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ENHANCING INSURANCE COVERAGE FOR BANK DEPOSITS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The RBI logo is pictured outside its head office in Mumbai. File | Photo Credit: Reuters

When word got out about the Reserve Bank of India (RBI)'s capping of withdrawals from the Punjab and Maharashtra Cooperative (PMC) Bank at 1,000, it did not take long for tragic stories to start pouring in. The death count had risen to three by the time the HDIL angle was discovered. With the Non-Performing Assets (NPA) situation not improving in most banks, the advent of another major crisis brought into focus, once again, the deposit insurance cover provided by the Deposit Insurance and Credit Guarantee Corporation (DICGC), a subsidiary of the RBI.

Most people agree that the insurance limit of 1 lakh, set in 1993, needs to be raised to a higher amount, with some suggestions being made to raise it to 15 lakh, which will cover 90% of the accounts completely.

But the discussion around deposit insurance must extend beyond the amount of coverage. 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 in the lurch in case of a crisis. Further, customers who want more coverage than the statutory cover on their deposits should be able to purchase this 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.

Another deficiency in the current DICGC cover is that the 1 lakh insurance amount only needs to be released if a bank goes belly up. Without liquidation of the bank, no liability accrues on the insurance company to pay such a claim. The flaw in this scheme is obvious today — the 'freezes' in withdrawal directed by the RBI essentially cut the depositor's access to his money. Hence, during such periods, 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.

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 draw inspiration from standard insurance practices and charge higher premiums from banks with a past history of higher claims, so that public sector banks (PSBs) — which have made zero claims so far — need not foot the bill for someone else's mistake. This will also provide a level-playing field for PSBs which are often disadvantaged due to tight government control and inflexibility.

Another possibility that needs to be analysed is that of bringing private sector insurers and re-insurers into the deposit insurance segment, which could drive down premium prices. In FY19, the DICGC collected 12,043 crore as premium and settled 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. And since underwriting such policies entails significant risk-bearing on which the country's economy thrives, it needs to be reinsured by credible entities even beyond traditional re-insurers like Lloyd's of London.

Compared to other BRICS nations, India today has the lowest deposit insurance cover to per capita income ratio, at 0.9 times. Denying people the right over their hard-earned money is a colossal hazard for the financial system, which runs on the trust of depositors. Already, trust in banks could be waning — in FY18, growth in bank deposits fell to a five-decade low. If the government is serious about formal financial inclusion, the stated objective of flagship schemes like the Pradhan Mantri Jan Dhan Yojana, it must realise that an immediate availability of funds is as important as the insurance coverage of funds to increase the confidence of citizens in the banking system. Hence, it must take purposeful strides in expanding and rectifying the deposit insurance scheme as a safety net of the financial system.

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