Thriving in the Digital Era

Qatar Banking Perspectives - 2023

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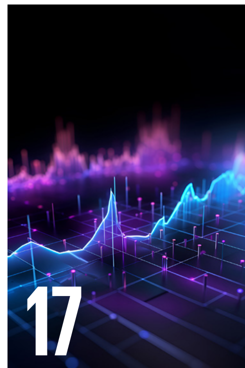

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Introduction

I am delighted to introduce the latest edition of our 'Qatar Banking Perspectives - 2023' report. This report provides a comprehensive overview of the dynamic landscape of Qatar's banking sector, its emerging trends, and the forces shaping its future. In this edition, we explore key areas including digital innovation, regulatory changes, fraud detection strategies, and the growing importance of sustainable finance. Our aim is to offer an invaluable resource to decision-makers so that they are able to assess current trends and develop strategies for a resilient and prosperous banking future.

The past year has been one of rapid transformation for Qatar's banking sector. We've witnessed the introduction of a range of regulatory enablers designed to facilitate the entry of new digital fintech players and support traditional incumbents in their shift to digital channels. Despite challenges, such as rising interest rates, margin pressures, geo-political uncertainty, and a complex credit environment, Qatar's banks have demonstrated remarkable agility. By managing costs effectively, embracing digital transformation, and maintaining a risk-focused approach, banks have succeeded in preserving robust profitability levels.

The Qatar Central Bank has also played a crucial role in this journey, by strengthening governance, transparency, accountability, and regulatory reform. These efforts are instrumental in fostering a robust financial ecosystem.

This year's report delves into key themes that are not only shaping the banking industry in Qatar but also influencing the wider region. Our subject matter experts offer their insights on a diverse range of topics including data analytics & cloud technology, financial crime, evolving regulatory landscapes, sustainable finance, the implications of global minimum tax, Anti-Money Laundering (AML) strategies, M&A activities, and the impact of Basel 3 reforms.

We trust that this report will not only provide you with valuable insights but also inspire strategic initiatives as we navigate the evolving banking landscape in 2024 and beyond.

Omar Mahmood
Partner, Head of Financial Services
KPMG in Qatar

Digital Innovation

As we delve into the realm of digital innovation, it's important to understand some of the key terms that will shape the future of banking. Distributed Ledger Technology (DLT) is a digital system for recording the transaction of assets in which the transactions and their details are recorded in multiple places at the same time. This technology underpins cryptocurrencies like Bitcoin and has significant implications for banking security and transparency. Similarly, Advanced Analytics and Artificial Intelligence (AI) refer to sophisticated tools that allow for deeper insights into customer behavior, risk management, and operational efficiency.

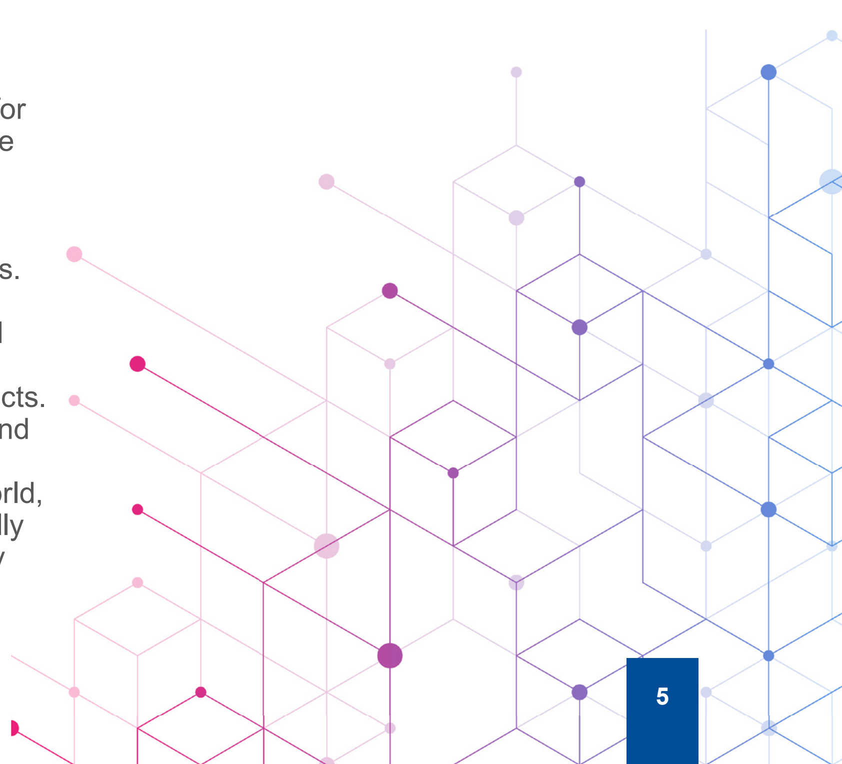
Traditional financial firms are embracing technology, including distributed ledger technology, AI, and machine learning. The rise of advanced analytics and AI, known as "AAAI" tools, is reshaping the industry. The rapid evolution of new technologies, including the Internet of Things, is improving accessibility. The next wave of innovation seeks to add a "human" touch to digital functionality, addressing customers' psychological needs for more personal interactions.

The shift toward digitalization, accomplishing tasks digitally instead of on paper or in person, has accelerated rapidly. Use of cashless payments has increased, with new forms of digital transactions, as well as new digital currencies and assets are emerging. Online investment tools are also on the rise, along with more seamless and immediate communications. Descriptions of services and products online are now more dynamic and customized, making them more engaging and educational.

Increased digitalization and new technologies can lead to better experiences and outcomes for consumers. However, regulators aim to mitigate risks such as aggressive selling practices and the biased presentation of product information, whether intentional or unintentional, that could hinder informed decision-making by consumers. This necessitates a reevaluation of existing conduct rules to acknowledge the fundamental shifts in the construction, delivery, and communication of financial services and products. Specific concerns revolve around vulnerable and financially excluded customers, who may face greater challenges in an increasingly digital world, emphasizing the importance of ensuring digitally excluded consumers do not become financially excluded.

The banking sector stands at a pivotal juncture, reshaped by AI and digital transformations. Artificial Intelligence is not just an add-on but a must to be reconsidered, driving unprecedented efficiency and personalized banking services. We're witnessing a shift from traditional transactions to intelligent banking, where AI predicts customer needs, mitigates risks, and streamline operations, leading to unparalleled efficiency and more customer-centric solutions.

Dr. Hamza Agli
Associate Director
Advisory



Firms need to assess whether changes to business practices benefit all customers, or at least do not harm them, in addition to benefiting the firm itself. They must strike a balance between their own commercial interests and those of their end customers. The fundamental building blocks underpinning all technologies and digitalization are infrastructure and data. Firms must ensure the integrity of exponentially expanding databases and possess the expertise to store and analyze them, whether in-house or through outsourcing to third parties. They must protect both customers' and market confidential data and share them to deliver services more efficiently and across borders. Ethical use of data and robust governance and controls regarding its utilization are essential.

The regulatory focus on the technological resilience of firms continues. Outsourcing to third parties, cybersecurity and managing of IT risks are common themes discussed by regulators to manage the financial services ecosystem of their country. These topics are not new, but there has been an increase in cyber security incidents during the pandemic and regulators are concerned about heightened (and new) risks in an increasingly digital world. Look out for our next new reality paper for a discussion on the broader topic of operational resilience. Good governance is needed across the piece. Effective controls are essential around internal processes, the storage and use of data, communications with customers and counterparties, and contractual arrangements with third parties. The positions of Chief Technology Officer and Chief Data or Information Officer, in addition to Chief Operating Officers, are becoming mainstream. Moreover, the use of RegTech applications has increased. The regulators themselves are trying to keep abreast of change, in the way they monitor wholesale and retail market activity, and how they use data submissions from firms and technological applications to perform their supervisory and enforcement activities. Use of SupTech applications by regulators is on the rise to manage the Supervision role through the use of Technology and innovation.

In this ever-transforming financial market, Qatar finds itself pacing to match (and even exceed) the prowess of Financial Centers around the world including and not limited to Singapore, Hong Kong, UK globally, while Saudi Arabia and Dubai regionally. In the last two quarters, Qatar Central Bank has laid out 'Fintech Strategy 2023', that enables it to regulate the 'upcoming' business models that use all the technology and innovation highlighted.

This Strategy focuses on expanding the sandbox participants to test their ideas, initiate international collaborations, introduce or enhance key regulations including but not limited to Payment Service Requirements, InsurTech (Price Comparison Websites), Crowd Funding and Emerging Technology (Cloud Computing, AI and DLT). Lastly, it also aims at creating key market infrastructure including innovation lab, test emerging technologies "Digital Identity (e-KYC)", and Open Banking Architecture.

This Strategy brings the entire financial services ecosystem together and paves the way for financial services players in the country and globally to embrace the use of innovation and technology to enhance their performance, positioning Qatar as a hub for Financial Technology.

Key Takeaways:

- New technologies introduce novel and emerging risks. Firms must innovate in identifying, measuring, and managing these risks, employing new techniques and tools.
- New business models, such as joint ventures with technology companies and platforms, complicate the ecosystem and customer interactions, posing challenges in managing conduct and financial crime risks.
- Given the evolving nature of products, services, delivery methods, and communications with customers and counterparties, regulators emphasize the importance for firms to prioritize the end customer throughout the business and at all stages of a product lifecycle.

Change is inevitable, especially in the ever-evolving landscape of technological innovation. In Qatar, firms have every opportunity to embrace innovation and emerge as leaders in the market. Regulators play a pivotal role in safeguarding this transformative journey, ensuring protection. Amidst this dynamic shift, customers stand to gain the most, continuously reaping the benefits of ongoing change.

Sanket Kothari
Senior Consultant
Advisory

D&A and Cloud Computing

Data analytics and cloud computing have become essential pillars of Qatar's banking sector, revolutionizing traditional banking practices, and ushering in a new era of innovation and customer-centricity. By harnessing the power of data analytics, banks are making more informed decisions, enhancing customer experiences, and optimizing their operations. Additionally, cloud computing provides the agility, scalability, and cost efficiency necessary for banks to stay competitive in a rapidly evolving digital landscape.

As Qatar's banking sector continues to embrace these transformative technologies, we can expect further advancements and a continued shift towards a data-driven and cloud-enabled future, in line with the country's National Vision 2030.

Digital Transformation is no more only a trending topic, but a necessity for institutions to cope with with the requirements of the regulatory authority, so as to identify potential risks and mitigate risks, empower customers and provide them with personalized products and services, optimize the efficiency in internal operations, and compete in the hyper-competitive market.

In this article, we delve deeper into understanding the impact that data analytics and cloud computing can bring into the organization.

Agility and Cost Efficiency through Cloud Computing

Cloud computing is a key enabler in driving technology adoption. With two major hyper-scalers coming to Qatar is a definite indicator of cloud adoption gaining momentum. Qatar's banking sector is rapidly adopting cloud computing to enhance agility, scalability, and cost efficiency.

With cloud computing, banks can experiment with new technologies, launch innovative services, and quickly respond to market dynamics. The cloud's flexibility enables faster time-to-market for new products and services, giving banks a competitive edge in the digital era.

Multi-Cloud is also gaining momentum in Qatar. It allows banks to leverage cloud optimally and allow for healthy market competition.

Improved Decision-Making through Data Analytics

Financial institutions in Qatar are leveraging data analytics to extract meaningful insights from vast volumes of customer information, transactional data, and market trends. This allows them to make more informed decisions and develop personalized products and services.

By employing advanced analytics techniques, such as artificial intelligence and machine learning, banks in Qatar can identify potential risks, fraud patterns, and customer preferences. This empowers them to proactively mitigate risks, prevent fraudulent activities, and deliver tailored solutions to their customers.

Data analytics also enables Qatari banks to optimize their operational efficiency by analyzing internal processes. By identifying bottlenecks and inefficiencies, they can streamline workflows, reduce costs, and enhance productivity.

Enhanced Customer Experience

The integration of data analytics in Qatar's banking sector has revolutionized customer experience. The country's banks are now able to gain a 360-degree view of their customers, enabling them to deliver personalized and proactive services.

By analyzing customer behavior and preferences, banks can offer tailored product recommendations, personalized marketing campaigns, and customized financial advice. This level of personalization not only improves customer satisfaction but also helps banks deepen customer relationships and increase customer loyalty.

Real-time analytics enables banks to anticipate customer needs and respond promptly. For example, if a customer experiences a suspicious transaction, data analytics can detect it immediately and trigger automated alerts, enhancing security and fraud prevention.

Enhanced Security and Compliance

Data security and compliance are critical concerns for the banking industry, and cloud computing addresses these challenges effectively. Cloud service providers offer robust security measures, including encryption, access controls, and regular audits, ensuring data protection and regulatory compliance.

By leveraging cloud solutions, banks can centralize their security measures and reduce the risks associated with decentralized data storage. This enables them to focus on their core banking operations while benefiting from the expertise of cloud providers in managing security risks.

Cloud-based backups and disaster recovery solutions ensure data resilience and business continuity, mitigating the impact of potential disruptions or data breaches.

Increased employee productivity using Generative AI

Generative AI, a subset of artificial intelligence that involves training models to generate content or data, offers numerous opportunities to increase employee productivity for banks and FSIs It allows for Automated Content Creation, where teams can quickly generate reports and documentation. It allows for personalized advanced search for all employees on internal data that helps find relevant information faster. It also provides opportunity for banks to reduce the on-boarding effort of new employees by providing an automated co-pilot for newly joined employees. There are many other areas in which Generative AI is helping banks improve employee productivity and experience.

Key Takeaways:

- Qatar's banking sector is undergoing a significant transformation with the adoption of data analytics and cloud computing which aligns with Qatar's National Vision 2030, marking a shift towards a data-driven and cloud-enabled future.

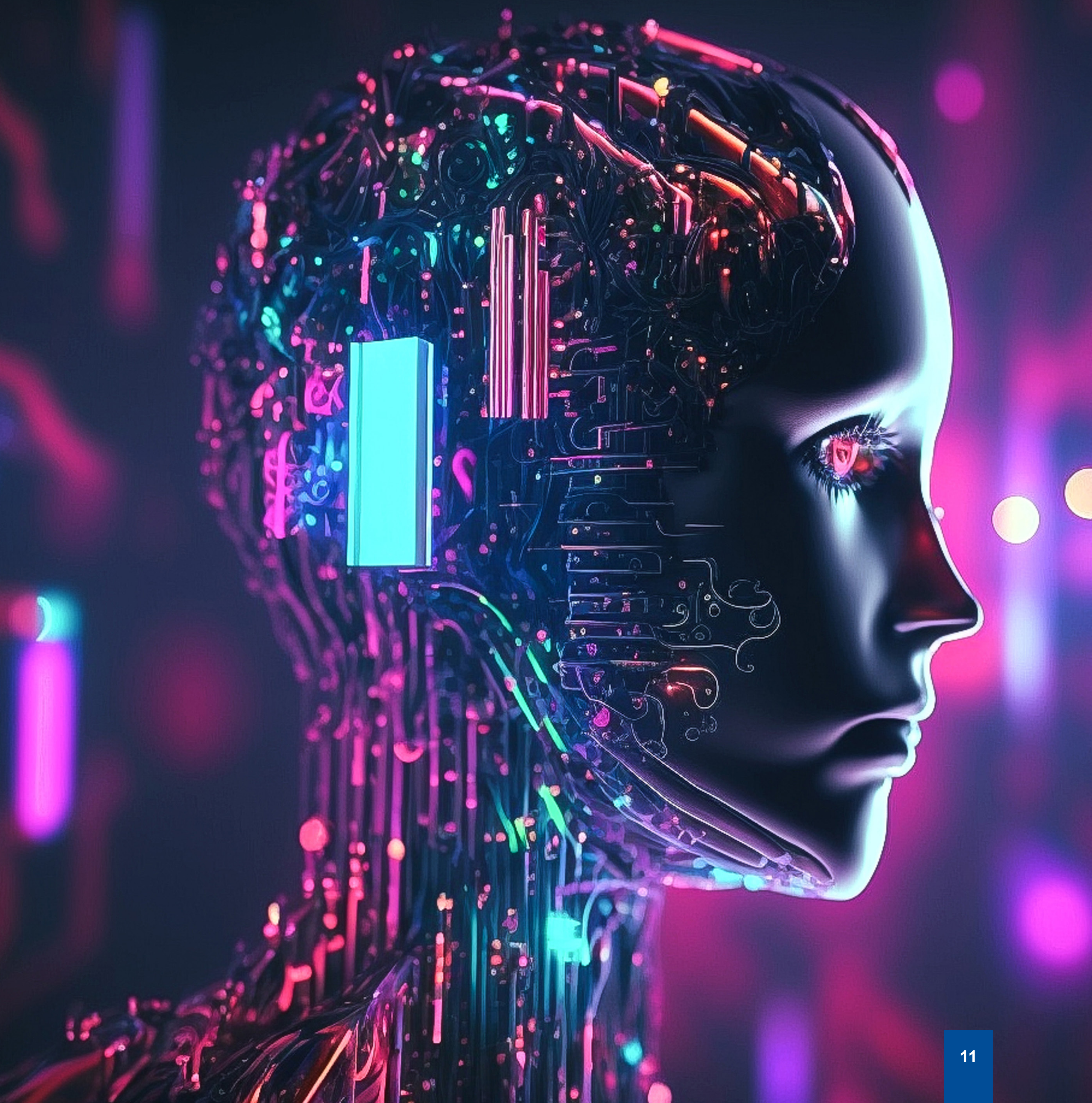
- Cloud computing serves as a key enabler, offering agility, scalability, and cost efficiency to Qatar's banking sector, allowing banks to experiment with new technologies, launch innovative services, and respond quickly to market dynamics.

- Data analytics is revolutionizing the customer experience, providing banks with a 360-degree view of customers for personalized and proactive services, with advanced analytics enabling risk identification, fraud prevention, and tailored solutions.

In recent years, Qatar has witnessed a significant transformation in its banking sector, with data analytics and cloud computing playing a pivotal role in reshaping the industry. As financial institutions recognize the power of data-driven insights and the flexibility of cloud infrastructure, they are embracing these technological advancements to enhance their operations and improve customer experience.

Siddharth Johri
Associate Director
Advisory

Fraud



Protection Against the Unseen:

- Set the right leadership tone
- Implement advanced prevention and detection models
- Perform periodic fraud risk assessment
- Ensure accountability and enforcement
- Create Communication channels

Imagine the disconcerting possibility of banks falling victim to undetected fraud, with no awareness of the silent menace lurking within digital channels. The absence of strong controls and delayed detection mechanisms enables fraudsters to exploit vulnerabilities, manipulate systems, and capitalize on stolen personal data to orchestrate intricate scams. These vulnerabilities have led to substantial financial losses, leaving banks and unsuspecting customers at prolonged risk. The 2022 ACFE Report to Nations reveals that nearly half of fraud cases resulted from a lack of internal controls (29%) and the override of existing controls (20%).

In one instance, a bank faced a risk of losing billions of dollars when a customer successfully transferred non-existent funds from one account to another. Another bank was unable to charge credit card purchases made during flights for several years. Moreover, the persistence of merchant fraud, often involving collusion between external and internal sources, continues to cause significant financial losses. As these instances can take various forms and numbers, the longer such fraudulent activities go undetected, the higher the potential financial and reputational damage. This highlights the urgent need for banks to address vulnerabilities and enhance their fraud prevention and detection controls.

Digital Channel: A Playground for Fraudsters

Digital channels have become fertile grounds for fraudsters to carry out their illicit activities. Weak security measures and inadequate authentication protocols within these channels expose banks and unsuspecting customers to significant risks. The integration of controls across all digital channels remains a challenge, as fraudsters exploit control gaps between channels to override security controls. Therefore, many banks in Qatar are prioritizing the renewal of their Operating Model to ensure seamless controls across all service channels.

Data Privacy: A Strong Shield Against Fraud

Cybercriminals target financial institutions to gain unauthorized access to sensitive customer information, which can be used for identity theft, or fraudulent activities, or sold.

> Cyber Risk is an operational business risk that can directly impact the organization's reputation or subject it to regulatory fines. This warrants the adoption of appropriate decision rights and governance to support the agility, emerging technology, and other needs of banking sector organizations.

Marwan Zalloum
Director
Advisory

Data privacy serves as the shield against fraud by helping banks protect sensitive information, building trust with customers, and enhancing security against phishing and scamming incidents.

With Data Protection ranking high on the compliance improvement agenda, as indicated by the KPMG CCO Outlook 2023, more countries are planning to implement robust measures to ensure the protection of data.

In the GCC region, including Qatar, where scams are increasingly prevalent, protecting customer information becomes even more crucial, as the leakage of customer information often serves as the starting point for these scams.

Financial Burden of Scams

KPMG Fraud Survey 2022 reports significant increases in phishing incidents by 44% and scamming cases by 33% in the past year, both linked to data leakage and theft.

In many countries, including Qatar, there is no clear set of rules outlining the financial burden of scams. As a result, different banks adopt different approaches: some banks hold customers responsible for the losses, while others evaluate each scam case-by-case to determine whether they will compensate affected customers for their losses. The varying responses from banks reflect the complexities surrounding such incidents within the banking industry.

The UK has proactively introduced the Contingent Reimbursement Model Code for Authorized Push Payment Scams, and as of 7 June 2023, the Payment Systems Regulator (PSR) has imposed new reimbursement requirements for banks and payment companies. It will be intriguing to see if more countries adopt similar frameworks.

Key Takeaways:

- There is an urgent need for banks to address vulnerabilities and enhance their fraud prevention and detection controls to mitigate the potential financial and reputational damage caused by undetected fraud in digital channels.
- Data privacy emerges as a robust shield against fraud, with cybercriminals targeting financial institutions for unauthorized access to sensitive customer information.
- Data protection serves as a crucial defense, aiding banks in protecting information, building customer trust, and enhancing security against phishing and scamming incidents.

The dynamic nature of today's digital banking environment demands constant vigilance against fraud. The integration of new service channels necessitates the deployment of stringent fraud prevention strategies. Utilizing advanced technologies is no longer a luxury; it is a fundamental requirement to protect operational integrity and maintain customer confidence.

Tibet Erdogan
Manager
Advisory

Regulatory Trends

Banking supervisions in Qatar is experiencing a paradigm shift as the country adapts to global economic trends and technological advancements. By prioritizing risk management, embracing FinTech innovation, and adhering to international standards, Qatar's banking sector is positioned for continued growth and stability. Initiatives to combat financial crime and promote sustainable finance are further evidence of Qatar's commitment to maintaining a resilient and secure financial landscape. As Qatar continues to evolve its regulatory framework, it continues to solidify its position as a key player in the global financial arena.

In recent years, the banking sector in Qatar has been characterized by continuous growth and stability, which has consolidated its position as a major player in the regional financial landscape. To maintain the sustainability of this progress, the country's regulators have always actively played their part, relentlessly adapting to evolving economic conditions and international standards. In this article, we have reviewed the latest trends in banking regulation in Qatar and highlighted the measures taken to protect the financial system and create an enabling environment for sustainable economic growth.

Implementation of Basel III Standards

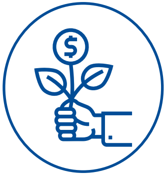
In line with international banking regulations, Qatar has progressively implemented Basel III enhancements to improve capital adequacy, liquidity and risk management in the banking sector. These standards place greater emphasis on the method of assessing the credit quality of bank assets, ultimately leading to a better reflection of the same in capital requirements. This has become particularly important in light of recent instances of global banking crisis. The central bank has properly adopted a phased approach to allow banks to build capital over a period of time and give them the scope to effectively address the underlying operational issues.

Fostering FinTech Innovation

Qatar's regulators have recognized the potential of financial technology (FinTech) to transform the financial services landscape and are actively promoting innovation in this area. Earlier this year, Qatar Central Bank unveiled the Qatar FinTech Strategy 2023, which is in line with the Qatar National Vision 2030 goal of promoting diversification and innovation in the financial sector. The QCB's financial technology vision is based on developing, diversifying and increasing the competitiveness of Qatar's financial technology and services sector through pioneering infrastructure and providing solutions that positively impact the customer experience. The launch of Qatar Credit Bureau’s new electronic application service and the granting of the license to Paywise are part of this initiative and reflect the overall commitment to developing and strengthening the financial technology sector.

Emphasis on Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF)

To combat financial crime and meet international standards, Qatar has recently tightened its anti-money laundering framework and CTF. By aligning itself with global best practices, Qatar aims to strengthen its reputation as a safe and trusted financial center while mitigating the risks of money laundering and terrorist financing. The results of this initiative are also reflected in the recent Financial Action Task Force (FATF) report, which commends Qatar's efforts in combating money laundering and terrorist financing.



Green Finance Initiatives

As global awareness of environmental challenges grows, Qatar has demonstrated its commitment to sustainable development by promoting green finance initiatives. Regulatory efforts have been made to encourage banks to invest in green projects and incorporate environmental risk assessments into their lending practices. Qatar is planning investments to integrate sustainable finance principles into the banking sector and aims to align its financial activities with global sustainability goals.

Managing Liquidity in the Market

As part of providing funding facilities to local banks and allowing them to meet short-term liquidity needs through market transactions, Qatar Central Bank recently launched the issuance of its own treasury bills. The initiative started in 2022 and has continued in the current year. The launch achieved a successful response and attracted overwhelming bids from the market, depicting the accomplishment of the initiative and its alignment with the local banking needs.

Key Takeaways:

- Qatar's banking sector is undergoing a transformative shift, adapting to global economic trends and embracing technological advancements. This evolution is marked by a commitment to risk management, FinTech innovation, and international standards, positioning the sector for sustained growth and stability.
- Qatar is advancing its banking sector by implementing Basel III standards for improved capital, liquidity, and risk management. Simultaneously, regulators are driving FinTech innovation aligned with the national goal of financial diversification.
- Strengthened Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF) measures demonstrate Qatar's commitment to global best practices.

In the fast-evolving financial landscape, the local banking sector faces imminent challenges in adapting to banking risk mitigation, technological advancements, and global trends. Striking a delicate balance between innovation and robust regulations will be crucial to safeguarding stability and fostering sustainable growth in the country's financial ecosystem.

Muhammad Moeez Siddiqui

Associate Director
Audit

Sustainable Finance

As Qatar continues to diversify its economy, the financial services industry has a unique opportunity to drive sustainable development. By integrating sustainable finance principles, developing innovative products, and fostering collaboration among stakeholders, the industry can shape a resilient and prosperous future. Embracing sustainable finance practices not only addresses global challenges but also enhances the industry's reputation, attracts new investors, and positions Qatar as a leader in sustainable finance within the region. Qatar's financial services industry's commitment to sustainable finance will be pivotal in achieving both national and global sustainability goals.

Sustainable finance offers a transformative approach to traditional financial practices, recognizing the interplay between economic, social, and environmental factors. For Qatar's financial services industry, embracing sustainable finance is paramount for several reasons. Firstly, it aligns with Qatar's commitment to United Nations Sustainable Development Goals (UN SDGs), contributing to a more resilient and inclusive economy. Secondly, it mitigates risks associated with climate change, resource scarcity, and social inequalities, safeguarding long-term financial stability. Qatar's commitment to the Paris Agreement and the Qatar National Vision 2030 further emphasizes the importance of focusing on sustainable finance. Embracing sustainable finance aligns with these ambitious national goals and underscore Qatar's dedication to creating a more sustainable and prosperous future for its citizens and the planet. Lastly, focusing on sustainable finance in Qatar will open doors to new markets and attract responsible investors who prioritize ESG factors, enhancing the industry's reputation and competitiveness.

Latest Global Trends in Sustainable Finance

Green Bonds and Sustainable Debt

Green bonds and sustainable debt instruments have gained significant traction globally. These financial products raise capital specifically for eco-friendly projects, such as renewable energy infrastructure, energy-efficient buildings, and sustainable agriculture.

Qatar has already made noteworthy contributions to this field with recent successful green bond issuances from financial institutions in the country. These issuances mark important milestones, including the first green bond issued from Qatar and the largest green issuance by a financial institution in the MENA region. The successful subscriptions to these green bonds underscore the confidence of global investors in the solid financial fundamentals and strong performance of Qatar's financial institutions. The use of proceeds from these green bond issuances for verified Eligible Green Projects further reinforces Qatar's commitment to financing, as well as refinancing sustainable initiatives.

As the momentum of green bonds in Qatar continues to build, the country has the opportunity to expand its green bond market and explore new avenues for sustainable financing. By encouraging the participation of various stakeholders and developing a favorable regulatory environment, Qatar can attract a broader range of issues and investors. This will not only support the country's transition to a low-carbon economy but also enhance its reputation as a leader in sustainable finance within MENA region and beyond.

Socially Responsible Investing (SRI)

SRI has witnessed remarkable growth, with investors increasingly seeking opportunities aligned with their values. Financial institutions can tap into this trend by offering SRI products and services tailored to socially conscious investors. By investing in sectors that contribute to social welfare, such as healthcare, education, and affordable housing, Qatar's financial services industry can foster inclusive growth and address societal challenges.

ESG Integration

Integrating ESG factors into investment decision-making has become essential for long-term value creation. By analyzing a company's environmental impact, social responsibility, and governance practices, financial institutions can make informed investment choices. ESG integration enables Qatar's financial services industry to identify sustainable investment opportunities, manage risks, and support companies committed to responsible business practices.

Impact Measurement and Reporting

With increasing emphasis on transparency and accountability, impact measurement and reporting have gained prominence. Financial institutions are expected to quantify and disclose the positive environmental and social impacts of their investments. By adopting standardized frameworks, such as the UN SDGs, Qatar's financial services industry can demonstrate its commitment to sustainable development and attract investors seeking measurable impact alongside financial returns. In line with this trend, the International Sustainability Standards Board (ISSB) has recently released its inaugural standards, namely IFRS S1 and IFRS S2. This significant development marks the beginning of a new era for sustainability-related disclosures in capital markets across the globe.

Key Takeaways:

- Qatar is actively embracing sustainable finance principles to align with Qatar National Vision 2030 and UN SDGs, fostering a resilient, inclusive economy while addressing climate change and contributing to global sustainability.
- Qatar is emerging as a leader in sustainable finance with successful green bond issuances, poised to expand its market and attract diverse investors in the MENA region.
- Qatar's financial services industry can capitalize on the rise of Socially Responsible Investing (SRI) by aligning products with socially conscious investors' values, emphasizing the importance of ESG integration for sustainable investment opportunities and responsible business practices.

In today's rapidly evolving world, the adoption of sustainable finance practices has become crucial for the global financial services industry. By integrating environmental, social, and governance (ESG) considerations into investment decisions, financial institutions can not only address global challenges but also unlock new opportunities for growth and resilience.

Ajay Jayakumar
Associate Director
Advisory

BEPS Pillar 2

As a member of the Inclusive Framework on BEPS, Qatar is likely to adopt the Pillar Two Rules, with a placeholder inserted in the Income Tax Law (vide the amendment of Law No. 11 of 2022). The detailed rules and implementation timelines, however, are yet to be published. We understand that the Qatar Central Bank has requested a high-level comment from the Banks regarding the impact of BEPS 2.0 on their operations and their preparedness in this regard. It is important to note that in the absence of a qualified domestic minimum top-up tax, foreign jurisdictions with constituent entities of Qatari parent entities may have the right to collect top-up taxes on Qatar sourced profits.

Based on publicly available information, we understand that at least six (6) Qatari headquartered banks would be in-scope entities. Additionally, under the amended IAS 12 requirements, in-scope entities are required to make a disclosure that states that in periods in which pillar two legislation is enacted or substantively enacted, but not yet in effect, an entity discloses known or reasonably estimable information that helps users of financial statements understand the entity's exposure to pillar two income taxes arising from that legislation. The time to act is now.

When the Base Erosion and Profit Shifting (BEPS) 1.0 project was finalised in 2015, there was significant and pervasive dissatisfaction among developing countries, particularly India, regarding the conclusions drawn under Action 1 and its failure to adequately address the challenges posed by digitalization of the economy and to reallocate income in the digital economy to market jurisdictions.

To address these challenges, the Inclusive Framework proposed a two-pillar solution under BEPS 2.0:

- Pillar One: Reallocation of profits to market jurisdictions.
- Pillar Two: Introduction of a Global Minimum Tax of 15%.

The Pillar One Model Rules contain a Regulated Financial Services Exclusion which excludes from the scope of Amount A the revenues and profits from Regulated Financial Institutions. However, Pillar One appears to have encountered a roadblock due to disagreements among jurisdictions over the allocation basis. On the other hand, Pillar Two is well on its way to being introduced by jurisdictions as early as 2024. There is no such exclusion for the banking industry under Pillar Two.

Key Features of Pillar Two

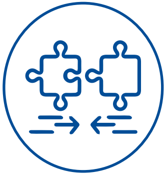
Pillar Two will be applicable to multinational entities with a minimum consolidated turnover of Euro 750 million.

The principal aim of Pillar Two is to ensure a minimum rate of tax and avoid tax competition among jurisdictions with a race to the bottom. This is achieved by:

- Introducing a minimum effective jurisdiction tax of 15 percent.
- An independent Subject To Tax Rule (STTR) which will ensure a minimum tax of 9 percent on certain treaty-based payments.

Pillar Two aims to ensure fair taxation with a 15% Global Minimum Tax. Adapting to these rules may require Tax leaders/ CFO's in Banks to navigate complexities and enhance their financial data capabilities and the skill sets that they need to effectively deal with the challenges of Pillar 2"

Abhishek Jain
Director
Tax



Implications

Under Pillar Two, if the minimum effective tax rate in a jurisdiction is below 15%, a top-up tax would need to be paid. The determination of which jurisdiction collects the top-up tax depends on the following scenarios:

- Qualified minimum domestic top-up tax: If the home country of the constituent entity has implemented a qualified minimum domestic top-up tax according to the Pillar Two model rules, the home jurisdiction will collect the top-up tax.
- Income inclusion rule: If the home country lacks a qualified minimum domestic top-up tax but the parent company's jurisdiction has implemented the Pillar Two rules, the top-up tax pertaining to the constituent entity will be collected in the parent entity's jurisdiction under the income inclusion rule.

Key Takeaways:

- Pillar Two is designed for multinational entities with a minimum consolidated turnover of Euro 750 million. Its primary goal is to ensure a minimum effective jurisdiction tax of 15%, discouraging tax competition and introducing an independent Subject To Tax Rule (STTR) for a 9% minimum tax on specific treaty-based payments.

- While there is a relief from deferred tax accounting implications arising out of Pillar 2, for current tax, in-scope MNEs should review the legislative status of the Pillar 2 rules in all countries where they have operations for the purpose of financial statements disclosures for FY 2023, even though the rules may become effective in FY 2024 or later.

- The Pillar 2 rules are very complex and the data requirement challenges are significant, which may not be addressed by existing financial or other systems. In-scope MNEs should start reviewing this aspect to identify gaps.

- Under-taxed profit rule: If neither the parent jurisdiction nor the jurisdiction of the constituent entity has implemented the Pillar Two rules, but the parent has a constituent entity in a third jurisdiction that has implemented the rules, the third jurisdiction will claim the right to top-up tax as per the under-taxed profits rule.

The under-taxed profits rule is generally deferred by one year (post-income inclusion rule) and is expected to be implemented from 1 January 2025.

Independent of the above, certain payments, such as royalties and interest, are required to be taxed at a nominal rate of at least 9 percent; otherwise, the payer's jurisdiction has the right to withhold any shortfall, under the treaty-based STTR.

The adoption of Pillar 2 by Qatar could potentially mean the end of the exemption enjoyed by large resident MNE banks and would result in the profits of the in-scope MNE banks being subject to an effective minimum tax rate of 15 percent. This would have a significant impact on the bottom line and shareholder returns. Banks may also need to review their loan books and stress test the impact of Pillar Two on counterparty positions.

Anand Krishnan
Director
Tax

AI in AML

By harnessing the power of AI, financial institutions and law enforcement agencies can boost their efforts to identify, prevent, and combat this global threat. Some of the best AI use cases for combating money laundering include transaction monitoring, customer risk profiling, and data sharing and collaboration. The early adoption of AI technology provides financial institutions with a competitive advantage in staying ahead of criminals' evolving tactics and maintaining customer and regulator trust.

Money laundering, estimated in the range of 2% to 5% of global GDP annually, poses significant threats to financial systems and national security. Criminal organizations and illicit actors exploit sophisticated methods to conceal the origins of illegally acquired funds, making traditional detection methods increasingly ineffective. In this era of technological advancements, artificial intelligence (AI) emerges as a crucial tool in the fight against money laundering. By harnessing the power of AI, financial institutions and law enforcement agencies can boost their efforts to identify, prevent, and combat this global threat.

AI offers several powerful use cases for financial institutions in the fight against money laundering. These use cases leverage the capabilities of AI to enhance data analysis, real-time monitoring, and risk assessment. Some of the best AI use cases for combating money laundering include:

AI-powered systems can analyze vast amounts of transactional data in real-time, enabling

Transaction Monitoring

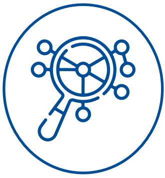
financial institutions to identify suspicious activities more efficiently. AI algorithms can recognize patterns associated with money laundering, such as structuring transactions to avoid detection thresholds or engaging in the rapid movement of funds across multiple accounts.

Customer Risk Profiling

AI can create dynamic risk profiles for customers based on their behavior and transaction history. By continuously monitoring and updating these profiles, financial institutions can detect changes in customer behavior that might signal involvement in money laundering or other illicit activities.

Know Your Customer (KYC) Processes

AI-powered solutions can streamline KYC processes by automating identity verification and risk assessment. This can enable financial institutions to detect and prevent fraudulent account openings or be used for money laundering.



Network Analysis

AI can conduct network analysis to identify complex relationships between individuals, accounts, and entities. By visualizing these networks, financial institutions can gain insights into money laundering networks and understand the connections between various actors involved.

Data Sharing and Collaboration

AI can facilitate secure data sharing and collaboration between financial institutions and regulatory authorities without compromising sensitive information.

On the other hand, the widespread accessibility of AI technology provides criminals with an opportunity to enhance their money laundering efforts. AI tools could be used to obscure the origin and destination of funds during transactions, identify vulnerabilities and blind spots in existing AML systems, develop adaptive money laundering strategies, generate vast amounts of false transactions to hide illicit funds amidst legitimate transactions, and create sophisticated social engineering schemes that trick individuals into providing sensitive financial information, facilitating money laundering operations.

In conclusion, AI technology offers financial institutions an unparalleled opportunity to strengthen their AML efforts, improve detection accuracy, and mitigate financial risks associated with money laundering. Moreover, the early adoption of AI technology provides financial institutions with a competitive advantage in staying ahead of criminals' evolving tactics and maintaining customer and regulator trust, protecting their reputation, and maintaining the global financial system.

Key Takeaways:

- Estimated at 2-5% of global GDP, money laundering poses threats. AI is pivotal for real-time monitoring, dynamic risk profiling, streamlined KYC, and secure data sharing, boosting AML efforts.
- AI empowers financial institutions to efficiently prevent and identify suspicious activities, adapt KYC processes, and visualize money laundering networks, ensuring enhanced detection accuracy and risk mitigation.
- Widespread AI accessibility poses risks, enabling criminals to obscure fund origins and exploit system vulnerabilities. Early AI adoption is crucial, strengthening AML measures, safeguarding reputations, and ensuring competitiveness globally.

AI technology is gaining serious momentum in the fight against money laundering. It helps reduce false positives, streamline KYC processes, and lower operational costs. AI technologies such as KPMG's AI-Enabled Monitoring (AIM) helped banks and insurance companies achieve 98.6% reduction in false positive alerts. However, and despite the promising results, some have been slow to adopt.

Saleh Sailik
Director
Advisory

MnA

Historically, we have witnessed banks acquiring other banks for the below specified reasons to achieve their individual objectives:

1. **Cost Benefits:** Economies of Scale, Efficiency, Lower cost of funding, and risk diversification

2. **Revenue Benefits:** Economies and scope for enhanced revenue from a larger customer base

3. **Economic conditions:** Higher resistance to up and down swings in business cycles

4. **Other:** Higher valuation, managerial benefits, and pre-empting possible takeover

Recent trends show that conventional banks have been acquiring and investing in small and mid-sized specialized firms with an aim of achieving the objective of customer retention, enhanced customer experience and sustainable long-term development goals. The inorganic expansion in fintech is helping the commercial banks save on customer acquisitions cost in such hyper-competitive markets and provides a significant cash influx to the specialized firms looking to survive and grow.

The digitalization of financial services is being increasingly adopted across the global banking sector post Covid-19. Based on our analysis, we noted that since the pandemic hit the financial markets in Feb-2020, the number of acquisitions and/or private placement in specialized firms by the conventional banks globally, has increased significantly and makes up more than 50% of total similar transactions occurred in last two decades (102 transactions post Covid-19 out of 192 transactions between 2004-2023 - source: Capital IQ).

In our view, the future M&A and investment activity in the banking sector would be driven by the following key themes;

S.no	Theme	Description	Objective
1	**Cyber security**	**Cyber security:** While M&A and investment activity globally was soft in H1'23, there continued to be active interest in acquisitions, consolidations and private placements, primarily driven by mature financial institutions/ banks looking to expand their security capabilities. The large number of small and mid-sized start-ups with bespoke cybersecurity solutions makes the sector particularly ripe for consolidation as larger players look to better respond to their customers' needs and wants.	Better customer retention and customer base expansion by offering secure banking services
2	**Digital Acceleration**	**a. Fintech – Payments:** Amid economic headwinds and increased market volatility, consolidation was a key factor driving funding activity in the fintech-payment space. Similar to how Apple pay and google pay have taken ownership of customer payment data, a number of banks embraced fintech acquisitions in order to scale and grow their reach.	Enhanced customer experience through increased convenience
	Digital Acceleration	**b. Blockchain technology in wealth and investment management:** There is strengthening interest from banks to embrace the latest development in blockchain and acquire firms focused on asset tokenization, particularly to tokenize and fractionalize assets to expand access to asset classes to different segments of investors.	Enables banks to offer more investment/ wealth management options to retain customers

	Digital Acceleration	**c. Increased Financial inclusion:** Banks are expected to continue to aggressively pursue technological transformation and further explore the use of digital platforms to make banking services more accessible to customers, along with implementing robotics, artificial intelligence, and other innovative ways to efficiently manage customers' banking needs.	Increase customer base by making banking facilities more easily accessible and convenient to operate
3	**ESG**	With stakeholders demanding sustainable business practices, more than 270 banks worldwide have joined the Principles for Responsible Banking framework. ESG-linked funds, bonds, assets, retail banking and investing products are on the increase, with wealth management arms embracing ESG investing, and capital markets adopting `green underwriting'.  However, many banks still possess significant profit-generating `brown' assets and must balance ESG ambitions against shareholders' desire for strong returns. As a result, in addition to financial viability, future deals will increasingly be viewed through an ESG lens, while banks' asset management units are likely to favor more sustainable companies.	Meeting long term sustainable development goals

The recent M&A and private placements towards the digitization of banking have been majorly observed globally, which may be an indication of similar future trends expected within the MENA region as well. Further, the regulators across the region are providing the right impetus for e.g., Qatar Central Bank establishing Buy-Now Pay-Later Regulation and Saudi Arabian Monetary Authority providing Payment Services Provider Regulation to facilitate the digital acceleration as a result of which many specialized firms and start-up companies are mushrooming, which could potentially be the targets for banks & financial institutions to invest and acquire in order to fuel their digital ambitions.

Key Takeaways:

- Historical trends saw banks acquiring for cost and revenue benefits; recent shifts focus on specialized firms for customer retention amid a hyper-competitive fintech landscape.
- Post-pandemic, global banks increased acquisitions in specialized firms by over 50%, driven by the need for inorganic fintech expansion and cost savings in customer acquisition.
- Future banking mergers will be driven by cybersecurity, digital acceleration (fintech, blockchain), financial inclusion, and a rising focus on ESG; MENA region expected to align with these trends supported by regulatory impetus.

In our view, in addition to the conventional drivers of M&A and investment activity in the banking and financial services, such as cost and revenue synergies, and higher asset base etc., the future M&A and investment in the banking & FS sector would be fueled by the need to adapt to ever evolving latest technological advancements aimed not only at enhancing customer experience but also to retain current customer base.

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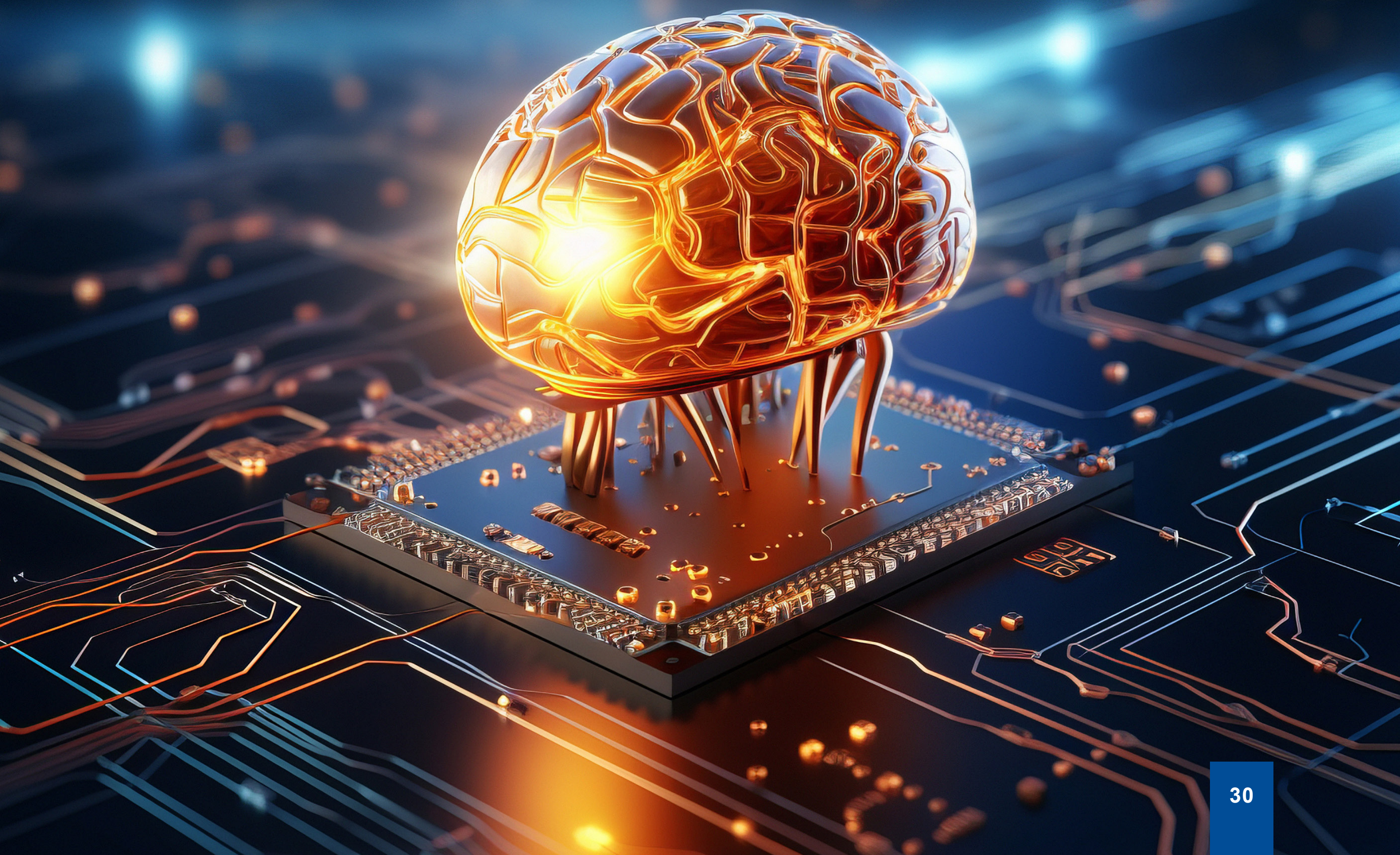
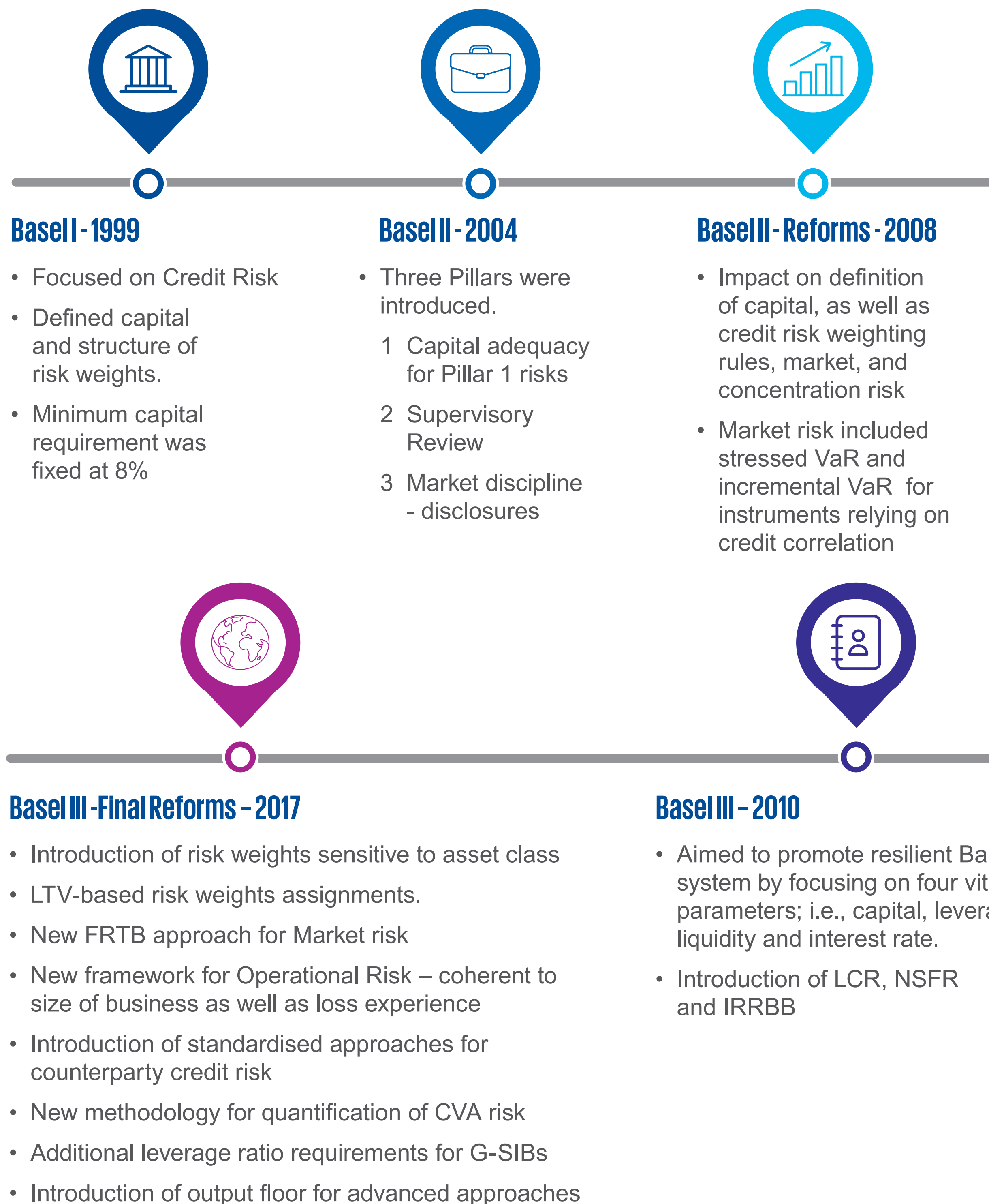
Basel III Reforms



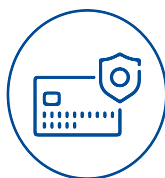
Qatar is one of the few jurisdictions and the second among the GCC countries to have set the timeline for meeting the official Basel III-Reforms implementation date. Under the regulatory direction and guidance of QCB.

Qatari Banks are required to adopt Basel III Reforms starting from the 1st of January, 2024 which is in line with the timeline targeted by most large economies of the world.

The Basel III final reforms aim to restore creditability in the calculation of risk-weighted assets (RWAs) by improving the sensitivity of the standardized approach used in calculating them and reducing reliance on the internal ratings-based approach, and setting a framework for comparison of the banks' capital ratios. Expanded risk coverage as a result of revised methods of the calculation are likely to have a wider impact on business models and capital allocation strategies.



Key changes and enhancements introduced by QCB



Credit Risk

Revisions focus on making the standardized approach more risk sensitive; by including the revised approach of LTV-based risk weight assignments, along with further granular segmentation for real estate finance, introduction of due diligence requirements for externally rated exposures, and revisions to the specialized lending framework and new SCRA approach for unrated Banks. Further, the risk weights for both listed and unlisted equities have been enhanced in accordance with the risk associated with the exposures.

Counterparty Credit Risk and CVA

The new guidelines introduce Standardized approach for Counterparty Credit Risk (SA-CCR), where the Banks will be required to estimate potential future exposure (PFE) based on proposed modelling methodologies contrary to the weight-based CEM approach. The existing credit valuation adjustment (CVA) method has been designed to calculate the capital charge for credit risk associated with derivatives and securities financing transactions and in its place are two alternative standard approaches: a basic approach (BA-CVA) and a standardized approach (SA-CVA). The Basel reforms introduce more risk sensitivity, recalibrated risk weights, different treatment of certain hedges, and a revised boundary between the banking book and the trading book.

Market Risk

A revised fundamental review of the trading book (FRTB) framework brings structural changes to processes and the calculation of risk-based capital requirements and market exposure for trading activities. The new scalars introduced as part of the simplified approach enhance the capital structure of banks, providing high loss-absorbing capability.

Operational Risk

The introduction of a single standardized measurement approach (SMA) for assessing operational risk replaces the use of simplified Business Indicator approach and makes the capital charge more comparable across banks, and greater risk sensitivity compared with previous approaches. SMA is based on a combination of a simple financial statement proxy for operational risk exposure called the business indicator (BI) and bank-specific loss data.

Potential Implementation Challenges

Benchmarking against global learnings, banks may face several challenges in migrating to the new Basel standards. The most significant challenges are detailed below:

- **Inadequate Readiness:** Given the official implementation timeline starts January 1, 2024, one of the most significant risks is related to inadequate readiness of all Banks in the current volatile environment with respect to timely implementation and reporting of Basel III final requirements across all risk dimensions. This includes carrying out the requisite changes in policies and procedures, system configurations/ enhancements, data governance as well as adopting to additional reporting complexities.

- **Data Availability and Quality:** Data availability, quality, and accuracy may pose a potential roadblock to implementing revised methodologies under various risk areas, will require review and reconfiguration. In most cases, this requires to conduct review and reconfiguration processes.
- **System and Data Implementation Complexities:** Revised requirements under standardized approaches add to system and data implementation complexities. There will be a requirement to assess the impact on banks' business and adjust business models and risk strategies accordingly.
- **Regulatory Differences:** Differences in regulatory requirements of central banks across various jurisdictions with QCB regulations, especially for banks with a high degree of interconnectedness and cross border banking operations may add to implementation reporting complexity.
- **Impact on Pricing and Earnings:** Revisions to capital requirements finally, the revisions to capital requirement will consequently flow to the pricing and earning of the Bank. Given the stressed interest rate scenario and looming risk of recession, it might be very difficult to adjust the pricing to reduce the impact on earnings and distribution.

Key Takeaways:

- Qatar aligns with Basel III reforms on an international timeline, being an early GCC adopter, with implementation set for January 1, 2024, directed by the Qatar Central Bank.

- QCB introduces robust credit risk measures, with a focus on risk sensitivity, LTV-based risk weight assignments, due diligence requirements, and revised frameworks. Counterparty credit risk and market risk are addressed through standardized approaches, and a new operational risk measurement approach is introduced.

- Banks in Qatar may face challenges in adapting to the new Basel III standards, including readiness issues, data complexities, adjustments to business models, along with regulatory differences and impact on pricing and earnings.

QCB published circular 33/2022 and circular 34/2022 encapsulating the Basel III -Reforms implementation guidelines for Islamic and Conventional Banks respectively, with 1st January 2024 as the timeline for adoption. The objectives of these reforms are to better capitalize banking sector, making the same less exposed to liquidity risk and vulnerabilities associated with real estate sector and more transparent to market participants and supervisors.

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