FRDI and digital economy concerns

What is the issue?

\n\n

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

\n\n

Click here to know more about FRDI

\n\n

How a Bail-in clause of FRDI works?

\n\n

\n
- 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.
\n
- The Resolution Corporation is empowered to monitor financial firms, calculate stress and take corrective actions in case of a failure.
\n
- 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.
\n
- The insurance option covers only up to Rs.1,00,000 of the deposited money.
\n
- The remainder of the sum deposited with a bank will be converted to tradable financial assets which can be redeemed.
\n

\n\n

What are the reasons behind proposing such bill?

\n\n

\n

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

\n\n

How the bill threatens the depositors?

\n\n

\n
- FRDI possess a larger threat to the deposits of ordinary citizens as it undermines the safety of bank deposits.
  \n
- 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.
  \n
- 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.
  \n
- Since the banks are already filed for bankruptcy, redemption value of tradable financial assets will not be immediately proportionate with the deposit amount.
  \n

\n\n

How Digital economy favours banks?

\n\n

\n
- 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.
  \n

- It also prevents recurrent crises of liquidity that are faced by banks.
  \n
- Under a cashless banking system depositors are essentially locked in by banks.
  \n
- Depositors in such cases will have no other option but to spend their money to escape a penalty on it.
  \n

\n\n

\n\n

Source: The Hindu

\n

