

CHAPTER V

MODIFICATIONS TO THE ROLE OF DICGC

Chapter IV presented a blueprint for reforming the deposit insurance system in India, along with some of the organizational issues pertaining to the Corporation (DICGC). The reformed Corporation, which is proposed to be named as the Deposit Insurance Corporation (DIC) – as it was before July 15, 1978 - will have the responsibility of carrying out the following functions:

- Insurance of bank deposits as defined
- Maintenance of adequate bank insurance funds
- Administration of risk-related deposit insurance premium as prescribed from time to time, which, in turn, would necessitate the Corporation to monitor the health of the insured banks on a continuous basis.
- Play a pro-active role in resolving a fragile/insolvent bank expeditiously when it is a *going* concern rather than a *gone* concern on *least cost basis* so that the viability and stability of the financial system is not affected.
- Build an adequate capital base for itself to undertake the abovementioned tasks.

5.2. In undertaking the abovementioned tasks, the Corporation should be in a position to provide a viable safety net as well as facilitate an orderly exit of inefficient entities and their restructuring. The Deposit Insurance Agency (DIA) has not only to administer deposit insurance efficiently, but also play an important role in reducing the time between an entity's insolvency and its resolution. The Basle "Core Principles" identifies 'compliance with laws' as well as 'safety and soundness concerns' as the pre-conditions for 'effective banking supervision'. This is where the FDIC's experience becomes very relevant. In this chapter we look at some of the legal implications of the proposed changes in the role and functions of the Corporation.

5.3. The envisaged task is gigantic and the Group examined whether the DICGC Act, in its present form, would have the necessary powers to execute its changed role and functions. At present, the Corporation is a

“passive player” in the financial scene, with its role confined to “paying-out” in case of bank failure (See Box 5.1). Presently, the Corporation does not enjoy adequate legal backing even to enforce some of the present rules and regulations on the insured banks. For example, the DICGC Act, 1961 contains certain provisions, such as Section 35 (Corporation to have access to records), Section 36 (inspection of insured banks by the Reserve Bank), Section 37 (Corporation to furnish information to the Reserve Bank) and Section 38 (Reserve Bank to furnish information to Corporation) through which DICGC comes to know about the affairs of the insured entities. The arrangement was conceived with the objective of avoiding duplication of the functions performed by the Corporation and the Reserve Bank and not burdening the insured banks with too many inspections. This arrangement, however, has not been satisfactory from the point of view of protecting the Corporation’s interests viz., the stability of the financial system and the Corporation’s viability in executing these tasks.

BOX-5.1

Deposit Insurance Payout: Bank of Karad Experience

The Bank of Karad was placed under liquidation at the instance of the Reserve Bank by the High Court of Bombay by its ad-interim order dated May 27, 1992. In order to mitigate the hardships suffered by the small depositors, DICGC decided to make immediate “On Account” payment to the liquidator to enable him to settle the claims of depositors pending preparation of the final list of depositors by the liquidator and settlement of claim as required under the provisions of Section 17 of the DICGC Act, 1961 by the Corporation. The insured deposits of the bank as on June 30, 1991 were about Rs.45 crores as per the ceiling applicable that time. The “On Account” payment was agreed to be released by the DICGC on the basis of the understanding that the bank would be ultimately liquidated. The Corporation had released a sum of Rs.37 crores in 3 stages which was utilized for making the payment to the depositors up to the then applicable ceiling of Rs.30,000/-. Later, the liquidator had submitted claim list which was duly scrutinized in the Corporation. The bank was finally wound up vide winding up order of the Bombay High Court dated July 20, 1994.

In the meantime, the proposals for sale of specified assets of Bank of Karad Ltd. were under consideration of the Reserve Bank. At

the instance of the High Court order fresh offers were required to be invited by the then Provisional Liquidator from banks incorporating therein a clause that the purchasing bank would be required to take over the outstanding deposit liabilities in the liquidated bank's books. The offer submitted by Bank of India was accepted for Rs.52.00 crores after careful consideration by all concerned. Thus, all depositors of the erstwhile Bank of Karad were fully covered in the process.

The amount of Rs.37.00 crores released to the liquidator has since been fully reimbursed to the Corporation by the liquidator. The Bank of Karad experience represents one of the relatively efficient liquidation and smooth deposit insurance payout which paved for smooth absorption of shocks in the system.

5.4. Some of the insured banks do not submit correct/timely information to the Corporation; some even do not pay premium in time and the Corporation is unable to initiate any legal action against the chronically erring banks. The resolution of failed banks is inordinately delayed, as the liquidators/receivers are appointed by the Government and not by the Corporation, even though it is the Corporation whose funds that are primarily involved. And, ultimately, the sufferers have been the depositors, the Corporation's deposit insurance fund, and the taxpayers.

5.5. The US experience is, however, strikingly contrasting. The FDIC Act vests with the FDIC powers of supervision/control over the insured depository institutions, including powers to take enforcement action against these institutions. The Act also empowers the FDIC for its own appointment as Conservator or Receiver³¹ to prevent loss to the deposit insurance fund. The Act also requires that the appropriate Federal Banking Agency shall not appoint conservator under certain provisions without giving the FDIC the opportunity to appoint the receiver. The Act also includes provisions that except with the prior approval of responsible agency, which shall in certain case be the Corporation, no insured depository institution shall merge or consolidate with any non-

³¹ The term 'receiver', as defined under Section 3(j) of the FDIC Act, includes a receiver, liquidating agent, conservator, commission person, or any other agency charged by law with the duty of winding up of the affairs of the bank.

insured bank or institution and there are several other restrictions. As per the provisions of Section 8 (o) of the FDIC Act, whenever the insured status of a State Member Bank is terminated by an action of the Board of Directors, the Board of Governors of the Federal Reserve System shall terminate its membership in the Federal Reserve System in accordance with the provisions of Section 9 of the Federal Reserve Act, and whenever the insured status of a National Member Bank shall be so terminated, the Comptroller of Currency shall appoint a receiver for the bank which shall be the Corporation. Under the FDIC Act, the Board of Directors of the Corporation prescribes certain entry norms for banks applying for insurance coverage. Besides, the Corporation has the option to accept or deny such insurance coverage and also take into account the suitability of the bank approaching it for insurance. The Corporation is also empowered to call for the necessary information from the insured banks through what is known as “Call Reports”. Thus, it would appear that the legislation in the USA, the ultimate objective of which is to maintain a safe and sound banking system, has been framed in such a manner that it provides a proper link for a coordinated action by all the respective authorities including the FDIC, which have control over the “insured depository institutions”.

5.6. In order to play an effective role in the liquidation (swift and surgical closure) of weak banks, the Corporation must equip itself with adequate powers for this purpose. There is, therefore, a need to consider the scope for further enabling provisions which may be considered and drafted after a policy decision is taken with respect to the extent and scope of coordinated action of the regulatory/supervisory authorities in relation to banking companies/co-operative banks.

Role of Liquidator and Receiver

5.7. One immediate area of concern is a proposal relating to failure resolutions so as to vest the DICGC with the power, without the intervention of the court,

- (a) to appoint liquidator in the case of failure of the insured entity;
- (b) to appoint parties to take over the assets, sell them and realize the proceeds to meet the liabilities, etc., of the insured parties; and
- (c) to take steps and adopt suitable measures for the reconstruction of the insured entity or for the amalgamation of the insured entity with any other institution.

5.8. In the present set up, the Corporation does not have any say about the types of institutions to be insured, monitoring of the insured entities and liquidation of insolvent entities. In the modified deposit insurance system discussed in Chapter IV, the Corporation will have the right to determine the institutions and type of deposits to be covered. However, the regulation and supervision will continue to be with the Reserve Bank. The Corporation is accorded a prominent role in the liquidation of insured entities. In India, in the case of banking companies, the Banking Regulation Act, Part III deals with suspension of business and winding up of banking companies. In the case of State Bank of India and its subsidiaries, only Central Government is competent to order for liquidation of these entities (as per Section 45 of the State Bank of India Act, 1955 and Section 57 of the State Bank of India (Subsidiaries Act, 1959). As the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, provisions relating to the winding up vests with the Central Government. In the case of RRBs, again the Central Government is empowered (as per Section 26 of the Regional Rural banks Act, 1976) to order for liquidation of RRBs.

5.9. As per the existing enactments, in certain circumstances, subject to the Reserve Bank and the Central Government agreeing to do so, the Corporation may also be appointed as a receiver or a liquidator (Sections

38(a) and 39 of the Banking Regulation Act, 1949). However, such appointment would not provide to the Corporation any better priority with respect to the realization of its dues than what is available to the Corporation today unless the Corporation is vested with a special power and position and is given priority over the debts of secured creditor, government dues/ dues of revenue, by way of special legislation in this regard and amendment of the existing provisions of the Acts in relation thereto because the order of priority of dues as existing now does not allow the Corporation to put its debt claims on top vis-à-vis Government or dues of revenue. Several existing legal frameworks, as mentioned below, will have to be taken into account for this purpose:

- (a) DICGC Act, 1961
- (b) Banking Regulations Act, 1949
- (c) Regional Rural Banks Act, 1976
- (d) State Bank of India Act, 1955
- (e) State Bank of India Subsidiaries Act, 1959
- (f) Co-operative Banks (State enactments)
- (g) Act pertaining to appointment of Liquidator in the case of winding or reconstruction or amalgamation of such entities.

Therefore, the Group **recommends that this aspect may be examined, in detail, by a group of experts in banking laws and regulations.**

5.10. Currently, the DICGC Act puts a cap on the rate of premium chargeable by the Corporation to the insured bank, which is flat rate, at Rs.0.15 per Rs.100 of assessable deposits. With the acceptance of the risk-based pricing of the premium, **the cap will lose its relevance and, therefore, has to be abolished through a suitable amendment of the Act.**

5.11. The Act should also **recognise two separate funds – one for commercial banks and the other for co-operative banks – as well as the need to define an optimum level of the deposit insurance funds and specify explicitly their levels in relation to insured deposits, i.e., 2 per cent as proposed .**

5.12. Currently, the Corporation cannot impose any penalty on the banks which are defaulting on providing timely and adequate information to the Corporation. We have prescribed that a higher rate of premium be charged to these kinds of erring banks. However, it will be **more appropriate if the Act is amended to enable the Corporation to impose fines on such banks depending on the type of error and the length of the period for which the errors remain unreconciled.**

Public Awareness Programme

5.13. As has been pointed out in Chapter II, the general depositors, even sometimes the sophisticated ones, are not aware of the facility of deposit insurance in India. This has been primarily attributed to the fact that the major banks in India being government-owned are considered to be “too-big-to-fail”. With the changing times, there arises a **need for the deposit insurance agency to educate the people about the safety nets available for financial entities through various media, as is being currently done in the case of NBFCs. Secondly, branches of various banks should be advised to display clearly in the branches that the depositors’ money is insured up to Rs.1 lakh to elucidate the point. Thirdly, the deposit insurance agency must develop a suitable logo, which would be displayed in the bank branches, account opening forms, etc. so as to exude necessary confidence among the depositors.** Even within banks, the staff is sometimes not aware of the details of deposit insurance. Therefore, the Group feels that **banks be directed to issue necessary guidelines/instructions/literature to the grass-root level operating units.**

Diversification of DICGC Functions

5.14 The DICGC will gradually be into the whole business of risk assessment and risk monitoring. As its abilities in the field pick up, **it may consider offering its services in the field of credit derivatives, e.g., assets securitisation, mortgage-backed securitisation, etc.** However, it will have to put in place suitable firewalls between its deposit insurance activity and the credit derivative activity.