*Transformative Governance through Sound Boards**

Shri Shaktikanta Das

I am delighted to be present here today for this second Conference of Directors of the Private Sector Banks. As many of you would be aware, we had organised the first such Conference last year in the month of May on the theme – "Governance in Banks: Driving Sustainable Growth and Stability". That interaction of the Reserve Bank with the Boards of Directors was very well-received with a strong feedback that such conferences be held on a periodic basis.

To set the tone for today's Conference, let me take a step back and reiterate the expectations from bank Boards which I had shared in the form of a 10-point Charter in the last year's Conference. The Charter essentially covered the tenets of a strong governance framework. What I am going to speak today is essentially built on top of that foundation. The expectations I shared last year were with respect to: (i) Governance and Stability; (ii) Ensuring requisite qualification and expertise in the Board; (iii) Objective and Independent Board; (iv) Role of Chairperson, Board Committees and Managing Director/Chief Executive Officer; (v) Corporate Culture and Value System; (vi) Quality of Information; (vii) Effective oversight of Senior Management; (viii) Business Model and Conduct; (ix) Integrity and Transparency of Financial Statements; and (x) Independence of Assurance Functions. I would like to urge you all to go through my last year's address which is available on the Reserve Bank's website.

Turning to today's Conference, the theme focuses on transformative governance. But what exactly does this entail? While the term may have multiple interpretations, here it signifies creating a governance framework that not only meets current regulatory standards but also proactively addresses emerging risks, opportunities, and changes in the financial landscape. Boards must move beyond traditional oversight roles and embrace agility, foster innovation, and ensure sustainability and adaptability to today's dynamic environment. I would like to share some thoughts on these aspects with you today.

The Indian banking sector is transitioning through a time which is replete with opportunities as well as risks and challenges. The banking sector remains strong and stable[1]. All the financial indicators have improved since we met in May last year, reflecting the efforts of the various participants of the banking sector, including their managements and Boards. I take this opportunity to congratulate the managements and Boards of banks for this achievement. To keep the resilience of the banking system intact, the strong fundamentals that we have today should be leveraged to reinforce and fortify the defences. Good times, after all, are the best times to reinforce resilience and grow sustainably.

The key principle underlying good governance is growth with stability; profitability with sustainability.

Importance of situational awareness for robust governance

In our rapidly evolving and technology-driven environment, organisations face significant challenges and risks. Factors like technological advancements, the rise of new-age fintech entities, third-party dependencies and climate change are reshaping the economic landscape. Amid these shifting tides, Boards should serve as a lighthouse for banks and provide steady guidance to help navigate these challenges

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1 CRAR at 16.7 per cent, Gross NPA at 2.5 per cent, Net NPA at 0.6 per cent and Provision Coverage Ratio at 76.4 per cent at the end of September 2024 (provisional).

and steer towards safe and prosperous shores. In this context, I would like to highlight a few points.

First, the Boards may adopt a proactive approach in identifying and addressing potential challenges. This necessitates clear understanding of both the external conditions as well as the internal currents within the organisation. The Board needs to continuously assess external factors like regulatory changes, shifting market winds, overall macroeconomic changes and advances in technology. Boards should also be fully cognisant of the organisation's internal strengths, vulnerabilities, and operational conditions, so that they have a clear situational awareness. Such an approach would enable the Board of Directors to properly guide the management to be well-prepared to weather unexpected challenges and navigate toward sustainable growth.

Second, Boards must be cognizant of build-up of concentrations in their business model. Excessive reliance on specific sectors, markets, or customer segments can expose the bank to amplified risks, particularly in times of economic stress or industry shifts. For instance, as you would be aware, seeing a build-up of concentration across certain loan segments, the Reserve Bank took a few counter-cyclical measures last year. Similarly, Boards can play a proactive role by regularly monitoring the bank's portfolios, identifying potential areas of over-concentration, and taking pre-emptive steps to maintain a balanced approach.

Third, the Boards must also remain vigilant to operational risks, particularly those arising from IT outsourcing and reliance on third-party vendors. As banks increasingly depend on external service providers for key operations, the potential for disruption grows, especially when coupled with vulnerabilities, if any, in cybersecurity. The CrowdStrike incident earlier this year demonstrated how a faulty patch update could cause millions of computers across countries to crash and create disruptions across several industries. Therefore, it is necessary to ensure that third-party relationships are thoroughly assessed, monitored, and governed with a focus on security and resilience. This includes implementing strong cybersecurity protocols, conducting regular risk assessments, and ensuring that third parties adhere to the same high standards of security expected within the organisation.

Fourth, technology has now facilitated innovative business models in banks, either in competition with or in collaboration with fintech. As digital platforms and financial technologies rapidly evolve, banks find themselves exploring new ways to deliver services, reduce costs, and enhance customer experience. There is, however, a need to balance innovation with security and stability. The key questions Boards should ask the managements include: (i) Does the bank understand the potential negative externalities of technological solutions (e.g., bias in AI models), and are there adequate mitigants in place? (ii) Are current governance structures, policies, and processes sufficient to manage risks related to third-party dependencies, consumer protection, cybersecurity, and data privacy? (iii) Are these innovations compliant with regulations in letter and in spirit? (iv) Is the bank investing adequately in scalable solutions to ensure that downtime is minimised?

Empowering assurance functions for stronger governance

Assurance functions— viz. risk management, internal audit, and compliance—can serve as invaluable resources for Board Directors. They provide critical insights into both the internal health of the organisation and its exposure to external risks. In order to effectively leverage these functions, Boards need to actively safeguard the independence of these functions and ensure that the connected teams are adequately resourced with skilled staff and are given due prominence within the organisation. Recognising the importance of these functions, the Reserve Bank has been organising conferences of Heads of Assurance functions and is also asking for their presence at the supervisory meetings with banks. I would, therefore, encourage Boards to build further on these initiatives.

Encouraging Diversity of Opinion

Another way for Boards to deepen their understanding of issues is by actively avoiding the pitfalls of groupthink and fostering an environment that encourages and welcomes a diversity of ideas. When Boards create space for varied perspectives, they gain a more comprehensive view of potential challenges and opportunities. Additionally, the Board should ensure that contrarian opinions are examined and decision thereon are recorded. A Board that is not open to review, or diversity of opinions, risks missing crucial insights.

It is also important for Boards to give due consideration to the critical views of senior management, employees, whistle-blowers, and, most importantly, customers. Often, these perspectives contain early warning signals of potential issues that might otherwise go unnoticed. There has to be healthy relationship and mutual respect between the Managements and Boards.

Given the dynamic and evolving landscape of the financial sector, it is crucial for the Directors to stay well-informed. As mentioned in my speech last year, ongoing orientation programmes may be helpful in facilitating this. These programmes should focus not only on business and regulatory updates but also on developments in risk management, technology, and governance practices.

I would also like to urge the MD & CEOs to ensure that the Board is provided with all the requisite information in a timely manner, and that meeting agendas are circulated well in advance with adequate background information.

Customer Centricity

Having spoken about proactive governance, I would now like to address another aspect that is also extremely important in the context of good governance, namely, customer centricity. Trust is the bedrock of banking, and the industry fundamentally relies on the faith of depositors and investors for its stability and growth. Building and maintaining this trust requires banks to place customers at the heart of their operations and ensuring that products, services, and policies genuinely meet customer needs and expectations.

In this context, it is disheartening to see the nature of some of the complaints and the observations in our inspection reports. There are instances where complaints are misclassified as customer queries. We also come across instances of rejected grievances not being escalated to the internal ombudsman of banks. I would like to urge the Boards and their Customer Service Committees to closely look into these aspects to ensure that banks have a genuine commitment to customer centricity.

The flexibility and space available to the banks for formulating their internal Board approved policies in line with the regulatory expectations needs to be used with utmost prudence, especially when it has a bearing on customers. Boards should give a close look at service charges and penalties when they are treated as avenues of profit or when forced bundling of products is done, or when disclosures to customers are non-transparent or selective. Ensuring fair lending practices and implementing robust grievance redress systems are critical to protecting customers' interests.

While progress has been made in enhancing customer awareness, there remains significant potential to improve financial literacy, particularly for the marginalized, less savvy, and rural population. These groups often struggle to navigate the complex financial landscape and are more vulnerable to usurious interest rates, fraud, and other unfair practices.

Board of Directors should also focus on strengthening the internal governance framework within the bank. Unethical practices, such as mis-selling of products or the opening of accounts without proper KYC verification need to be curbed. Staff incentives should be carefully structured to avoid encouraging mis-selling or unethical practices. While such practices may yield short-term gains, they ultimately expose the bank to significant long-term risks, including reputational damage, supervisory scrutiny, and financial penalties.

As I proceed to conclude, I would like to touch upon our collective aspirations for the future. As India progresses towards becoming a developed and more inclusive economy by 2047, it is imperative that our banking and financial sector—both public and private—align their strategies with the developmental aspirations of our people. I would like to request the Board members to set clear and actionable objectives that support these aspirations. Together, we should foster a financial system that is resilient, inclusive, and sustainable for future generations.

This year also marks the 90th year of the Reserve Bank. We have set ambitious goals for RBI@100, which include deepening financial inclusion, expanding credit availability, globalising India's financial sector, and universalising India's payment systems. Achieving these goals will require active collaboration with the banks. I look forward to your continued support in helping us realise this vision.

Let me now conclude. A well-functioning Board of Directors with proactive oversight of governance, supported by robust assurance functions and policies built around customer centricity, is what sets a resilient and agile bank apart from an ordinary one. Such a Board would ensure that the organisation remains adaptable to change, anticipates emerging risks, and builds a strong foundation for sustainable growth. By maintaining a sharp focus on both internal and external challenges, a Board can drive long-term success and build trust within the financial ecosystem. With this, I wish you an insightful and enriching Conference.

Thank you and Namaskar.