DICGC Overcharging Commercial Banks

For Prelims: **Deposit Insurance**, Limit and Coverage of Deposit Insurance, **DICGC**

For Mains: Importance of Deposit Insurance and the need of the **Deposit Insurance and Credit Guarantee Corporation (DICGC)**

Source: LM

Why in News?

The **Deposit Insurance and Credit Guarantee Corporation (DICGC)**, a subsidiary of the **Reserve Bank of India (RBI)** is under scrutiny for its **premium structure**, which appears to **overcharge** **commercial banks** while disproportionately **benefiting** **cooperative banks**.

- This raises concerns about the **fairness and efficiency of the current system**, prompting calls for a **reevaluation of premiums based on the risk profiles** of different banking institutions.

How are the Commercial Banks Being Overcharged for Deposit Insurance?

- **Disproportionate Premium Burden**: DICGC collects **94% of premiums from commercial banks**, which account for **1.3% of net claims**, while **cooperative banks contribute 6% of premiums** and **claim 98.7% of net claims**.
    - Since 1962, commercial banks have filed gross claims of Rs 295.85 crore, with net claims totaling Rs 138.31 crore.
        - In contrast, **cooperative banks have filed gross claims** of Rs 14,735.25 crore, with net claims amounting to Rs 10,133 crore.
    - This means that **well-managed commercial banks are effectively subsidising** the **higher risks associated with cooperative banks**, which require a significant portion of claims.
- **Implications for Overcharging Commercial Banks:**
    - **High Compliance Costs:** The **uniform premium rate** of 12 paise per Rs 100 insured, **regardless of risk profile**, imposes **high compliance costs on commercial banks** which can affect their **operational efficiency and profitability**, ultimately impacting their ability to lend and serve customers effectively.
    - **Inequitable Risk Assessment:** Commercial banks, which generally have **lower risk profiles**, are penalised **through higher premiums**, undermining the principles of risk evaluation that should guide insurance pricing.
    - **Impact on Financial Stability:** The high premiums can lead to **reduced financial stability** for commercial banks, as they may need to pass on these costs to depositors and borrowers.
        - This could **result in higher interest rates for loans** and **lower returns for depositors**, affecting the overall banking ecosystem.
    - **Encouragement of Poor Management Practices:** By requiring **commercial banks to bear the costs associated with cooperative bank failures**, the current structure

may **inadvertently encourage poor management practices** within cooperative banks, as the **consequences of defaults are shifted to more stable institutions.**

What are the Key Facts About DICGC?

- **About:**
  - It came into existence in **1978** after the merger of **Deposit Insurance Corporation (DIC)** and **Credit Guarantee Corporation of India Ltd. (CGCI)** after passing of the **Deposit Insurance and Credit Guarantee Corporation Act, 1961** by the **Parliament.**
  - It serves as a **deposit insurance and credit guarantee for banks** in India.
  - It is a **fully owned subsidiary** of and is governed by the **Reserve Bank of India (RBI).**
- **Funds Managed by DICGC:**
  - **Deposit Insurance Fund:** Provides **insurance to bank depositors** in case the **bank fails financially and has no money to pay its depositors** and has to go in for liquidation.
    - It is funded by premiums from banks.
  - **Credit Guarantee Fund:** It is the guarantee that often provides for a specific remedy to the creditor if his debtor does not return his debt.
  - **General Fund:** It covers DICGC's **operational expenses,** funded by **surplus from its operations**.

What is the Deposit Insurance Scheme of DICGC?

- **Limit for Deposit Insurance:** Currently, a depositor has a claim to a **maximum of Rs 5 lakh per account** as insurance cover. This amount is termed **'deposit insurance'.** The cover of Rs 5 lakh per depositor is provided by the **DICGC**.
  - Depositors having **more than Rs 5 lakh in their account have no legal recourse** to recover funds in case a **bank collapses.**
  - Premium for the insurance has been raised from 10 paise for every Rs 100 deposit, to **12 paise** and a limit of 15 paise has been imposed.
    - The premium for this insurance is **paid by banks to the DICGC**, and not be passed on to depositors.
    - The Insured banks pay **advance insurance premiums** to the corporation semi-annually within 2 months from the beginning of each financial half year, based on their deposits as at the end of previous half year.
- **Coverage:**
  - **Banks**, including **regional rural banks, local area banks, foreign banks** with branches in India, and **cooperative banks**, are mandated to take deposit insurance cover with the DICGC.
    - **Primary cooperative societies** are **not insured** by the DICGC.
- **Types of Deposits Covered:** DICGC insures **all bank deposits**, such as saving, fixed, current, recurring, etc. **except** the following types of deposits.
  - Deposits of foreign Governments.
  - Deposits of Central/State Governments.
  - Inter-bank deposits.
  - Deposits of the **State Land Development Banks** with the State co-operative banks.
  - Any amount due on account of any deposit received outside India.
  - Any amount which has been specifically exempted by the corporation with the previous approval of the **RBI**.
- **Need of Deposit Insurance:**
  - Troubles for depositors in getting immediate access to their funds in banks in recent cases such as **Punjab & Maharashtra Co-operative (PMC) Bank**, **Yes Bank** and **Lakshmi Vilas Bank** had put spotlight on the subject of deposit insurance.

Why is there Need to Reevaluate Deposit Insurance Premiums by DICGC?

- **Proposal:** There has been a proposal to **reduce the premium for commercial banks** from 12

paise to 3 paise per Rs 100 insured, which could relieve these banks of approximately Rs 20,000 crore in FY26.
    - Conversely, **premiums for [cooperative banks]** could remain **at 12 paise or increase** to 15 paise.
- **Benefits:**
    - **Risk-Based Premiums:** Aligning **premiums with the risk profiles of banks** sends a clear message that **insurance costs should reflect actual risk.**
    - **Economic Efficiency:** Lower **compliance costs for commercial banks** can enhance **their operational efficiency, benefiting depositors** and borrowers.
    - **Encouraging Good Management:** By **not penalising well-managed banks**, the system promotes better banking practices.

Drishti Mains Question:

Discuss the significance of deposit insurance in the banking sector and the challenges faced by the DICGC in India.

UPSC Civil Services Examination Previous Year Question (PYQ)

Prelims

Q. Which of the following grants/grant direct credit assistance to rural households? (2013)

1. Regional Rural Banks
2. National Bank for Agriculture and Rural Development
3. Land Development Banks

Select the correct answer using the codes given below:

(a) 1 and 2 only
(b) 2 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (c)

Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

(a) 1 and 2 only
(b) 2 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (b)

Mains

Q. Pradhan Mantri Jan Dhan Yojana (PMJDY) is necessary for bringing unbanked to the institutional finance fold. Do you agree with this for the financial inclusion of the poorer section of the Indian society? Give arguments to justify your opinion. **(2016)**

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