



THE IMPACT OF UNCLAIMED DEPOSITS ON THE INDIAN BANKING SYSTEM: ASSESSING THE IMPLICATIONS ON BANK LIQUIDITY, PROFITABILITY, AND OVERALL FINANCIAL HEALTH

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ABSTRACT

Unclaimed deposits, which refer to funds left dormant in bank accounts for extended periods, have become a significant concern in the Indian banking system. These deposits, typically inactive for 10 years or more, can pose challenges related to liquidity, profitability, and overall financial health of banks. The Reserve Bank of India (RBI) and the government have established guidelines to manage these deposits, such as transferring unclaimed funds to the Depositor Education and Awareness Fund (DEAF). However, the increasing volume of unclaimed deposits raises questions about their impact on the banking sector and the economy.

This paper aims to explore the implications of unclaimed deposits on the Indian banking system, focusing on three key areas: liquidity management, profitability, and financial health. First, unclaimed deposits represent idle capital that banks cannot use for lending or investment, affecting their liquidity. While these funds are technically part of a bank's reserves, their inactivity prevents them from contributing to economic growth. Second, banks incur administrative costs to track and manage dormant accounts, reducing overall profitability. Moreover, the opportunity cost of not utilizing these funds for revenue-generating activities is significant. Finally, the broader financial health of the banking system is affected, as unclaimed deposits may signal issues such as poor customer engagement or lack of financial literacy.

The paper also discusses potential solutions to address the issue, including improving customer engagement, enhancing financial literacy, leveraging digital banking technologies, and revising regulatory frameworks. By adopting these strategies, banks can better utilize dormant funds, reduce inefficiencies, and contribute to a more stable and inclusive financial system. Ultimately, addressing the challenge of unclaimed deposits can help enhance the financial well-being of both individual depositors and the broader economy.

Keywords: *Unclaimed Deposits, Indian Banking System, Bank Liquidity, Financial Health.*

1. INTRODUCTION

Unclaimed deposits refer to funds deposited in bank accounts that remain inactive for a specified period, typically several years. These deposits become unclaimed when the account holder fails to operate the account or claim the funds. While seemingly a small issue, unclaimed deposits can have significant implications for the Indian banking system, affecting liquidity, profitability, and overall financial health.



The Indian banking system, as one of the largest in the world, serves as the backbone of the nation's economy. A significant challenge that has surfaced over the years is the growing volume of unclaimed deposits in banks, which refers to funds that have not been accessed by the account holders for a specified period (typically 10 years). These unclaimed deposits include savings accounts, fixed deposits, and recurring deposits, and while they do not pose immediate operational threats, their accumulation raises concerns about the financial health of banks and the economy at large.

The impact of unclaimed deposits can be multifaceted. On one hand, these funds represent dormant capital, which could be better utilized for lending, investment, or other economic activities. On the other hand, the management of such funds requires compliance with regulatory guidelines and can affect liquidity, profitability, and overall financial stability.

This paper aims to assess the implications of unclaimed deposits on bank liquidity, profitability, and the broader financial ecosystem in India, proposing potential measures to mitigate these challenges.

2. LITERATURE REVIEW

This section will review existing literature on unclaimed deposits, focusing on:

- **Global trends:** Examining the prevalence and management of unclaimed deposits in other countries.
- **Indian context:** Analysing the specific challenges and regulatory framework related to unclaimed deposits in India.
- **Impact on banks:** Exploring the effects of unclaimed deposits on bank liquidity, profitability, and risk management.
- **Stakeholder perspectives:** Understanding the views of depositors, banks, and regulators on unclaimed deposits.

3. METHODOLOGY

This study will employ a mixed-methods approach, combining quantitative and qualitative data:

- **Quantitative analysis:** Analysing data on unclaimed deposits from the Reserve Bank of India (RBI) and other sources to identify trends, patterns, and correlations.
- **Qualitative research:** Conducting interviews with banking professionals, regulators, and depositors to gain insights into the challenges and perspectives related to unclaimed deposits.

4. FINDINGS

The findings will be presented in three main sections:

- **Magnitude and characteristics of unclaimed deposits:** Analysing the volume, growth rate, and distribution of unclaimed deposits in India.



- **Factors contributing to unclaimed deposits:** Identifying the reasons behind the accumulation of unclaimed deposits, such as lack of awareness, financial illiteracy, and dormant accounts.
- **Impact on the banking system:** Assessing the effects of unclaimed deposits on bank liquidity, profitability, and risk management.

5. THE PHENOMENON OF UNCLAIMED DEPOSITS IN INDIA

5.1. Definition and Causes

Unclaimed deposits are funds that have remained inactive for an extended period, typically 10 years as per the Indian Banking Association's regulations. Common causes for the accumulation of such deposits include:

- Death of account holders without nomination.
- Migration of customers without updating records.
- Prolonged inactivity due to changing banking habits (e.g., digital transactions over traditional ones).
- Financial distress or a lack of awareness regarding dormant accounts.

5.2. Regulatory Framework

In India, the Reserve Bank of India (RBI) and the Indian government have set clear guidelines for handling unclaimed deposits. These funds are eventually transferred to the Depositor Education and Awareness Fund (DEAF) after a period of inactivity. The government uses these funds for the purpose of educating depositors about banking services and improving financial literacy.

6. IMPACT OF UNCLAIMED DEPOSITS ON BANK LIQUIDITY

Liquidity refers to the ability of a bank to meet its short-term obligations, and unclaimed deposits can affect liquidity in the following ways:

- **Accumulation of Idle Capital:** Banks are required to set aside capital for unclaimed deposits, which could otherwise be employed in lending or investment activities.
- **Regulatory Pressure:** Banks are mandated to transfer unclaimed funds to the DEAF, but maintaining records of such funds and adhering to the regulatory guidelines creates operational burdens that could otherwise be alleviated by more effective management strategies.

Missed Investment Opportunities: Unclaimed deposits, while technically still part of the bank's reserves, do not generate returns as effectively as funds that are actively invested or lent out.

On Bank Profitability: Unclaimed deposits can also affect the profitability of banks in the following ways:



- **Lost Interest Earnings:** Funds in unclaimed accounts are not being utilized for income-generating activities. Banks lose out on potential interest or returns they could have earned through loans, bonds, or other investment avenues.
- **Administrative Costs:** Banks incur costs related to maintaining accounts with unclaimed deposits, including staff time and resources for tracking, notifying, and managing these accounts.
- **Potential Reputational Risk:** Excessive accumulation of unclaimed deposits could be seen as a sign of poor customer engagement or inadequate financial education, potentially damaging the bank's reputation and customer trust.

Impact on Financial System Efficiency: Unclaimed deposits represent an inefficient use of capital within the financial system. The funds sitting dormant in banks cannot contribute to economic growth through lending, investments, or other financial activities. The diversion of these funds into productive uses could spur growth in various sectors, including housing, infrastructure, and small businesses.

Impact on Financial Inclusion: Unclaimed deposits often belong to individuals who may not have the financial literacy or awareness to manage their accounts effectively. This creates an opportunity for banks and the government to focus more on financial inclusion efforts, providing education, outreach, and better financial products to ensure that more individuals remain engaged with their accounts.

7. STRATEGIES FOR ADDRESSING UNCLAIMED DEPOSITS

7.1. Improved Customer Engagement

- **Better Communication:** Banks should engage in regular communication with account holders, particularly those with dormant accounts, to encourage account activity.
- **Incentive Programs:** Offering small incentives or benefits for reactivating dormant accounts may encourage account holders to claim their funds.

7.2. Financial Literacy Programs

- **Education Initiatives:** Government and banks should jointly invest in programs that raise awareness about the importance of keeping accounts active, updating beneficiary information, and creating financial plans.

7.3. Enhanced Digital Solutions

- **Digital Banking Services:** Leveraging technology, such as mobile apps or online banking platforms, can help customers access their funds easily, thereby reducing the likelihood of accounts becoming dormant.
- **Automatic Re-engagement:** Banks can deploy systems that automatically alert account holders about their dormant accounts, facilitating easier recovery or reactivation.



7.4. Legislative Measures

- **Review of the 10-year Dormancy Rule:** The current 10-year period after which deposits are transferred to DEAF could be reassessed to potentially shorten the duration or incentivize quicker re-engagement by customers.

Nomination and Succession Planning: Banks could implement policies encouraging customers to designate nominees at the time of opening accounts, making it easier to track down heirs or beneficiaries of unclaimed funds.

8. CONCLUSION

The conclusion will summarize the key findings and their implications for the Indian banking system. It will also offer recommendations for mitigating the impact of unclaimed deposits and enhancing the efficiency of the banking system.

Unclaimed deposits represent both a challenge and an opportunity for the Indian banking system. While these funds can strain liquidity and limit profitability, they also highlight a broader issue of financial awareness and customer engagement. Through better regulatory practices, innovative financial products, and enhanced financial literacy initiatives, the negative impacts of unclaimed deposits can be mitigated. With appropriate strategies in place, India's banking sector can unlock the potential of these dormant funds, contributing to overall economic growth and stability.

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