*Deposit Insurance: Keeping Pace with the Changing Time**

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Deputy Governor Swaminathan J, distinguished delegates from International Association of Deposit Insurers (IADI) and global deposit insurers, board members and officers of Deposit Insurance and Credit Guarantee Corporation (DICGC), officers of RBI, ladies and gentlemen, good afternoon to all of you. At the outset, I would like to thank IADI and DICGC for inviting me for delivering the valedictory address at the IADI Asia-Pacific Regional Committee International Conference being held in the beautiful city of Jaipur.

The theme of the Conference *'Navigating the evolving financial landscape: Emerging Challenges for deposit insurers and the significance of crisis preparedness'* is quite contextual for these times, given the rapid innovations and digitalisation seen in the financial services, the expansion of the footprints of financial sector globally as well as the increasing inter-connectedness of the financial services entities that are transforming the landscape for the financial services around the world.

Over the last two days, you would have had enriching panel discussions with diverse perspectives, expert insights, and thought-provoking debates on the emerging challenges and risks that impact the deposit insurers. Whether it is the emergence of central bank digital currencies (CBDC), tokenised deposits, climate change related risks or the future financial systems like Finternet, the evolving and futuristic developments are likely to change the global financial landscape and in turn will transform the deposit insurance function. The key issue which then we need to consider is how we can make the deposit insurance function future ready. The challenges like Finternet, tokenisation of deposits, CBDC/digitalisation *etc.* highlights the need for financial ecosystem to have enhanced technological backbone to support the financial sector activities. But this does not in any way deflect the deposit insurers from their core mandate of providing a backstop for the depositors so as to generate confidence in the financial sector entities who support the real sector and also promote financial stability. As I see it, we should explore the need to examine whether deposit insurance should expand vertically (*i.e.*, increase the cover offered) or horizontally (increase the nature of entities to be covered through insured products) and also explore its role along a third dimension reflecting fintech innovations which changes the way the depositors' liabilities reside within the financial services sector.

In the light of these challenges, let me avail this opportunity to share a few thoughts with an Indian perspective on specific issues, focussing amongst others on adequacy of insurance coverage, funding, risk-based premium, coverage of digital products, timeliness of payments and communication strategy *etc.* which we collectively need to mull on and look for potential solutions going forward.

History of Deposit Insurance in India

Just to set the context for these issues, let me briefly share a historical perspective of deposit insurance in India. Deposit insurance, as we know it today, was introduced in India in 1962. At that point in time, we were the second country in the world to introduce such a scheme after the United States of America (where it was introduced in 1933). We started off with a Deposit Insurance Corporation (DIC). The DIC was later merged with another entity

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the Credit Guarantee Corporation of India Ltd (CGCI), in 1978 to form the DICGC. The merger was intended to bring together the deposit insurance and credit guarantee functions, creating a more cohesive and efficient system. Consequent to the liberalisation of the financial sector, the Credit Guarantee Scheme was discontinued in April 2003. Today deposit insurance remains the principal function of DICGC and the policy objective is to protect the 'small depositors' of banks from the risk of loss of their savings arising from probable bank failures. The aim is to increase the confidence of the depositors in the banking system and facilitate the mobilisation of deposits to accelerate growth and development. When the deposit insurance scheme was introduced in 1962, 287 banks were registered as insured banks, this number has gone up to 1,997 as of end March 31, 2024[1].

Adequacy of Insurance Coverage

An important issue to my mind is going to be the issue of adequacy of insurance coverage for customer deposits. According to an IADI survey[2], the median deposit insurer covers around 41 per cent of the value of eligible deposits. The number for India is slightly higher at 43.1 per cent. In India, the number of fully protected accounts constitute 97.8 per cent as on March 31, 2024 of the total number of accounts in the banking system as against the international benchmark of 80 per cent. While the scope and coverage appear satisfactory at this juncture, there are likely challenges going forward.

Let me elaborate. Today we count India to be amongst the fastest growing large global economies and this healthy growth rate is expected to continue in the near future. A growing and formalizing economy can naturally be expected to see a sharp increase in both primary and secondary bank deposits, driving a wedge between the desirable insurance reserve requirement and the available reserve. At present, limited coverage option is adopted in India with uniform deposit insurance coverage limited to an amount of ₹5,00,000 per depositor of each insured bank. Considering multiple factors like growth in the value of bank deposits, economic growth rate, inflation, increase in income levels *etc.*, a periodical upward revision of this limit may be warranted. This means that the deposit insurer has to be mindful of the additional funding and needs to work out suitable options to meet the same.

Funding and Risk Based Premium

This then brings up the issue of funding the deposit insurance system and whether the premium paid by the financial institutions should be based on their respective risk profile. Globally, more than 96 per cent[3] of the deposit insurance systems, including the one followed by DICGC in India, are *ex-ante* funding systems wherein deposit insurer maintains a deposit insurance fund, primarily financed by premium collected from the insured institutions and the fund is used to pay the depositors in the event of a bank failure.

The deposit insurers collect premium from member financial institutions either at a flat rate or a differentiated rate based on an individual bank's risk profile. Although flat rate premium structure has the advantage of being relatively easy to understand and administer, it does not consider the level of risk that a bank poses to the deposit insurance system and can be perceived as antithetical to the concept of insurance. The primary objective of differential premium systems is to provide incentives for banks to avoid excessive risk taking, minimise moral hazard and introduce greater equity into the premium assessment process. Keeping this objective in view, many jurisdictions are

1 RBI Annual Report 2023-24.

2 IADI Report- The 2023 banking turmoil and deposit insurance systems - Potential implications and emerging policy issues

3 IADI Report -Deposit Insurance in 2024 – Global trends and key issues- (www.iadi.org).

transiting towards Risk Based Premium (RBP). As per IADI, around 55 per cent[4] of deposit insurers use a differential premium system.

In India,[5] several committees, including the Narasimham Committee on Banking Sector Reforms (1998) and the Capoor Committee on Reforms in Deposit Insurance in India (RBI, 1999), Committee on Credit Risk Model (2006) constituted by the DICGC, and the Committee on Differential Premium Systems (2015) had recommended RBP, but that recommendation could not be adopted. IADI Core Principle 9 prescribes certain conditions that need to be ensured if the deposit insurer uses differential premium systems, such as ensuring that the system for calculating premiums is transparent; the scoring/ premium categories are significantly differentiated; and the ratings and rankings resulting from the system pertaining to individual banks are kept confidential. The introduction of RBP to address the issue of fairness in pricing of insurance is a natural corollary. However, it is extremely data driven and relies on a robust model for arriving at the rating of the insured bank and the corresponding insurance premium which in turn depends on the deposit insurance model adopted by a jurisdiction.

Given the diversity in Indian banking sector, ranging from scheduled commercial banks with global operations to co-operative banks operating as a single branch model with limited computerised operations, meeting the data requirements poses a great challenge. There is also a dilemma that introduction of a RBP can render the riskier institutions more vulnerable to deposit flight and shorten the distance to failure. However, we also need to recognise that with greater innovations in product offerings by banks newer risks which can impact deposit growth, the demand for higher coverage for deposits, Risk Based Premium would be a better option for the deposit insurer to ensure robustness of its finances and also enhance its capability to operate in changed financial milieu. It is therefore important for us to carefully examine the option of adopting risk-based deposit insurance cover.

Paybox Plus Mandate for Resolution

In addition to reimbursement of insured deposits, some deposit insurers also provide financial support in cases of mergers of banks. In India, the DICGC Act provides a limited resolution function in terms of financial support in the case of merger of a weak bank with a strong bank after the approval of the merger by the regulator. DICGC assists in mergers by meeting the shortfalls in depositors' claim up to the coverage limit when the acquiring bank is unable to meet this liability in full. Recently, DICGC provided financial support in respect of insured deposits claims of an Urban Co-operative Bank (UCB) pursuant to its amalgamation with another bank. Given the importance of the UCB sector in India, as it has the potential of driving financial inclusion and credit delivery to those with limited means, the role of DICGC in supporting consolidation in this sector is a matter which requires greater focus under least-cost resolution principles.

Insurance Cover for Digital Products

The rapid technological developments in the financial sector have resulted in introduction of various innovative digital financial products and services for the customers. The countries with deposit insurance generally adopt three different approaches for digital "deposit-like" products based on their market structure, legal and regulatory frameworks and their assessment of risks associated with the widespread adoption of these products[6]. While the

[4] IADI report- The 2023 banking turmoil and deposit insurance systems - Potential implications and emerging policy issues

[5] RBI Annual Report- 2020-21- Box VI.6.

[6] Research Paper- Deposit Insurance for Digital Financial Products and Services by Dr. Andreas J. Zimmermann Prof. Dr. Walter Farkas, November 2021, revised September 2022 by Lucas Metzger (esisuisse).

direct approach clearly defines the digital deposit-like products as insured deposits, under the exclusion approach, these accounts are explicitly not covered by the deposit insurance system due to digital payment services accounts being regarded as primarily instruments of temporary value storage to make payments or transfers. The third approach provides deposit insurance cover to these products indirectly if the "float" collected by providers of digital payment services is placed in pooled custodial accounts with an insured depository institution. However, in India, the definition of 'deposit' has an inclusive character to cover all unpaid dues to a depositor by whatever name called.

The innovations in financial sector are generally facilitated by the regulators as they play a critical role in expanding the reach of financial products and services to the hitherto excluded sections of the population. These innovations have also immensely benefited the financial inclusion initiatives. Even as digital products become more pervasive, there would be a need to consider whether coverage of such digital deposit-like products should also be an option for the Deposit Insurer. A committee formed by RBI for review of customer service standards in its regulated entities in its recent report has recommended extending deposit insurance cover to money kept in wallets of pre-paid card issuers. While there is clearly no "one-size-fits-all" solution to cover digital products, we need to choose a suitable approach which is consistent with the primary objective of the deposit insurance function.

Incidentally, the uncertainty associated with climate change related financial risks is higher than ever before and materialising at a fast clip. Climate change may increase the default risk of the financial institutions by impacting the credit quality and repayment capacities of the borrowers. The impact of climate change and risks related therewith on deposit insurance has remained largely undealt with. A 2022 survey[7] of IADI members indicated 60 per cent of deposit insurers do not have a formalised Environment, Social and Governance (ESG) policy that goes beyond existing legal obligations. Therefore, assessing the impact of climate change on risks to deposit insurers and framing a comprehensive policy incorporating elements of climate change may also need to be carried out in all jurisdictions.

Prompt Access to Insured Deposits

A key function of a deposit insurance system is to give depositors prompt access to their insured deposits when a bank is liquidated. In India, the DICGC Act was amended in 2021 to empower DICGC to make interim insurance payment to depositors of banks who are under All-Inclusive-Directions (which restricts the depositors from accessing their deposits) imposed by RBI, without waiting for liquidation of the bank. Unlike the situation prior to the amendment, depositors of stressed banks need not wait for prolonged period for repayment of their deposits.

The timely settlement of claims may become challenging on account of delay in submission of the list of eligible depositors in time, non-availability of complete information with the bank and/or lack of alternate bank accounts of these depositors, particularly in case of smaller co-operative banks. We, therefore, need to contemplate further steps that can be taken to make this process more streamlined and less dependent on the officials of the stressed banks so that eligible depositors can access their funds with the least amount of disruption.

The failure and near-failure of few banks in USA and Europe in 2023, were seminal moments for regulators around the world. While the failures were apparently due to their liquidity mismanagement, flawed business models and concentrative focus on specific class of depositors, it does spark a debate on

[7] IADI Survey Brief on ESG and Deposit Insurance: Taking Stock and Looking Ahead by Bert Van Roosebeke and Ryan Defina.

the financial stability risk arising from a confluence of factors including the quantum of uninsured deposits, adequacy of deposit insurance coverage as well as the role of digitalisation of financial services and the role of social media in the episode. As the deposit run was triggered by the spread of information through social media and the withdrawal of the deposits by the depositors in a coordinated manner at an unprecedented speed, the crisis has brought to fore not just the impact of social media on behaviour of depositors, but also the importance of safety nets such as insurance coverage, the liquidity risk management policies adopted by the insured institutions in the light of changed depositor behaviour and availability of substantial resources with the deposit insurer for effective resolution. It has led to a significant number of deposit insurers and authorities re-evaluating the appropriateness of the scope and level of coverage to minimise the risk of bank runs.

On the face of it, having full insurance cover for deposits appears to be ideal for depositors and also help to avoid bank runs. However, this is likely to be a suboptimal solution given the associated moral hazards and financial non viability. At the same time, we could also examine the possible economic viability of an alternate targeted insurance approach with full coverage for certain sections of the customers like small depositors, senior citizens *etc.* or pools deposits of smaller depositors based on a careful evaluation of the constructs, costs and benefit of such an approach.

Public Awareness

As I have alluded to previously, with the availability of round the clock banking services and increasing influence of social media, the withdrawal of deposits has been enabled much faster than before. Sometimes, even a misinformation may lead to a frenzied reaction from the depositors. Therefore, in order to mitigate the impact of false information, public awareness on deposit insurance needs to be strengthened. Again, citing a recent IADI sponsored study, it is evident that public awareness of deposit insurance can decrease the propensity of depositors to run on their bank by 67 per cent.[8] The deposit insurers must therefore take initiatives to increase awareness about deposit insurance, as educating depositors about the deposit insurance can be of great help in restricting the instinctive response of depositors to rush and withdraw their deposits, which eventually helps in minimising the disruption to the financial system. A nuanced exploration of the best communication strategy which meets the requirement of diverse customer base and its effective implementation would be warranted.

Conclusion

To conclude, let me re-emphasise the fact that deposit insurance and deposit insurers are essential components of a stable and trustworthy financial system. They not only help in maintaining public confidence by protecting depositors but also play a crucial role in promoting overall economic growth. By providing a financial safety net, the deposit insurers contribute significantly to financial stability. It has become imperative for the regulators and the deposit insurers to realign their policies and regulations to enable banks to better manage and enhance their risk management capabilities, especially liquidity risk management. The rapidly changing financial landscape will keep on throwing new challenges in the field of deposit insurance but we need to treat these challenges as opportunities to grow, learn and evolve. It takes a very alert and nimble deposit insurer to keep pace with the changing times.

So, stay alert and be nimble.

Thank you.

[8] IADI Report- The 2023 banking turmoil and deposit insurance systems - Potential implications and emerging policy issues.