

Chapter I: Introduction

Reforming the deposit insurance system is one of the major items of the second phase of financial sector reforms in India. The Narasimham Committee Report on the *Banking Sector Reforms* (1998¹), while focusing on the structural issues, observed:

“Deposit insurance has increased public confidence in the banking system, promoted savings in bank deposits and has enabled banks to perform the intermediation function more effectively...Deposit insurance and the aversion to bank failures could create a moral hazard that distorts the incentives for banks and create competitive distortions... The Committee is of the view that there is need for a reform of the deposit insurance scheme. In India, deposits are insured up to Rs.1 lakh. There is no need to increase the amount further. There is, however, need to shift from the ‘flat’ rate premiums to ‘risk based’ or ‘variable rate’ premiums...”. (paras 5.30 to 5.42)

1.2. In India, the feasibility of extending deposit insurance to non-banks, which mobilize substantial financial resources from the so-called small depositors, has become another compelling force behind reforming the deposit insurance system. The concern arises from the fact that several non-banks in the country are prone to failure. The Shere Committee (1997) and the Vasudev Committee (1998²), which went into this aspect, advised against extending deposit insurance to the non-banks on the grounds of moral hazard, among others. In fact, the Committee on Banking Sector Reforms (1998) also endorsed this view. Thus, given the increasing signs of vulnerabilities in certain segments of banks and non-banks, a review of the deposit insurance system was overdue.

1.3. It was in the above-mentioned context that the RBI constituted, on April 9, 1999, an Advisory Group and a Working Group under Shri Jagdish Capoor, Deputy Governor to look into this issue. The Groups consisted of the following persons :

Advisory Group

1. Shri Jagdish Capoor, Deputy Governor .. **Chairman.**
2. Dr. Y.V. Reddy, Deputy Governor.
3. Shri M.G. Bhide, Former Chairman, Bank of India.
4. Shri S.H. Khan, Former Chairman, IDBI.
5. Dr. Ganti Subrahmanyam, Director, NIBM.
6. Dr. Ajay Shah, Professor, IGIDR.
7. Shri A. Chandramouliswaran, E.D., DICGC.

Working Group

- 1) Shri V.S.N. Murty, CGM, DNBS, RBI.
- 2) Shri M.R. Das, Chief Manager, SBI.
- 3) Dr. Mathew Joseph, ICICI.
- 4) Shri J.P. Sharma, GM, DICGC.
- 5) Shri K.V. Subba Rao, DGM, UBD, RBI.
- 1) Dr. D. Ajit, Director, DEAP, RBI .. Convenor.

Shri S.P. Talwar, Deputy Governor was a permanent invitee.

1.4. The terms of reference of the Working Group are as follows:

1. Review the role of Deposit Insurance in financial sector and economic developments, including a review of the international experience with regard to Deposit Insurance.
2. Conduct a detailed survey of the nature of Deposit Insurance in India – instruments, institutions and regulatory legal framework.
3. Propose changes in the existing system in regard to deposit coverage, institutions to be brought within the ambit of the Deposit Insurance, regulatory systems to be put in place in the case of each category of institutions accepting deposits from public as a pre-requisite for extension of the Deposit Insurance, risk-based premium and the parameters relevant for the assessment of the risk in regard to each category of the institutions and the ownership and capital of the existing Deposit Insurance Agency.
4. Consider any other matter referred to it by the Advisory Group.

1.5. Against this backdrop, the Report is organized into six chapters including the introductory one. Chapter II deals with the nature and role of deposit insurance, the international experience in this regard and certain issues that are considered important from the viewpoint of reforming the deposit insurance system in India. The chapter also explores the experiences of a few countries, which have no deposit insurance. Chapter III presents a detailed survey of deposit taking activities in India by banks, NBFCs, FIs and NBNFCs and the associated regulatory aspects. Chapter IV deals with the present system of deposit insurance in India and puts forth several recommendations to reform it. Chapter V deals with modifications to the role of DICGC. Chapter VI summarises the conclusions of the Report.

1.6. The Working Group had benefited immensely from interactions with the Advisory Group on several occasions. The Working Group members interacted among themselves and other invitees several times (See Annexure 1.1).

1.7. The Secretariat of the Group was located in the Division of International Economic Relations (DIER), Department of Economic Analysis and Policy (DEAP), Reserve Bank. Apart from providing logistics support to the Group, the Secretariat prepared the issue-based notes for both the Groups. It organized a one-day workshop on risk-based pricing of deposit insurance premium in which Prof. Ajay Shah (IGIDR), Prof. Ganti Subramanyam (NIBM), Shri Anand Sinha, General Manager, Department of Banking Supervision, Reserve Bank, etc., participated. The workshop was extremely useful to the Working Group.

1.8. The Group also benefited from the technical materials received from the FDIC, the FSA, the UK Building Societies and the Bank of Thailand (See Annexure 1.2).

1. Government of India, (1998) *Report of the Committee on Banking Sector Reforms*, April, New Delhi (Chairman: M. Narasimham).

2. Government of India (1998) *Report of the Task Force on Non-Banking Finance Companies*, October (Chairman: C.M. Vasudev), New Delhi.