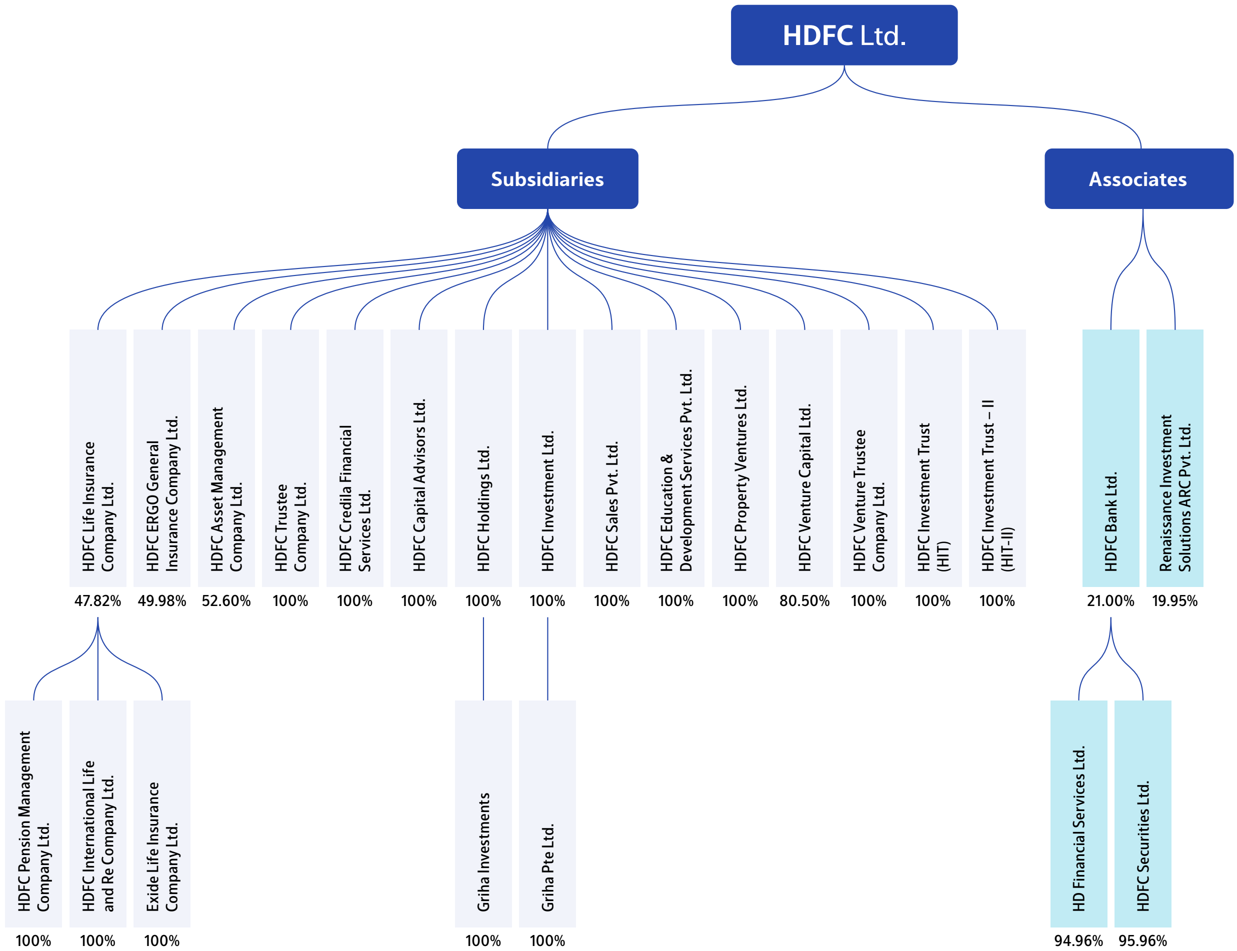
HDFC Investments was incorporated in 1994 as a wholly-owned subsidiary of HDFC Limited. The principal business of HDFC Investments is to make investments in equity shares, preference shares, venture funds, mutual funds and other securities. HDFC Investments has been registered as a Systemically Important Non-Deposit Accepting Non-Banking Finance Company with the RBI.

iv. HDFC Holdings

HDFC Holdings was incorporated in 2000 as a wholly-owned subsidiary of HDFC Limited. Similar to HDFC Investments, it carries on the business of investments in stocks, shares, debentures and other securities and is registered as a Systemically Important Non-Deposit Accepting Non-Banking Finance Company with the RBI.

Both are HDFC Investments and HDFC Holdings are unlisted public companies.

A chart of the HDFC Limited and its subsidiaries (including HDFC Investments and HDFC Holdings) and HDFC Bank is provided below[7].



6 https://www.livemint.com/companies/news/hdfc-bank-merger-to-create-entity-twice-the-size-of-icici-bank-sp-11649071891440.html

7 Annual Report of HDFC Limited for FY 2021-22.

B. Chronology of Events

Date	Event
April 03, 2022	Approval of the Board of HDFC Investments and HDFC Holdings, for the merger with and into HDFC Limited
April 04, 2022	Approval of the Board of HDFC Limited for the Scheme
	Approval of the Board of HDFC Bank for the Scheme
July 02, 2022	No-Objection Letter from BSE and NSE to HDFC Limited and HDFC Bank
July 04, 2022	No-Objection Letter from RBI to HDFC Bank.
July 08, 2022	Approval from PFRDA

C. Deal Snapshot

Date	Event
Transferor Company I	HDFC Investments
Transferor Company II	HDFC Holdings
Transferee Company / Amalgamating Company	HDFC Limited
Amalgamated Company	HDFC Bank
Mode of Transaction	The Deal is proposed to be implemented through a composite Scheme in accordance with BR Act and the SEBI Schemes Circular
Shareholding in HDFC Bank prior to the Deal	Promoter Group: 25.73%[8] ▪ HDFC Limited: 19.10% ▪ HDFC Investments: 6.63% ▪ HDFC Holdings: 0.00% Public Shareholding: 74.27%[9] ▪ Institutional: 59.42% ▪ Central Government: 0.16% ▪ Non-institutional: 14.69%

8 https://www.bseindia.com/corporates/shpPromoterNGroup.aspx?scripcd=500180&qtrid=114.00&QtrName=

9 https://www.bseindia.com/corporates/shpPublicShareholder.aspx?scripcd=500180&qtrid=114.00&QtrName=

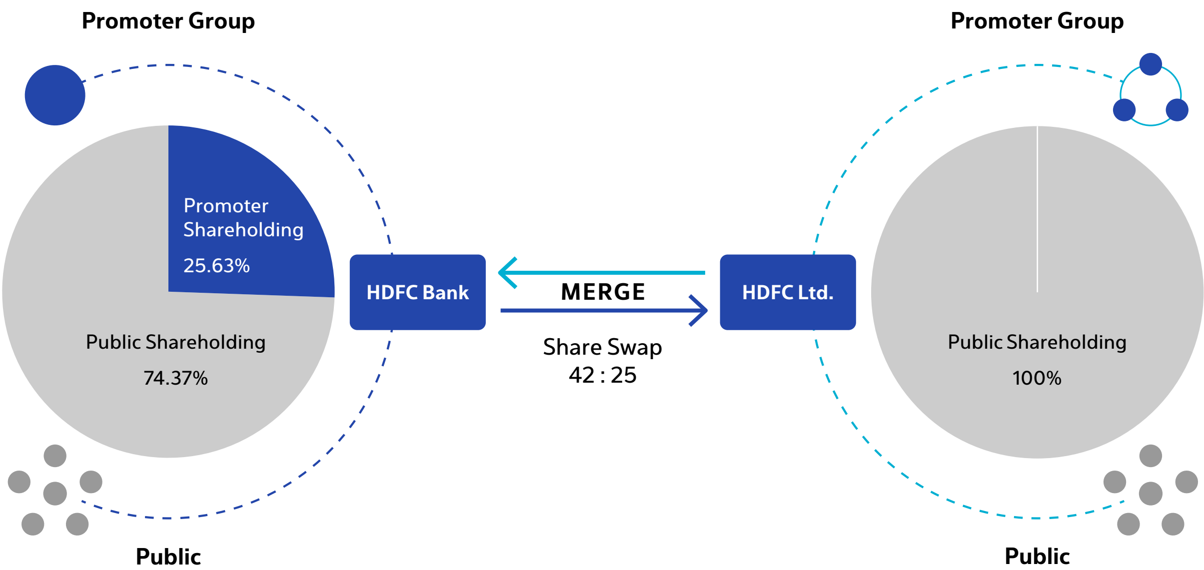
2. Details of the Deal

Date	Event

Shareholding in HDFC Limited prior to the Deal	Promoter Group: 0.00%[10]
	Public Shareholding: 100%[11]
	▪ Institutional: 88.77%
	  ▪ FPIs: 67.75%
	  ▪ Mutual Funds: 11.71%
	  ▪ Insurance Companies: 8.24%
	  ▪ AIFs: 0.12%
	  ▪ Financial institutions/banks: 0.07%
	  ▪ Pension Funds: 0.88%
	▪ Non-institutional: 11.09%
	▪ Central Government: 0.14%

Post-Merger Shareholding in HDFC Bank	Public Shareholding: 100% 41% stake in the HDFC Bank shall be held by the existing shareholders of HDFC Limited.
Consideration	As per the Share Exchange Ratio. Resultantly, the existing shareholders of HDFC Limited will hold ~41% stake in HDFC Bank.

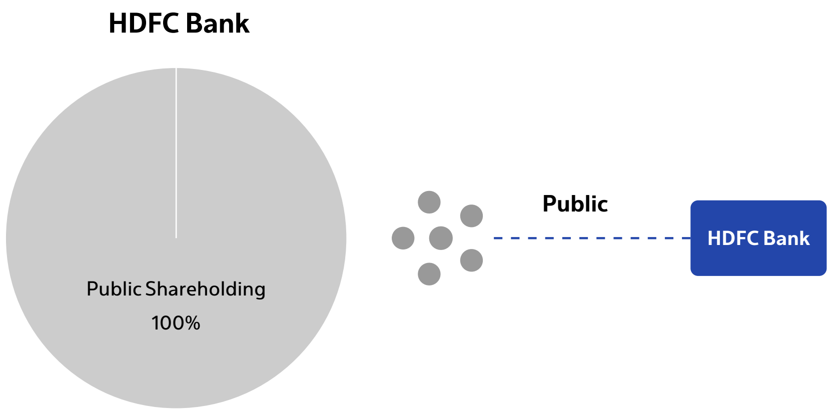
Pre-Merger Shareholding



10 https://www.bseindia.com/corporates/shpPromoterNGroup.aspx?scripcd=500010&qtrid=114.00&QtrName=

11 https://www.bseindia.com/corporates/shpPublicShareholder.aspx?scripcd=500010&qtrid=114.00&QtrName=

Post Merger Shareholding



D. Structure of the Deal

i. Deal Structure

The proposed merger is structured as a two-fold Scheme under Sections 230 to 232 of the CA 2013 and provisions of the BR Act.

Under the first leg of the Scheme, the identified wholly-owned subsidiaries of HDFC Limited i.e., HDFC Investments and HDFC Holdings will merge into HDFC Limited along with its business, assets, properties, investments and liabilities ("**Merger 1**"); and subsequently, HDFC Limited will merge into HDFC Bank, along with its business, assets, properties, investments and liabilities ("**Merger 2**").

Upon the Scheme becoming effective, the shareholders of the HDFC Limited will receive shares of HDFC Bank as per the Share Exchange Ratio. The equity shares held by HDFC Investments and HDFC Holdings in HDFC Limited and the equity shares held by HDFC Limited in HDFC Bank will be extinguished as per the Scheme.

The key terms of the Scheme are as follows:

- **Appointed Date 1**: The date of amalgamation of HDFC Investments and HDFC Holdings into HDFC Limited.
- **Appointed Date 2**: The date of amalgamation of HDFC Limited into HDFC Bank or the Effective Date of the Scheme.

- **Effective Date**: The date of filing of the certified copy(ies) of the order(s) of the Tribunal sanctioning the Scheme, with the ROC after obtaining the required approvals.

- **Dissolution without winding up**: Upon effectiveness of Merger 1, and from the Appointed Date 1, HDFC Investments and HDFC Holdings shall stand dissolved without being wound up. Similarly, upon effectiveness of Merger 2, and from the Appointed Date 2, HDFC Limited shall stand dissolved without being wound up.

- **Swap Ratio**: As per the Share Exchange Ratio.

- **Transfer of Employees**: All the 3,599 employees (as on 31 March 2022)[12] of HDFC Limited shall on and from the Effective Date, become employees of HDFC Bank. HDFC Bank shall issue stock options to eligible employees. Options granted by HDFC Limited to its employees shall automatically stand cancelled as on the Appointed Date 2 and fresh options shall be granted by HDFC Bank to eligible employees after taking into consideration, the Share Exchange Ratio and the terms and conditions that are existing and are in force in the stock option plans of HDFC Limited.

- **Key Approvals**: The requisite consent, approval or permission of relevant Governmental authorities including but not limited to the RBI, CCI, Stock Exchanges, IRDAI, PFRDA, NHB, SEBI, public shareholders, Tribunal, etc.

ii. Key Documentation

HDFC Limited and HDFC Bank entered into an implementation agreement (“**Implementation Agreement**”)[13], which *inter alia* sets out the manner of implementing the amalgamation contemplated under the Scheme and the rights and obligations of the respective parties in relation to the amalgamation.

12 Investor presentation dated 13 May 2022. Available at: https://www.hdfc.com/sites/default/files/2022-05/HDFC_13_May_2022.pdf

13 https://www.hdfc.com/sites/default/files/2022-04/SE_Intimation_Reg_30_040422.pdf

Overview of Banking, NBFC sector and M&As in the two sectors

A. Evolution of Banking Industry in India

The banking industry in India has transformed from a licensed and regulated sector to a liberalized and modern sector. Traditionally, small money lenders had sprung into business and provided loans. The first banks were established during the colonial era which earmarked the growth of the banking industry. The first three banks established during the British era were the Bank of Calcutta in 1806, which was renamed as the Bank of Bengal in 1809, the Bank of Madras in 1843 and the Bank of Bombay in 1868. It is quite fascinating to note that the Bank of Madras was set up as a result of the reorganization and amalgamation of four banks i.e. Madras Bank, Carnatic Bank, Bank of Madras and the Asiatic Bank[1]. Furthermore, the three presidency banks merged in 1921 to form the Imperial Bank of India. Several private banks were also established in the early 1900s which as a result of being unregulated began to exploit the poor. This led to the establishment of the Reserve Bank of India in 1935 in accordance with the Reserve Bank of India Act, 1934. In spite of the formation of the RBI, the growth of the banking industry in India was quite low and in order to streamline the functioning and activities of around 1100 commercial banks during that period, the Government formulated a special legislation, the Banking Companies Act, 1949. The Banking Companies Act was renamed as the Banking Regulation Act in 1966.

Post-Liberalization, the banking industry has seen drastic changes such as the Government approved foreign investment route, allowing for foreign banks to set up a branch office in India, and permitting small domestic banks to open branches throughout the country. Later, payment banks were created allowing a more accessible banking structure in India.[2]

Banks are *inter alia* regulated by the RBI Act, 1934 and the BR Act. Further RBI issues various guidelines, circulars, and notifications from time to time to regulate the banking industry.

B. Evolution of NBFCs industry in India

In the 1960s, NBFCs were started in India to pose as an alternative for investors whose financial needs were not sufficiently met by the existing banking system. They operated on a scale that did not make much impact on the banking industry. Due to the complex course of the operations where financial companies acted as financial intermediaries, a separate regulatory mechanism became crucial. Therefore, RBI took initiative to regulate NBFCs and included Chapter III B in the Reserve Bank of India Act, 1934, which assigned the RBI with limited authority to regulate deposit-taking companies.

In 1997, RBI made several changes to the Chapters III-B, III-C, and V of the RBI Act, 1934 to improve regulatory and supervisory structure. After the amendment, the NBFCs grew their operation, range of instruments and market products, and technological advancement. In 2016, the union cabinet agreed for foreign direct investment (FDI) through the route established in regulated NBFCs.

1 http://www.pbr.co.in/julyseptissue/10.pdf

2 https://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=2758

The governance of NBFCs was increasingly becoming complex and there was a need felt to streamline, consolidate and rationalize the same. RBI issued the Scale Based Regulation (SBR), a revised regulatory framework for NBFCs (**"SBR Framework"**). The new calibrated SBR framework includes capital requirements, governance norms, prudential regulation, and other elements. It categorises NBFCs based on their asset size, business activities, system interconnectedness, and perceived risk. Previously, NBFCs were classified depending on their asset size and their activity. Thus, NBFCs are now categorised into a four-tier pyramid, with the bottom layer subject to the least restrictive restrictions and the top layer subject to the strictest controls.

C. Consolidation in the Indian banking and NBFC sector

Being in the same industry in some sense, consolidation of NBFCs into banks in India are seen as an option in certain scenarios. Some instances of such consolidation are provided below.

- Capital First Limited (an NBFC) and IDFC Bank Limited (a private bank) entered into a merger in the year 2018 to create IDFC Bank Limited to strengthen banking capabilities and operate as a large bank. IDFC was trying to grow its retail portfolio and this merger was made to fulfill the vision.
- Indiabulls Housing Finance (an NBFC) and Lakshmi Vilas Bank (bank) attempted a merger which could not proceed owing to non-approval by RBI. The proposal was rejected on account of regulatory non-compliance. The main ground was that IndiaBulls Housing Finance was facing regulatory inquiries along with pending litigations against Laxmi Vilas Bank.[3]
- IndusInd Bank Limited (bank) and Bharat Financial Inclusion Limited (an NBFC) merged in 2019 in order to create a complimentary network and to provide banking facilities to the already existing customers of Bharat Financial Inclusion Limited. Post the merger, the operations of BFIL became a part of IndusInd Financial Inclusion Limited (IFIL) which was a wholly owned subsidiary of IndusInd Bank Limited.[4]
- Industrial Development bank of India (IDBI), a Development Financial Institution (DFI) and IDBI Bank Limited (a bank) merged in 2005 to create a better growth prospect for the IDBI Bank Limited.[5]

D. M&As by NBFCs into Banks in India

As a highly regulated industry, the banking industry has seen very few mergers and acquisitions since the privatization of the sector.

Traditionally most cases of bank mergers had taken place on the directions of RBI. Its ground was to merge weak banks with the stronger banks to maintain a balance in the economy. Though not very high in number, market led mergers and amalgamations have found their way in the banking sector.

RBI Amalgamation Directions *inter alia* governs amalgamation of an NBFC with a banking company. Further, Section 232 and 234 of CA 2013 governs the voluntary merger of two companies.

3 https://timesofindia.indiatimes.com/business/india-business/rbi-rejects-merger-of-indiabulls-lakshmi-vilas-bank/articleshow/71513146.cms

4 https://www.indusind.com/content/dam/indusind-corporate/investors/investor-presentation/FY2018-2019/IndusInd-Bank-and-Bharat-Financial-Inclusion-Merger-Update.pdf

5 https://www.idbibank.in/pdf/history-of-idbi-.pdf

Commercial Considerations

A. Why was the amalgamation undertaken? What was the reason for undertaking the amalgamation now?

The merger of HDFC twins has been in contemplation since the last decade, however, the same was largely based on market speculations. In this connection, in 2015, there was a reference of denial by HDFC Bank of a potential merger with HDFC Limited.[1]

Numerous reasons have been cited for the Deal; however, it is primarily rooted in the complementary nature of value built by the two entities. While HDFC Limited brings a huge opportunity for HDFC Bank to penetrate the housing loan segment, widen its existing customer base and benefit from its expertise in low and efficient processing of loans which has enabled an 8.1% cost income ratio[2], it simultaneously provides a broad product portfolio, large distribution franchise, a robust capital base and cushion against exposure to unsecured loans. The resultant HDFC Bank will have a market cap of INR 12.8 Lakh Crores (approx. USD 160 Billion) and a larger balance sheet of INR 17.9 Lakh Crores (approx. USD 223.75 Billion) which will permit HDFC Bank to undertake larger underwriting at scale.[3]

Key commercial considerations for this Deal are described as below:

i. Structural drivers in place for housing finance sector

Many structural changes in the housing finance sector such as tax incentives on interest and principal amount for home loan borrowers,[4] increased budget allocations for affordable housing,[5] special refinance facilities for NBFC-HFCs,[6] 'Infrastructure' status being accorded to affordable housing,[7] etc. has increasingly contributed to housing being considered to be a huge growth opportunity and one of the key drivers of India's GDP over the next decade.[8]

ii. Arbitrage between Banks and NBFCs

In 2021, RBI issued the SBR Framework which effectively proposes to eliminate the regulatory arbitrage for NBFCs compared with the banks. A series of regulatory measures has over the years nullified HDFC Limited's advantages of remaining an NBFC and made raising money for NBFCs difficult.[9] HDFC Limited

1 ADR Preliminary Placement Document of HDFC Bank, "There have been reports in the Indian media suggesting that we may merge with HDFC Limited. We consider business combination opportunities as they arise. At present, we are not actively considering a business combination with HDFC Limited. Any significant business combination would involve compliance with regulatory requirements and shareholder and regulatory approvals."

2 https://economictimes.indiatimes.com/markets/expert-view/keki-mistry-and-sashidhar-jagdishan-explain-hdfc-hdfc-bank-merger-what-it-will-mean-for-shareholders/articleshow/90638406.cms

3 https://www.moneycontrol.com/news/business/hdfc-hdfc-bank-merger-receives-no-adverse-observations-from-bse-nse-8773621.html

4 https://www.bankbazaar.com/tax-benefit-on-home-loan.html

5 https://economictimes.indiatimes.com/industry/services/property-/-cstruction/govts-rs-48000-crore-allocation-for-pmay-to-boost-affordable-housing/articleshow/89274858.cms?from=mdr

6 https://www.rbi.org.in/commonman/English/Scripts/PressReleases.aspx?Id=3236

7 https://pib.gov.in/Pressreleaseshare.aspx?PRID=1519109

8 Integrated Annual Report, 2021-22. Available at: https://www.hdfcbank.com/content/bbp/repositories/723fb80a-2dde-42a3-9793-7ae-1be57c87f/?path=/Footer/About%20Us/Investor%20Relation/annual%20reports/pdf/HDFC-Bank-IAR-FY22-21-6-22.pdf

9 https://www.moneycontrol.com/news/business/banks/5-reasons-for-fall-in-hdfc-bank-share-price-after-merger-announcement-8362961.html#:~:-text=To%20begin%20with%2C%20why%20did,raising%20money%20for%20NBFCs%20difficult.

had to rely on wholesale fund-raising from the market or borrowings from banks, both of which are relatively costly.[10] Therefore, the merged entity will be able to improve its loan book with the help of HDFC Bank's low cost funding base.

Further, recent harmonization of financial regulations governing banking institutions and NBFCs has also played a role in making the merger seamless. Regulations applicable to banking institutions are now applicable to NBFCs as well such as introduction of liquidity coverage ratios for NBFCs, similar asset quality norms, norms for non-performing assets, etc. Further, the eased SLR and CRR from a combined 27% to 22% and an additional INR 80,000 Crores (approx. USD 10 Billion) of liquidity cushion created a conducive environment for the amalgamation of the two entities.[11]

iii. Regulatory Framework for HFCs

RBI took over the regulation of HFCs from NHB in 2019.[12] Subsequently, in October 2020, a regulatory framework was issued by RBI for HFCs for regulatory transition in a phased manner. During the year, RBI introduced certain regulatory changes for HFCs such as the principal business criteria for housing finance, definition of housing finance, minimum net owned fund requirements, guidelines on liquidity risk management framework and liquidity coverage ratio, amongst others.[13] The increasing complexities of regulatory requirements for HFCs may have nudged the Parties for a merger.

iv. Foreign Institutional Investment

According to media reports, FII shareholding in HDFC post-merger will be around 66% while the FII cap is at 74%. Therefore, the extinguishing of shareholding will open-up around 7-8% headroom for fresh FII investors to invest into HDFC Bank.[14]

v. Build housing loan portfolio

Per internal assessment, 70% of HDFC Limited's customers do not bank with HDFC Bank and of the 68 million customers of HDFC Bank, only 2% have a mortgage from HDFC Limited.[15] Further, HDFC Bank sources home loans for a fee to HDFC Limited, upon the merger of the two entities, HDFC Bank will be able to cross-sell into the large housing loan customer base of HDFC Limited. HDFC Limited's domain expertise in housing finance complemented by HDFC Bank's low-cost funding base due to high level of CASA deposits will help HDFC Bank for growing the long tenor loan book[16] and to provide flexible mortgage offerings at competitive prices.

10 https://www.business-standard.com/article/finance/effects-of-hdfc-hdfc-bank-merger-go-beyond-banking-rajnish-kumar-122040500064_1.html

11 https://economictimes.indiatimes.com/industry/banking/finance/banking/nearly-8-years-ago-a-rbi-notification-had-triggered-possible-hdfc-hdfc-bank-merger-talks/articleshow/90637634.cms?from=mdr

12 https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=47871 See also: https://tealindia.in/insights/why-did-the-rbi-take-over-the-regulation-of-housing-finance-companies-from-the-national-housing-bank/

13 https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/NT605BE165AA9E8043EFA087339829CCF469.PDF

14 Investor presentation dated 13 May 2022. Available at: https://www.hdfc.com/sites/default/files/2022-05/HDFC_13_May_2022.pdf

15 Ibid.

16 https://m.economictimes.com/industry/banking/finance/banking/mortgage-lender-hdfc-announces-merger-with-hdfc-bank/articleshow/90633253.cms

vi. Larger underwriting abilities

With the multi decade mortgage lending expertise of HDFC Limited accompanied with a larger balance sheet and net worth after merger, HDFC Bank will be able to underwrite large ticket loans with reduced proportion of exposure to unsecured loans. This will also reduce default rates as the loans will be offered by the same bank where such accounts are maintained. Further, HDFC Limited's mortgages will increase the asset duration of HDFC Bank's retail book without any requirement of infusion of capital.[17] This will also mitigate single product risk and help HDFC Bank to diversify its assets and product range.[18]

vii. Operating efficiencies

HDFC Bank has a banking network of 6,342 branches in 3,188 cities and towns and a customer base of 68 million, this will help HDFC Limited in leveraging the power of distribution in urban, semi-urban and rural geographies. In lieu, HDFC Bank can capitalise on the loan management system, comprising of rule engines, IT tools and rules, agents connected through a central system.[19] By leveraging on the technological capabilities of one another, the HDFC twins can symbiotically excel in financing various customer segments.

B. Why was the Deal structured as a merger and not a share acquisition?

While no direct reasons have been cited by any of the parties for the reason why the Deal was structured as a merger and not a share purchase, the following are some considerations that the parties may have considered:

i. Promoter Dilution, Shareholding & Capital Expenditure

HDFC Limited together with HDFC Investments and HDFC Holdings are the promoter group entities of HDFC Bank. Since the Deal was structured as a merger, no capital expenditure was required (which would have been required for a share purchase), it allowed HDFC Limited to avoid the cash needs of an acquisition and dilute the promoter shareholding in HDFC Bank whilst making it a 100% publicly held entity.

The shareholding of HDFC Limited's shareholders in HDFC Bank increased from 21% to 41%, thereby serving dual purpose of (a) diluting the promoter shareholding in HDFC Bank; and (b) increasing the effective shareholding of HDFC Limited's shareholders in HDFC Bank.

ii. Takeover Code Exemption

The merger falls within the ambit of exemptions for the obligation to make an open offer under the Takeover Code. Consequently, HDFC Limited was exempt from having to make an open offer. However, it is pertinent to note that HDFC Limited would have to comply with the above requirement if they had opted into structuring their Deal as share purchase.

17 https://economictimes.indiatimes.com/markets/expert-view/keki-mistry-and-sashidhar-jagdishan-explain-hdfc-hdfc-bank-merger-what-it-will-mean-for-shareholders/articleshow/90638406.cms?from=mdr

18 https://www.mymoneymantra.com/blog/hdfc-merge-with-hdfc-bank-know-reason-and-impact

19 https://www.hdfcbank.com/content/bbp/repositories/723fb80a-2dde-42a3-9793-7ae1be57c87f/?path=/Footer/About%20Us/Other%20stake-holders%27%20Information/Disclosure-PDFs-for-2022/4-Outcome.pdf

iii. Four Entities

If the Deal was structured as share purchase the same would have resulted into four separate entities. However, since the primary commercial reason for the Deal was to consolidate the businesses of HDFC Investments, HDFC Holdings, HDFC Limited and HDFC Bank into a single large entity and drawing the benefits of a larger balance sheet and increasing the capital base, this also one of the main reasons why an amalgamation was preferred over a share purchase.

iv. Tax Benefits

The Deal being structured by way of a merger, was tax neutral under the IT Act as opposed to a share purchase which would have been subject to capital gains tax.

C. What is the impact of this merger on the subsidiaries of HDFC Limited?

Upon the Effective Date of the Scheme, all the 15 subsidiaries of HDFC Limited will be transferred to and become the subsidiaries of HDFC Bank. While this will not materially affect the business of most of the subsidiaries which operate in financial, brokerage, investments, consultancy or education sectors, it is likely, however, to impact the subsidiaries undertaking insurance businesses. After the merger, HDFC Bank will hold substantial stake of 47.8% in HDFC Life Insurance and 49.9% stake in HDFC Ergo General Insurance.[20]

While there is no official amendment of any laws, RBI has been frowning upon banks owning high stakes in insurance businesses and expects the banks to limit their ownership to 20%.[21] Recently, it had also rejected Axis Bank's plea to hold 17% stake in Max Life Insurance.[22] However, a few banks hold more than the said limit in many cases such as (a) ICICI Bank directly holds 51.32% in ICICI Prudential Life Insurance and 48.05% in ICICI Lombard General Insurance; (b) State Bank of India holds 55.48% in SBI Life Insurance and 70% in SBI General Insurance, similarly (c) Kotak Mahindra Bank owns 100 per cent stake in both Kotak Mahindra Life Insurance Company and Kotak Mahindra General Insurance Company.[23]

On July 04, 2022, HDFC Bank received a no-objection letter from RBI, however, it is speculated that RBI has granted a conditional approval to HDFC Bank and directed HDFC Bank to reduce stake in HDFC General Insurance and HDFC Life Insurance.[24]

20 https://www.business-standard.com/article/companies/hdfc-bank-writes-to-rbi-seeks-approval-to-hold-50-stake-in-hdfc-life-122040400601_1.html

21 https://www.businesstoday.in/latest/corporate/story/axis-max-life-deal-faces-regulatory-hurdle-rbi-rejects-direct-stake-buy-proposal-277141-2020-10-30

22 https://www.businesstoday.in/latest/corporate/story/axis-max-life-deal-faces-regulatory-hurdle-rbi-rejects-direct-stake-buy-proposal-277141-2020-10-30

23 https://www.business-standard.com/article/companies/hdfc-bank-writes-to-rbi-seeks-approval-to-hold-50-stake-in-hdfc-life-122040400601_1.html

24 https://www.thehindubusinessline.com/markets/stock-markets/hdfc-shares-drop-after-rbi-directive-on-stake-in-merged-insurance-arm/article31612099.ece

D. How was the merger valued?

The swap ratio was arrived at by the independent valuers appointed by HDFC Limited and HDFC Bank respectively who recommended the Share Exchange Ratio, which was accepted by the respective Boards. The independent valuers valued using all of the following methods: (i) Underlying Asset Method; (ii) Income or Discounted Cash Flow Method; (iii) Market Price Method; and (iv) Cost Method.[25]

E. What does the merger mean for the shareholders of HDFC Limited / HDFC Bank?

The merger of the HDFC twins is seen as a win-win situation for the shareholders of both the entities. In addition to benefitting from the share swap of 42 shares of HDFC Bank in lieu of every 25 shares of HDFC Limited and holding potentially ~41% of shareholding in HDFC Bank, they also benefit from the increase in the value of shares consequent upon the merger coming into effect. HDFC Bank will emerge as a behemoth in the banking industry being among the top 10 banks in the world in terms of market capitalization and only to increase its footprint in the housing loan market by cross-selling across the customer base of HDFC Limited.

As mentioned above, the housing loan market is expected to bear fruits for the merged entity owing to the favorable regulatory nudge, competitive housing products, ability to underwrite large ticket loans, larger balance sheet, an augmented loan book and likelihood of a rise in the foreign investor holding by 7-8%, thereby causing an increase in the value of shares in the open market and consequently profiting the shareholders of the HDFC Bank.

25 Valuation Report dated 04 April 2022. Available at: https://www.hdfc.com/sites/default/files/2022-04/Valuation%20Reports.pdf

Legal and Regulatory Considerations

A. What is the difference between merger under CA 2013 and BR Act?

Chapter XV of CA 2013 deals with Compromise, Arrangements and Amalgamations. Merger under CA 2013 is provided HDFC for under Section 230 to Section 232. The merger under CA 2013 is a Tribunal led process which is initiated by filing of an application to the NCLT.[1]

Whereas the aforementioned provisions under the CA 2013 provides for mergers and amalgamations between two companies, there are special provisions for merger and amalgamation of banking companies issued by the RBI i.e. RBI Amalgamation Directions. The governing provision for merger and amalgamation of banking companies is Section 44A of the BR Act. It is pertinent to note here that the provisions of BR Act are in addition to, and not in derogation of CA 2013.[2] Therefore, any compliance under the BR Act is in addition to the compliance under CA 2013 unless specifically provided otherwise.

Additionally, another important aspect in this Deal relates to the issue of merging of an NBFC with a bank in India. The governing provisions for the merger of an NBFC with a bank would be Sections 230-232 of CA 2013, along with the provisions of the RBI Amalgamation Directions. RBI Amalgamation Directions cover two types of amalgamations, first is an amalgamation between two private banks and second is the amalgamation of an NBFC with a private bank.[3]

Key differences

S. No	Basis for difference	CA 2013	BR Act
1.	**Provisions**	Section 230-232 of CA 2013	Section 44A of the BR Act
2.	**Initial Step**	The initial step starts with drafting of a scheme of merger or amalgamation which stipulates the details of the merger or amalgamation including the consideration and valuation.	The initial steps under the BR Act are the same as the CA 2013.
3.	**Foreign shareholding**	The restrictions on FDI will be based on the sector in which the merging or amalgamating companies are involved.	The FDI restrictions in the banking sector will be applicable. Up to 49% would be allowed under the automatic route whereas 49% to 74% would require government approval.[4]
4.	**Oversight**	The Tribunal approves the scheme prepared in the initial steps.	If the scheme of amalgamation is approved by the requisite majority of shareholders, it shall be submitted to the RBI for sanction.[5]

1 Section 230(1) of the Companies Act, 2013.

2 Section 2 of the Banking Regulation Act, 1949.

3 Direction 4, Master Direction DBR PSBD No. 96/16.13.100/2015-16.

4 Schedule I, F2, FEMA (Non-Debt Instruments) Rule, 2019

5 Section 44A (4) of the Banking Regulation Act, 1949.

S. No	Basis for difference	CA 2013	BR Act
5.	**Notices**	CA 2013 requires the issuance of a notice of consolidation and documentation (such as a copy of the Scheme and valuation report) not only to shareholders and lenders but also to various regulators including the Department of Business Affairs (Regional Director, Registrar of Companies and Legal Liquidator), RBI (where non-resident investors are involved), SEBI (listed companies only), the Competition Commission of India (where deposit limits and proposed mergers may have a negative impact on competition), Stock Exchange (listed companies only), Income Tax authorities and other sector regulators or authorities that may be affected jointly.[6]	The notice has to be given in line with the relevant articles of association (AoA). The notice shall include the date, the time, the place and the object of the meeting. Moreover, the notice shall mandatorily be published once a week in at least two newspapers, and this shall continue for a period of three weeks consecutively. Furthermore, the newspapers in which the Notice is published should have a circulation in the localities or locales where the registered offices of the banking companies are located. Also, one of these newspapers must be in the language understood by the people residing in the locality.[7]
6.	**Power of Central Government**	The Central Government can provide for the mandatory merger or amalgamation.	Under section 45 of the BR Act, RBI has the power to force the merger of a weaker bank with a stronger bank, if the scheme is in public interest or in the interest of the depositors of the distress bank or to secure proper management of a banking company, or in the interest of the banking system.
7.	**Consents**	The scheme requires consent of majority of the: Creditors/class of creditors of the company Members/class of members of the company	Before filing of the scheme, it requires approval of majority in number representing two-thirds in value of the shareholders of each bank/NBFC
8.	**Approvals**	Approved by the NCLT	Approved by the NCLT and RBI
9.	**Dissent**	Dissenting shareholders can approach the Tribunal.	The dissenting shareholder may claim from the banking company, in respect of the shares held by him in that company, the value of shares as determined by the RBI when sanctioning the scheme.[8]

6 Section 230 (2) of the Companies Act, 2013.

7 Section 44A (2) of the Banking Regulation Act, 1949.

8 Section 44A (3) of the Banking Regulation Act, 1949.

B. What approvals and consents are required for the Deal under the BR Act, Merger Guidelines?

i. Board and Shareholder Approval

As per the BR Act, a proposed amalgamation of an NBFC with a bank would require the respective Boards to approve amalgamation by a two-third majority[9] of the total board strength and not just those present and voting. Additionally, the non-executive and independent directors are also required to enter into deed of covenants with the bank owing to the responsibility that they have because of the peculiar nature of the banking industry.

Post the approval of the scheme of arrangement by the board of the bank, the scheme should then be presented to the shareholders of the bank. This would then require to be passed by a majority in number that represents two-thirds in value of the shareholders present and voting.[10] Shareholders can opt for proxy voting in these resolutions as well. The BR Act provides for a ceiling on voting, wherein any shareholder cannot exercise voting rights on poll in excess of 10% (ten percent) of the total voting rights of all the shareholders. The shareholders voting should be convened only after the boards of the bank involved have approved the draft scheme.[11]

The considerations that the boards will have to look into while approving the draft scheme includes[12]:

- the value at which the assets, liabilities and the reserves of the amalgamated company are proposed to be incorporated in the books of the finally amalgamated company and the effect of such incorporation;
- the due diligence conducted by the parties;
- whether the swap ratio has been determined by independent valuers, the competence and experience of the valuer and whether the swap ratio is proper and fair;
- the shareholding patterns in the amalgamating companies and if there is any effective shareholding in the amalgamated company which would be violative of RBI guidelines or require approval;
- the impact of the amalgamation on the profitability and capital adequacy of the amalgamating companies;
- changes in the board of directors and its compliance with RBI guidelines.

As per the announcement by HDFC Bank and HDFC Limited, the respective boards of HDFC Bank and HDFC Limited approved the Scheme on April 04, 2022.[13]

9 Chapter II, Direction 6, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

10 Chapter III, Direction 7, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

11 Chapter III, Direction 8, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

12 Chapter III, Direction 9, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

13 Available at: https://www.hdfcbank.com/content/bbp/repositories/723fb80a-2dde-42a3-9793-7ae1be57c87f/?path=/Footer/About%20Us/Other%20stakeholders%27%20Information/Disclosure-PDFs-for-2022/4-Outcome.pdf

ii. RBI Approval

The amalgamation after having received the approval of the Board and the shareholders, would be then submitted to RBI for its scrutiny.[14] HDFC Bank vide a disclosure dated July 04, 2022, announced that the Scheme had received a no-objection letter from the RBI on July 04, 2022.[15]

iii. Companies Act – for amalgamations with NBFC

The RBI Amalgamation Directions require that the voluntary amalgamation of an NBFC with a banking company is governed by Sections 232 to 234 of the CA 2013 in terms of which, the scheme of amalgamation has to be approved by the Tribunal.[16] The Scheme is pending approval by the Tribunal.

C. Why was the approval of Stock Exchanges required?

Listing Regulations require all the publicly listed entities entering into a scheme of amalgamation to file the draft scheme with the relevant stock exchanges, prior to filing them with the Tribunal (as per the process laid down under CA 2013), to seek an observation letter or no-objection letter from the relevant stock exchanges.[17] Since both the entities, HDFC Limited and HDFC Bank are entities listed on stock exchanges, approval from relevant stock exchanges was required.

However, the above requirement of seeking an approval from the stock exchanges shall not apply to schemes which solely provide for merger of a wholly owned subsidiary with the parent company.[18] Therefore, the said requirement is not triggered for Merger 1, i.e., merger of HDFC Investments and HDFC Holdings with HDFC Limited, but will be required for Merger 2, i.e., merger of HDFC Limited with HDFC Bank.

HDFC Bank received the observation letter with 'no-adverse observations' and 'no-objection' from BSE and NSE respectively on July 02, 2022.[19]

D. Why was the approval of RBI required?

RBI Amalgamation Directions *inter alia* governs amalgamation of an NBFC with a banking company. For an amalgamation 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.

While approving an amalgamation proposal, the board is required to *inter alia* consider the impact of the amalgamation on the profitability and the capital adequacy ratio of the amalgamating company. The amalgamating company (bank) thereafter is required to submit certain documents such as valuation report for determining

14 Chapter III, Direction 10, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

15 Available at: https://www.business-standard.com/article/finance/hdfc-bank-receives-no-objection-letter-from-rbi-for-merger-with-hdfc-122070401339_1.html

16 Chapter IV, Direction 14, the Master Direction – Amalgamation of Private Sector Banks, Directions, 2016.

17 Regulation 37(1) of Listing Regulations.

18 SEBI Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017

19 https://www.businesstoday.in/industry/banks/story/hdfc-hdfc-bank-merger-gets-no-objection-from-rbi-after-bse-nse-nod-340300-2022-07-04

the share swap ratio and detailed computation of such valuation, to the RBI for it to consider the amalgamation proposal and scope for value.

As noted earlier, the RBI has provided a No-Objection Letter to HDFC Bank for the Deal on July 04, 2022. Interestingly, the RBI has not provided its approval as envisaged in the RBI Amalgamation Direction and instead provided No-Objection Letter to HDFC Bank and included certain conditions/conditionalities as per news in the public domain.

E. Why was the approval of CCI required?

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' ("**AAEC**") within the relevant market in India, and renders such a combination void.

"Combination", for the purposes of the Competition Act, includes a merger or amalgamation in which the resultant entity post the merger has assets in India or outside India that exceed the financial thresholds prescribed under the Competition Act.

As per Section 5(c)(ii) of the Competition Act, an amalgamation of enterprises shall be a 'combination' if any amalgamation in which the group, to which such enterprises remaining after the amalgamation, have or would have, (a) either in India, the assets of the value of more than INR 4,000 Crores (approx. USD 500 Million) or turnover more than INR 12,000 Crores (approx. USD 1.5 Billion); or (b) in India or outside India, in aggregate, the assets of the value of more than USD 2 Billion [including at least INR 500 Crores (approx. USD 62.5 Million) in India], or turnover more than USD 6 Billion [including at least INR 1,500 Crores (approx. USD 187.5 Million) in India].

Accordingly, the Deal has been notified to the CCI in June 2022 by the Parties and is awaiting approval from CCI.

F. Why was the approval of IRDAI required?

HDFC Life Insurance and HDFC General Insurance are subsidiaries of HDFC Limited. Prior to the Deal, HDFC Limited held 47.81% in HDFC Life Insurance and 49.98 in HDFC General Insurance.

Section 6A(4)(b) of the Insurance Act, 1938 ("**Insurance Act**") requires that, in relation to a public company which carries on life insurance business, general and health insurance business etc. prior approval of the IRDAI is required for; (a) any acquisition of 5% or more of the paid-up share capital of an insurance company by a transferee; and (b) the transfer of shares of shares of such (public) insurance company, in a scenario where the nominal value of the shares proposed to be transferred by a 'constituent of a group' or 'body corporate under the same management' exceeds 1% of the paid-up equity capital of the insurance company. The manner of seeking approval is set out in a separate regulation issued by IRDAI[20].

Further, IRDAI (Issuance of Capital by Indian Insurance Companies transacting Life Insurance Business) Regulations, 2015 and the IRDAI (Issuance of Capital by Indian Insurance Companies transacting other than Life

20 IRDAI (Transfer of Equity Shares of Insurance Companies) Regulations, 2015

Insurance Business) Regulations, 2015 requires that in case of a listed insurance company, a transfer of shares other than pursuant to a 'public issue' or 'offer for sale' under SEBI regulations, which triggers the thresholds laid down under Section 6A(4)(b) of the Insurance Act, shall require the prior approval of the IRDAI.

Further, Guideline 5 of the IRDAI (Listed Indian Insurance Companies) Guidelines, 2016 requires a prior approval of the IRDAI when a person intends to acquire or make an arrangement for acquisition which will take the aggregate holding of such person together with shares held by him, associate enterprises and persons acting in concert with him, to 5% or more of the paid-up equity share capital of the concerned insurer or entitles him to exercise 5% or more of the total voting rights of the concerned insurance company.

Pursuant to the Scheme, the ownership of HDFC Life Insurance and HDFC General Insurance would be ordinarily transferred to HDFC Bank. Accordingly, HDFC Bank would need to procure necessary approvals from IRDAI before proceeding with the Scheme.

As per publicly available reports, post the Deal, HDFC Bank is expected to hold 48% in the HDFC Life Insurance, 50% in HDFC General Insurance. RBI has been reacting adversely to banking companies holding in excess of 30% shareholding in insurance companies with its concern stemming from the fact that insurance is a capital guzzling business, and this could jeopardise the interest of bank depositors.

Although historically, RBI has permitted banks to hold up to 50% in insurers (with RBI retaining the ability to allow higher equity contribution by a promoter bank on a selective basis), over the years, RBI has been reportedly, advising banks seeking to acquire stakes in insurers, to limit such stakes to a maximum of 30%, and more recently directed them to cap stake purchases in insurers at 20%[21].

G. Was the approval of SEBI required?

CA 2013 requires that the scheme of amalgamation be presented before the SEBI[22] and shall require that any representations or comments to be made by SEBI within a period of 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[23], failing which, it shall be presumed that SEBI has no objection to the proposal.

Upon receiving the draft scheme of arrangement and the relevant documents in terms of Regulation 37(1) of the Listing Regulations, the relevant stock exchange is required to forward the same to SEBI for its approval.[24] Once the relevant stock exchanges issues their no-objection letter, SEBI shall process the draft scheme and issue its comments thereon[25] within a period of 30 days from the later of the following:

- date of receipt of satisfactory reply on clarifications, if any sought from the listed entity by SEBI; or
- date of receipt of opinion from independent chartered accountant, if sought by SEBI; or
- date of receipt of 'no-objection' letter from relevant stock exchanges.

As on July 28, 2022, the Scheme is pending approval from SEBI.

21 https://www.livemint.com/insurance/news/rbi-restricting-banks-from-raising-stakes-in-insurance-firms-report-11614684604707.html

22 Section 230 (5) of the CA 2013.

23 SEBI Circular No. SEBI/HO/CFD/DIL1/CIR/P/2020/215 dated November 3, 2020

24 Regulation 94 of the Listing Regulations.

25 SEBI Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017 and SEBI Circular No. SEBI/HO/CFD/DIL1/CIR/P/2020/215 dated November 3, 2020s

H. What are the disclosures required to be made?

The Listing Regulations provide that a every listed entity shall make disclosures with the stock exchange of any events or information which, in the opinion of the Board of such listed company, is material in order to enable the shareholders and the public to apprise the position of such company, and to avoid the establishment of a false market in its securities.[26] As such, on April 04, 2022 HDFC Limited[27] and HDFC Bank[28] filed a letter of intimation to BSE and NSE informing them of the Scheme immediately after the Board meeting approving the merger on the same day.

As per the Listing Regulations, the listed companies have to make the disclosure to the stock exchange in the beginning for obtaining the no-objection letter or no-observation letter[29], after that the procedure given under CA 2013 containing Sections 230 to 232 is followed. The listed entities are required to file the following items with the relevant stock exchanges wherever the securities are listed in case of merger and amalgamation:[30]

- Shareholding pattern;
- Pre and post arrangement shareholding pattern; and
- Capital structure

  In addition to the above, a listed entity seeking a merger is required to submit the following documents:[31]

- Draft scheme of amalgamation/ merger;
- Valuation report accompanied with an undertaking from the listed entity stating that no material event impacting the valuation has occurred during the intervening period of filing the scheme documents with stock exchange and period under consideration for valuation;[32]
- Report from the audit committee recommending the draft scheme;
- Fairness opinion by a SEBI registered merchant banker on valuation of assets/shares;
- Pre and post amalgamation shareholding pattern of unlisted entity;
- Auditor's certificate to the effect that the accounting treatment contained in the scheme is in compliance with all the Accounting Standards specified by the Central Government under Section 133 of the CA 2013 read with the rules framed thereunder or the Accounting Standards issued by ICAI, as applicable;
- Detailed Compliance Report (duly certified by the Company Secretary, Chief Financial Officer and the Managing Director) confirming compliance with various regulatory requirements specified for schemes of arrangement and all accounting standards;
- Report from the Committee of Independent Directors recommending the draft Scheme, taking into consideration, *inter alia*, that the scheme is not detrimental to the shareholders of the listed entity;

26 Regulation 30(1) of the Listing Regulations.

27 https://www.hdfc.com/sites/default/files/2022-04/SE_Intimation_Reg_30_040422.pdf

28 https://www.hdfcbank.com/content/bbp/repositories/723fb80a-2dde-42a3-9793-7ae1be57c87f/?path=/Footer/About%20Us/Other%20stake-holders%27%20Information/Disclosure-PDFs-for-2022/4-Outcome.pdf

29 Regulation 37(1) of the Listing Regulations.

30 Regulation 69(2) of the Listing Regulations.

31 SEBI Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017, SEBI Circular No. CFD/DIL3/CIR/P/ 2018/2 dated January 3, 2018 and SEBI Circular No. SEBI/HO/CFD/DIL1/CIR/P/2020/215 dated November 3, 2020

32 SEBI Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000657 dated November 16, 2021

- Declaration from the listed entity on any past defaults of listed debt obligations of the entities forming part of the scheme.[33]
- No-objection Certificate (NOC) from the lending scheduled commercial banks/ financial institutions/ debenture trustees.[34]

Since HDFC Bank had issued debt securities on NSE INX in 2021,[35] in addition to the above requirements, HDFC Bank was also required to disclose all events which are material or price sensitive[36] as per the 'Framework for Listing of Debt Securities.'

I. Why did the Takeover Code not get triggered?

Regulation 10(d) of the Takeover Code sets out that any acquisitions pursuant to a scheme:

> *"of arrangement involving the target company as a transferor company or as a transferee company, or reconstruction of the target company, including amalgamation, merger or demerger, pursuant to an order of a court or a competent authority under any law or regulation, Indian or foreign".*

The Deal, being a merger under CA 2013 and covered by the exemption under Regulation 10(d), did not trigger an open offer under the Takeover Code.

J. Approvals from other regulatory authorities?

The amalgamation would require the receipt of approvals from the following regulators and entities:

- RBI – HDFC Bank got an approval from the RBI on July 04, 2022. This requirement arises from the RBI Master Direction.[37]
- SEBI, Insurance and Regulatory and Development Authority, Pension Fund Regulatory and Development Authority – As per the CA 2013, the scheme should also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India, if necessary, and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement and shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals. The arrangement has received approvals from stock exchanges. Additionally, since both HDFC Bank and HDFC Limited are registered as Point of Presence for the National Pension Scheme under the PFRDA (Point of Presence) Regulations, 2018, the arrangement would also require approval of the PFRDA.
As per the PFRDA (Point of Presence) Regulations, 2018 any change of status or constitution of the Point

33 SEBI Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000657 dated November 16, 2021

34 SEBI Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000657 dated November 16, 2021 read with Circular No. SEBI/HO/CFD/DIL2/CIR/P/2021/0000000659 dated November 18, 2021

35 https://www.business-standard.com/article/news-cm/hdfc-bank-raises-uds-1-bn-via-issue-of-3-70-basel-iii-compliant-additional-tier-i-notes-121082600209_1.html

36 Regulation 1, Chapter IV Continuing Obligations, Framework for Listing Debt Securities, NSE INX.

37 Direction 10, Master Direction – Amalgamation of Private Sector Banks, Directions, 2016

of Presence should require the prior approval of the PFDRA.[38] The arrangement has been approved by the PFRDA on July 07, 2022.[39]

- National Company Law Tribunal – As per CA 2013 and the RBI Master Direction, the amalgamation would require the approval of the NCLT. The approval of NCLT to HDFC Bank is still pending.
- BSE and NSE - Regulation 37 of LODR provides that the listed entities desirous of undertaking scheme of arrangement or involved in a scheme of arrangement shall file the draft scheme with stock exchange(s) for obtaining Observation Letter or no-objection Letter, before filing such scheme with any court or Tribunal. HDFC Bank received observation letter with 'no-adverse observations' and 'no-objection' from BSE and NSE respectively on July 02, 2022.[40]

K. What are the US Law Considerations?

Section 3(a)(10) of the US Securities Act, 1933 provides for an exemption from registration requirement for securities issued pursuant to certain transactions. As such, the securities which are anticipated to be offered or sold pursuant to such transactions shall be exempt from seeking registration as required under the US Securities Act, 1933.[41] Section 3(a)(10) provides for certain conditions for availing such exemption:

- *First*, the transfer of security should be in a form of exchange for securities, claims, or property interests and cannot be offered for cash.[42] The above condition is satisfied as the Deal is structured as a share swap and without any cash considerations.
- *Second*, the transfer or exchange must be approved by a court or authorized governmental entity[43] and such authority must approve the fairness of the terms and conditions of the exchange, in an open hearing conducted by such authority.[44] HDFC Bank intends to use the order(s) of the Tribunal approving the Scheme for the purpose of fulfilling the said condition.[45]
- *Third*, the issuer must provide appropriate notice of the hearing in a timely manner and file Form 6-K[46] on or prior to the record date.[47] On 04 April 2022, HDFC Bank has already fulfilled the above condition by filing Form 6-K and intimating the NYSE about the Scheme.[48]

38 Regulation 11(a) of the PFRDA (Point of Presence) Regulations, 2018

39 https://www.bseindia.com/xml-data/corpfiling/AttachLive/62296e87-ab70-4b4e-ba5e-024ce277938d.pdf

40 Available at: https://www.businesstoday.in/industry/banks/story/hdfc-hdfc-bank-merger-gets-no-objection-from-rbi-after-bse-nse-nod-340300-2022-07-04

41 Section 5 of the US Securities Act, 1933.

42 Section 3(a)(10) exempts sales of securities that are "partly in such exchange and partly for cash...". It is the Division's view that Section 3(a)(10) exempts transactions that are predominantly exchanges and that the "partly for cash" language is intended merely to permit flexibility in structuring those exchanges.

43 "any court" in Section 3(a)(10) may include a foreign court; See: See, e.g., Lucas Industries plc (August 20, 1996); Symantec Corp. (November 22, 1995); Orbital Sciences Corp. (October 13, 1995); Minera Andes, Inc. (September 21, 1995); Cadillac Fairview, Inc. (May 26, 1995); LAC Minerals Ltd. (June 27, 1991); The Hongkong and Shanghai Banking Corporation Ltd. (January 23, 1991).

44 https://www.sec.gov/interps/legal/cfslb3r.htm#FOOTNOTE_1

45 Clause 32.2 of the Scheme.

46 17 CFR, Section 240.13a-16 - Reports of foreign private issuers on Form 6-K

47 **Clause 5.1(xx) under the Scheme;** "Record Date" means the date to be fixed by the Boards of the Amalgamated Company[HDFC Bank] in consultation with the Amalgamating Company (HDFC Limited) for the purpose of determining the equity shareholders (members) of the Amalgamating Company, to whom the Amalgamated Company Shares will be allotted pursuant to this Scheme.

48 https://www.sec.gov/Archives/edgar/data/1144967/000119312522095376/d292183d6k.htm

Tax Consideration

What are the tax implications arising out of the Deal?

The term 'merger' is not defined under ITA. However, the term 'amalgamation' is defined under Section 2 (1B) of the ITA as a merger of one or more companies into another company or a merger of two or more companies to form a new company in such a way that the following conditions should be fulfilled:

- all the properties of the amalgamating companies must become the properties of the amalgamated company by virtue of the amalgamation;
- all the liabilities of the amalgamating companies must become the liabilities of the amalgamated company by virtue of the amalgamation; and
- the shareholders holding not less than 3/4th (three – fourth) in value (i.e., 75% - seventy five per cent) of shares in the amalgamating company (apart from the shares already held by the amalgamating company or its nominees) must be shareholders in the amalgamated company by virtue of the amalgamation.

Generally, any income from the sale or transfer of an asset / undertaking is subject to taxation. However, if a merger qualifies as an amalgamation, subject to fulfillment of certain additional conditions, the amalgamation can be regarded as tax-neutral and can be exempted from capital gains tax in the hands of the amalgamating company and its shareholders. In a scheme, if the amalgamated company is an Indian company, Section 47(vi) specifically exempts any transfer of a capital asset by the amalgamating company to the amalgamated company from the definition of 'transfer'. In such cases, the cost of acquisition of the capital assets for the amalgamated company will be deemed to be the cost for which the amalgamating company had acquired such assets, increased by the cost of any improvement incurred by the amalgamating company.[1] Further, the period of holding of such assets by the amalgamated company (for determination of short term or long term nature of gains arising at the time of their alienation) would include the period for which the assets had been held by the amalgamating company.[2]

Further, Section 47 (vii) of the ITA also exempts any transfer by a shareholder, in a scheme, of a capital asset being a share or shares held by him in the amalgamating company, from the definition of '*transfer*', subject to fulfillment of the following conditions:

- the only consideration received by the shareholders must be the allotment of shares in the amalgamated entity; and
- the amalgamated company must be an Indian company.

In the above case, the cost of acquisition of shares of the amalgamated company will be deemed to be the cost at which the shares of the amalgamating company had been acquired by the shareholder.[3] Additionally, the period of holding of the shares of the amalgamated company will include the period for which shares of the amalgamating company has been held by the shareholders.[4]

1 Indian Tax Act, 1961, Act No. 43, Acts of Parliament, § 49, cl. 1.

2 Indian Tax Act, 1961, Act No. 43, Acts of Parliament, § 2, cl. 42A.

3 Indian Tax Act, 1961, Act No. 43, Acts of Parliament, § 49, cl. 2.

4 Indian Tax Act, 1961, Act No. 43, Acts of Parliament, § 2, cl. 42A.

While dealing with the tax implications of share swap in a merger, it is pertinent to refer to the decision of Supreme Court in the *Grace Collis* case.[5] In this case, the Court held that transfer of shares by an amalgamating company would lead to an "extinguishment of rights" in capital assets and therefore, such an act would fall under the definition of 'transfer' under Section 2(47) of the ITA. However, the same has been specifically exempted under Section 47 (vii) of ITA. Consequently, if an amalgamation does not meet the conditions of the exemption under Section 47, the transfer of shares could be regarded as a taxable transfer under the ITA.

In the case at hand, the Deal would be considered as an amalgamation under Section 2 (1B) of the ITA due to the following reasons:

- all properties of HDFC Limited would become the property of HDFC Bank[6];
- all liabilities of HDFC Limited would become the liabilities of HDFC Bank[7];
- the current shareholders of HDFC Limited would become the shareholders of HDFC Bank,
- Further, since the only consideration that the shareholders of HDFC Limited would receive are the allotment of shares in HDFC Bank, an Indian company, the conditions under Section 47 to receive an exemption are fulfilled. Hence, the transaction would be considered as a tax neutral transaction, thereby exempting HDFC Limited and its shareholders from taxation.

5 CIT v. Grace Collis, [2001] 248 ITR 323 (SC).

6 Part C, Clause 9 of the Scheme.

7 Part C, Clause 10 of the Scheme.

Epilogue

The merger between HDFC Limited and HDFC Bank will be one of the most historic and largest deals ever witnessed by the India Inc. With HDFC Limited already at vanguard of the housing finance coupled with HDFC Bank being a forerunner in digital banking, the merger is touted to revolutionize Indian housing finance and banking sector.

This financial mega-merger will not only result in HDFC Bank becoming the largest private bank in India but also put it on the global map as the 6th largest lender in the world by market capitalization.[1] This marks a beginning for Indian financial institutions to take on the challenging global markets.

Having received the no-objection letters from the RBI, PFRDA, BSE and NSE, the Deal seems to have traversed through major regulatory milestones. However, it remains to be seen how IRDAI, SEBI, NHB view this Deal. This Deal has taught India Inc that mammoth scale is possible when it comes to implementing large M&A deals in India. It remains to be seen if HDFC will be able to hold the record for the largest M&A deal in India for long or would another mega M&A deal trump HDFC-HDFC Bank deal soon.

We have always taken initiatives to provide updates and analysis on the latest legal developments. M&A Lab is one such initiative which provides insight and analysis of the latest M&A deals. We believe in knowledge sharing and hence would appreciate any feedback or comment. Feel free to direct your comments/views on this Lab to **concierge@nishithdesai.com**.

1 https://www.business-standard.com/article/finance/hdfc-twins%E2%80%88merger-hdfc-bank-to-be-6th-biggest-lender-globally-in-m-cap-122040600012_1.html#:~:text=The%20merger%20shall%20make%20HDFC,in%20terms%20of%20m%2Dcap

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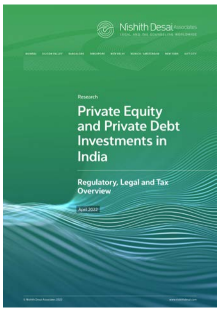

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