Untethered opportunity: day of the digital

UAE banking perspectives 2023

March 2023
KPMG Lower Gulf

Foreword

I am pleased to introduce the eighth edition of our annual publication, UAE Banking perspectives. In this report, we examine the relevant topics and trends impacting the global banking sector with a particular focus on the United Arab Emirates (UAE). Our subject matter experts have shared their input on critical areas and strategies helping financial institutions maintain growth and increase profitability. The articles provide a comprehensive analysis of the key topics concerning banks in the region, including risk management, the future workforce, financial crime compliance and the metaverse.

While the global banking ecosystem is currently experiencing greater levels of volatility and stress, the banking sector in the UAE is expected to maintain a stable outlook in 2023. The country is among the largest financial centers in the Middle East, and the banking industry continues to play a significant role in supporting the UAE's economic growth.

One of the major factors contributing to the stability of the sector is the government's commitment to regulatory reforms aimed at promoting a healthy financial environment. The Central Bank of the UAE has introduced several measures aimed at strengthening governance frameworks, leading to an increase in the levels of transparency and accountability.

Abbas leads the financial services sector for KPMG in the Lower Gulf. He has almost 20 years of international experience in financial services assurance and advisory in the UK and the Middle East. He has worked with global and regional financial services companies including banks (both conventional and Islamic), sovereign wealth funds, asset management companies and private equity funds. Over the years, Abbas has gained experience in auditing, finance, accounting, operations, process improvement, regulatory compliance, internal audit and risk management working with senior stakeholders and leading multi-cultural domains and teams. Abbas has been with KPMG since he graduated and qualified as a Chartered Accountant from the Institute of Chartered Accountants in England and Wales while with KPMG in London.

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> "The UAE's vibrant economy and its favorable business environment have attracted a significant amount of foreign investment, with banks benefiting from large pools of capital and high net worth customers attracted by the politically neutral milieu.

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Foreword

The month of March was fraught with challenges for the global banking sector. In spite of international volatility, UAE banks are relatively well placed to manage the contagion risk from this due to limited lending activity in the United States. Most of their assets in the US are likely to be high-credit quality instruments or with the US Federal Reserve Bank. In light of their strong funding and liquidity profiles, and expected government support in case it is needed, the probability of UAE banks having to sell meaningful volumes of investment securities appears limited. If they did, and all unrealized losses crystallized, the impact would be less than 25% of their 2022 net income on average, resulting in an impact of approximately 60 basis points on the capital adequacy ratio of the top ten banks. If these number were to further deteriorate, which is possible, we would expect extraordinary government support in line with its robust track record of supporting banking systems in times of stress.

Nevertheless, 2022 was a promising year, with total assets increasing by 10.6% year-on-year, driven by strong growth in deposits, loans and advances. The top ten UAE listed banks analyzed in this publication reported robust operating and financial performances in 2022, with a 31% increase in their net profits. This is mainly due to an increase in net interest income, on account of higher interest benchmark rates and lower impairment charges compared to FY21, resulting from improved asset quality and credit worthiness of borrowers. The cost to income ratio during the year also improved by 1.8% on average and banks maintained sufficient capital levels well above the minimum regulatory requirements. The UAE is well placed to tackle the impact of the ongoing recession due to its strong liquidity and capital position.

For the third consecutive year, KPMG partnered with social media analytics company, DataEQ, to analyze the key drivers of consumer satisfaction amongst major UAE banks. Although there were overall improvements in "net consumer sentiment" across the banks analyzed, the topic of customer service generated the highest volume of negative conversation. The biggest pain points for customers were slow turnaround time, non-responsiveness and staff competency issues.

Digital enablement

As consumers become more dynamic and demanding in the ways they interact with banks, global commercial banks are seeking opportunities to deliver technology-enabled services that go beyond traditional banking. The growing demand for digital financial services and the rapid adoption of fintech solutions are driving constant growth, enhancing the customer experience and industry competitiveness. For instance, UAE banks including Emirates NBD are exploring the metaverse as a new channel to provide financial services to their customers and connect with the larger banking ecosystem.

An essential element of banks' digital growth strategies is cloud adoption. The banking sector is implementing the cloud in a hybrid mode; combining on-premise private cloud and public cloud (software as a service and infrastructure as a service) to provide benefits including scalability, flexibility and cost effectiveness.

Another key consideration for banks making their transition into the cloud is developing a multi-cloud strategy. A multi-cloud infrastructure provides a solid foundation for IT resilience and greater agility, and enables banks to leverage cloud service providers (CSPs) and avoid vendor lock-in. Financial institutions in the UAE would do well to consider multi-cloud hosting environment strategies as there are a number of CSPs already operating in the country. At a micro level, this would allow organizations to reap the benefits of tailoring workloads to CSPs on fitness-for-purpose. This can also significantly enhance their operational resilience at a macro level.

The increasing cost of risk

Today's global economy is experiencing a rise in costs of risk resulting from the increasing risk of recession. Almost 89% of global financial services CEOs are expecting a recession in the next 12 months. 57% of CEOs however believe the recession will be mild and brief. This uncertain geopolitical and macroeconomic environment presents challenges involving operational costs and loss of income. In times of economic uncertainty, banks should have strong early warning systems to reassure their external stakeholders of their readiness to react to these emerging conditions. A shift in mindset is also necessary for effective and proactive risk management. Banks can no longer depend on their existing early warning systems, which are built on indicators with a high percentage of false positives and a backward-looking perspective.

Therefore, by leveraging technology, banks can gain real-time insight into risks and achieve a predictive advantage.

The green revolution

The green financing market in the UAE is growing at an exponential rate. Abu Dhabi Global Market (ADGM) and the UAE's Security and Commodities Authority (SCA) have both announced ambitions to develop their own carbon trading platforms. In 2022, ADGM united with AirCarbon Exchange (ACX) to develop the world's first fully regulated voluntary carbon trading exchange and carbon cleaning house. The proposed mechanism is unique as it shifts traditional views on carbon as a waste product and global issue, to recognising carbon as an investment opportunity and emissions instrument. The UAE SCA is also currently in talks with the Ministry of Climate Change and Environment to establish a carbon trading scheme. While the venture capital markets and trading platform landscape will play a vital part in achieving the UAE's goal of becoming net zero by 2050, if the world truly intends to achieve decarbonisation and sustainability goals in the long term, it should be highlighted that carbon credits and carbon offsets do not make a direct contribution to emissions reduction. Carbon offsetting should therefore be considered a short-term fix that will eventually need to be phased out of global emissions reduction strategies.

Compliance on the rise

Over the last three years from 2019 till early 2022, the Middle East recorded a 63% increase in the size of its organizations' compliance teams. The total projected cost of financial crime compliance was USD 4.2 billion in early 2022, with the UAE representing a sizeable chunk of this at USD 1.7 billion (40%). It is anticipated that compliance functions will implement technology platforms to maintain and monitor regulatory obligations, enabling compliance risk assessments, alerting potential non-compliance incidents, and allowing action plan tracking.

They are also likely to integrate existing technology platforms with compliance/GRC platforms to streamline workflows, and adopt innovative RegTech solutions to automate their operations.

Combatting financial crime remains a key challenge for the banking sector and the deployment of machine learning (ML) and artificial intelligence (AI) for financial crime detection is also expected to accelerate. In addition, financial crime compliance will be purpose-led and will focus more on effectiveness, concentrating on outcomes rather than outputs. Advancements in technology and data will also result in new ways to approach know-your-customer (KYC) and customer due diligence (CDD) procedures in the next ten years.

The human angle

The rise of emerging technologies and automation in the banking sector is reshaping the future workforce, leading to the creation of new jobs in areas such as fintech, data analytics and cyber security. Banks in the UAE are enthusiastically embracing these technologies, investing in innovative solutions and promoting hybrid work environments to enhance productivity and optimize costs.

On behalf of KPMG Lower Gulf, we would be delighted to further discuss the topics within this publication. We are also deeply appreciative of the response elicited by last year's report and look forward to exploring future opportunities for your organization, together. Please contact me or our featured authors if you have any queries or would like to take a deeper dive into the content of UAE banking perspectives 2023.

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01.

Performance highlights

For the top 10 local banks

	2021	2022	%
Total assets *(USD billion)*	816.37	898.89	10.1%
Net profit *(USD billion)*	12.26	15.52	26.6%
Net assets *(USD billion)*	104.23	112.41	7.9%
Net provision charge on loans and advances (financing assets for Islamic banks) *(USD billion)*	4.96	4.34	-12.4%
Cost-income ratio (%)	35.6%	33.8%	-1.8%
Capital adequacy ratio (%)	17.3%	17.1%	-0.2%

	2021	2022	% point +/-
Return on assets (%)	1.2%	1.6%	0.4%
Return on equity (%)	9.5%	13.7%	4.2%
Net interest margin (%)	2.6%	3.0%	0.4%
Dividend payout ratio (%)	42.8%	41.5%	-1.2%

Key
- Year-on-year improvement
- No change
- Year-on-year deterioration

Coverage ratios on loans

Total loans subject to ECL

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

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02.

Highlights of the UAE Banking Sentiment Index 2022

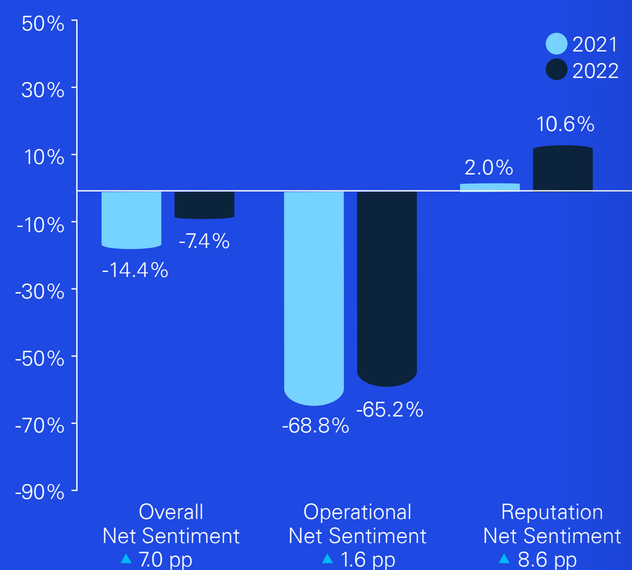
KPMG partnered with social media analytics company, DataEQ, to track 96,321 Twitter posts about seven UAE banks from 1 January to 31 December 2022

A statistically significant random sample of 82,000 of these mentions were processed through DataEQ's Crowd, with each mention receiving a sentiment rating — positive, neutral, or negative. These ratings were then used to calculate a Net Sentiment score for each bank. The major traditional UAE banks included in the analysis were **Abu Dhabi Commercial Bank, Abu Dhabi Islamic Bank, Commercial Bank of Dubai, Dubai Islamic Bank, Emirates NBD, First Abu Dhabi Bank, and Mashreq Bank UAE**. Only public tweets were included in this study.

Although still negative, industry Net Sentiment improved from the 2022 study

Both operational and reputational Net Sentiment improved from last year. Operational Net Sentiment is the sentiment score of consumers who indicate they are interacting with the brand as a customer. Reputational Net Sentiment pertains to consumer or press conversation that does not directly relate to being in a customer journey with a brand. This includes sponsorships, campaigns, and other reputational content. This resulted in an industry aggregate of -7.4%, which marks a seven-percentage point improvement from the industry aggregate of -14.4% in the 2022 study.

Industry Net Sentiment comparison 2021-2022

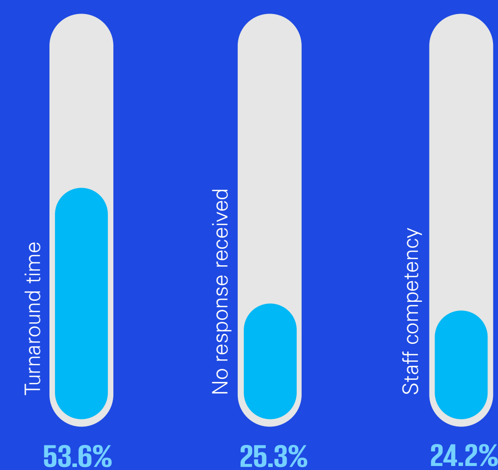


When looking at the individual performance of the banks, six out of the seven banks saw an improvement in Net Sentiment from last year, with two banks breaching barriers to achieve positive scores.

Customer service remained a major driver of negativity, with a Net Sentiment of -83.7%

While the topic of account admin scored lowest in terms of Net Sentiment, customer service generated the highest volume of negative conversation. The biggest pain points for customers were slow turnaround time, non-responsiveness and staff competency issues.

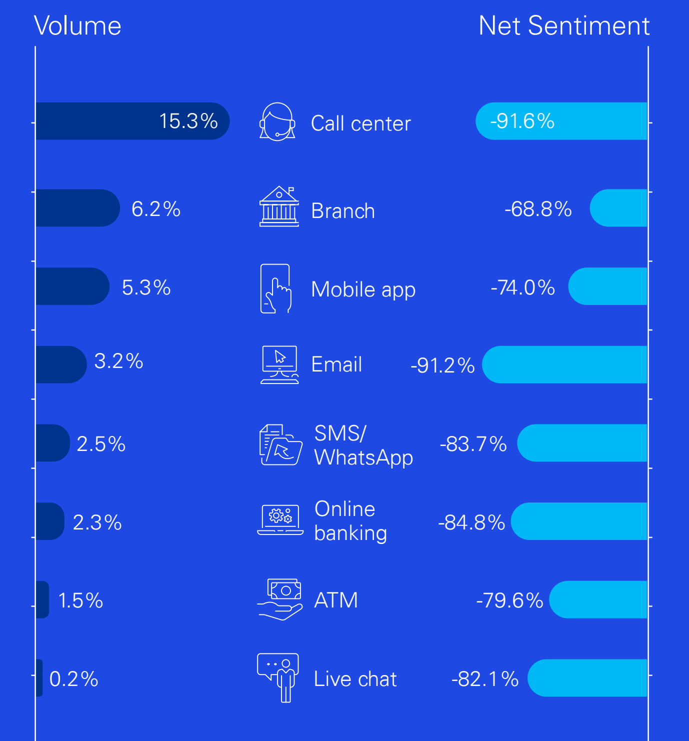
Topics driving customer service complaints



Call centers remained the most complained about customer channel

In terms of communication channels, call centers were mentioned most frequently (15.3%), followed by physical branches (6.2%) and mobile apps (5.3%). Out of all the channels, call centers had the highest levels of negative sentiment (-91.6%), eliciting frequent customer complaints.

Industry channel distribution



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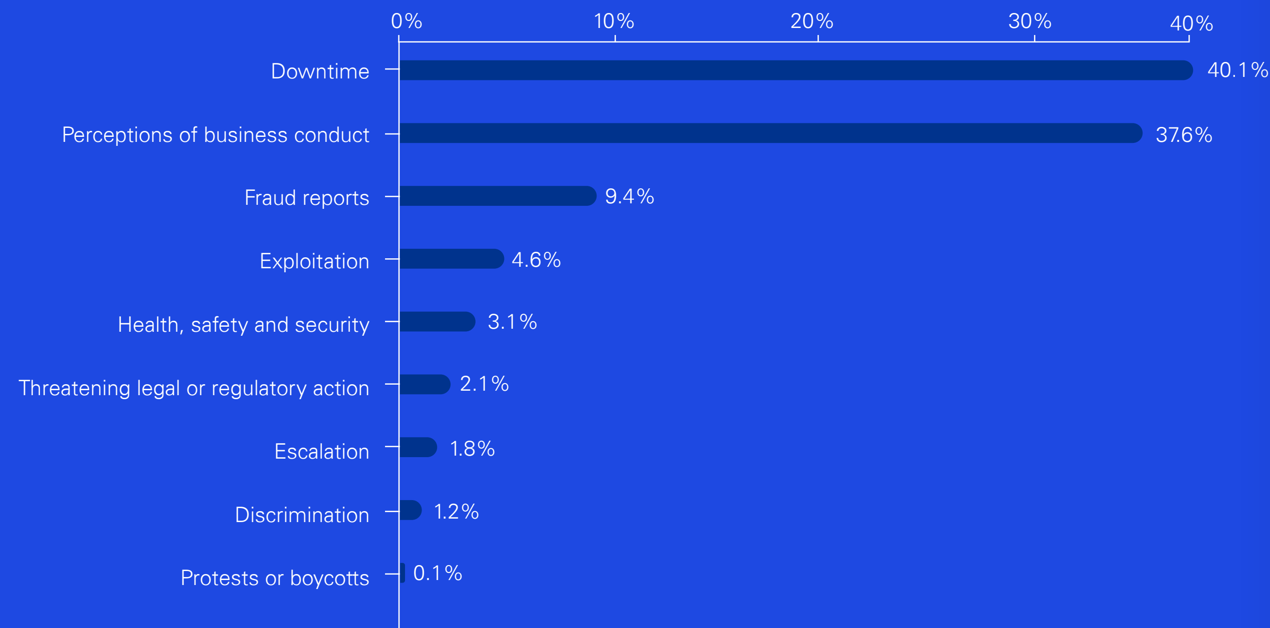
Percentage of total risk volume



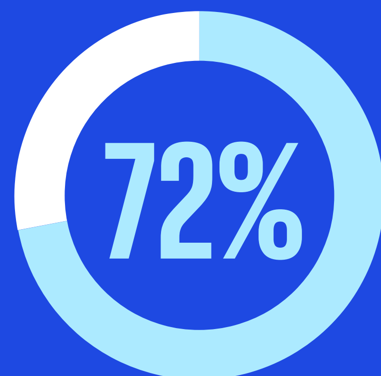
The banking industry's risk conversation increased substantially from the 2022 study

Risk conversation refers to mentions which pose a potential risk to one of the banks or the industry as a whole. These mentions are identified by the Crowd against a specified list of potential risk factors, which include downtime, discrimination, fraud, etc.

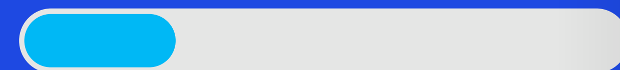
From last year's study, the ratio of risk conversation increased by almost 13.1 percentage points, driven largely by downtime complaints and perceptions of business conduct. The 2023 study saw downtime overtake perceptions of business conduct as the biggest risk factor, as customers complained about their inability to access online banking, malfunctioning mobile apps, and faulty ATMs.

Banks responded to 72% of priority consumer conversation on social media

While banks responded to over two-thirds of consumer conversation, the average time it took to respond was 11.5 hours.



25%



A quarter of consumer conversation referenced at least one market conduct theme

On average, 25% of all consumer mentions about the banks contained at least one of the six Treating Customers Fairly (TCF) outcomes. Outcome five, performance and service, was the most notable conduct theme across the UAE banking industry, which is consistent with DataEQ's findings in other markets.

A complete study will shortly be released by KPMG and DataEQ with further insight into the drivers of consumer satisfaction for the major retail banks, and whether they are meeting expectations of conduct and service.

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03.

The future of the commercial banking ecosystem

The commercial banking environment is facing more complex client demands than ever before. Rapid enhancement in digital capabilities, digitization and new sources of competition are forcing banks to urgently innovate. Gonçalo Traquina explores how leading commercial banks can target a broad range of evolving customer needs by implementing platform-based ecosystems that go beyond traditional banking.

Commercial banking is heading towards platform-based service models and competitive ecosystems enabled by data and cloud technology and accessed through APIs. This trend will support next-generation banking built around multiple personalized client segments. Platformization can also improve the accessibility and speed of innovation for products and and services, and significantly reduce the time to achieve mass adoption. It can also improve banks' data collection and analysis capabilities, giving them an edge over non-financial competitors. Failure to embrace modular and platform approaches will likely lead to shrinking market share.

Global commercial banks have an opportunity to deliver technology-enabled arbitrage in areas like interest rates and forex swaps. Regional super banks can quickly pivot to become technology and data companies, generating income from software, banking-as-a-service (BaaS), digital banking and digital currencies.

The reimagined digital commercial bank

Digital commercial banks can leverage capital and data while commercializing traditional cost centers by re-bundling their services and transforming into fully connected digital banks. They can offer a full range of hybrid value propositions and banking services to generate new income streams. They are also able to leverage data driven insight (at industry and individual client level) and convert sector insight into thought leadership publications. In addition, the reimagined digital commercial bank will focus on intricate and substantial private equity financing, leveraging human relationships and complex case expertise. This includes advisory functions for clients that require specialist knowledge.

Banking-as-a-service models

BaaS providers can develop and license services and products, and manage user interfaces to provide commercial banking services to end users, through intermediary partners. They rely on product and services for income streams and deliver through APIs using a platform-based infrastructure.
Examples include payment management solutions, risk scoring products, know your customer (KYC) verification services, risk profiles and financial crime screening to reduce the verification and onboarding of customers to under 48 hours. BaaS models can also enable banks to start packaging new financial products, and offer smart contracts, digital currencies and software IP licensing.

Digital banking platforms

Platform providers can offer, maintain or police a banking ecosystem with either open or closed access. They develop the infrastructure that enables commercial banking ecosystem and provide a gateway to any number of services and clients. Applications include the development of digital product marketplaces, mega apps, cloud services and API governance, and the management of third-party data connections. This technological infrastructure is a key source of income and can result in capital market disintermediation and new data and information trusts.

As they transition towards a connected enterprise, commercial banks should bear in mind the following considerations.

Innovating relationship models

Historically, success has relied on relationship managers (RMs) acquiring, nurturing and retaining client relationships, while selling a broad range of the bank's products and services. However, relationship management models are likely to be complemented and superseded by digital technologies. This includes executing transactional and routine tasks digitally, with the support of robotic advice and chat bots. This will free up an RM's capacity to become a banking solution architect, financial risk advisor and driver of trust for clients, using data insight to inform meaningful, personalized, relevant and timely interactions.

Transitioning to new ecosystems

Open platforms provide access to new ecosystems and facilitate partnerships that encompass a range of services across the banking sector. Such an approach combines legacy banks' risk and compliance capabilities with leading edge technologies and new customers. Through horizontal integration, banks can develop solutions that can be applied across multiple verticals (customer segment or industry) with minimal modification.

Assessing current technology systems and platforms

Commercial banks would do well to evaluate if their current technology platforms and architecture are fit-for-purpose. This helps them decide whether to adapt, hollow out, create a digital skin or twin, or replace and re-platform current systems to ensure their organization is future-ready.

Transforming operating models and cost structures

Commercial banks should also aim to further reduce their cost-to-income to maximize value and boost their revenue. Renewing operating models and cost structures can also deliver better returns on capital by measuring capital effectiveness and optimizing capital allocation.

Delivering operational excellence through AI

Automated and AI-enabled digital operational processes can improve the speed and quality of decision making and enhance the customer experience. However, banking leaders and teams will need to act as a moral compass to embed ethics, regulation and security into technological innovation.

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04.

Banking on the metaverse

The metaverse, a term coined by science fiction author Neal Stephenson, refers to a virtual space where users can interact and engage with one another in a shared, immersive environment. As technology advances and the lines between the physical and digital worlds continue to blur, the metaverse is becoming a reality. Gonçalo Traquina, Alessandro Porro and Kapoor Singh elaborate.

In the financial services industry, the metaverse presents a significant opportunity for banks to connect with employees and new generations of consumers. These include Millennials and Generation Z, who constitute approximately 60% of the population in the GCC and have grown up with digital technology at their fingertips. They are comfortable with digital interactions and expect seamless experiences across all touchpoints. Banks that can provide this will be able to connect with the new generation of users in a way that traditional banks have not been able to. The metaverse is a perfect example of a platform for banks to engage with these consumers.

In the GCC region, banks are already starting to explore the metaverse as a new channel for their services and connect with the wider ecosystem. For example, Emirates NBD has launched a campaign in the metaverse for a startup accelerator. Commercial Bank International (CBI) has also announced its plans to launch a virtual branch in the metaverse to provide banking services to customers in the virtual world.

Exploring the metaverse as a sales and marketing solution

Major retailers, from Nike to Samsung to Gucci, have harnessed the power of the metaverse to appeal to consumers. It is little wonder that banks are following suit. Banks can use the metaverse as a channel catered to new generations to explore innovative ways of interaction with clients. This includes gamification, virtual events and virtual banking assistants. It can also be a way for banks to build trust and loyalty with customers, who may be more likely to use banking services if they are presented in an engaging and interactive manner.

Entering the ecosystem with dedicated products and services

Banks can leverage their expertise in products and services and introduce them to metaverse users. Expanding their current product portfolio can enable banks to meet new customer needs. An example could be "buy now, pay later" for digital assets related purchases. More traditional banking products, like lending and insurance, can also be complemented with a digital asset flavor (accepting NFTs as collateral, insuring a digital wallet).

Historically, the role of banks has been to provide a safe place to store valuable assets. Banks can play the same role in the metaverse ecosystem by providing digital wallets for digital assets and custodial services for corporate clients. They can also help sustain crypto adoption by facilitating access to digital assets (cryptocurrencies and NFTs). By doing so, they can create partnerships that provide customers with better access to crypto and attract more clients.

Bridging the metaverse with "in real life" (IRL) banks can also enable banks to facilitate the creation of back-of-the-house payment rails in the metaverse. This would help fluidify the payment experience and offer means of payment that can merge the virtual world with reality through cards that allow payment from customers' crypto accounts.

How banks can embrace the metaverse

Entering the metaverse will provide financial institutions with access to a new array of data that would give them a complete view of the customer journey and their behavior. This includes spending patterns, investment preferences and risk behavior. This data could be used to develop new products and services, improving the customer experience and complementing the customer's overall financial behavior.

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The metaverse economy is already showing significant customer propensity in buying and investing in digital assets. In 2021, the market for NFTs reached an all-time high of $25 billion, with notable sales from digital art and collectibles. The gaming industry also witnessed considerable volumes in the sales of in-game assets, with popular games such as Fortnite and Axie Infinity generating millions in revenue. Banks can play a significant role in providing means of payment for these transactions, enabling the growth and stability of the metaverse economy.

A high-level roadmap for banks to enter the metaverse space and start experimenting with it could include the following steps:

- Conducting research and analysis of the metaverse market, including potential use cases and revenue opportunities
- Identifying potential partners and collaborators in the metaverse ecosystem, such as game developers, virtual reality companies and blockchain startups
- Developing a pilot program to test and validate potential use cases, such as virtual banking branches or virtual credit card services
- Evaluating and iterating on the pilot program, and scaling successful use cases across the organization
- Continuously monitoring and adapting to the developments in the metaverse space, and exploring new opportunities as they arise.

The metaverse seems to present a significant opportunity for banks – not as the main players to attract consumers to the metaverse but as enablers to ensure a smooth and safe experience for users. There is scope for the sector to play an essential role in the growth of the metaverse economy.

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05.

Cost of risk high as global recession looms in 2023

Effective and proactive risk management is key to staying on top of the rising cost of risk, according to Slim Ben Ali and Akshay Amberkar. By taking advantage of new technologies, such as artificial intelligence (AI) and machine learning (ML), banks can improve their risk management capability and achieve greater value.

A large proportion of central banks across the globe have simultaneously hiked interest rates to tackle inflation in 2022. KPMG surveyed 356 CEOs globally across the financial services landscape, including banking, insurance and asset management for the KPMG 2022 Global CEO Outlook, to see how they are preparing for the near-term challenges while also looking at their priorities and concerns over the coming three years.

Nearly all financial services CEOs, 89 percent, agree a recession is inevitable in the next 12 months. The good news is the majority, 57 percent, believe the recession will be mild and brief. But that doesn't mean there won't be some economic pain. Earnings over the next 12 months could take a hit – half of financial services CEOs say it could be between 6 and 10 percent, while nearly a quarter think the impact could be greater, anywhere from 11 to 30 percent.

The IMF, FED and ECB have recently reiterated that banks take a prudent approach to the highly uncertain geopolitical and macroeconomic environment. While it is true that the positive effects of rising rates can offset some of the impact of weaker asset quality and higher funding cost, banks are advised not to be overly optimistic and keep monitoring the downside risks ahead. These include ensuring that their models have adequate adaptability and predictive capability.

Managing non-performing loans

Although it is not possible to know exactly how the current challenging market environment may affect banks' loan portfolios, pressure on borrowers is expected to intensify. This can lead to a surge in non-performing loans (NPLs) which often consume a bank's capital, management time and attention. They also decrease probability and undermine the viability and sustainability of a bank.

At the outset, the bank should update their customer databases with the latest accurate information.

Banks should also implement digital collection tools which can provide ease of access to the bank for repayment purposes. They should ensure that they will have enough capacity when needed to perform recovery and collection activities.

Banks are expected to be aggressive in managing their NPLs even if this involves bearing operational costs or crystallizing losses on a sale. While the majority of banks in the UAE are well prepared to deal with a higher level of NPLs, the situation might be different elsewhere. For instance, the required buildup of risk provisions in Europe cannot be covered by retained earnings and some of the European banks may need to tap into their capital buffers to mitigate the damage.

Prevention is better than cure

Banks should conduct a detailed downturn scenario analysis and identify major factors which are likely to hurt capital or earnings. The scenarios analysis may also consider the opportunities that the bank may have post-recession. Further, they should also develop an expense control plan for the downturn. This plan should categorize the banks' costs into the minimum needed for survival and to attain the strategic objectives of the bank. Having a plan in place will enable the bank to react to recession in an efficient manner.

The effective management of NPLs starts with a governance framework, an underwriting process and a sound lending policy at the time of origination. This involves developing more rigorous qualitative and quantitative standards when lending followed by effective proactive risk management which can help banks identify early warning signs.

History has shown that during recession, banks face significant pressures in managing their existing customer relationship and the risk of delinquency. Being able to understand the financial situation of each customer beforehand and act upon it with foresight can be a source of competitive advantage.

AI/ML can enable faster identification of risks from more valued sources, monitor customer behavior and adjust risk management strategies. More precisely, AI/ML powered solutions can help with predictive modeling and improve forecasting accuracy. This is crucial in time of crisis as traditional regression models cannot adequately capture non-linear relationships between the macro-economic environment and the finances of a borrower in the event of a stressed scenario. ML offers superior forecasting accuracy due to its ability to capital non-linear effects between scenario variables and risk factors.

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Proactive and effective risk management to identify early warnings using analytics

Through the use of analytics, risk management systems can analyze large amounts of data to identify hidden patterns and measure the organization's current cost of risk. This type of data driven intelligence can be used to anticipate risks and to make appropriate changes in a bank's risk strategy.

Advanced analytic models are also useful to allow banks to measure the impact of mitigating actions and to understand the correlation between their risk management practices and their losses.

By leveraging these technologies banks can gain real time insight into risks and achieve a predictive advantage, helping them better identify and manage risks before they lead to losses.

In times of crisis, AI-driven credit decisioning can help the banks manage credit risk effectively in the following areas:

1. Credit assessment. AI can accurately help analyze a large segment of consumers and determines whether a particular customer is eligible for the loan.
2. Limit management. AI can enable dynamic limit monitoring which can help the banks in revising the limits on an on-going basis and even determine the maximum borrowing threshold based on pre-determined parameters.
3. Dynamic pricing. AI can help the bank achieve dynamic pricing which may enable banks to offer highly competitive rates and adjust pricing according to market shifts

AI and ML amplify many elements of model risk which are often insufficient to deal with current mechanisms and frameworks. During economic contraction and recession, external stakeholders from shareholders to regulators would seek reassurance that banks have solid early warning capabilities. This ensures robust credit monitoring and risk mitigation across the credit value chain. Banks can no longer rely on their current early warning systems which are based on backward looking indicators with a high number of false positives. They have limited time to adapt respond to the emerging scenarios.

Effective and proactive risk management also requires a change in mentality, and taking the right steps towards a culture of transparency and accountability.

The next few years may be challenging for banks, making the transformation of risk efficiency and effectiveness crucial for organizations with an aspiration to land on the right side of the credit cycle. Achieving this transformation will not take place overnight, and banks must take swift action to be prepared for a potential recession.

Slim Ben Ali
Director, Financial Risk Management

Akshay Amberkar
Director, Financial Risk Management

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06.

Multi-cloud strategies for operational resilience

To compete in today's fast-moving environment, banks are embarking on digital strategies of which cloud adoption is an intrinsic part. Dimitrios Petropoulos outlines the requirements of establishing a multi-cloud hosting environment that may ensure data and systems security, balanced costs, scalability and other benefits that a single-cloud strategy may not provide.

The banking sector is adopting the cloud, predominantly in a hybrid mode, combining on-premise private cloud and public cloud (SaaS and IaaS). Operating in the cloud provides scalability, flexibility, faster time-to-value, cost effectiveness and a range of other benefits. Cloud service providers (CSPs)—in addition to raw compute, networking and storage—offer a comprehensive range of CSP-native proprietary products/services including high-performance databases, data analytics, AI and ML, serverless platforms, developers/DevOps, automation, orchestration and security tools. The seamless integration of these solutions invites further cloud workload migration which increases the value of cloud adoption.

The use of CSP-specific products and services also increases cost-effectiveness; yet it can result in vendor lock-in. Moving traditional commercial off-the-shelf (COTS) platforms between hosting environments is no mean feat but is a tractable problem solved many times in the past. However transitioning out of a CSP when the service consumer is completely relying on CSP-native and proprietary products and services is a different challenge.

The continuous provision of important financial services by institutions is reliant on the resilience of their respective CSP. Regulators are therefore issuing supervisory expectations specific to cloud outsourcing. They are requiring financial institutions to identify the cloud services that the provision depends on, and set cloud exit strategies and CSP migration plans in line with the importance of the services offered. Regulators would also demand action to be taken in some cases of systemically critical entities or considerable concentration of risk.

Very seldom will a de-risking cloud exit strategy involve migrating the bulk of the workload back to on-premise hosting environments as this is the least cost-effective and sustainable strategy.

Usually, these strategies involve taking advantage of multi-cloud hosting environments by preparing the plans and architecture to transition services to different CSPs that can provide the required scalability. Therefore it is essential to apply containerization, cloud-native but CSP-agnostic platforms, and careful planning and testing to ensure the delivery of results within the required impact tolerance. This works better in IaaS and PaaS than in SaaS where exit strategies might be more complex and alternatives are more limited.

A host of benefits

Developing a strategy that involves a multi-cloud provides a solid foundation for IT resilience and introduces a wide range of additional advantages including greater agility, while avoiding vendor lock-in. Although these hosting environments bring numerous benefits to an organization, IT departments are still facing some management challenges associated with the multi-cloud. These include increased architecture complexity, requiring additional employee skills and securing heterogeneous hosting environments at scale. Identity, access management, data visibility, data protection, and network and communications security are foundational capabilities that can be developed across the multi-cloud to reduce residual risk regardless of the hosting environment.

Financial services industries around the world started embracing the benefits of the cloud decades ago. This allowed numerous organizations to reach advanced levels of digital maturity. Their experience has created a comprehensive body of knowledge that organizations can benefit from today as they embark on their multi-cloud journey.

There are a number of CSPs currently operating in the UAE, removing data residency/sovereignty obstacles to the adoption of multi-cloud strategies. Financial institutions should consider multi-cloud hosting environments at the macro level to enhance organizations' operational resilience. At the micro level, they can also reap the benefits of tailoring workloads to CSPs on a fitness-for-purpose basis.

In this article the term 'multi-cloud' is used to denote the use of more than one IaaS/PaaS CSP.

"Very seldom will a de-risking cloud exit strategy involve migrating the bulk of the workload back to on-premise hosting environments as this is the least cost-effective and sustainable strategy. Usually, these strategies involve taking advantage of multi-cloud hosting environments by preparing the plans and architecture to transition services to different CSPs that can provide the required scalability.

Dimitrios Petropoulos
Partner, Cyber

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07.

Revolutionizing the Voluntary Carbon Market

The UAE is making significant strides towards its sustainable development and decarbonization efforts in the lead-up to achieving net zero by 2050, with green finance instruments growing at an exponential rate. Fadi Al Shihabi elaborates.

UAE governments understand the need to diversify into new, expanding areas of financial opportunity, such as sustainability and green initiatives. The UAE has declared 2023 as the "Year of Sustainability". The UAE acknowledges that the region has a large carbon footprint and recognizes the importance of developing local carbon trading platforms.

Two of the UAE's biggest players, Abu Dhabi Global Market (ADGM) and the UAE's Security and Commodities Authority (SCA), separately announced ambitions to develop their own carbon trading platforms.

In 2022, ADGM united with AirCarbon Exchange (ACX) to develop the world's first fully regulated voluntary carbon trading exchange and carbon cleaning house. It was the first regulator to develop a mechanism that promotes carbon as a serviceable product and commodity, allowing entities to treat carbon and other greenhouse gases (GHG) as they would financial assets. It should be highlighted that the scheme was anticipated to be launched in 2022. ADGM has not yet released an update.

In addition, the UAE SCA is currently in talks with the Ministry of Climate Change and Environment to establish a carbon trading scheme. The news was announced in January 2023.

The carbon trading exchange/platforms will allow entities to ultimately offset their carbon emissions, by purchasing permits that authorize them to emit a certain quantity of carbon and other GHG, according to the purchased credits. Globally, the voluntary carbon market (VCM) has grown rapidly in recent years but has faced criticism over the fact that purchasing credits do not address carbon emission reduction or removal from the atmosphere. Conversely, it can be argued that opening the VCM redirects finance towards projects and initiatives that would address these key areas of sustainable development.

The global decarbonization landscape

The UN Net-Zero Banking Alliance is working towards facilitating, promoting, and accelerating the deployment of decarbonization initiatives, through the provision of an "internationally coherent framework and guidelines". The Alliance's Finance Initiative is focused on setting climate-related targets within an international framework to collectively contribute towards global climate goals and commitments. The framework emphasizes the crucial role that banks have in supporting and driving global decarbonization efforts. Furthermore, banks are in a unique position, whereby they not only have to be aware of their own environmental, social, and governance (ESG) impact, but also those stemming from their portfolios and value-chain.

It is anticipated that more stringent ESG (non-financial) disclosure requirements will likely be extended to banks. It is imperative they prepare for any regulatory changes and start to identify their gaps, and begin measuring, reporting, and disclosing, to ensure that the sector is ready for future disclosure requirements.

Major banks will benefit from integrating carbon credits and other services into their portfolios. Carbon credits would be an exciting addition to green bonds (sukuks), which are already prevalent in the region. Banks would do well to go above and beyond in extending their ESG criteria across their future and existing portfolios, to address emissions across their value chain (e.g. scope 3 emissions).

Towards a more sustainable future

Given the success of the established carbon credits trading platform in Saudi Arabia, the 'Riyadh Voluntary Carbon Market (VCM)' initiative in 2022, it is expected that the UAE will experience similar triumph. It is anticipated that the UAE, ADGM, and the SCA will announce an update to their prospective platforms during COP 28, which is being hosted across the UAE in late 2023.

Fadi Al Shihabi
Partner, ESG Services Leader

While the VCM and trading platform landscape will play a vital role in the UAE's journey towards net zero by 2050, if the world truly intends to achieve decarbonization and sustainability goals in the long term, it should be highlighted that carbon credits and carbon offsets do not make a direct contribution to emissions reduction. Carbon offsetting should be considered a short-term fix that will eventually need to be phased out of global emissions reduction strategies.

Nonetheless, carbon credits/offsets are an effective way of redirecting finance towards carbon zero or carbon net positive projects and initiatives. They will continue to play a major role in short- to medium-term mitigation strategies, at least until technologies and solutions mature enough to contribute to achieving the ambitious emissions targets currently being set, both locally and internationally.

Strategy

1. How does the bank compare to peers?
2. How is the bank going to meet its public net zero commitments?
3. Are the products offered ready from an ESG perspective?
4. Is the ESG incorporated in the target operating model?
5. How is the bank engaging with its clients and their transition strategies?

Operational effectiveness

1. Is the bank aware of ESG matters across its organization, including processes, systems and controls?
2. Does the functional decision-making take ESG matters into account?
3. Is ESG considered while developing products and services?
4. Are ESG risks and opportunities integrated in procedures and policies?
5. Is the bank taking advantage of the opportunities that IDE policies can bring?

Regulatory compliance and reporting

1. Is the company ready to cope with existing and upcoming regulatory requirements?
2. What are the gaps that can already be identified?
3. Is the company measuring, reporting and disclosing non-financial ESG information that is critical to understanding both strategic intent, risks and opportunities?
4. Who in the bank is responsible for ESG at functional and board levels?

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08.

Automating compliance programs in the wake of regulatory reform

Banks are recording an increase in the cost of compliance to manage the risks associated with regulatory reform. Maryam Zaman explains how compliance functions are expected to undergo a digital transformation journey supported by their governance, risk management and compliance (GRC) tools to automate business as usual.

As per KPMG's 2022 Global CEO Outlook report, regulatory concerns remain one of the key risks to growth over the next three years. Some of the critical regulatory concerns include navigating the emerging and complex compliance landscape given the increasing risks in the digital age. The Central Bank of the UAE (CBUAE) has passed important regulations and standards in the recent years to ensure adequate supervision of financial institutions in the UAE (e.g. model management, anti-money laundering, consumer protection, etc.). It has also imposed administrative and financial sanctions on a number of licensed financial institutions with weak compliance programs, resulting in fines and penalties surpassing AED 8 million in 2022.

Over the last three years from 2019 till early 2022, the Middle East recorded a 63% increase in the size of its organizations' compliance teams. The total projected cost of financial crime compliance is USD 4.2 billion in early 2022, with the UAE representing a sizeable chunk of this at USD 1.7 billion (40%). Therefore, is it anticipated that compliance functions will implement technology platforms to maintain and monitor regulatory obligations, enabling compliance risk assessments, alerting potential non-compliance incidents, and allowing action plan tracking. They are also likely to integrate existing technology platforms with compliance/GRC platforms to streamline workflows, and adopt innovative RegTech solutions to automate their operations.

Increased focus on regulating virtual assets and cryptocurrencies

2022 was a challenging journey for cryptocurrencies. With a loss of USD 2 trillion in market value and lack of public confidence in the viability and durability of virtual assets, the CBUAE, Dubai Financial Services Authority (DFSA), Financial Services Regulatory Authority (FSRA), and Virtual Assets Regulatory Authority (VARA) are all currently focusing on enhancing their regulatory framework. Their aim is to protect consumers from fraud, prevent money laundering and terrorist financing, and provide a legal framework for the use and trading of cryptocurrencies.

Local and global regulators are implementing a comprehensive and multi-pronged approach to effectively tackle the risks associated with the cryptocurrency industry.

Some of these measures include:

- Licensing and registration requirements for cryptocurrency exchanges and other entities that handle virtual currencies. This can help to ensure that only legitimate businesses operate in the industry.
- Anti-money laundering (AML) and know-your-customer (KYC) regulations which can help prevent the use of virtual currencies for illegal activities such as money laundering and terrorist financing
- Investor protection measures such as requiring disclosures and providing education to investors about the risks associated with virtual currencies
- Monitoring and enforcement activities to detect and deter fraudulent activity
- International cooperation with other regulators and law enforcement agencies to share information and coordinate efforts to combat fraud in the virtual currency industry
- Review of the regulations and adapt them as the technology evolves.

The collapse of FTX has deterred investors, who are ambivalent about stability and security of virtual assets, to invest in cryptocurrencies. The impending flood of litigations by investors who may not recover their assets is another cause for concern. In the UAE, VARA revoked the approvals for FTX's local counterpart and implemented measures to ensure that FTX MENA cannot onboard and service new clients.

The Central Bank of the UAE (CBUAE) has passed important regulations and standards in the recent years to ensure adequate supervision of financial institutions in the UAE (e.g. model management, anti-money laundering, consumer protection, etc.). It has also imposed administrative and financial sanctions on a number of licensed financial institutions with weak compliance programs, resulting in fines and penalties surpassing AED 8 million in 2022.

Regulators see this collapse as a justification for tightening regulatory scrutiny of virtual assets. In cases of misuse of funds or limited disclosures by FTX, regulators will deep dive into stringent policies and real-time monitoring of such platforms.

To remediate the gaps observed in the downfall of FTX, financial institutions and virtual asset service providers may need to take additional steps in implementing stricter internal compliance and audit functions. Some of the breaches observed during this collapse included the commingling of company and customer funds, inadequate corporate governance and financial reporting, incomplete records of payments, and the lack of an accounting function/CFO and risk management policies.

Maryam Zaman
Partner, Head of Corporate Governance

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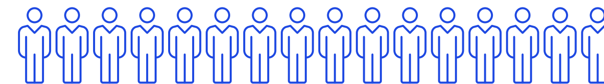
Some regulators and financial institutions are moving away from the 'tick box' technical compliance mentality, which was kickstarted by the effectiveness assessment approach of the Financial Action Task Force (FATF). In the UAE, this paradigm shift is further facilitated by the country's high level of political commitment to implementing the actions recommended by the FATF.

Sachith Amarasekara
Director, Forensics

09.

The evolution of financial crime compliance

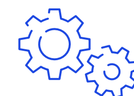
As financial crime continually becomes more challenging and complex, Sachith Amarasekara tells us how global financial crime experts are foreseeing a fundamental shift in organizations' approach to compliance.



Based on our interviews with 16 global thought leaders, we have identified five major trends that are anticipated to disrupt financial crime compliance over the next decade.

Financial crime compliance will be purpose-led

Financial institutions are expected to drive effective financial crime compliance outcomes by being purpose-led. Institutions will also need to focus on the spirit of financial crime compliance laws: preventing criminals from having anonymous access to the financial system and providing actionable intelligence to law enforcement to disrupt criminal activity for the good of the society.



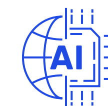
Effectiveness rather than 'tick box' compliance

Some regulators and financial institutions are moving away from the 'tick box' technical compliance mentality, which was kickstarted by the effectiveness assessment approach of the Financial Action Task Force (FATF). In the UAE, this paradigm shift is further facilitated by the country's high level of political commitment to implementing the actions recommended by the FATF.

The focus on outcome rather than output in financial crime compliance is also expected to significantly increase over the next ten years. This presents an opportunity for regulators and the industry to work closely together to agree on the desired results and allow some flexibility to focus on threats.

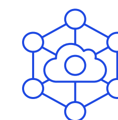
New ways to know-your-customer and customer due diligence

Know-your-customer (KYC) is foreseen to remain central to both compliance and core business process. Many institutions continue to struggle with inefficient and ineffective implementation of KYC and customer due diligence (CDD) resulting from cumbersome processes, fragmented data and labor-intensive operations. Over the next ten years, there will likely be a significant shift in the execution of KYC due to advances in technology and data. Automation of key processes can also support the digitization of KYC as ongoing CDD becomes more data-driven and uses real-time monitoring based on customer risk.



Next-generation financial crime detection systems

Many institutions are currently struggling with high ratios of false positive alerts. Global experts in financial crime anticipate the next generation of detection tools to be more dynamic, using intelligence to assess real threats and produce higher value alerts for investigation. A rapid increase in the deployment of machine learning and artificial intelligence for financial crime detection is also expected to result in earlier flagging of higher value cases and, consequently, better-targeted investigations.



Data and technology underpinning the financial crime compliance evolution

Data collected on customers and their behavior is expanding at a rapid rate. Growth in automation of case management activities is also allowing financial crime analysts to allocate more time to analysis rather than the collation of information. A good data structure, data governance strategy and risk-based approach to data lineage can be leveraged to provide a pathway to complete, accurate and timely data.

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10.

The dynamics of the future workforce

The future of work, while exciting, carries apprehension of reduction or change in the composition of required skills. Gunjan Shroff believes that banks in the UAE are particularly future focused and have embarked upon several initiatives to help their employees develop.

The corporate world is evolving, often driving organizations and their leadership towards becoming more innovative and forward thinking as they invest in the future. Financial services organizations are no exception to transforming their customer and employee services to be more futuristic and digitized, making the workplace more interactive, efficient and simple.

The future workforce in the banking sector is consequently largely influenced by automation and emerging technologies. This will likely lead to the creation of new jobs in areas such as digital banking, fintech, data analysis and cyber security.

Banks in the UAE are redefining jobs, upskilling and reskilling employees, and placing a greater emphasis on digital literacy. They are also leveraging technology, investing in innovative solutions and promoting hybrid work environments to enhance productivity and optimize costs. Their approach aims to embrace workforce diversity and encourage innovative thinking.

Enabling the future workforce requires a dynamic vision. According to KPMG research, a large proportion of CHROs have stated that understanding the shape, size, composition and skills of the workforce is one of the most important long-term priorities. However, less than 25% reported they currently have the capability to do so.

Creating a culture of learning

The banking sector ecosystem is struggling to match the supply and demand of its employees and anticipate workforce demand based on growth. Organizations are struggling to identify future skills and the ideal work culture (full-time, gig/contingent workers, hybrid work environment etc.).

Therefore, corporate organizations and academic institutions should focus on building the right curricula and leveraging training solutions such as AI tools to predict future skills. This would enable banks to balance talent supply with changing demand.

Forward planning (or "future proofing") is ongoing, dynamic and requires a constant finger on the pulse to understand the size, skills and evolving expectation of today's workforce. Talent retention remains one of the top priorities in the banking sector. The Great Resignation has changed what employees look for and how they engage with their work. Employees also require a purpose-centric role (a reason to enter the workforce), transparent career progression plans to enable skill advancement, a person-centered approach towards matching jobs with skills, and integration into a diverse engaging environment.

Making way for the next generation

The future workforce – generations Z and alpha – are young, empathetic, forward thinking, hungry for knowledge and have a big appetite for fluidity. Organizations, academic institutions and training solutions providers have a responsibility to plan for both the current and prospective workforce by adopting a strategic and dynamic approach towards skills identification and development. This is not limited to emerging technical skills and includes critical capabilities such as cultural competence, digital mindset, inclusivity, innovation and compliance. To remain relevant and competitive, the sector needs to make more visible investment in creating an inclusive and attractive environment. This includes partnering with education institutions for future skill development and continuously evaluating the workforce to build the relevant mix of skills, composition and size to meet changing market needs.

Gunjan Shroff
Partner, People and Change

Banks in the UAE are redefining jobs, upskilling and reskilling employees, and placing a greater emphasis on digital literacy. They are also leveraging technology, investing in innovative solutions and promoting hybrid work environments to enhance productivity and optimize costs. Their approach aims to embrace workforce diversity and encourage innovative thinking.

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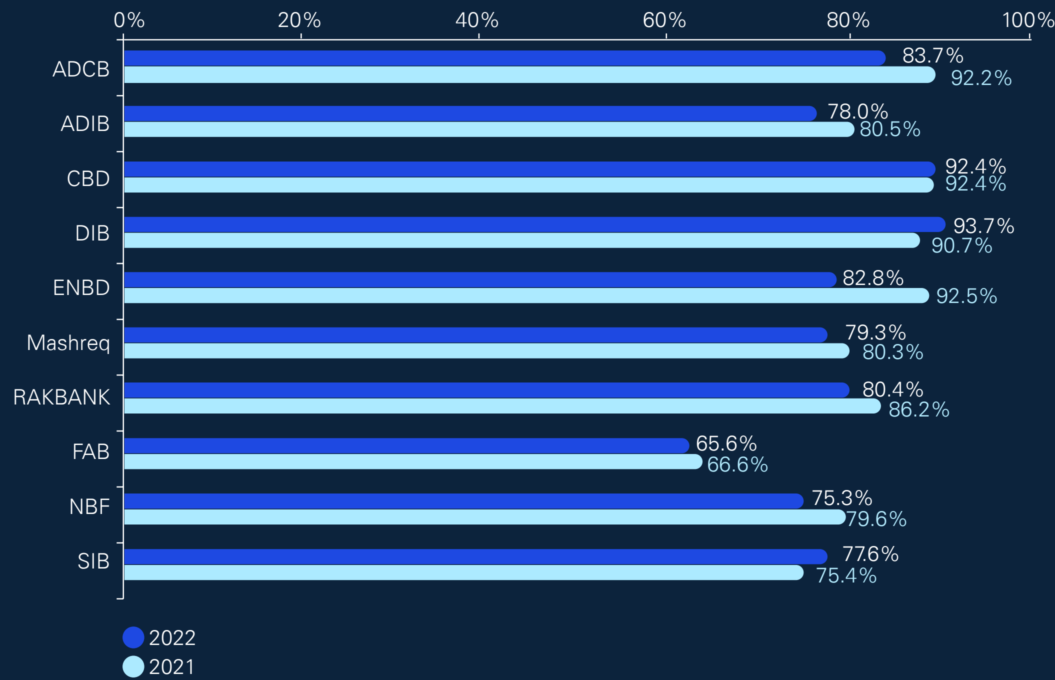
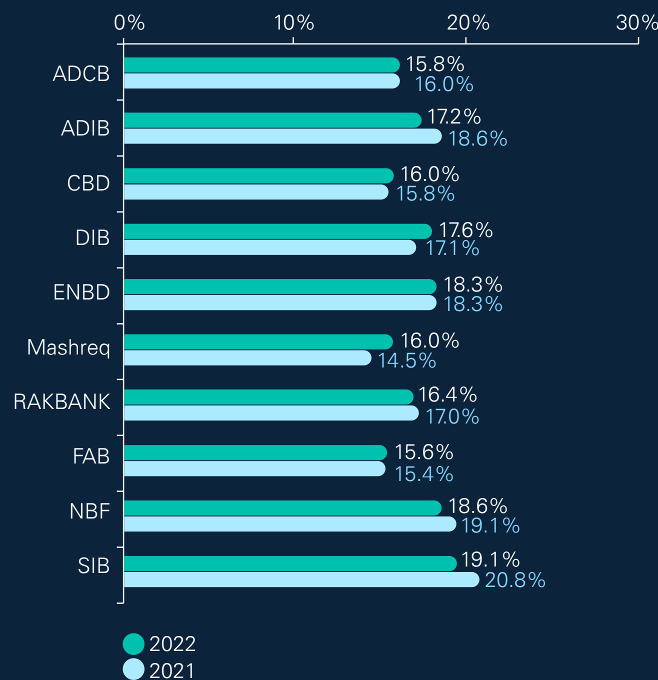
11.

Key banking indicators

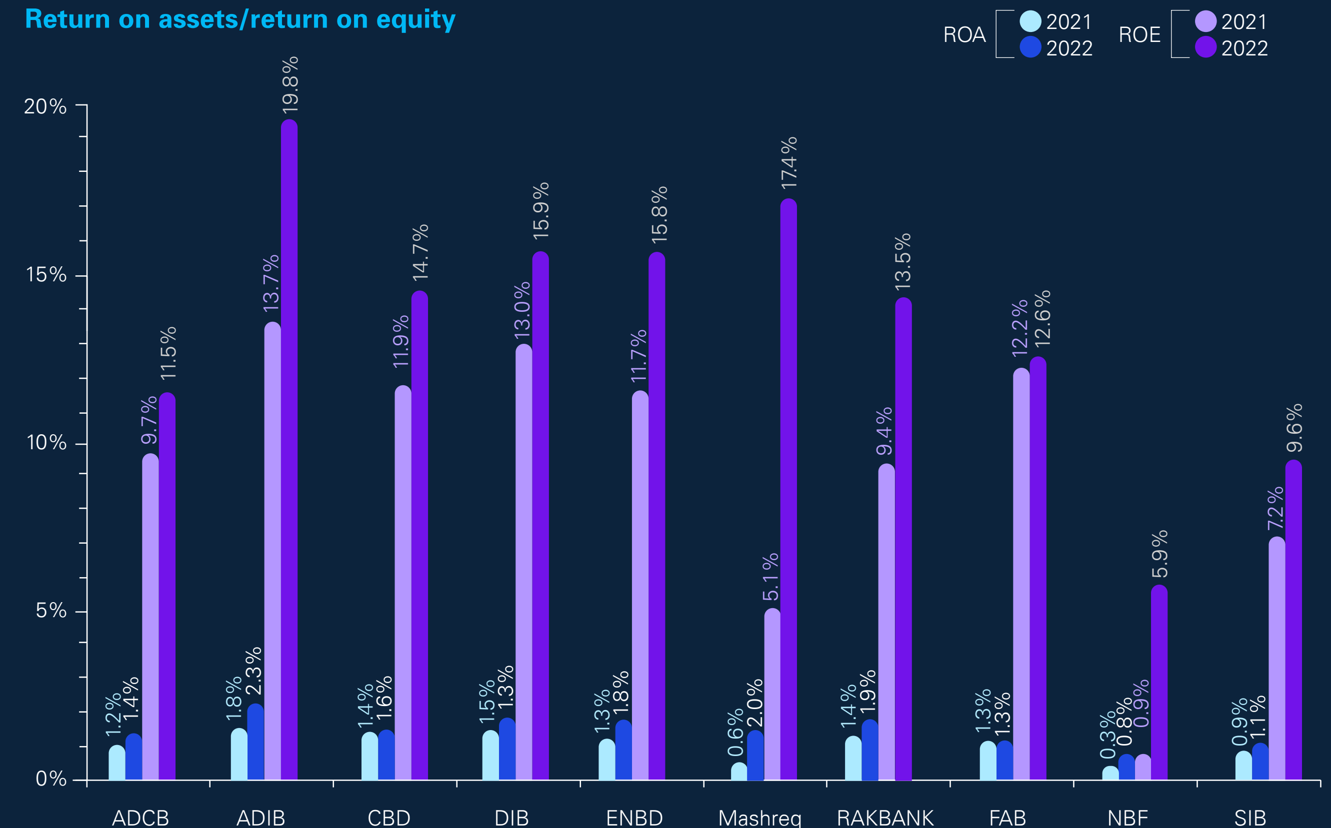
Loan deposit ratio



Capital adequacy ratio



Return on assets/return on equity



Glossary

Net Profit attributable to the equity holders of the bank

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

Average assets are calculated as (total assets for the current year + total assets for previous year) divided by 2

Average equity is calculated as (total equity for current year + total equity for previous year) divided by 2

Non-performing loans and advances (or, in the case of Islamic banks, non-performing financing assets)

Dividend payout ratio is calculated as dividend per share (recommended for the year by board) divided by basic earnings per share

Net interest margin (NIM) is calculated as net interest income divided by average earnings assets

Total (gross) loans and advances (or total (or gross) financing assets for Islamic banks

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

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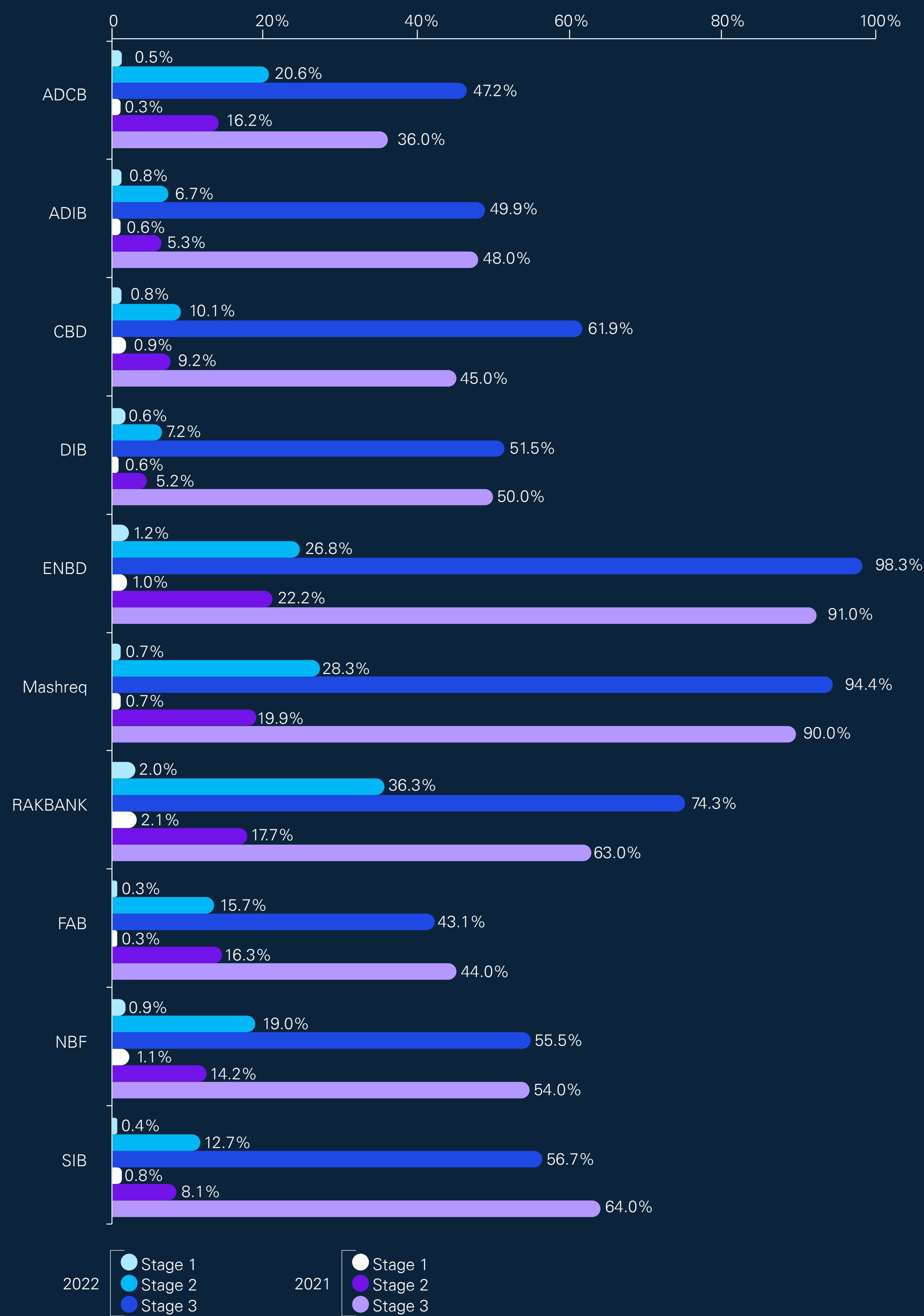
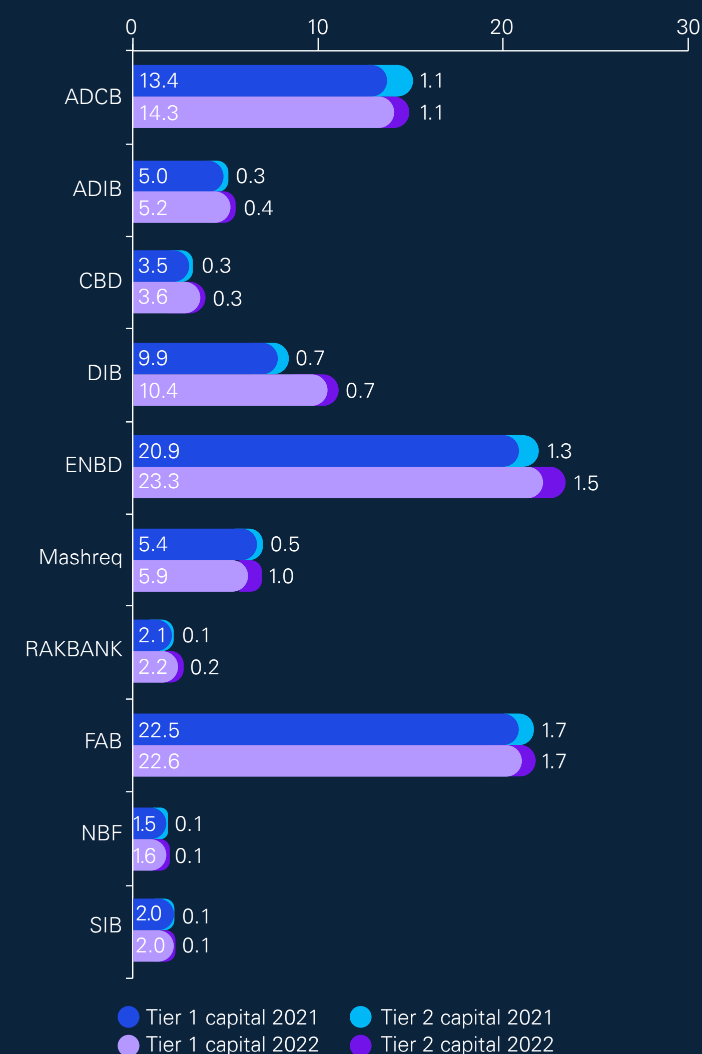
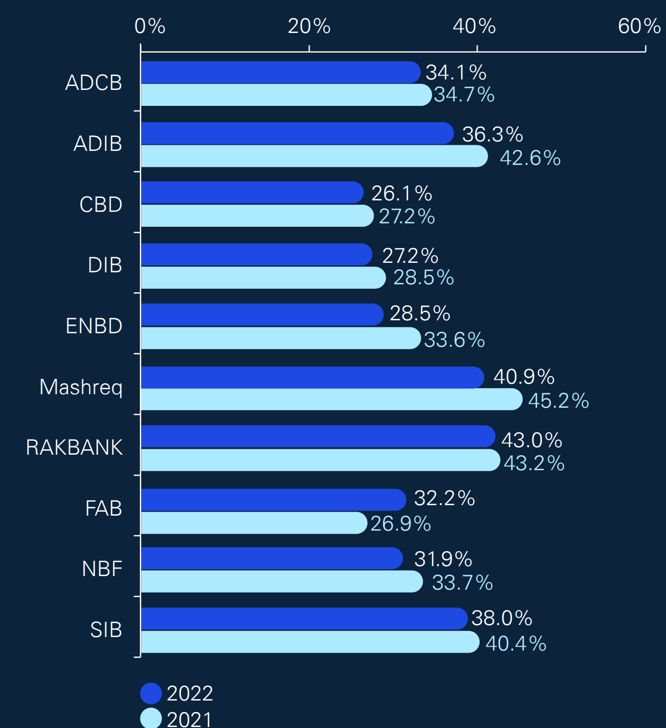
Coverage ratios on loans by stage



Regulatory capital
(USD billion)



Cost-income ratio



Credit ratings

Bank	S&P - long term issuer rating	S&P - outlook	Moody's - long term issuer rating	Moody's - outlook	Fitch - long term issuer rating	Fitch - outlook
ADCB	A	STABLE	Aa3	STABLE	A+	STABLE
ADIB	NA	NA	A1	STABLE	A+	STABLE
CBD	NA	NA	A3	STABLE	A-	STABLE
DIB	NA	NA	A2	STABLE	A	STABLE
ENBD	NA	NA	A1	STABLE	A+	STABLE
Mashreq	A-	STABLE	A3	STABLE	A	STABLE
RAK	NA	NA	A3	STABLE	BBB+	STABLE
FAB	AA-	STABLE	Aa2	STABLE	AA-	STABLE
NBF	BBB	STABLE	A3	STABLE	NA	NA
SIB	A-	STABLE	Baa1u	STABLE	BBB+	STABLE
UAE	NA	NA	Aa2	STABLE	AA-	STABLE

Source: Bloomberg. Credit ratings are as of 9th February 2023.

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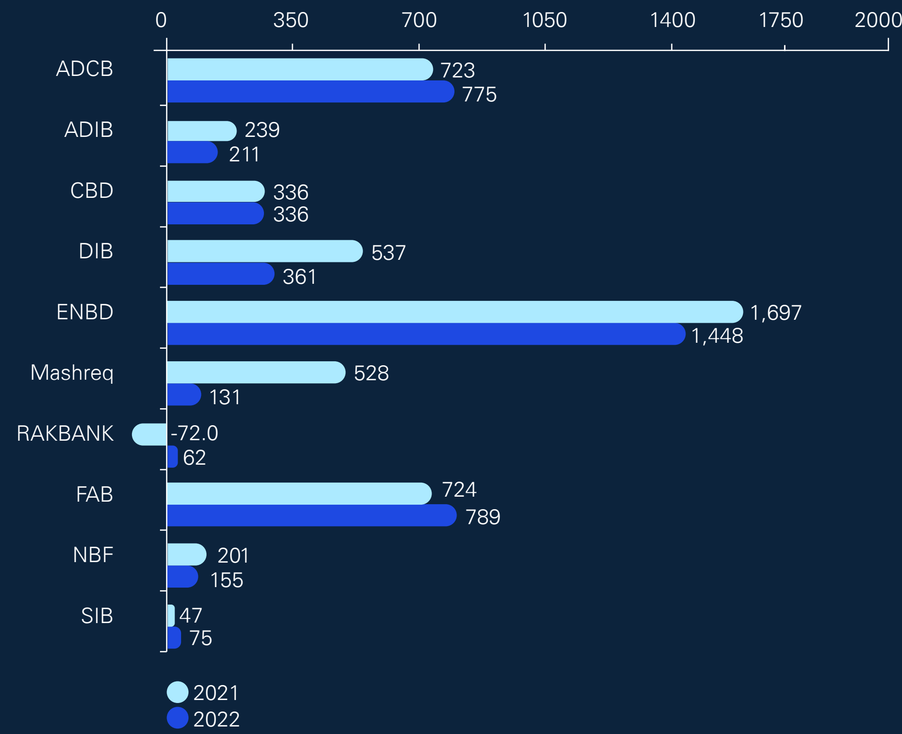
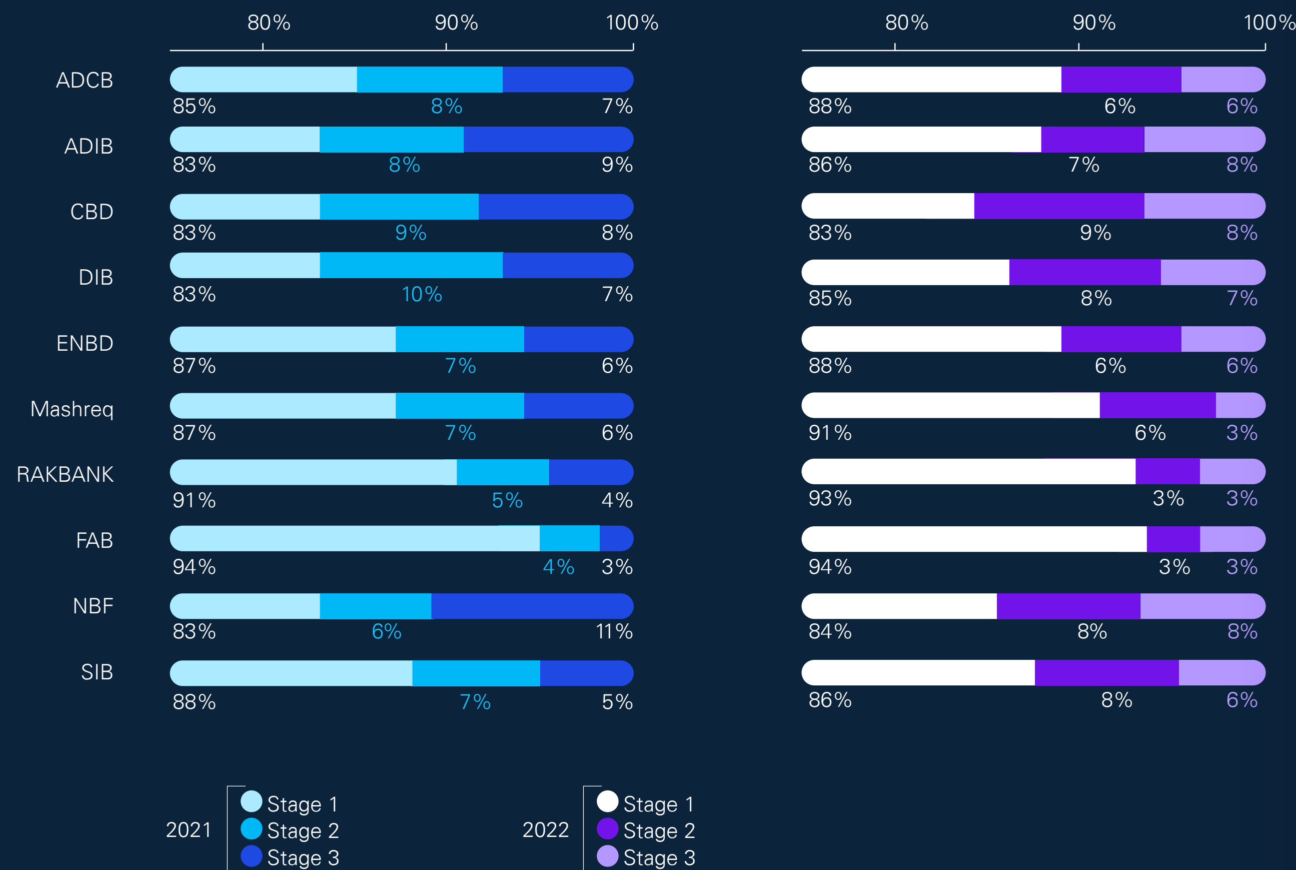
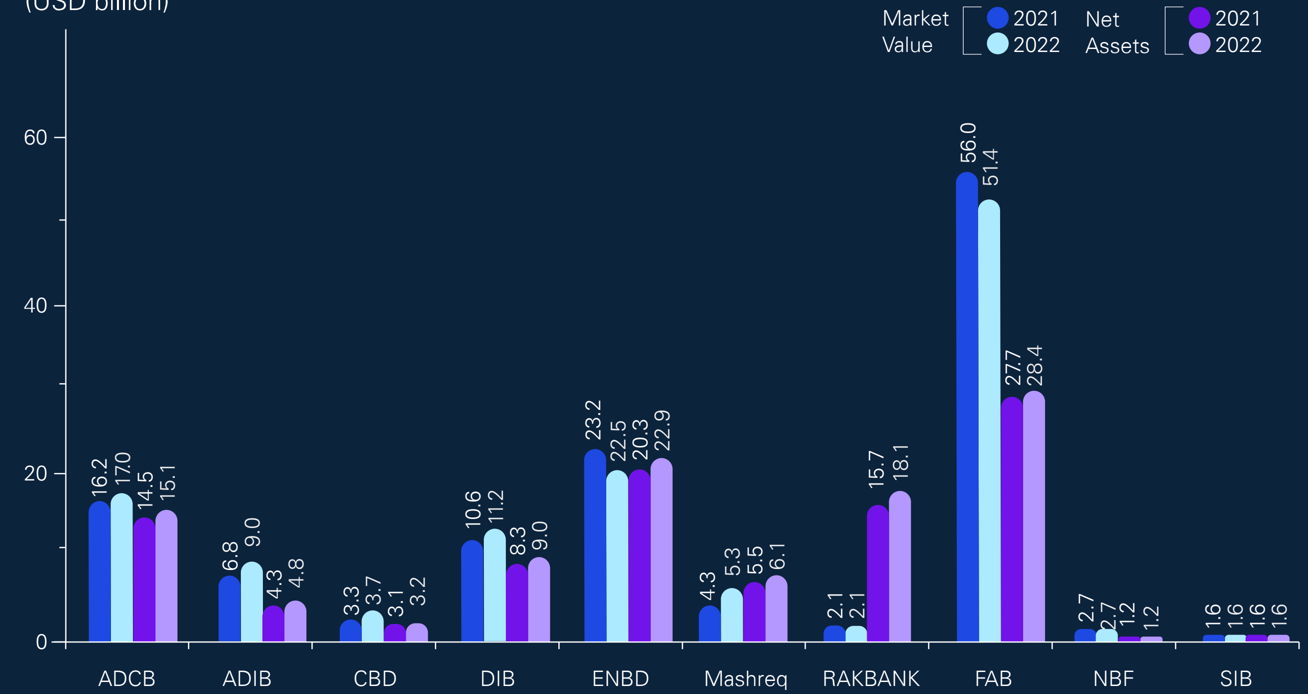
Net impairment charge on loans and advances
(USD million)



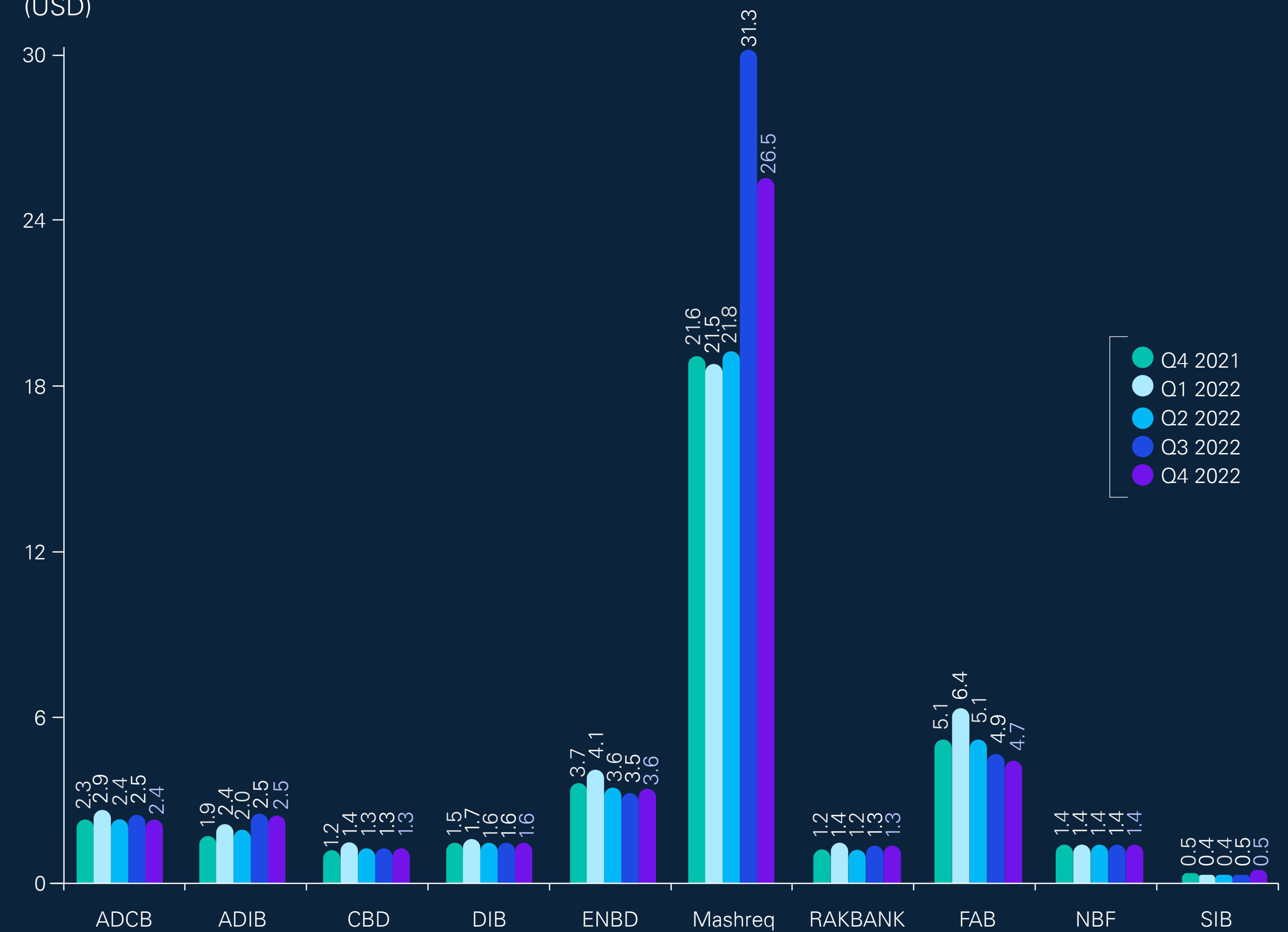
Total loans subject to ECL by stage



Market value/net assets
(USD billion)



Share price
(USD)



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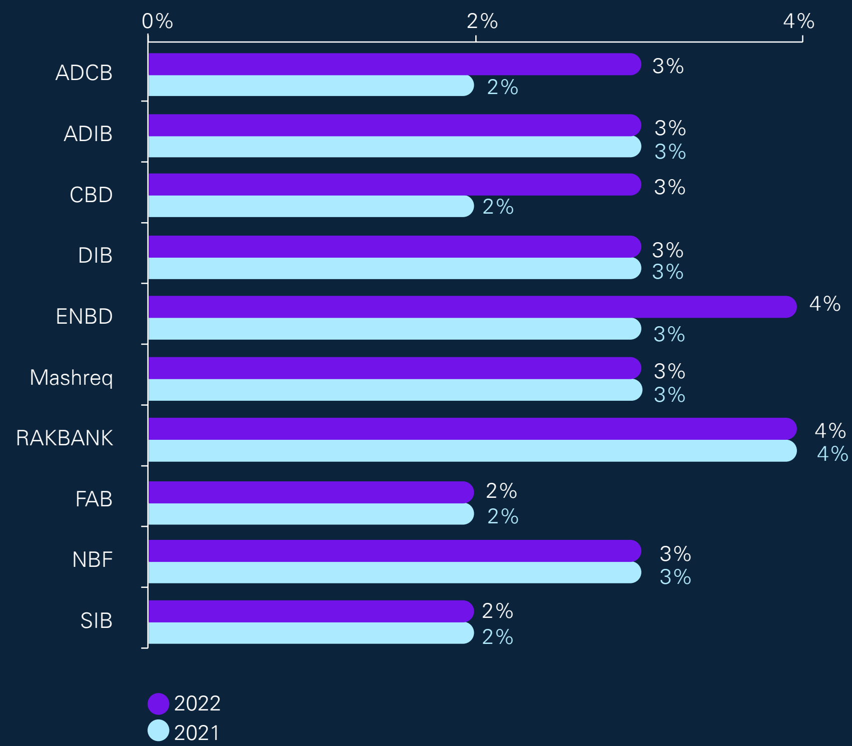
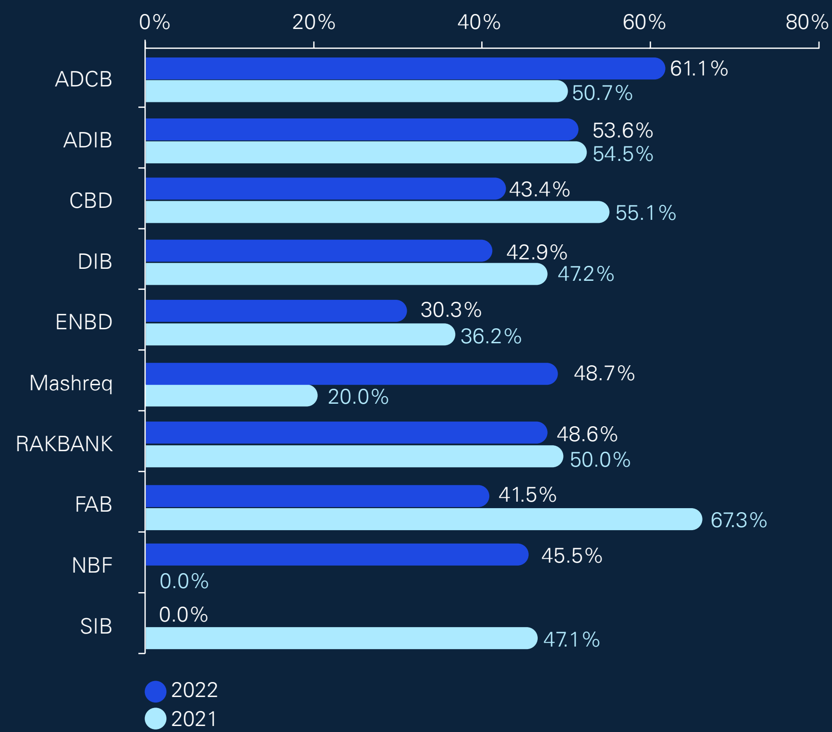
Net interest margin



Dividend payout ratio



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About KPMG Lower Gulf

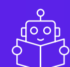
For almost 50 years, KPMG Lower Gulf Limited has been providing audit, tax and advisory services to a broad range of domestic and international, public and private sector clients across all major aspects of business and the economy in the United Arab Emirates and in the Sultanate of Oman. We work alongside 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 236,000 professionals in over 144 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, the Lower Gulf firm now employs approximately 1,780 people, including about 190 partners and directors across the UAE and Oman.

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.

Disclaimer: Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

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