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Present Status Of Deposit Insurance In India

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Abstract

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Deposit insurance was formed to protect small unit banks in the United States when branching regulations existed. In India, Deposit Insurance was introduced in 1962. The Deposit Insurance Corporation commenced functioning on January 1, 1962 under the aegis of the Reserve Bank of India (RBI). 1971 witnessed the establishment of another institution, the Credit Guarantee Corporation of India Ltd. (CGCI). In 1978, the DIC and the CGCI were merged to form the Deposit Insurance and Credit Guarantee Corporation (DICGC). **Deposit Insurance and Credit Guarantee Corporation** (DICGC) is a wholly owned subsidiary of Reserve Bank of India. It was established on 15 July 1978 under the Deposit Insurance and Credit Guarantee Corporation Act, 1961 for the purpose of providing insurance of deposits and guaranteeing of credit facilities.

Deposit insurance is a measure implemented in many countries to protect bank depositors, in full or in part, from losses caused by a bank's inability to pay its debts when due. Deposit insurance systems are one component of a financial system safety net that promotes financial stability.

Key Words: Deposit Insurance, DIC, CGCI, DICGC, Guarantee, Financial System etc.

Introduction:

Deposit insurance is a measure implemented in many countries to protect bank depositors, in full or in part, from losses caused by a bank's inability to pay its debts when due. Deposit insurance systems are one component of a financial system safety net that promotes financial stability.Deposit insurance institutions are for the most part government run or established, and may or may not be a part of a country's central bank, while some are private entities with government backing or completely private entities.

Need of Deposit Insurance:

Banks are allowed to lend or invest most of the money deposited with them instead of safe-keeping the full amounts. If many of a bank's borrowers fail to repay their loans when due, the bank's creditors, including its depositors, risk loss. Because they rely on customer deposits that can be withdrawn on little or no notice, banks in financial trouble are prone to bank runs, where depositors seek to withdraw funds quickly ahead of possible bank insolvency. Because banking institution failures have the potential to trigger a broad spectrum of harmful events, including economic recessions, policy makers maintain deposit insurance schemes to protect depositors and to give them comfort that their funds are not at risk.

Working of Deposit Insurance:

All deposits maintained by the depositor across all branches of the failed bank are clubbed. Or in other words, if a person keeps deposits in different branches of a bank, they are paid a maximum of up to Rs. One Lakh only on the aggregate amount.This limit of Rs. One Lakh includes principal and interest amount both. With a view to providing a greater measure of protection to depositors in banks the Deposit Insurance and Credit Guarantee Corporation has raised the limit of insurance cover for depositors in insured banks from the present level of Rs.1 lakh to Rs. 5 lakh per depositor with effect from February 4, 2020 with the approval of Government of India.[1] The amount of saving account, current account and fixed deposit are covered under deposit insurance scheme. However, deposits maintained with different banks are not clubbed.The deposit insurance scheme covers all banks operating in India including private sector, co-operative and even branches of foreign banks in India. There are some exemptions like deposits of foreign governments, deposits of central/state governments and inter-bank deposits. Every insured bank pays 0.001% as premium of deposits to DICGC.

History of Deposit Insurance in India:

Deposit insurance was formed to protect small unit banks in the United States when branching regulations existed. Banks were restricted by location thus did not reap the benefits coming from economies of scale, namely pooling and netting. To protect local banks in poorer states, the federal government created deposit insurance.[2]

As on 31 January 2014, 113 countries have instituted some form of explicit deposit insurance up from 12 in 1974. There are a number of countries with more than one deposit insurance system in operation, including Austria, Canada, Germany, Italy, and the United States.

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Benefits of Deposit Insurance:

1. When a nation state has a deposit insurance scheme, foreign investors (aka non-resident bank depositors) are more likely to *passively deposit* larger amounts of money into the banks of that nation state.

2. Having a *bank deposit insurance scheme* (for all practical purposes) guarantees that a nation state will more likely have a higher rate of passive foreign investment (within the margin of insurable amount).

3. Passive foreign investment in a nation state's finance system allows for more lending to be made when global finance system conditions constrict the amount of lendable money. There has been substantial research done over the years on the impact on *foreign investment* of *bank deposit insurance schemes*.

4. Deposit insurance enables banks to increase the money supply, without it underfunded banks might suffer a bank run which is prevented by the insurance. This encourages inflation.

Criticisms:

Detractors of deposit insurance claim the schemes introduce a moral hazard issue, encouraging both depositors and banks to take on excessive risks.[4] Without deposit insurance, banks would compete prudently for deposits because depositors would prefer safe banks over risky banks to guard their money. With deposit insurance, banks can take excessive risks because depositors do not fear for their deposits' safety and thus do not move their money to safer banks. The risks are shared by all banks, safe or risky.

If deposit insurance is provided by another business or corporation, like other insurance agreements, there is a presumption that the insurance corporation would either charge higher rates or refuse to cover banks that engaged in extremely risky behavior,[5] which not only solves the problem of moral hazard but also reduces the risk of a bank run.

The Bibby plan, which avoids the problem of moral hazard but still prevents bank runs, would have the state provide deposit insurance, with the banks paying regular premiums to the state reflecting the extent of the deposit insurance. The level of the deposit insurance could be at the choice of the banks, and the inherent risk in that particular bank. The plan would allow some element of differentiation between banks in terms of investment risk and in the level of insurance offered.

Analysis of Working of DICGC in India:

The Deposit Insurance and Credit Guarantee Corporation (DICGC) functions primarily as a pay box entity, i.e., reimbursing the depositors of failed member banks, although it has some role in resolution through the provision of financial support to depositors of weak banks that merge with strong banks after the approval of the merger by the regulator. With the present limit of deposit insurance in India at 1 lakh, the number of fully protected accounts constituted 92 per cent of the total number of accounts. Amount-wise, insured deposits at 33,70,000 crore as at end- March 2019 constituted 28.1 per cent of assessable deposits at 1,20,05,100 crore. The total premium collected from member banks was 12,040 crore during 2018-19. Commercial banks contributed 93 per cent of the premium while cooperative banks accounted for the remaining 7 per cent. Premium received for H1:2019-20 was 6,484 crore. The corporation sanctioned aggregate claims of 40 crore with respect to 15 cooperative banks during 2018-19.

The Reserve Bank of India (RBI) issues directions to cooperative banks to protect the interests of the depositors and in public interest on finding serious irregularities during the course of regular inspections. The nature of these directions includes a ban on grant/renewal of loans and advances, grant of accommodation without specific authorization from National Bank for Agriculture and Rural Development (NABARD)/RBI, making/renewing investments in bonds without prior approval of the RBI and incurring any liability including borrowing of funds and acceptance of fresh deposits or making any payments or discharging any liability or obligation except in accordance with the provisions of the directives. The extent of devolvement on DICGC in the event of all the banks 'under direction' or weak banks going into liquidation/ordered to be wound up, would be 3,414 crore in the case of StCBs/DCCBs and 10,684 crore in the case of UCBs (including Punjab and Maharashtra Co-operative (PMC) Bank).[7]

Table no. 1

DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION - INSURED DEPOSITS					
					(Number in Lakh)
Year	**Number of fully protected accounts**	**Number of Un-protected accounts**	**Total number of accounts**	**% of protected accounts**	**% of Un-protected accounts**
2010	9770	750	10520	92.870722	7.129277567
2011	9960	770	10730	92.823858	7.176141659
2012	13930	890	14820	93.994602	6.005398111
2013	12670	1030	13700	92.481752	7.518248175
2014	13450	1110	14560	92.376374	7.623626374
2015	15530	1290	16820	92.330559	7.669441141
2016	17380	1470	18850	92.201592	7.798408488
2017	17750	1660	19410	91.447707	8.552292633
2018	20000	1740	21740	91.99632	8.003679853
2019	21610	1890	23500	91.957447	8.042553191

(Source: rbidocs.rbi.org.in)

Table no. 1 shows the number of accounts protected, unprotected and total number of accounts from the year 2010 to 2019 (i.e. last 10 years) with percentage of protected accounts and percentage of unprotected accounts. In the study period the total number of accounts has been increased from 10520 lakh to 23500 lakh i.e. more than 200%, which shows the awareness and trust of public in Indian banking system. The number of protected accounts is increasing every year, but the percentage of protected accounts is same at near about 92% because of the total number of accounts is also increasing every year. The same increasing trend of un-protected accounts is also seen but the percentage of un-protected accounts are fixed at near about at 8% during the study period that is also due to increasing trend in total number of accounts.

Conclusion:

The deposit insurance agency has an important role in safeguarding financial stability. DICGC has facilitated the merger of 22 weak banks with strong banks since 1985 (nine commercial banks and 13 cooperative banks). However, the recovery rate of funds provided by DICGC is not satisfactory and it requires to be improved by the RBI.

Suggestions:

1. The investors should not deposit all their money in the same bank. They should deposit their money in the different banks. By doing this, they will get maximum amount of deposit insurance on his deposits in case of failure of banks.

2. The investors should deposit their money in commercial banks instead of co-operative banks. Reserve Bank merges the commercial banks in case of weak financial conditions into other commercial banks. Hence, the cases of failure of commercial banks are very less in comparison to co-operative banks.

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