

Bank mergers: How the rushed stake sale in insurance subsidiaries may fetch low value

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Most PSU banks have non-core investments that can be monetised to raise funds from time to time. Investments in insurance businesses, asset management companies and housing finance companies, etc, make for good value unlocking opportunities for many capital-crunched PSU banks. But the big bank mergers announced by the Centre recently can lead to a hasty sell-off of such investments, fetching unattractive price and value for PSU banks.

Why hasty sell-offs?

According to the Insurance Regulatory and Development Authority of India (IRDAI) regulations, an institution can promote only one insurance company in the life or non-life sector. In the case of PNB, OBC and United Bank merger, while PNB has 30 per cent stake in PNB Metlife India, OBC has 23 per cent stake in Canara HSBC Oriental Bank of Commerce Life Insurance. Since both life insurance companies cannot exist under the combined entity post-merger --- one of the banks, likely OBC, will have to offload its investment in its insurance company.

Similarly, in the case of the Union Bank, Andhra and Corporation Bank merger, Union Bank holds 25 per cent stake in Star Union Daichi Life Insurance, while Andhra Bank holds 30 per cent stake in India First Life Insurance Company. Andhra Bank may have to offload its stake in the insurance business before the merger.

Hasty moves by these banks to sell their stakes in the insurance companies only to comply with the IRDAI regulations before the mergers, can make it difficult to find good buyers. Importantly, such sales could also end up fetching low value for these businesses.

As such, the low market share and weak performance metrics of some of these insurance players, have depressed their valuations. A hurried sale can only make matters worse.

Multiple holdings

Digging out information from annual reports on banks' non-banking subsidiaries, joint ventures/ associates and other investments (wherever disclosed), reveals that many PSU banks have notable investments in insurance businesses, asset management companies and housing finance companies.

In case of PNB, the bank has 74 per cent stake in PNB Gilts, a listed primary dealer in India. It also has 32.79 per cent stake in PNB Housing Finance and 30 per cent stake in PNB Metlife India Insurance. The bank also had stake in Principal PNB Asset management, which it sold off in August 2018. Monetising the rest of the investments, can fetch about Rs 5,000-7,000 crore, complementing the capital infusion by the Centre to some extent. But this is contingent on sales happening at a good price.

In case of insurance businesses, finding buyers could be challenging for weaker players. Life insurance players in the industry with scale, balanced product portfolio and diversified distribution model derive premium valuations. Listed players such as SBI Life, HDFC Life and ICICI Pru Life, for instance, trade at 3-5 times their embedded value. Embedded value is a measure used to value a life insurance business which, among other parameters, takes into account the future earnings of the company.

A little more than half of the private life insurance business is contributed by these three players alone --- the top five insurers, including Max Life and Bajaj Allianz, constitute nearly 70 per cent of the total premiums (first year premiums according to IRDAI data). Hence, for smaller players, the valuations can be far lower --- at 1-2 times the embedded value.

PNB Metlife has a market share of just about 2.3 per cent among private players (based on first year premium) as of March 2019. Market share for the insurer was similar five years ago.

PNB is the anchor bank in the merger with OBC and United Bank and, hence, while PNB Metlife may continue operations, OBC may have to sell off stake in Canara HSBC OBC Life Insurance. The market share for this insurer is a low 2 per cent and hence a frantic sale can fetch lower valuations.

In the case of Union Bank, Andhra and Corporation Bank merger, Andhra Bank offloading stake in India First Life Insurance may also prove challenging. The insurer had a market share of just 2.7 per cent as of March 2019, down from 4-5 per cent share five years ago.

Rationalisation of investments

In the case of the other two mergers — Canara Bank with Syndicate and Indian Bank with Allahabad Bank — only one bank has investments in an insurance company and hence there will be no need for a quick sale of investments. Canara Bank has 51 per cent stake in Canara HSBC OBC Life Insurance and Allahabad Bank has 28.5 per cent in Universal Sompo General Insurance. With no investments or subsidiaries in insurance companies by their counterparts in the mergers — Syndicate and Indian Bank — these investments can be retained.

However, depressed valuations in other sales can lower the value of these investments. For instance, OBC selling stake in Canara HSBC OBC Life at a low valuation, would indirectly impact Canara Bank's value of holdings in the insurer.

Also, with all the mega mergers, PSU banks will have to rationalise their investments in insurance and other companies. For instance, Star Union Dai-Ichi Life Insurance is a joint venture between Bank of India and Union Bank and Dai-

Ichi Life Insurance. Similarly, India First Life is a JV between Andhra Bank, Bank of Baroda and Carmel Point. Post mergers, bancassurance agreements may also have to be revisited.

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