KPMG

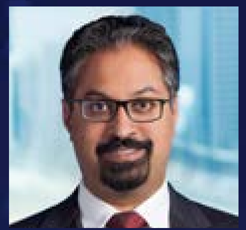
UAE banking perspectives 2021

Innovating, balancing, and governing

March 2021

kpmg.com/ae

Foreword



Abbas Basrai
Partner
Head of Financial Services
KPMG Lower Gulf

I am pleased to introduce the sixth edition of our annual UAE Banking perspectives report.

With major sectors like energy and natural resources, aviation, tourism and hospitality, and supply chains facing slower than anticipated activity, the outlook for Gulf Cooperation Council (GCC) countries seems to be unpredictable. While banks had to weather Covid-19, they were also on the front line of implementing financial support measures instigated by the government and Central Bank of the United Arab Emirates (UAE). The banking industry would do well to act rapidly to address these challenges while contributing positively to economic recovery.

During a time of seismic change, the UAE government is steadily working to realize its vast potential for growth. In recent years, it has been building an ecosystem that is conducive to the success of the financial services sector. And we are hopeful that the economic rebound will be swift as the UAE rolls out its vaccination program. The standing of UAE banks in the international market seems to be improving, with the sector remaining in a strong position, regardless of potential uncertainty.

In this report, our financial services team explore a gamut of topics of critical importance to the industry. INNOVATING and serving customers is at the forefront of disruption and change, which is supported by a delicate BALANCING act of the core and non-core functions while leveraging the cloud for operational resilience. None of this is possible without the right people and culture; reimagining the employee journey therefore becomes imperative. During this time of rapid developments, GOVERNING and regulating is of immense importance to ensure confidence in the banking sector.

We are delighted to have for the first time in this publication series, an interview with a sector leader about the future of the industry. Suvo Sarkar, Senior Executive Vice President & Group Head of Retail Banking and Wealth Management, Emirates NBD, tells us how banks are poised to operate a decade from now.

I hope you find this report a thought-provoking read. I would be delighted to discuss with you the views outlined within it and explore how we could assist your organization in capitalizing on potential opportunities.

Please hover you mouse & click where indicated

Contents

Executive summary

It has been a tumultuous last 12 months for banks, despite decisive and far-reaching central bank actions that have supported the economy. Banks continue to persevere in an environment characterized by low interest rates and having to deal with issues relating to counterparties' creditworthiness and provisioning.

While organic growth has been minimal, in the United Arab Emirates (UAE), one of the most notable trends we have seen over the past few years is an inclination toward consolidation. With around 50 banks, plus new digital banks coming up, serving a population of approximately ten million, the UAE could still be considered 'overbanked'. Further merger and acquisition activity, therefore, may well take place.

During 2020, net profit for the top 10 UAE banks in our analysis has dropped on average by 41% compared with 2019. This decrease is due to the significant increase in the provision charge on loans with banks expecting higher losses and customer defaults as a result of the pandemic. Non-performing loans (NPL) ratio also increased to 4.4% percent in 2020. Net Interest Margin continues to be under pressure because of record low interest rates, exacerbated by increased competition. Despite this, the Capital and liquidity position remains strong.

The challenge for banks in 2021 will be to effectively extract value from data to help them focus on their most profitable segments. With revenue pressure expected to continue, the only way banks are likely to maintain profit margins is by strictly managing costs. Underlying this is the need to bolster back-end functions, which tend to be driven by people and paper, rather than merely focusing on what is visible to the customer. The imperative for strong IT infrastructure is more relevant than ever as lockdowns have rendered invaluable effective remote-working technology.

In a precarious market, banks are being forced to consider alternative models utilizing cutting-edge technology, including **Banking as a Platform** (BaaP), which allows third-party FinTech developers to build products and services on behalf of bank customers. There is now a broad range of FinTech applications for loans, payments, investing, wealth management, and other services.

Banks can **overhaul their operating models** by considering a combination of partnerships and alliances, technology incubators, FinTech acquisition, investments, and transformation of their internal capabilities. They will need to rethink the customer experience by leveraging 'design-thinking' as an approach to identify the customer journeys that prompt digital offerings from the platform. Banks should be increasingly training their employees to guide customers toward platform-based services. The process, risk, and control framework should be realigned, and the control environment will likely need to be extended to third parties.

Today's customer is generally seeking a self-service, seamless, automated, and omnichannel experience – with minimal waiting time. To enable this, banks across the Middle East are digitalizing complex processes and end-to-end customer journeys across the front, middle and back offices. It remains to be seen whether banks are truly delivering on the promises they make to their customers, but the outlook is promising. The UAE has a strong regulatory foundation for the launch and operations of digital-only banks.

Technology is not, however, a universal panacea; wider implications around legacy infrastructures and data repositories remain. This has led several banks to consider alternative services that can support customer demands for consistent execution and provide for consolidated data storage and near real-time reporting – at lower operating costs. **Managed services companies can help banks outsource certain functions.** Banks can thereby optimize their footprint, business continuity planning (BCP) strategy, and total cost of operations.

In times of uncertainty, canny **liquidity management** can be vital. Recently, we have seen a surge in NPLs for the majority of banks worldwide; many have booked higher provisions. Banks should perform adjustments to their credit risk models to increase responsiveness to external factors and improve the accuracy of their market predictions. They would also be well advised to consider reviewing their Risk function.

In some cases, the only – or optimal – approach may be to **restructure rather than liquidate** the exposure through collateral sale resulting in shutting down the customer's business. There exist several tools to do this effectively. In certain scenarios, liquidation may result in a better outcome than restructuring, for instance when the ongoing cost of solving the problem outweighs the value of current assets.

It seems unlikely that banks can continue to maintain their competitive edge without effectively leveraging digital transformation to match their customers' evolving expectations and behavior.

They can optimize their customers' seamless digital journey by outlining a framework that aims to provide a coherent digitalization. This should be based on the current tech maturity, positioning of the bank, providing next-best-action recommendations, and proposed processes elimination.

Cloud computing has presented consumers with stronger security and privacy tools, and improved measures for detecting, responding to, and preventing security breaches. This can ease the burden for IT functions. By migrating to the cloud, banks can leverage solutions that are inherently better suited to manage six key operational risks: cybersecurity, digital sovereignty, the remote workforce and customers, third party, technology, and facility.

Automation and AI are instrumental not only in driving operational efficiencies but can play a key role in boosting employee satisfaction. The **people aspect** of technology cannot be disregarded: it can help staff focus on the more fulfilling parts of their job, freeing them from monotonous, tedious tasks that can be done by a machine. Over the coming years, banks are projected to increase their reliance on robotic process automation (RPA) technologies to conduct human resources (HR) functions like onboarding and talent acquisition[1]. This should be combined with a focus on upskilling and reskilling employees through investment in learning and development initiatives.

Meanwhile, the local tax landscape has seen a slew of **new legislation transforming the sector**, in a move towards greater transparency. Examples of developments over the past few years include the Automatic Exchange of Information ("AEOI") regimes in compliance with the US Foreign Account Tax Compliance Act ("FATCA") and the OECD's Common Reporting Standard; Economic Substance Regulations ("ESR"); regulations around the Ultimate beneficial owner ("UBO"); Country by Country Reporting ("CbCR"); and UAE value-added tax (VAT).

Keeping up with technological innovation is only part of the puzzle: the overarching concern for any bank's operations is **robust regulatory compliance and governance**. In the UAE, over the last two years alone, local authorities have issued or revised many regulations to enhance financial stability. New ones pertaining to banks include those issued by the UAE Central Bank, such as the Corporate Governance and Risk Management regulations. The Federal Government recently published an updated Banking Law, Anti-Money Laundering (AML) Law, and Companies Law. To succeed in an environment characterized by continual change, banks must adopt compliance frameworks that are mature and flexible, possibly using existing ones as a starting point.

Regional regulators have also issued **regulations related to internal controls over financial reporting** (ICOFR). Globally, ICOFR was introduced by the Sarbanes–Oxley Act of 2002 (SOX). The UAE Central Bank's Internal Controls, Compliance, and Internal Audit regulation of 2018 states that the board and senior management of banks are responsible for implementing an adequate internal control framework that identifies, measures, monitors, and controls all risks. Unlike their US and UK counterparts, however, local banking regulators do not generally mandate periodic reviews on the effectiveness of ICOFR systems.

An integral part of robust corporate governance is the **statutory audit.** The relationship between auditors and audit committees (ACs) plays a critical role in good governance. The discussion of the audit should not be considered as merely an 'agenda item' for the AC at quarter and year ends, but as an opportunity for the external auditor to provide independent insight on matters discussed in the AC meeting. We would also encourage more frequent bilateral (regulator and auditor) and trilateral meetings (including the bank) to create a better understanding of the audit approach taken.

Regulators, standards setters, audit committees, and investors—indeed, the full spectrum of stakeholders—expect a culture of transparency and strong governance. They are seeking enhanced clarity and consistency of metrics being reported; faithful, complete disclosures; and greater assurance around the governance and culture framework of an organization. Banks are witnessing a time replete with dissonances: great technological advancement tempered by the potentially catastrophic implications of the pandemic. Customer retention will be key, and retention strategies can be supported with digital transformation drives. Banks should deliver on the promises they make to customers, ensure their experience is seamless, and fortify their control environment against the threats that abound.

Performance highlights

For the top 10 local banks

Key

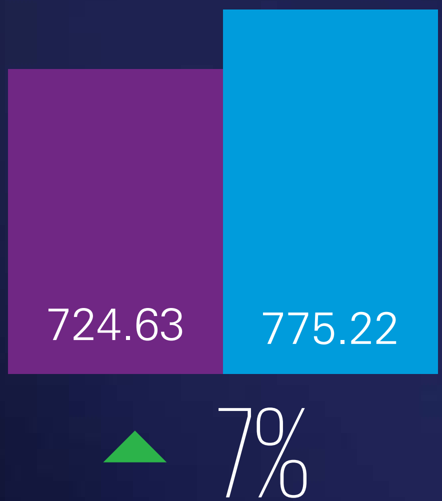
%

2019 · 2020

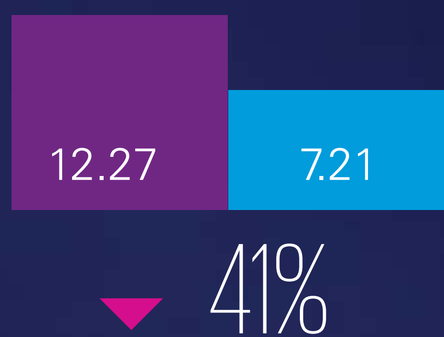
Y-o-y improvement · No change · Y-o-y deterioration

The percentages are based on straight line averages of top 10 local banks

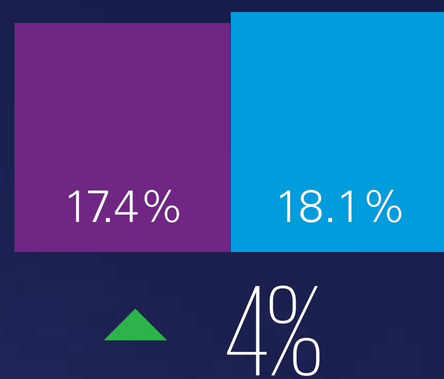
Total assets *(USD billion)*



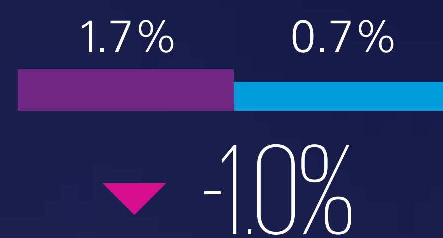
Net profit *(USD billion)*



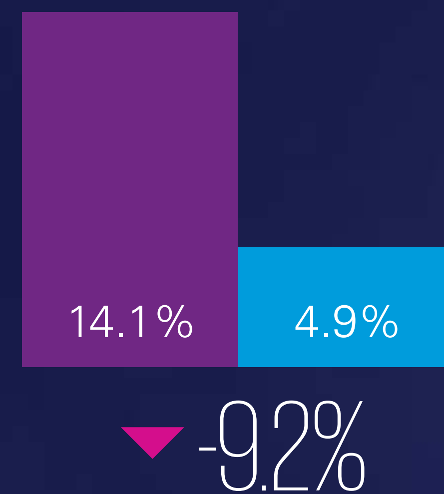
Capital adequacy ratio *(%)*



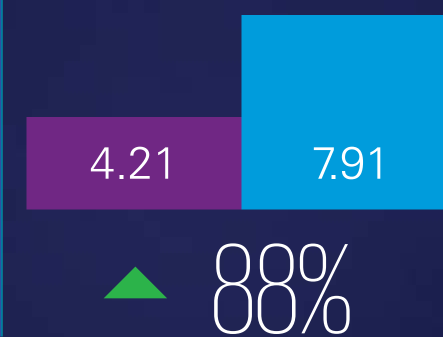
Return on assets *(%)*



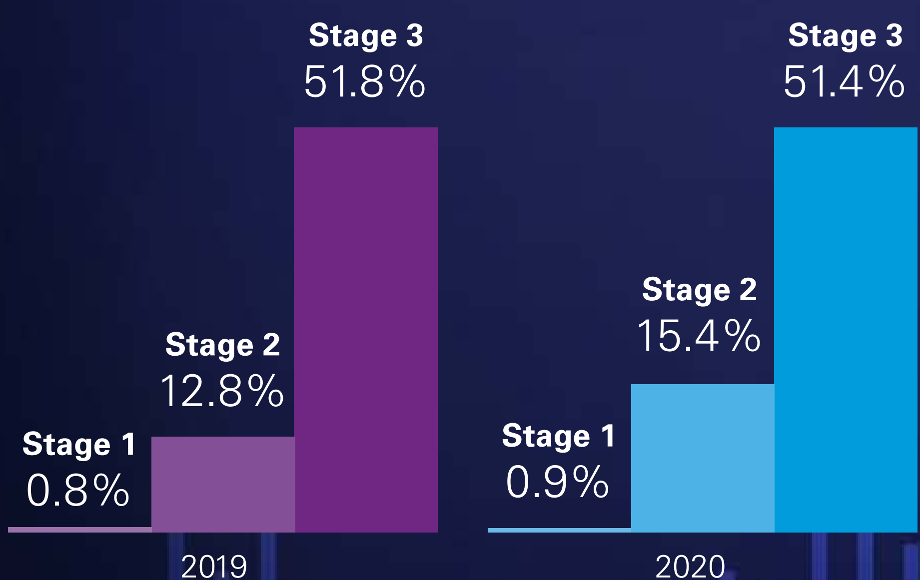
Return on equity *(%)*



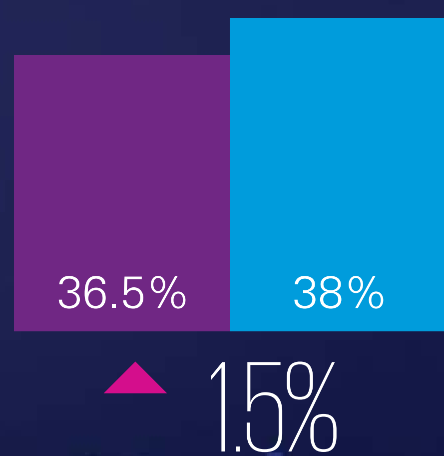
Net provision charge on loans and advances (financing assets for Islamic banks) *(USD billion)*



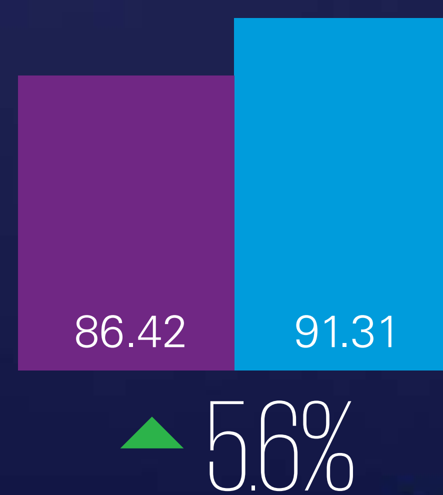
Coverage ratios on loans



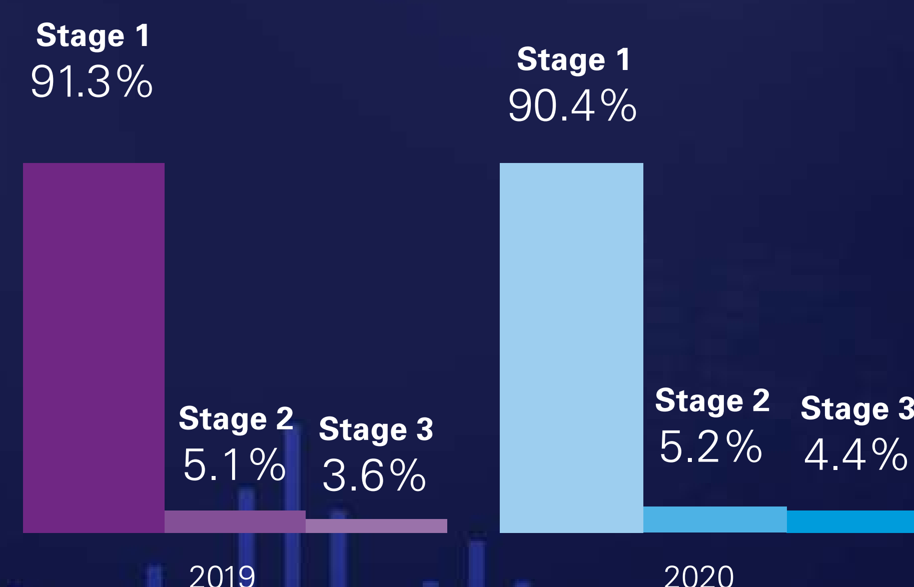
Cost-income ratio *(%)*



Regulatory capital *(USD billion)*



Total loans subject to ECL



01

INNOVATING and serving customers

Platform banking: the imperative to reshape the business model

Banks are facing stiff competition from challengers that have been quick to adopt innovative technologies and embed them into the heart of their operations. Gonçalo Traquina explores the need for banks to follow in their footsteps or risk obsolescence.

Banks are increasingly having to compete with large, established technology companies like 'the four horsemen' or GAFA (Google, Amazon, Facebook, Apple), as well as a crop of FinTechs which are constantly coming up with innovative and customer-centric solutions. To survive and thrive in this era, banks will need to adopt new models.

Most major banks today are vertically integrated, with closed-loop offerings. Their products and services run within proprietary distribution channels and tightly controlled infrastructure. Driven by regulation, the advent of open application programming interfaces (APIs), for instance, open banking, will upend the status quo by allowing third parties to act as alternative distributors and offer a new range of products.

Additionally, customers have embraced platform-based businesses for reduced friction, lower prices, and better service, along with the convenience of using mobile devices as the primary point of contact.

An evolution in consumer preferences is also driving the shift towards platform-based models. Indeed, our research and experience suggest that — after nearly a decade of fragmentation and unbundling of services in their lives — consumers are starting to revert towards 'rebundling'. Instead of having multiple apps for ordering food, ride-sharing, and payment options, they may want just one. Consumers may not be specifically demanding 'super apps', but many want the convenience and simplicity that super apps can offer.

The concept of banking as a platform

Digital platforms are poised to dramatically alter business models, competitive structure, pricing, and customer behavior in banking, in line with what we have observed in other industries, such as retail.

Given the rapid pace of change, incumbent banks are being forced to consider alternative models— one of these options being Banking as a Platform (BaaP).

By establishing a banking platform, banks can allow third-party FinTech developers to build products and services on behalf of bank customers, creating a broad network of FinTech applications for loans, payments, investing, wealth management, and other services, while enabling financial institutions to deliver a unified banking experience.

Learning and leveraging from FinTechs

Recognizing the market opportunity to serve mobile-first customers, FinTech companies are introducing disruptive business models that eliminate unneeded expenses and display greater efficiency in terms of capitalizing on customer data.

These business models support no-fee or low-fee products and services that threaten banks' fee and margin revenues.

Players like Alipay (China) and WeChat (China) offer their customers access to thousands of products from hundreds of financial services providers in a single digital ecosystem.

Two more super apps have emerged in South East Asia, from the leading ride-share platforms, Go-Jek and Grab. Both apps now offer a range of other services from food delivery to medical advice, and both are competing to help consumers select and purchase financial products.

Fintechs are leading the way in innovation using rapid development methodologies on the latest technology stacks, launching products and services not yet offered by banks. Banks would be well advised to take heed of these developments for several reasons.

They are disintermediating banks from their customers. Super apps like WeChat and Alipay offer a range of basic banking, savings and investment products to customers. While for now, these products are being originated and underwritten by traditional financial institutions, this still means that these institutions are being moved one step further away from their customers. Much like what happened in the insurance sector with platform plays and aggregators, traditional financial institutions may quickly find they have been relegated to performing the regulated activities while the super apps retain the customer experience and relationship.

The rise of super apps

Increasingly, "super apps" are using their vast wealth of data to deliver better services, and improve operational processes — for instance by using social media and transactional data to risk-assess loan applicants, and better target financial products to customers, at the exact time they need them. Traditional banks, with their siloed data and mainframe technology estates, are struggling to obtain a complete and representative view of their customers.

Apps are also building their brand reputations in financial services. Offering payment services within the app may seem fairly innocuous at first; a marketplace without a payment mechanism may be doomed from the start. Currently, the vast majority of these payments are flowing through traditional banking and card issuer infrastructure. However, most of the bigger super apps now also have strong relationships with banking arms (e.g. WeChat has WePay for payments and WeBank for banking products; Alibaba has AliPay and Ant Financial) which are using the app's brand reputation and reach to access new customers and build trust in financial services.

Using these approaches, FinTech companies can provide banking products and services without the legacy cost structures of traditional banks. The banking industry has thus far avoided the level of disruption seen in other industries, owing to a combination of regulatory barriers, industry structure, entrenched customer relationships, and customer concerns over privacy and reputation. Yet those are not insurmountable obstacles, especially when customers expect and demand high levels of service and convenience. With mobile networks and platform-based business models, FinTechs can bypass the strengths of today's banking industry. The next article in this series explores how banks should respond to these challenges, and future-proof their operational strategy.

Gonçalo Traquina
Partner
Financial Services
Management Consulting Lead
KPMG Lower Gulf

A call to arms: how banks can transform their operational strategy

Traditional banks would do well to build a model that draws upon their strengths in terms of customer reach, regulatory expertise, and branding. Abbas Basrai elaborates on what steps should be taken to integrate platform-based banking with their operations.

Rather than competing with industry challengers, banks around the world are increasingly finding value in partnering with them and brokering their products in online marketplaces. Several international banks provide some sort of developer hub, portal, or exchange that allows third-party apps to access, integrate and/or extract data about the bank's customer base.

Many digital challenger banks have been able to partner with leading financial services providers in several product categories. Going a step further, players like Starling Bank (United Kingdom) and Fidor Bank (Germany) offer customers a handful of third-party providers in each category.

These are variations on the platform banking model. They tend to give their customers access to products by third-party providers; thus strengthening their offering while avoiding the cost of competing with established providers. This can free up resources to invest in the part of the business that differentiates them and adds value for consumers.

For traditional banks, the key question is whether they can develop the capabilities to meet customer expectations for instant mobile access to a wide range of products and services. To do so, they would have to embrace the platform-based business model, either as an active participant on others' platforms or platforms of their own.

Rethinking the vertical value chain

In the traditional operating model, banks own and operate a vertically integrated value chain that stretches from production to sales, distribution, and servicing. Although banks can outsource various components, the overall cost structure remains fixed. But the imminent threat of disintermediation may render the traditional operating model unsustainable.

As these trends accelerate, banks' fee and margin revenues can be increasingly at risk. Although the traditional banking industry has numerous regulatory and reputational advantages, disruptive innovation usually finds a way through to the marketplace. In response, banks need to re-evaluate their vertically integrated banking business models by considering platform-based models.

Instead of trying to imitate the way that FinTech companies approach technology development, traditional banks may do well to capitalize upon the formers' innovations by incorporating external products and services in their portfolio. For instance, some Singaporean banks are building their marketplaces: DBS launched its car marketplace in partnership with sgCarMart and Carro, while UOB launched its travel marketplace. Both these initiatives are a natural extension of the financial products they offer and in doing so they move up the customer lifecycle. Those who own a customer's path to purchase can gain a form of "ownership" of the customer.

The banking platform model of the future

A platform for financial transactions would need to establish "plug-and-play" standards enabling developers to build products and services for consumers. The platform infrastructure would manage the secure exchange of data, oversee authentication and authorization, and ensure compliance with regulations. Oversight and governance of a banking platform would ideally be managed using defined and shared standards among institutions working in federation with network operators and FinTechs' associations.

Based on their knowledge of their customers and markets, banks are increasingly using the full range of the platform's capabilities to build omnichannel "customer journeys" that anticipate customers' interaction across digital and physical environments. Sales and service interactions need to be designed for self-service, with escalation paths that provide context to bank employees and support human interactions.

For developers, including FinTech companies and banks' internal development teams, the base-level capabilities available through a banking platform would allow them to focus on delivering value to consumers, instead of building custom overhead for secure connectivity, identity management, and regulatory compliance. Working through a bank-led platform can allow developers to focus on building transformative ideas with greater confidence and they can reach the marketplace with a solid, t
ested product.

For customers, the experience of banking would be completely transformed away from the current, vertically integrated model. Instead of being limited to the products and services offered only by their bank, customers would instead have access to a digital banking "app store" that allows them to select their services from a broad range of sources. With the knowledge that whatever financial apps they select have been vetted by the platform, customers will be able to build their own personalized banking experiences based on their individual needs.

A plan for action

Our experience suggests that, almost regardless of size and scope of business, bank executives should be considering the following key aspects to achieve success.

Banks will need to decide soon whether they plan to be a front-office player within a BaaP model, a back office enabler or simply a piece of regulated infrastructure in the future. They can then start investing and evolving towards achieving that vision in regard to a combination of partnerships and alliances, technology incubators, FinTechs acquisition/Investments and internal capabilities.

They will need to decompose their operations into capabilities and manage interactions and services with third parties, and redesign the customer experience by leveraging a "design thinking" approach to identify the customer journeys that prompt digital offerings from the platform, as well as those moments that require human interaction.

Extracting value from data

Much of the success of today's BaaP model is predicated on the fact that they can share data across various service areas and lines of business to develop a better view of their customers. Banks will need to consider how they can use APIs and open data architecture to exploit the rich data flows.

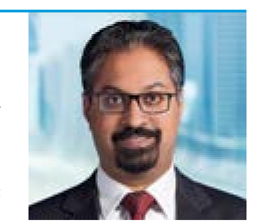
Having extensive customer data and knowing what it all means are two very different things. Banks will probably need to redouble their investment in improving both their data management and their analytics capabilities if they want to compete on a global level.

Organizations should also update their development approaches by training development teams in Agile, microservices, and DevOps, mimicking FinTech approaches to synchronize with their development capabilities playing field with super apps.

Lastly, they should be streamlining operations for existing manual processes and existing operations, so that bank capabilities can be delivered through APIs as platform-based services to FinTech providers.

Our experience suggests that, at least for the next decade, the trend among consumers and businesses is leaning towards BaaP models. The question is whether banks understand how they will deliver value in a world dominated by FinTechs and super apps. And whether they can respond quickly enough before the disruption reaches a tipping point.

Abbas Basrai
Partner
Head of Financial Services
KPMG Lower Gulf



Are banks delivering on their promises?

Banks globally and in the Gulf region have been trying to create a frictionless and effortless digital customer experience, reducing or doing away with the need for human intervention. Ankit Uppal contemplates their various success rates, and whether actions match the words.

The UAE banking market is highly competitive, comprising 48 commercial banks and 10 wholesale banks.[2] This has compelled financial institutions to strive to differentiate themselves in the fields of customer experience and digitalization. We are witnessing the rise of the connected customer, a term encompassing a demographic group which harbors a strong preference towards online channels, technological innovation and on-demand services. The Covid-19 pandemic has amplified the need for easy access to products, services and information.

Stakeholders may look to Asia Pacific for a glimpse of what is to come. Here, the proliferation of mobile devices and online engagement is staggering, and citizens are using connected tools to augment nearly every aspect of their lives. Customers expect cutting-edge infrastructure, uninterrupted access, and service providers who can cater to their expectations around the clock.

Banks, in collaboration with their FinTech partners, have taken great strides in fulfilling their promises to customers.

The UAE leads the way

As the ongoing digital revolution sweeps across the financial sector, traditional banks in the UAE are increasingly embracing new technologies to remain competitive, increase market share and target new customer segments, including millennials and Generation Z. Newly introduced smartphone apps include Liv by Emirates NBD, Mashreq Neo by Mashreq Bank, and Hayyak by Abu Dhabi Commercial Bank.

According to KPMG's 2020 UAE Customer Excellence Experience report[3], the financial services sector (along with the utilities sector) has seen the largest increase in a focus on customer experience, with the top three performers being HSBC, Emirates NBD, and Abu Dhabi Commercial Bank.

HSBC Middle East has focused on accelerating the digitalization of its customer service capabilities with the goal of delivering a simple, convenient, fast and secure banking experience. This is evident in its latest offering, a Customer Service Unit (CSU) in Mirdif City Centre. The CSU has undergone a digital upgrade to provide a mix of technology-enhanced and in-person advisory services. Emirates NBD has focused on accelerating its digital capabilities by leveraging artificial intelligence and machine learning. This seems to have led to simplified processes, for instance allowing customers to open a new account in minutes, or the launch of an interactive teller machine which allows the customer to complete most transactions without the need to visit a branch.

Uniting the front and back-end functions

Today's customer appears to be seeking a self-service, seamless, automated and omni-channel experience with minimal waiting time—a set of criteria that remains consistent regardless of the type of service, be it customer onboarding, increasing their credit limit, applying for a new product, or redeeming loyalty points. To enable this, banks across the Middle East are digitizing complex processes and end-to-end customer journeys cutting across the front, middle and back offices. The process is driven by business rules, triggers and events in the back end and delivered through an intuitive and self-guiding user experience from the front end (for instance mobile apps or portals). Similar to fully digital banking licenses issued in Hong Kong and Singapore, the UAE has a strong regulatory foundation for the launch and operationalization of digital-only banks.

We have observed a number of initiatives being undertaken by banks to deliver on their promises to customers:

- Harnessing data, advanced analytics, and actionable insights with a real-time understanding of the customer to shape integrated business decisions
- Creating intelligent and agile services, technologies, and platforms, and enabling the customer agenda with solutions that are secure, scalable, and cost-effective
- Engaging, integrating and managing third parties through open data to increase speed to market, reduce cost, mitigate risk and close capability gaps
- Building a customer-centric organization and culture that inspires people to drive business performance
- Designing seamless, intentional user experiences for customers, employees and partners, supporting the customer value propositions and business objectives

Banks should endeavor to become distinguishable by the degree to which their customer experience efforts are integrated and connected. The boundary between their front and back offices is blurring, and they are gaining increasing intimacy with their customers, driving them to innovate by the insight they gain. Many banks today are structuring their operations in new and exciting ways. They are seeing customer experience as a source of commercial value: not just a differentiator from their competition but a mechanism for potentially superior profitability.

Ankit Uppal
Director
Digital & Innovation
KPMG Lower Gulf

Guest feature: Banking in 2030

For the first time in the banking perspectives series, we interview a sector leader about the future of the industry. Suvo Sarkar, Senior Executive Vice President & Group Head of Retail Banking and Wealth Management, Emirates NBD, shares how banks are poised to operate a decade from now.

What do you expect from a bank that is aiming to become future-ready?

Banking continues to be transformed, driven by technology, changing customer behavior, the growing participation of non-traditional players, and an evolving regulatory landscape. The bank of the future will provide fully automated end-to-end processes across most core services, supported by biometrics, augmented reality/virtual reality (AR/VR), machine learning and other technologies. Advanced data analytics, data warehouses and artificial intelligence (AI) will help provide customers with ultra-personalized solutions delivered at the right time and place, as well as position banks to be primary custodians of customer data.

Traditional distribution will evolve rapidly, as banks look to trim networks and reformat branches. Core banking platforms will be transformed with the addition of digital stacks, micro-services, blockchain and cloud computing. This will provide increased agility and connectivity and also enable banks to become a stronger eco-system player by actively partnering with FinTechs, e-commerce companies, marketplaces, and other third parties.

Most notably, customer service and centricity will assume paramount importance as non-traditional global players and consumer protection regulations continue to raise the bar. Last but not the least, sustainability will become embedded in all facets of the organization.

What long-term impact do you think Covid-19, and other potential pandemics, will have on banks over the next ten years?

The pandemic has accelerated several trends. Digital adoption saw a step change as many new customers signed up to use mobile or online banking for the first time: over three-quarters of Emirates NBD's customer base are today digitally active.

Temporary closures of branches and social distancing-led branch transaction restrictions drove customers to migrate at a faster pace to digital platforms. Ninety-six percent of all our transactions currently happen outside the branch, and face-to-face transactions are at about half of pre-Covid-19 levels. Cashless payments recorded a major boost with close to nine out of ten point-of-sale transactions now happening in a contactless manner. Domestic e-commerce volumes have grown rapidly across a range of categories.

The crisis also underscored the part that banks play in supporting customers and the wider community during times of distress, through relief measures, debt restructuring programs and other initiatives.

What does the people agenda of a bank look like in 2030, considering competencies and skillsets?

Reskilling will be key as digitalization and the continued transformation of business models changes the nature of jobs across the organization, ensuring also employee buy-in. The use of people analytics tools will become more prevalent to guide hiring, support performance management and enhance productivity. Work policies to engage with the gig economy will need to be put in place to cover remote and flexible working models. Diversity and inclusion are likely to become a central part of the agenda, providing a strong differentiator to business performance and helping to attract top talent.

To what extent do you think future banks will cater to millennials and Generation Z? What are the key success factors of Emirates NBD's digital lifestyle bank, Liv.?

Millennials and centennials will make up 75% of the workforce by 2030. Millennials will also inherit a significant share of wealth from baby-boomer parents in the coming decade.

Millennials and Gen Z customers are digital natives for whom design is of paramount importance. They place more value on life experiences rather than material goods, and banks will need to factor this in when constructing products or providing personalized offers. Millennials also look to deal with banks and organizations that have strong ethical and sustainable policies.

Banks may consider building their own neo-banks to appeal to this demographic. For example, Emirates NBD's Liv. is a digital lifestyle bank that is today the fastest growing retail bank in the UAE. Liv. enables customers to keep track of their daily activities as well as finances in one app. Customers can open a new account instantly, send money using social media channels, obtain an instant digital credit card or apply for a personal loan, and access cinema ticket bookings.

Liv. is aimed at millennial customers and has been built from the ground up by a like-minded team of millennials. The platform also serves to act as a crucible to test innovative ideas and transfer leading practices to the main bank.

E20. is your new digital business bank, targeted towards entrepreneurs and the SME sector. What are the implications of its establishment for the wider industry?

E20. was launched with the objective of helping SMEs start, manage and expand their business by meeting their banking needs at different stages of their life cycle. To provide increased flexibility to small business customers, the E20. current account does not carry a minimum balance requirement. Account holders are provided with chequing facilities as well as a free Business Debit Card for use at ATMs and for making purchases. Additionally, the platform provides a set of digital tools to assist customers in managing their business finances.

Banks would do well to provide an enhanced and simplified digital banking experience for small business customers that takes away the hassle of dealing with banks through traditional channels, while also making it more cost effective.

Do you believe that middle and back office functions are evolving rapidly enough to support the digital evolution?

The first phase of digital transformation carried out by banks focused on the customer-facing side. The focus has now shifted to the middle and back office processes to ensure that processes are digitalized end-to-end, providing an instant and one-click user experience, as well as enabling banks to save significant operational costs.

Most traditional banks are saddled with complex legacy IT systems, paper-based processes and disconnected data sources, leading to high staff-operational costs, errors, lack of agility and consequent lower customer satisfaction—it is critical that organizations work to address these to keep up with the digital revolution.

Emirates NBD has invested AED 1bn in a transformation program of technology platforms to provide enhanced flexibility and connectivity. We have rolled out an automated credit engine that enables instant decisioning of all retail asset products. Scorecards are being put in place to assess customer compliance risk and new customer on-boarding. Most branch procedures have been digitalized, enabling straight-through processing of customer requests. Robotic processes have been rolled out to carry out repetitive tasks quickly and in an error-free manner

How should banks reduce the risk of cyber threat?

The cyber threat matrix is continuously changing and traditional prevention methods are no longer able to protect consumers and banks from complex and sophisticated financial crimes. Against this landscape, banks need to embrace advanced technologies such as analytics and AI to improve threat visibility and detect potential fraud effectively.

Cyber security leading practices comprising appropriate policies, procedures and technologies should be implemented that will help reduce the surface area of attack for adversaries to exploit. A strong and capable security monitoring team should be in place to build muscle memory to detect and respond to cyber-attacks or compromise. Additionally, staff and customer awareness programmes must be carried out to strengthen alertness.

Finally, cyber security should be part of top management agendas and oversight to ensure it gets the right level of visibility, attention and investment.

What role do you think a bank like Emirates NBD will play in 2030 to help the UAE realize its vision of a sustainable future?

The bank's social investment commitment translates into several focus areas such as financial and workplace inclusion for people of determination, encouraging volunteering, enhancing donation platforms, promoting financial literacy, and provide environmentally friendly banking solutions.

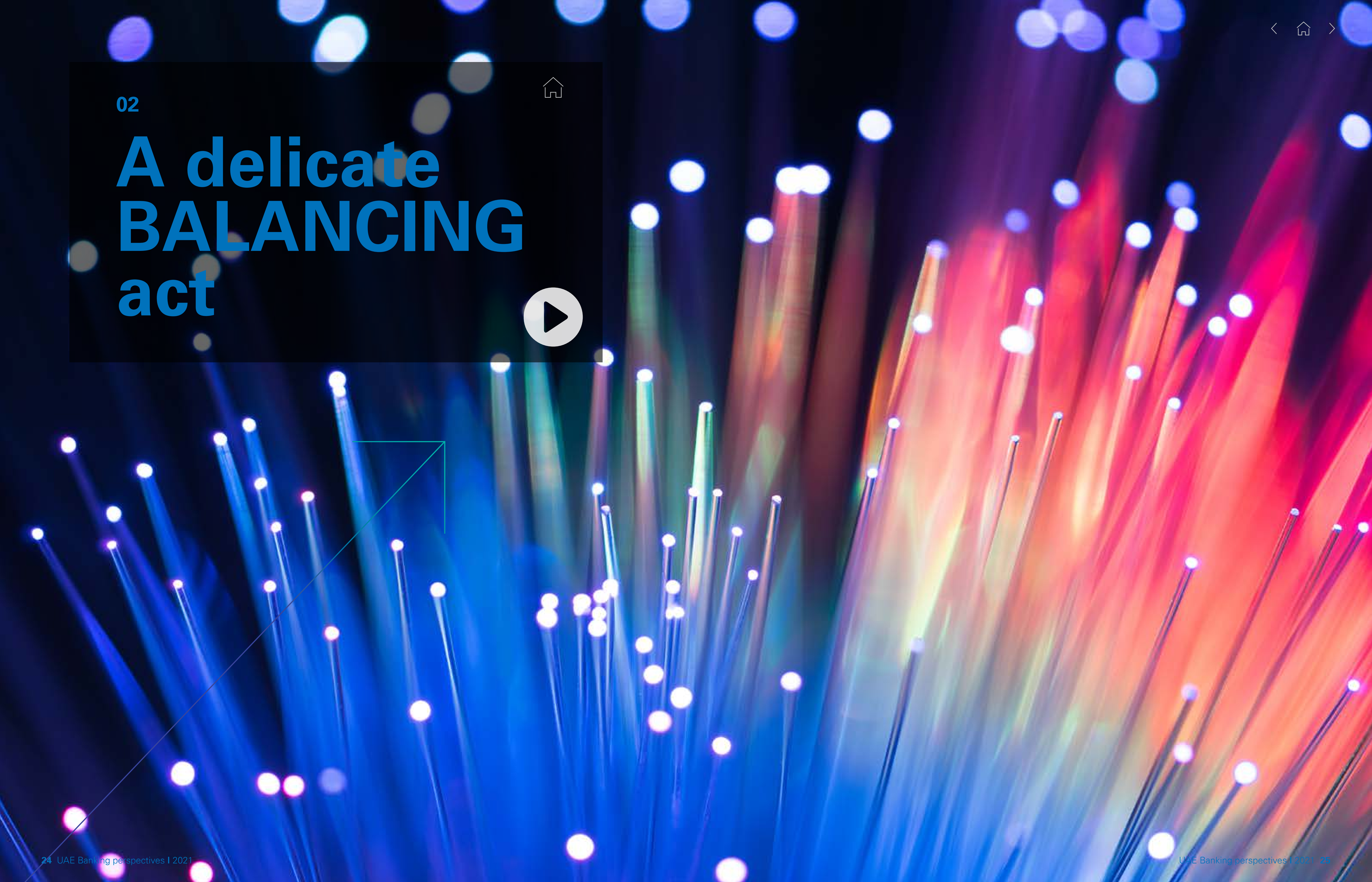
About half of our branches are now disability-friendly, and we plan to extend this to all our network in the future. Branch staff have been trained in etiquette to assist people with disabilities and in sign language to facilitate easier communication. We collaborate with authorities to carry out public awareness campaigns on safe banking practices and to raise financial literacy. The group also implements carbon footprint reduction initiatives such as lowering electricity consumption and recycling plastic.

What are your thoughts on the emergence of platforms and adoption of open banking in the UAE?

Banking as a platform or banking as a service is an emerging trend that utilizes the open banking framework to operate. To host or participate in a platform effectively, it is important to be able to provide personalized offerings and services tailored for customers in line with their lifestyle and requirements.

Banks can also build eco-systems by partnering with other service providers, orchestrated around providing hyper-personalized experiences. Customers are increasingly looking to control their own experience and showing willingness to adopt a self-service plug-and-play model.

Banks seeking a sustainable platform, however, may need to contend with challenges around security, aligning culture, legacy systems and budget constraints.



02

A delicate BALANCING act

Outsourcing and offshoring non-core functions

Managed services companies can help banks to outsource certain functions, for instance HR or client due diligence/know your customer. Varun Bhatia elaborates on how this gives rise to opportunities for operational and legal synergies, especially in the UAE where most of the population consists of expatriates.

The last decade has been a challenging period for conventional banking. New technologies have accelerated the rise of digital banks and niche payment providers, which have been challenging the status quo. In general, the banking sector seems to be playing catch-up in a dynamic business environment, often hindered by legacy systems, poor quality data, fragmented operating models and manual processes, all of which require substantial investment to bring it on par with best in class. At the same time the needs of its customers, both internal and external, continue to rise with demands for straight-through processing wherever possible. Given these constraints, banks have started to look towards cost-efficient solutions that can help standardize customer journeys, that can be highly digitized, automated and integrated within an existing channel experience.

While banks can benefit from the implementation of new technologies, technology itself can only solve part of the problem. Wider implications around legacy infrastructures and data repositories remain and investment requests in this environment are hard to come by. This has led several banks to consider alternate services that are not only able to support customer demands for consistent execution, but also provide for consolidated data storages, near real-time reporting, analytic driven insights to enable faster and accurate decision making, all at potentially lower operating costs. One such option is managed services. Managed services companies move away from a typical outsourcing model, to provide an enduring customer service experience, reliant not only on people but provide a leading service architecture using technology, processes and big data. Our understanding of the market indicates that while several banking clients have started a journey towards transformation of their non-core functional areas, albeit rather slowly. Those partnering with managed-services providers can have greatly accelerated throughput and enjoy productivity improvement in their banking operations.

Realizing the value within CDD

Managed services companies can help banks optimize their footprint, business continuity planning (BCP) strategy, and total cost of operations. Many providers are offering attractive outcome-based pricing models which move away from a typical "your mess for less" approach by bringing in experience design, automation and re-engineering into the transition phase of the engagements. This also allows banks to adopt agility and co-ownership of outcomes as both banks' employees, and service provider resources, work cohesively as one team.

An area where managed services have truly transformed the way banks operate is with Client Due Diligence (CDD). CDD services which have been a major cost source for most banks have benefited from such models immensely by enhancing the customer experience using state-of-the-art technologies (e.g. case management, data aggregation, intelligent automation), process enhancements and a motivated workforce driven by customer behavior rather than policy requirements. Leading managed service providers in this space can bring in a suite of cutting-edge assets including automated workflows, character recognition, artificial intelligence (AI) and natural language processing (NLP)-based tools to enhance improvements. They are increasingly being used as "plug and play" models. These alliances have allowed banks to unlock value in their CDD operations and technology teams through these broad themes:

- Simplification of high-impact customer journeys and underlying processes
- Elimination of non-value added and standardization of retained activities
- Automation of repetitive manual tasks and processes
- Usage of analytics and insights to accelerate decision making
- Adopting agile ways of working

These themes from engaging managed services partners can easily be replicated within other functional areas as well e.g. Human Resources, and not only CDD. Questions remain, however. Do banks take the traditional route to try to revamp their customer lifecycle journeys themselves or copartner with strategic players? Do they launch multiple, siloed improvement projects versus an integrated transformation program keeping customer experience at its core?

Determining the optimal approach

The approach banks decide to take will vary according to several factors, including the maturity of their internal support model (infrastructure, expertise and governance), and appetite to spend. For banks to reinstate (lost) profits, they will need to leverage an appropriate ecosystem, including partners and alliances to improve productivity and customer experience. For expediting their shift towards agile and automated operations, leveraging the right partners will be instrumental to pivot quickly rather than investing in their own center of excellences and shared services set-up, which typically are capital intensive and have a multi-year rate of return cycle time.

The right partner can help with an integrated, orchestrated program which delivers higher business outcomes in shorter timelines. Adopting these changes can take time. While most Middle Eastern banks have set aside budgets and focused efforts across different functional domains, unfortunately, a few home-brewed initiatives have realized sub-optimized outcomes. Typical challenges witnessed include:

- Not fully understanding the real objectives of the program
- Multiple projects teams working on different areas of the customer lifecycle with little synergy
- Siloed, duplicative and inconsistent data repositories which hinder successful integration
- Hesitance to uproot legacy systems
- Processes are not streamlined beforehand resulting in disjointed results

Managed services models will continue to be discussed, especially as countries face the brunt of subsequent waves of the Covid-19 pandemic. The economic pressure on the banking industry will likely mount as credit losses and a slow economic recovery will test resilience. We expect renewed efforts by banks in the Middle East to identify new ways of optimization of their non-core processes and to pivot towards a more digitally led and unified customer engagement process. Choosing the right approach and partner could be a key differentiator for determining who emerges out of the pandemic stronger and prepared for the future.

Varun Bhatia
Partner
Managed Services
KPMG Lower Gulf

How can CFOs reinvent their role in light of digital transformation?

Never has the pressure on banks' chief financial officers been so high for digital transformation. Just as bank's seek to transform their business models to align with the expectations of the market and their customers, chief executives and chief information officeers (CIOs) expect their finance functions to assume greater strategic responsibility, argues Vijay Baines.

Most banks are still in control of their finance functions and of traditional value-protection activities such as the accounting of transactions and financial reporting. Typically, this type of activity (some recurring and routine) can be cost-optimized by the application of digital transformation technology. This can then free up Finance to focus on strategic activities and generate value for the bank as a whole.

Many banks with lower-cost indexes with Finance have been centralizing, standardizing, and externalizing significant components of the function, investing in cloud and end-to-end automation capabilities, and integrating financial and risk/reporting functions. Heightened automation will likely dramatically change the size, structure, and delivery model for Finance. These capabilities can make automatic processes that are typically delegated to shared-service centers; entities with less externalization can reduce the efficiency gap in more mature competitors.

The finance function of the future will likely be the main driver of change in banking as it harnesses digital transformation know-how. There are five main trends we have observed:

1 Big Data – Many banks are struggling with the proliferation of data and have invested heavily in data modeling, data mining, and data scientists. Results have been mixed to date, however: huge returns on investment have yet to be tapped from the integration of machine learning and cognitive computing. Some CFOs have struggled to understand the processes required to build up the data models, and data scientists have found it challenging to realise the promise of Big Data in delivering real value.

2 Hybrid workforce – As remote working has increased during the Covid-19 pandemic, many banks have had to invest heavily in remote working technology and automation, not just within the Finance team, but also throughout the bank. With renewed pressures on costs, many CFOs are looking at new ways of operating using a blend of digital workers, third parties, as well as partners, to deliver value most rapidly in Finance & Operations.

3 Enterprise resource planning – Many banks who had invested heavily in enterprise resource planning (ERP) platforms, have now invested in microservices and intelligent automation (IA) to digitize the final mile of their processes. This proliferation of additional technologies means finance processes are now more automated than ever, and the real value of the digital worker may be realized within Finance.

4 Business demand – The expectations of banking's business units seem to be increasing with many wanting real-time reporting, increased business partnering, and automated budgeting. Several leading banks have automated and digitalized these functions in order to support the business more rapidly, with investments in algorithmic forecasting, as well as chat bots helping answer basic finance queries. This can elevate the CFO to a true partner in the business, and to concentrate on strategic insights and business value.

5 Self Service – Many banking customers can meet their finance needs using self-service toolsets through apps as well as the bank's website. So too the Finance function is increasingly adopting self-service functionality, report production, trend analysis and automated budget queries. This helps to ease the operational burden, and can be met in real time by a combination of automation and data modelling.

That said, any digital transformation of the finance function should bear in mind the following factors:

- The need for the integration of finance and risk functions to leverage efficient management of available and reported information
- The set-up and sponsorship of excellence research centers in the finance function, as a core strategic role within the organization, capable of responding simultaneously to business requirements and risk reporting
- Control over budgeting processes and allocation of costs by line business through automation of functions and activities to support effective strategic decisions
- Speeding-up of innovation and transformation processes of the finance function in all domains (organization, technology and regulation), bypassing potential chronic "immobility" attributed to some financial institutions
- Migration to cloud technologies as baselines structures to support the business digitalization (core systems, extract, transform and load (ETL), data warehouse (DW), modeling, planning and reporting tools)
- The establishment of partnerships with FinTech platforms for outsourcing back-office activities
- The implementation of digital transformation platforms to support process optimization and control (business process management (BPM) and robotic process automation (RPA) platforms supported by artificial intelligence (AI) and machine learning (ML)
- The development of solutions supported by blockchain technology in order to mitigate operational error and increase process efficiency

The financial function of the future will likely evolve over the coming five years, with the focus expected to evolve from "reorganize and originate" to "digitalize to transform". To keep pace with a digital future, the DNA and culture of the CFO (and the entire finance structure) should be reinvented and planned at a strategic level.

Vijay Bains
Director
Finance Transformation
KPMG Lower Gulf

Liquidity management during a pandemic

The banking industry has faced unparalleled challenges over the past twelve months due to Covid-19. Slim Ben Ali describes the seismic impact on financial institutions of volatile market conditions, liquidity pressure, deteriorating credit quality and continuity challenges.

The nature of the coronavirus outbreak is unprecedented in the twenty-first century, and is clearly beyond the realms of any traditional or even stressed business cycle. The crisis raised questions around banks' existing risk management frameworks in terms of their effectiveness and agility.

In the coming years, we believe banks will continue to enhance agility. We can therefore expect regulators to increase their focus on ensuring that banks demonstrate sound and robust risk-management practices, systems and controls to effectively manage the increasing level of risk—particularly credit risk.

Recently, we have seen a surge in non-performing loans (NPLs) for the majority of banks worldwide. Many have booked higher provisions, especially now that they have adopted IFRS 9. The next year will likely be equally challenging and a robust, advanced credit risk-management strategy will be crucial.

Overhauling the credit risk model

Nevertheless, banks should take advantage of the recent macroeconomic environment to perform adjustments to their credit risk models, to increase responsiveness to external factors and improve the accuracy of their market predictions.

In fact, we expect banks will aim to become more proactive to prevent both a surge in credit defaults and the subsequent collapse in the value of collateral. This is a timely opportunity for banks to review their risk function. Among the most successful banks, the risk function of the future will likely assume a more proactive role and be involved in all business decision processes. And, with margins likely continuing to be squeezed and global macroeconomic uncertainty set to continue at least in the short term, the risk function will likely become a key differentiating factor among banks.

Smarter risk management through the life cycle, especially in the early stages of identification and prevention, should be another area of focus. This generally requires not only better analytics, tools and technology to spot risks before they escalate, but also adequate process, preventive controls and the right people.

Liquidity pressure remains yet another challenge, with the increase in savings utilization and deferrals in loan repayment. Ensuring healthy liquidity supply may prove problematic as banks will be required to continue lending at historical levels and supporting the economy, while maintaining adequate liquidity buffers and stable funding.

We predict banks will continue to work to attract new depositors by offering competitive market rates, and/or delivering specific deposit campaigns with incentives. This could be an opportunity for banks to reshape the funding composition towards deposits categories that are less "liquidity consuming".

Navigating the phase-out of LIBOR

The LIBOR transition adds further uncertainty to an already volatile environment, with potential impact on banks' products, models, systems, services, customers and even reputation.

We expect the transition from IBORs to the new risk-free rates (RFRs) to lead to considerable costs and risks for banks if not managed properly. As is common knowledge now, the new proposed alternative rates are significantly different from IBORs and will require changes to risk and valuation models, product design, hedging strategies and systems.

In addition, banks which are using internal models to calculate regulatory capital for their trading book exposure will also need to carefully consider the interaction between the transition and the implementation of the Fundamental Review of the Trading Book (FRTB) as part of Basel IV reform.

A sustainable, digital future

The Basel IV framework, meanwhile, remains relevant: banks are anticipated to remain committed to implementing the new framework despite the change in timelines. On 27 March 2020, the Basel Committee on Banking Supervision (BCBS) announced its deferral of the implementation of Basel IV by one year to 2023 in response to Covid-19. This delay could be an opportunity for the Basel committee to consider emerging issues such as climate risk and other elements of environmental, sustainable and governance (ESG) and see whether these issues should be integrated into the reforms.

Lastly—but equally important, we expect the application of regulatory technology will transform risk management and compliance, presenting significant growth opportunities. We expect banks to actively consider how they can adopt RegTech developments to address areas of concern that have arisen due to Covid-19.

It is clear that successful banks will be the ones that look beyond deploying RegTech solutions as a purely defensive strategy to meet regulatory requirements, and instead use these solutions to drive efficiency, create a better customer experience, and pursue their agendas for growth.

Slim Ben Ali
Director
Financial Risk Management
KPMG Lower Gulf

Restructure or liquidate?

Rising levels of corporate debt globally have taken a toll on virtually every component of the system. Bruce Matthews delves into how banks can balance the needs of stakeholders in the GCC.

The operating challenges of the past few years continue to act as stress factors for businesses. As is the case with most critical situations, effective action initially requires accurate diagnosis of the problem. Assessing the risks and pay-off is a critical next step. Restructuring or liquidation requires deliberation on nuances including the entities, the region, the culture, and the economy: these will differ significantly across instances and can impact the outcome for all parties involved. The insolvency landscape is complex to navigate from a legal perspective, but the basic principles may be kept simple to assess obstacles and help stimulate innovation.

Identifying restructuring approach requires examining the situation from every angle. Two common perspectives in the restructuring industry are the entities' – the lender, and the company. These are often not aligned, and banks and companies need a holistic understanding of the other's perspective to circumvent frustrating complications.

In distressed situations, after determining what the problem is, the next step is to work out which tools can be used to solve it. These tools should add to transparency of the situation, provide clarity of options, and provide viable methodologies to fixing the problem. They include but are not limited to restructuring business reviews, 13-week cash flows, debt restructuring, asset sales, cash optimization, supply chain analysis or people and process re-engineering. Using them at the right time and in the right way is vital to achieving the optimal outcome.

Liquidation is also a means to resolution, but with a more terminal outcome. But liquidation may result in a better outcome than the restructuring option, where the ongoing cost of solving the problem outweighs the value of assets, or where the fundamentals of the operation are flawed. However, it can destroy value quickly. Understanding the problem thoroughly, and considering other variables and obstacles, including the costs of winding down, will help to determine the best course of action.

In financial services sectors in Western economies, hybrid approaches have emerged, including the so-called 'bad bank' or 'distressed credit fund' concepts. These transfer the problem to someone else to solve, with reasons ranging from economies of scale or specialized skills.

Regional norms

What is common practice in one region, in respect of speed and severity of action, bank enforcement, and debtor prevention from enforcement, may not be applicable in another.

This year, the UAE celebrates its 50th anniversary and, like other GCC members, is considered, in global terms, to be relatively young. A younger country may be able to leapfrog antiquated laws of other jurisdictions to better meet the technical sophistication of the times, or the political or cultural norms of the region. A newer jurisdiction may create more flexible laws, adapting the best elements of older regions to modern circumstances.

In Western jurisdictions, it is common to use insolvency legislation, such as court appointed administrators (UK Insolvency Act 1986)[4], scheme of arrangement (UK Companies Act 2006)[5], or Chapter 11 "Reorganization"[6] and Chapter 7 "Liquidation"[7] of the US Bankruptcy code.

Bankruptcy laws in the GCC are considered to be still in their infancy and are not used as frequently. Using them can help organizations find the ways in which they don't work, which leads to innovation.

Commonly available statistics show the benefits of speed in terms of recovery and cost for bankruptcy. Bankruptcy legislature in the Middle East has recently been overhauled, and some jurisdictions are increasingly adopting Western tools, such as the court supervised processes in Dubai International Financial Centre (DIFC), which are similar to the US Bankruptcy code Chapter 11 procedures. The challenge remains for local entities to execute them with optimal speed and recovery.

Additionally, bank lending in the region may face issues such as lender fraud, local underwriting, weak corporate governance and poor information flow, which can affect speed and recovery.

Spotlight on culture

Seeing an opportunity from one's own cultural lens can become opportunistic and ultimately lead organizations to develop methodologies that are incongruent with the cultural norms of the region.

It follows that if one is going to set up a 'bad bank' or 'distressed credit fund', it should be aligned with the cultural context of the region, work with the central bank, link into the processes of regional banks, and create value for that particular jurisdiction, rather than 'leaking' it out of the region. These models can be used to help stabilize the region or otherwise shore up existing gaps and build on regional strengths.

When looking to develop insolvency systems, the entities must make a concerted effort to understand the shareholders' culture, as well as the banking culture.

In other countries, bankers and other stakeholders are usually separate and non-related, so the process becomes depersonalized and legalistic. It enables a more arm's length level of accountability, yet may result in unbalanced approaches. In the Middle East, there tends to be greater interconnectivity, which requires a thorough understanding of the relationships between organizations. The large expatriate population with diverse cultures adds another layer of nuance to navigate.

Considering economic factors

The Middle East has a unique economic history, having experienced meteoric growth over the past decade. Businesses have expanded rapidly, followed by waves of international movement in credit and economic cycles. This has been accompanied by maturing businesses and familial wealth often propping businesses up, sometimes keeping them open even if they do not make "financial sense", as would be defined in the Western world.

The intersection of the pandemic with this unique confluence of factors lends itself to new opportunities to address the gaps in banking, credit and debt. Learning from what has worked and what hasn't will help lead the way forward. Local organizations need to develop organic solutions that are tailor-made to address challenges that are peculiar to this region, the culture and the economy, and may surprise the world with their innovative flair.

The most successful entrepreneurs and companies succeed when they are not fazed by their mistakes, but pivot by learning and growing from them. They find opportunities within challenges that would not have appeared had they not been open to exploring new avenues, and hence, pioneers are born.

Bruce Matthews
Partner
Deal Advisory - Restructuring
KPMG Lower Gulf

Leveraging the cloud for operational resilience

Cloud computing has significantly disrupted enterprises' approach to information technology. Sheikh Shadab Nawaz explains why it is critical that organizations adopt it to drive innovation and increase agility.

With rapid growth in both spending and revenue, the public cloud services market is forecast to be worth more than USD 6 billion by 2024 in the MENA region, as per leading industry reports.[8] Many banks in the Middle East are turning to cloud computing to achieve greater scalability, accelerate product development, and reduce cost. Most hyper-scale cloud service providers (CSP) have either established their data centers in the region already or are in the process of establishing them.

Microsoft Azure and Oracle both have data centers in the UAE, while Amazon Web Services has established data centers in Bahrain with an Edge and Direct Connect location in the UAE. Regional examples include Alibaba, which has signed a memorandum of understanding (MoU) with Zain Telecommunications to provide Alibaba cloud services in Saudi Arabia. Meanwhile, Google is in the process of launching its Middle East data center in Qatar. There is also a slew of local cloud providers who have launched their cloud services in the region.

Today's cloud is much richer and more nuanced than it was at its inception over ten years ago. Cloud consumers now have more native options, stronger security and privacy tools, and improved measures for detecting, responding to and preventing security breaches. As regulations and knowledge surrounding the cloud continue to be enhanced, these advances have increased customer confidence and eased the burden for IT functions.

By migrating to cloud, financial services firms can leverage solutions that are inherently better suited to manage six key operational risks: cyber security, digital sovereignty, the remote workforce and customers, third party, technology, and facility.

A robust cyber security framework

The technical infrastructure of CSPs is designed to safeguard the entire information processing lifecycle with secure infrastructure, services, data and internet connections.

Secure infrastructure

- Stringent supply chain vetting as part of their hardware and software acquisition process
- Secure hardware design
- Enhanced operating system for server and network equipment

Secure services

- Zero trust between services
- Certificate-based identification procedures for each service
- Inter-service communication restrictions through strict access management

Secure data

- Customer managed keys
- Customer owned keys
- External key manager

Secure internet communications

- Private IP space for internal workloads
- Transport layer security (TLS) based communication with internet facing workloads
- Multi-tier, multi-layer disk operating system (DoS) protection

Digital sovereignty

Digital sovereignty includes three distinct pillars: data sovereignty, operational sovereignty, and software sovereignty. CSPs should provide adequate control over who can access customer data and who can manage the infrastructure (from service provider) that hosts customer data, and have the ability to run the services across different clouds, avoiding lock-in or concentration risk.

Data sovereignty

- Customers can store and manage encryption keys outside the cloud
- The customer has the authority to grant access to these keys based on detailed access justifications

Operational sovereignty

- Customers can restrict the deployment of new resources to specific provider regions
- Customers can limit service provider personnel access based on predefined attributes such as citizenship or geographic location

Software sovereignty

- Customers can make use of open-source technologies provided by CSPs to build a multi-cloud approach and enhance portability
- Customers can utilize technologies that support the deployment of applications across multiple clouds using orchestration tooling

The remote workforce and customers

The pandemic has changed the way organizations will employ staff and service customers. We are likely to increasingly see a decoupling of employees and customers from geographical restrictions. This introduces several operational challenges, such as the need to work remotely and provide online services to customers, which in turn can increase operational risk. The cloud provides a number of potential solutions.

Zero trust approach

- CSPs should employ a zero trust-based approach to enable remote access for employees without traditional VPNs

Built-in collaboration tools

- Best-in-class remote collaboration tools to enhance productivity of a remote and distributed workforce

Faster customer service

- CSPs can enable organizations to deploy AI/machine learning based solutions to address customer queries rapidly

High elasticity

- CSPs can provide additional resources e.g. analytics on the fly, to meet significant traffic spikes for high workloads

Managing third parties

Third party risk is a significant component of a firm's overall operational resilience position. CSPs can provide transparency via various mechanisms including audit and assurance, exit plans, and support for portability.

Audit and assurance

CSPs allow onsite audits and can provide necessary assurance through a third party compliance certification process

Exit plan

CSPs can support multi-cloud strategies as financial services organizations move their critical workloads to the cloud.

Portability

CSPs may support multi-cloud approaches through open-source technologies that can provide customers with adequate levels of portability. However, it is advisable that financial services organizations explore cloud native services where possible to fully leverage CSPs' managed services, only limiting their use where it will impact their exit plans.

A metamorphic approach to technology risk

Traditionally, financial services organization have implemented technological systems where front offices operate asynchronously with back offices. Most of these technologies are self-managed and on-premise. However, customers now expect real time omni-channel presence at any time. This requires a complete overhaul of technological systems. This can be a prohibitively costly and unattainable strategy which is prone to failure if organizations were to follow traditional models of on-premise IT. By migrating to the cloud, financial services organizations can ensure that their technology arms are focused on delivering high-quality applications and experiences to customers, and not on operating underlying infrastructures.

Managed infrastructure

Financial services organization would be well advised to focus on delivering impactful products and an enhanced customer experience, rather than focusing on underlying infrastructure e.g. data centers, physical servers, and network equipment.

Microservices deployment

Most CSPs support microservices architecture that can reduce the technical debt associated with maintaining unsupported hardware and operating systems. CSPs can also provide different orchestration engines to manage the deployment and maintenance of microservices on a continuous basis.

Rethinking the facility

CSPs build and maintain highly secure and resilient data centers with multiple layers of physical security and geographical spread. By migrating to the cloud, financial services organizations can get rid of the technology debt of costly data centers whose value depreciates; the associated operational costs of maintaining such facilities also increases over time.

Multi-geographical spread

CSPs may operate data centers across multiple regions and geographies, providing a level of protection against localized natural or man-made events e.g. natural calamities, riots, and attacks.

24/7 support

CSPs may have globally distributed support functions that can provide 24/7 support to financial services organizations in adverse situations.

Reduced disaster recovery (DR) costs

CSPs can help reduce costs of maintaining the costly and mostly idle infrastructure of DR sites. Financial services organizations may take advantage of the inherently resilient network of CSPs' data centers.

Operational resilience remains critical to financial services organizations, their customers and regulators. The cloud is a key capability that financial services organization would be well advised to adopt—and indeed it has already been adopted by many—to maintain product and service excellence in the highly competitive Middle Eastern market.

Sheikh Shadab Nawaz
Director
Digital & Innovation
KPMG Lower Gulf

Reimagining the employee journey and HR agenda

The new ways of conducting business inevitably create a knowledge gap that must be bridged. Marketa Simkova makes the case for why the adoption of innovative business models should be accompanied by a focused people strategy for organizations to thrive.

The global economy is witnessing profound change as digital platforms and technologies recast the relationships between customers, employees and employers.[9] Digital transformation has become an integral feature for banks. Banks in the UAE have responded by remolding themselves and accelerating the adoption of digital technology. In the future, the banks will likely continue to focus on AI and robotic process automation (RPA), leading to minimal human intervention.

In front-office functions, banks are leveraging AI algorithms to enhance customer experience and deepen partnerships with internal and external stakeholders through chatbots and voice assistants to provide personalized insights and recommendations. Various AI strategies across banks' business lines are being implemented within middle-office functions to assess risks, detect and prevent payments fraud, improve processes for anti-money laundering (AML), and perform know-your-customer (KYC) regulatory checks.[10] Back-office operations may benefit the most from process automation, in areas such as transaction processing, wire transfers and account openings.

The transformative impact of automation

"The changes in the customer journey consequently impact the employee journey," *says Eman Abdulrazzaq, Group Chief Human Resources Officer, Emirates NBD.*

"As the traditional bricks-and-mortar branch banking model is replaced by FinTech and online banking, job roles and key skill requirements in banks have also changed. Employees are likely to focus more on value-adding tasks like capitalizing on data sciences and improving algorithms, leaving potentially monotonous and tedious operational tasks to be implemented by bots."

Internally, the employee experience offered by HR is set to undergo radical change. In the future, banks are projected to accelerate their reliance on RPA technologies to conduct HR functions such as onboarding, talent acquisition, compensation and benefits among others.[11] RPA will likely take over tasks such as gathering employee documents and making new employee records, as well as autonomous updating of payroll inputs. Instead of spending hours on filing paperwork, HR employees may be able to engage in the more satisfying aspects of their jobs. We have also observed banks increasingly investing in workforce analytics. These changes can pave the way to a more interactive job domain for HR individuals where the function can be more "strategic", and contribute positively towards the organization's goals, leading to great job satisfaction amongst employees.[12]

Investing in people

Yet with opportunities, come challenges. To successfully transition into a desired future state, it is not enough to have a bold vision and an impressive budget. The UAE banking sector is embarking on an exciting journey of innovation and transformation, though this must be a combined with a focus on upskilling and reskilling employees, as well as drawing in new talent to bridge the knowledge gap. This challenge is not unique to the UAE banking industry, but a global phenomenon, with banking CEOs around the world identifying talent shortage as one of the main threats to their growth prospects.[13]

To address this challenge, banks around the world are investing in talent development initiatives to focus on the upskilling and reskilling of their employees. For example, Canada's BMO bank has approached the reskilling of its employees as a journey, rather than an event. BMO provides employees with ongoing training, with several flexible and informal learning options.[14] These development initiatives have helped the bank stay competitive despite the pandemic.

Locally, increasing the percentage of Emirati talent in the banking sector is a key component of the national strategy and an ongoing aim for banks. However, as banks shift away from serving customers face to face and expand their online platforms, the types of roles available for Emiratis have also changed. Adequate focus on building analytical skills will be necessary as data mining continues to remain important. This will probably require partnerships between banking players, regulatory bodies and academia, to ensure that Emirati fresh graduates are well equipped to address the changing needs of the banking sector.

Does digitalization pose a threat?

Another concern that inevitably comes to mind is the fear of job losses due to AI and other technologies. While CEOs might view automation as a vehicle to reduce time and increase efficiency, employees may view AI-related initiatives as threatening. Such concerns are generally not without merit.

A study by Citibank revealed that "30% of bank jobs could be lost between 2015 and 2025, mainly due to retail banking automation."[15] Industry experts expect this trend to keep growing in the future with lay-offs happening at a significant scale, as AI replaces the tasks of employees. However, digital transformation in the banking sector need not be disruptive to an employee's job security, nor hamper their drive to perform. If left unattended, these concerns can create an environment of uncertainty for existing employees, fueling fear and resistance which can harm the bottom line, break trust and hamper innovation efforts.

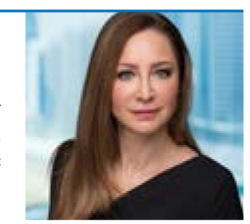
If managed well, employers can promote digitalization and obtain buy-in from employees. It is crucial for banks to proactively develop a clear 'case for change,' articulate why the change is happening, how it will impact those involved and how it will benefit them. A well-crafted change policy, including communication and stakeholder engagement strategies, can be a powerful tool to create alignment between business objectives and employees' passions, and enhance transparency. Putting together a sound change-management plan is essential to a successful transition to new ways of working with minimal disruption.

Developing a roadmap for change

An effective change strategy can mitigate risk such as loss of talent, widespread panic, low morale and toxic rumors. For example, employees whose roles are becoming redundant can be provided with a development plan to support an effective transition to other roles and opportunities. In other instances, technology may translate to an adjustment of specific tasks an employee is undertaking. A re-training program can communicate to employees how automation can support them in attending to a wider array of customers than they could otherwise cater to.

Digital transformation unlocks an array of opportunities for the banking industry as traditional relationships between consumers, financial institutions and employees continue to be redefined. To capitalize on the opportunities of tomorrow, it is crucial for banking institutions to have a clear and well thought-out strategy to engage existing employees through effective communication, training and upskilling, while concurrently attracting diverse talent to support their vision.

Marketa Simkova
Partner
People & Change
KPMG Lower Gulf



03

GOVERNING and regulating

Tax compliance in the age of a surfeit of data

Complying with new tax rules is requiring banks to disclose larger volumes of financial and non-financial data. David Fernley delineates key developments driving this change in recent years.

The tax environment that banks operate in continues to evolve as the OECD's Base Erosion and Profit Shifting (BEPS) initiative, global corporate tax reform driven by the G20 countries, is implemented.

In the UAE and the GCC, new tax rules are frequently being introduced due to BEPS requirements and pressures on countries' budgets. There is also greater public scrutiny of the tax affairs of multinationals, with the function increasingly being considered as a key component of ESG.

The combination of these factors means there has been a step change in the approach taken by banks across the globe to tax, shifting from a focus on optimization, to an emphasis on compliance and risk management.

A key component of tax compliance and risk management is getting the right data to the bank's tax function. Compliance with new tax regimes requires data from a broad range of sources, not merely the traditional management accounting or transaction data that is relied upon for corporate tax and VAT. Most of these new regimes are referred to collectively as "tax transparency" as they involve sharing of data with foreign governments. Below, we discuss examples of these regimes and the risks they result in.

FATCA/CRS – Automatic Exchange of Information (AEOI) regimes

UAE banks have been required to comply with the US Foreign Account Tax Compliance Act (FATCA) and the OECD's Common Reporting Standard for a number of years. These regimes broadly require banks to report on their foreign tax resident customers to their regulator. This information is then shared with foreign tax authorities globally.

The customer data that is reported is extremely sensitive in nature; it covers major personal details of the customers as well as their account balance with the bank. Aside from the obvious data protection concerns, any data inaccuracy could result in a bank's customer being audited by foreign tax authorities. The OECD expects governments to audit banks' compliance with AEOI. Misreporting could be seen as an audit-related compliance failing by the regulator, and there may be fines associated with this.

Economic Substance Regulations (ESR)

ESR was introduced in 2019 and affects all UAE entities. Entities that perform "relevant activities", one of which is banking, are required to file an economic substance notification and file a report on the Ministry of Finance portal on an annual basis. The report is subject to review and audit by the Central Bank and/or the FTA. To produce the report, data is required on the entity's employees, premises, management, and costs, besides the need to conduct operations and maintain documentation to prove compliance with the substance tests (e.g. the requirement to have in the UAE core-income generating activities, direction and management, as well as adequate employee count, operating expenses and physical assets).

As of 2020, companies based in the UAE mainland and commercial free zones are required to file registers of their ultimate beneficial owners (UBO) and shareholders with the relevant registrar and licensing authorities. This information may be shared with foreign governments on request as part of international cooperation measures. Similar information is required to be filed under ESR.

Country by Country Reporting (CbCR)

Many UAE-headquartered banks are now subject to CbCR rules as they have an international footprint and consolidated revenues equal to or exceeding AED 3.15 billion.

CbCR requires UAE banks to report a significant amount of information to the UAE MOF including: revenues, profits/losses before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than non-cash or cash-equivalent assets). Similar to the other regimes, this information is then shared with foreign governments.

Unlike CRS and ESR data requirements, CbCR data is holistic and typically consolidated, making interpretation difficult. Where context is limited, it can potentially result in further questions being raised. Given the OECD's 2020 CbCR peer review, further changes to CbCR are expected for FY21. Whilst the details are yet to be announced, the direction of travel on CbCR transparency is clear with further information (e.g. group royalty payments, withholding taxes etc.) most likely to be added to CbCR requirements in the future.

The preparation of CbCR data should take into consideration how it aligns to other information prepared and submitted to fiscal authorities. A holistic risk assessment should be performed to ensure any areas of uncertainty can be quickly and efficiently explained should an audit be initiated. This may be easier where tax authorities have other transfer pricing documentation to hand, for instance a group's master file or local file. However, where the CbCR data is publicly leaked, this becomes more challenging.

VAT

Due to a streamlining of the UAE VAT rules in 2020, banks now need to have a higher degree of visibility on knowledge of their non-resident clients to apply zero rating of fees and charges. These rules are now much more restrictive and require the bank to understand the purpose, nature and duration of any presence a client might have in the UAE. As digital banking strategies are rolled out, compliance with VAT is likely to require greater attention to detail.

Oversight and control of a global workforce

From a tax, legal and regulatory perspective, banks need to have readily available data on where their employees and officers are undertaking their day-to-day activities. In the absence of robust oversight and controls around remote working, the bank as well as its employees and officers could be exposed to foreign taxes. The risks have become magnified due to Covid-19 related travel disruption and remote working.

Considerations for UAE banks

To practically manage tax risks, banks in the UAE should integrate tax reporting into their finance and tax governance frameworks, and assign roles and responsibilities internally to ensure that the data being released is consistent and has been considered from all stakeholders' perspectives—including that of the board, employees, NGOs and the general public. Such processes should be flexible enough to adapt reporting strategies to the evolving UAE tax landscape given the likelihood of a global minimum tax rate being introduced by the OECD in 2022, likely to have a significant impact on UAE banks.

It is important to note that such responsibilities in foreign banks are often assumed by the (typically sizeable) tax team. Given such tax teams are less prevalent in the UAE, consideration as to who in the organization leads such efforts (and/or whether additional tax resource is required) is vital to avoid the additional burden that may potentially be placed on existing finance teams. Such a proactive and "helicopter" approach is often fundamental in meeting the board's agenda in efficiently preparing for change, addressing future challenges and ultimately managing reputational risk.

The tax department's role in an organization cannot be relegated to the sidelines: it has become more complex and intricate than ever. Sharing of information between various authorities is now commonplace, making accurate reporting essential. The function's footprint will need to be across the bank's business lines, and will need data from multiple sources besides finance to ensure compliance with a rapidly evolving regulatory landscape.

"Getting the right financial data has always been crucial for tax compliance. With new tax regulations being implemented, our tax function now has to work with stakeholders across the entire business to get the right data, remain compliant and manage tax risk.

Nick Giannopoulous, Head of Tax, ADCB

David Fernley
Director
Tax
KPMG Lower Gulf

The role of stringent regulatory compliance

A failure to develop and factor in regulatory expectations is a significant threat to an organization's ability to meet strategic objectives. Maryam Zaman explains why unforeseen changes to laws and regulations may derail otherwise well thought out plans.

Regulatory risk has been a major concern for financial institutions over the past few years. The global and local regulatory environment continues to become more complex, and a closer look at the results of the KPMG 2020 Global CEO Outlook[16] survey in the banking sector indicate why regulatory risk will remain a top concern for some time to come.

The banking sector's appetite for growth remains strong, with 99 percent of survey respondents stating they intend to grow their banks geographically over the next three years. Respondents also recognized that the complexity of regulatory risk increases as banks grow and become exposed to multiple regulatory environments. As a result, they also identified regulatory risk as a threat to their organizational growth plans. A further complication is the increasing pace of change within each regulatory environment. An understanding of the current regulatory landscape is no longer enough. Instead, banks must form expectations on the regulatory trajectory and factor these expectations into expansion plans.

In the UAE, the regulatory landscape is rapidly evolving. Over the last two years alone, local authorities have issued or revised many regulations to strengthen the banking sector, ensure financial stability, and reinforce a new round of economic growth. New banking regulations include those issued by the UAE Central Bank, such as the Governance, Consumer Protection and Risk Management regulations. The Federal Government has also been active, recently publishing an updated Banking Law, Anti-Money Laundering (AML) Law, and Companies Law. These are in addition to the many other regulations issued by the Securities and Commodities Authority (SCA), Abu Dhabi Accountability Authority (ADAA), and the Tax Authority over the same period.

Building robust compliance frameworks

To succeed in an environment characterized by continual change, banks must adopt compliance frameworks that are mature and flexible. Existing frameworks can be a good starting point. A well-established example is Compliance Management Systems (ISO 19600:2014). Banks may even opt to develop their own frameworks; however, they should ensure that key elements, such as compliance risk assessments, policies and procedures, training and communications, whistleblowing and investigation, monitoring, testing, and reporting are included in their framework. In all cases, the selected compliance framework should be tailored to the bank's circumstances, strategic objectives, and growth plans. If this framework alignment is sufficiently detailed, compliance costs need not rise as the bank grows and regulations change.

Emerging market regulators, such as those in the UAE, are playing catch-up to their developed market counterparts or industry-leading practices as they seek to facilitate greater integration with the global financial system and attract foreign investment. For example, the UAE Central Bank recently issued a Consumer Protection regulation[17] covering market and business conduct, disclosure and transparency, advertising, and sales, as well as data privacy and complaint management. Similar regulations have been in force in developed markets for over a decade. This catch-up pattern allows banks to proactively anticipate regulatory changes by benchmarking current local regulations against those in developed markets. Important insights into upcoming regulatory developments may be gained in this manner, particularly in areas relating to environmental protection, cybersecurity, data-privacy, and risk-based compensation. Of course, local economic and market conditions must be considered while performing such benchmarking analysis.

The compliance function itself has not escaped the attention of regulators. Several new banking regulations have introduced minimum standards aimed at ensuring the effectiveness of compliance functions. The UAE Central Bank's Corporate Governance Regulation, issued in July 2019, requires banks to establish an independent Compliance function that, while primarily reports the CEO, must have direct access to the board or a relevant board committee (e.g., board audit or risk committee). The 2018 Regulation on Internal Control, Compliance, and Internal Audit, also issued by the UAE Central Bank, requires the establishment of a board-approved compliance policy, quarterly compliance risk reporting to senior management and the board, an annual compliance function performance review by a board committee, as well as an independent external quality assurance review of the compliance function at least once every five years.

Formulating an action plan

Because new regulations often necessitate changes to multiple business processes, when a new regulation is issued, banks should follow the following steps:

- Update the bank's regulatory repository
- Communicate changes to the relevant stakeholders (e.g. process owners, senior management, the board, board compliance committee)
- Conduct an impact assessment of the new regulations
- Review policies and procedures across the bank impacted by the new regulation and assess whether any updates are required therein
- Identify, document and implement controls to ensure compliance with the new regulations
- Design appropriate compliance testing techniques and adjust compliance monitoring plans
- Conduct employee trainings on the new regulations, the revised bank's processes and their roles and responsibilities to ensure compliance.

Technology to the forefront

IT tools should be carefully considered when designing a compliance framework. They can help compliance functions implement complicated tasks more efficiently by supporting the maintenance and functioning of regulatory repositories, compliance checklists, and compliance monitoring plans. They can be leveraged for the automation of compliance self-assessments, provision of real-time compliance calendars, and implementation of bank-wide dashboards diagnosing the overall compliance health of the organization.

Given the pace of change and global development, coupled with the UAE's drive to develop its legislative and legal framework to ensure compliance with international standards, we can expect further regulatory developments. It is vital for compliance professionals to keep themselves up to date with ever-changing legislation and regulatory guidance. The deluge of new and expanded regulations is also a signal to banks in the UAE to start the process of re-designing compliance frameworks and re-thinking the way the compliance function operates, and its place within the organization. Failure to do so may lead to an exponential increase in compliance costs that can potentially reduce opportunities for growth.

Maryam Zaman
Partner
Internal Audit, Risk and Compliance Services
KPMG Lower Gulf

A gamut of sweeping changes: the transformative impact of ICOFR

The Sarbanes–Oxley Act introduced extensive requirements for internal controls over financial reporting (ICOFR). Supriya Kubal outlines its relevance to the UAE.

The Sarbanes–Oxley Act of 2002 (SOX) was the United States' response to a string of accounting scandals that characterized the years before and after the turn of the millennium. Among other developments, SOX introduced a plethora of requirements for internal controls over financial reporting (ICOFR) and financial disclosures, and mandated both audits and reports on those controls.

Similar regulation in the UK, detailed within the Corporate Governance Code, places the responsibility for establishing and monitoring ICOFR systems with the board. The board is also responsible for conducting an annual review of ICOFR systems, the results of which must be included in the bank's annual report.

Some Middle-Eastern regulators have also issued ICOFR-related regulations. For example, all Islamic banks in Kuwait are obliged to submit to the Central Bank annual reports on the extent and adequacy of their internal control systems, including those related to financial reporting. Such reports must be prepared by international audit firms approved by the Kuwaiti Central Bank.

Local developments

Regulators in the UAE recently enacted several new laws and regulations of a similar nature. The Central Bank's Internal Controls, Compliance, and Internal Audit regulation of 2018 states that the board and senior management of banks are responsible for implementing an adequate internal control framework that identifies, measures, monitors, and controls all risks. Specifically required (Article 2 section 2) are ICOFR systems that deal with "accounting and financial reporting policies and procedures". Unlike their US and UK counterparts, however, local banking regulators do not mandate periodic reviews on the effectiveness of ICOFR systems.

Keen observers will note that there is a local trend toward stricter requirements around ICOFR systems. The Abu Dhabi Accountability Authority (ADAA) issued a law this year stating that it will examine the ICOFR systems of all entities under its oversight. The recent Insurance Authority (IA) Circular 21 of 2019 also requires external auditors to understand and issue an opinion on the operational effectiveness of "internal controls relevant to the audit." It is therefore reasonable to expect similar ICOFR regulations to be issued by the Central Bank of UAE in the not too distant future.

Zeroing in on high-risk areas

A robust ICOFR system is one that provides stakeholders with reasonable assurance that material misstatements in financial statements are either prevented outright or detected and promptly corrected. It also should ensure unauthorized acquisition, use, or disposition of assets that could have a material effect on financial statements is prevented or detected in a timely manner. The latter point means that ICOFR systems cannot be restricted to the finance and accounting departments. Financial reporting teams depend on the quality of data reported by employees across the organization. ICOFR systems must therefore address risks throughout the bank by encompassing controls at the entity, core revenue-generating processes, and support function levels. Integrated internal control frameworks, such as the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework adopted by many organizations, can help address this issue.

As a first step, banking boards and senior managers should assess existing ICOFR systems to identify the most high-risk areas. A common and critical area of weakness is ICOFR systems governance, where it is often unclear who owns the overall program, who designs, performs, and tests the controls. It can also be useful to define an ICOFR systems strategy that will reduce financial reporting risks without increasing costs by identifying the most critical areas. A robust and effective risk-assessment process will help establish and support the ICOFR strategy, control selection, and testing design. Banks can then focus both their control performance and testing efforts on the most critical areas.

Adapting to the times

Banks should also consider their ICOFR strategies when drafting Business Continuity Plans (BCPs). Management override of controls tends to increase during periods of crisis and uncertainty. For example, the Covid-19 induced social distancing rules and work-from-home arrangements have weakened controls related to supervisory review and document security. Although it may be justified during the initial crisis response phase, continued suspension of ICFOR systems in the long or even medium-term increases the risk of unintentionally creating environments conducive to errors or fraud. Covid-19 has also presented banks with accounting challenges that require an increased level of judgement on the part of senior managers, such as the computation of expected credit losses and identifying significant increases in credit risk.

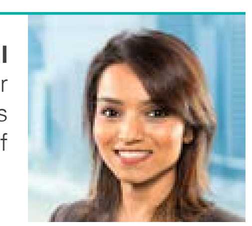
The local and regional financial services industry is maturing. Regulators will almost certainly place more emphasis on transparency and increase ICOFR requirements. When implemented incorrectly, ICOFR systems can increase costs dramatically without significantly reducing financial reporting risks. On the other hand, well-designed ICOFR systems based on a thorough assessment of all critical areas of a bank can lead to significant reductions in financial, regulatory, and reputational risk, all with minimal increases in costs and disruption to daily operations.

That said, in many cases, it comes down to corporate culture.

"Although the three-lines-of-defense concept had been around for a long time, the real understanding of 'businesses themselves, not the control functions or Internal Audit, are the party with the main responsibility for identifying risks and implementing controls' came with the Sarbanes-Oxley Act in 2002," says Volkan Pekince, Group Chief Internal Auditor, Dubai Islamic Bank.

"However, the maturity on this still differs amongst organizations. The most successful are the ones with fully embedded risk management culture in daily operations at every seniority level, not the ones expecting that Internal Audit will capture all our problems"

Supriya Kubal
Director
Financial Services
KPMG Lower Gulf



Unlocking the value of external audit

Some commentators have recently been asking what the value of an audit is. Luke Ellyard and Mohammad Zamani outline the areas where it can add considerable value to the interests of all stakeholders, and the action that can be taken to facilitate this.

Too often, the audit is seen as a "tick-box exercise" rather than as a critical pillar in a bank's governance structure. Nowhere is a strong and effective corporate governance framework more important than in the banking sector. In the UAE, significant steps have been taken already, with regulations recently introduced on enhancing the corporate governance framework within banks to move towards international leading practice. However, less widely covered is the auditors' role in the overall corporate governance framework, and particularly the role external auditors play in supporting the aims of the Audit Committee (AC).

Encouraging robust dialogue

After the global financial crisis, the Institute of Chartered Accountants in England and Wales (ICAEW) presented several recommendations on how the audit process might evolve to promote confidence in the banking system. A key finding was that the relationship between auditors and ACs plays a critical role in good governance.

In the follow-up report, Enhancing the Dialogue between Bank Auditors and Audit Committees a working group of audit firms and banks made a number of observations on how to make the relationships work well, some of which have been implemented in the UAE.

The report stressed the need to strike the appropriate balance between cooperation and challenge. Whilst there is not always the need for extensive debate on judgments, engagement on these critical areas are sometimes lacking in ACs.

One of the topics most discussed with the external auditor in the AC is what we consider to be the range of provisioning judgements. It is vital the AC understands where management have positioned themselves on the auditors' views of the range of acceptable and possible outcomes. There are, however, several areas of judgement that can also be debated throughout the audit cycle, rather than at the end of the year. The ICAEW suggests "if those discussions result in a changed approach, there is time to implement the change in an orderly manner".

Attendance at audit and risk committee meetings

The discussion of the audit should not be considered as merely an 'agenda item' for the AC at quarter and year ends, but as an opportunity for the external auditor to provide independent insight on matters discussed in the AC meeting. In addition, audit teams typically have significant experience across a large number of different banks; extracting and taking full advantage of that experience can provide independent insight, contributing to an enhanced audit experience.

Good practice, as recommended by the ICAEW report, is that the audit partner attends the full meetings of the Audit and Risk committees. Our experience indicates it is clearly advantageous to ensure timely involvement of the auditors in understanding the background of critical matters, rather than reviewing minutes months later.

The ICAEW report recommends that where there are separate audit and risk committees, the auditor also attend the risk committee where "sharing risk assessments could assist both the auditor and risk committee in performing their roles".

Increasing auditor engagement

In recent years there has been commendable progress in the areas of direct engagement throughout the audit cycle and reviews of the audit files by some of the UAE's regulators. The DFSA has been recognized by the Independent Audit Regulators (IFIAR) as a leader of the Emerging Regulators Group (ERG) for four years, and it has worked with the World Bank to disseminate knowledge to new and potential audit regulators.

We would encourage more frequent bilateral, i.e. between regulator and auditor, and trilateral meetings, including the bank, to collectively create a better understanding of the audit approach taken and the work done.

Unleashing the power of data

Increasing use of Data & Analytics (D&A) is often the key to unlocking the rich information stores that businesses hold. For audits, this means D&A is providing better insight into an organization's controls and risks and enables the auditor to further challenge assumptions and conclusions.

As banks in the UAE are investing significantly in technology, the quality and depth of 'data pools' are enhanced. The value of data analytics and forecasting can be vast, but only if this data is made available timely, without significant undue effort, to the auditors who have also heavily invested in resources with data analytical capabilities.

Examples of where technology has been used effectively include revaluing 100% of derivatives portfolios using special platforms, and using analytics and machine-learning technology to identify unusual trends and outliers in 100% of journal entries and loan portfolios. By obtaining this deeper understanding of data populations and focusing on higher risk transactions, audit quality can be enhanced.

The audit profession is continually improving, evolving and reacting to audit regulator challenges. However, in order to unlock the value of external audit for stakeholders, there should be collective responsibility to ensure auditors work jointly with the audit committee and regulators. The ultimate objective is the same: to contribute to the quality of financial statements that provide a 'true and fair view'.

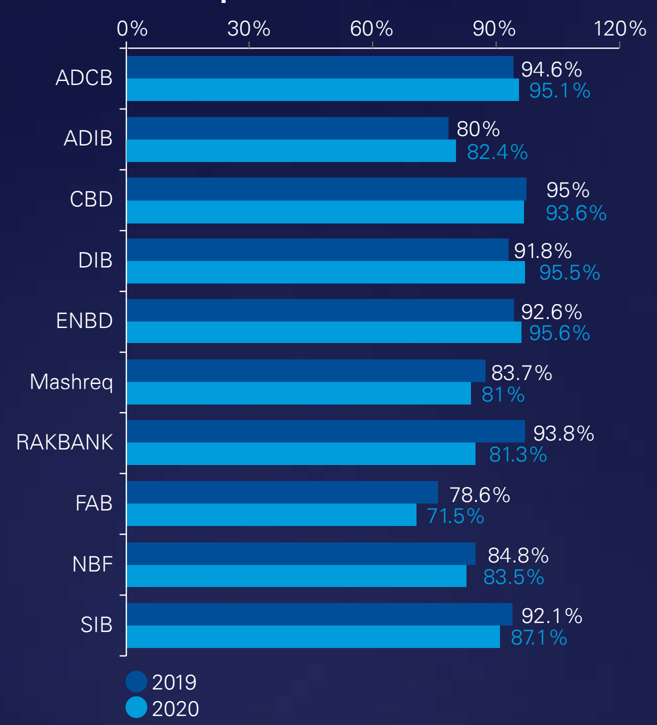
It is an exciting phase in the development of audit — the potential for auditors to add greater and deeper value, to clients and wider stakeholders in the capital markets, is significant.

Luke Ellyard
Partner
Financial Services
KPMG Lower Gulf

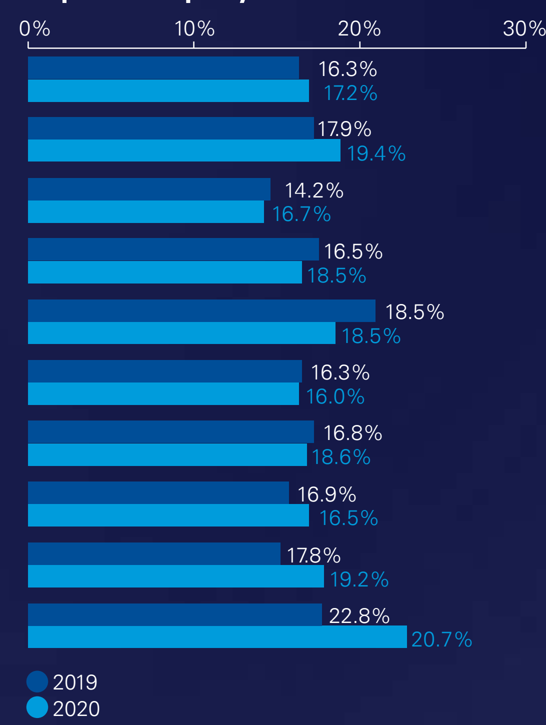
Mohammad Zamani
Director
Financial Services
KPMG Lower Gulf

Key banking indicators

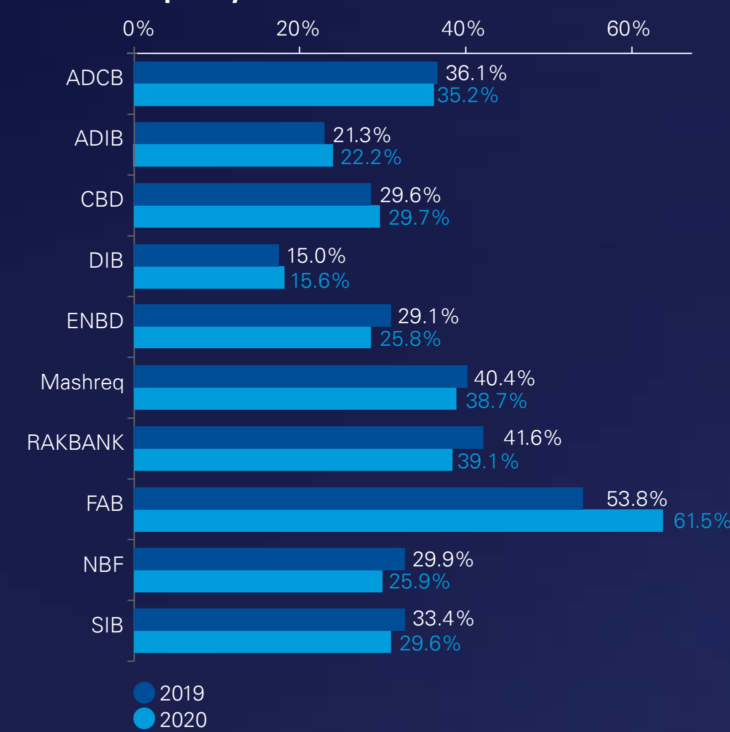
Loan Deposit Ratio



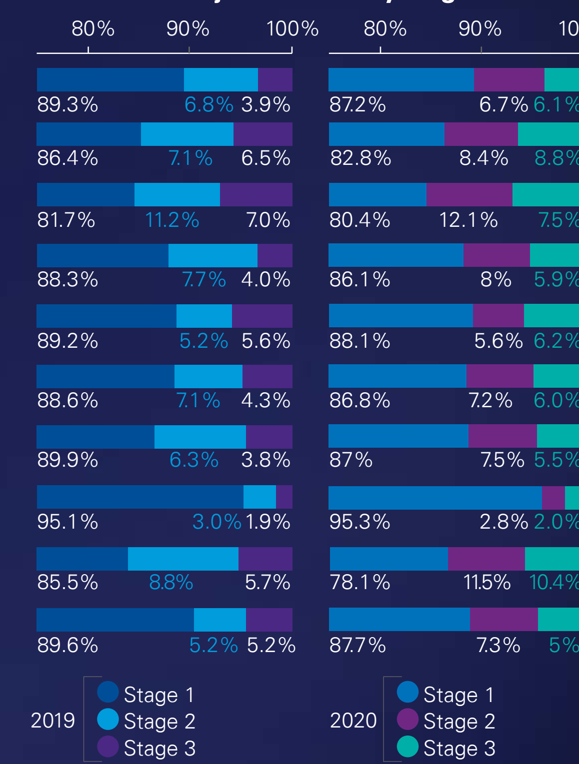
Capital Adequacy Ratio



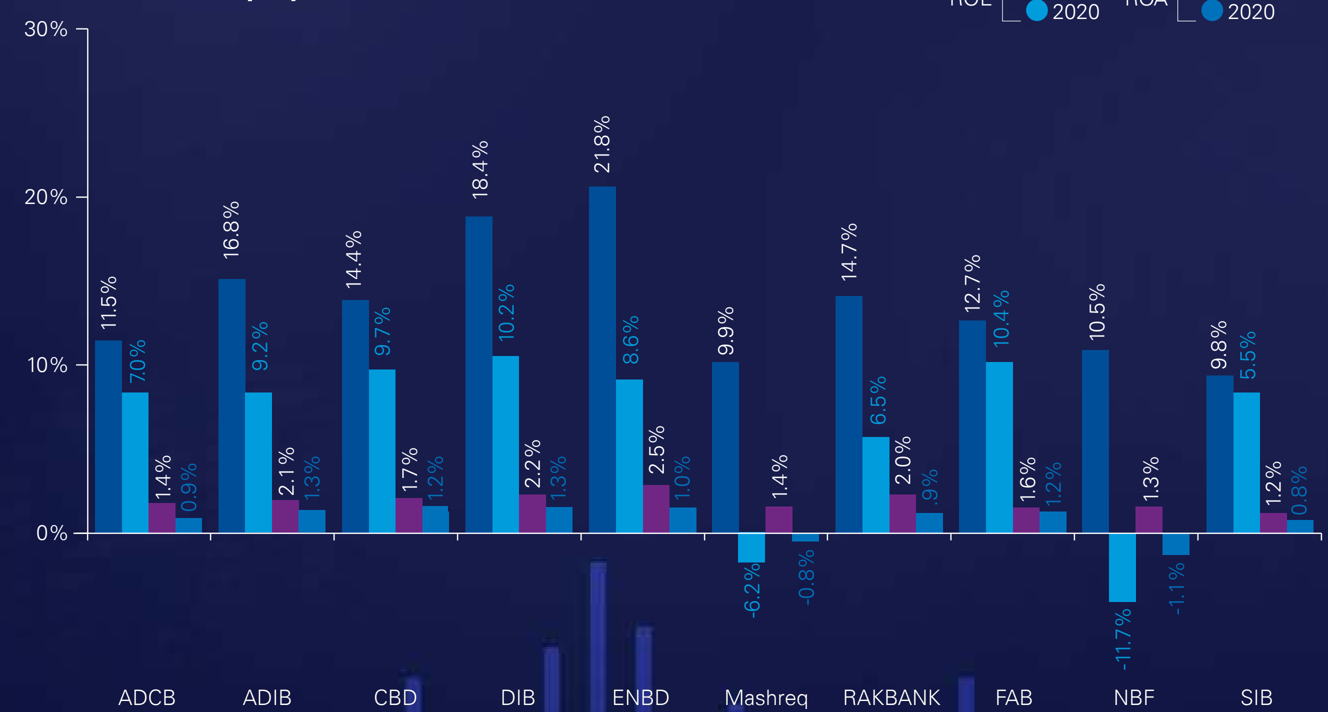
Liquidity ratio



Total loans subject to ECL - By stages



Return on Equity/ Return on Assets



Glossary

Loan Deposit Ratio (LDR) is calculated as loans and advances to customers (or financing assets in case of Islamic Banks) divided by customer deposits (including unrestricted investment accounts in case of Islamic Banks).

Capital Adequacy Ratio (CAR) is calculated as total eligible capital divided by total risk weighted assets.

Return on Assets (ROA) is calculated as net profit attributable to the equity holders divided by average assets.

Return on Equity (ROE) is calculated as net profit attributable to the equity holders divided by average equity.

Liquidity Ratio is calculated as assets (which include cash and cash equivalents, investments, placements) divided by liabilities (which include deposits, borrowing and other borrowed funds including sukuks).

Coverage Ratio is calculated as provisions (including interest in suspense) for the respective stages as a percentage of relevant exposure.

Abu Dhabi Commercial Bank - ADCB

Abu Dhabi Islamic Bank - ADIB

Commercial Bank of Dubai - CBD

Dubai Islamic Bank - DIB

Emirates NBD - ENBD

Mashreq Bank - Mashreq

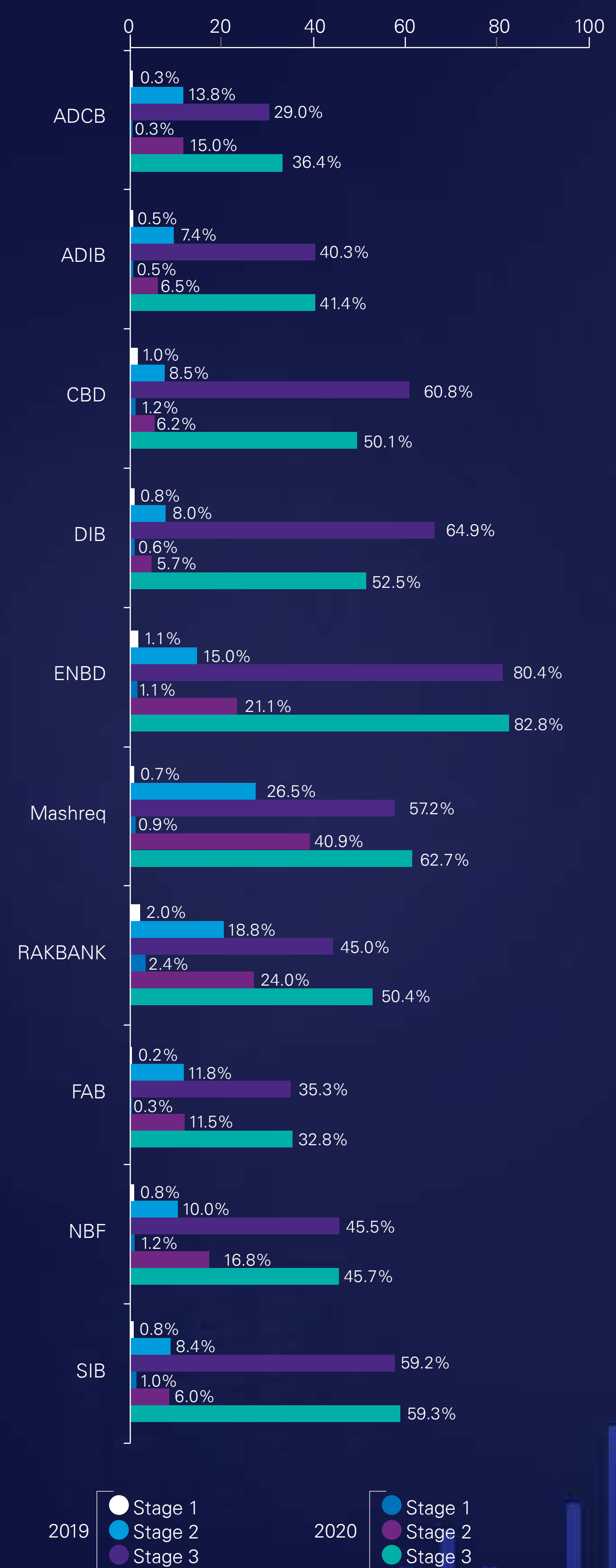
RAK Bank - RAKBANK

First Abu Dhabi Bank - FAB

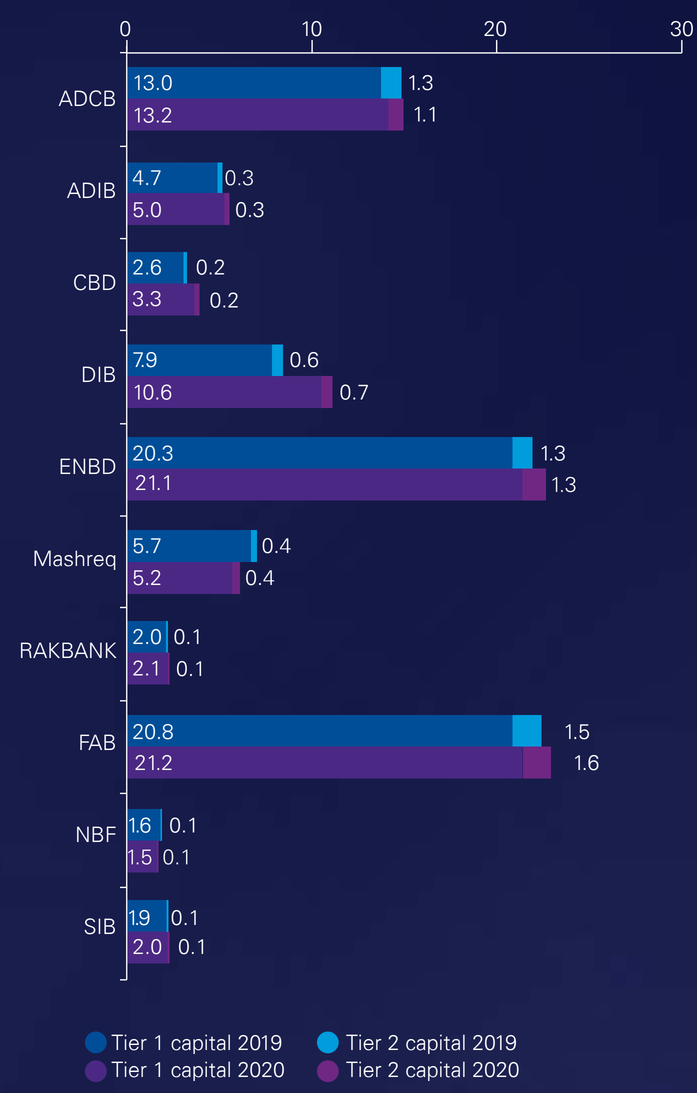
National Bank of Fujairah - NBF

Sharjah Islamic Bank - SIB

Coverage ratios on loans by stage

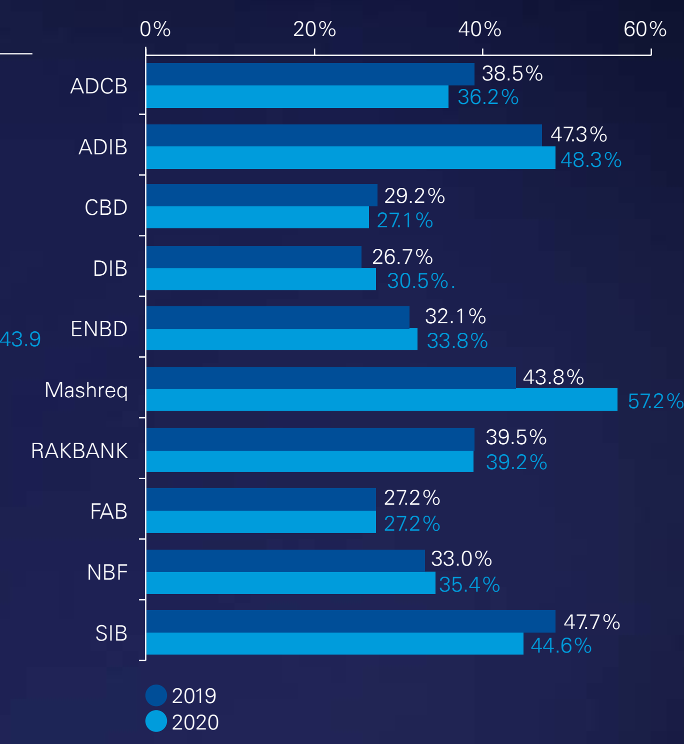


Regulatory capital
(US$ billion)



Net impairment charge on loans and advances
(US$ million)

Cost-income ratio



Credit rating

	S&P	Fitch	Moody's
ADCB	A-	A+	A1
ADIB	*NA*	*A+*	*A2*
CBD	NA	A-	Baa1
DIB	*NA*	*A*	*A3*
ENBD	NA	A+	A3
Mashreq	A-	A	Baa1
RAKBANK	NA	BBB+	Baa1
FAB*	AA-	AA-	Aa3
NBF	BBB+	NA	Baa1
SIB	*A-*	*BBB+*	*A3*

1.'All numbers are presented for loans and advances (financing assets for Islamic banks) except for ADCB, FAB and RAK Bank,where numbers have been reported for all financial instruments at amortized cost. Where interest suspense has not been disclosed in the financial statements, we have assumed the amount of interest suspense to have been already netted with outstanding of exposure loan and hence amount of interest suspense has not been taken into the formula to calculate coverage ratio.
2.The ECL numbers presented in this document are on loans and advances (including financing assets for Islamic banks) for all top 10 listed banks except for ADCB, FAB and RAK Bank where ECL numbers are presented on all financial assets measured.

Contributors

The information in this report is based on our authors' in-depth knowledge of the UAE's financial services industry, allied with detailed analysis of banks' financial performance. The GCC listed banks results report compares the performance of approximately 60 of the GCC's leading listed banks. A snapshot of those findings is included on pages 52-55

About KPMG

For almost 50 years, KPMG Lower Gulf Limited has been providing audit, tax and advisory services to a broad range of domestic and international, public and private sector clients across all major aspects of business and the economy in the United Arab Emirates and in the Sultanate of Oman. We work alongside our clients by building trust, mitigating risks and identifying business opportunities.

KPMG Lower Gulf is part of KPMG International Cooperative's global network of professional member firms. The KPMG network includes approximately 227,000 professionals in over 146 countries. KPMG in the UAE and Oman is well connected with its global member network and combines its local knowledge with international expertise, providing the sector and specialist skills required by our clients.

KPMG is widely represented in the Middle East: along with offices in the UAE and Oman, the firm operates in Saudi Arabia, Bahrain, Kuwait, Qatar, Egypt, Jordan, the Lebanon, Palestine and Iraq. Established in 1973, KPMG in the UAE and Oman employs 1,485 people across four offices, including about 100 partners and directors.

Our latest initiative, KPMG IMPACT, aims to help clients future-proof their businesses amid times of increasing focus towards issues such as climate change and social inequality. The goal is to help them achieve success across 17 major Sustainable Development Goals (SDGs) and become more resilient and socially conscious. For FY21, the firm has earmarked a global budget of USD 1.43 million for the initiative.

As we continue to grow, we aim to evolve and progress, striving for the highest levels of public trust in our work. Our values are:

Integrity: We do what is right.

Excellence: We never stop learning and improving.

Courage: We think and act boldly.

Together: We respect each other and draw strength from our differences.

For Better: We do what matters.

To meet the changing needs of our clients, we have adopted an approach aligned with our global purpose: Inspiring Confidence, Empowering Change. Our three pillars – exceptional quality of service, an unwavering commitment to the public interest, and building empowered teams – are the foundation of our firm.

Sources

[1] https://www.researchgate.net/publication/338348152_A_structured_approach_to_implementing_Robotic_Process_Automation_in_HR

[2] https://www.centralbank.ae/en/financial-institutions/Commercial%20Banks

[3] https://home.kpmg/ae/en/home/insights/2020/11/a-different-service-for-a-new-reality.html

[4] https://www.legislation.gov.uk/ukpga/1986/45/contents

[5] https://www.legislation.gov.uk/ukpga/2006/46/part/26

[6] https://uscode.house.gov/view.xhtml?path=/prelim@title11/chapter11&edition=prelim

[7] https://www.legislation.gov.uk/ukpga/2006/46/part/26

[8] https://www.cio.com/article/3408018/cloud-computing-in-the-middle-east-the-next-big-tech-market.html

[9] https://www.businessinsider.com/ai-in-banking-report

[10] https://www.researchgate.net/publication/338348152_A_structured_approach_to_implementing_Robotic_Process_Automation_in_HR

[11] https://www.forbes.com/sites/forbeshumanresourcescouncil/2018/07/20/robotic-process-automation-is-coming-to-hr-heres-what-you-need-to-know/?sh=4d1754ce37f6

[12] https://www.weforum.org/agenda/2019/11/ceos-worry-skills-gap-retraining-ai-automation/

[13] Learning & Development at BMO Financial: "A Driving Force of Cultural Pride" | HR Exchange Network

[14] https://www.entrepreneur.com/article/294142

[15] https://assets.kpmg/content/dam/kpmg/ae/pdf-2020/10/ceo-outlook-report.pdf

[16] https://www.centralbank.ae/en/consumer-protection

[17] ICAEW Financial Services Faculty "Audit of banks: lessons from the crisis" (2010)

[18] ICAEW Financial Services Faculty "Enhancing the Dialogues between Bank Auditors and Audit Committees" (2012)

[19] https://www.icaew.com/archive/technical/financial-services/enhancing-audit-audit-committee-dialogue?fromSearch=1

Contact us

Nader Haffar
Chairman and CEO
t: +971 4 403 0400
e: naderhaffar@kpmg.com

Abbas Basrai
Partner
Head of
Financial Services
t: +971 4 403 0484
e: abasrai1@kpmg.com

kpmg.com/ae

Follow us on:

Designed by KPMG Lower Gulf Creative team.

Publication number: 3385

Publication date: April 2021