Do Indians need insurance for bank deposits?

What is the issue?

India needs to move to a risk-adjusted premium model so investors are more aware of the risks

What is Revamped Deposit Insurance Scheme?

- The revamped deposit insurance scheme was upgraded through the Deposit Insurance and Credit Guarantee Corporation (DICGC) Amendment Bill, 2021,
- It guarantees **to compensate depositors up to a limit of Rs. 5 lakh within a period of 90 days** from when a bank fails.
- So far Rs. 1,300 crore has been paid to depositors in troubled cooperative banks.

Why should we raise the value of the deposits that will be insured?

- Rs. 1 lakh limit was set in 1990s.
- Considering the inflation rate this has become extremely inadequate.
- Compared to international standards our insurance limit is much lower (6 to 10 times) than several comparable economies like South Korea and Brazil.
- We are also way below U.K. and U.S.A.
- Though we cannot compare figures across countries in isolation due to differences in purchasing power we still have a lower amount of deposit insurance than other countries.
- So, by raising the limit to Rs. 5 lakh, we are going in the right direction.

Why do we need insurance for bank deposits?

- **History -** Discussion on deposit insurance began in India after a number of bank failures. Attempts were made to stabilise the banking system.
- In the 1930s, the U.S. set up deposit insurance. India set it up in the 1960s to deal with bank failures.
- So each time your banks fail in large numbers, the central bank does something about deposit insurance.
- **Confidence Building Measures -** We want to give confidence to depositors that if a bank does go down, they don't need to run to the bank.
- Instead they can keep their money in the bank, and the bank can continue operating without any financial trouble. It is a combination of these things.
- **Cost of Delayed Payment –** Investors are not able to figure out good banks and bad banks. They generally invest in banks where returns are high.
- But no one has lost money in any scheduled commercial bank in India.
- There may be a liquidity risk but no credit risk because the government always comes in and rescues banks. It means there is 100% insurance.
- However there may be a delay in case of bad banks and that can be pretty costly. The sooner

we get there, the better it is.
- So we need risk-based deposit insurance premiums, which is simply absent in India.

Can Private insurers provide confidence during a crisis?

- It comes into play **when panic sets** in, like in 2008.
- Everybody was panicking about the financial sector and wanted their money back, fueling a self-fulfilling crisis.
- In that scenario, private insurance might not work because people might think that the private insurer will become bankrupt.
- This is where the might of the government comes in because the government has the ability to be the lender of last resort.
- We saw in the 2008 crisis that the U.S., which is generally seen as a more market-driven financial system, had to be eventually bailed out by the government.

What should RBI do beyond insurance for bank deposits?

- The DICGC is basically owned by the RBI.
- But when it comes to bank failures, it is the RBI and not the DICGC that is playing a major role
- In U.S.A the Federal Deposit Insurance Corporation also plays a role in the resolution of troubled banks
- The Federal Reserve doesn't play an active role in the resolution process other than lending to the troubled institution.
- When these bank failures happen there are a lot of signs of the failure that build up leading to the crisis.
- Regulators are always a few steps behind the banks. They are still playing the catch-up game in figuring out the true level of risk that banks have.
- RBI should disclose risk information and take quick action before a bank fails. For this you need to have a good model to figure out which bank is under stress.
- Depositors discipline has to go hand in hand with improvement in risk management system across the board.

Reference

1. https://www.thehindu.com/todays-paper/tp-opinion/do-indians-need-insurance-for-bank-deposits/article38024606.ece

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