27th May, 2024.

To

The Finance Minister,
Government of India,
134/North Block,
New Delhi 110001

Honourable Finance Minister Smt.Nirmala Sitharaman ji,

Sub: Should India adopt a new Banking Model?

Silicon Valley Bank (USA) collapsed after a run on the bank about a year ago. This is neither the first bank to go under nor it will be the last one. There are many reasons for a bank to collapse, the main one being 'Fractional Reserve Banking', a model the banks followed world over for centuries. This model may have served some purpose when financial markets were not as developed/evolved as they are today and the kind of technology that we have today was not available back then. Coupled with this the Government of India's undeclared policy of 'Banks cannot/should-not fail' makes the present banking model extremely complicated and highly toxic. We wonder whether the time has come for us to think of a new banking model. We would like to share our views in this regard here (**A word of caution : Our suggestions may look a bit weird at this point of time but they sure deserve a serious look**).

**Our proposed model:**

1. Divide all Financial Institutions into two categories:
   - Universal Financial Institutions (UFIs) and
   - Exempted Financial Institutions (EFIs).

   At present we have a plethora of financial institutions and different rules regulating each one of them. This compartmentalization of financial institutions makes no sense any more. We have at present Scheduled Commercial Banks, NBFCs, Payment Banks, Small Finance Banks, Local Area Banks etc., etc., In fact, many times the same set of promoters float different financial institutions under different statutes/categories. Take the case of this leading mortgage lender who floated a Commercial Bank which in turn promoted an NBFC (now the former two are merged). Either the system is creating unnecessary hurdles or creating scope for 'profiteering' or both. We do not want to get into that for now and that is outside the scope of this letter. All that we want to say is - **issue one, only one, set of guidelines for all financial institutions to follow, to**

**comply with**. Simple. Let the promoters decide what business they want to pursue. If someone wants to focus on the mortgage business, good. If someone wants to focus on consumer/personal loans, excellent. Let them decide what they want to do. Government focus should be on maintaining the overall health of the financial sector and economic stability. Accordingly the government would prescribe the rules and regulations everyone should follow and such rules are uniform to everyone. Of course, if there are some financial institutions which find it impossible/difficult to follow then they should seek an exemption. The Government may, in genuine cases, exempt such institutions subject to stringent conditions such as restricting their size, their reach etc., so that they can never pose any threat to the system. Thus the government should divide all financial institutions into UFIs and EFIs.

2. Tackle Asset Liability mismatch: Next important step would be regarding mobilizing financial resources by these Financial Institutions. These Financial Institutions should raise funds from the debt market by issuing bonds for an appropriate tenor (1 year to 10 years or more). Short term funds like Savings Bank Account balances or Current Account balances should not be allowed to be utilized for onward lending. Such **CASA balances, if any, should be invested in suitable markets like overnight call money markets**. Even terms of 'Term Deposit Receipts' should be altered suitably.

**What to expect from the above:**

1. With the above changes, we believe that **the financial sector will become more stable**. 'Run on the banks' becomes history. The Finance Minister and RBI Governor can sleep better. By this change we are also bringing in an extra layer of supervision over the financial institutions. The investors, may be Mutual Funds, may be Debenture Trustees who are buying those bonds issued by the financial institutions will keep constant vigil over their performance and governance. That is a huge positive.
2. The proposed change, according to us, **will stop distorting the value of (fiat) money**. We are of the opinion that the present model is distorting the value of money to the advantage of Rich, Influential, Powerful and well connected (RIPs in short). This distortion, again according to us, is shifting huge amounts of wealth from the proletariat, from the common-man to the RIPs continuously, 24/7. (There, of course, are many other government policies that are working against the proletariat/common-man like unbridled/reckless import of capital, deficit financing without proper justification etc.. Maybe we will take up this issue separately some other time).
3. The proposed change, according to us, **will discourage unscrupulous and fly by night operators from floating/setting up financial institutions**. A decade back or so setting up a bank was not easy. But with the liberalized policy environment (when bank licenses are available 'on tap') everyone is eager to have some fun. We can not blame them. After all, when banks/financial institutions can not fail, promoters of these institutions can literally 'have the cake and eat it too'. They know that if something goes wrong then the government will bail them out.

4. With this change, we believe, **public sector banks stop burning the 'public money'** (euphemistically called recapitalization) **endlessly**. When the proposed changes are implemented, the financial institutions, everyone, either have to perform or will perish and die a natural death very slowly and at a steady pace (they don't collapse overnight). That will improve the overall health of the financial sector. Any objections?
5. The proposed changes, according to us, **lead to efficient allocation of 'capital'**. At present, in the existing system, the cost of capital is the same (almost) for everyone. It is the same for both most efficient and least efficient operators. It goes against the very grain of finance and economics. Under the proposed changes the best and most efficient can raise capital at much cheaper rates compared to the ones that are not so efficient. So 'capital' one of the precious inputs/factors will be allocated more efficiently.

> We suspect that not so efficient Public Sector Banks are able to mobilize funds at lower rates, relatively speaking, due to perceived 'Sovereign Protection'. We feel that Private Sector Banks are taking advantage of this situation by using these 'lower rates' as a benchmark.

6. **Arrests the ill effects of the 'cheap money', albeit, partially**. As already said the present model is distorting the value of money and making it cheap for RIPs. But this cheap money is not available to everyone. The ones who have access to it are using it with brute force to decimate petty traders, cottage industries, artisans and other players in the unorganized sector (No wonder we have huge and ever growing inequality). Further we strongly believe that this 'cheap money' is attracting crooks/criminals in hordes (Jaggery left in the open bound to attract flies - a saying in Telugu). Most of them probably wouldn't have availed bank finances if the price of the money was realistic. With the proposed changes some of these ills may get addressed to some extent.
7. **Some interesting observations we made in this connection**:
    - We understand from publicly available information that Scheduled Commercial Banks are the main source of funds for NBFCs. So all this categorization is very superficial. They are intricately connected already.
    - We observed that in some cases banks are offering interest on Savings Bank Account balances at rates higher than the prevailing 10 year G-Secs (or thereabouts). Are we missing a signal?
    - The Indian Banking Sector, as a whole in general and the Private Sector in particular, is showing extraordinary performance. The total Net Profit of Banking Sector crossed Rs.3 Lakh Crores for the financial year 2023-24 (Times of India - 20th May, 2024). We wonder how much of it is due to its efficiency and how much of it is due to the liberal and supportive policies of the Government.
    - Incidentally foreign ownership in most of the top notch private sector banks is as high as 60%/70%. That means : One, they are Indian Banks nominally and Two, foreign investors are extremely gung ho about them (Maybe they know more than what yours truly knows). Interesting.

- Did you ever wonder why leading Indian Business Houses (including Asia's richest man) are so eager to sell *chana-batana and aloo-pyaz* instead of focusing on manufacturing some high-tech stuff? Does this have something to do with the way we are allocating/directing the capital, domestic or imported? Time to think about it.

Finally we would like to conclude by saying that like water flows towards the lowest point, eventually, money flows towards the highest return (risk adjusted), eventually. No amount of rules and regulations (or dams and reservoirs) can stop this process (Yes, they can delay it).

The above idea is for your consideration and for further development.

Thank you,

Yours truly,

Sd/-

(Chandra Sekhar Gupta Boggarapu)
Founder, Proletarian Power (proletarianpower.org),
502, Vaishnavi Twins Plaza, G-90/A, Madhura Nagar,
Hyderabad - 500038.

Copy to : The Governor, Reserve Bank of India, Shahid Bhagat Singh Road, Fort, Mumbai 400001.

**Postscript:**

The Government, in the changed scenario as envisaged above, may have to come up with innovative financial products to meet specific needs of vulnerable segments and develop an efficient mechanism to deliver such products. 'Shree Currency', a local/community currency designed by us could be one such product. Thanks to technology, it is easier now to develop such financial products through the Central Bank Digital Currency (CBDC).

Proletarian Power (proletarianpower.org) is a not-for-profit entity primarily engaged in analyzing the macro economic environment in India from 'public interest' angle..