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Indian Banking Sector

Increase in deposit insurance limit to impact banks’ profitability but may aid their liquidity coverage

MARCH 2025

Highlights

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Under various scenarios of increase in insured deposit base to 47%-66% of total bank deposits, the banking sector RoA and RoE could moderate by 1-4 bps and 7-40 bps respectively.

Additionally, If the proposed hike in deposit insurance premium is implemented, the cumulative impact on RoA and RoE is estimated to be ~3-7 bps and ~27-68 bps, respectively.

- The increase in deposit insurance limit from Rs. 1 lakh to Rs. 5 lakh per depositor per institution was last done in February 2020 by the Deposit Insurance and Credit Guarantee Corporation (DICGC). This has come under focus, given the recent failure of a cooperative bank. In addition, the insurance premium may be raised to Rs. 0.15 (from Rs. 0.12) per Rs. 100 of deposit, with the prior approval of the Reserve Bank of India (RBI), to help the DICGC shore-up its Deposit Insurance Fund (DIF).
- As on March 31, 2024, 97.8% of the total number of eligible/assessable accounts were fully covered. The remaining 2.2% of the accounts were partially covered up to the coverage limit of Rs. 5.0 lakh. The coverage ratio in terms of value of deposits, termed as insured deposit ratio (IDR; insured deposits to assessable deposits), was 43.1% as on March 31, 2024 (44.4% as on March 31, 2023).
- While the proposed increase in deposit insurance limit is not known, however, under various scenarios, whereby IDR increases to 47.0-66.5%, ICRA estimates the banks' profit after tax (PAT) to be adversely impacted by Rs. 1,800-12,000 crore annually, translating into a moderation of return on assets (RoA) by 1-4 basis points (bps) and return on equity (RoE) by 7-40 bps. Additionally, if the insurance premium is increased, the cumulative impact on RoA and RoE will be 3-7 bps and 27-68 bps respectively.
- The increase in insured deposit base would also lead to a reduction in ratio of DIF to insured deposits base called reserve ratio (RR). Under various scenarios, ICRA estimates the RR to fall to 1.5-2.1% from current level of 2.1%. With the increase in premium to Rs. 0.15 from Rs. 0.12 per Rs. 100 deposit, the DIF would get a marginal benefit and the moderation in RR would be 1.6%-2.1%.
- The rise in insurance limit may increase the deposits qualifying for the stable deposit base (and hence attracting lower outflow rates). This may result in the overall decline in deposit outflow rates for calculation of liquidity coverage ratio (LCR), thereby reducing the requirements of excess High Quality Liquid Assets (HQLA, which are Government securities) held by banks.

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