

RBI Can Now Reconstruct or Merge a Bank Without Placing it Under Moratorium

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Nikunj Ohri 27 Jun 2020

The Reserve Bank of India can now prepare a scheme of reconstruction or amalgamation of a bank without placing it under moratorium, according to the Banking Regulation Amendment Ordinance 2020.

The cabinet had approved the ordinance, which also brings urban and multi-state cooperative banks under the RBI's ambit, on Wednesday. It received the President's assent on Friday.

The ordinance makes an amendment in Section 45 of the Banking Regulation Act, stating that at any time, and not just during the period of moratorium, the RBI—in public and depositors' interest—can prepare a scheme of reconstruction or amalgamation of a bank with any other banking entity.

According to the original Act, when a bank is placed under a moratorium, it cannot “make any payment to any depositors or discharge any liabilities or obligations to any other creditors.” The Ordinance further restricts this by saying that a bank under moratorium cannot make “any loans or advances or make investments in any credit instruments.” The original Act provides for exemptions to this rule via directions given by the Central Government.

The Ordinance enables preparing a scheme of reconstruction or amalgamation of a banking company for protecting “the interest of the public, depositors and the banking system and for securing its proper management”, even without making an order of moratorium, so as to avoid disruption of the financial system, said a government statement.

Currently, the RBI sends an application to the central government to place a bank under moratorium. In March, the government had placed Yes Bank under moratorium and superseded the board of the lender due to decline in its financial position.

Placing a bank under moratorium makes depositors lose confidence in the lender, said former banking secretary DK Mittal. The ordinance will help in allowing a seamless merger of a bank without depositors facing any difficulty or a run on the bank, Mittal said. Calling it a good step, Mittal said that this will protect depositors, and boost confidence in the Indian banking system.

Babu Sivaprakasam, a partner at Economic Law Practice, agreed. A moratorium hurts confidence in the system and the government is looking to avoid imposing a moratorium. The idea is to reconstruct a bank without disrupting the system and ensuring business continuity, Sivaprikasam said.

The RBI can assess an individual situation and decide if a moratorium is necessary or can opt for reconstruction or amalgamation, he said. The RBI can prepare the scheme of reconstruction or amalgamation of a bank, and then seek government's final approval, he added.