

FRDI and digital economy concerns

What is the issue?

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The “bail-in” clause of the Financial Resolution and Deposit Insurance Bill (FRDI) has led to worries about the safety of bank deposits.

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Click [here](#) to know more about FRDI

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How a Bail-in clause of FRDI works?

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- In case of a bankruptcy the bill enables the government to confiscate the deposits of ordinary citizens by a Resolution corporation to liquidate the assets of the bank or insurance company.

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- The Resolution Corporation is empowered to monitor financial firms, calculate stress and take corrective actions in case of a failure.

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- The bill proposes 'bail-in' as one of the methods to resolution which gives banks the authority to issue securities as a replacement of the money deposited.

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- The insurance option covers only up to Rs.1,00,000 of the deposited money.

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- The remainder of the sum deposited with a bank will be converted to tradable financial assets which can be redeemed.

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What are the reasons behind proposing such bill?

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- Banks have been a major source of funding for governments and their economies across the world.
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- Most of government lending happens through loans which are not backed by savings but instead through fresh money creation.
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- Policies like negative interest rates push depositors to rush out of banks to escape the tax imposed on their deposits.
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- Such an event can lead to severe bank runs and destabilise the banking system because bank deposits are only fractionally backed by actual cash.
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How the bill threatens the depositors?

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- FRDI possess a larger threat to the deposits of ordinary citizens as it undermines the safety of bank deposits.
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- According to Section 52 of the proposed Bill, depositors will lose their rightful claim to retrieve their savings in case of liquidation of banks and insurance companies.
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- It would also strip depositors of the power to withdraw their deposits in the form of cash to escape any tax or other forms of confiscation by the government.
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- Since the banks are already filed for bankruptcy, redemption value of tradable financial assets will not be immediately proportionate with the deposit amount.
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How Digital economy favours banks?

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- Digital economy makes banks easier to carry out their business of credit creation without the risk of having to satisfy the demand for cash from depositors.
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- It also prevents recurrent crises of liquidity that are faced by banks.
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- Under a cashless banking system depositors are essentially locked in by banks.
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- Depositors in such cases will have no other option but to spend their money to escape a penalty on it.
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Source: The Hindu

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