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SC CORPORATE CASE STUDY SERIES

Proposed Merger of the Businesses and Undertakings of CIMB Group Holdings Berhad, RHB Capital Berhad and Malaysia Building Society Berhad and the Creation of an Enlarged Islamic Banking Franchise

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The following definitions shall apply throughout this case study.

Act	-	Malaysian Companies Act 1965
Assets and Liabilities	-	Assets, liabilities, business and undertakings
Bursa Securities	-	Bursa Malaysia Securities Berhad
BNM	-	Bank Negara Malaysia
Board	-	Board of Directors
CEO	-	Chief Executive Officer
CIMB	-	CIMB Group Holdings Berhad
CIMB Bank	-	CIMB Bank Berhad
CIMB Group	-	CIMB and its subsidiaries
CIMB Islamic	-	CIMB Islamic Bank Berhad
CIMB Shares	-	Issued and paid-up ordinary shares of CIMB of RM1.00 each
EPF	-	Employees Provident Fund (*Kumpulan Wang Simpanan Pekerja*)
FPE	-	Financial period ended
FYE	-	Financial year ended
IDR	-	Indonesian Rupiah
Listing Requirements	-	Main Market Listing Requirements of Bursa Securities
MBSB	-	Malaysia Building Society Berhad
MBSB Group	-	MBSB and its subsidiaries
MBSB Share	-	Issued and paid-up ordinary shares of MBSB of RM1.00 each
Mega Bank	-	The enlarged banking group together with the Mega Islamic Bank, as the result of the Proposed Merger
Mega Islamic Bank	-	The proposed enlarged Islamic banking franchise, as a result of the Proposed Islamic Bank Merger
NA	-	Net assets

Negotiating Parties	-	CIMB, RHB Capital and MBSB
PB	-	Price-to-book ratio
PE	-	Price-to-earnings ratio
Proposed Disposal	-	The proposed disposal by CIMB of all its Assets and Liabilities to RHB Capital
Proposed Islamic Bank Merger	-	The proposed merger of the Assets and Liabilities of CIMB Islamic, RHB Islamic and MBSB to create a mega Islamic bank
Proposed RHB Islamic Acquisition	-	The proposed acquisition by CIMB Islamic of the Assets and Liabilities of RHB Islamic
Proposed Merger	-	Collectively the Proposed Disposal, Proposed RHB Islamic Acquisition and Proposed Islamic Bank Merger that would result in the creation of the Mega Bank
RHB Bank	-	RHB Bank Berhad
RHB Capital	-	RHB Capital Berhad
RHB Capital Shares	-	Issued and paid-up ordinary shares of RHB Capital of RM1.00 each
RHB Group	-	RHB Capital and its subsidiaries
RHB Islamic	-	RHB Islamic Bank Berhad
RM and sen	-	Ringgit Malaysia and sen respectively
USA	-	United States of America
USD	-	United States Dollar

Interpretation

In this case study, words referring to the singular shall, where applicable, include the plural and *vice versa*, and words referring to the masculine gender shall, where applicable, include the feminine and neuter genders and *vice versa*. References to persons shall include a company or a corporation.

Note:

For the purpose of this case study, all information, including information on companies listed on Bursa Malaysia, share prices, market capitalisations, corporate announcements, legislation and financial positions referred hereto is based on the information before 14 January 2015, being the announcement of the termination of the Proposed Merger, unless otherwise specified.

A Case Study on the Proposed Merger of the Businesses and Undertakings of CIMB Group Holdings Berhad, RHB Capital Berhad and Malaysia Building Society Berhad and the Creation of an Enlarged Islamic Banking Franchise

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Case Study

1. Introduction

On 10 July 2014, the Negotiating Parties respectively announced the approval from BNM for them to commence negotiations for the proposed merger of the businesses of the CIMB Group and RHB Group as well as the proposal to create a Mega Islamic Bank with the MBSB Group. The approval to commence negotiations was valid for a period of six (6) months from 10 July 2014.

The Negotiating Parties had, on the same day, entered into a 90-day exclusivity agreement to negotiate and finalise the pricing, structure, and other relevant terms and conditions for the Proposed Merger ("**Exclusivity Period**"). There would be an automatic extension of the Exclusivity Period upon submissions being made to BNM on the Proposed Merger, until the date of execution of the relevant definitive agreement(s) to affect the Proposed Merger.

On 9 October 2014, the Negotiating Parties announced that a joint application had been made to BNM on 8 October 2014 to seek the approval of BNM and Ministry of Finance for the Proposed Merger. The Proposed Merger was intended to encompass the following:

(i) Proposed Disposal

CIMB to dispose of all its Assets and Liabilities to RHB Capital in consideration for new shares in RHB Capital ("**CIMB Consideration Shares**") via a proposed scheme of arrangement under Section 176 of the Act between CIMB and its shareholders, and RHB Capital, CIMB Islamic Bank, and RHB Islamic and a business sale and purchase agreement entered into between CIMB and RHB Capital. In addition, CIMB will undertake a capital reduction exercise under Section 64 (please refer to Exhibit 3 of this Case Study) of the Act to facilitate the distribution of the CIMB Consideration Shares to its shareholders, following which CIMB shall be delisted from the Main Market of Bursa Securities.

The consideration for the Proposed Disposal ("**CIMB Merger Consideration**") was proposed at approximately RM7.27 per CIMB Share. This was equivalent to an aggregate CIMB Group Merger Consideration of approximately RM60,581.5 million based on the number of shares in CIMB as at 31 July 2014 of approximately 8,336.5 million CIMB Shares. The CIMB Merger Consideration represented a premium of 0.4% over the market price of CIMB of RM7.24 as at the reference date of 9 July 2014. The CIMB Merger Consideration then valued RHB Capital at approximately RM10.03 per share based on the number of shares in RHB Capital as at 24 July 2014 of approximately 2,572.5 million RHB Capital Shares. This represented a premium of 15.0% over the market price of RHB Capital of RM8.72 as at the reference date of 9 July 2014.

(ii) Proposed RHB Islamic Acquisition

As an integral part of the Proposed Merger, it was proposed that CIMB Islamic would acquire all the Assets and Liabilities of RHB Islamic in exchange for new ordinary shares in CIMB Islamic ("**RHB Islamic Consideration Shares**").

The consideration for the Proposed RHB Islamic Acquisition ("**RHB Islamic Purchase Consideration**") was proposed at approximately RM4,146.8 million. This was equivalent to an implied price per share in RHB Islamic of RM3.53 based on the number of shares of RHB Islamic of approximately 1,173.4 million RHB Islamic shares as at 31 March 2014. Pursuant to the Islamic Purchase Consideration, RHB Islamic was valued at a PB of 1.96 times the unaudited consolidated NA attributable to the equity holders of RHB Islamic of approximately RM2,119.3 million as at 30 June 2014.

Proposed Islamic Bank Merger

The Proposed Islamic Bank Merger would involve the acquisition by CIMB Islamic of all the Assets and Liabilities of MBSB ("**Proposed MBSB Acquisition**") in consideration for new redeemable convertible preference shares in CIMB Islamic ("**MBSB Consideration Shares**"). MBSB would undertake a capital repayment exercise under Section 64 of the Act ("**Proposed Capital Repayment**") to distribute the rights to the MBSB Consideration Shares (i.e. the CIMB Islamic redeemable convertible preference shares and/or the rights and entitlements thereunder) to all the shareholders of MBSB as at an entitlement date to be determined and announced later.

MBSB shareholders would have the option of receiving cash or MBSB Consideration Shares. Upon completion of the Proposed Capital Repayment, MBSB would eventually be delisted from the Main Market of Bursa Securities.[1]

The consideration for the acquisition of the Assets and Liabilities of MBSB ("**MBSB Purchase Consideration**") was proposed at RM2.82 per MBSB Share and represented a premium of 20.5% over the market price of MBSB of RM2.34 as at the reference date of 9 July 2014. This was equivalent to an aggregate consideration of approximately RM7,768.1 million (on a fully diluted basis, based on approximately 2,676.0 million outstanding MBSB Shares, 18.0 million unexercised MBSB warrants which were issued in 2011 and will be maturing in 2016 and 60.6 million unexercised options of MBSB employee share option scheme as at 27 August 2014).

[1] The Star, 10 October 2014. *RHB Cap to acquire CIMB Group, while offer for MBSB is RM2.82 per share.*

The implied issue price for CIMB Islamic in respect to the RHB Islamic Purchase Consideration and MBSB Purchase Consideration was approximately RM5.40 per CIMB Islamic share. Therefore, CIMB Islamic was valued at a PB of 1.93 times the unaudited consolidated NA to equity holders of CIMB Islamic of approximately RM2,803.4 million as at 30 June 2014.

Upon completion of the Proposed Islamic Bank Merger, the Mega Islamic Bank would undertake a capital raising exercise to bolster its capital base for future growth. It was envisaged that following the capital raising exercise, the Mega Bank would retain a controlling stake in the Mega Islamic Bank.

The Proposed Disposal and Proposed RHB Islamic Acquisition were not conditional upon the Proposed Islamic Bank Merger and vice versa, or any other transaction or proposal involving the Negotiating Parties. The Negotiating Parties were looking forward to sign a definitive sale and purchase agreement in early 2015 and the Proposed Merger was expected to be completed in the middle of 2015.

Had the Proposed Merger been successful, CIMB's shareholders would have ended up with approximately 70.0% stake in the country's largest banking group that would have been created following the Proposed Merger. RHB Capital's shareholders would have owned the remaining 30.0%.[2]

It should be noted that although RHB Capital appeared to be the acquirer and eventual listing entity, CIMB was deemed the acquirer from the accounting perspective as it is the larger entity. The Board and management of CIMB would be running the Mega Bank.[3] It was also expected that the merged CIMB Group and RHB Group would retain a controlling interest, which is about 51.0% to 60.0% equity interest, in the Mega Islamic Bank following a subsequent capital-raising exercise to boost the latter's capital base for future growth.[4]

EPF is deemed an interested party in the Proposed Merger pursuant to the Listing Requirements as it is a substantial shareholder of the respective Negotiating Parties. Therefore, EPF is required to abstain from voting at shareholders' meetings related to the Proposed Merger. RHB Capital and MBSB, on behalf of EPF, applied to Bursa Securities for a waiver from complying with the related party transaction requirements in the Listing Requirements.

[2] The Edge, 10 October 2014. *CIMB's shareholders to hold 70% stake in enlarged banking group*
[3] The Star, 11 October 2014. *Mega bank merger deal re-drawn to ensure easier passage, say sources*
[4] The Edge, 30 October 2014. *No change in CIMB-RHB-MBSB merger views*

On 21 October 2014, RHB Investment Bank Berhad and AmInvestment Bank Berhad announced, on behalf of RHB Capital and MBSB respectively that Bursa Securities had rejected the application for a waiver from complying with the related party transaction requirements in respect of the rights of EPF as a shareholder to vote on the relevant resolution(s) pertaining to the Proposed Merger.

On 13 January 2015, in response to an article published in The Edge Financial Daily regarding the status of the Proposed Merger, MBSB and RHB Capital clarified that the Negotiating Parties to the Proposed Merger were still in discussions.

However, on 14 January 2015, CIMB announced that after further deliberation, the Board of CIMB had arrived at a decision to abort the Proposed Merger in light of the prevailing economic conditions.

CIMB had also notified RHB Capital and MBSB respectively via letters dated 14 January 2015. Following this announcement to abort the Proposed Merger, CIMB Group and RHB Group then withdrew their joint applications made to BNM and the Ministry of Finance Malaysia on the Proposed Merger.

(Source: Announcements on Bursa Securities' website)

2. Motivations for the Proposed Merger

(i) To create the largest bank in Malaysia

We believe that the main catalyst for the Proposed Merger would be to combine the strengths of CIMB Group and RHB Group to make the merged bank as the largest bank in Malaysia. The Proposed Merger is motivated by the need for consolidation of local banks, in anticipation of the eventual liberalisation of the banking sector in the ASEAN countries as a response to the Financial Sector Blueprint of the ASEAN Economic Community. The consolidation of the local banking sector will place local banks in a stronger position to compete with the foreign banks operating in the region, particularly in the face of the full liberalisation of the ASEAN banking sector, expected to happen in 2020.[5] By creating a bigger number of large local banking institutions through merger and consolidation of several local banks, it may deter the foreign banks from acquiring the larger domestic banks as it would cost more to do so given the size of the domestic banks after the said merger and consolidation.

Had the Proposed Merger been successful, the Mega Bank would have ended up to be the fourth largest bank in ASEAN, after DBS Group Holdings Ltd, Oversea-Chinese Banking Corp. Ltd and United Overseas Bank Ltd. The table below illustrates the four (4) biggest banks in ASEAN in terms of total assets compared to the estimated total assets of the Mega Bank as at 31 December 2014:

	Total Assets (RM'000)
DBS Group Holdings Ltd	1,166,486,969(1)
Oversea-Chinese Banking Corp. Ltd	1,062,085,403(1)
United Overseas Bank Ltd	811,961,244(1)
Mega Bank	**671,176,695**
Malayan Banking Berhad ("**Maybank**")	640,299,956

Note:

(1) Based on exchange rate of approximately SGD1.00:RM2.65 as at 31 December 2014 (Source: Annual report 2014 of respective companies)

[5] The Sundaily, 21 October 2014. *New round of local banking consolidation?*

As at 31 December 2014, there were a total of eight (8) full-fledged local banks, excluding Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad ("**Bank Muamalat**"), and 22 foreign banks operating in Malaysia as listed in the table below:

Local banks	Foreign banks
1. Affin Bank Berhad	1. BNP Paribas Malaysia Berhad
2. Alliance Bank Malaysia Berhad	2. Bangkok Bank Berhad
3. AmBank (M) Berhad	3. Bank of America Malaysia Berhad
4. CIMB Bank(1)	4. Bank of China (Malaysia) Berhad
5. Hong Leong Bank Berhad ("**Hong Leong Bank**")	5. Bank of Tokyo-Mitsubishi UFJ (Malaysia) Berhad
6. Maybank	6. Citibank Berhad
7. Public Bank Berhad ("**Public Bank**")	7. Deutsche Bank (Malaysia) Berhad
8. RHB Bank(2)	8. HSBC Bank Malaysia Berhad
	9. India International Bank (Malaysia) Berhad
	10. Industrial and Commercial Bank of China (Malaysia) Berhad
	11. J.P. Morgan Chase Bank Berhad
	12. Mizuho Bank (Malaysia) Berhad
	13. National Bank of Abu Dhabi Malaysia Berhad
	14. OCBC Bank (Malaysia) Berhad
	15. Standard Chartered Bank Malaysia Berhad
	16. Sumitomo Mitsui Banking Corporation Malaysia Berhad
	17. The Bank of Nova Scotia Berhad
	18. The Royal Bank of Scotland Berhad
	19. United Overseas Bank (Malaysia) Berhad
	20. Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
	21. Asian Finance Bank Berhad
	22. Kuwait Finance House (Malaysia) Berhad

Notes:

(1) CIMB Bank is a wholly owned subsidiary of CIMB

(2) RHB Bank is a wholly owned subsidiary of RHB Capital

(Source: BNM's website)

The CIMB Group has a track record in acquiring, integrating, and extracting value from its past acquisitions. Thus, it is expected that the CIMB Group can draw on its experience to successfully rationalise and integrate the Proposed Merger. Mergers and acquisitions experienced by CIMB Group are as follows:

(i) the merger between CIMB Bank with Bumiputra-Commerce Bank in 2005;

(ii) the merger with Southern Bank Berhad in 2006;

(iii) the acquisition of Indonesia's PT Bank Niaga Tbk (later known as PT Bank CIMB Niaga Tbk ("**CIMB Niaga**") in 2002;

(iv) the acquisition of Singapore's stock brokerage G.K. Goh Holdings Limited in 2005;

(v) the merger between CIMB Niaga with PT Bank Lippo Tbk in 2008;

(vi) the acquisition of Bank Thai Public Co Ltd in 2009; and

(vii) the acquisition of part of the Royal Bank of Scotland Group Plc's ("**RBS**") Asia-Pacific investment banking business.

RHB Group is currently the fourth largest banking group in Malaysia. In 1993, Tan Sri Abdul Rashid Hussain secured a broker's licence and set up Rashid Hussain Securities Sdn Bhd. In 1996, Tan Sri Abdul Rashid Hussain acquired 75.0% stake in Kwong Yik Bank Berhad. Kwong Yik Bank Berhad and DCB Bank Berhad were then merged and formed RHB Bank with Tan Sri Abdul Rashid Hussain as its Executive Chairman and a substantial shareholder. In the aftermath of the 1997/1998 Asian financial crisis, Sime Bank Berhad (formerly known as UMBC Bank) had merged with RHB Bank and formed RHB Group in 1999. In 2003, Kuching-based Bank Utama (Malaysia) Berhad, the banking arm of Cahya Mata Sarawak Berhad, merged into the RHB Group. RHB Group received a banking licence for RHB Islamic in 2005. In 2012, the RHB Group acquired OSK Investment Bank Berhad. Both RHB Group and CIMB Group have gone through several merger and acquisition exercises.[6]

MBSB was incorporated in 1950 as a property financier under the name Federal and Colonial Building Society Limited. In 1956, it changed its name to Malaya Borneo Building Society Limited, with the Malaysian Government as its major shareholder. Malaya Borneo Building Society Limited was then listed on the Stock Exchange of Malaya and Singapore in August 1963. MBSB became a company incorporated in Malaysia under the Act on 17 March 1970 and later on listed on Kuala Lumpur Stock Exchange (now known as Bursa Securities) on 14 March 1972.[7]

Unlike CIMB Bank or RHB Bank, MBSB is not a banking institution. MBSB is categorised as a Scheduled Institution under the repealed Banking and Financial Institution Act 1989 ("**BAFIA**"). The status of an Exempt Finance Company was granted to MBSB by the Ministry of Finance, which allows MBSB to undertake a financing business without a banking licence. The BAFIA has been repealed and replaced with the Financial Services Act 2013 ("**FSA**"). The exemptions granted under the BAFIA are deemed to have been granted under the corresponding provision of the

[6] The Star, 12 July 2014. *Story behind CIMB merger plan*
[7] MBSB annual report 2014

FSA and shall remain in full force and effect until amended or revoked. As an Exempt Finance Company, the MBSB Group offers a spectrum of innovative financial products and services for both individual and corporate customers throughout its branch network nationwide.[8]

(ii) To strengthen capital and liquidity base

The second motivation is to strengthen the capital and liquidity base of the merged bank in the light of higher capital requirements under the capital framework of Basel III (as defined below) and in the face of increasing competition from regional banks.

In December 2010, the Basel Committee on Banking Supervision has detailed out measures to strengthen global capital and liquidity rules with the goal of strengthening the resilience of the global banking system in the documents Basel III: A global regulatory framework for more resilient banks and banking systems and Basel III: International framework for liquidity risk measurement, standards and monitoring (collectively referred to as **Basel III**).

The Basel III accords are set to be fully implemented in Malaysia by 2019. The financial holdings companies, which recently come under the scrutiny of the BNM by virtue of the FSA, must now also comply with the Basel III requirements that are already imposed on the banks. The EPF is also classified as a financial holdings company due to its shareholdings in MBSB.

We summarise below the Basel III requirements and compare with the current compliance by the local banking institutions as at 30 June 2014:

	Common Equity Tier 1 ("CET 1") %	**Tier 1 capital %**	**Total capital %**
Basel III requirements	**7%**	**8.5%**	**10.5%**
CIMB Group	10.98	12.54	14.70
RHB Group	11.08	11.54	13.59
Maybank	11.64	13.19	16.16
Public Bank	9.33	10.85	14.24
Hong Leong Bank	10.90	12.31	15.07
AMMB Holdings Berhad ("**AMMB Holdings**")	10.37	11.84	16.23

[8] *Ditto*

	Common Equity Tier 1 ("CET 1") %	**Tier 1 capital %**	**Total capital %**
Affin Holdings Berhad ("**Affin Holdings**")	11.84	11.84	12.68
Alliance Financial Group Berhad ("**Alliance Financial**")	10.05	11.06	13.21

(Source: BNM's website and annual reports of the respective companies)

Malaysian banking institutions are generally well capitalised to comply with the capital requirement of Basel III. From the table above, CIMB Group, RHB Group, AMMB Holdings and Affin Holdings and Alliance Financial are considered financial holdings companies. Public Bank and Hong Leong Bank have in December 2014 and August 2015 raised funds via rights issue to further strengthen their capital base. RHB Capital, after the call off of the Proposed Merger, has announced its intention to carry out a rights issue in April 2015 to raise funds in order to strengthen its capital position. Alliance Bank Malaysia Berhad is also undertaking fund-raising exercise in September 2015 via the issuance of bond.

However, starting from 1 June 2015, local banking institutions in Malaysia are required to maintain a minimum liquidity coverage ratio ("**LCR**") of 60% and this ratio requirement will be stepped up gradually to 100% by 1 January 2019. LCR is an indication of whether a banking institution is able to withstand an acute liquidity stress scenario over a 30-day timeframe and is computed by dividing its high-quality liquid assets by its net cash out flow. This requirement requires the banking institutions to increase their retail deposits.

On the other hand, deposits of Malaysian banking system have only grown 8.4% in 2012, 8.3% in 2013 and 7.3% in 2014, in contrast with the growth in loans of 10.4%, 10.6% and 9.3% over the same period.[9] This trend would pose a challenge to the Malaysian banks to secure sufficient retail deposits in order to comply with and maintain the minimum LCR. This will also create a competition among the local banks to reach out for more customers and to provide attractive promotions to attract more deposits.

"*We think that the new guidelines will pose long-term problems for banks. Even if they can achieve the minimum requirements, banks will have to compete on deposits to keep their ratios above these levels,*" opined an analyst.[10]

[9] BNM annual report 2014

[10] The Star, 6 April 2015. *Higher liquidity coverage ratio for Malaysian banks*

The Proposed Merger was expected to strengthen the fundamentals of the Negotiating Parties in order to comply with the Basel III requirements. The Mega Bank was also expected to have a wider reach to the customers and would be able to attract more retail deposits through the networks of branches and enhanced information technology platform.

In the press announcement, dated 10 July 2014, in relation to the exploring of the Proposed Merger, Dato' Sri Nazir Razak had stated his view that "*There is a prima facie case for a value-creating merger between the Negotiating Parties and we want to get into detailed discussion to validate it*."

"*This exercise will cement CIMB Group's position amongst the top banks in ASEAN and bring a host of value creation opportunities to our stakeholders*" he said in a CIMB Group's press announcement dated 9 October 2014. "*This merger is a natural step in our growth story, enabling us to become a regional financial powerhouse via Mega Bank*," stated Kellee Kam, then RHB Group Managing Director in the same press announcement.

(iii) To create a mega Islamic bank

The third motivation for the Proposed Merger, in our view, is to create a mega Islamic bank in Malaysia. The idea of a mega Islamic bank with a capitalisation of USD1.0 billion was first mooted by the BNM Governor, Tan Sri Dr Zeti Akhtar Aziz more than five (5) years ago in order for the Malaysian Islamic banks to better compete for business in the Gulf Corporation Council countries and to enhance Malaysia's position as an Islamic Financial Centre.[11]

Malaysia is by far the largest Islamic Financial Centre in Asia, due to its majority Muslim population, its strong financial and political links with the Middle East as well as a well-developed market for Islamic banking and financial services. In the first half of 2014, Malaysian Islamic banking institutions issued a total of RM3.3 billion of RM denominated sukuk, which is by far the largest in any year so far.[12] In June 2014, CIMB Group together with HSBC Bank Plc as the joint lead managers helped arranged a five (5)-year £200.0 million sukuk for the British Government, which was the first Islamic bond issued by a Western sovereign.[13]

Indirectly, CIMB Group's involvement in the sukuk issuance had mooted the idea of Dato' Sri Nazir Razak, the Chairman of CIMB Group, of establishing a mega Islamic bank as part of the Proposed Merger. Hence, CIMB Group proposed the formation of

[11] The Edge, 14 January 2015. *Malaysia megabank dream fades as merger stalls*
[12] Financial Times, 11 July 2014. *Malaysia banks in mega-merger talks*
[13] Reuters, 13 June 2014. *UK mandates banks for maiden sovereign sukuk 'in coming weeks'*

a mega Islamic bank by way of the consolidation of the Islamic banking businesses of CIMB Islamic and RHB Islamic and the merger with the MBSB Group. The Proposed Merger was intended to create the largest bank in the country and one of the largest banks in the region. The Proposed Islamic Bank Merger, which was an integrated part of the Proposed Merger, would also fulfil BNM's objective of creating a mega Islamic bank.[14]

The total assets of the Mega Islamic Bank are estimated to be worth RM122.0 billion. This compares well with the total assets of Maybank Islamic Berhad as at 31 March 2014 of RM126.5 billion.[15]

The global Islamic finance industry has been in an upward trajectory, evidenced by its assets' double-digit compound annual growth rate of 17.0% between 2009 and 2013. The industry's assets are estimated to be worth USD1.87 trillion as at the first half of 2014, having grown from USD1.79 trillion as at 31 December 2013. Of these total assets, Asia represented a 22.4% share in the global total, largely spearheaded by the Malaysian Islamic finance marketplace. In Malaysia, Islamic banking assets as a proportion of total banking assets represent 21.9% of the domestic banking sector while accounting for 9.6% of the global Islamic banking assets.[16]

The Proposed Islamic Bank Merger was also in line with the recommendation of BNM in its Financial Sector Blueprint to continue to enhance financial linkages between different jurisdictions by undertaking efforts, amongst others, to:

(a) Encourage greater participation by Islamic banking institutions in offering trade finance facilities to expand cross-border Islamic financial transactions;

(b) Encourage Islamic financial institutions to increase international correspondent banking arrangements to facilitate capital flows in multi-currencies, and better support economic and financial integration in the region; and

(c) Support and encourage a regional presence of strong Islamic financial institutions offering basic Islamic financial needs in retail financing and takaful. [17]

The Proposed Islamic Bank Merger, had it been successful, was also intended to provide a catalyst for other Malaysian Islamic banks to expand their offerings in Islamic finance and to position Islamic banking as an alternative to conventional banking.

[14] The Star, 12 July 2014. *Story behind CIMB merger plan*
[15] The Edge, 1 October 2014. *Structure of three-way bank merger not finalized, says Zafrul*
[16] The Islamic Financial Services Board's Islamic Financial Services Industry Stability Report 2015.
[17] BNM, Financial Sector Blueprint 2011-2020

Questions:

1. *What are the challenges for smaller local banks to compete with the larger banks in Malaysia and grow organically?*
2. *What are the barriers for the existing Islamic banks to scale up to achieve the status of a Mega Islamic Bank?*

3. How would other banks be affected if the Proposed Merger had gone through?

The Malaysian banking industry has undergone a major transformation since the Asian financial crisis in 1997/1998. There had been an industry wide consolidation via mergers and acquisitions, encouraged by the Malaysian Government since 1999, where some 23 local banks were then consolidated and eventually reduced to eight (8).

There are expectations that the Proposed Merger, if successfully effected, would spark off another round of merger and acquisition in the local banking industry. This time around, the consolidation exercise would be driven more voluntarily by business objectives than by way of government directive. Among the banks which are speculated to be interested in the next round of merger and consolidation are AmBank (M) Berhad, Affin Bank Berhad and Alliance Bank Malaysia Berhad.[18] Any new bank merger in the future would be motivated by the overall objective of BNM's Financial Sector Blueprint to build larger and more efficient Malaysian financial institutions, better capable of competing in the wider region.[19]

The Mega Bank, if successfully effected, would have surpassed Maybank as Malaysia's biggest bank in Malaysia in terms of assets. Therefore, the Mega Bank is expected to attract more customers as people prefer banks with bigger capital base and stronger balance sheets. This will result in healthy competition between local banking groups and foreign banking groups in Malaysia to compete for customers' deposit and business.

The table below gives a comparison of the unaudited financial positions as at 30 June 2014 between the Negotiating Parties and other local banking groups in terms of total assets, total equity and deposit from customers:

	Total assets RM' 000	**Total equity RM' 000**	**Deposit from customers RM' 000**
CIMB Group	386,535,090	36,625,463	268,593,251
RHB Group	205,523,283	17,956,698	149,571,231
MBSB Group	36,886,450	4,029,619	29,372,849
Maybank	583,924,505	50,686,654	406,529,429
Public Bank	323,656,667	22,203,722	264,536,713
Hong Leong Bank	170,350,803	14,530,178	130,252,337
AMMB Holdings	124,657,441	14,827,169	86,937,330
Affin Holdings	63,645,166	6,686,871	47,314,654
Alliance Financial	50,133,414	4,147,764	39,614,072

(Source: Quarterly financial reports of the respective companies on Bursa Securities' website)

[18] The Edge, 25 November 2014. *Fewer banks, fewer choices*

[19] The Edge, 14 October 2014. *Fitch: MBSB will result in asset quality weakness in merged mega bank*

While some analysts speculate that there would be more bank mergers in Malaysia, other analysts feel that it is unlikely that another merger and acquisition exercise will happen in the Malaysian banking industry in the near future due to the fact that Malaysian banks are generally expensive and potential acquirers may need to pay a high premium which may not be commercially justifiable.[20]

It was speculated that Maybank may seek merger and acquisition as a strategy to stay ahead of the banking industry in Malaysia. However, Maybank Group CEO, Datuk Abdul Farid Alias has stated that the current size of Maybank is sufficient to serve its Malaysian customers [21] while Maybank's Chairman, Tan Sri Megat Zaharuddin Bin Megat Nor, commented that Maybank would pursue merger and acquisition opportunities if it will add value to the shareholders.

On the possible impact on the smaller banks, Deputy Chairman of Affin Holdings believes that the Proposed Merger is not expected to have an impact on Affin Holdings and that Malaysia still needs small banks like Affin Holdings to serve niche markets.[22]

Question:

If the Proposed Merger had been successful, how would the other banks in Malaysia compete with the Mega Bank?

[20] The Edge Markets, 19 January 2015. *Aborted deal a setback for Ong?*
[21] The Edge, 28 August 2014. *Maybank will not acquire another bank just to have biggest size assets says CEO*
[22] The Edge, 20 October 2014. *Small banks still needed*

4. Potential synergies expected from the Proposed Merger

The five (5) reasons for the Proposed Merger as highlighted by Dato' Sri Nazir Razak are:

(i) To achieve necessary scale to compete in the ASEAN community space and to position the Mega Bank in the top five (5) within the region;

(ii) To achieve economies of scale with synergistic benefits;

(iii) The deal is earnings accretive though return on equity was expected to be dilutive in the near term;

(iv) Opportunity for the merged entities to rebalance its geographical portfolio and to tap on each entity's core strengths; and

(v) To create a new growth engine in Islamic finance.

Generally, analysts have envisaged that the Negotiating Parties would gain potential long term synergies from the Proposed Merger, amongst others, economies of scale, new business development via the Mega Islamic Bank and expanded regional presence.

(i) Larger bank

The Proposed Merger would encourage further consolidation in the banking industry in Malaysia, which may in turn reduce the stiff competition among Malaysian banks and this should improve banks' margins. The Mega Bank was expected to enjoy a larger and diversified base for funding and liquidity. A larger entity would also provide advantages against the increasing competition in terms of capital investments to improve its performance. These investments may include continuous development of information technologies to offer more products and to reach a wider range of customers.

Moody's Investors Service, Inc. expected that the RHB Group would derive a larger, more diversified and stronger financial group from the Proposed Merger. It would benefit from CIMB Group's stronger standalone credit metrics and the support from the financially strong Mega Bank.[23]

As part of the Mega Islamic Bank, MBSB may be able to obtain borrowing funds with lower cost with greater access to funding. It might also benefit from the Proposed

[23] The Edge, 14 October 2014. *Mega bank merger credit negative for CIMB Islamic Bank*

Merger as it would be able to access the retail deposit base of banks which will in turn lower its costs of funding for its lending activities.

The Mega Bank was also expected to benefit from a higher level of support from the Malaysian Government because as the country's largest financial group it would become more systemically important.[24]

Furthermore, the Proposed Merger was expected to strengthen the investment banking business of both CIMB Group and RHB Group as they are able to share their resources, expertise, presence and strength in different markets.

(ii) Cost synergies

It was envisioned by analysts that the potential synergies are 86.0% from cost and 14.0% from revenue as reported in the media.[25]

Generally, mergers and acquisitions benefit the merged entities as a result of increasing economies of scale and reduction in its operating costs.

The Mega Bank was expected to be in a position to share some of their supporting services, which would eventually lower the operating cost. In addition, cost rationalisation could also be undertaken at the merged bank.

It was also reported that some of the excess costs and branches of the Mega Bank could be transferred to the Mega Islamic Bank.[26] As noted by a banking analyst, it is understood that some legacy RHB Group and CIMB Group staff will be moved to the Mega Islamic Bank.

CIMB has the highest cost-to-income ratio among the local banks in Malaysia. As at 30 June 2014, the cost-to-income ratio of CIMB Group stood at 57.9%, while the cost-to-income ratio of RHB Group and MBSB Group stood at 54.4% and 20.3% respectively. The Proposed Merger was expected to improve the cost-to-income ratio as a result of cost rationalisation and synergies from operating efficiency. Below are the cost-to-income ratios for the Negotiating Parties, Maybank and Public Bank for FYE 31 December 2013 and FPE 30 June 2014:

[24] The Edge, 13 October 2014. *Moody's: Mega bank merger credit negative for CIMB Islamic Bank*
[25] The Sun Daily, 13 October 2014. *Analysts are neutral on three way merger of RHB-CIMB-MBSB*
[26] The Edge, 30 October 2014. *No change in CIMB-RHB-MBSB merger views*

	FYE 31 December 2013 %	FPE 30 June 2014 %
CIMB Group	57.7	57.9
RHB Group	51.3	54.4
MBSB Group	19.6	20.3
Maybank	48.2	47.7
Public Bank	30.7	31.8

(iii) Revenue synergies

The management of the banks to be merged saw synergistic benefits from the retail, Small and Medium Enterprise ("**SME**") banking and the regional operations.[27] The revenue synergies may come from an expanded network which will enable wider reach to customers and create opportunities for cross selling to different clientele base of the Negotiating Parties, which they were unable to do as individual banks.

Tengku Dato' Zafrul Tengku Abdul Aziz, the then Acting Group CEO of CIMB pointed out that they will be able to tap into an expanded pool of clients across the spectrum spanning retail, SMEs, corporate and governments, which means being able to leverage on a deeper network for referrals and connections.[28]

(iv) Expansion in regional development

ASEAN, with a combined population of about 650.0 million, is a lucrative market for the banking industry. This is supported by robust domestic economies, relatively high savings rates and the emergence of regional companies.

By combining the strengths of the Negotiating Parties, the Mega Bank was envisaged to have the potential to achieve more both domestically and in the regional markets in order to archive the vision of CIMB Group and the aspiration of RHB Group which are "to be the leading ASEAN company"[29] and "to be a leading multinational financial services group"[30] respectively.

The Mega Bank can expand its network through the strengths of one another which will enable a wider reach to customers locally and abroad. CIMB Group and RHB Group are formidable banking entities in their own rights. CIMB Group has more

[27] The Star, 11 October 2014. *Mega bank merger deal re-drawn to ensure easier passage, say sources*
[28] The Edge, 10 October 2014. *CIMB's shareholders to hold 70% stake in enlarged banking group*
[29] CIMB annual report 2014
[30] RHB Capital annual report 2014

than 1,000 retail branches in 17 countries with over 40,000 employees while RHB Group has 800 branches and 18,000 staff around the region. The MBSB Group has more than 40 branches in Malaysia.[31]

CIMB Group has a strong commercial presence in Indonesia via CIMB Niaga while RHB Group has a full banking licence in Singapore, which enables it to venture into consumer banking, business banking, corporate banking, treasury and investment banking.[32] RHB Group has planned to penetrate into Indonesian market, as evidenced by its negotiation with PT Bank Mestika Dharma Tbk which was eventually ceased as per announcement in Bursa Securities' website on 30 June 2014. Had the Proposed Merger been successful, the RHB Group would have been able to gain access to the commercial banking business in Indonesia via CIMB Niaga.

The Proposed Merger was expected to provide an opportunity for the Negotiating Parties to reinforce their domestic banking franchises and expand their platforms across Asia to become a leading regional player. The Mega Bank would emerge as the largest banking group in Malaysia as measured by assets. It would also become a regional Islamic and investment banking player capable of, amongst other services, facilitating the rapidly expanding cross-border activities of Malaysian business enterprises.

According to an analyst, on proforma basis, the Mega Bank will raise the contribution from the Malaysian and Singapore operations from 68.0% under CIMB Group to 79.0% while its profit before tax from Malaysia and Singapore will be raised from 71.0% to 83.0%.[33] However, combining these two (2) large entities might see an overlap in the wholesale banking business and higher cost-to-income ratio as a result of sticky costs due to the enlarged workforce and duplication in operations.

(v) New business opportunities via the Mega Islamic Bank

The Proposed Islamic Bank Merger would create one of the largest Islamic banks in Malaysia. The Mega Islamic Bank would be a lender with the financial clout to win bigger sukuk deals against the other banks such as HSBC Holdings Plc and Standard Chartered Plc.[34] As highlighted by Dato' Ahmad Zaini Othman, the President and CEO of MBSB that the Proposed Islamic Bank Merger would be an opportunity for MBSB to benefit from the prominent value and strength of the MBSB Group. The Proposed Islamic Bank Merger would also strengthen the positioning of Malaysia as an Islamic financial hub and with the regional presence of the CIMB Group and RHB

[31] The Wall Street Journal, 9 October 2014. *Three Malaysian banks to merge to form country's largest lender*
[32] The Star, 12 July 2014. *Story behind CIMB merger plan*
[33] The Star, 11 October 2014. *Mega bank merger deal re-drawn to ensure easier passage, say sources*
[34] The Edge, 14 January 2015. *Malaysia megabank dream fades as merger stalls*

Group, this could raise the international prospects of Malaysia's Islamic finance further.

The Proposed Islamic Bank Merger will create the Mega Islamic Bank that would start off on a hybrid business model but may eventually run as a standalone bank to garner wider international appeal. A hybrid model means it will leverage its conventional banking parent's branches, which most domestic Islamic lenders currently do such as CIMB Islamic and RHB Islamic. However, to achieve this standalone basis, it will take 12 to 16 months.

The Islamic finance industry will pay much attention on the type of business model the Mega Islamic Bank will eventually employ. The Islamic finance industry had long debated about the standalone versus the leverage banking model, with the true player of Islamic banking taking the view that the leverage model is not truly Islamic given that it leverages on the conventional bank's infrastructure and resources. [35]

A banking analyst suggested that the Mega Islamic Bank that would be created from the Proposed Islamic Bank Merger was expected to be more innovative in terms of business and product offerings. Therefore, the Mega Islamic Bank may as well expand further and penetrate the USA and European countries.[36]

Question:

Considering that the cost-to-income ratio of both CIMB Group and RHB Group are higher compared to the other domestic banks such as Maybank and Public Bank, do you think the expected cost synergies from the Proposed Merger could be realistically achieved?

[35] The Edge, 25 November 2014. *Mega Islamic bank to start on hybrid model*
[36] *Ditto*

5. The role of EPF in the Proposed Merger

EPF's decision was very crucial in determining whether the Proposed Merger would be approved by the shareholders of the Negotiating Parties. In the event that EPF was allowed to vote, it would most likely vote for the Proposed Merger and with its weight of shareholdings in the Negotiating Parties, the Proposed Merger should result in a favourable outcome in the extraordinary general meetings of shareholders. However, in the event that EPF was required to abstain from voting, the Negotiating Parties might have difficulties in obtaining the required approval from the shareholders for the Proposed Merger. This was especially the case from RHB Capital's perspective, given that Aabar Investments PJS ("**Aabar Investments**"), the 21.4% foreign shareholder of RHB Capital, has reportedly indicated that they would not support the Proposed Merger.

The EPF is a social security pension institution formed under the Employees Provident Fund Act 1991 (Act 452) which provides retirement benefits for members through management of their savings in an efficient, prudent and reliable manner. The EPF also provides a convenient framework for employers to meet their statutory contributions and moral obligations to their employees.[37] The CEO of EPF, Datuk Shahril Ridza Ridzuan had said in December 2014 that EPF had approximate 14.0 million contributors. It was reported that the EPF's equity investments constituted approximately 43.0% of its asset classes in 2013. EPF's presence in the domestic stock market is dominantly felt based on its significant shareholdings in almost all listed blue-chip companies.[38]

The substantial shareholders of CIMB as at 14 February 2014 were as follows:

	No. of CIMB Share			
	Direct	%	Indirect	%
Khazanah Nasional Berhad	2,329,803,754	28.3	-	-
EPF (1)	1,390,583,615	16.9	-	-
Mitsubishi Financial Group Inc (2)	-	-	753,166,054	9.2

Notes:

(1) Include shares through nominees

(2) Deemed interested by virtue of Section 6A(4) of the Companies Act, 1965

(Source: CIMB annual report 2013)

[37] EPF website

[38] The Edge, 23 December, 2014. *Bursa postpones deliberation of EPF appeal*

The substantial shareholders of RHB Capital as at 3 March 2014 are as follows:

	No. of RHB Capital Share			
	Direct	**%**	**Indirect**	**%**
EPF	1,052,922,512	41.3	-	-
Aabar Investments	545,787,168	21.4	-	-
International Petroleum Investment Company PJSC (1)	-	-	545,787,168	21.4
OSK Holdings Berhad ("**OSK**")	252,304,688	9.9		
Tan Sri Ong Leong Huat @ Wong Joo Hwa (2)	-	-	252,304,688	9.9
OSK Equity Holdings Sdn Bhd (3)	-	-	252,304,688	9.9

Notes:

(1) Deemed interested pursuant to Section 6A(4)(c) of the Act, through control of its subsidiary, Aabar Investments

(2) Deemed interested pursuant to Section 6A of the Act, by virtue of his substantial shareholdings in OSK

(3) Deemed interested pursuant to Section 6A of the Act, by virtue of its substantial shareholdings in OSK

(Source: RHB Capital annual report 2013)

The substantial shareholders of MBSB as at 28 February 2014 are as follows:

	No. of MBSB Share			
	Direct	**%**	**Indirect**	**%**
EPF	1,697,126,483	64.7	-	-

(Source: MBSB annual report 2013)

Being a substantial shareholder of CIMB and major shareholder of RHB Capital and MBSB, EPF's intention towards the Proposed Merger and its voting in the EGM of the Negotiating Parties would be the determining factor whether or not the Proposed Merger will be passed through in the respective shareholders' meetings. Under the Bursa Securities' Listing Requirements, EPF, being an interested party in the Proposed Merger, was not permitted to vote in the shareholders' meetings to consider the Proposed Merger. However, it was understood that EPF wanted to vote only in shareholders meetings of RHB Capital and MBSB as only RHB Capital and MBSB had submitted application to Bursa Securities, requesting for waiver from the listing rules to allow EPF to vote in the Proposed Merger.

The relevant rules governing related party transactions in the Listing Requirements and the Act, which disallow EPF to vote, will be discussed in more detail in Section 7.

(i) Assuming that EPF was allowed to vote

Based on the shareholding structure of the Proposed Merger, EPF would end up holding approximately 22.6% equity interest in the Mega Bank. Given the expected synergies as discussed in the previous section, as an investor who continuously seeks for attractive returns for its contributors, it would make sense for EPF to vote in favour of the Proposed Merger.

(a) MBSB

MBSB, which would undertake a major disposal under the Proposed Merger exercise, would require at least 75.0% approval from its shareholders before the disposal can be effected. Being the controlling shareholder in MBSB, holding 64.7% of the equity interest in MBSB, EPF was considered the decision maker in the Proposed Islamic Bank Merger.

(b) RHB Capital

On the other hand, RHB Capital, as the acquirer of CIMB Group, would require 50.0%+1 of its shareholders' votes to seal the Proposed Merger. As a very substantial shareholder of 41.3% equity interest in RHB Capital, EPF's vote would be critical if the Proposed Merger and the Proposed Islamic Bank Merger were to proceed.

Had the Proposed Merger and the Proposed Islamic Bank Merger been successful, EPF would have ended up as the largest shareholder in the Mega Bank, ultimately holding about 22.6% of the Mega Bank.

(ii) Assuming that EPF was required to abstain from voting

Under the Listing Requirements, EPF was considered a related party in the Proposed Merger and was therefore required to abstain from voting for the Proposed Merger. The outcome of the shareholders' general meetings of the respective companies could be different from what the EPF had hoped for if EPF had to abstain from voting.

(a) MBSB

From MBSB's perspective, the decision would very much rely on the approval of the minority shareholders. It was expected that the minority shareholders may vote for the disposal of Assets and Liabilities of MBSB in view of the attractive valuation[39] and expected shareholders' value enhancement in the Proposed

[39] The Edge, 14 November 2014. *Bursa listing committee to discuss EPF vote on Oct 21*

Islamic Bank Merger. MBSB was valued at a premium of 20.5% over its share price traded on 9 July 2014 of RM2.34.

(b) RHB Capital

In RHB Capital, Aabar Investments, which owned a 21.4% stake in RHB Capital prior to the announcement of Proposed Merger, is the second largest shareholder of RHB Capital after EPF. If EPF was required to abstain from voting, Aabar Investments would hold 36.5% voting power in the shareholders' meeting. Aabar Investments' support is therefore crucial for the Proposed Merger to go through.

In 2011, Aabar Investments acquired the 24.9% equity stake in RHB Capital at RM10.80 per share from its sister company, Abu Dhabi Commercial Bank PJSC. RHB Capital Share's price had yet to trade above RM10.00 since then. In the Proposed Merger, RHB Capital Share was valued at RM10.03 per share which was below Aabar Investments' cost and this might not be good enough for Aabar Investments to support the Proposed Merger. It is noted that up to 23 July 2014, Aabar Investments had received an accumulated dividend of approximately RM0.64 per RHB Capital Share since its acquisition in 2011. It was reported that Aabar Investments wanted RHB Capital Share to be valued at between RM11.00 to RM12.00 per RHB Capital Share.[40]

Furthermore, Aabar Investments' shareholding would be very much diluted from 21.4% in RHB Capital as at 31 December 2014 to approximately 6.4% in the Mega Bank after the acquisition of Assets and Liabilities of CIMB via the issuance of new RHB Capital Shares upon the completion of the Proposed Merger.

Given these reasons, there was a genuine concern that Aabar Investments might not vote in favour for the acquisition of Assets and Liabilities of CIMB by RHB Capital. CIMB and RHB Capital would have to convince Aabar Investments on the merits and expected synergies from the Proposed Merger.

It was reported that Maybank had in 2011 competed with CIMB to merge with RHB Capital. However, both proposals did not materialise due to the high valuation then which was triggered by the deal involving the RHB Capital Shares transferred by Abu Dhabi Commercial Bank PJSC to Aabar Investments.

[40] The Edge, 24 October 2014. *Abu Dhabi state fund for more in $22 billion Malaysia banking deal*

The offer made by Aabar Investments, which valued RHB Capital at the PB of 2.25 times, was above the industry average of 2.20 times at that time.[41]

In respect of the Proposed Merger, another substantial shareholder of RHB Capital, OSK, which held 9.9% stake, would also be an important voter since it was the second biggest shareholder in RHB Capital permitted to vote should EPF be required to abstain from voting. OSK's cost of investment in RHB Capital was RM7.36 per share based on the disposal consideration when OSK disposed of its investment banking business to RHB Group in 2012. With the Proposed Merger, OSK would have the options to cash out from RHB Capital once the Proposed Merger is completed or hold to its shares in the Mega Bank which should trade at a better valuation after the Proposed Merger. After the Proposed Merger is completed, OSK's shareholding in the Mega Bank would have been diluted to approximately 3.0%. It would be much easier for OSK to sell all or part of its investments at a desirable market price given that the Mega Bank, being the largest Malaysian bank and its shares more liquid after the merger, should trade at a better valuation.

Given this scenario, although there was a possibility that the Proposed Merger might pass through even if Aabar Investments were to vote against it, it would have been more challenging for RHB Capital to gain the required approval level of at least 50.0% from OSK and the other minority shareholders. A banking analyst had said that if the management of RHB Capital can present the case for merger synergies well enough and able to show the value enhancement of the Proposed Merger, the majority of the shareholders might have approved it.[42]

On 20 November 2014, it was reported that Aabar Investments might now support the Proposed Merger as it believed the merger value would be good. While it was not clear why Aabar Investments would now agree with the Proposed Merger, it was quoted that there had been top-level government discussions between Malaysia and Abu Dhabi.[43]

While EPF had been looking to vote in the shareholders' meeting of RHB Capital and MBSB, it was reported on 23 November 2014 that the EPF might be willing to abstain from voting at MBSB but still wanted to make out a case to vote at RHB Capital.[44]

[41] The Wall Street Journal, 24 June 2011. *Malaysian Bank Chiefs Explain Deal Failure*
[42] The Edge, 3 November 2014. *Merger valuations seem fair, but will Aabar accept?*
[43] The Edge, 20 November 2014. *Aabar now in favour of mega merger*
[44] The Edge, 23 December 2014. *Bursa postpones deliberation of EPF appeal*

Dato' Sri Nazir Razak said "*We (CIMB) are very confident that once the business case is presented to the shareholders, we would be able to get the endorsement of shareholders. We think we will get it through with or without EPF's vote*". He was optimistic that the idea of the Proposed Merger coupled with the expected synergies would be attractive enough to gain the required approval from the shareholders regardless of who can or cannot vote. He had, on 1 December 2014, given the assurance that the progress for the Proposed Merger was still on schedule and was progressing into the due-diligence stage. [45]

Question:

Given EPF's very substantial shareholdings in CIMB, RHB Capital and MBSB, how would it benefit from the Proposed Merger if it had gone through?

[45] The Edge, 2 December 2014. *Merger will go through with or without EPF*

6. The challenges faced by the shareholders and stakeholders of the Negotiating Parties

(i) Shareholders' interest

According to the CEO of Minority Shareholder Watchdog Group ("**MSWG**"), Rita Benoy, the challenge of the Proposed Merger was to ensure the deal was fair to all shareholders, which would include the minority shareholders, and the process of the deal was properly implemented. The valuations for the deals should represent fair transactions and good exit offers to the minority shareholders.

In the event that EPF were allowed to vote in RHB Capital and MBSB, there would be a concern for the other shareholders that their preference may be out-voted by EPF. As a significant shareholder of all the Negotiating Parties, EPF's position and motivation may be different from the other shareholders, the majority of whom are minority shareholders of the respective companies.

From the minority shareholders' point of view, a good offer shall include a cash option for them to exit their investment should they not be in favour of the valuation of the Proposed Merger. However, as announced on 9 October 2014, the Proposed Disposal will be affected entirely by share swaps. This might not appear to be favourable to the minority shareholders who might have wanted a cash option and therefore might oppose the Proposed Disposal.

It is also pertinent for the minority shareholders to be treated fairly in relation to the Proposed Merger. As such, there should not be any separate deals made for a certain group of shareholders, for example those who may have incurred a much higher cost of investment than other in the shares of the Negotiating Parties, according to MSWG.[46] As we noted previously, it was reported that there has been government to government discussion between Malaysia and Abu Dhabi which might influence Aabar Investments to accept the Proposed Merger. We were not informed about the deal, but the minority shareholders may not enjoy the same terms if certain conditions had been agreed upon between the two parties.

However, MSWG had questioned the necessity of extending the exclusivity after the lapse of the Exclusivity Period as the companies should consider other potential

[46] The Edge, 18 August 2014. *MSWG: Better for EPF not to vote in mega merger*

competing bids after the Exclusivity Period. Competing bids would often offer better terms for the transaction and therefore may be beneficial to the minority shareholders.

Notwithstanding the above arguments, it is our view that minority shareholders can benefit from the Proposed Merger if the valuation and terms are fair to all parties. The benefits will come from the enhanced valuation as a result of larger scale of operations and cost and revenue synergies from the merger exercise.

(ii) Employees' interest

Generally, during the integration process following the merger transactions, there would be retrenchments, either in the form of voluntary separation schemes or mutual separation schemes, to reduce redundancies in the Mega Bank, although the retrenchments may not be carried out immediately after the merger.

Taking two (2) previous examples of mergers in Malaysian banking sector, CIMB Bank had stated in 2009 that it would close down and merge some 60 bank branches, which action was consistent with its branch rationalisation plan following the merger of Bumiputra-Commerce Bank Bhd with Southern Bank Bhd in 2006. The rationalisation plan was aimed at creating an optimal network size of the bank.[47] On the other hand, Hong Leong Bank had said that it had a workforce in excess of 11,000 staff as a result of the merger with EON Capital Berhad in 2010.[48]

It was reported that 250 branches would be closed down and 8,000 employees would be laid off as part of the integration plan of the Proposed Merger.[49] Given the uncertain economic conditions foreseen for the near future, it would be very challenging for the employees of the merged entities to find new jobs should they be retrenched after the completion of Proposed Merger.

[47] Reuters, 6 April 2009. *Malaysia's CIMB to close 60 branches - report*
[48] The Star, 23 November 2011. *Hong Leong Bank: No Bank Negara Approval needed for VSS*
[49] The Star, 17 January 2015. *CIMB, RHB staff relieved mega-merger did not happen*

(iii) Public's interest

MSWG stated that Malaysian banks should grow stronger and bigger, if necessary to meet the challenges of the global environment. Banks must ensure the fairness in their business practices in order to lessen the concerns of monopoly.[50]

In the event that the Proposed Merger was successful, the number of local banks would be reduced from eight (8) to seven (7) and thereby further reducing competition in the banking sector. There is a trend of oligopolistic traits in the Malaysian banking industry, where a group of two (2) or more banks controls at least 25.0% of the market and prevents, restricts or reduces competition and it is estimated that the Proposed Merger would point to a 23.0% share of the domestic loans market, which may give it pricing power.[51] However, as the banking industry in Malaysia is fairly competitive with the participation of foreign banks, and that the industry itself is tightly regulated by BNM, the issue of monopoly may not be worrying.

A few years ago, the mortgage business became very competitive and a "price war" took place. At the time, industry observers were reported to have said that some of the banks were concerned about price undercutting and efforts were made to stop the price war.

Hence, creating bigger banks is not necessarily beneficial to consumers, as it reduces choice and competition. The experience in other countries is that this especially impacts the SMEs, which have always faced difficulties in getting bank funding.

The involvement of EPF in the Proposed Merger had also caught the Public Accounts Committee's ("**PAC**") attention. The PAC had said publicly that it would determine if it was within the PAC's scope to discuss issues concerning the EPF's involvement in the Proposed Merger. Mr Tony Pua Kiam Wee, a member of the PAC, has commented that the PAC would consider talking to EPF if the deal was deemed relevant to public interest.[52] However, there was no further publicly available update from the PAC on its finding on this matter.

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[50] The Edge, 18 August 2014. *MSWG: Better for EPF not to vote in mega merger*
[51] Reuters, 14 July 2014. *Fitch: Malaysian Bank Mega-Merger Comes with Risks*
[52] The Malaysian Reserve, 30 October 2014. *PAC weighs in on mega-bank merger deal*

On the other hand, bigger banks may be beneficial to the public as they are able to reach a wider coverage and to provide better banking products and services using information technologies and innovations. A larger entity may also gain advantages compared to the other smaller peers as it can afford to invest more resources in developing technologies to provide more product varieties and digital services to the public.

(iv) National's interest

The Proposed Merger has escalated beyond a business-to-business transaction when Sheikh Mansour Zayed Al Nahyan, the Deputy Prime Minister and Minister of Presidency Affair of United Arab Emirates, had sent a letter to the Prime Minister of Malaysia, Dato' Sri Mohd Najib Abdul Razak, expressing the concern of United Arab Emirates Government about EPF's right to vote in the Proposed Merger.[53] There has been no public available information on the development on this matter but we have commented in the previous section that there had been top-level government discussions on Aabar Investments' position in the Proposed Merger.

Question:

The Proposed Merger, if successful, would have created the largest bank in Malaysia, with an estimated total asset of RM671.2 billion. Should the Government and public consider this as an issue of "too big to fail" and what action should be taken by the regulatory bodies to address it?

[53] The Edge, 1 October 2014. *Structure of three-way bank merger not finalized, says Zafrul*

7. How would the applicable regulations affect the Proposed Merger?

(i) Rules on related party transactions

As we have discussed in the previous section, EPF is a substantial shareholder of the Negotiating Parties respectively. Accordingly, it is deemed an interested party in the Proposed Merger pursuant to Paragraph 10.08 of the Listing Requirements.

As such, at the request of EPF, RHB Capital and MBSB have applied to Bursa Securities for a waiver from complying with the related party transaction requirements under paragraph 10.08(7)(a) of the Listing Requirements in respect of the rights of EPF as a shareholder to vote on the resolution(s) to approve any proposals pertaining to the Proposed Merger.[54]

Paragraph 10.08(7)(a) of the Listing Requirements states that:

In a meeting to obtain shareholder or unit holder approval –

*(a) the interested director, major shareholder or person connected with a director or major shareholder with any interest, direct or indirect ("**interested major shareholder**" or "**interested person connected with a director or major shareholder**"); and*

(b) where it involves the interest of an interested person connected with a director or major shareholder, such director or major shareholder,

must not vote on the resolution approving the transaction. An interested director or interested major shareholder must ensure that persons connected with him abstain from voting on the resolution approving the transaction.

Additionally, a provision under Section 132E(3) of the Act states that:

"*The resolution of the company or its holding company at the general meeting of the company or its holding company to consider the arrangement or transaction shall be subject to the director, substantial shareholder or person connected with such director or substantial shareholder, as the case may be, abstaining from voting on the resolution whether or not to approve the arrangement or transaction*".

[54] The Edge, 15 October 2014. *Bank vote decision will have implications, says EPF*

Both the provisions were meant to protect the rights of minority shareholders. The provision under Section 132E(3) of the Act does not allow a substantial shareholder to vote at a general meeting to decide on transactions that involve the acquisition or disposal of shares or non-cash assets in which the substantial shareholders are conflicted.[55]

On 21 October 2014, RHB Investment Bank Berhad and AmInvestment Bank Berhad announced, on behalf of RHB Capital and MBSB respectively, that Bursa Securities had rejected their waiver application, as there were no adequate justifications that the potential conflicts of interests involving EPF has been eliminated or sufficiently mitigated.

In arriving at its decision, Bursa Securities has taken into consideration the following:

(a) EPF being a common major shareholder in all three (3) affected companies;

(b) EPF being the single largest shareholder of both RHB Capital and MBSB; and

(c) EPF had prior knowledge of the Proposed Merger as it was notified by CIMB.

As such, there might exist such a potential conflict of interest situation, where EPF may be able to influence the Proposed Merger to its own benefit.

EPF stressed that it has the right to vote on the Proposed Merger as it is the major shareholders of both CIMB and RHB Capital. It should not be denied from voting in the business fundamentals or strategic matters of the companies it invests in only due to the size of its shareholdings in the concerned companies for the following reasons:

(a) EPF represents its 14.0 million members and that its right to vote is critical to protect the financial interest of these members; [56]

(b) EPF has not been part of any discussion on the details of the Proposed Merger.[57] As noted by Datuk Shahril Ridza Ridzuan, "*we don't get involved in the day to day management. We are updated whenever the company makes an announcement, but we*

[55] The Edge, 11 August 2014. *Should EPF be allowed to vote in bank mega merger?*
[56] The Sun Daily, 9 September 2014. *EPF needs to have a say in mega banking merger: Shahril*
[57] The Edge, 5 September 2014. *EPF lambasts leak of document within RHB Cap's board, calls for investigation*

try to stay out of it. No scheme has been put to us, apart from what we hear from the media."; and [58]

(c) EPF is a passive investor in these companies.

We examined the situation of EPF against the conditions as stated in Paragraph 10.08 of the Listing Requirements where a transaction between a listed company and another party, which have common major shareholders, is not regarded as a related party transaction:

Condition	**EPF's position**
(aa) the major shareholder and/or the person connected with the major shareholder is/are not the largest shareholder of the listed issuer;	EPF is the largest shareholder of both RHB Capital and MBSB.
(bb) the major shareholder and/or the person connected with the major shareholder is/are not a party to the said transaction, initiator, agent or involved in any other manner in the said transaction;	EPF claimed it was not involved in the discussion of the Proposed Merger. Sources close to the EPF said the EPF was merely notified of CIMB's intention to explore a merger with RHB Capital and MBSB and that it was not privy to any other information.[59]
(cc) the major shareholder does not have any representative in an executive capacity on the board of directors of the listed issuer or any of its subsidiaries; and	Tan Sri Azlan Zainol, who retired as the CEO of EPF on 8 April 2013, is a non-executive director of RHB Capital while Datuk Shahril Ridza Ridzuan is a non-executive director of MBSB. According to Datuk Shahril Ridza Ridzuan, they were not involved in the deal.[60] There are no other EPF representatives on the Negotiating Parties.

[58] The Edge, 15 October 2014. *Bank vote decision will have implications, says EPF*
[59] The Edge, 4 December 2014. *Bursa may consider EPF appeal if there are fresh reasons*
[60] The Edge, 15 October 2014. *Bank vote decision will have implications, says EPF*

Condition	**EPF's position**
(dd) the major shareholder is – *(A) a statutory institution who is managing funds belonging to the general public;* *(B) a closed end fund, unit trust or investment fund (but excluding an investment holding company); or* *(C) an insurance corporation whose activities are regulated by any written law relating to insurance and are subject to supervision by Bank Negara Malaysia, and the said insurance corporation is managing its insurance funds (together with its own shareholders' funds or otherwise). For the purposes of this subparagraph, "insurance funds" has the meaning given in section 2 of the Insurance Act, 1996.*	EPF is a statutory institution who is managing funds belonging to its contributors which could be deemed as the general public.

On the other hand, other than representatives of EPF and the Board of RHB Capital and MBSB, we note that Dato' Sri Nazir Razak sits on EPF's investment panel.[61]

On 31 October 2014, EPF had submitted an appeal application through RHB Capital and MBSB to Bursa Securities on its decision to reject the application for a waiver from complying with the related party transaction requirements under paragraph 10.08(7)(a) of the Listing Requirements.[62]

Before Bursa Securities could make a decision on the waiver, it requested, among others, the Boards of both RHB Capital and MBSB to indicate whether they think the EPF should be allowed to vote on the Proposed Merger. However, it was reported that both Boards of RHB Capital and MBSB did not indicate their stands clearly to Bursa Securities.[63] The rationale for Bursa Securities to make such request could possibly be to assess whether or not EPF was involved in the initiation and planning

[61] EPF's website

[62] Announcements on Bursa Securities' website

[63] The Edge, 14 November 2014. *Bursa listing committee to discuss EPF vote on Oct 21*

for the deal as well as to pass the responsibility to determine the merits of the waiver to the Boards of the two (2) companies concerned.

On 5 December 2014, EPF had been requested to make an oral representation before the Appeal Committee of Bursa Securities ("**Appeal Committee**") ("**Hearing**"). RHB Capital and MBSB had also been requested to hold a watching brief in relation to the said Hearing (collectively referred to as "**Requests**"). There is no automatic right to oral representation and it is the prerogative of the Appeal Committee to allow or disallow such Requests. As such, RHB Capital's representatives, MBSB's representatives and EPF's representatives were requested to be present on 10 December 2014 in the event the Appeal Committee grants the Requests. However, a banking analyst said that Bursa Securities may not change its mind on the matter, even if the EPF provides new reasons. Furthermore, the fact that the EPF had prior knowledge of the Proposed Merger is one of the reasons why Bursa Securities did not allow the EPF to vote, and that decision will remain even if the EPF sold it stakes in CIMB.[64] Controversy would arise if Bursa Securities were to reverse such an important decision just like that, and it will set an unhealthy precedent.

On 10 December 2014, EPF attended the Hearing and made an oral representation. On the same date, RHB Capital and MBSB received letters from Bursa Securities stating that the Appeal Committee decided to dismiss the appeal and uphold the decision of Bursa Securities made on 21 October 2014 as there were no adequate justifications that the potential conflict of interests involving EPF has been eliminated or sufficiently mitigated.

An industry observer stated that there was a precedent in this voting issue whereby Permodalan Nasional Berhad voted in the mega merger of several companies that formed Sime Darby Berhad back in 2007.[65]

(ii) Rules on acquisitions and disposals

As discussed in Section 1, the Proposed Merger was structured as a reverse merger, with RHB Capital, being the smaller company, to issue shares to acquire CIMB Group. So in order for the Proposed Disposal to go through, RHB Capital, as the acquirer, would need more than 50.0% of the votes from its shareholders present at the

[64] The Edge, 20 November 2014. *Aabar now in favour of mega merger*
[65] The Edge, 2 December 2014. *Bursa may consider EPF appeal if there are fresh reasons*

shareholders' meeting. This structure of the deal was also seen as a way to overcome potential opposition from Aabar Investments, the second largest shareholder of RHB Capital.[66] As for CIMB, being the company that disposed all of its Assets and Liabilities to RHB Capital, it would need to get at least 75.0% approving votes from its shareholders as stated in item (1)(d) of paragraph 10.11A of the Listing Requirements:

"*A listed corporation which intends to undertake a major disposal must convene a general meeting and obtain shareholder approval of at least 75.0% in value of the shareholders present and voting either in person or by proxy at the meeting for such major disposal.*"

The same rule applied to MBSB where it must obtain at least 75.0% approval from its shareholders in its shareholders' meeting as MBSB was going to dispose all of its Assets and Liabilities to CIMB Islamic, in the Proposed Islamic Bank Merger.

If RHB Capital's Assets and Liabilities were to be acquired by CIMB in the Proposed Merger, RHB Capital would have to obtain approval from at least 75.0% of its shareholders present at the shareholders' meeting. In this scenario, Aabar Investments' opposition might hinder the approval of the Proposed Merger.

Question:

*Are the existing Securities Commission Malaysia's ("**SC**"), BNM's and Bursa Securities' regulations adequate to protect the interest of all the parties involved in the Proposed Merger, especially minority shareholders?*

[66] The Edge, 14 September 2014. *RHB said to plan all-stock acquisition of CIMB in reverse merge*

8. Key issues that led to the termination of the Proposed Merger

We believe that the main reason for the calling-off of the Proposed Merger is that the expected value creation criteria of the respective parties were no longer agreeable to all. Thus, it might have faced resistance from certain parties. The situation was made worse by the unfavourable development of the global economy.

This is supported by the following statements by the chiefs of the respective Negotiating Parties.

"*We had thoroughly deliberated the merger, and while we remain convinced that the combination of our three franchises follows sound strategic logic, we ultimately were not able to arrive at a value creating transaction for all stakeholders. The decision to cease discussions was arrived at after a detailed review of potential synergies that could be realistically delivered, especially in the current economic environment*," Tengku Dato' Zafrul Tengku Abdul Aziz said in a joint statement.[67]

"*We undertook the discussions of the proposed merger on the premise that we would be able to arrive at a value enhancing proposal for our stakeholders and bring it to our respective shareholder. Protecting and creating stakeholder value is paramount to all parties and given the changes in environment we could not conclude a case to proceed*," said Kellee Kam in the joint statement.[68]

In CIMB's annual report 2014, Dato' Sri Nazir Razak stated that:

"We decided not to proceed with the merger as we were not able to reaffirm the potential synergies that we targeted for various reasons including the deterioration of the macro environment. It is always disappointing when deals get called off after so much time and energy have been expended but I think this demonstrated our uncompromising focus on value – the deal had to make commercial sense for stakeholders and in our final analysis, it could not meet the target we set in terms of medium term return-on-equity enhancement, capital formation and so on, based on robust and realistic assumptions of the next few years."

[67] Announcement on Bursa Securities
[68] *Ditto*

On the other hand, Dato' Ahmad Zaini Othman had stated in MBSB's annual report 2014 that:

"We went through a relatively difficult period last year and the economic landscape has also changed drastically towards the end of the year. Unfortunately, the latter also became the main reason for the cessation of a merger negotiation between MBSB, RHB Capital and CIMB for the creation of a mega Islamic bank."

While there was no other official statement to further explain in detail the specific reasons for the termination of the Proposed Merger, we believe the following were the main reasons for calling off the Proposed Merger:

(a) Earlier valuations no longer agreeable to all parties;

(b) Change in macro conditions and worsening share prices; and

(c) Softening economic conditions make targeted synergies difficult to achieve.

(i) Earlier valuations no longer agreeable to all parties

We believe that the main reason for the Proposed Merger to be called off might be due to the failure to reach an agreement on the valuation and principal terms by the Negotiating Parties.

CIMB Group's performance has deteriorated since the announcement of the Proposed Merger. For the third quarter of 2014, the Group's non-interest income against the same period in the previous year declined by 8.8%, due to lower volatility in treasury markets, weaker equity markets and lower Indonesia bancassurance fees. CIMB Niaga's contribution to CIMB Group was also impacted by an 11.5% year-on-year foreign exchange depreciation in the IDR. This was mainly due to the difficult operating conditions in Indonesia coupled with the weaker IDR, which brought about a 36.4% year-on-year decline in CIMB Niaga's profit before tax contributions.[69]

For FYE 31 December 2014, CIMB Group recorded a 9.8% contraction in profit before tax. CIMB Niaga has been contributing substantial portion of the earnings of the CIMB Group. For three (3) FYE up to 31 December 2014, CIMB Niaga contributed

[69] CIMB quarterly report on consolidated result for FPE 30 September 2014

23.45% to 29.19% of revenue to the CIMB Group. With the weakening of the IDR, the increase in Bank Indonesia's policy rates to its highest in six (6) years, and weak commodity prices, the financial result of CIMB Group's Indonesian business was disappointing. CIMB Niaga posted a profit before tax contraction of 45.1% due to lower non-interest income and higher provisioning.[70] This might have raised the concern of fair valuation for the CIMB Group.

For FYE 31 December 2014, CIMB Group recorded a total net impairment allowances for losses on loans and advances of RM1.7 billion, which increased 134.3% from RM726.0 million for FYE 31 December 2013. The increase was due to a sharp increase in corporate loan provisions in Indonesia and Malaysia, goodwill impairment of CIMB Group's investment banking operations as well as lower loan recoveries during the year.[71] The provisions and impaired loans and advances in the Indonesian operations for FYE 31 December 2014 was RM2.5 billion, up 70.8% from RM1.5 billion for FYE 31 December 2013.

In addition, the CIMB Group was having difficulties in integrating RBS's Asia-Pacific investment banking business which was acquired in 2012. This resulted in CIMB Group having to close down its investment banking business in Sydney and Melbourne and to make a substantial impairment from the acquisition of RBS's investment banking business. This should have adversely affected the valuation for the CIMB Group.

On the other hand, the MBSB Group has also been applying a different provisioning standard for many years from the CIMB Group and RHB Group given that it did not come within the purview of BNM until the enforcement of FSA. Should the same provisioning standard be applied to the MBSB Group as applied to the CIMB Group and RHB Group, the impact on the NA value of the MBSB Group could be significantly different.

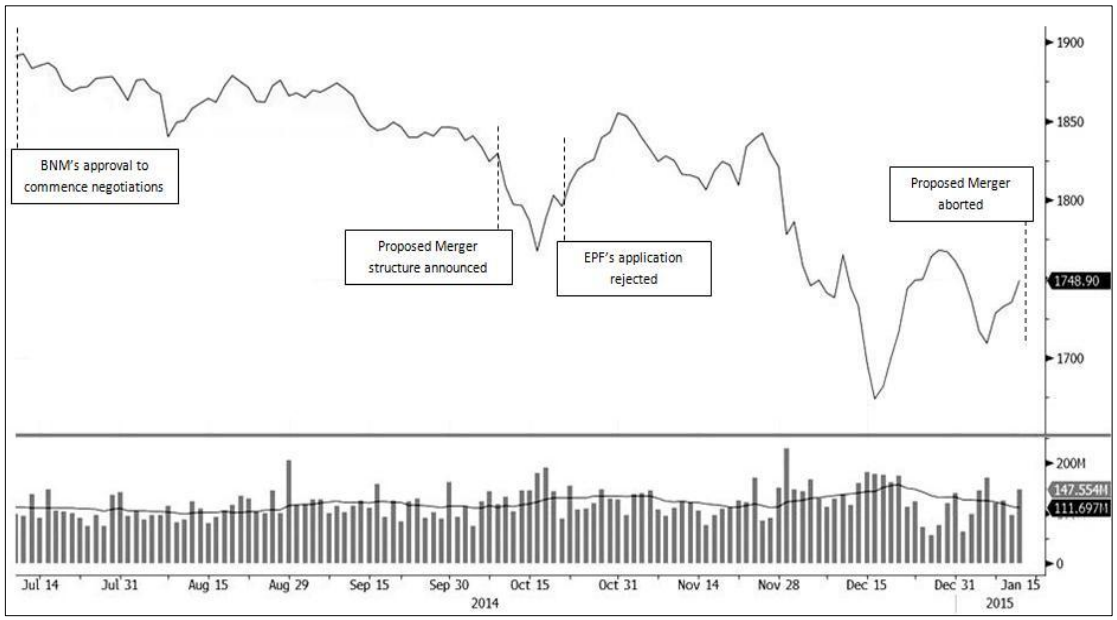
The concerns of the loan provisions and impairments could also have been the basis for the Negotiating Parties to call off the Proposed Merger.

[70] CIMB annual report 2014
[71] *Ditto*

(ii) Change in macro conditions and worsening share prices

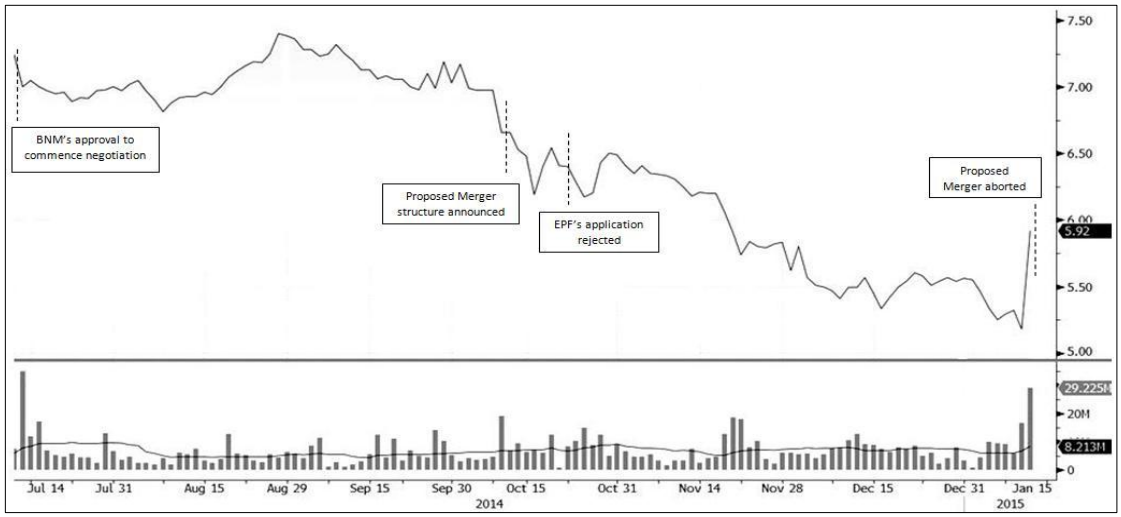
All the Negotiating Parties had cited the change in macro conditions as the main reason for calling-off the Proposed Merger. The macro and stock market conditions had changed significantly for the six (6) months from the announcement of the Proposed Merger up to the date when the Proposed Merger was called off.

Subdued earnings sentiments and lower growth expectations have affected the sentiments in the Malaysian stock market towards the later part of 2014. Stock market capitalisation contracted by 2.9% to RM1.65 trillion, while the FTSE Bursa Malaysia Kuala Lumpur Composite Index ("**FBMKLCI**") ended the year 5.7% lower, closing at 1,761.25 points in 2014. The chart below illustrates the performance of FBMKLCI from 9 July 2014, a day prior to the first Proposed Merger announcement, until 13 January 2015, the day before the Proposed Merger was officially called off:

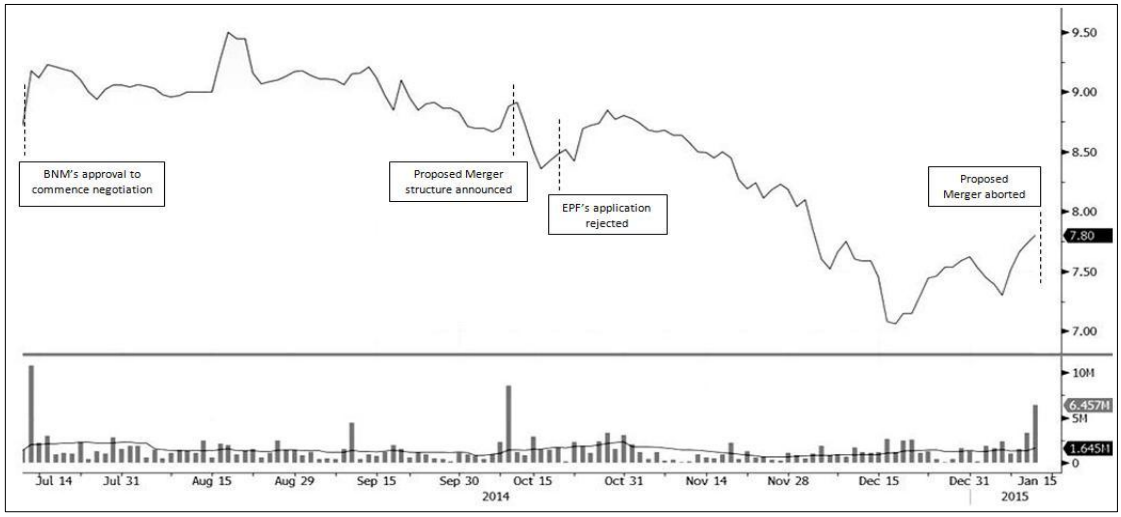


(Source of chart: Bloomberg)

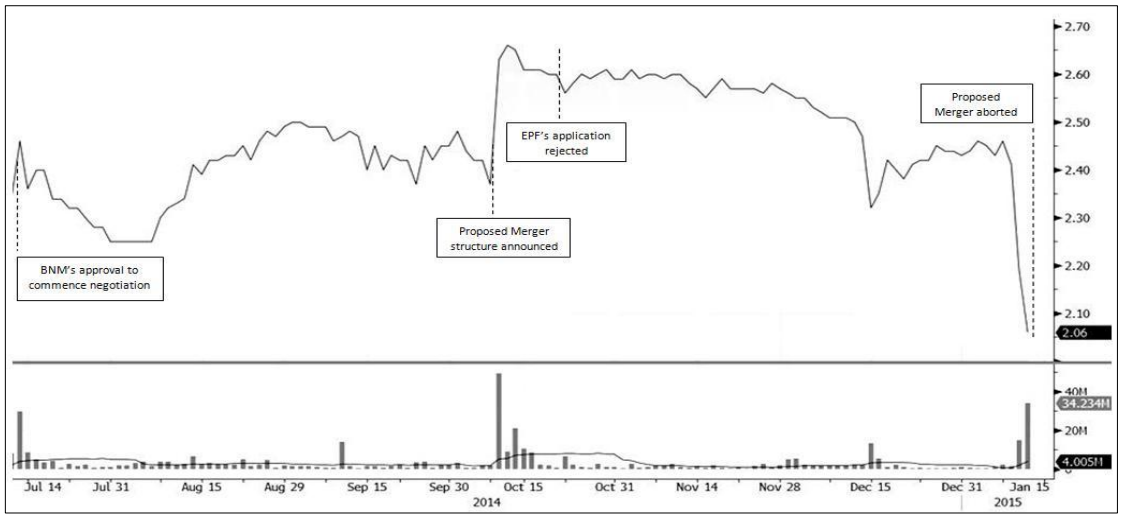
Likewise, the share prices of CIMB, RHB Capital and MBSB have also declined significantly.



CIMB



RHB Capital



MBSB

(Source of charts: Bloomberg)

CIMB Shares, RHB Capital Shares and MBSB Shares were traded at RM5.34, RM7.05 and RM1.65 respectively on 9 July 2014, a day prior to the first Proposed Merger announcement. CIMB's PE of 13.12 times was equivalent to the average PE of the finance sector while the PEs for RHB Capital and MBSB of 12.13 times and 10.27 times respectively, were below the average PE of times for the sector.

From PB's perspective, CIMB's PB of 1.67 times, RHB Capital's PB of 1.25 times and MBSB's PB of 1.52 times, based on the respective unaudited consolidated NA as at 30 June 2014 , were all lower than the industry average PB of 1.81 times.

On 13 January 2015, the day before the Proposed Merger was officially called off, the market price of CIMB Shares, RHB Capital Shares and MBSB Shares had dropped to RM5.92, RM7.80 and RM2.06 respectively. The PE of CIMB declined to 10.73 times while the PEs of RHB Capital and MBSB dropped to 10.85 times and 9.04 times respectively. The PEs of CIMB, RHB Capital and MBSB were lower than the industry average PE of 11.93 times.

From the PB's perspective, CIMB's PB of 1.37 times, RHB Capital's PB of 1.12 times and MBSB's PB of 1.34 times, based on the respective unaudited consolidated NA as at 30 June 2014, were all lower than the industry average PB of 1.52 times

The market price of CIMB Share as of 13 January 2015 was traded at a hefty discount of 18.6% to the value estimated for CIMB Consideration Share of RM7.27 per share. This may not have made the deal structure attractive to RHB Capital. Due to the adverse performance of CIMB Share price, it was reasonable for RHB Capital to request for a revision in the consideration shares or to include a cash option for the deal.[72] This would make the deal no longer feasible for CIMB Group as the additional cash component may financially burden the group.

The change in the macro conditions could have also raised concerns of further loan provisioning and impairments for the Negotiating Parties which would have an impact on the share prices of CIMB, RHB Capital and MBSB. Any significant change in the macro conditions and share prices of the Negotiating Parties would make the Proposed Merger untenable.

(iii) The softening of economic conditions make the targeted synergies difficult to achieve

The calling off of the Proposed Merger could also be due to the reason that the targeted synergies from the Proposed Merger may not be realised due to the softening of economic conditions. Since the economic and stock market conditions have softened significantly, the earlier assumptions on financial performance adopted for the Proposed Merger would no longer hold true.

As commented by Dato' Sri Nazir Razak, "*We have said that there is limited revenue synergies from this deal and the real synergy upside would have to come from cost, and in a slow economic environment, cost synergies are a bit more difficult to achieve*."[73]

It was reported that the expectation of the management of CIMB Group to achieve a targeted post-merger return on equity of more than 13.0% by end of 2016 from an estimated pre-synergy Mega Bank of 9.8% was unrealistic. This would mean that the Mega Bank has to extract close to RM3.8 billion in total cost synergy and is equivalent to a 31.0% reduction of the total operating costs of the Mega Bank.[74]

[72] The Edge, 4 February 2015. *High chance mega bank merger could be off*
[73] The Star, 7 January 2015. *CIMB, RHB Cap, MBSB merger confirmed called off*
[74] The Star, 17 January 2015. *CIMB, RHB staff relieved mega-merger did not happen*

The Mega Bank has to revise their post-merger plan to adjust to the current unfavourable market conditions. The Mega Bank may have to cut more jobs and close more branches. According to an official close to the integration team, they might have to close down 250 branches compared to 150 branches in the original plan and lay off 8,000 employees compared to 4,000 to 5,000 in the original plan.[75]

We have discussed in the previous section that it would be more difficult to retrench employees in view of the prevailing economic conditions. Therefore, the take-up rate for any voluntary separation scheme may not be high. There are also concerns that the initial cash flow in relation to the voluntary separation scheme would be high given the numbers of employees expected to be laid off and timing in which the Mega Bank would be able to recover the outflow. If the Mega Islamic Bank were to absorb the excess personnel and branches from the Mega Bank, it would face a higher cost base. Therefore, either way, it would be more difficult for the Mega Bank to achieve the cost synergies as originally planned.

CIMB Group management had estimated that the post-merger integration with the RHB Group and the MBSB Group to cost about RM1.4 billion, in which 80.0% of it was for capital expenses while the rest were for operating expenses.[76]

The anticipated objective of being better able to comply with the Basel III requirements might not be achieved given the outcome from the due diligence exercise and uncertain economic situation. According to news report, Fitch Ratings Ltd stated that the impact on CET1 capital was likely to be limited, as the transaction between the CIMB Group and RHB Group will be done through a share swap. It is estimated that the Mega Bank's CET1 capital would be around 9.0%, down from 9.5% as reported by CIMB Group as at 30 June 2014. CIMB Group's management had highlighted the target for CET1 capital of 9.5% and might look to replenish capital if the ratio falls below 9.0%.[77]

[75] *Ditto*

[76] The Edge, 31 October 2014. *CIMB-RHB-MBSB post-merger integration to cost RM1.4b*

[77] The Edge, 14 October 2014. *Fitch: MBSB will result in asset quality weakness in merged mega bank*

Questions:

(1) All the Negotiating Parties have cited the change in macro conditions as a reason for the abortion of the Proposed Merger. Do you think the Negotiating Parties would explore the merger again when the macro conditions improve?

(2) CIMB Shares and RHB Capital Shares were generally traded sideways and began to decline after the announcement of the deal structure of the Proposed Merger. What could be the reasons for this unfavourable reception from investors?

(3) Given the current market conditions with some banks offering voluntary and mutual separation schemes for their employees, do you think there would be motivations for other domestic banks in Malaysia to embark on a merger exercise in the near future?

9. Lessons learnt from the Proposed Merger

(i) From regulator's perspective

From the regulatory perspective, Bursa Securities' decision in not granting a waiver to EPF from abstaining it to vote in the Proposed Merger was seen positively by the market. Bursa Securities' decision, which was made based on the consistent application of the Listing Requirements, has shown that Bursa Securities has applied its listing rules strictly irrespective of the parties involved. By doing so, Bursa Securities is also seen to be leading by example by upholding good corporate governance among the companies listed on Bursa Securities.

Given the shareholdings of EPF in the Negotiating Parties and the deal structure, the minority shareholders may very much likely be out-voted if EPF was allowed to vote in this related party transaction as the vote of EPF would very much influence the outcome of the Proposed Merger. As discussed previously, there are concerns that EPF, as a significant shareholder of all the Negotiating Parties in the Proposed Merger, may benefit differently from the other minority shareholders in their respective companies. If EPF had been allowed to vote in the Proposed Merger, it may set a precedent to other related party cases, which may undermine the interest of minority shareholders and affect the standing of Bursa Securities as a regulator in enforcing its rules. Thus, it may affect the confidence among investors, in particular the foreign investors. This may in turn adversely affect the image of the Malaysian capital market and some foreign investors may avoid our market unless valid justifications and explanations are given.

(ii) From EPF's perspective

As a custodian of public funds, the EPF has its responsibilities in protecting the interest of its contributors. Over the years, it has earned its reputation as a respected pension fund investing prudently in the domestic and overseas markets and its ability to generate decent returns to its contributors.

The EPF has widespread holdings in the companies listed on Bursa Securities in which it owns more than 5.0% equity interest in over 100 companies.[78] Chances are it could get caught again in a similar situation in future. In managing its equity portfolio, EPF should remain cautious when it is involved in a deemed related party transactions

[78] The Edge, 23 December 2014. *Bursa postpones deliberation on EPF*

similar to the Proposed Merger in such a manner that it would not be perceived as a dominant shareholder which does not care about the interest of minority shareholders. As an institutional investor with good reputation, minority shareholders would look up to EPF to play its role in shareholder activism and push for good governance.

According to Datuk Shahril Ridza Ridzuan, the EPF needs to decide on a strategy to avoid this kind of situation in the future.[79]

One such option is for EPF not to have controlling shareholdings in its investee companies. A controlling shareholding would require EPF to drive and manage the business of investee companies such as RHB Group and MBSB Group. The disadvantages of EPF being a major shareholder in these companies are that it cannot readily exit its investments in these companies and it has to continuously pour in resources to sustain its shareholders value in these companies. In addition, EPF should consider reducing its investments in the banking institutions in which it has a controlling stake to relieve it from the burden of complying with Basel III requirements as a financial holdings company. It is also BNM's regulatory objective for financial institutions to have well-diversified shareholders base, which is in line with international best practices.[80] As disclosed in the latest annual reports of the respective companies, EPF's shareholdings in the banking industry are as follows:

	EPF's equity interest %
CIMB	15.6
RHB Capital	41.5
MBSB	64.1
Maybank	12.8
Public Bank	14.9
Hong Leong Bank	13.4
AMMB Holdings	16.2
Affin Holdings	7.6
Alliance Financial	17.7

[79] The Edge, 15 October 2014. *Bank vote decision will have implications, says EPF*
[80] The Star, 9 January 2015. *Cracks in CIMB, RHB, MBSB merger plan; EPF may not able to vote*

(iii) From the perspective of listed companies

A listed company, seeking to grow via merger and acquisition, shall do so in a disciplined way observing all applicable rules and taking into consideration the interests of all parties including minority shareholders. It should look into the benefits expected to be derived for the company and value creation to its shareholders. Where possible, a cash option should be provided for the merger offer to allow minority shareholders who wish to exit to do so. The Board or CEO should be guided by these principles.

In this Proposed Merger case, CIMB, which was believed to be the initiator of the Proposed Merger, and RHB Capital have demonstrated discipline when they called off the deal when market conditions have changed significantly and the expectations of value creation objectives of the Negotiating Parties could no longer be met.

According to the Managing Director of Khazanah Nasional Berhad, Tan Sri Azman Mokhtar, when asked to comment about the calling-off of the Proposed Merger, CIMB had shown the ability to grow in a disciplined way.[81] The decision not to proceed with the Proposed Merger reflects the prudence on the part of CIMB, according to Fitch Ratings Ltd in its statement on 15 January 2015.[82]

[81] The Star, 15 January 2015. *CIMB, RHB Cap, MBSB merger confirmed called off*
[82] The Edge, 16 January 2015. *Aborted merger plan reflects CIMB's prudence, says Fitch Ratings*

10. How would a merger of such size happen in the future?

In the aftermath of the failed Proposed Merger, the Negotiating Parties had gone their separate ways. However, they are still keen on merger opportunities in the future. Tengku Dato' Zafrul Tengku Abdul Aziz said that CIMB Group had been working very hard behind the scenes of its new mid-term strategy and roadmap to 2018. Now that the Proposed Merger is no longer proceeding, CIMB Group is ready to start implementing its own strategic plan. Kellee Kam said that RHB Group would refocus its energy on accelerating its five (5)-year transformation plan, known as Ignite 2017.[83]

Dato' Ahmad Zaini Othman said "*Given that the discussions have ceased, we (MBSB) can now continue to focus on the strength of our franchise and achieving the goals that we have originally set for ourselves*".[84] On 1 October 2015, MBSB announced that it received a letter from BNM which allows MBSB to commence negotiations with the existing shareholders of Bank Muamalat, namely DRB-HICOM Berhad and Khazanah Nasional Berhad, for a proposed merger of MBSB and Bank Muamalat. BNM requires that the negotiations must be completed within three (3) months from the date of BNM's letter, 30 September 2015. This is in line with MBSB's aspiration which is to become an Islamic banking institution and that the logical way forward is via a merger with an Islamic bank.

Looking forward, Malaysian banks may expand their businesses via mergers and acquisitions. Any potential future mergers, regardless of size, would happen in the same way as the Proposed Merger. There are several factors to be taken into consideration, internal and external, for any merger to succeed such as fair valuation, economic conditions, expectations of value enhancement to shareholders, potential risks pertaining to integration, regulatory issues and other factors as discussed in the previous sections. Support and approval from BNM and other regulatory authorities are also needed in order for any future merger to proceed smoothly.

Maybank had expressed interest in RHB Capital in the past, but bankers familiar with Maybank's management way of thinking said that Maybank would wait and see if CIMB Group can successfully complete the Proposed Merger. Now that the Proposed Merger has fallen through, Maybank might revive its interest to pursue RHB Capital in the future.[85]

[83] The Edge Markets, 15 January 2015. *Merger Off*
[84] *Ditto*
[85] Reuters, 16 July 2014. *Bankers woo Maybank with deal ideas after CIMB threatens crown*

(i) From the regulator's perspective

For any mergers, whether they are of the similar size as the Proposed Merger or not, involving the interests of minority shareholders, the SC and Bursa Securities will continue to ensure that the interests of minority shareholders are protected.

Bursa Securities has to make sure that any parties involved in the merger proposals abide by the Listing Requirements and other regulations set by the authorities. Bursa Securities shall scrutinise any potential areas of conflict of interest arising from related party transactions.

As far as the minority shareholders are concerned, they should be relieved that there are existing regulations that are meant to protect their interests when they invest in the Malaysian capital market. Furthermore, small investors should also feel comforted that the Malaysian regulators are pro-active in updating and enhancing regulations to safeguard investors. For example, the rule on the 75%-approval requirement from shareholders for disposal of major assets and business undertakings by a listed company was introduced a few years back as a result of consultation between the SC, Bursa Securities and market practitioners. It is our view that the existing rules governing merger and take-over transactions in Malaysia are adequate to safeguard the interests of small investors. With regard to the waiver application from EPF to vote in the Proposed Merger, Bursa Securities has made a decision not to grant a waiver pursuant to the Listing Requirements that abstained EPF from voting in the Proposed Merger and this decision was in the spirit of investor protection and based on Bursa Securities' existing rule on related-party transactions.

With the recent establishment of the Malaysia Competition Commission, there is now an additional authority to look into the interests of public and consumer protection and to prevent a monopoly when mega mergers are undertaken. This is intended to protect the interest of the public or consumers.

(ii) From the interested substantial shareholder's perspective

Major pension fund and investment institutions such as EPF, Kumpulan Wang Persaraan (Diperbadankan), Permodalan Nasional Berhad and Lembaga Tabung Angkatan Tentera, hold substantial equity interests in a large number of companies listed on Bursa Securities. They may face a similar situation as EPF if they undertake interested-party merger transactions in the future. To overcome this potential problem, it is important for them to plan their future merger proposal carefully and

formulate a win-win proposal so that non-interested shareholders will readily support their merger transaction. This also applies to other major shareholders of listed companies when contemplating merger transactions involving related and interested parties.

(iii) From the perspective of listed companies

Merger and acquisition proposals are major corporate exercises which involve extensive resources. Listed companies therefore require careful planning before embarking on such proposals to avoid potential pitfall and failure.

Thorough evaluation of the merger target will need to be undertaken to ensure that the merger partner is a good fit. The merger objectives, value-enhancement measurements and post-merger integration issues must first be fully understood, discussed and ironed out before embarking on the merger exercise.

The decision whether or not to undertake the merger plan shall be made based on the outcome of a thorough evaluation, and the decision must be objective after taking into consideration the interests of all stakeholders involved including shareholders and employees. Once the decision is taken to proceed with the merger plan, the listed company should engage a team of experienced professionals to undertake a pre-merger due-diligence exercise to determine the credibility of the numbers and value expected to be created from the merger exercise.

If the initial evaluation points to no-go decision, the companies in the negotiation shall relook the merger proposal in a disciplined manner and terminate the merger proposal when it no longer makes business sense. In the case of the Proposed Merger, CIMB Group decided to abort the Proposed Merger. This suggested a level of caution and responsibility on the part of CIMB Group's management.

On the part of the Board, they must carry out their director's duty with due care and candour when deliberating on a merger proposal. The Board of a listed company must take an objective view of the proposal and decide based on considerations whether the merger proposal is in the best interest of the company, guided by the principle of acting in good faith. If they have an interest or are conflicted in the merger proposal, they must disclose their interest and abstain from deliberating and voting on the merger proposal.