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Why DICGC Act amendment is big news for small depositors

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The collapse of UCBs like Punjab and Maharashtra Cooperative Bank (PMC Bank) has added to the customers' distrust.

In the 2021 Union Budget, Union Finance Minister Nirmala Sitharaman proposed to amend the Deposit Insurance and Credit Guarantee Corporation Act (DICGC). This is aimed at enabling depositors of troubled banks to access their money through DICGC route even if banks are temporarily unable to meet the obligations. This announcement assumes significance, particularly for smaller depositors. Earlier, DICGC could be invoked only on liquidation of banks.

What does this mean?

The Indian banking system now has a much better safety net for depositors of failed institutions, especially smaller depositors, compared to what was available a year ago. Deposit Insurance, as the name suggests, is a scheme under which the depositors of banks will get up to Rs5 lakh in the event of a bank failure.

Until a year ago, the depositors of a failed bank in India could claim only up to Rs 1 lakh through DICGC. This amount was too low considering many pensioners park their entire life's savings in banks seeking the safety of bank deposits. But, the collapse of Punjab and Maharashtra Cooperative Bank (PMC) led the policymakers to rethink this limit.

Last year, the government increased the amount one could claim under DICGC to Rs 5 lakh from Rs 1 lakh. That came as a big relief for many. At least, a bigger number of small depositors could get protection for their entire savings in banks. The decision was welcomed by all.

But, this wasn't enough.

There have been cases where crisis-ridden banks continued to be in ICU for a prolonged period. Technically, these entities aren't shut but due to their poor financial condition, many crisis-ridden banks were not in a position to honour obligations to depositors. The RBI often places banks under moratorium when the financial situation worsens beyond a point. In some cases, the moratorium will be in effect for a prolonged period. DICGC wasn't of much help to depositors in such cases. Under the Act, depositors could seek claims only after liquidator approve the claims.

What is new?

"With the proposed amendment, the depositor does not need to wait till the bank get liquidated to claim their money. Even if the bank is under a moratorium, the depositors can claim the deposits under DICGC Act. This is a progressive step," said Sanjay Agarwal, Head of BFSI and NBFC at CARE Ratings.

In other words, with the latest amendment, this scheme will be a major relief to thousands of small depositors of banks which are under a moratorium for a prolonged period.

Are deposits in different banks separately insured?

Yes. According to DICGC rules, all funds held in the same type of ownership at the same bank are added together before deposit insurance is determined. "If the funds are in different types of ownership or are deposited into separate banks they would then be separately insured," the DICGC says.

In other words, if the customer has a deposit with more than one bank, the deposit insurance coverage limit is applied separately to the deposits in each bank.

PMC a major trigger

The failure of PMC Bank two years ago was a big eye-opener to the Reserve Bank of India (RBI) and the government forcing them to rethink the norms on depositor safety. Even today a section of PMC Bank depositors have not got their money back. The RBI superseded PMC Bank board in September 2019. Of its total loan book of Rs 8,383 crore, as on March 31, 2019, about 70 percent had been taken by real estate firm HDIL. The bank had Rs 11,600 crore in deposits.

While enhancing the withdrawal limit to Rs 1 lakh for PMC depositors in June last year, the RBI had said more than 84 percent of the depositors of the bank will be able to withdraw their entire account balance. But, for the remaining depositors, the wait continued.

The PMC episode was followed by a crisis in two more banks—Yes Bank and LVB. In both cases, the RBI announced moratorium before the banks were bailed out.

Cooperative bank failures

These instances apart, there have been scores of cooperative bank failures in recent years. In many of these cases, depositors are stuck with money--awaiting resolution.

To get a perspective, look at these numbers. In 2020 alone, the RBI has issued a total of 106 directives to co-operative banks either restricting their business operations or extending the period of existing directions. About 60 of them were in the second half of the year. The latest amendment will hopefully bring relief to these borrowers.

"The GOI proposes to streamline the provisions of the DICGC Act, 1961, enabling the depositors of banks under stress some ease of access to their deposits in a time-bound manner. This step will instil investor trust in the banking industry," **BrickWork Ratings** said in a report.

The deposit insurance guarantee scheme was set up in 1961 to ensure depositors are guaranteed at least some amount in the event of a bank collapse. This amount was enhanced to Rs one lakh only in 1993 from Rs 30,000. The DICGC enhanced the cover to Rs One lakh per depositor in May 1993 for deposits of Commercial Banks, RRBs, Local Area Banks (LABs) and Co-operative Banks and rest of the deposit amount is forfeited in the rare event of a bank failure.

An October 2019 SBI analysis showed that in terms of the number of accounts, 61 percent of the total accounts are less than Rs 1 lakh, around 70 percent are less than Rs 2 lakh, and 98.2 percent are less than Rs 15 lakh. This means small depositors are adequately covered in terms of insurance cover.

The problem, however, is that in terms of quantum of deposits, the percentage of deposits less than Rs 1 lakh is only 7.8 percent of the deposit base. This means while a majority of depositors in number may get their money back, the remaining is set to lose a big chunk of their savings in the event of a bank collapse. According to the SBI report, about 20.4 percent of the deposits are contributed by customers having deposits of more than Rs 15 lakh but less than Rs 1 crore with an average deposit of Rs 35 lakh.

For them, Rs 5 lakh cover is not enough, but better than what it was before.