Significance of Digital banks

Why in news?

NITI Aayog published a discussion paper titled 'Digital Banks: A Proposal for Licensing & Regulatory Regime for India' in November 2021 and the final report in July 2022.

What did the report say?

- The NITI Aayog's report explained the value proposition of full-stack digital banks and laid down an implementation plan.
- The main plank of Aayog's advocacy is setting-up of full-stack digital banks.
- The report also drew distinction between Digital Banks and Digital Banking Units.

What are Digital banks?

- Digital banks are financial institutions that have no physical branches and offer banking services entirely online through their website and mobile banking app.
- Digital banks will be completely independent banks to be licensed under the Banking Regulation Act, 1949 and they will follow the Reserve Bank norms on par with commercial banks.

Digital Banking Units (DBUs) on the other hand, do not have legal personality and are not separately licensed under the Act.

What are the significances of Digital Banks?

- Full-stack digital banks is a potential solution for the persistent policy challenge of credit deepening.
- Digital banks are seen as the next stage of financial inclusion.
- Digital banks can solve the problem of lack of credit penetration among MSMEs.

What are the factors to make digital banks a reality?

- The infrastructure for digitising services allied to financial services already exists.
- Connecting them will make full-stack digital banking services available to customers.
- The infrastructure that are readily available for digital banks are:
- **India Stack** - It consists of identity rails, payment rails and data sharing rails and it widens the access to financial services at lesser cost.

- **Digital Document Execution Platform** - National E-Governance Services Ltd. through this platform has started digitalizing loan documents.
- **Public Credit Registry** - RBI is setting up a PCR to reduce information asymmetry, enabling the lender to know the credit history and the current indebtedness of the borrower.

How digital banks can help MSMEs?

- MSMEs lack access to formal credit due to their informal nature.
- Formal banks face challenges in credit risk assessment owing to lack of financial information, historical cash flow data, etc.
- New age techniques like predictive analyses and AI can be used by digital banks to arrive at real time decisions for time-busy MSMEs.
- Digital banks can reduce high operational costs and tedious assessment of creditworthiness of each unique SMEs.
- Digital banks can provide fast approval process and certainty regarding funds availability for MSME borrowers.

What is the road ahead?

- Digital banks can rethink and retool lending mechanism and credit underwriting process.
- The technology enabled digital banks will allow banks to move from traditional funding methods based on collaterals to advanced cash flow lending.
- The field of credit assessment and delivery in India will be changed in a natural progression with the entry of digital banks.

Quick Facts

- India Stack is the name used to describe a collection of disparate technology products and frameworks.
- The components of this collection are owned and maintained by different agencies.

Rails	**Product**	**Authority owned / maintained**
Identity rails	Aadhaar products such as e-auth and e-KYC	Unique ID Authority of India (UIDAI)
	eSign	Ministry of Communications
	Digilocker	Ministry of Electronics and Information Technology
Payment rails	Unified Payments Interface (UPI)	National Payments Corporation of India
Data sharing rails	Account Aggregator framework	Regulated by RBI Owned by ReBIT.

Reference

[The Hindu Business Line | The stage is set for digital banks]



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