On the 2024 bank board agenda

Board Leadership Center (India)

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As we enter 2024, Indian banks stand on a solid foundation compared to their global counterparts, boasting ample capital, robust earnings[1]. Stable interest rates, robust GDP, and declining inflation are expected to positively impact banking business. The interconnectedness between the banking and the Non-Banking Financial Companies (NBFCs) remains a matter of regulatory focus and exposure management. The Indian financial sector is also witnessing significant innovation and transformation such as Central Bank Digital Currency (CBDC), payment infrastructure, regulatory sandbox, etc.

In a highly interconnected world, global economic volatility, geo-political tensions, technology and business model disruption, elevated cyber security risks, climate risks, societal polarisation, third party risks, etc. continue to remain areas of concerns and requires a very close attention. The growing prominence of artificial intelligence opens new opportunities while creating different risks / concerns.

In this volatile operating environment, demands—from investors, regulators, employees, and other stakeholders—for greater disclosure and transparency, particularly around the oversight and management of risks to the bank's operations and strategy, will continue to intensify. The pressure on management, boards, and governance will be significant.

Drawing on insights from our survey work and interactions with directors and business leaders, we are highlighting ten topics to keep in mind as boards consider and carry out their 2024 agendas:

01 **Boardroom dialogues on strategy, risk and global disruption**

02 **Establish governance structure for development and use of generative artificial intelligence (Gen AI)**

03 **Maintain focus on cyber security resilience**

04 **Embed climate and environmental, social and governance (ESG) matters in risk and strategy discussions**

05 **Boardroom vigilance in regulatory compliance**

06 **Enhance communication and coordination regarding risk oversight activities among the Board and its committees.**

07 **Prioritise talent and CEO succession for organisational success**

08 **Think strategically about talent, expertise, and diversity in the boardroom.**

09 **Assess third party eco-system and resilience**

10 **Drive digital transformation and prioritise customer experience**

[1] Indian banks financially strong and outperforming global peers, The Economic Times, August 2023

1 Boardroom dialogues on strategy, risk and global disruption

The past one-year uncovered vulnerabilities in the global financial systems as well as turbulence in the global economy. Collapse of several mid sized banks in the United States and Europe, volatility in energy and food prices, escalation of wars, socio-political conflicts, and polarization of society added to the global economic turmoil. These and other risks, including supply chain disruptions, cybersecurity, inflation, interest rates, market volatility, impact of AI on the jobs and the risk of a global recession will continue to drive global volatility and uncertainty in 2024.

Despite successive shocks, and large global spill overs, India remains one of the fastest growing major economies in the world. The domestic financial system has demonstrated strong resilience, with adequate capital, liquidity buffers and robust earnings. The Reserve Bank of India has been pro-active with a slew of measures to mitigate the risks posed by the growing share of unsecured consumer loans, unfair banking practices, cracks in the fin-tech partnerships, outsourcing etc. This has brought regulatory compliance as a core theme to the forefront for the banking entities.

In this context, board should have a clear understanding of how to tackle uncertainties:

- Does management have an effective process in place to monitor changes and early warning signals in the external environment and evaluate revision in the strategy?
- Are the enterprise risk management framework and risk identification tools established enough to identify the early sign of vulnerabilities converted into risk?
- Are the right people leading this effort and is there adequate coordination within the organisation?
- Whether scenario analysis as well as stress testing are undertaken considering the adverse factors and potential challenges?

The banking entities need to monitor events, early warning signals and how they will impact the bank's business model and strategy. It is also critical to understand the underlying structural shifts taking place—geopolitical, demographic, technological, economic, climate, global energy transition, societal, etc.—and their longer-term implications.

In today's environment, looking at only internal factors will not give an outlook of future. With advanced technology and unpredictable geopolitical tension, the future is uncertain. A combined effort of board and workforce is required to convert these threats into opportunities.

2 Establish governance structure for development and use of generative AI

Machine Learning and Artificial Intelligence have been playing an important role in transforming the financial services industry, especially in the customer service segment by enhancing customer support, credit underwriting and fraud mitigation. The unlocking of AI potential has become a key success factor for the banks. Indeed, generative AI has been the focus of discussion in most boardrooms as banks and boards seek to understand the opportunities and risks posed by the technology—a challenge given the pace of the technology's evolution.

The potential benefits of generative AI include automating business processes, analysing customer data to provide the individual personalised experience, enhancing efficiency, cost cutting, speeding up the accuracy of customer support, generating realistic and informative financial scenarios, enhancing portfolio optimisation strategies, enabling sophisticated risk simulations and fraud detection. The risks posed by the technology are significant, including inaccurate results, data privacy and cybersecurity risks, intellectual property risks, and compliance risks arising from efforts across the globe to regulate generative AI.

Given the strategic importance of generative AI, the risk management, risk mitigation and regulatory strategies must keep up with the changing technology environment. The deployment of AI tools in the industry is not only about operational efficiency and customer experience enhancement but also about managing regulatory requirements.

Having said this, boards should be monitoring management's efforts to design and maintain a governance structure and policies for the development and use of generative AI.

Among the areas of focus are the following:

- How and when is a generative AI system or model—including a third-party model— to be developed and deployed, and who makes that decision?
- How are the company's peers using the technology?
- How is management mitigating the risks posed by generative AI and ensuring that the use of AI is aligned with the bank's values? Which generative AI risk management framework is used? What is the company's policy on employee use of generative AI?
- How is management monitoring rapidly evolving generative AI legislation globally, and ensuring compliance with data privacy and security rules in India?
- Does the organisation have the necessary generative AI–related talent and resources, including in finance and internal audit?
- How are the board and bank actively working to address and mitigate ethical concerns related to AI, including bias in algorithms, potential job displacement, and ensuring accountability for AI decision-making?
- Boards should also assess their governance structure for board and committee oversight of generative AI. In addition to the full board's engagement in overseeing AI, do (should) certain committees have specific oversight responsibilities, including taking deeper dives into certain aspects of generative AI?

3 Maintain focus on cybersecurity resilience

In the contemporary banking landscape, the modern financial institution resembles a digital fleet sailing through the vast and perilous waters of cyberspace. This fleet encompasses invaluable financial assets, sensitive customer data, and interconnected systems steering the institution's course. However, these digital waters present risks such as cyberattacks, data breaches, ransomware, and espionage, posing threats to disrupt the Bank's operations and compromise its integrity.

The growing sophistication of the cyber threat points to the continued cybersecurity challenge—and the need for senior management and board to continue to focus on resilience.

Reserve Bank of India has recently issued master directions on Information technology governance, risk management, controls and assurance practices. It prescribes procedures and framework for strategic alignment, risk management, resource management, performance management and business continuity/ disaster recovery management. It also provides for periodic reviews of risks, IT and information security risk management framework, information security policy and cyber security policy.

The master direction has also captured the essence of the Digital Personal Data Protection Act, 2023 and is in line with the overall objective of the authorities to eliminate the threat of any data breaches and cybersecurity incidents altogether. Accordingly, banks need to ramp up cybersecurity investments and IT resources significantly.

The board's responsibility: Anchoring cybersecurity

01

Understanding the cyber landscape

The board needs to understand the dynamic cybersecurity landscape which involves - staying informed about emerging threats, vulnerabilities, and the broader cybersecurity ecosystem. This knowledge equips the board to make strategic decisions effectively.

02

Fostering a culture of security

The board plays a pivotal role in fostering a cybersecurity culture within an organisation. This culture should extend from the boardroom to every employee, emphasising the shared responsibility for safeguarding digital assets.

03

Risk assessment and mitigation

The board should actively participate in performing comprehensive risk assessment, identifying vulnerabilities and prioritising cybersecurity investments accordingly.

04

Ensuring compliance

Compliance with cybersecurity regulations is non-negotiable. Boards must oversee the development of robust cybersecurity policies and practices to meet legal requirements and safeguarding the organisation's reputation.

4 Embed climate and ESG matters in risk and strategy discussions

How companies manage material climate and other ESG risks is seen by many investors, research and ratings firms, activists, employees, customers, and regulators as fundamental to the business and critical to long-term value creation.

Over the past decade, there has been a growing emphasis towards the significant economic and financial impact of Environmental, Social and Governance (ESG) related risks and opportunities. This has resulted in ESG investing becoming increasingly popular among the investors and other stakeholders and led to increase in the number of ESG funds being launched and related rating products being used.

Consequently, there is a growing expectation from the companies to provide comprehensive, accurate and reliable ESG related disclosures.

According to the KPMG in India report[2], 69 percent of CEOs have embedded ESG into their business as a means of creating value, and 50 percent anticipate significant returns from those efforts over the next three to five years.

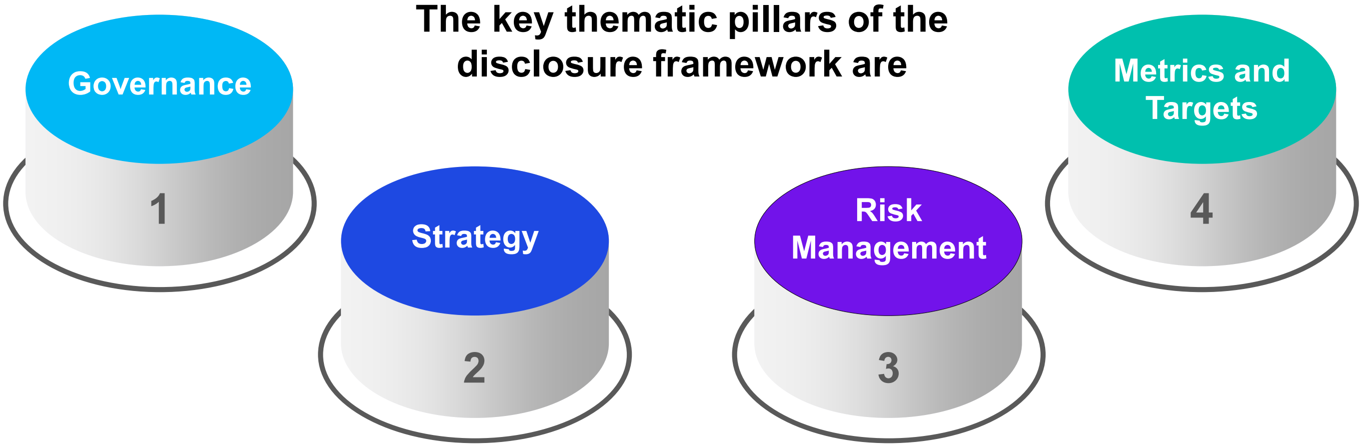
On 12 July 2023, SEBI issued the framework prescribing the disclosure and assurance requirements for Business Responsibility and Sustainability Reporting (BRSR) core, ESG disclosures for value chain, and assurance requirements. The nine attributes of BRSR core are as follows:

- **Green-House Gas (GHG) footprint**
- **Enhancing employee well-being and safety**
- **Enabling gender diversity in business**
- **Enabling inclusive development**
- **Water footprint**
- **Energy footprint**
- **Open-ness of business**
- **Embracing circularity– details related to waste management by the entity**
- **Fairness in engaging with customers and suppliers.**

[2] KPMG 2023 India CEO Outlook, KPMG in India, October 2023

Reserve Bank of India has recently issued draft disclosure framework on climate related financial risks for the regulated entities in India.The banks are expected to implement robust climate related financial risk management policies and processes to effectively counter the impact of climate related financial risks.

The key thematic pillars of the disclosure framework are



In this environment, several fundamental questions should be front and center in boardroom conversations about climate and ESG:

- Has the bank laid down appropriate governance, strategy, risk management framework and metrics in relation with climate and ESG matters ?
- Which climate and ESG issues are material or of strategic significance to the banks?
- How is the bank addressing these issues as long-term strategic issues and embedding them into core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance?
- Is there a clear commitment with strong leadership from the top and organisation wide buy-in?
- In internal and external communications, does the bank explain why ESG issues are materially or strategically important?

5 Boardroom vigilance in regulatory compliance

The Global Financial services industry is experiencing a level of regulatory intensity rarely seen before – combining a high volume of regulatory issuances, complexity, and breadth of regulatory supervision, and the impact that these changes impose across the organisation – according to the KPMG US report[3].

Reserve Bank of India has been augmenting the overall regulatory framework by introducing periodic regulatory directions to maintain financial stability, customer protection, risk mitigation, etc.

The past few months also witnessed stern actions by Reserve Bank of India and other market regulators against Banks and other regulated entities on account of potential non-compliances and delays in remediation of open issues.

The recent regulatory guidelines reiterates the need for robust governance and oversight by the Board on key topics. Boards are expected to actively engage in risk oversight, pursue robust risk management framework, monitor key risks, challenge management on risk-related matters, and ensure the implementation of appropriate risk mitigation measures to protect the Bank's interests and stakeholders.

Further, there is clear expectation from the regulator to implement comprehensive, integrated, enterprise wide, and workflow-based solutions / tools to enhance overall compliance monitoring function of the Bank.

The board should periodically assess following key aspects:

- Whether the compliance function within the bank is adequately staffed with right level of technologies and expertise?
- Whether the issues highlighted by regulators are being remediated in a timely manner?
- Can regulatory non-compliances of the third parties engaged by the bank have an adverse impact on banks reputation and business?
- How is the compliance culture embedded within the bank?
- Independent quality assessment of the compliance function of bank.

[3] Ten Key Regulatory Challenges of 2024, KPMG US, 2023

6 Enhance communication and coordination regarding risk oversight activities among the board and its committees.

The increasingly complex and dynamic risk environment—and the fusion of risks unfolding simultaneously—requires a more holistic approach to risk management and oversight. Many of the risks companies face today are interconnected or interrelated. Investors, regulators, ESG rating firms, and other stakeholders continue to demand higher- quality disclosures about risks and how boards and their committees oversee them.

Many boards are reassessing the risks assigned to each standing committee. In the process, they are often assigning multiple standing committees' oversight responsibility for different aspects of a particular category of risk. For example, the nomination, governance, compensation, and audit committees may each have some overlapping oversight responsibility for climate, Human Capital Management (HCM), and other ESG risks. If cybersecurity and data governance oversight reside in a technology committee (or other committee), the audit committee will still have certain oversight responsibilities (e.g., over internal and disclosure controls and procedures).

Given these overlapping committee risk oversight responsibilities, boards should encourage more effective information sharing and coordination among committees by:

1. Identifying areas where committee oversight responsibilities may overlap and developing a process for frequent communication and discussion of committee activities in these areas
2. Maintaining overlapping committee memberships or informal cross-attendance at committee meetings
3. Conducting joint committee meetings when an issue of strategic importance to multiple committees is on the agenda
4. Holding periodic meetings of committee chairs to discuss oversight activities.

Additionally, all boards should insist on focused, appropriately detailed, and robust committee reports to the full board.

Essential to effectively managing a bank's risks is having an up-to-date inventory of risks and maintaining critical alignments— of strategy, goals, risks, internal controls, incentives, and performance metrics. The full board and each standing committee have a role to play in helping to ensure that management's strategy, goals, objectives, and incentives are properly aligned, performance is rigorously monitored, and that the culture the company has is the one it desires.

7 Prioritise talent and CEO succession for organisational success

The banking industry is undergoing a technological revolution, from digitalisation to artificial intelligence. To thrive in this digital age, Banks must prioritise skills that align with these advancements. As digital disruption driven by technology opens new avenues, it simultaneously presents fresh challenges. The banking & Finance sector encounters various hurdles, including the evolving regulatory landscape, shifting customer preferences, changing stakeholder expectations, and the need to provide secure and compliant services with confidentiality. Adapting to emerging technologies and intelligent automation requires the sector to realign itself, thereby making talent management an increasingly intricate task.

Some of the key considerations could be following:

- How are the talent management strategies aligned with the overall strategic goals and objectives of the bank? How closely are the board and HR department collaborating to implement effective talent management initiatives?
- What measures are being taken to address the need for digital skills development among the workforce? How is the bank leveraging technology for talent management processes, such as AI-driven recruitment tools and data analytics for workforce planning?
- How robust is the succession planning process in identifying and developing future leaders within the organisation?
- What initiatives are in place to promote diversity and inclusion within the workforce?
- How is the organisation prioritizing employee well-being, including wellness programs and mental health support? What initiatives are in place to enhance employee engagement and foster a sense of belonging within the organisation? How is the bank evaluating and adapting remote work policies to accommodate changing expectations regarding flexibility and work-life balance?
- What steps are being taken to develop effective talent acquisition and recruitment strategies to attract top talent? How are environmental and social responsibility integrated into talent management practices?

Effective CEO succession planning is crucial for boards seeking to mitigate risk and optimise CEO performance, business profitability, and alignment with organisational values. Given the growing complexity of the banking sector and to enable succession planning, Reserve Bank of India has recently mandated the need for presence Of at least two whole time directors including MD & CEO on the board of private sector banks and wholly owned subsidiaries of foreign banks.

Some of the key considerations could be following:

- How robust are the board's succession planning processes and activities?
- How can the board establish a succession planning process that emphasises the importance of internal candidates, aiming to create a continuous pipeline of exceptional talent for long-term sustainability?
- Has the succession plan been updated to reflect the CEO skills and experience necessary to execute the bank's long-term strategy? Those strategies may have changed over the last two years.
- Are succession plans in place for other key executives? How does the board get to know the high-potential leaders two or three levels below the C-suite?

8 Think strategically about talent, expertise, and diversity in the boardroom.

Boards, investors, regulators, and other stakeholders remain focused on the alignment of board composition with the Bank's strategy - particularly director expertise and diversity.

Increased investor engagement on this issue points to a central challenge with board composition: Having directors with experience in key functional areas critical to the business while also having deep industry experience and an understanding of the bank's strategy and the risks to the strategy. It is important to recognise that many boards may not have experts in all the functional areas such as cybersecurity, climate, HCM, etc., and may instead choose to engage outside experts.

In dynamic landscape of corporate governance, the importance of the diversity within boardroom cannot be overstated. While gender, work experience, ethnicity, and geographical representation have rightfully garnered attention, one might question if the transformative power of age diversity has been long overlooked?

The boardroom is aimed to be a confluence of diverse ideas and perspective and 'age diversity' can have a key role in achieving that. The interplay between the younger generation and seasoned stalwarts can contribute to shaping the growth trajectory for an organisation with each set bringing its unique strengths to the table.

The recent RBI guidelines on IT governance, requires bank board to have independent director with substantial IT experience (minimum of seven years of experience in managing information systems and/or leading/ guiding technology/ cybersecurity initiatives/ projects). This has resulted in increasing demand for young independent directors with experience of information technology, new-age technologies such as digital, artificial intelligence and cybersecurity.

Board composition, skill sets and diversity, should remain the key areas of board focus in 2024, as a topic for communications with the bank's institutional investors and other stakeholders; and most fundamentally, positioning the board strategically for the future.

9 Assess third party eco-system and resilience

Indian banks have been engaging various service providers for core financial services as well as various technology related services. Further, in the past few years, there has been growing partnerships with a number of third-party service providers and fintech players for services such as Know Your Customer (KYC) checks, database checks, digital signatures, document execution, cloud storage, etc.

While these third-party arrangements present great opportunities, it also exposes the bank to key risks such as customer privacy, data protection, cyber vulnerabilities, etc. Identifying the right partner and establishing the best controls are imperative for building a robust third-party eco-system and resilience.

Using third parties effectively means that your outsiders are your insiders because businesses have been outsourced. Many organisations are unaware of hidden backdoor entry points to critical internal and client data that criminals seek to exploit. The processes (or lack thereof) employed by management to counter these relentless attacks and probes, demand that boards consistently ask assessment questions, like those provided here, of management teams.

In addition to the guidelines on outsourcing of financial services activities, Reserve Bank of India has recently issued critical guidelines on outsourcing of IT services as well as digital lending guidelines.

Some of the key considerations could be following:

- When were your vendors last evaluated by you on their risk protocols, especially if those vendors are using cloud-based technologies to store the bank's information?
- When did your organisation examine the risk evaluation parameters used in selecting third parties for such high-risk functions?
- Looking at your bank's stated strategic outsourcing risk profile, are you, as board members, comfortable that all third parties your bank uses align with that profile?
- Does your bank have a documented vendor-risk profile?
- Is the bank relying too heavily on one vendor? Should more vendors be used for specific operations provided they are properly vetted?

10 Drive digital transformation and prioritise customer experience

Digital disruption has changed the customer expectations regarding banking services and products. This has brought the importance of enhancing customer experience and journey to the forefront of the Bank's product strategy and service delivery. The board should support long term transformations and innovative strategies that focus on overall experience of customer which includes everything from brand messaging to marketing and customer onboarding to customer servicing journey.

Many Indian banks have embarked on transforming of their operations to meet the client expectations. Further, most of them have accelerated digital transformation of their services, including modernisation of core banking systems. However, the evolving models of fintech partnerships, leveraging of central utilities, etc. would require further changes to the existing technology infrastructure at these banks.

Reserve Bank of India has recently established regulatory sandbox framework to enable innovation and digital transformation. Further, Reserve Bank of Innovation Hub (RBIH), subsidiary of RBI which was setup to facilitate and promote innovation across financial services sector has been collaborating with various banks to develop innovative products.

Some of the key focus areas of the board could be the following:

- **Developing** customer first strategy and customer one view
- **Modernisation** of existing technology and introduction of new technologies into business and customers
- **Untapped** value due to poor customer experience
- **Bridging the gap** between the board and marketing / product functions
- **Creating engaging** future customer experiences **leveraging** new age technologies, VR, AR, AI, etc.
- **Collaborate** with RBIH and other Innovation Hubs to develop innovative products and solutions
- **Participate** in the regulatory sandbox programs.

In Conclusion

In the dynamic economic context of 2024, Indian bank boards must exercise vigilance amid favourable conditions. To ensure sustained performance, a comprehensive risk management strategy is paramount, encompassing both external and internal factors. Adoption of artificial intelligence demands a robust framework, coupled with meticulous risk mitigation measures. As technology propels opportunities and growth, bank boards should concurrently scrutinise and fortify cybersecurity and data protection frameworks. Embracing climate and ESG considerations is essential in strategic planning, aligning the bank's operations with evolving global priorities. The regulatory landscape presents heightened scrutiny, necessitating a meticulous approach to ensure compliance. Clearly defined accountability for various risk taxonomies across board-level committees ensures an integrated risk management view. Talent management initiatives, coupled with engagement of external domain experts, reinforce the board's capacity to navigate complexities. Long-term sustainability and succession planning take center stage, safeguarding customer and investor interests. Continuous assessment of the third-party ecosystem's resilience and risk management mechanisms is imperative. Digital transformation remains a focal point, driving efficiency and elevating the customer experience through innovative solutions. The confluence of these efforts positions bank boards to thrive amidst a dynamic and challenging financial landscape in 2024.

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