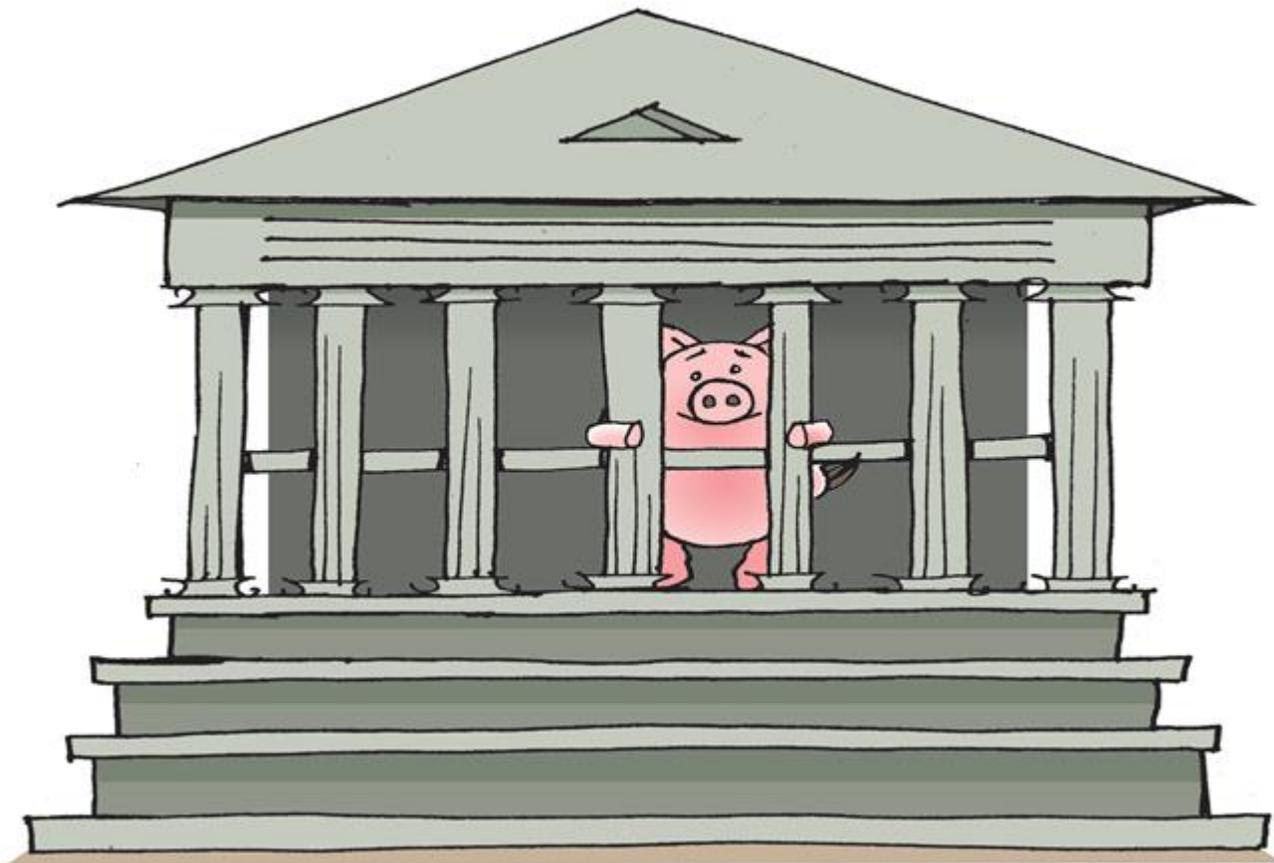


How safe is your bank deposit?

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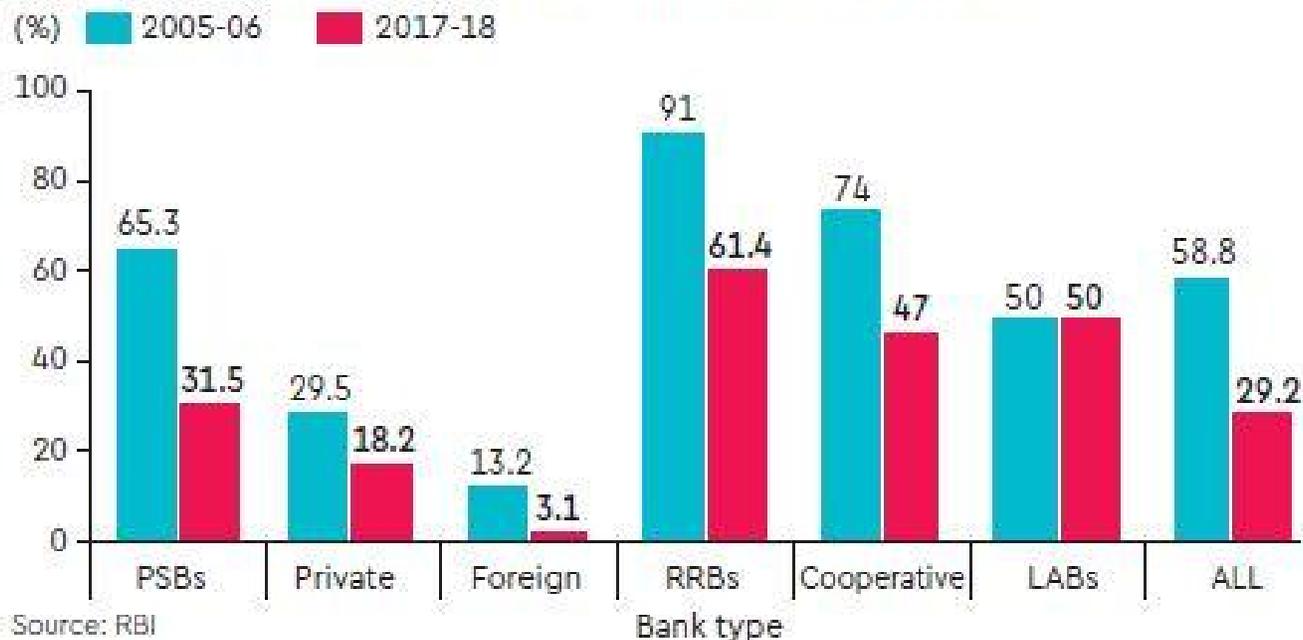
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The PMC Bank episode raises several issues on regulation, governance, transparency, etc. on the business side and a more down to earth concern for deposit holders. Cooperative banks in particular tend to offer higher interest rates which make them attractive to households. The retired gentry prefer this avenue as they can get higher returns which can go up to 100 bps beyond the senior citizen premium. However, when the bank fails or there is a cloud of suspicion, the safety of deposits is jeopardised.

Also, it is normally argued that bank deposits are safe as banks never fail and one can always get the money back. This is why they are preferred to even AAA rated fixed deposits of private companies even though the returns could be lower. The price one pays for safety is the difference as there is an implicit understanding that the bank can never default. If one looks at the history of Indian banking, names like Global Trust Bank

or Bank of Rajasthan come to mind which failed, but were merged with other banks, and, hence, the deposit holder was protected.

Share of insured deposits in total deposits



Is this really true? Globally, the closing down of Northern Rock Bank at the time of the financial crisis made deposit holders lose a substantial part of their savings during the financial crisis. There is deposit insurance which is provided by the DICGS (Deposit Insurance Credit Guarantee Corporation) in India. The website says that: Each depositor in a bank is insured up to a maximum of Rs 1,00,000 (Rupees one lakh) for both principal and interest amount held by her in the same right and same capacity as on the date of liquidation/cancellation of bank's licence or the date on which the scheme of amalgamation/merger/reconstruction comes into force. Therefore, there are limits to which bank deposits are secure. In this context, it is interesting to see to what extent deposits are insured by banks.

The corresponding table is interesting as it gives a clear picture of the quantum of deposits of banks that are insured in the true sense. The premium for insurance is paid by the bank, and, hence, the cost is not directly borne by the deposit holder even though it could be adjusted for in the deposit interest rate. The table shows that the PSBs, RRBs and cooperative banks have the highest coverage ratio in both the years. The private banks and foreign banks have lower cover, and in case of the latter it is really very low. This means that if deposits went bad for a foreign bank, the recovery through insurance would be miniscule.

The second takeaway is that the banks have progressively been reducing their insurance cover and the cover for the system as a whole has come down from 58.8% to 29.2% in a period of around 12 years. Even PSBs have halved their cover. This means that the banks are carrying higher risk on their books.

The lower insurance cover can be attributed to the fact that the bulk of the deposits are coming from the higher income groups whose deposits tend to be higher than Rs 1 lakh but qualify for lower cover. The DICGS clearly states that when dealing with a bank that has become insolvent, all the deposits in the name of the holder are summed and the upper limit of cover would not be more than Rs 1 lakh. This has led to a fall in the overall cover of deposits under insurance. Foreign banks would tend to be more concentrated as the account holders would typically be high net worth individuals whose deposit size would be very high.

For example in 2017-18, based on [RBI](#) data on number of deposit accounts and o/s deposits in various bank categories, the average balance per account in a PSB was around Rs 53,000, private bank Rs 1.24 lakhs and foreign banks Rs 10.9 lakhs. Therefore, with an upper limit of Rs 1 lakh for a deposit, intuitively the bank need not take cover for the bulk of the deposits that are held. The smaller deposits would tend to be repaid without a loss for the holder, while the deposit holders with higher savings would be impacted the most.

Can anything be done? The first is that savers need to be more clairvoyant in distributing their deposits across banks. While there seems to be an implicit sense that PSBs can never fail as the government will always step in (which may be true to a large extent), the fact that we are talking of privatisation at some stage would raise the antenna in future.

Second, the quantum of insurance needs to be increased any which way. Instead of Rs 1 lakh being the upper limit, it should be increased to Rs 5 lakhs so that the risk factor is reduced. Given the developments in the cooperative banking space, there would be a lot of apprehension for this sector and increasing the limit would have to be done with alacrity.

Third, when it comes to banks, there has to be a clear policy on how one should evaluate the resilience of a bank in terms of their ability to counter adverse economic cycles. To begin with there can be a special fund created for tackling such a contingency which may never arise but built over time which can be used for financing the higher insurance cost.

Fourth, it would be advisable to have a resuscitation package for banks which are likely to fail so that in such an eventuality there is a template that can be followed. To begin with such banks should be moved to the PCA framework and only deal with GSec investments to ensure that an income stream is available. Sale of collateral of dodgy assets can be considered simultaneously. In the last stage merger with stronger banks should be an option so that the integrity of the system is protected.

Banking has progressively become risky with several pressures being exerted on all sides. There are internal pressures to make profit which leads to governance failure which inspection rarely captures due to the

complexities involved. At the same time, there are pressures to lend to certain sectors based on national priorities which come from above. The structures of certain kind of banks which today appears to be cooperatives and RRBs may have to be revisited and strengthened and ways worked out to ensure that the models followed are transparent.

Deposit holders already bear the brunt of declining interest rates as policies are skewed towards the same family of borrowers where the rotten apples cause these problems. As bank deposits are the spine of financial savings there is an immediate need to address such concerns.

(The author is Chief Economist, CARE Ratings. Views are personal)

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