1105M160

Candidate's Seat No :________

M.B.A.-II (Sem.-IV) Examination
Banking & Insurance
May-2017

Time : 3 Hours] **[Max. Marks : 100**

Instructions: (1) This paper contains five questions.
(2) Questions 1 and 5 are compulsory.
(3) Question 2, 3, 4 have internal options.
(4) Figures in the right side in the parenthesis indicate marks

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Q-1
(a) What is Retail banking? Why do Banks focus on Retail Banking? Explain the Emerging Issues in Handling the Retail Banking? (10)
(b) Define the term banker and customer and bring out the relationship that exists between them? (10)

Q-2 (a) Define Central Bank? Explain its role in economic development in India? (10)
Q-2 (b) What is Credit Monitoring? Explain the provisions related to Sickness, Rehabilitation, and Loan losses for the commercial bank. (10)

OR

Q-2 (a) Explain the structure of the balance sheet of the bank? Give the suitable example to justify the same? (10)
Q-2 (b) What is credit delivery? Explain in brief the different modes of credit delivery in case of commercial banks. (10)

Q-3 (a) Define Insurance? Explain Rating of Insurance Products. (10)
Q-3 (b) Explain in brief: (1) Popular Life Insurance Plans (2) Reinsurance (10)

OR

Q-3 (a) Define Insurance? Explain in brief Underwriting of Insurance Products. (10)
Q-3 (b) Define Insurance? Explain the basic principles of insurance viz (1) Principle of Utmost Good Faith (2) Principle of Insurable Interest (3) Principle of Indemnity and (4) Principle of Subrogation. (10)

Q-4 (a) Explain in brief: (1) Social Insurance (2) Rural Insurance. (10)
Q-4 (b) What is Marine Insurance? Explain the Elements of Marine Insurance Contract? (10)

OR

Q-4 (a) Explain in brief: (1) Motor Insurance (2) Property and Liability Insurance. (10)
Q-4 (b) What is Fire Insurance? Explain the Elements of Fire Insurance Contract? (10)

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Q-5 **Case Study: The Reverse Merger of ICICI with ICICI Bank** (20)

Development financial institutions have been facing huge problems with respect to business activity and resource mobilization. State Government owned financial institutions had to borrow from markets at relatively high cost of funds. Moreover, the funding of long-term projects was done with short-term funds, which led to critical asset-liability mismatch.

The reverse merger of ICICI with its offspring, ICICI Bank, was aimed at becoming a universal bank and the merger made it the second largest bank in India. The merger caused ICICI Bank to gain critics, mass and major thrust on the retail front.

This merger brought development institutions into the domain of retail banking. ICICI Bank wanted to wipe out its huge portfolio of bad assets and make retail account for 45% of the total loans. The merger obtained the consent of some 70-odd foreign institutional investors who own 47% of the merged entity.

K V Kamath's universal banking project was internally code named ***Project Dream.*** The development financial institutions-such as IDBI and ICICI-had been created in the 1950s to meet the financial requirements of Indian industry.

The date of the merger was 31st March 2002. The merged entity, ICICI Bank Ltd, with an asset base of over Rs 95,000 crore, emerged as the country's second largest bank after the State Bank of India. The merger of two wholly owned subsidiaries of ICICI-ICICI Personal Financial Services and ICICI Capital Services-also took place in 2002. The merged entity also had 396 branches/extension counters, 140 retail finance offices and centres and 8275 employees. ICICI Personal Financial Services was into distribution and servicing of various retail credit products-including auto and home loans-and had around 40 offices across the country. ICICI Capital was into distribution of financial products of the ICICI Group, and had around 100 offices across the country.

In the organizational revamp, ICICI defined the role and structure of over 30 major groups. The new entity had a new board with N Vagul as the non-executive chairman, and the executive management comprised of K V Kamath as MD and CEO, H N Sinor and Lalitha D Gupte as joint MDs, and Kalpana Morparia. S Mukherji, Chanda D Kochhar and Nachiket M Mor as executive directors. The elements of new strategy included focus on the following issues: aggressive capital management, optimal size, technology intensive multi-channel delivery architecture, world class skill bases and enduring customer relationships.

Before the merger, ICICI held 46% of the paid up equity share capital of ICICI Bank. This holding constituted 15% of the merged entity. The swap ratio had been fixed at one share of ICICI Bank for every two shares of ICICI. This was based on the valuation by ICICI's advisors, JM Morgan Stanley and DSP Merrill Lynch. The regulator appointed audit and consultancy firm AF Ferguson as an independent evaluator. The merger was approved by 99.9% plus ICICI shareholders at a court convened meeting.

Regulatory Issues At the time of the merger, one of the critical issues for the merged bank was concern about the priority sector lending norms. While the norms specify that 40% of the net bank credit has to

be aimed at the priority sector, ICICI was far short of that level. It required Rs 23,000 crore by way of Statutory Liquidity Rights (SLR) for the combined entity. The bank had Rs 5000 crore in its SLR portfolio. ICICI mobbed up SLR aggressively, funding it through a combination of retail deposits and asset swaps.

Regulations did not allow the merged bank to have any subsidiary that was involved in non-banking activities. In fact, ICICI had already reduced the number of subsidiaries from 33 to 11 in the run-up to becoming a universal bank. The core subsidiaries included ICICI Prudential Life Insurance, ICICI Lombard General Insurance, ICICI Venture Funds Management and ICICI Securities and Finance. ICICI had to lower its stake in ICICI InfoTech to 30% from 92%. RBI stipulates that 25% of a bank's branches have to be located in semi-urban and rural areas. ICICI Bank was able to meet these criteria due to its merger with Bank of Madura. At the time of the merger, the capital adequacy situation was under control. ICICI Bank's capital adequacy ratio stood at 14.1% and ICICI's at 14.8%. The merged entity had a capital adequacy ratio of 12.1%.

The merged entity had 358 branches, of which 173 were semi-urban and rural branches, which was 49% of the total. At the time of the merger, the Bank had an impressive 1000 ATMs.

Merger Gains

The major gains may be classified as follows:

- Economies of scale through volumes in operating costs and technology development
- Economies of scope through large product suite and cross selling potential
- Optimisation of human and financial capital.

For ICICI: The merger helped to improve its ability to diversify its portfolio and revenue. It also lowered cost of funds by offering access to retail funds. It also provided opportunity to ICICI to grow fee income. The key impact of the merger was on ICICI's cost of funds. As a financial institution, ICICI had been raising funds on an incremental basis, at an average rate of 10.5%. The ICICI Bank was raising funds, at an average rate of 7.2%. The cost of borrowing for the new entity was expected to come down by at least 100-150 basis points. ICICI got access to cheap retail funds. ICICI was constrained in exploiting its corporate relationships to develop fee income as it was not a part of the banking system, and was precluded from broad based access to trade and forex related services. Though ICICI Bank could pursue these businesses, it did not have sufficient capital. The combined entity had significant capital to extract synergies in fee income after the merger.

For ICICI Bank: The merger catapulted ICICI Bank to the number 2 position in the banking industry, and it became the largest private sector bank in India. The bank gained critical size in assets and distribution. The expected merger benefits include improved access to low cost retail deposits, and a more unified organisation structure that would enable better penetration of the group's customer base and better utilization of resources. The ICICI Bank could achieve size and scale operations by leveraging ICICI's capital and client base for higher fee income and higher profitability, by leveraging on technology and low cost structure

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and access to its talent pool. The bank would be able to provide a complete product suite with immense cross selling opportunities through ICICI's presence in retail finance, insurance, investment banking and venture capital.

ICICI Group has a strong distribution network and technology platform. This would enable ICICI to cross-sell a suite of products in the most cost effective manner.

The merged portfolio consists of two major service segments:

(a) Retail Services: ICICI; ICICI Bank; ICICI Capital; ICICI Prudential; ICICI Web Trade; ICICI Personal Finance; ICICI Home.

(b) Corporate Services: ICICI; ICICI Bank; ICICI Securities; ICICI Brokerage; ICICI Venture; ICICI InfoTech; ICICI Lombard.

At the time of the merger, ICICI had Net NPAs at around Rs 3000 crore or 5.3% while ICICI Bank had net NPAs at 1.36%.

Before the merger, the bank had 70% in retail deposits and 30% in corporate deposits. The aim of 1 merger was to bring retail to 60%, with corporate deposits and bonds accounting for 40%. In 2002, ICICI had highest number of auto and consumer loans in the country, second highest number of home loans and third highest number of credit cards. The bank also had leadership position in Internet banking. The retail sector was poised to become the largest distribution powerhouse in the country by distributing a range products-like third party products, mutual funds, insurance (life and non-life), pension products and bonds issued by RBI and other entities. The major focus of the bank was on cross selling. In 2002, the cross selling ratio was 1.1, that is, every ICICI customer held 1.1 ICICI products. The major advantage of the cross selling is that customer acquisition cost comes down massively and credit quality increases.

Questions

1. Discuss the scope of Mergers and Acquisitions in the Indian Banking Industry as described in the case.
2. Explain ICICI Group's Strategic M&A perspective for growth.

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