DEPOSIT INSURANCE AND CREDIT GUARANTEE CORPORATION : ECONOMY

NEWS: *Centre likely to raise deposit insurance limit from ₹5 lakh*

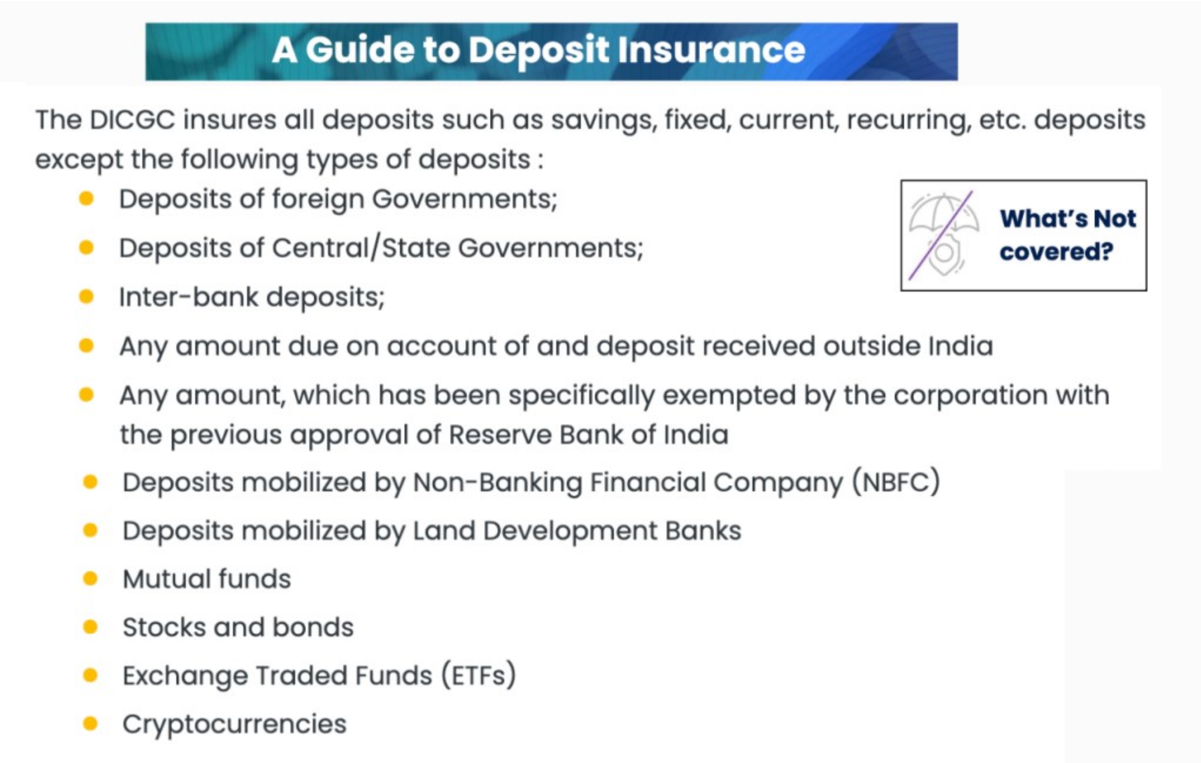
WHAT'S IN THE NEWS?

Introduction to Deposit Insurance Deposit insurance acts as a financial safeguard for depositors against the risk of bank failures, ensuring that a portion of their deposits is secured. In India, this system is managed by the Deposit Insurance and Credit Guarantee Corporation (DICGC), a subsidiary of the Reserve Bank of India (RBI), which plays a critical role in maintaining confidence in the banking system, averting bank runs, and bolstering financial stability.

Understanding Credit Guarantee A credit guarantee serves as a safety net for creditors by providing a specific remedy if the debtor defaults on their obligations, thus facilitating lending and reducing the risk of losses.

Deposit Insurance and Credit Guarantee Corporation (DICGC)

- **Overview**: Established under the Deposit Insurance and Credit Guarantee Corporation Act of 1961, DICGC is one of the oldest deposit insurance entities globally and operates as a fully owned subsidiary of the RBI.
- **Coverage**: DICGC insures deposits across a variety of banking institutions including
    - all scheduled commercial banks,
    - foreign banks operating in India,
    - small finance banks, payment banks,
    - regional rural banks,
    - local area banks,
    - state co-operative banks,
    - district central co-operative banks, and
    - urban co-operative banks.
- However, it does not cover primary cooperative societies.



A Guide to Deposit Insurance

What's Not covered?

The DICGC insures all deposits such as savings, fixed, current, recurring, etc. deposits except the following types of deposits :

- Deposits of foreign Governments;
- Deposits of Central/State Governments;
- Inter-bank deposits;
- Any amount due on account of and deposit received outside India
- Any amount, which has been specifically exempted by the corporation with the previous approval of Reserve Bank of India
- Deposits mobilized by Non-Banking Financial Company (NBFC)
- Deposits mobilized by Land Development Banks
- Mutual funds
- Stocks and bonds
- Exchange Traded Funds (ETFs)
- Cryptocurrencies

Evolution of Deposit Insurance in India

- **Historical Increases**: The deposit insurance limit was initially set at ₹1 lakh in 1993. This limit was increased to ₹5 lakh in 2020 following the crisis at Punjab and Maharashtra Cooperative Bank (PMC Bank).
- **Recent Developments**: Post the New India Cooperative Bank issue in 2024, there's an ongoing discussion led by the Finance Ministry to consider further increasing the insurance limit. This discussion is backed by the RBI's Deputy Governor, advocating for periodic adjustments in the deposit insurance cap based on inflation, deposit growth, and rising income levels.

Current Insurance Coverage

- **Insurance Limit**: The current coverage limit by DICGC stands at ₹5 lakhs, which includes both the principal and interest amounts across savings, fixed, and recurring deposits.
- **Aggregation Rules**: Deposits across different branches of the same bank are aggregated for insurance purposes, with a maximum of ₹5 lakhs payable. However, deposits under different ownership types or in separate banks are insured independently.
- **Premiums**: Banks fund the deposit insurance scheme by paying a premium of ₹0.12 per ₹100 deposited.

Trigger for DICGC Payout DICGC is mandated to compensate depositors up to the insured amount if a bank is liquidated, and this payout is processed within two months from the date the claim list is submitted by the liquidator.

Significance of Deposit Insurance

- **Financial Stability**: By protecting depositor funds, deposit insurance prevents bank runs and boosts depositor confidence, particularly among small account holders.
- **Protection for Small Depositors**: Approximately 97.8% of depositors are fully covered under the current system, safeguarding their finances against bank insolvencies.
- **Encouragement for Savings and Financial Inclusion**: Insured deposits encourage public trust in the banking system, promoting savings and contributing to overall financial inclusion.

Challenges with the Current System

- **Coverage Limits**: The existing insurance cap of ₹5 lakh may be insufficient due to inflation and the growing volume of deposits.
- **Delayed Payouts**: Depositors can experience significant delays in receiving insured amounts when banks fail.
- **Moral Hazard**: The assurance of deposit insurance may incentivize banks to undertake riskier financial practices, knowing depositor funds are secured against losses.
- **Limited High-Value Deposit Coverage**: While a large percentage of accounts are insured, only 43.1% of the total deposit value is covered, leaving substantial deposits at risk.

Recommendations for Improvement

- **Periodic Adjustment of Coverage**: Linking the deposit insurance limit to economic indicators such as inflation could ensure more robust depositor protection.
- **Enhanced Oversight of Cooperative Banks**: Strengthening regulatory oversight over cooperative banks can preempt financial instabilities that lead to bank failures.
- **Streamlining Claim Settlements**: DICGC should enhance its claim processing mechanisms to minimize payout delays.
- **Increased Public Awareness**: Enhancing depositor awareness about the extent and limitations of their insurance coverage is crucial for ensuring informed banking decisions.

This detailed exploration reflects the importance of adapting deposit insurance policies to contemporary economic conditions and challenges, aiming to safeguard depositor interests while maintaining systemic financial stability.

Source: https://www.thehindu.com/business/Economy/plan-to-hike-deposit-insurance-limit-in-banks-says-finance-ministry/article69230447.ece