What is Bank Moratorium?

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In news

Central government, on the recommendations of RBI imposed moratorium on Lakshmi Vilas Bank for a period of thirty days

What is a bank Moratorium?

- The Reserve Bank of India which is the regulatory body overseeing the country's financial system, has the power to ask the government to have a moratorium placed on a bank's operations for a specified period of time.
- Under such a moratorium, depositors will not be able to withdraw funds at will.
- Generally, there is a ceiling that limits the amount of money that can be withdrawn by the bank's customers.
- For instance, in the present case of Lakshmi Vilas Bank depositors cannot withdraw more than ₹25,000 during the one-month moratorium period.
- RBI in most of the case allows for funds of a larger quantum to be withdrawn in case of an urgent requirement, such as medical emergencies, but only after the depositor provides the required proof.
- Main objective of a moratorium is to protect the interests of depositors. Even if they are temporarily handicapped by facing restricted access to their funds, there is a high probability that the bank would soon return to normal functioning once a bailout is arranged.

Can the Moratorium on a Bank be withdrawn before the specified period?

The bank moratorium is lifted even before the originally stipulated deadline is reached.

For example, Yes Bank, which went into a spiral while unsuccessfully trying to find an investor, was placed on a one-month moratorium starting March 5, with a cap of ₹50,000 on withdrawals. With investors led by State Bank of India (SBI) infusing ₹10,000 crore into Yes Bank, the moratorium was lifted on March 18

When a Moratorium is imposed on a Bank?

- The regulator(RBI) steps in if it judges that a bank's net worth is fast eroding and it may reach a state where it may not be able to repay its depositors.
- When a bank's assets (mainly the value of loans given to borrowers) decline below the level of liabilities (deposits), it is in danger of failing to meet its obligations to depositors.

Effects of Moratorium

- It primarily helps prevent what is known as a 'run' on a bank, by clamping down on rapid outflow of funds by wary depositors, who seek to take their money out in fear of the bank's imminent collapse.
- Temporarily, it does affect depositors who may have placed, for example, their retirement with the bank, or creditors who are owed funds by the bank but are struggling with the collection.
- It gives both the regulator and the acquirer time to first take stock of the actual financial situation at the troubled bank.
- It allows for a realistic estimation of assets and liabilities, and for the regulator to facilitate capital infusion, should it find that necessary.