Boosting Neobanks

Why in news?

Bengaluru-based startup Open which is a neobank has recently become India's 100th unicorn.

What is a Neobank?

- A neobank is a digital bank that does not have any branches and is entirely online.
- A neobank is a fintech firm that provides digital and mobile-first services like payments, debit cards, money transfers, lending, and more.
- In India, these firms don't have a bank licence of their own but rely on bank partners via corporate collaborations to provide licensed core banking services and over-the-top financial services.
- Neobanks provide products that come under the regulatory framework of the three financial regulators — the Reserve Bank of India, the Securities & Exchange Board of India, and the Insurance and Regulatory Development Authority of India.

India’s neobank startups raised more than $230 million in 2020, according to a report by a fintech research firm.

What are the key models of Neobank?

- Neobanks in India presently work on two prominent models
    - Payment gateways
    - Payment banks
- They also serve non-retail customers like MSMEs with white-label solutions.

How is a Neobank different from the traditional bank?

- Neobanks bridge the gap between the services that traditional banks offer and the evolving expectations of new-age customers.
- They do this by providing personalised experiences, employing data-driven insights and offering value-added services.
- While traditional banks continue to struggle with bringing their legacy-based infrastructure into the digital age, neobanks leverage its modern digital platforms modern digital platforms to analyse customer data and make data-driven decisions.
- Neobanks can also afford to slash customer fees by a significant amount since they don’t have to bear the expenses of running physical locations.
- While neobanks don’t have the funds or customer base to overthrow traditional banks, they have innovation to serve their customers much more quickly than traditional banks.
- Neobanks cater to retail customers, and small and medium businesses, which are generally underserved by traditional banks.

What are the pros and cons of neobanks?

Pros of neobanks

- **Low costs-**Fewer regulations and the absence of credit risk allows neobanks to keep their costs low. Products are typically inexpensive, with no monthly maintenance fees.
- **Convenience-** These banks offer customers the majority (if not all) of banking services through an app.
- **Speed-** Neobanks allow customers to set up accounts quickly and process requests speedily. Those that offer loa ..

Cons of neobanks

- **Trust building**- Neobanks are at a disadvantage in building trust with customers when compared to traditional banks.
- **Regulatory hurdles-** Since the RBI doesn't yet recognise neobanks as such, officially customers may not have any legal recourse or a defined process in case of an issue.
- **Impersonal-** Since neobanks don't have a physical branch, customers don't have access to in-person assistance.
- **Limited services-** Neobanks generally offer fewer services than traditional banks.

What initiatives have boosted the Neobanks?

- NITI Aayog's 2021 proposal to set up full-stack digital banks lays down the roadmap for a licensing and regulatory mechanism for neobanks.
- Initially, the RBI too conceptualised in its Report by Working Group on Digital Lending to enlist such neobanks in a regulatory sandbox.
- The Digital Banking Units (DBUs) Rules have been recently introduced in the 2022 Budget.
- Countries like the US, and many Asian economies like Singapore, China, Malaysia, Hong Kong, etc., have also adopted digital banking licensing regimes.

The DBU rules allow only scheduled commercial banks with past digital banking experience to expand into digital units as separate banking outlets.

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