Relook at Deposit Insurance in India

What is the issue?

- The RBI recently capped withdrawals from the Punjab and Maharashtra Cooperative (PMC) Bank at Rs. 1,000.
- In this context, here is an overview at the nature of deposit insurance in India and the working of Deposit Insurance and Credit Guarantee Corporation (DICGC).

What is the crisis at PMC?

- The PMC bank allegedly enabled frauds worth Rs.6,500 crore by promoters of Housing Development Infrastructure Ltd (HDIL).
- More than 70% of PMC Bank's total loan book has exposure to HDIL.
- HDIL's inability to repay its debt may lead to shutting down of the lender.
- This has placed thousands of depositors' money at risk.
- Denying people the right over their hard-earned money is a fatal hazard for the financial system, which runs on the trust of depositors.

What is deposit insurance?

- Deposit insurance is a measure to protect bank depositors, in full or in part, from losses caused by a bank's inability to pay its debts when due.

- The Centre has set up Deposit Insurance and Credit Guarantee Corporation under RBI to protect depositors if a bank fails.
- The deposit insurance scheme is mandatory for all banks and no bank can voluntarily withdraw from it.
- Compared to other BRICS nations, India today has the lowest deposit insurance cover to per capita income ratio.

What are the shortfalls and the reforms needed in this regard?

- **Insurance limit** - A limit is the highest amount an insurer will pay for a claim that an insurance policy covers.
- Most people agree that the insurance limit of Rs.1 lakh, set in 1993, needs to be raised to a higher amount.
- Suggestions are being made to raise it to Rs. 15 lakh, which will cover 90% of the accounts completely.

- **Coverage** - Customers who want more coverage than the statutory cover on their deposits should be able to purchase it by paying additional premium.
- This option should be extended directly to banks that wish to increase the coverage of deposits to above the statutory requirements.
- **NBFCs** - The lack of DICGC coverage for deposits at NBFCs (many of whom the RBI regulates) and primary cooperative societies is one such aspect.
- These entities often serve vulnerable sections and their depositors must not be left stranded in case of a crisis.

- **Withdrawal** - Another deficiency in the current DICGC cover is that the Rs.1 lakh insurance amount only needs to be released if there is a bankrupt.
- Without liquidation of the bank, no liability accrues on the insurance company to pay such a claim.
- The flaw in this scheme is obvious as the 'freezes' in withdrawal directed by the RBI essentially cut the depositor's access to his/her money.
- Hence, during such periods (freezes), at least the statutory amount should be released.
- This will go a long way in preventing bank runs, which could be triggered when customers get alarmed about the ability of banks to repay their deposits.
- **Premium** - Currently the DICGC charges a flat 0.1% insurance premium on the deposits of banks.
- However, as suggested by an RBI panel in 2015, premium should be based on differential risk based on the lending practices of the bank, among other things.
- An SBI report states that 93% of the premium collected by the DICGC in 2018-19 came from commercial banks (public sector: 75%, private sector: 18%).
- But, over 94% of the claims settled (ever since the inception of the DICGC) have been those of cooperative banks.
- Clearly, poor governance in cooperative banks has been cross-subsidised by the better-performing commercial banks.
- The DICGC must thus draw inspiration from standard insurance practices.
- It should charge higher premiums from banks with a past history of higher claims.
- This will also provide a level-playing field for PSBs which are often disadvantaged due to tight government control and inflexibility.

- **Private insurers** - Another possibility to be analysed is that of bringing private sector insurers and re-insurers into the deposit insurance segment.
- This could drive down the premium prices.
- In FY19, the DICGC collected Rs. 12,043 crore as premium and settled Rs. 37

crore worth claims.

- Clearly, this is a lucrative area for private players who can bring in more accurate risk-based pricing of these policies.
- Notably, underwriting such policies entails significant risk-bearing on which the country's economy thrives.
- So, it needs to be reinsured by credible entities.
- Given all these, the government must take purposeful steps in expanding and rectifying the deposit insurance scheme as a safety net of the financial system.

Source: The Hindu