CHAPTER-FOUR

INSURANCE COVER AND RESOURCE MOBILISATION

(i) Bank Failure in India.
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CHAPTER 4

Insurance Cover And Resource Mobilisation

Bank Failure is a kind of trouble that typically spreads, feeding on itself. Confidence is undermined. If one bank closes, people get afraid that other will also fail. The psychology of alarm grows, perhaps into panic. ¹

Bank failure gave severe blow to the banking structure of the country in pre-nationalisation period. The faith of the common man was shocked in the banking system of the country. This loss cannot be measured in statistical terms, so far as big deposits are concerned, the loss of deposits may be a drop in ocean for them; But a bank failure takes away the savings of life-long labour of small depositors, as it happened at the time of Palai Failure. Writing about the failure of the Palai bank one of the noted journals reported. "The condition of small depositors was pitiable. Sobbing women with infants in their arms, clutching the collapsible gates of the bank's, New Delhi Office, a washerman who had deposited all that he had earned in his life time, several employees who had just credited their pay cheques retired officials who had placed provident fund and gratuity in the fixed deposits etc., were

1. C. Lowell Harriss "Money and Banking"

Page 126.
adversely affected by the bank failure. So far as the faith of the common man in banking system of the country was concerned, it was badly shaken. Depositors of other banks also began to withdraw their deposits from their banks. They thought that their banks were also going to meet the same destiny though actually it did not mean that the financial position of other banks was unsound. Inspite of their financial soundness, they had to bear shocks. It is difficult to measure this shock statistically. Hence a problem emerged out of this situation. How the loss caused by bank failure to depositors in particular and banking structure of the country in general can be minimised.

Bank Failures In India:

India is not an exception in bank failures. The number of banks failed from 1913 has been shown in the table. Bank failures in India as elsewhere, have been due to a variety of causes. First of all, a good number of early failures were due to laissez faire policy pursued by the Government in economic matters. There should be no objection to strong Banking laws, strong regulations for preventing dishonesty and fraud. But apart from this,

## BANK FAILURES IN INDIA BETWEEN 1913 - 1961

<table>
<thead>
<tr>
<th>Period</th>
<th>No of Banks Failed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913 - 14</td>
<td>50</td>
</tr>
<tr>
<td>1915 - 20</td>
<td>43</td>
</tr>
<tr>
<td>1921 - 30</td>
<td>143</td>
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<tr>
<td>1931 - 36</td>
<td>232</td>
</tr>
<tr>
<td>1939 - 45</td>
<td>482</td>
</tr>
<tr>
<td>1946</td>
<td>27</td>
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<tr>
<td>1947 (March)</td>
<td>37</td>
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<tr>
<td>1947 (Dec)</td>
<td>45</td>
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<tr>
<td>1949</td>
<td>53</td>
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<tr>
<td>1950</td>
<td>45</td>
</tr>
<tr>
<td>1950 - 61</td>
<td>54</td>
</tr>
</tbody>
</table>

Source - Reserve Bank of India, Supplementary of Banking and Monetary Statistics of India, Part - I, page - 82.
it does seem that the best way in which a nation can work out its own banking salvation is by its own experiments and its own experiences. Secondly, many bank failures were due to tax laws, public ignorance of banking business and bad and dishonest management. Thirdly the low level of paid-up capital compared to subscribed capital, and authorised capital is one of the factors that has tended the downfall of some small banks. As there was no legal regulation to check this malpractice promoters of bank took advantage of this legal loophole. Fourthly, mushroom growth of banks during the war was also responsible for a number of bank disasters in the post war period. Lastly, sickly investment, not readily realisable were also responsible for bank failure as in the case of Bharat Bank Ltd.

A Case of Deposit Insurance:

In the context of bank failures in India, it was suggested to the central government to enact an appropriate legislation so that the interests of small depositors and confidence of public in the banking structure of the country might be well protected. A columnist reported as early as in 1949 that "already Bengal is in the grip of banking crisis and who knows that when other provinces may be in similar circumstances. Therefore, I appeal with all the force at my command that the government of India should
at once, take necessary steps to establish a Deposit Insurance Corporation (D.I.C.) of India. In the year 1950 the Rural Banking Inquiry Committee also stressed the need for the establishment of D.I.C. But no decision could be arrived at. The committee on Finance for private sector under the chairmanship of Shri A.D. Shroff in 1954, also recommended the introduction of Deposit Insurance in the country.

With a view to facilitating expeditious payments to the depositors of bank in liquidation and also vesting the Government and the RBI, with additional powers to rehabilitate bank in difficulties, the Banking companies (Second Amendment) Act 1960 was passed and brought into force on September 19, 1960. Prior to this Amendment, the procedure for determination of claims of secured creditors and other persons entitled preferential treatment was responsible for a good deal of delay in the payment to depositors of banks in liquidation. The Amendment required that such preferential payment should be made or provided for within three months from the date of winding up. The amendment further provided that every savings bank

depositors should be paid the balance at his credit subject to a maximum of Rs. 250 or the balance at his credit whichever was less in priority over all other debts. The maximum amount up to which a savings bank depositors enjoyed preferential claim prior to the amendment was Rs. 100 only.

Deposit Insurance Scheme:

There had been several cases of bank failures in India. The process of bank failures continued even after 1947. As already started in 1960, two well known banks namely, the Lekshmi Bank of Maharashtra and Palai Central Bank of Kerala met with failure. This gave a rude shock to public confidence and many people started withdrawing their deposit from the banks out of panic. To face this situation and to secure the interests of the middle-class depositors, the Government of India set-up in January 1962 the Deposit Insurance Corporation (D.I.C.).

The authorized and the paid up capital of the Corporation was Rs. 1.5 crores which was contributed wholly by the Reserve Bank of India. The paid-up capital of the corporation increased from 1.5 crores on January 1, 1975. The corporation can even borrow to the tune of Rs. 5 crores from the Reserve Bank of India in case of emergency. The Parliament introduced an amendment in the Deposit Insurance Corporation Act in December 1968. Under
The amendment the authorized capital of the corporation was raised from Rs. 1 crore to Rs. 5 crores. The number of Directors was also increased from 5 to 8. According to this amendment the Deposit Insurance Scheme became now applicable to state and central co-operatives Banks as well. In 1976-77 the scheme became applicable even to the Regional Rural Banks in the country. The membership of this corporation is compulsory for all commercial and other banks in the country. The corporation has fixed the insurance limit at Rs. 30,000/- for every depositor in every bank. In other banks, if any fails, the deposits of every depositors to extent of Rs. 30,000/- would be safe (But before July 1, 1976 the insurance cover per depositors used to be Rs. 10,000/-). Thus, as a result of the working of this Corporation, the deposits of the small and medium depositors have been made secure. It should however, be remembered that this scheme does not apply to the deposits of the central and state government lying in the banks. The corporation is charging at the present moment, 4 paisa per annum for every 100 rupees as insurance premium from the member-banks. If any member bank does not pay its premium, the corporation is authorized to charge interest at the rate of 8 percent per annum.

On July 15, 1978, the Reserve Bank of India amalgamated the Credit Guarantee Corporation of India with the
Deposit Insurance Corporation. It was renamed now as the Deposit Insurance and Credit Guarantee Corporation of India. Its capital was also raised from Rs. 2 crores to Rs. 10 crores.

The corporation continued to strike for the achievement of its twin objectives of giving insurance protection to small depositors in banks and Guarantee support to credit facilities extended to certain categories of small borrowers particularly those belonging to the weaker sections of the society.

An Assessment of the Progress and Achievements:

At the time of the establishment of the DIC some big bankers did not like the idea of its establishment because it put additional burden of Insurance premium on banks. Some leading bankers expressed their disappointment with the manner and method followed by the Government in initiating compulsory deposit insurance. They were of the opinion that the problem had not been given sufficient thought and the result was that deposit insurance had become a drag on big banks. It had actually cut in their earnings.

An examination of profit and loss accounts and balance sheets of the PNB reveals that total deposits of the bank increased from Rs. 151 crores to 215 crores in
which saving deposits accounted for Rs. 41 crores and 69 crores respectively between 1961-64. Profits of the bank also increased from Rs. 114 lakhs in 1962 to 141 lakhs in 1964. This comes to the fact that premium on deposits was not a burden on profit but a springboard for profits and deposits. An analysis of deposit accounts according to the size of insured banks indicate that the insurance cover is relatively greater in the case of small banks than in the case of large banks. Whereas the proportion of deposit accounts fully insured by the DIC was 72.2 percent in the case of banks with deposits Rs. 1 crore or less. This proves that the DIC has been helpful to the solidarity of small banks.

Examination of insured banks from time to time is an indispensable function which DIC must perform; because it is only thus the DIC can be in a position to watch, assess and improve the standard of banking in the country. Under the present provisions of the DIC it may request the RBI getting any report and information relating to an insured bank. In order to enable the DIC to function independently and effectively it is advisable to empower the DIC to inspect any insured bank at its discretion. This will place the DIC in a position

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to make its own assessment of the insured banks and to exercise its independent judgement at least in special cases.

Another point about the management aspect of the DIC also needs consideration. At present there is too much official representation in the Board of Directors of the DIC. Some non official experts of their subjects should also be nominated on the board. It will help the DIC to work more effectively. The DIC has created confidence amongst depositors and has also made appreciable contribution towards the solidarity of the banking system of the country. It has done more good of small depositors and small banks.

Functions of Deposit Insurance Corporation :

The total amount of Deposit Insurance claim paid or provided for since the inception of the scheme up to June 1982 in respect of 14 commercial banks and 11 co-operative banks aggregated 190 lakhs, respectively, the co-operation has received from the commercial banks co-operatives banks Rs. 78 lakhs and Rs. 13 lakhs, respectively towards repayment. Thus D.I.C. has played in important role in mobilising resources in the country and in Uttar Pradesh particular. By now, almost all banks U.P. Commercial banks
Regional rural banks and co-operative banks) have come under its insurance cover. Thus the banking system in India has played a pivotal role in the growth of financial savings in the past two decades. This has been possible for banks in view of their ability and efforts to offer a wide range of savings instruments combining different attributes such as safety, liquidity, transferability and yield to the various sections of society.

With deposit insurance up to the cover of deposit insurance and credit guarantee corporation (DICGC), and back up of the sovereignty of the state in the case of public sector banks in India enjoy safety of funds. There is no risk of capital depreciation although there is no hedge against inflation. The yield is decided by the monetary authorities since interest rate of deposits and loans are administered. Deposits of various categories are offered to the savers. Banks also channelise savings from small savers into a national savings pool, which can be drawn upon by all enterprises needing capital and pursuing diverse economic activities.