

Executive Summary

The Backdrop

Traditionally, India has been a savings-oriented economy, which is widely acknowledged too. The household sector has been the largest contributor to gross domestic savings. It is also true that the highest chunk of savings is channelled through banks. As far as the household sector is concerned, in 2014-15 (Preliminary Estimates), while (change in) bank deposits constituted the highest share in (change in) gross financial assets at 46.9%, the share of (change in) bank loans in (change in) gross financial liabilities was as high as 93.3%. As proportion of GDP (at current market prices), bank deposits and loans are estimated to be 69.1% and 53.6% respectively in 2015-16. Thus, being the spinal cord of the economy and the financial sector alike, the banking sector, if disturbed, can transmit tremors through a significant part of the financial sector as also economic superstructure of India.

A typical bank depositor in India is small, unsophisticated and worried more about the safety of her/his deposits than return on those. Depositors prefer public sector banks (PSBs) to other banks as the former is predominantly owned by the central government and hence perceived as fail-safe. Even otherwise, in general, the commercial banks are considered 'too-important-to-fail' (TITF). However, the cooperative banking sector is considered and observed to be fragile.

In view of the above, Deposit Insurance (DI) is a logical necessity of any banking system. The logic derives from basically two factors: (a) It instils a sense of confidence in the teeming millions of lower and middle income group citizens who form the backbone of the banking system and thereby protects depositor runs at the time of banking crises that ultimately ensures systemic safety and soundness ('crisis prevention' function) and (b) It ensures quick resolution of failed banks and therefore guarantees smooth functioning of the banking system, post-crisis ('crisis management' function).

The Indian DIS is the second oldest in the world having been set up in 1962 after FDIC was established in 1933. DICGC, India's Deposit Insurance Agency (DIA), is a fully-owned subsidiary of RBI and its operations are of low profile nature, unlike the DIAs in many advanced economies. However, conditions are changing.

Motivation

It is the interplay of the following 3 factors that has motivated the researcher to choose this topic for his doctoral research. First, he has long-standing association with the subject of

deposit insurance dating back to 1994 not only as a researcher but also as a practical policy maker. Secondly, deposit insurance *per se* being an unimportant banking activity, the subject has also remained grossly under-researched. Therefore, with his above-mentioned background on the subject, he wants to fill up the gap to some extent. Finally, at a personal level, the researcher is concerned about the safety of the deposits of the bank depositor, especially those of the small depositors to whom the post-tax return (both nominal and real) is not so rewarding.

Objectives of Research

In this research, it is argued that the transformations that are taking place in the Indian economy in general and financial services industry in particular will make imperative changes in the Deposit Insurance System (DIS) too. The paper focuses on these emerging scenarios and works out an agenda for reforming the DIS in India. It does not argue for abolishing deposit insurance but emphasizes on bolstering the existing system. Working towards this, the following specific objectives have been explored:

- i. To review the role of DI in the financial sector and economic development
- ii. To conduct a detailed survey of the nature of deposit taking activity in India – depositors, instruments, institutions and regulatory framework
- iii. To explore the origin and history of DI in India
- iv. To critically examine the various functions of the existing DIS in India
- v. To recommend changes in the existing system
- vi. To redefine the role of DIA

Methodology and Database

This is a descriptive but practical policy-oriented work – policies which *can* be implemented for the common good and thereby enhancing the utility of the research work in the real situation. It is an argumentative paper which combines theoretical concepts of both banking and insurance with insight, experience and judgement sourcing from practical experience with a view to arriving at policy conclusions which will be in consonance with contemporary real operating environment. In this effort, theoretical and empirical evidences have been greatly sourced. While making policy recommendations, the latest global benchmarks and/or best practices which have been issued by FSB, BIS and IADI have been kept in view.

Scope

The focus is on bank deposits. Insurance for non-bank deposits does not fall in the purview of the work.

Quantitative Techniques

Simple statistical techniques, such as, measures of central tendency, measures of dispersion and trend analysis have been used. Besides, graphs have been extensively used.

Structure of the Thesis

Besides the Executive Summary which is presented in the beginning, the rest of the research document is organized as follows:

Chapter I deals with the introduction, objectives and methodology, etc.

Chapters II to IV dwell on a literature survey relating to (a) the link between financial development, economic growth and banks, (b) bank risks, and bank and depositor runs and (c) theories of deposit insurance and evidences, respectively.

Chapter V analyzes the various facets of the DISs all over the world.

Chapter VI briefly introduces the Indian banking sector and its segmental vulnerability. It also provides a glimpse of the history of bank failures in India.

Chapter VII gives a detailed account of the deposit-taking activities by the Indian banks and analyzes in greater detail the characteristic features of a typical Indian bank depositor.

Chapter VIII carries a detailed critical assessment of the DIS in India.

Chapter IX elaborates the efforts made hitherto to bring in reforms in the prevalent DIS.

Chapter X argues why Deposit Insurance will become important in future and how imminent the same is.

Chapters XI to XV deal with our recommendations relating respectively to (a) monetary coverage limit, (b) risk-based premium pricing, (c) Deposit Insurance Fund, (d) Resolution Mechanism and (e) Organizational matters.

Chapter XVI concludes.

Limitations

- i. Scarcity of literature on DI in India leading to reliance on foreign literature, most of which originate from the US

- ii. Another limitation perhaps could be the extent of purity and integrity of secondary databases.

Part – A: The Underpinnings

Financial Development, Economic Growth and Banks

- There is wide and deep theoretical and empirical evidence that financial development contributes to economic growth.
- Although financial development enhances growth, the dark side is finance *per se* is vulnerable to shocks or fragility.
- Although there have been debates as to whether banks, as financial infrastructure, are better than the market, the consensus, by and large, is that they are complementary to each other.
- Banks have been conceptualized as:
 - information collector, analyst and disseminator
 - a balance sheet with “synergies” between the assets and liabilities sides
 - liquidity creators
 - providers of transformation service
 - ‘special’ business units
 - “agents” of socio-economic change
 - fragile business units
 - financial superstores

Bank Risks, Deposit Run, Bank Panic and Bank Contagion

- Banks have to manage several risks of which credit risk, interest risk, liquidity risk and operational risk are the most important. Many banks in the recent past have waded into troubled waters owing to inappropriate management of these risks
- Trade-off of risks is possible either through *ex ante* or *ex post* mechanisms of which the former is more effective and economical.
- Depositor runs are susceptible to become a self-sustaining process, and when these become so, a typical bank run ensues.

- Bank runs result in depositors running to safer banks, and taking flight to quality (i.e., investing in safer securities) as well as to currency. Flight to currency is most pernicious.
- Runs on large banks produce only “churning” among the banks or securities or both - larger the bank, more serious is the churning.
- Bank contagion:
 - occurs faster
 - spreads more broadly within the industry
 - results in a large number of failures
 - results in large losses to creditors (depositors) although such losses are smaller than in non-bank industries
 - spreads more beyond the banking industry and causes substantial damage to the financial system as a whole and the macro economy
- By and large, it is widely acknowledged that bank runs impose heavy socio-economic cost on the society through various channels, besides dampening investors’ confidence.

Deposit Insurance: Theory and Evidence

- According to monetary authorities, deposit insurance can substantially reduce the external diseconomies - both micro and macro - arising out of bank failures.
- Both deposit insurance and ordinary insurance contracts are founded on the same insurance principles; nevertheless, all the existing deposits insurance systems are not proper insurance. Mostly structured on the model of insurance contract, they are rather financial guarantees for depositors' accounts.
- There are fundamental differences between deposit insurance and LLr.
- Deposit insurance aims at
 - Protecting small depositors
 - Preventing bank runs and
 - Preventing cost of bank runs via precluding
 - ❖ Contractionary effect on money supply

- ❖ Disruption of the payment system
 - ❖ Interference with financial intermediation and
 - ❖ Systemic effects of runs on individual large banks.
- Failure of banks in the US in the 1990s brought to the fore some of the negative facets of deposit insurance. These include concerns about
 - Moral hazard
 - Coverage and pricing
 - Bank supervision and
 - Competitiveness of banking industry.
 - Rajan, one of the vociferous critics of deposit insurance, calls it as an “anachronistic subsidy” for banks.

Part – B: Deposit Insurance Systems – A Global Phenomenon

World Deposit Insurance Systems

- Although the system of insuring bank depositors started in 1933 pioneered by USA in the post-Depression period, most of the DISs were established in 1990s, followed by the 7-year period 2000-07 and in the post-2007-08 crisis.
- Explicit DISs are predominant.
- Most of the Explicit systems have separate legal arrangements and are publicly administered.
- Both ‘Pay-box Plus’ and ‘Pay-box only’ roles are common.
- In all the countries, DIS is compulsory for the domestic banks as well as local subsidiaries of foreign banks. However, in several countries, the local branches of foreign banks participate.
- Apart from domestic deposits, foreign currency deposits are covered by several countries. Almost a third of the countries cover inter-bank deposits too. Co-insurance is very limited; it lost its appeal during the 2007-08 crisis.
- Majority of the DISs follow *ex ante* funding and are funded privately.
- About four-tenth of the countries report backstop facility.

- A little below one-third of the DISs follow the risk-adjusted premium system.
- Both total deposits and covered deposits are predominant as the assessment base.
- ‘Per depositor per bank’ is the predominant form of pay-out.
- The number of Explicit schemes is more in the relatively high income group countries than in the relatively low income group countries.
- In the aftermath of the 2007-08 financial crisis, many countries had increased their deposit insurance coverage levels in terms of their local currencies, most of which belonging to the advanced economies which were hit the hardest by the crisis.
- After the impact of the financial crisis dissipated, most of the countries kept their deposit insurance coverage unchanged at the 2010 level.
- However, in terms of the coverage/GDP ratios, maximum number of countries reported initial increase during 2003-10 but decrease during 2010-13.
- In the post 2007-08 crisis period, while 12 countries were added to the DIS space, all over the world, as many as 58 increased their DIS coverage levels.
- Post 2007-09 crisis, co-insurance declined.

Part – C: The World of Indian Banks and Bank Depositors

Banking System and Bank Failures in India

- The Indian commercial banking sector predominantly comprises: (a) Public Sector Banks - State Bank Group and Nationalized Banks, (b) Private Sector Banks - Old, New and ‘new’ New Banks, (c) Foreign Banks and (d) Regional Rural Banks.
- The cooperative banking sector is dominated by the Urban Cooperative Banks. There also exists a distinct rural cooperative banks segment.
- The commercial banking sector is perceived and evidenced to be more safe and sound than its cooperative counterpart.
- Within the commercial banking sector, PSBs are regarded as fail-safe due to government ownership.
- Historically, bank crises and failures in India date back to the 18th, 19th and the early 20th century.

- Banking turbulence is historically observed to have been linked to political and economic disturbances, although instances of mismanagement cannot possibly be ruled out entirely.

Deposit Taking Activities by Banks and Indian Bank Depositors

- Deposits of the banks in India are basically classified into: (i) Demand Deposits, (ii) Savings Bank Deposits and (iii) Term Deposits. Except (ii), the other two are composed of: (i) inter-bank deposits and (ii) public deposits.
- As at March-end 2015, two-third of the total deposits of SCBs (excluding RRBs) were term deposits and the remaining one-third CASA deposits, comprising 9% Demand Deposits and 24% Savings Deposits.
- Banks mobilize deposits from both Resident and Non-Resident Indians.
- For banks to carry out their deposit taking activities in India they must fulfil 3 basic regulatory requirements. These are meeting the: (a) Cash Reserve Ratio (CRR) requirements, (b) Statutory Liquidity Ratio (SLR) requirements and (c) Deposit Insurance requirements.
- Currently, banks enjoy full freedom in determining their deposit rates.
- As at March-end 2015:
 - There were 1,440 million deposit accounts (135 million in 1980) with a balance of INR 89,221 billion (INR 84 billion in 1972). Out of the total 1,440 million accounts, 1,115 million (90%) were individual deposit accounts which had INR 50,601 billion as balance, constituting 56.7% of the total.
 - The average balance per individual depositor account was a little over INR 39,000, which highlights that they were 'small' depositors.
 - A predominant 89% of individual depositors banked with PSBs (including RRBs). In terms of amount, they held 78% of deposits.
 - Over four-fifth of total number of accounts were Savings Bank accounts which are normally maintained for transaction purposes and small savings.
 - Individual depositors preferred short-maturity deposits which highlights their need for liquidity as also risk averseness. Frequent changes in interest rates by banks do also play a role in recent times.

- Sixty-eight per cent of individual deposit accounts were ‘small’ with deposit sizes below INR 0.1 million, i.e., the current threshold for deposit insurance cover
 - Sixty-two per cent of total number of individual accounts belonged to rural and semi-urban centres, whereas the rest belonged to urban and metro centres. However, amount-wise, the share of the latter was much higher at 66% than the former at 35%.
 - In terms of number of individual accounts, Savings Bank accounts were, in general, concentrated in rural and semi-urban areas, varying in the range of 57% to 67% during 1980 to 2015. In contrast, in urban and metro areas, current accounts were predominant because of crowding of industry and business there.
 - Gender disparity among bank depositors is diminishing fast.
- In a word, characteristically, an Indian individual depositor is small, unsophisticated (a large part belonging to rural and semi-urban areas where the literacy rate is lower than that in urban and metro areas) and risk-averse and hence, s/he throngs to PSBs which are perceived by her/him as safe and secure.

Part - D: Enter the Deposit Insurance System in India

- The Deposit Insurance Corporation (DIC), and with it the insurance of bank deposits came into existence in 1962, directly as a consequence of the crash of the Laxmi Bank and Palai Central Bank (Kerala) in 1960.
- DIS is compulsory for all banks except cooperative banks in those States which are yet to pass the required legislation.
- In July 1978, DIC assumed also the function of credit guarantee, and hence, was renamed as Deposit Insurance and Credit Guarantee Corporation (DICGC). At present, no credit institution is participating in any of the credit guarantee schemes administered by it.
- The authorised capital of DICGC is INR 500 million which is entirely subscribed by RBI.
- DIS covers all commercial banks (including RRBs and LABs) and all cooperative banks, except a few designated ones. As at March-end 2015, 2,129 banks were registered comprising 92 commercial banks, 56 RRBs, 4 LABs and 1,977 cooperative banks.

- The scheme covers, by and large, the entire deposits of the household sector. Simultaneously, the scheme covers high-value deposits, such as, CDs and FCNR (B) deposits.
- DIS, with effect from May 1, 1993, protects INR 100,000 of deposits held by the depositor at all the branches of a bank put together in the same capacity and right, increased in stages from the original INR 1,500.
- As at March-end 2015, 92.4% of the total deposit accounts were fully protected. Amount-wise, 30.8% were 'insured' deposits.
- Although the DICGC Act, 1961 allows for a variable premium system, DICGC follows a flat rate premium system which currently stands at INR 0.10 per INR 100 of 'assessable' deposits per annum (statutory cap - INR 0.15 per INR 100).
- Premium received from the cooperative banks constituted a small proportion of the total premium which moreover declined over time.
- Both DIF and the Reserve Ratio reflected continuous upward movement from 1992-93 onwards. Although there is no mandate to maintain the Reserve Ratio at a specific level, DICGC aims at maintaining the ratio at not below 2%. The Reserve Ratio at March-end 2015 stood at 1.9%.
- As at March-end 2015, the amount of claims settled cumulatively stood at a tad below INR 50 billion, registering an EGR over 21% per annum between March-end 1997 and March-end 2015.
- The average amount of claims settled per year turned out to be INR 2.63 billion with a high of INR 6.54 billion and low of INR 0.02 billion. In general, the amount moved up over the years.
- As far as claims settlement and their repayment by banks are concerned, cooperative banks reflected an extremely poor show vis-à-vis commercial banks.
- The average period for settlement of claims came down substantially over time and was 25 days in 2014-15.
- As on March 31, 2015, the number of legal suits relating to deposit insurance activity of DICGC pending in various courts stood at 196 - almost 3 times that in 2003.

- DICGC is vested with powers to (a) cancel the registration of an insured bank under various conditions (in 2014-15 21 banks – all cooperative – were deregistered), (b) have free access to the records of an insured bank and call for copies of such records and (c) request RBI to undertake/cause examination/investigation of an insured bank.
- All officials of DICGC, except CFO, are on deputation from RBI. The staff strength showed a declining trend over time.
- DICGC has been on a path of becoming an officer-oriented organization, which is a healthy feature, besides being in consonance with the recommendation of the RBI Deposit Insurance Reforms Report, 1999 in regard to HR.
- The financial indicators and efficiency parameters portray a healthy picture of DICGC.
- The Indian DIS is in a ‘Good’ position vis-à-vis the IADI-BIS 16 Core Principles for Effective Deposit Insurance Systems, as it operates in the desired way specified by the “Principles” to various extent.

Deposit Insurance Reform Endeavours in India

- Reforming the deposit insurance system emerged as one of the major items of the second phase of financial sector reforms in India. The Narasimham Committee Report on the Banking Sector Reforms (1998), while focusing on the structural issues, observed: (a) No need to increase the insurance limit (i.e., INR 100,000) further. And (b) Need to shift from the ‘flat’ rate premiums to ‘risk based’ or ‘variable rate’ premiums.
- The RBI Report on Deposit Insurance Reforms (1999), the first serious attempt to reform DIS, made wide-ranging reform proposals including coverage of DIS, premium system, DIF, structure of DICGC, etc. However, many are not yet acted upon.
- The then Finance Minister in his Union Budget speech for 2002-03 announced that DICGC would be converted into the Bank Deposits Insurance Corporation (BDIC) to make it an effective instrument for dealing with distressed banks, and appropriate legislative changes would be brought in for this purpose.
- Following the Budget announcement, a High-Powered Committee of the Ministry of Finance, RBI and DICGC visited US to study the FDIC system and submitted a report to MOF.

- Subsequently, based on a DICGC presentation on the salient features of the Bill to MoF, the following two suggestions were confirmed by the latter: (a) BDIC should have powers to initiate remedial/rehabilitation measures for failing banks if the regulatory/supervisory authorities do not act promptly and (b) RBI should have a senior officer nominee dealing with regulation and supervision issues on the Board of BDIC to facilitate exchange of information.
- Further, the RBI Governor indicated that DICGC should work on a new law taking into consideration the latest international best practices, but tailored to Indian financial conditions.
- In 2008, the Committee on Financial Sector Assessment stressed the need for maintaining an adequate and solvent DIF for ensuring public confidence in DIS. It also recommended grant of exemption to DICGC from paying income tax.
- The Committee on Financial Sector Reforms (2008) made several recommendations which, inter alia, included: (a) strengthening the capacity of DICGC to both monitor risk and resolve a failing bank, (b) instilling a more explicit system of prompt corrective action and making Deposit Insurance premiums more risk-based, (c) making DICGC independent of RBI and (d) maintaining *status quo* on monetary coverage of deposit insurance.

Part – E: Policies towards Comprehensive Reforms

Emerging Significance of Deposit Insurance: An Assessment

- The following emerging factors in the economic and banking sphere would necessitate a robust Deposit Insurance System:
 - Increasing participation by retail customers both on assets and liabilities side of banks.
 - Continued high level of stressed assets of PSBs
 - Emerging compulsion to phase out the ‘tradition’ of government recapitalization of PSBs
 - Imminent changes in the mind-set of decision makers at political and bureaucracy level

- Need to annul cross-subsidization between commercial banks and cooperative banks as far as payment from DIF is concerned.
 - Reforming DIS is overdue
 - Need to institute a functionally sound resolution process for the troubled financial institutions
 - Continuously increasing interconnectedness among the various segments of the financial sector leading to increasing contagion
- The ‘velocity’ of the changes will be limited by:
- The speed with which political and bureaucratic consensus is built, the necessary Bills are passed by the Parliament and the consequent regulatory changes are brought about.
 - Likely trade union problems that may jam the banking activities.
 - HR-related issues in banks in case mergers/acquisitions take place in the banking arena.
 - The government is trying to mitigate the debt issue which may bring some relief to banks in the medium-term, if not short-run.
 - Banks are well capitalized.
 - RBI’s armour has adequate weapons to forestall any system-wide crisis.
- Thus, although there are grounds for reforming the DIS, the factors may not materialize within a span of 3 to 5 years. However, the intervening period may be utilized to refurbish the DIS in a phased manner so that it is ready for the new regime, when it ushers in, and fulfils the ‘IADI-BIS Core Principles’ for a sound and globally benchmarked DIS.

Deposit Insurance Coverage

- Institutional coverage of deposit insurance should exclude the 2 RBI-recognized TBTF banks and the nationalized banks. In other words, in the commercial banking sphere, deposit insurance coverage should be made available to the
- Associate Banks of SBI
 - Old private banks

- Remaining 6 new private banks
 - 2 ‘new’ private banks which have started operations recently
 - RRBs and
 - LABs
- Moreover, in future, as the insured banks expand and become either TBTF or are nationalized, they should automatically be excluded from enjoying deposit insurance coverage.
- Conversely, when the government shareholding in any nationalized bank falls below 50%, deposit insurance should be extended to that bank.
- The last hike – a bullet one - in the monetary limit of deposit insurance coverage from INR 30,000 to INR 1,00,00 which was effected in 1993 in the wake of the failure of Bank of Karad as an emergency measure still remains in force even after over 2 decades.
- At this level, 92.4% of the depositors and 30.8% of the deposit amount were fully covered as at March-end 2015 vis-à-vis the internationally favoured of 80% and 20% respectively.
- During 2014-15, the coverage limit was 1% and 12.3% higher than the per capita GDP and the per capita NNP respectively.
- Internationally speaking, India is positioned 95/111 from the top in terms of the coverage limit to per capita GDP ratio, though the ratio has been declining since 2003.
- There are 2 ‘thumb rules’ for setting the coverage level. Going by the first rule, i.e., on an average, the coverage levels should amount to 2 times per capita GDP, there is a case for increasing the ‘per depositor’ insurance limit at least by 50%. The *RBI Report of the Committee on Customer Service in Banks (2011)* recommended for a drastic hike in the coverage limit.
- However, if one goes by the second rule, i.e., fully cover 80% of the number of depositors but only 20-30% of the value of deposits, the present corresponding coverages at over 90% and over 31% are, to some extent, in excess.
- Further, a hike in the coverage limit, especially in the present scenario when PSBs are beleaguered by huge NPA problem may send a wrong message or be misinterpreted that the banking sector is facing some crisis.

- In view of the above 2 reasons, it is recommended to maintain status quo in coverage limit till such time the NPA issue eases and the actual coverage limit climbs down.
- In order to avoid frequent changes in the coverage limit, every revision should remain valid for next 3 years, unless otherwise warranted by possible bank crises.
- The female depositors may be provided an extra 10% to 20% coverage over and above the prevalent monetary coverage limit (i.e., at present, INR 1,00,000 + 10% to 20%)

Risk-based Premium System

- The methods for determining the risk-based deposit insurance premium system, whether based on market or non-market information and *ex ante* or *ex post*, are fraught with some limitations or the other. The epicentre of the problems lies in ‘information’: availability, quality, cost, ease, adaptability, confidentiality, transparency, comprehensiveness, integrity and reliability. All these have a bearing on developing a simple, durable, intelligible and verifiable system of explicit deposit insurance premium.
- In India, officially, the voices to have a variable system of deposit insurance premium have been making rounds since 1998 when the Narasimham Committee-II mentioned about it in its Report.
- Finally, in September 2015, DICGC put the *Report of the Committee on Differential Premium System for Banks in India* on its Web Site for public comments/suggestions. The Report combines risk measures and supervisory ratings as the basis for computing differential premium system.
- Alternatively, we have mooted for using GNPA as the basis for risk-based premium system because the GNPA figure reflects the root of vulnerability of a bank in the Indian setting.
- In India, the existence of the moral hazard problem in banking is not well-established. According to the SNI value for India computed in the IMF Survey, it could be very low.
- Nevertheless, there are many other issues, such as, bifurcating DIF between commercial and cooperative banks, depositors’ literacy about deposit insurance, the extent to which depositors exercise discipline on their banks and overwhelming control of the government in banking business which need to be fixed before implementing a risk-based premium system.

- If a variable premium system comes, there should also be a system of rebate. When DIF achieves its required reserve ratio, there should be premium holidays for banks and/or when a bank is in the 'zero-risk' cell in the matrix, it should pay zero premium until its rating deteriorates.
- DICGC should base the premium not on 'assessable' but on 'insured' deposits.
- DICGC may consider conducting a survey of bankers and depositors before implementing the new system.

Deposit Insurance Fund

- A scientific determination of the optimal size of DIF, either in terms of an absolute amount or in relation to some measure of exposure, is not possible because bank failures and insurance losses are cyclical in nature, and therefore, difficult to predict.
- Simply and objectively speaking, DIF should have money enough to cover losses and meet cash needs first.
- Such a system necessitates insurance assessments on banks to be high enough to keep the reserve ratio of DIF at a desired level always.
- As at March-end 2015, DICGC's DIF stood at INR 504.5 billion with the Reserve Ratio at 1.9% which was a tad below the 'desired' level of 2.0% in the absence of any mandate to maintain the Reserve Ratio at a specific level.
- DICGC protects equally the insured deposits of both commercial banks and cooperative banks. Despite the latter being highly fragile, DICGC doesn't maintain a separate DIF for them.
- The practice has been demonstrated to be inappropriate.
- Internationally, the median Fund size to covered deposits ratio stood at 0.37% with high-low values at 6.2%-0.12%.
- Pursuing the recommendations of the *RBI Report on Deposit Insurance Reform (1999)* DICGC should institute 2 deposit insurance funds, one for the commercial banks and the other for the cooperative banks.
- In case the DIF (Cooperative Banks) falls short of fund, the DIF (Commercial Banks) may lend stipulated amount at stipulated rate of interest to the former, maybe at the prevailing Bank Rate.

- As a rule of thumb, three-year moving averages of the cooperative bank failures can be taken to predict the next year's expected failure and accordingly DIF (Cooperative Banks) may be capitalized.
- Capitalization of DIF through a line of credit or collateralized borrowing from the government at the times of crises may be facilitated, which the RBI Report on Deposit Insurance Reform had recommended.
- Another alternative to guarantee a minimum fund size could be some sort of capitalization of DIF through the banking industry deposits or capital contributions.

Resolution Mechanism

- At present, India lacks a special resolution regime or comprehensive policy or law on bankruptcy exclusively for the financial institutions as a whole. However, there are some provisions contained in various Acts which empower the respective regulator/supervisor and/or the Central government to resolve different types of problems of financial institutions in India.
- RBI, assisted by DICGC, carries out the resolution of troubled or failed banks. The typical resolution methods used in India are assisting the troubled bank in restructuring or merging it with a strong institution or closure.
- DICGC assists in mergers by meeting the shortfalls in depositors' claims up to the coverage limit, when the acquiring bank is unable to meet this liability.
- One of the imperatives to reform DICGC is to establish a well-defined, well-structured and seamlessly integrated resolution mechanism for financial institutions in trouble. The urgent need for this has been felt globally as also in India in the aftermath of 2007-09 financial crisis.
- Following the FSB's announcement of *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the 'Key Attributes') in 2011, the Indian government set up the Financial Sector Legislative Reforms Commission which recommended in 2013 for a single Resolution Corporation for financial institutions.
- It also recommended that DICGC should be subsumed by the Resolution Corporation.
- However, we have argued that a separate Resolution Corporation for banks in India at this stage is not called for. The present arrangement of separate segment regulators

along with FSDC is adequate. However, DICGC may be designated as the Resolution Corporation for the banking sector when the situations warrant such a body.

Organizational Matters

- DICGC may continue as a 100% subsidiary of RBI, but it should be accorded complete independence in its working and functions. Besides, both RBI and DICGC should act in tandem without any ‘complex’ on either side.
- The authorized capital of DICGC may be hiked to at least INR 5 billion and contributed fully by RBI in tranches. In addition, it should have a lender of last resort facility or collateralized liquidity support from the central bank as well as government support to meet any contingencies.
- There should be a department exclusively devoted to regular coordination and exchange of information with the Department of Banking Regulation, Department of Banking Supervision, Department of Co-operative Bank Regulation and Department of Co-operative Bank Supervision. The same department may also hold periodic meetings with the Financial Stability Unit.
- If DICGC is to be made an independent organization, it has to have its own staff.
- There should be an overall expert on Deposit Insurance in the Board of DICGC. Alternatively, an exclusive advisor on the subject should be appointed in the senior executive cadre either on regular or consultation basis.
- A case may be made out to the government to tax the investment income, not the deposit insurance premium.

Part F: Concluding Remarks

The Changed Role of DIC

- If our proposals as to institutional coverage, monetary coverage limits, shifting the assessment base to ‘insured’ deposits from ‘assessable’ deposits and risk-based premium system are implemented, the required size of DIF will lower and hence the premium rates for the insured banks.
- Ultimately, DICGC should aim at moving towards becoming a full-fledged resolution institution for the banking sector with increasing powers for regulation and supervision.

- DICGC, in its new avatar, may be named as the Bank Deposit Insurance Corporation (BDIC), as was proposed by Yashwant Sinha in his Budget in 2001-03.
- Its metamorphic role should be as follows:
 - Insurer of bank deposits
 - Guardian of DIFs
 - Administrator of risk-based deposit insurance premium
 - Monitor of riskiness and health of banks
 - Resolution authority
 - Reimbursing the dues of depositors of failed banks in time
 - Accomplishing independence in working and function
- It has a big role to play in spreading awareness about Deposit Insurance among the public directly as well as indirectly through bank branches, besides making it part and parcel of the Financial Literacy Programme.