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Deposit insurance: A way to secure your money deposited into bank

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Abstract
Deposit insurance is a measure implemented in many countries to protect bank depositors, in full or in part, from losses caused by a bank's inability to pay its debts when due. Deposit insurance systems are one component of a financial system safety net that promotes financial stability. Deposit insurance institutions are for the most part government run or established, and may or may not be a part of a country's central bank, while some are private entities with government backing or completely private entities.

Keywords: Deposit insurance, financial system safety

Introduction

Banks are allowed to lend or invest most of the money deposited with them instead of safe-keeping the full amounts. If many of a bank's borrowers fail to repay their loans when due, the bank's creditors, including its depositors, risk loss. Because they rely on customer deposits that can be withdrawn on little or no notice, banks in financial trouble are prone to bank runs, where depositors seek to withdraw funds quickly ahead of possible bank insolvency. Because banking institution failures have the potential to trigger a broad spectrum of harmful events, including economic recessions, policy makers maintain deposit insurance schemes to protect depositors and to give them comfort that their funds are not at risk.

Working of deposit insurance

All deposits maintained by the depositor across all branches of the failed bank are clubbed. Or in other words, if a person keeps deposits in different branches of a bank, they are paid a maximum of up to Rs. One Lakh only on the aggregate amount. This limit of Rs. One Lakh includes principal and interest amount both. With a view to providing a greater measure of protection to depositors in banks the Deposit Insurance and Credit Guarantee Corporation has raised the limit of insurance cover for depositors in insured banks from the present level of Rs.1 lakh to Rs. 5 lakh per depositor with effect from February 4, 2020 with the approval of Government of India [1]. The amount of saving account, current account and fixed deposit are covered under deposit insurance scheme. However, deposits maintained with different banks are not clubbed. The deposit insurance scheme covers all banks operating in India including private sector, co-operative and even branches of foreign banks in India. There are some exemptions like deposits of foreign governments, deposits of central/state governments and inter-bank deposits. Every insured bank pays 0.001% as premium of deposits to DICGC.

History of deposit insurance in India

Deposit insurance was formed to protect small unit banks in the United States when branching regulations existed. Banks were restricted by location thus did not reap the benefits coming from economies of scale, namely pooling and netting. To protect local banks in poorer states, the federal government created deposit insurance [2].

As on 31 January 2014, 113 countries have instituted some form of explicit deposit insurance up from 12 in 1974. There are a number of countries with more than one deposit insurance system in operation, including Austria, Canada, Germany, Italy, and the United States.

In India, Deposit Insurance was introduced in 1962. The Deposit Insurance Corporation commenced functioning on January 1, 1962 under the aegis of the Reserve Bank of India (RBI).

1971 witnessed the establishment of another institution, the Credit Guarantee Corporation of India Ltd. (CGCI). In 1978, the DIC and the CGCI were merged to form the Deposit Insurance and Credit Guarantee Corporation (DICGC). Deposit Insurance and Credit Guarantee Corporation (DICGC) is a wholly owned subsidiary of Reserve Bank of India. It was established on 15 July 1978 under the Deposit Insurance and Credit Guarantee Corporation Act, 1961 for the purpose of providing insurance of deposits and guaranteeing of credit facilities. DICGC insures all bank deposits, such as saving, fixed, current, recurring deposit for up to the limit of Rs. 100,000 of each deposits in a bank [3]. This limit of Rs.1 lakh has been increased by DICGCto Rs. 5 lakh per depositor with effect from February 4, 2020 with the approval of Government of India

Benefits of deposit insurance

1. When a nation state has a deposit insurance scheme, foreign investors (aka non-resident bank depositors) are more likely to *passively deposit* larger amounts of money into the banks of that nation state.
2. Having a *bank deposit insurance scheme* (for all practical purposes) guarantees that a nation state will more likely have a higher rate of passive foreign investment (within the margin of insurable amount).
3. Passive foreign investment in a nation state's finance system allows for more lending to be made when global finance system conditions constrict the amount of lendable money. There has been substantial research done over the years on the impact on foreign investment of bank deposit insurance schemes.
4. Deposit insurance enables banks to increase the money supply, without it underfunded banks might suffer a bank run which is prevented by the insurance. This encourages inflation.

Criticisms

Detractors of deposit insurance claim the schemes introduce a moral hazard issue, encouraging both depositors and banks to take on excessive risks [4]. Without deposit insurance, banks would compete prudently for deposits because depositors would prefer safe banks over risky banks to guard their money. With deposit insurance, banks can take excessive risks because depositors do not fear for their deposits' safety and thus do not move their money to safer banks. The risks are shared by all banks, safe or risky.

If deposit insurance is provided by another business or corporation, like other insurance agreements, there is a presumption that the insurance corporation would either charge higher rates or refuse to cover banks that engaged in extremely risky behavior [5], which not only solves the problem of moral hazard but also reduces the risk of a bank run.

The Bibby plan, which avoids the problem of moral hazard but still prevents bank runs, would have the state provide deposit insurance, with the banks paying regular premiums to the state reflecting the extent of the deposit insurance. The level of the deposit insurance could be at the choice of the banks, and the inherent risk in that particular bank. The plan would allow some element of differentiation between banks in terms of investment risk and in the level of insurance offered.

Punjab and Maharashtra Co-operative (PMC) Bank Scam

Punjab and Maharashtra Co-operative (PMC) Bank has its 92% deposits of 30% depositors. Bank has 898 crore deposits of such depositors who have less than 25000/- deposits in the bank out of total 11617 crore deposits. The bank was placed under restrictions by RBI for allegedly trying to mislead the banking regulator by masking its core banking system and creating over 21,000 fake accounts to hide loan defaults by HDIL group companies. This was the case of bank fraud.

The majority amount of loan borrowed (around Rs 1520.49 crore) from PMC was by three group companies - HDIL, PPIPL and GACL. The principle amount of these loans was Rs 513.01 crore while the interest came to Rs 1007.47 crore. HDIL had a total 44 loan accounts with PMC Bank, which included personal accounts of promoters Rakesh Wadhawan and Sarang Wadhawan. The majority of loans borrowed by HDIL and group companies were used to settle loans or liabilities of other group companies. The loan worth Rs 33 crore sanctioned to HDIL group company Excel Arcade Pvt Ltd was utilised to pay off loan of HDIL group company Privilege Industries Ltd. PMC had also sanctioned another loan of Rs 200 crore to HDIL group company Somerset Constructions PVT, which was used to settle the liabilities of HDIL Group company Blue Star Realtors. A term loan of Rs 100 crore sanctioned by the bank to Excel Arcade Pvt Ltd was used to clear the OD of Excel (Rs 30 crore). The remaining Rs 70 crore was also further diverted for payment of a loan of Privilege Industries Ltd. The balance OD of Rs 21 crore was transferred to the Excel loan account.

The bank's CMD Joy Thomas would personally look into the accounts of HDIL and group companies and had instructed systems department to apply access code so that the HDIL accounts don't appear in the overdrawn and overdue statements. This was done to hide the company's loan exposure from RBI [6].

Analysis of Working of DICGC in India

The Deposit Insurance and Credit Guarantee Corporation (DICGC) functions primarily as a pay box entity, i.e., reimbursing the depositors of failed member banks, although it has some role in resolution through the provision of financial support to depositors of weak banks that merge with strong banks after the approval of the merger by the regulator. With the present limit of deposit insurance in India at 1 lakh, the number of fully protected accounts constituted 92 per cent of the total number of accounts. Amount-wise, insured deposits at 33,70,000 crore as at end-March 2019 constituted 28.1 per cent of assessable deposits at 1,20,05,100 crore. The total premium collected from member banks was 12,040 crore during 2018-19. Commercial banks contributed 93 per cent of the premium while cooperative banks accounted for the remaining 7 per cent. Premium received for H1:2019-20 was 6,484 crore. The corporation sanctioned aggregate claims of 40 crore with respect to 15 cooperative banks during 2018-19.

The Reserve Bank of India (RBI) issues directions to cooperative banks to protect the interests of the depositors and in public interest on finding serious irregularities during the course of regular inspections. The nature of these directions includes a ban on grant/renewal of loans and advances, grant of accommodation without specific authorization from National Bank for Agriculture and Rural Development (NABARD)/RBI, making/renewing investments in bonds without prior approval of the RBI and incurring any liability including borrowing of funds and acceptance of fresh deposits or making any payments or discharging any liability or obligation except in accordance with the provisions of the directives. The total insured deposits (IDs) of State Co-operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Urban Co-operative Banks (UCBs) put under direction by the RBI as well as weak UCBs as on September 30, 2019 are given in Table no. 1. The extent of devolvement on DICGC in the event of all the banks 'under direction' or weak banks going into liquidation/ordered to be wound up, would be 3,414 crore in the case of StCBs/DCCBs and 10,684 crore in the case of UCBs (including Punjab and Maharashtra Co-operative (PMC) Bank) [7].

Table 1: Total insured deposits (Rs. in crore)

Quarter ended	STCBs/ DCCBs Under Direction	UCBs Under Direction	Weak UCBs except (3)	Total (2+3+4)
(1)	(2)	(3)	(4)	(5)
June 2019	3,873	3,427	2,706	10,006
September 2019	3,414	8,116	2,568	14,098

Source: DICGC.

Insured deposits of banks which are 'under direction' or 'weak' constituted about 0.4 per cent of the total insured deposits of commercial and cooperative banks as at end-September 2019. As a percentage of the deposit insurance fund, these deposits are about 13.9 per cent. It needs to be noted that the banks which are under direction/ weak will go under liquidation over a period, not together at a particular point of time. Weak banks may also witness a revival.

Conclusion

The deposit insurance agency has an important role in safeguarding financial stability. DICGC has facilitated the merger of 22 weak banks with strong banks since 1985 (nine commercial banks and 13 cooperative banks). However, the recovery rate of funds provided by DICGC is not satisfactory and it requires to be improved by the RBI.

Suggestions

1. The investors should not deposit all their money in the same bank. They should deposit their money in the different banks. By doing this, they will get maximum amount of deposit insurance on his deposits in case of failure of banks.
2. The investors should deposit their money in commercial banks instead of co-operative banks. Reserve Bank merges the commercial banks in case of weak financial conditions into other commercial banks. Hence, the cases of failure of commercial banks are very less in comparison to co-operative banks.

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