



# Bank board agenda

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**As banks focus on the future after an unprecedented recent past, institutional resilience (of strategy, the organisation, and operations) is the foundation for differentiation in this era of radical business transformation.**

**Banks are reshaping operating and business models by putting customers first and deepening digital engagement. At the same time, they are prioritising the well-being of their workforce as well as addressing a range of environmental, social and governance (ESG) issues.**

Additionally, bank boards are also expected to continue monitoring management's responses to the industry's risk environment: Increased cyber security risks, including ransomware attacks; economic challenges; a fast-changing (and uncertain) regulatory landscape and risks. These are matters that will challenge even those boards that are at the top of their game.

Drawing on our domestic and global research, insights and interactions with bank directors and senior executives, we highlight these key issues for bank boards to keep in mind as they carry out their 2022 agendas:



## Maintain a relentless focus on understanding the bank's strategy and its future



Given the volatile environment managing hybrid working, employee activism, digital transformations, and strengthening connections with customers whose preferences, and expectations are changing, there is a special need to take time to reassess the board's engagement with management in setting the bank's strategy. We urge a review of the organisation's alignment of culture, values, and strategy. This requires identification of specific practices that can drive quality boardroom discussions about strategy and the future. Be sure boardroom conversations are, in fact, conversations. Allocate sufficient agenda time to meaningful, two-way discussions between management and the board about forward-looking issues challenging assumptions and considering scenarios (likely and unlikely) versus

reviewing historical, compliance-related information which, while essential, can crowd-out valuable agenda time.

The board's fiduciary role remains oversight, but effective engagement in strategy discussions (which investors expect) increasingly calls for a collaborative mindset. Keep these questions in mind:

- How can the board help management think through the implications of pressing and potentially existential strategic questions and decisions?
- Is management providing meaningful materials to the board to prepare directors for critical conversations in order to maximise the board's contribution?

## Embed ESG, including climate risk and DEI matters, into regulatory, risk, and strategy discussions



A near certainty in the current regulatory environment is that banks will need to provide detailed and measurable public information about how they are addressing and responding to climate change, DEI and other ESG risks. Transparency on how these risks are managed is critical to investors, research and ratings firms, activists, employees, customers, and regulators.

Stakeholders are demanding high-quality sustainability information. The board should challenge management to identify material ESG matters, define meaningful metrics, develop a control framework to gather data for reporting and encourage management to obtain assurance over the completeness and accuracy of disclosures. The attention to climate change as a financial risk for banks has become more urgent. One of the most visible risks is the accelerating physical impact of climate change, including the frequency and severity of thereof impacting, for example, decisions to underwrite credit in at-risk areas.

Several fundamental questions should be front and centre in boardroom conversations about the bank's ESG

journey. After determining which ESG issues are material to the bank, assess which of these issues are of strategic significance.

- How is the bank embedding ESG issues into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance?
- Is there a clear commitment and strong leadership from the top as well as enterprise-wide buy-in?
- Are the right people leading this effort and is there coordination within the organisation?

Oversight of these risks and opportunities is a significant challenge, involving the full board and multiple board committees. Overlap among committees is to be expected, but any overlap also puts a premium on information sharing and coordination among committees. It also requires that committees have the expertise to oversee the issues delegated to them.

# Approach cyber security and data privacy holistically



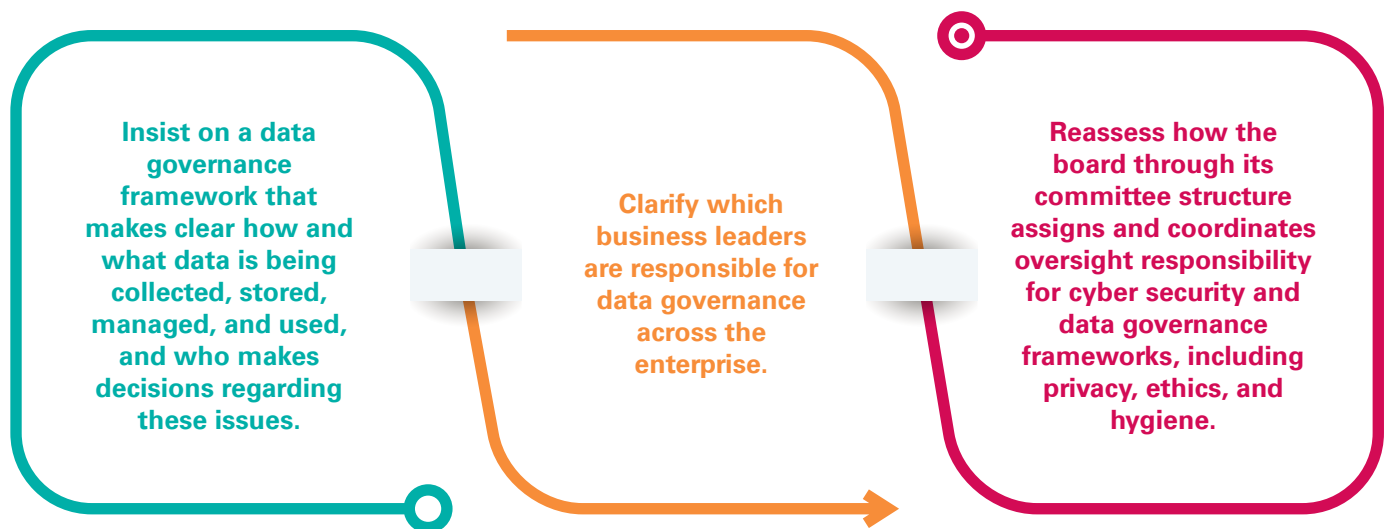
The rapid shifts banks and other companies have made during the pandemic to keep their businesses up and running hybrid work arrangements, increased reliance on online platforms, outsourcing certain operations, and other tactics have been a boon to organised crime, hackers, and nation states. Cyber attacks and ransomware demand highlight the far-reaching implications and threats caused by these shifts, including more outsourcing activities.

Boards have made strides in monitoring management's cyber security effectiveness. There are ongoing efforts to enhance information technology and cyber-deterrence capabilities within banks' operational departments as well as on boards and relevant committees. Despite these efforts, the acceleration of digital strategies, hybrid work

models, increased regulatory scrutiny of data privacy, and the growing sophistication of cyber attackers all point to the continued cyber security challenge ahead.

Data governance includes compliance with privacy laws and regulations that govern how personal data from customers, employees, or vendors is processed, stored, collected, and used. Data governance also includes the bank's policies and protocols regarding data ethics in particular, managing the tension between how the bank may use customer data in a legally permissible way and customer expectations as to how their data will be used. Managing this tension poses significant reputation and trust risks for banks and represents a critical challenge for leadership.

Consider following pointers to oversee cyber security and data governance more holistically:



# Know the opportunities and threats of entering the digital assets realm



While digital assets hold the promise of helping reduce the existing friction in the payments landscape, there is much for management and boards to learn about these types of assets. But, how well prepared is the traditional banking industry to manage the proliferation of these new asset classes?

With the Reserve Bank of India planning to launch the Digital Rupee in due course, which would be a Central Bank Digital Currency, it may very well replace traditional money over a period of time in an institutionalised and regulated manner.

The challenge for traditional banks and their boards is getting up to speed on the risk and opportunities of entering into the digital assets realm in order to attract and retain customers interested in dealing with the assets

and “differentiate themselves from competitors and find new sources of noninterest income”<sup>1</sup>.

Boards should have a clear understanding of how management plans to establish the necessary infrastructure to support facilitation of transactions in these assets, thus keeping existing customers who are seeking investments in digital assets and perhaps attracting new customers with similar interests. While becoming involved in digital assets may enhance a bank’s reputation, boards must understand the downside risks as well as the growth potential. Candour about the current capabilities (and potential shortcomings) of the digital assets team will be critical. Boards will need to become educated about the assets in order to ask appropriate questions.



1. “Blockchain and Banking: Opportunities and Risks With Digital Assets,” Bank Director, September 14, 2021



# Champion technology upgrades while attracting and retaining technology talent in the finance organisation



The acceleration of digital strategies expanded service offerings, new data requirements. Further the transformations that many banks are undertaking are impacting finance organisations and presenting important

opportunities for finance to reinvent itself and add greater value to the business. As audit and risk committees (and ultimately, the board) help guide finance's progress in this area, we suggest a few areas of focus:

# 1

Press management to assess and report regularly on the bank's technology talent. The talent issue remains challenging in the current labour-constrained environment.

# 2

Does expertise exist in-house or would it make sense to bring in consultants or outsource (with the proper risk controls) some elements of new technology?

# 3

Does management understand the impact on internal controls over financial reporting that any new technologies might have?

# 4

Recognising that much of finance's work involves data gathering, boards should discuss with management the organisation's plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs, and improve efficiencies.

# 5

How is the finance function using data analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital?



## Focus on talent and human capital management and CEO succession matters



The events of 2020–2021 underscore the strategic importance of human capital management (HCM). Institutional investors have been increasingly vocal about the importance of human capital and talent development programmes and their link to strategy, including calling for more engaged board oversight and enhanced disclosure of HCM-related metrics.

In 2022, we expect continued scrutiny of how banks are adjusting their talent development strategies. The challenge of finding, developing, and retaining talent, amid a labour-constrained market has created a war for talent. Does the board have a good understanding of the bank's talent strategy and its alignment with the bank's broader strategy and forecasted needs for the short and long term? Does the talent strategy reflect a commitment to DEI at all levels?

More broadly, as millennials and younger employees who increasingly choose employers based on alignment with their own values join the workforce in large numbers

and talent pools become globally diverse, is the bank positioned to attract, develop, and retain top talent at all levels? For example, does the bank offer flexible or hybrid working arrangements, and will employees be permitted to work from home or other geographic locations?

An important element to these issues is also having the right CEO in place to drive culture and strategy, navigate risk, and create long-term value. Is the bank prepared for a CEO change, whether planned or unplanned, on an emergency interim or permanent basis? CEO succession planning is a dynamic and ongoing process, and the board should always be focused on developing a pipeline of potential CEO candidates as well as all other C-suite positions.

Further, with the Reserve Bank of India capping the maximum tenure for the MD & CEO of commercial banks, the board will require to assess and lay down a suitable succession plan for key roles, including that of MD & CEO.

## Understand short and long-term plans for mergers and acquisitions (M&A) as growth, cost optimisation and customer-service strategies



Banks increasingly are turning to M&A not only as a growth strategy, but also as a way to create scale, enhance customer-service programmes, optimise cost-reduction plans, and acquire technology capabilities they would otherwise be hard-pressed to achieve.

As with any strategic initiative, M&As can have both upsides and downsides, which puts pressure on boards to gain comfort that such a move is accretive in both the

immediate and longer term. With the increased focus on M&A as a strategy, there are unique operational accounting and control matters that the audit committee and the overall board should be focused on, such as valuations of acquired assets and liabilities, the migration of systems and integration of people and processes. In our view, boards and management teams will often benefit by having an independent third-party assist with credit reviews and valuation before committing to a deal.



## Monitor risk and compliance issues that accompany fintech alliances



As acquisitions of, and alliances with, financial technology firms have accelerated, banks have stepped up measures relating to internal controls that affect financial reporting, security, and data privacy, among others. Results, frankly, have been mixed.

In the case of alliances or joint ventures with fintechs, bank board members should inquire about cultural differences between the bank and its fintech alliances that could lead to differing perceptions of risk and compliance. Additionally, we recommend the board request specific and routine information to monitor whether fintechs are maintaining acceptable controls, including whether the fintechs are outsourcing a bank's work. When outsiders become insiders through alliances, management of the control environment moves high on the watch list at the board level. As the bedrock of any bank, controls and security cannot be an afterthought.

Any slip-up with fintechs in this regard raises broader questions of overall readiness by banks and their boards for crisis prevention and readiness. Crisis prevention goes hand-in-hand with good risk management identifying and anticipating risks and implementing a system of reporting and controls to help prevent or mitigate the impact of such risk events.

We're clearly seeing an increased focus by boards on key operational risks across the organisation. Has the bank experienced any control failures after a fintech alliance, and if so, what were the root causes?

Periodically reassess the clarity and appropriateness of board and committee risk oversight responsibilities related to fintech alliances being mindful to not overload the audit committee's agenda and recognising the importance of good communication and coordination among committees.

## Continued focus on business-portfolio health and be wary of "stretch-for-growth" programmes as banks seek to increase revenue and net income



It is becoming more imperative for bank managements to conduct periodic portfolio reviews and assess the health of business portfolio/s. This includes closer monitoring of key measures taken to manage stressed assets such as legal remedies, Insolvency and Bankruptcy Code, sale of assets or even settlements.

Boards must be wary that some banks could be facing pressures to make riskier choices to achieve growth and income. One form of pressure might be calls to waive certain covenants in loan underwriting as a means to boost results. Another may be to invest excess liquidity in higher risk investments to improve net interest income and/or net interest margin. The urge to put some portion of that large amount of cash in unconventional investment vehicles can be tempting.

The board should probe management about such manoeuvres or pressures.

- What measures are in place to deal with such pressures if they arise?
- What guardrails are in place to monitor and assess growth initiatives?
- How well defined are rules for management to report on any changes to underwriting and investment standards?

The board should also play an important role in building robust risk culture, including communicating the same across the organisation. It will be pertinent to establish robust early warning signal mechanisms and strengthen the risk and internal audit functions to ensure proactive and continuous monitoring mechanisms aligned to the overall risk appetite of the bank.



# Think strategically about talent and diversity in the boardroom



Boards, investors, regulators, and other stakeholders are increasingly focused on the alignment of board composition with the bank's strategy with diversity issues front and centre. Indeed, the increased level of investor engagement on this issue highlights investor frustration over the slow pace of change in boardrooms and points to the central challenge with board composition: a changing business and risk landscape. Addressing competitive threats require a proactive approach to board building and diversity of skills, experience, thinking, gender, and race/ethnicity.

In the US, more than half of the directors surveyed recently by KPMG said their board's composition would be (moderately or completely) different if they were able

to rebuild it to best meet the company's needs for today and the future. And more than 40 percent expressed concern that a lack of diverse views in the boardroom "hampers insightful discussions or identification of blind spots and issues important to the company's future".<sup>2</sup>

As part of the board's self-assessment, it should ask: What skills, knowledge, or representation does our board need, and what steps are we taking to search for the person who embodies these characteristics?

In addition, directors of banks and financial institutions should leverage specific programmes designed by the Banks Board Bureau in collaboration with Indian Bank's Association, to enhance overall effectiveness and impact of the board.



2. Based on a 2021 survey of U.S. directors conducted by the KPMG Board Leadership Center.

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