



Digital Banks

For Prelims: Digital Banks' Differing from Digital Banking Units, Financial Inclusion, UPI

For Mains: Digital Banks and its Need, NITI Aayog Report on Digital Bank

Why in News?

Recently, [NITI Aayog](#) has released a Report titled- '**Digital Banks: A Proposal for Licensing & Regulatory Regime for India**'.

- It suggested setting up Digital Banks and **a licensing and regulatory framework for such Banks.**

What are the Findings of the Report?

- In recent years, India has made rapid strides in furthering [Financial Inclusion \(FI\)](#), catalysed by the [Pradhan Mantri Jan Dhan Yojana \(PMJDY\)](#) and [India Stack](#).
- However, **credit penetration remains a policy challenge**, especially for the nation's 63-million-odd MSME (Micro, Small and Medium Enterprises).
- The FI has been furthered by the [Unified Payments Interface \(UPI\)](#), which has witnessed extraordinary adoption.
 - UPI recorded over 4.2 billion transactions worth Rs 7.7 trillion in October 2021.
- The FI also **resulted in** [Direct Benefit Transfer \(DBT\)](#) through apps such as [PM-KISAN](#) and extending microcredit facilities to street vendors through [PM-SVANIDHI](#).
- India is at the **cusp of operationalizing its own open banking framework.**
- Creating a blueprint for digital banking regulatory framework and policy **offers India the opportunity to cement her position as the global leader** in Fintech at the same time as solving the several public policy challenges she faces.

What are the Recommendations?

- Issue of **a restricted digital bank licence**, the license would be restricted in terms of volume/value of customers serviced and the like.
- Enlistment of the licensee in **a regulatory sandbox framework enacted by the Reserve Bank of India.**
- Issue of a **'full-scale' digital bank licence**, contingent on satisfactory performance of the licensee in the regulatory sandbox, including salient, prudential and technological risk management.

What is Digital Bank and What is its Need?

- **Digital Bank:**
 - It will be defined in the [Banking Regulation Act, 1949](#), and shall have its own balance sheet and legal existence.

- It will be **different from the 75 Digital Banking Units (DBUs)** -- announced by Finance Minister in [Union Budget 2022-23](#) -- which are being set up to push digital payments, banking and fintech innovations in underserved areas.
 - A DBU is a **specialised fixed point business unit** or hub housing certain minimum digital infrastructure for delivering digital banking products and services as well as servicing existing financial products and services digitally in self-service mode at any time.
- Digital banks will be **subject to prudential and liquidity norms on a par with existing commercial banks.**
- **Need:**
 - **Credit Gap:**
 - The success India has witnessed on the payments front is yet to be replicated in meeting the credit needs of its micro, small and medium businesses.
 - The credit gap reveals a need for **leveraging technology effectively to cater to these needs and bring the underserved** further within the formal financial fold.
 - **Reliance on Digital channels:**
 - Banks and fintech businesses that offer digital banking services rely primarily on **digital channels that organically have high-efficiency metrics relative to incumbent commercial banks.**
 - This structural feature makes them a potentially effective channel through which policymakers can achieve social goals like empowering the under-banked small businesses, and enhancing trust among retail consumers.
 - **Neo-Bank Models Face Challenges:**
 - Existing partnership-based [neo-bank](#) models face several challenges, such as **revenue generation and viability.**
 - Neobanks don't have a bank license of their own but count on bank partners to provide bank licensed services.
 - They have **limited revenue potential**, high cost of capital, and offer products of only partner banks.

[Source: PIB](#)

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