Shaktikanta Das: Keeping the financial system resilient, future ready and crisis resistant

Inaugural address by Mr Shaktikanta Das, Governor of the Reserve Bank of India, at the Second Global Conference on Financial Resilience, organised by the College of Supervisors (CoS), Mumbai, 20 June 2024.

* * *

Professor Sheri Markose[1];

Dr. Hiroko Oura[2];

Deputy Governor Shri Swaminathan;

Shri Arijit Basu, Chairman, Academic Council, College of Supervisors;

Dr. Rabi N. Mishra, Director, College of Supervisors;

Distinguished speakers and panelists;

Members of the Academic council, College of Supervisors;

My colleagues from the Reserve Bank;

Ladies and Gentlemen.

Namaskar.

I am delighted to be here to inaugurate the second edition of the global conference on financial resilience organised by the College of Supervisors (CoS) of the Reserve Bank of India. The first edition of the conference was held last year in April and I had participated in the same. Since its establishment in the year 2020, the CoS has made significant contributions to strengthen supervisory capacity of not just the Reserve Bank, but also the supervisors from a few other countries who have participated in the various programmes[3] organised by the college. My compliments to the Team CoS for their dedication in successfully carrying forward the objectives of the organisation.

I am also happy to note that the conference has participation of eminent speakers, panelists and academicians from around the world. This three-day event would cover diverse topics of interest to the global financial community.

The theme of the conference, 'Keeping the Financial System Resilient, Future-Ready and Crisis-Immune', is one which will never lose relevance, no matter which side of the economic cycle we are in. In fact, the ethos of being future-ready and resilient against crisis needs to be built into every financial institution. It has to be a key element of their organisational culture. It has to be developed proactively when the system is healthy rather than reactively when there may not be enough headroom to strategise and implement.

Fortunately, all stakeholders in India, namely, the Reserve Bank, the Banks and Non-banking financial companies (NBFCs), and the government have made tangible efforts in this direction. India's domestic financial system is now in a much stronger position[4], characterised by robust capital adequacy, low levels of non-performing assets, and healthy profitability of banks and NBFCs. I would like to compliment the banks and other financial sector entities for such a stellar performance. There is, however, no room for complacency. We must keep constant vigil and continue to take proactive measures to sustain this progress.

In today's environment which is characterised by turbulent global spillovers and uncertainties, it is important for the financial sector to follow an adaptive and forward-looking approach to navigate amidst the emerging challenges. This would entail strengthening governance and risk management practices; employing sustainable business models; and embracing technological advances and using them to our advantage. On its part, the Reserve Bank will continue to fine tune the regulatory architecture and the supervisory rigour, as may be required, to promote long term resilience and stability of the financial system. Let me now elaborate on each of these aspects.

Governance

Strong governance is at the core of resilience, especially in the financial sector. It is in fact the bedrock for informed and strategic decisions that align with long-term goals and risk management principles. In this context, I would like to highlight three major imperatives. First, effective governance entails establishing clear roles and responsibilities for the Board of Directors and the executive management. Both of them should possess necessary expertise and independence to take the right decisions and to effectively exercise appropriate oversight on operations.

Second, robust governance also involves implementing comprehensive internal controls and strong assurance functions, namely, risk management, internal audit and compliance. Internal controls should be designed to detect and mitigate potential risks before they escalate into significant issues. Regular internal and external audits play a critical role in this process as they provide independent assessments of the organisation's financial health. They also facilitate genuine compliance with regulatory requirements. Perfunctory compliance with regulations would actually be self-defeating. I am happy to note that at the systemic level, there has been significant improvement in compliance culture in our financial system. The Reserve Bank is bilaterally engaged with the outlier entities wherever it notices deficiencies. The heads of risk management, internal audit and compliance functions are the conscience keepers of a financial institution. They should have the necessary seniority and independence within the organisation. These verticals in a Bank or NBFC play a critical role in identifying the gaps and weaknesses, if any, in their organisations and help in managing risks and safeguarding the institution and its reputation.

The third point which I wish to highlight is the importance of ethics in governance which involves compliance with laws and regulations, both in letter and spirit; pursuit of sustainable business practices; and avoidance of mindless pursuit of bottom lines.

Business models

Let me now turn to business models. Both regulated entities and supervisors need to be vigilant to risks, if any, in the business models of organisations. While business models may be designed to drive profitability and growth, they sometimes contain vulnerabilities that may not be apparent. Pursuit of business growth is important, but it should never come at the expense of taking on unacceptable risks. Robust risk mitigants are essential for ensuring long-term success and resilience of a regulated entity as well as the overall financial system.

Leveraging technology while managing its risks

As the financial sector gets increasingly digitised, adoption of advanced technologies can significantly strengthen the ability of Banks and NBFCs to withstand and respond to various risks. It has to be, however, ensured that these technologies are secure, reliable and aligned with the institution's overall strategic goals.

Integrating advanced and emerging technologies such as artificial intelligence (AI), machine learning (ML), and big data analytics into organisational functioning can transform the way financial institutions operate. AI and ML can enhance predictive analytics and enable banks and NBFCs to identify potential risks and trends more accurately. These technologies can improve fraud detection by recognising unusual patterns and transactions in real-time. Thus, they can protect the institutions and their customers from financial crimes and frauds. Operational efficiency can be improved through automation of routine tasks, which reduces human error and frees up resources for more strategic activities. Robotic process automation (RPA) can handle high-volume and repetitive tasks, such as data entry and transaction processing, more quickly and accurately than humans.

As financial institutions increasingly rely on advanced technologies to enhance their operations, the dependency on third-party vendors and service providers may increase. A vendor's inability to deliver services reliably can directly impact the regulated entity's operations and customer service. Therefore, a thorough due diligence becomes necessary before selecting third-party vendors. This includes assessing their financial sustainability, technical capabilities, security standards, and their ability to comply with regulations. Further, there should be continuous monitoring of third-party vendors to ensure that they adhere to the agreed standards and practices.

Fine tuning the regulatory framework and supervisory rigour

As risks evolve and new challenges emerge, the Reserve Bank as a regulator and supervisor constantly focuses on being vigilant, adaptive and proactive with regard to the regulatory frameworks and supervisory systems to safeguard the stability of the financial system.

Over the past few years, the Reserve Bank has undertaken a comprehensive review of regulations under the aegis of the Regulations Review Authority (RRA) 2.0 constituted by it. Apart from withdrawal of many redundant instructions, the RRA has also made valuable recommendations to ease compliance and reduce the regulatory burden; streamline the reporting mechanism; and bring in more clarity in regulatory instructions.

In recent years, the Reserve Bank has also comprehensively restructured the regulatory architecture for banks (both commercial and urban co-operative banks), NBFCs, Housing Finance Companies (HFCs), Asset Reconstruction Companies (ARCs), Digital lenders, Micro-finance lenders and Core-investment companies. Thus, the financial sector regulations are now not only in sync with the changing times but also forward looking with the required readiness to take further proactive measures as may be necessary. Steps have also been taken to set up Self-Regulatory Organisations (SROs) for NBFCs and Fintech companies. This is a completely new approach to facilitate greater consultation and close interface with the stakeholders in the system. It will make regulations even more dynamic and proactive. In the same breath, I would like to emphatically state that there is no intention to make frequent regulatory changes, but only to ensure that there is greater regulatory clarity and responsiveness to changing circumstances.

The Reserve Bank has also significantly strengthened its supervisory systems, transitioning beyond an entity-focused approach to a more thematic and activity-based approach. We now look at sustainability of business models of banks and NBFCs. Root cause analysis of problems and vulnerabilities are undertaken. Advance action is initiated wherever we notice or smell a crisis.

Structural changes have been implemented within the Reserve Bank by creating a unified department of supervision[5] to ensure holistic assessment of the financial sector as well as to analyse the health of multiple entities within a group. The idea is to enhance agility and comprehensiveness of supervision. Unconventional methods are also being adopted now. Onsite supervision of Credit Information Companies has been made annual and intense. When problems appear too serious in a financial entity, a senior officer of the Reserve Bank in the rank of Executive Director addresses the full Board of the organisation and shares our concerns. Similarly, when we find material discrepancies between the auditor's report and our supervisory findings, or when we see that certain material issues are not properly addressed by the auditors, we invite the auditors for a direct discussion. These are some of the examples of our new methods of supervision.

The College of Supervisors (CoS) is itself a shining example of our proactive initiatives to enhance the quality of our supervision and capacity of our supervisors. This is a very critical component of our efforts to strengthen the supervisory system of the Reserve Bank. At the core of CoS's mandate is the professional development of supervisors, both at the initial foundation level as well during the later stages in their careers. Our effort is to ensure that the supervisors of the Reserve Bank remain abreast of emerging trends, best practices, and supervisory and regulatory developments in the dynamic financial landscape.

As the Reserve Bank approaches its centenary year (RBI@100), we have drawn up strategies that will gear it up to remain future ready for India's fast growing economy. We propose to take necessary policy actions for positioning the Reserve Bank as a model central bank of the global south[6]. Our goal is to make Reserve Bank's supervision a global model, by building a 'Through the Cycle' Risk Assessment Framework with continuous Horizon Scanning and a Holistic Risk Assessment. It also envisages having a more customer centric framework that protects and promotes

customers' interest by improving the conduct of supervised entities. In pursuance of this goal, we look forward to active co-operation from all financial sector players which I am sure they will provide.

Conclusion

In conclusion, the journey towards a more resilient, future ready, and crisis resistant financial system is ongoing. It demands collective efforts, innovation, and adaptability from all stakeholders. I have delved into certain aspects which are crucial for achieving this goal, ranging from governance and assurance to the adoption of sustainable business models as well as leveraging technology while managing its risks. I have also emphasized on the role of regulatory and supervisory frameworks in safeguarding financial stability. As we move forward, it is imperative for all stakeholders to remain committed to advancing these principles and practices. I am confident that they will continue to contribute to the long-term sustainability and resilience of the Indian financial system.

With this, I extend my best wishes for successful deliberations during this three-day conference and commend the organisers for their efforts. May the next three days be filled with fruitful exchanges, innovative ideas, and collaborative solutions that would contribute to the process of keeping our financial system resilient, future ready, and crisis resistant.

---

[1] Dr Sheri Marina Markose, Professor of Economics, University of Essex, Colchester, UK & CBDC Academic Advisory Group, Bank of England & UK HM Treasury.

[2] Dr. Hiroko Oura, Head, Financial Sector Assessments and Policies Division, Mission Chief, FSAP, India, IMF, Washington DC, USA.

[3] Through a combination of training programs, workshops, seminars, and conferences, the College equips supervisors with the knowledge, skills, and tools necessary to fulfil their responsibilities effectively.

[4] The gross non-performing assets (GNPA) ratio for the Scheduled Commercial Banks (SCBs) was 2.74 per cent at end March 2024 (provisional), down from 3.87 per cent as on March 31, 2023 and 5.82 per cent as on March 31, 2022. The capital to risk weighted assets ratio (CRAR) at 16.8 per cent at end March 2024 is also much above the minimum regulatory requirement. The GNPA ratio of NBFCs was 3.96 per cent at end March 2024 (provisional), down from 5.03 per cent at end March 2023, and 6.29 per cent at end March 2022. The capital to risk-weighted asset ratio (CRAR) at 26.58 per cent at end March 2024 is also well above the minimum regulatory requirement.

[5] The erstwhile departments of banking supervision, non-banking supervision and cooperative banking supervision were merged to form a single unified department of supervision.

[6] Refer paragraph 2 of Governor's Monetary Policy Statement dated June 7, 2024 (https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=58049)