In 2016, KPMG produced its first UAE banking perspectives, highlighting some of the most significant challenges for the financial services industry in the UAE. Twelve months later, it is surprising how much has changed – but equally how persistent some of those issues have proven to be. Last year, we made a number of predictions about regulatory reform; the effects of IFRS 9; the importance of banks understanding the entire SME customer journey; the threats posed by cyber; the need for banks to digitize and remain relevant; and the need to attract and retain the right talent. In this year’s report, we revisit many of the same areas. Nevertheless, it is instructive to stand back and reflect on their evolution over the last 12 months.

The financial services sector is a key pillar of the UAE’s drive to diversify its economy. The importance of doing just that – diversifying – has been brought even more into focus over the last year as a consistently subdued oil price – despite the best efforts of OPEC and others – has had a significant impact on the growth of regional economies. The UAE is a developing banking market with operators and customers at varying levels of complexity and maturity. Tighter liquidity – some of it caused by external forces – has stressed a number of financial institutions. It is to the credit of the regulator and the leading financial institutions that the sector has emerged relatively unscathed from the experience.

In truth, the financial services sector has not only been directly impacted by lower oil prices. We have seen lower levels of government spending, as well as more restrained spending by GCC investors and tourists. In an overbanked market, a number of investors have identified synergies and potential savings, although consolidation can be easier in theory than in practice.

Established UAE banks face a number of explicit and implicit threats, ranging from new and emerging external threats like cyber security to existing and recognized risks like conduct and regulatory changes. Like other private sector businesses, banks are under pressure to make a return for their stakeholders – whether that is dividends for shareholders or improved job satisfaction for employees. At a time when GDP growth is slowing, banks and other financial institutions are also being hit by rising impairments and non-performing loans, while being encouraged by the government to support the growth of SMEs. VAT will have significant implications for the financial services industry. It is increasingly likely we will see consolidation and accelerated structural reform over the next 12 months.

I hope you find much to ponder in the second edition of our UAE banking perspectives and look forward to discussing the articles with you.

Emilio Pera
Partner I Head of Financial Services
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Economic growth
— Despite dollar-driven appreciation of the dirham (AED), which has weighed on competitiveness, the UAE has continued to benefit from its perceived status as a safe haven, with political stability and a comparatively diversified economy.
— While low hydrocarbon prices have depressed government revenues, the UAE’s non-oil economy grew by over two percent in 2016, driven by increasing tourism, a resilient real estate sector and a thriving financial services sector.
— The banking sector grew by 5.4 percent in 2016 to reach AED711b.

Key performance indicators
— Returns on both assets and equity dropped sharply as profits fell, caused by higher cost of funds and higher impairment charges.
— Impairments against loans and advances increased in 2016, illustrating stresses in the SME, real estate and construction sectors.
— While customer deposits increased during the year, liquidity is still impacting banks operating in the UAE. The lending to stable reserve and liquid assets ratios are marginally lower than last year.
— An increase in capital has marginally improved capital adequacy ratios, suggesting banks are better positioned as Basel III requirements become more stringent.

Liquidity
— The CBUAE’s continuing commitment to the US dollar peg led to a rise in key interest rates. International reserves fell.
— Banks have had to rely on more expensive deposits to maintain liquidity, negatively impacting margins.

Consolidation
— Slower economic growth, increasing non-performing loans (NPLs) and higher expenses have negatively impacted bank profitability, leading to some scaling back in operations.
— Given the synergies offered by consolidation, the shareholders of First Gulf Bank and National Bank of Abu Dhabi agreed to a merger that will create one of the region’s largest banks with assets of approximately US$175b.

Building books
— With limited opportunities for top line growth, there has been a strong push to improve a range of ratios by cutting costs – whether by pushing the digital agenda, reducing headcounts, or reducing the depth and breadth of services.
— Without further consolidation and with limited opportunities for outsourcing and other forms of retrenchment, deep strategic planning may be needed to tighten operating models.

Source: KPMG analysis of the published 2016 results of the UAE’s top 10 listed banks
Outlook

Up next?
— Emerging regulations – on a national, regional and international level – will continue to drive the strategic agenda.
— Having effective governance in place will continue to be critical when trying to manage change – whether to support new standards or to strengthen the integrity of the financial system.
— Liquidity pressures, despite a more stable oil price and an improving geopolitical environment, will continue to weigh on the financial sector.
— Further consolidation, increasing efficiencies and delivering savings, should be expected.

Economic environment
— VAT is going to significantly impact the financial services sector across the UAE - with implementation expected in early 2018.
— By signing up to a range of automatic exchange of information (AEoI) agreements, the government has pledged to obtain information from financial institutions and exchange data automatically with other signed up nations.

Trust and confidence
— A lower oil price and tighter liquidity will continue to impact general business confidence.
— The new federal bankruptcy law should improve the business environment as it will allow companies in financial distress to restructure their debt.

Customer experience
— Customers increasingly want the opportunities offered by seamless, 24/7 banking – but banks need to get better at explaining what the benefits are and why they are the right institutions to offer those benefits.
— Over the next 12 months, we expect to see considerable investment into, and development of, virtual banking services – with some of the UAE’s leading banks already making significant progress in this area.

Digitalization
— The ongoing drive to reduce costs and improve efficiency ratios is accelerating the push to digitize the entire financial services industry – with potential implications for back, middle and front office positions.
— In an increasingly digitized world, the impetus for cyber security will have to change from a defensive mindset. There is increasing evidence that cyber security, rather than being a compliance cost, can in fact be a significant source of competitive advantage.

Relevance
— Banks want to remain relevant – but as they become more and more invisible, they are ever more tightly controlled by regulators and threatened by non-traditional competition.
— The growth of FinTech – whether blockchain or advances enabled by the rise in data & analytics (D&A) - increases the risk of non-traditional competition for the UAE’s banks – and raises interesting challenges for regulators.
— Although 2016 saw a global decrease in FinTech investments – with investors spooked by a combination of Brexit, the election of President Trump, a Chinese slowdown and fluctuations in exchange rates – stakeholder interest in the UAE has continued to grow, albeit from a low base.
Luke Ellyard

In this year’s perspectives, we once again set out what we see as some of the most significant challenges for banks in the UAE across two potentially opposing themes – regulation and innovation. While innovative ideas can sometimes chafe against regulatory constraints, one common thread is that true improvement across an organization is only possible if you have a strong and positive culture. We believe banks should be asking themselves: Does our firm have the strong, positive culture it needs to ensure we not only address regulatory challenges but also drive growth through innovation to remain relevant in this digital age? Are we getting the balance right?

KPMG works extensively with banks globally, helping them to understand and deal with the challenges arising from commercial, regulatory and (wider) societal pressures on them to improve their culture, behavior and standards of conduct. This goes well beyond legalistic conformity with detailed rules to a much wider and deeper consideration of culture and behavior. Banks need to ask themselves some fundamental questions about their desired culture and values and how these are reflected across all levels and parts of their organizations – before their supervisors ask them much the same questions.

So what is ‘culture’ and why does it matter?

Culture is an intangible that is reflected in the choices and behaviors of a firm’s employees. The values, goals and priorities chosen by a firm to define “business success” work together to create a firm’s culture. A “good culture” is marked by specific values – integrity, trust and respect for the law – carried out in the spirit of a fiduciary-type duty toward customers (that is, keeping the customer’s best interest at the heart of the business model) and a social responsibility toward maintaining market integrity. It embodies the “ethic of reciprocity” at all points of interaction between a firm and its customers and between the employees of the firm, fostering an environment that is conducive to timely recognition, escalation, and control of emerging risks and risk-taking activities that are beyond a firm’s risk appetite. A strong and positive culture can help address some of the challenges illustrated in each of our regulatory and innovation challenges.

In our first article, we ask if, under Basel III, liquidity is more important than capital. Complex changes are forcing banks to change the way they operate and address fundamental issues around profitability and future plans, with an initial focus, for those banks going through the liquidity coverage ratio (LCR) approval process, on the qualitative aspects of the liquidity regulations. These establish robust processes covering governance, stress testing, tolerance limits, contingency funding plans and buffers. Going forward, strategies will need to take into account potential liquidity constraints, and end results will determine by how much “the business” can grow the balance sheet. Ensuring this is done properly can help reduce the risk of regulatory action, strengthen asset quality, protect banks and enhance their reputations with multiple stakeholders – all critical success factors for banks with strong and positive cultures.

These concepts are equally applicable when asking what banks have learnt during their IFRS 9 implementation journeys. The most successful banks have found setting up an appropriate governance framework - with representation across all areas of the business - critical. However, many banks have underestimated the time and effort needed for impairment disclosures. Ongoing efforts remain significant, often including a risk and finance system implementation project, with some banks taking the opportunity to develop integrated reporting solutions. As IFRS 9 is likely to impact the way banks price and arrange loans, sell investments and manage financial assets, approaching this challenge positively will almost certainly bear fruit in the long run.

The banks that are seeing positive outcomes from our first two challenges also tend to be positively focused on two tax changes challenging businesses. Both VAT and CRS will have, or already have had, a significant impact on every UAE bank. With the implementation date for VAT widely assumed to be early in 2018, time to prepare is short. Many banks are only now starting to ramp up for this significant fiscal development.

Some financial institutions, in the wake of proliferating, stringent and far-reaching global regulation, are struggling to balance risk management with growth, restricting business relationships with entire countries or classes of customer, with correspondent banking a particular focus. Good correspondence is important but this ‘de-risking’ matters because, perversely, the inability to access normal banking channels may drive payment flows underground, posing a threat to the stability and integrity of the financial system. Is the current balance right? Or is the system working to the
Getting the balance right

detriment of good and responsible customers who just happen to be in the wrong country or business?

In our global experience, firms (and their supervisors) have often preferred to focus on processes and controls rather than customer outcomes. Genuinely embedding cultural change requires a greater focus on the risks to good customer outcomes and how those risks can best be addressed—which is why trust is key for banks and SMEs. In recent years, SME business owners have faced multiple problems, including delayed payments and an unclear economic outlook. The reaction of banks has been diverse—but most are looking to reduce their exposure to a critical sector of the UAE economy. How banks react to the challenges customers face may come down to culture—are banks looking after clients’ long-term interests? Deciding—and communicating—what is “doing the right thing” can be difficult when judgment is required, and where there is a trade-off between customer and counterparty treatment and profitability. Trust and transparency are key. Despite continuing economic headwinds, we believe these fundamentals, combined with continuing government support, better risk profiling by banks and more robust approaches by SME owners to core business planning and cash generation, will continue to drive broader economic participation and success through 2017.

However, while banks deal with these challenges, they shouldn’t lose sight of innovation—a driving force when designing and pricing services, rewarding staff, and interacting with customers. While big data or deep learning may grab headlines, banks must remain relevant in the robot age. Automate trivial tasks and banks will reap huge benefits, not just in terms of significantly reduced costs and improved speed and accuracy, but also improved leadership, with staff either freed up to focus on higher value activities—or let go. Unless banks get employee buy-in by integrating positive change into the culture, the process is likely to be slow, difficult and disruptive and banks’ long-term survival may depend on how they react.

Putting customers and their experience at the forefront of any cultural program should ensure win-win outcomes, better aligning a bank’s demand for growth with the long-term interests of its customers. In the retail banking arena, rather than seeing innovation, some product segments have become increasingly commoditized and standardized, with differentiation primarily confined to rates and fees. Given this, it is no surprise that retail banks in the UAE end up having to push their products to customers. Customers are often left feeling bruised by the experience and might end up worse off. With the rise of aggregators, the entire sales model gets reversed. Customers “pull” what they need from the market. Retail financial institutions need to realize they are one step further away from directly interfacing with customers—and one step closer to becoming invisible. It’s time for these retail financial institutions to rethink their roles in the value chain.

Part of that will mean ensuring that they have a strong and positive culture that promotes innovation and new product development designed to serve customers better. Part of it will require banks nurture data as they do customers. Data is proving to be a dramatic differentiator in a market that has seen traditional banking products and services become commodities. The effective use of data is enabling businesses to operate more effectively and data & analytics (D&A) will soon become a necessity to survive in an increasingly competitive and digitally driven market.

A final challenge which—like many of the other themes we have focused on—could become a source of competitive advantage is the risk posed by cyber-security. Cyber under-preparedness is a strategic threat to banks’ future growth, particularly when so many are undertaking ambitious, customer-focused transformation programs amid widespread technological disruption and competitive threats. In a region which is increasingly prone to malicious attacks, building a more adaptive, agile cyber security strategy that aligns more closely to the business will help set the stage for security, innovation and growth.

The common theme across all areas is the need for a strong and positive culture. As a start, clients may find it useful to:

— Self-assess against regulatory core standards and principles and the expectations of other stakeholders
— Clarify how improved governance will be measured from a commercial perspective
— Seek independent assurance of progress made and gaps still to be addressed

We look forward to driving this debate forward in the UAE and ensuring our clients understand the importance of culture in getting the balance right.
Regulate

a : to govern or direct according to rule
b  (1) : to bring under the control of law or constituted authority
    (2) : to make regulations for or concerning • regulate the industries of a country

Source: Merriam-Webster
The Basel III challenge - liquidity or capital?

Steve Punch

For banks, both here in the UAE and more generally, there is no doubt that regulation is a significant driver of strategic agendas. Financial services firms are buffeted from a number of different positions. They must manage a complex suite of new and pending rules enacted by global, regional and national policy setting bodies, leading to changes in strategy, business models and operating procedures. Implementation of complex changes over extended timescales, coupled with impending changes from what has loosely been bundled together as Basel IV, is forcing banks to change the way they operate and address fundamental issues around profitability and future plans. Managing regulatory change is a major business issue in itself.

Prior to the global financial crisis, one key measure of bank survival was the amount of capital it held over and above the amount of mandated regulatory capital. The obvious answer to the question we pose in the title therefore would have - before the global financial crisis - been "no". However, the reality is that, just prior to the global financial crisis, banks globally were well capitalized and exceeding regulatory thresholds. As the crisis unfolded and in the ensuing aftermath, banks continued to be sufficiently capitalized, at least according to Basel's minimum requirements. The repricing of credit evaporated the interbank funding that bridges the gap between a bank's assets and liabilities.

Perhaps a more appropriate answer to the question we pose in the title is, "well, it depends". If markets are behaving "normally" (or as they have done in the past), then the capital set aside should be sufficient to cover both expected and unexpected risks. However, during times of abnormal stress, it appears that deep capital reserves may not be sufficient to ensure bank survival and that liquidity is perhaps more important.

Developing more resilient banking systems

The Basel response to the global financial crisis and the deficiency in liquidity guidelines was swift. Initial consultative papers for the 30-day liquidity coverage ratio (LCR) and one year net stable funding ratio (NSFR) were released in 2010, with final regulations released in 2013 and 2014 respectively. The implementation of these rules is currently in transition, with implementation dates expected by January 2019.

The Central Bank of the UAE (CBUAE) has responded promptly and requested banks to meet minimum qualitative and quantitative liquidity requirements. Local banks have been quick to move, realizing the importance of the new measures. Several banks have been internally reporting Basel III LCR numbers for some time and are now investing heavily to ensure a sound liquidity system with appropriate systems and controls in place to comply with the new regulatory requirements. In fact, several local banks have independently reviewed the framework and have subsequently been granted approval from the CBUAE to adopt the Basel III LCR.

Is this the end of the process?

The introduction of new liquidity measures effectively requires banks to hold sufficient liquid assets to ensure they remain liquid during times of severe stress. These measures have led to a scramble for stable deposits that has already pushed deposit rates up. The negative net interest margin (NIM) effect is being split, with borrowers paying part of the premium to help preserve banks margins, ultimately dampening credit growth.

Notwithstanding the changes to the liquidity framework, it seems the regulatory agenda is not yet complete. As the Basel Committee releases fresh discussion papers that will usher in new ways to calculate Pillar 1 risks, referred to as Basel IV, most regulators are still grappling with the burden of introducing Basel III requirements within their own jurisdictions. There are several BCBS "works in progress", such as the standardized measurement approach for operational risk and the revised standardized approach for credit risk.

Most regulators are still grappling with the burden of introducing Basel III requirements within their own jurisdictions.

"
With this in mind, the CBUAE recently released Circular 52 covering local adoption of the Basel III capital changes. There are effectively three central themes to the new CBUAE rules: a significant amendment to minimum CET1 levels; the introduction of a capital conservation buffer of 2.5 percent of CET1 capital for all banks; and a countercyclical buffer and other capital reserves that may be brought in as needed by the CBUAE.

### Capital adequacy requirements

The overall effect of Circular 52 is that minimum local capital adequacy requirements will be raised from 12 percent to 13 percent and may also include additional buffers as a cushion against macro-economic idiosyncratic or global shocks. However, the quality of the capital base is stronger, as it reflects a higher level and proportion of CET1 and Tier 1 capital overall. Depending on an individual bank’s situation, these changes could impact their ability to lend, and potentially lead to lower credit growth.

#### Improving capital

While Basel II focused on expanding the risk-weighted asset (RWA) definition to include risks and introduced the internal capital adequacy process (ICAAP), Basel III rationalizes the numerator of the CAR calculation and strengthens the capital base. Tier 3 capital is no longer recognized and the definition of what can be included in Tier 1 and Tier 2 capital has been tightened.

No longer can banks lead annual strategy sessions with credit growth as the single denominator upon which strategy is formed. Strategy will need to consider liquidity constraints upfront, and with a particular focus on the extent to which the bank can fund its customers’ needs. Making something stronger invariably requires upfront pain. Depending on how banks react, it is possible that that pain will gestate into lower banking sector profitability, lower credit growth and slower GDP growth, with sector restructuring also an important step that will ensure a healthier banking sector.

### UAE capital requirements

- **Minimum CET1 ratio**
  - Basel II 2016: -
  - Basel III 2017: 7.0%
  - Basel III 2018: 7.0%
  - Basel III 2019: 7.0%

- **Minimum Tier 1 capital ratio**
  - Basel II 2016: 8.0%
  - Basel III 2017: 8.5%
  - Basel III 2018: 8.5%
  - Basel III 2019: 8.5%

- **Minimum CAR**
  - Basel II 2016: 12.0%
  - Basel III 2017: 10.5%
  - Basel III 2018: 10.5%
  - Basel III 2019: 10.5%

- **Capital conservation buffer**
  - Basel II 2016: -
  - Basel III 2017: 1.25%
  - Basel III 2018: 1.875%
  - Basel III 2019: 2.5%

- **Total capital**
  - Basel II 2016: 12.0%
  - Basel III 2017: 11.75%
  - Basel III 2018: 12.375%
  - Basel III 2019: 13.0%

- **Countercyclical buffer (at the discretion of the CBUAE)**
  - Basel II 2016: -
  - Basel III 2017: 0-1.25%
  - Basel III 2018: 0-1.875%
  - Basel III 2019: 0-2.5%

**Note:** Additional capital requirements for domestic systemically important banks (D-SIBs) will be notified separately by the CBUAE.

**Source:** Circular 52/2017, CBUAE

“Making something stronger invariably requires upfront pain. Depending on how banks react, it is possible that that pain will gestate into lower banking sector profitability, lower credit growth and slower GDP growth, with sector restructuring also an important step that will ensure a healthier banking sector.”
IFRS 9 - lessons from implementation

Yusuf Hassan

IFRS 9 - Financial instruments was issued in July 2014 and was widely seen as a game-changer in financial instrument accounting. Put most simply, the effects of IFRS 9 can be grouped into three categories – classification, impairments and hedging.

Categories for classification of financial instruments were reduced and the accounting of financial assets was aligned with how they were managed. We moved from an incurred loss approach to an expected loss approach, with bankers asked to provide 12 month expected credit losses on loans and investments from the day they were acquired. A further increase in provisions is required when there is a significant increase in credit risk with the expectation that more losses will be recognized earlier. And a more logical economic relationship test has been introduced for hedging.

Most banks here in the UAE are now entering the last phase of parallel runs before the go live date (1 January 2018) with the current quarter ending 31 March 2017 the first to be reported under IFRS 9. What have they learnt along the way?

Setting up an appropriate governance framework was critical. Most banks set up technical committees, focus groups and an overall project board that reported periodically to the audit committee. Representation from risk, finance, business, auditors, consultants and internal audit was needed. We saw a number of technical challenges early on as there were – at least initially – few international precedents. Clarifications from the IASB and others eased the interpretation burden – although certain interpretations are still being discussed and deliberated.

Most banks underestimated the time and effort needed for the impairment phase. Ongoing efforts remain significant and we may not know the real outcome for another six months. Financial reporting and risk teams – in some cases for the first time - have had to work closely together, particularly on impairments and disclosures. IFRS 9 implementation also often includes a risk and finance system implementation project, with some banks taking the opportunity to develop an integrated solution for all aspects of financial reporting. Larger banks had separate teams reporting to the project board to address data- and system-related issues - one of the biggest issues in successful implementation. Most banks appointed consultants to advise on technical accounting and model validation issues.

Sometimes, internal audit was involved, focusing on gaps in documentation and governance issues.

While early fears relating to excessive additional provisions seem to have been put to rest, the time and effort involved in post-implementation support will be significant. Models will need to be maintained and revisited. IFRS 9 is likely to impact the way banks price loans, sell investments, arrange loans and manage financial assets. Risk and accounting professionals have had to develop a new technical skill set – and retaining these professionals has been challenging.

Banks that began preparing to implement IFRS 9 in early 2016 have a first footers’ advantage. The CBUAE has received initial impact assessments and is charting a future course of action. Banks that haven’t yet kick started implementation have little time to lose.

It remains to be seen whether the implementation of IFRS 9 will meet the IASB’s objective of simplifying accounting for financial instruments. The future of accounting, it is fair to say, is less uncertain but definitely more interesting.

“ The ever changing regulatory environment is piling further pressure on banks. ”
The importance of good correspondence

Katerina Pagoni

What lessons can be drawn from a third regulatory challenge? In the wake of the global financial crisis and the ensuing proliferation of stringent and far-reaching regulation, financial institutions are struggling to balance risk management with growth. Averse to the rising costs and resources required to assess and mitigate the risk associated with international exposure and business relationships, some financial institutions are restricting business relationships with entire countries or classes of customer. Correspondent banking - which facilitates the cross-border movement of funds and provides financial institutions access to financial services in different currencies and foreign jurisdictions, supporting international trade, commerce and economic development - has been a particular target.

Global regulators and bodies, such as the UK’s Financial Conduct Authority (FCA) and the US Department of the Treasury are concerned that a decline in correspondent banking may drive payment flows underground, posing a threat to the stability and integrity of the financial system. ‘De-risking’ correspondent banking relationships could, perversely, increase the risk of the financial services system being abused by criminals.

Research recently performed by the FCA suggests that firms blame tighter anti-money laundering (AML) requirements as the reason for exiting business relationships, when in fact the reasons have often been commercial. Financial institutions, here in the UAE and in global banking centers, must ensure they have effective governance in place to adequately assess risk and consider any adverse impact that the termination of correspondent banking relationships may have on customers and countries.

Likewise, central banks may wish to strengthen their AML and counter-terrorist financing (CTF) frameworks to increase confidence and trust in the region’s financial system and enhance global business relationships. The 2016 Basel AML Index ranks countries according to their risk of money laundering and terrorist financing. While GDP and offering cross-border financial services increase risk factors, the Basel Institute on Governance uses five key factors to determine risk: a lack of public transparency, high levels of perceived corruption, shortfalls in the AML/CTF framework, poor financial standards and transparency, and weak political rights and rule of law. While the index scores are supposed to be used to rank countries, and not directly compare them, it is instructive that Iran is ranked as the highest risk country – and Finland is ranked as the lowest.

Raising governance standards and working with financial institutions to enhance and grow business relationships is likely to achieve a common good: increasing the stability of the global financial system.

Financial institutions must ensure they have effective governance in place to adequately assess risk and consider any adverse impact that the termination of correspondent banking relationships may have on customers and countries.
Tax changes challenging businesses

Clare McColl and Umair Hameed

Along with the regulatory changes we have already looked at that are being driven externally, there are two specific changes that are going to herald the dawn of a new era for the banking sector in the UAE: value added tax (VAT) and common reporting standards (CRS). These are both likely to have a significant impact on every bank currently operating in the UAE.

What about VAT?

The government has – up to the date of writing – continued to suggest that VAT will be introduced in the UAE with effect from 1 January 2018, with other GCC member states set to implement VAT over the course of the next 12 to 24 months. So why does VAT matter to banks? In short, because VAT is likely to be an irrecoverable cost, negatively affecting margins for the banking sector. It is therefore imperative that the impact of VAT on UAE banks is clearly understood.

VAT is a tax on transactions and impacts all areas of business from IT systems to legal, HR to marketing, and procurement to finance. The standard rate of VAT is expected to be five percent. An additional taxable rate of zero percent may be extended by some GCC member states to cover certain financial services. Whether a service is supplied at either five percent or zero percent, the taxpayer making the supplies is generally entitled to recover any VAT incurred on their costs – for banks, this will include administrative and cash flow costs.

However, it is likely that many financial services will be VAT exempt. VAT exempt is not a rate of tax and so cannot be added to the price of goods or services. Supplies that are VAT exempt do not typically allow for VAT incurred on costs to be recovered, thereby creating a blocked VAT cost.

“VAT matters to the financial services industry because it is likely to be an irrecoverable cost for the banking sector. It is imperative that the impact of VAT on UAE banks is clearly understood.”

Banks are likely to have supplies at various VAT rates. Ordinarily, it would be expected that fees for services would be standard (five percent) rated. Transactions involving moving money are likely to be VAT exempt. International transactions may be zero rated or outside the scope of VAT.

A bank that provides both taxable (whatever the rate) and VAT exempt services will be required to calculate how much VAT it is entitled to recover. The exact amount will depend on the currently unreleased UAE legislation - international practice varies from fixed percentages to reasonable or special methods that may require negotiation with the tax authority.

With less than ten months until implementation, time to prepare is short. Many banking organizations have already started their VAT journey. The first steps are to secure resources, plan and analyze the project, raise awareness and assess VAT’s impact. This clearly involves identifying and mapping the categories of supplies based on the expected VAT outcome: five percent, zero percent and VAT exempt. This should be done now – assessing VAT impact typically takes two to three months and will not be significantly affected by national legislation.

Why VAT matters

Electricity bill for AED1000 (plus VAT at 5%)

Bank

Airline

Shop

VAT exempt supplies

0% rated supplies

5% rated supplies

AED50 can’t be recovered from the tax authority – must be covered by the business or passed on to customers

AED50 can be recovered from the tax authority

No effect on costs or profits

Higher customer charges

Lower profits

Numbers, companies and other details are representative
Assessing VAT’s impact will help determine the steps required to implement VAT. This will include internal and external resources, changes to IT systems, documentation and training, followed by VAT registration and testing to ensure compliance with the new tax regime. These are significant changes and will take time to implement – as will another external change.

**How common are CRS?**

The US Congress enacted the Foreign Account Tax Compliance Act (FATCA) in 2010 as a means of preventing offshore tax abuse by US persons. FATCA rules, which came into effect by 2013, required global financial institutions to start identifying and reporting US persons to the US tax authorities on an annual basis.

In 2014, common reporting standards (CRS) – also known as the automatic exchange of information (AEoI) - was proposed by the OECD as a global version of FATCA to counter tax evasion and increase transparency. CRS requires financial institutions in participating countries to report information on certain entities and accounts held or controlled by tax residents of reportable jurisdictions to other tax authorities. While Saudi Arabia formally signed up to the agreement in November 2016, bringing the total number of signatories to 87, the UAE has committed to sign up. The UAE’s Ministry of Finance, as well as other regulatory authorities, have been proactively engaging and communicating with financial institutions to ensure they are CRS ready.

The Central Bank of the UAE, in a workshop organized in November 2016, confirmed the 1 January 2017 go-live date and instructed regulated entities to ensure that they were ready with CRS compliant on-boarding procedures. The CBéUAE has also issued guidance to provide further clarity on CRS requirements. However, many financial institutions seem to be lagging in their CRS implementation efforts.

The increased volume of data to be collected, stored, retrieved and reported under CRS is a significant logistical challenge. The bigger challenge, however, is around new customer communication and existing customer remediation. Whilst FATCA was relatively binary - customers were either US nationals or not - under CRS a customer may have multiple tax residency jurisdictions. Financial institutions should build on their FATCA experience to help develop more complex and far-reaching CRS processes and procedures, including training for relationship managers and the back-office team responsible for data management.

Financial institutions should also consider obtaining CRS relevant information from all their customers, rather than only customers from jurisdictions that have signed up to CRS as the number of participating countries continues to increase. As of the end of February, 139 countries had signed up. It will surely only be a matter of time before other countries also come on board.

**How CRS works**

While VAT and CRS are both assessed here in terms of the impact they have on an institutional level, they will both also impact individuals. CRS means financial information can be accessed by any jurisdiction where they are tax resident. “Banking privacy” is increasingly becoming a relic of the past. Tax evaders should be worried. Those of us who file and report our taxes have nothing to hide. Equally, VAT will almost certainly increase prices of many of the goods and services we access on a daily basis here in the UAE, including electricity, clothing and many household items.

> It will only be a matter of time before other countries also come on board… Tax evaders should be worried. Those of us who file and report our taxes have nothing to hide.
Why trust is key for banks and SMEs

Keith Buck and Abbas Basrai

Small and medium-sized enterprises (SMEs) are the lifeblood of the UAE economy. They contribute approximately 40 percent of total UAE GDP (or 70 per cent of non-oil GDP) and employ 42 percent of the workforce.

However, in recent years, SME business owners have faced multiple challenges. To start with, there was a macro-economic slowdown which began in China, a steep reduction in commodity prices across the globe (with a subdued oil price significantly impacting all of the GCC economies) and the devaluation of a number of major currencies, making exports more expensive. An austerity drive from the UAE government – sparked by many of the same factors – has further tightened liquidity.

Combined with a general, endemic and long-standing reluctance to pay suppliers on time, this has resulted in a number of SMEs having working capital issues, leading to an inability to repay their debts. Due to volatility in the market and an unclear macro-economic outlook, SME owners have struggled to accurately predict and control cash flows, working capital cycles and inventory levels, all of which has had a direct impact on profitability margins and a knock-on impact on cash and debt repayments.

There have been a number of different reactions to these difficulties, by both the banks and the regulatory authorities. Some banks have chosen to exit the SME segment completely, while others have reduced exposures to certain industry segments. The Central Bank of the UAE (CBUAE) has worked with banks to enhance credit standards. However, statistics from the CBUAE suggest banks are less willing to extend finance, despite increase demand for credit, due to heightened risk aversion. For some SMEs, it has simply become more difficult and more expensive to borrow.

The reaction of the banks is - to some extent - a reaction to the misuse of advanced funds, in particular from core businesses into riskier deals – such as property and real estate development – or unrecoverable assets offshore. Banks have learned their lesson and are pushing forensic due diligence of receivables, inventories and cash flow statements. Some SME owners have unfortunately translated this leading practice as a lack of faith, resulting in a strained relationship with their bankers.

However, there is a silver lining. While banks enhanced credit due diligence and tightened standards, they became more aware that some previously successful – and still well run - businesses were facing real distress and needed financial support. This began with several banks holding joint lender meetings with distressed SME owners. More often than not, the first meeting began with the banks and the SME owner trading charges about lack of transparency and being uncooperative. Fortunately, later meetings evolved into consultative and problem solving sessions. Banks also formed a cohesive SME working group under the umbrella of the UAE banks federation (UBF).

The UBF has now formally adopted a collaborative blueprint to address the distressed SME market. SME owners who have demonstrated a willingness to work with their banks, instead of ‘skipping’, and have established business credibility, are being given particular support. Banks are maintaining active dialogues, helping to analyze business plans and find flexible solutions. According to the UBF, this initiative helped to restructure some AED7b of debt owed by more than 1,700 companies in 2016.

Numerous SMEs have benefitted from longer tenors to repay existing debts, with working capital lines to support business as usual. Some SME owners, who clearly understand the situation and the sentiments of their bankers, are giving banks enhanced collateral in return for continuing facilities, demonstrating their commitment to their business.

“SME owners have struggled to accurately predict and control cash flows, working capital cycles and inventory levels, all of which has had a direct impact on profitability margins and a knock-on impact on cash and debt repayments.”

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Another important development is the UAE’s new bankruptcy law which provides three options for distressed SMEs: preventative composition (a pre-insolvency “debtor in possession” rescue scheme akin to the US’ Chapter 11), restructuring and liquidation. Under the new law, a court application for preventative composition allows for the possibility of obtaining new financing on a priority basis, provides for a moratorium on enforcement and includes measures allowing the cram down of unsecured claims. It does not, however, allow the claims of secured creditors to be crammed down without their consent.

Restructuring is an out-of-court process that involves the newly established committee of financial reorganization supervising the restructuring in a manner mutually agreeable to debtors and creditors. The liquidation option ensures that full bankruptcy proceedings can be brought in the courts.

What impact will the law have? We don’t expect a flood of court applications. While the law contains aspects that make preventative composition or bankruptcy more attractive, creditors, banks and SMEs are still likely to restructure debts in a consensual manner.

Like any new law, it will take time for all stakeholders to fully understand how the law will be implemented in practice. Until applications are filed, the approach of the courts and trustees, timelines and practical implementation of the law will remain theoretical. The bankruptcy law should, however, help promote SME bank-lending in the UAE and encourage potential ‘skippers’ to try to restructure their debts and save their businesses.

Trust and transparency are key. Despite economic headwinds, these fundamentals, combined with continuing government support, better risk profiling by banks and more robust approaches to core business planning and cash generation, will continue to drive broader economic participation and success through 2017.

“The bankruptcy law should help promote SME bank-lending in the UAE and encourage potential ‘skippers’ to try to restructure their debts and save their businesses.”
Innovate

: to make changes : do something in a new way

Source: Merriam-Webster
Remaining relevant in the age of robots

Farhan Syed

We live in interesting times. From political turmoil and election surprises to rising nationalism and protectionism, any outsider may well be skeptical about where markets are going. Yet the UAE CEO Outlook we released in December 2016 shows positivity throughout industries, including the banking sector: 91 percent of the CEOs we interviewed expect their businesses to grow over the next three years. Perhaps even more surprising, constant change actually drives optimism – where some people see risk and focus on damage control, leaders see opportunities to improve, to create new markets and to encourage growth.

Innovation – such an important factor in economic growth - happens faster in the banking sector. Until relatively recently, the sector was closely guarded by protectionist rules and a lack of truly differentiated options. Advancements in technology have made data storage and processing power faster and cheaper. Browsing the internet has become many people’s preferred weekend activity. FinTech is paving the way for radical disruption of both the financial services industry and capital markets.

Banks recognize that technology is a major driver of opportunities as well as cost, so key decision makers – and the regulators - are cautiously navigating through some more radical concepts like blockchain, cloud computing and artificial intelligence (AI). Still though, millions of staff hours are devoted to trivial or manual activities, particularly in customer service, business support and operations. While big data or deep learning may grab headlines, the figures speak for themselves: automate trivial tasks and banks will reap huge benefits, not just in terms of significantly reduced costs and improved speed and accuracy, but also improved leadership, with staff freed up to focus on higher value activities.

This is where robotic process automation (RPA) helps. RPA is automation software that executes tasks and activities in the same way a human operator would interact with applications and systems. At KPMG, we call it digital labor - replicating the specific actions and decisions an operator would take while working on the computer and interacting with an IT application.

In the next 15 years, some analysts suggest that at least half – and possibly as many as three-quarters – of back and middle office jobs in the banking sector will be performed by RPA. And it is not just administrative roles. Today’s complex global financial markets require unprecedented levels of speed, accuracy, and cost efficiency - beyond what a human can provide. That’s why banks are increasingly turning to RPA and AI-driven cognitive automation to transform their businesses.

Although capital markets have been expanding, competition from traditional competitors as well as from disruptive new entrants is increasing. Some of these new entrants are far more nimble and tech savvy than established firms with legacy infrastructure to support. This increased competition, together with the ever-mounting pressure to reduce costs means firms have to work smarter, not just harder.

Constant change actually drives optimism – where some people see risk and focus on damage control, leaders see opportunities to improve, to create new markets and to encourage growth.

One important aspect of RPA that should be considered early in the process is how to get employee buy-in. This will be particularly important in the GCC, where the finance sector has been one of the most significant sources of coveted private sector jobs. Banking isn’t the only industry that will be affected - some industry observers predict that more than 100 million knowledge workers could be replaced by robots by 2026.

RPA is the use of machine intelligence and software tools to perform human tasks. Cognitive automation is a confluence of many technologies- including natural language processing, machine learning, data analytics and probabilistic reasoning – which combine to interact, learn and simulate decision making the way a human does.
Without building employee support – by focusing on operational effectiveness and efficiency, demonstrating the value of being involved with these high-tech tools, building quick wins and ensuring that systems work before rolling them out – the process is likely to be slow, difficult and disruptive.

RPA solutions assist organizations to improve service delivery, reduce costs and derive specific business outcomes to achieve sustainable, continuous improvements and competitive advantage. However, it is important to assess where RPA offers the most benefits by identifying how and where RPA can be used to optimize processes, as well as selecting the right automation vendor. Once a bot has been selected, appropriate programming is critical so it replicates the actions of a human operator, logs all activities and identifies exceptions where further investigation is required.

RPA already has a place in the banking sector. It is generating significant labor cost savings and offers significant benefits in terms of speed, accuracy and productivity - and the ability to gather, input, and analyze vast amounts of data. For banks, both here in the UAE and more broadly, the questions key decision makers should be thinking about are “How quickly do I want to get on board?” and “How deeply do I want to dive in?” Your long-term survival may depend on your answers.

The three stages of RPA
The rise of the aggregator

Umair Hameed

Despite the hype, it’s increasingly apparent that there has been limited innovation when it comes to retail banking products such as personal loans, credit cards, mortgages, savings and deposits accounts. In fact, rather than seeing innovation, these product segments have actually become increasingly commoditized and standardized, with differentiation primarily confined to rates and fees.

Given such high levels of standardization and commoditization, it’s no surprise that retail banks end up having to push their products to customers, whether through advertisements in print and digital media, promotional campaigns or other aggressive sales pitches. How many of us receive text messages and calls – on a daily basis – from retail banks trying to offer us products we don’t really want, or, in some cases, already have? The ongoing push by outsourced salespeople trying to sell premium credit cards is just one example.

Customers are often left feeling that the terms, fees and exclusions associated with a given product have not been fully disclosed and – in a worst case – might end up worse off.

Whilst the push model has been relatively successful in the UAE, it drives up the cost of acquiring new customers in the UAE’s highly competitive retail financial segment. At the same time, the lack of differentiation decreases customer “stickiness”, as customers switch product providers on the basis of lower rates or better benefits.

Some may argue that the time and hassle associated with “shopping around” is outweighed by financial gains. With over 75 banks and finance companies operating in the UAE, obtaining rates for each type of credit card, personal loan, mortgage, or saving products from each provider has been cumbersome.

However, with the advent of FinTech, a new wave of retail financial product comparison websites (or aggregators) have significantly simplified the process of shopping around. While a relatively new phenomenon in the UAE, these aggregators cater to the tech savvy, price conscious, busy consumers of today, with simplicity, product transparency and ease of navigation being their mantra.

Using aggregators’ web portals or mobile apps, customers enter their requirements and the aggregator can instantly churn out a raft of product options, including rates and features. Some aggregators in the UAE feature thousands of different products.

“ These aggregators cater to the tech savvy, price conscious, busy consumers of today, with simplicity, product transparency and ease of navigation being their mantra. ”
Depending on which product the customer selects, the aggregator then either directs them to the product provider’s portal or, in some cases, the purchase can be completed on the aggregators’ portal itself.

With aggregators, the entire sales model gets reversed. Customers source and “pull” what they need from the market, rather than financial institutions “pushing” products that customers may not want. Aggregators tend to charge the same commission levels to all service providers, further reducing any product bias. As the aggregator is only providing different options, rather than recommending any particular product, the customer feels a lot more empowered. In time, aggregators build greater levels of trust, resulting in more repeat business.

Aggregators in the UAE market are experiencing 60-80 percent CAGR (admittedly from a low base) in the number of products being purchased through their platforms.

From the perspective of a retail bank, these aggregators ultimately become another digital channel through which they can sell their products. For some of the smaller financial institutions, it makes more sense to sell products exclusively through aggregators, rather than having to worry about the cost and complexity associated with building internal sales capabilities.

Ironically, it’s the aggregator that initially relies on retail financial institutions to offer their products on its website. However, as more and more institutions list their products with aggregators and an increasing number of customers start to use aggregator portals, the situation reverses.

It then becomes a case of the financial institutions needing to ensure that their products are available for purchase through the aggregators, otherwise they run the risk of losing business.

At the same time, given the data that aggregators collate from customers with each product search and purchase, the aggregators end up knowing much more about the entire market rather than any single financial institution – which only has access to data for their own customers. With such customer insights on preference and pricing, the aggregators can partner with retail banks to develop dynamic pricing models for different products.

Retail financial institutions need to realize that, with a commoditized and standardized product offering, and increasing disruption to the traditional competitive model, as aggregators increasingly becoming the intermediary between them and the end customer, they are one step further away from having a direct interface with the customer – and one step closer to becoming invisible to the customer. It’s time for these retail financial institutions to rethink their roles in the value chain.

“Retail financial institutions need to realize they are one more step further away from having a direct interface with the customer – and one step closer to becoming invisible. It’s time for these retail financial institutions to rethink their roles in the value chain.”
Nurture data as you would your customers

Cristian Carstoiu

Most bankers agree that data is the new black - or, perhaps more relevantly for the UAE, the new oil. With one important distinction: data’s market value is not going down. On the contrary, data is proving to be a dramatic differentiator in a market that has seen traditional banking products and services become commodities.

There is no time like the present. Analysis suggests that many banks – both here in the UAE and globally - continue to make decisions by looking back at what may have gone wrong. However, leading organizations are using new analytics tools to predict the future—and getting it right. Banks live and die by data, but are internal sources sufficient? The more data-rich the models are, the more accurate they are, which is why local banks have started combining internal bank data with external sources. For example, the Dubai data law (2015) ensures that data gathered by Dubai government entities can be shared with the private sector to capture the benefits of that data for the emirate’s residents and visitors. The open data platform will soon host a wealth of aggregated data, representing a gold mine for any organization, not just banks.

Our 2016 Global CEO Outlook confirmed that many global CEOs clearly feel they are not keeping up and identified data and analytics (D&A) as one of their top three investment priorities for the next three years. But how and where should organizations start? Investing in D&A can be extremely expensive: infrastructure, software and services costs, combined with a serious, difficult to solve scarcity of skilled D&A personnel, are one reason the D&A “solution-as-a-service” model has become pervasive in many smaller and medium-sized banks.

As banks digitize front-end processes and increasingly turn to targeted digital marketing, there is still more information available that can be analyzed to predict behavior and outcomes. If predictive analytics can identify the customers who will ask for a personal loan in the coming weeks or months or accurately predict when a particular SME customer will default (and how far into the red they may be), why say no? After all, it is much easier to get internal alignment and make decisions if you already know what is going to happen.

From a marketing perspective, D&A is easily the most valuable technology, outperforming marketing platforms and wearables. D&A can improve the accuracy of targeting and increase conversion rates. Marketing platforms enable banks to reach customers digitally, expand their target market and significantly lower the cost of both reaching desired customers and launching new products and services. While customer acquisition is a thorny issue in a busy banking environment, advanced analytical approaches help sales officers identify acquisition leads by analyzing customers’ social networks.

Key drivers of D&A trust

Infrastructure, software and services costs combine with a serious, difficult to solve scarcity of skilled D&A personnel.

Making decisions or targeting consumers based on inaccurate predictions will quickly erode, if not extinguish, consumer trust and shake the confidence of those executives who rely on these predictions to make informed decisions.
According to our Global CEO Outlook, just 38% of organizations have a high level of confidence in their customer insights. And only a third of CEOs seem to trust the analytics they generate from their business operations. Yet the vast majority say these insights are critical to their business decision-making. Almost exactly the same majority of CEOs also recognize that the reports generated are cumbersome and, when available, any valuable business insights are hidden between layers and layers of graphics and charts. Optimized reporting allows CEOs to increase visibility across KPIs and drives management performance and efficiency.

D&A drives better forecasting by analyzing sales patterns to optimize limited resources like human capital costs or staff allocations by branch. Running accurate, multiple what-if analyses helps product and service departments to forecast financial impact and adapt services to customer demand - or competitor activity - more quickly. In a similar fashion, using data pointers throughout existing back-, middle- and front-office processes allows accurate and fast analysis of where inefficiencies lie and generates valuable insights into how to gain operational advantage.

Lower profits encourage courageous cost-cutting actions, such as increasing the productivity of sales officers, predicting employee performance and lowering attrition rates. Questions like how to identify and retain the salespeople with the greatest potential; who should be invested in and how; why the performance of salespeople differs; which salespeople are considering leaving the company; and how to keep those with the most potential can be – at least partially - answered using D&A algorithms that analyze structured and unstructured data, combining endogenous and exogenous data to form a universe of thousands of data points for each individual and then generating insights for each particular question.

The effective use of data is enabling businesses to operate more effectively. Although D&A is currently seen as a differentiator, it will soon become a necessity to survive in an increasingly competitive and digitally driven market.

D&A underpins competitive advantage

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Next steps: master trusted analytics

- Get basics right: assess your trust gaps and identify priorities
- Set purpose: clarify and align goals and measure performance and impact
- Raise awareness: increase internal engagement
- Develop expertise: build internal cultures and capabilities - your first guardian of trust
- Be transparent: open the ‘black box’ to a second set of eyes - and a third
- Develop a 360 degree view: look at ecosystems, portfolios and communities
- Innovate: enable experimentation and build an innovation lab
Making cyber security a source of competitive advantage

Emilio Pera

Banks are caught in something of a perfect data storm: disruptive technologies, the evolution of customers’ expectations, connectivity and the sheer volume of sensitive data is increasing risk but – importantly and simultaneously – opportunities for those organizations that manage this challenge well.

When most of us hear the term ‘cyber security’, the first thing that may come to mind is an IT infrastructure challenge. Of course, strong IT security infrastructure is a critical part of any cyber security program. However, it is not the only part. In 2017, a traditional ‘defense-first’ mindset is too limited and can actually hinder long-term growth prospects. Cyber under-preparedness is a strategic threat to banks’ future growth, particularly when so many are undertaking ambitious, customer-focused transformation programs amid widespread technological disruption and competitive threats.

Tomorrow’s leading businesses will ultimately wield their cyber security capabilities as a competitive advantage. For customers, cyber security solutions are a core value proposition to drive growth. For management teams, board members and investors, they are a necessity to continue investing in technology-enabled transformations. Without confidence in cyber security solutions from all of these stakeholders, organizations limit their ability to innovate business and operating models, leading to the loss of customers and slower growth.

As the fourth industrial revolution ushers in an era of machine learning, cognitive computing and artificial intelligence where virtually everything is connected through the internet of things, the pace of change continues to accelerate. The bottom line for CEOs transforming their companies is that they and their leadership teams need to act now to implement a strategic, holistic approach to cyber preparedness that will not only protect their valuable data, but also enhance agility and better position their company for future growth.

“Supervisors, banks, and cyber risk specialists generally agree that a real-time alert database could significantly improve cyber resilience.”

Most CEOs have some perception of the risk side of the cyber equation: if we don’t do this and we have a breach, we will lose customers which will negatively impact our brand. But there’s also a positive aspect to this equation: cyber preparedness can actually enable companies for new opportunities for revenue growth. This is a message that more and more CEOs are keen to hear. Adopting new technologies to gain a competitive advantage, like putting information ‘in the cloud’, is becoming increasingly commonplace. Leading cloud service providers understand security is a priority for their clients and so build their systems accordingly. Being more agile than competitors with legacy, slow-moving IT infrastructure is giving some banks – traditional and non-traditional - a distinct competitive advantage.

Another major opportunity is to view cyber security as a strategic part of a company’s holistic business strategy, rather than simply as an IT risk. The question shouldn’t be ‘How much of my IT budget are we spending on cyber?’ but ‘How much of my business change and innovation budget are we spending on cyber security?’ Treating cyber security as something wider than a pure IT risk allows opportunities and inflection points that could help fuel business growth.

Data is the lifeblood of modern business. A high-quality cyber preparedness program will not only focus on keeping data safe and secure, it will also help to increase and improve the integrity of that data, ensuring you have the right, complete data as a base for business decisions.
In KPMG’s 2016 Global CEO Outlook, cyber security was the top risk named by global CEOs, up from the fifth-highest ranking last in the prior year. Despite this global level of awareness and concern, 72 percent of CEOs say their companies are not fully prepared for a cyber event. In the UAE, awareness is still emerging. Only seven percent of UAE CEOs cited cyber security as a top investment area, compared to 22 percent of global CEOs. Roughly a quarter of UAE CEOs saw cyber security as a top three risk.

However, companies – here and globally - are hungry for growth. CEOs have told us they’re prioritizing innovation at a strategic level. Organizations that continue to underinvest in cyber security will quickly find that under-preparedness becomes a top barriers to innovation. In an increasingly connected and fast-paced business environment, leadership teams must look at every major business decision through a cyber-security lens. They need to ensure that they have people in all parts of the organization who understand cyber issues. And they need to talk about and plan for these issues up front, so they can understand where the business is going, plan for that change and build a more adaptive, agile cyber security strategy that aligns more closely to the business to help set the stage for security, innovation and growth.

Anatomy of a regional FS hack
(July 2015 to April 2016)

Recon: Automated SQL scans saved on bank’s domain

C&C: Bank’s environment accessed remotely through web-shell

Execute: Data extracted over 9-10 months

Weaponize

Install: Web-shell installed on web server

Deliver

Exploit: SQL scans injected onto server to access underlying database

“In an increasingly connected and fast-paced business environment, leadership teams must look at every major business decision through a cyber-security lens.”
Contributors and key banking indicators

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 banking survey analyses and compares the performance of approximately 60 of the GCC’s leading listed banks. A snapshot of those findings is included on pages 30 and 31.
We are proud of our reputation for delivering cutting-edge solutions and exceptional client value. With over 75 partners and directors leading over 850 professionals across six offices in the Lower Gulf, we work shoulder to shoulder with our clients, offering independent audit, tax and advisory services to business corporations, government bodies and not-for-profit organizations. We are proud of our reputation for developing our people and the wider business community. We actively support our staff and are recognized as a leading employer.

Complemented by a global network of dedicated partners and professionals located across the global network of individual firms, our value lies in our depth of talent and the experience we have gained helping clients respond to industry, market and regulatory changes and challenges. We work with our clients to adapt and capitalize on the trends being set by today’s rapidly changing environment. With deep industry experience, insight and technical support, our qualified professionals deliver a broad range of audit, tax and advisory services to meet the unique needs of our clients.

**Service offerings:**

**Audit**
- An independent audit is an important foundation for decision-making. Our experience matters. To deliver global audit leading practice, external auditors must fully understand the complexities of future directions and regulatory requirements. Understanding the financial performance of any business must be placed in the context of strategic priorities, risk appetites and competitive positioning. Our technology-enabled audit approach applies extensive data analytics to provide the necessary evidence confirming that critical controls and disclosures uphold the highest level of integrity.

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- Our high capability teams offer expertise, deep industry and technical knowledge, and market-leading tools to deliver solutions across every business and industrial sector. Our expert practitioners help clients to make better decisions, reduce costs, enhance organizational effectiveness and develop appropriate technology strategies.

**Risk Consulting**
- Our risk consulting practice combines the knowledge and expertise of over 100 partners, directors and professionals. We help organizations transform risk and compliance efforts into competitive advantage by applying a risk lens to corporate strategy. This improves risk intelligence and decision making, protects financial and reputational assets, and enhances business value.

**Deal Advisory**
- Our experienced investment professionals skilfully assess how opportunities to buy, sell, partner, fund or fix a company can add and preserve value. Our teams combine a global mindset and local experience with deep sector knowledge and superior analytic tools to support clients. From helping to plan and implement strategic change to measurably increasing portfolio value, we deliver tangible results.

**Tax**
- A business’s approach to tax is increasingly subject to public scrutiny and is now a major reputation driver. From company set-up to cross-border and transfer pricing solutions, we work with a wide range of national and multi-national organisations to deliver effective tax solutions. Our tax professionals combine international experience with local knowledge to provide leading edge commercial tax strategies tailored to specific client needs.

Tax issues are constantly evolving. Changes in law, practice, or approach – in the UAE and globally – can have major ramifications on local and international organizations.

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**About KPMG**

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Contributors

**Luke Ellyard**  
Partner | Financial Services | T: +971 50 240 2553 | E: lellyard@kpmg.com

Based in Dubai, Luke leads KPMG’s financial services audit practice in the UAE. He specializes in the audits of local and international retail and corporate banks and investment management firms, with additional experience on sovereign wealth funds, central banks across the region, exchange houses, private equity houses and DFSA regulated entities. Luke also adds a specialist financial services perspective to many of KPMG’s regional advisory engagements, including work on the first auto-loan securitization in the UAE, a number of bank asset buy-side due diligence exercises, internal audit, internal control design and implementation assurance, and most recently, regulatory advisory work across the UAE’s banking sector. While with KPMG in London and Japan, he worked widely with European and Asian global investment banking clients.

**Steve Punch**  
Director | Financial Risk Management | T: +971 50 240 2553 | E: spunch1@kpmg.com

Steve is an ex-banker and chartered accountant with more than 25 years’ experience with G-SIBs in Australia, the UK, Japan, New Zealand and Hong Kong. Before joining KPMG in 2011, he was a director at a Swiss bank based in Hong Kong. Steve is now Head of our Financial Risk Management (FRM) practice in the Lower Gulf, coordinating FRM across MESA. He has been a regular speaker at banking conferences in several counties and frequently contributes thought leadership to risk magazines, journals and newspapers.

**Yusuf Hassan**  
Partner | Risk Consulting | T: +971 50 167 5443 | E: yusufhassan@kpmg.com

Yusuf leads our Accounting Advisory Services function for the Lower Gulf firm and is widely recognized as a leading IFRS expert. He assists KPMG audit teams and clients with technical IFRS issues, in particular advising on: the interpretation and application of IFRS to specific transactions and scenarios; the implementation of the latest IFRS developments; standard setting processes; and regional IFRS issues. Yusuf has provided IFRS assistance to a wide range of blue chip clients in various industries across the Middle East. He has conducted IFRS training in South Africa and across the Middle East and has presented at a number of regional IFRS seminars.

**Katerina Pagoni**  
Associate Director | Forensic | T: +971 56 992 9366 | E: kpagoni@kpmg.com

Katerina leads our AML and sanctions practice in the Lower Gulf and is a compliance expert with over 23 years’ experience in banking and financial services consultancy. Prior to joining KPMG, Katerina led the financial services compliance practice for another Big 4 firm. Katerina possesses around 20 years’ banking experience at global financial institutions and has broad experience in money laundering deterrence, sanctions, financial crime, regulatory compliance and business risks.

**Clare McColl**  
Partner | Indirect tax | T: +971 4 424 8959 | E: cmccoll1@kpmg.com

Clare heads our VAT team in the Lower Gulf and is based in Dubai. She has 30 years’ VAT experience and was previously head of KPMG’s Scottish indirect tax team. She is a VAT and financial services specialist, having previously worked on a wide portfolio of financial services clients in the UK including banking, insurance, fund managers, pension funds and private equity. Clare previously worked for the UK government and latterly chaired meetings between the government and advisors with a view to implementing new rules regarding the recovery of VAT incurred on pension schemes. Her experience is directly relevant to financial services clients who need to understand the impact of – and plan for – VAT.
Umair Hameed
Partner | Management Consulting | T: +971 50 658 4486 | E: uhameed@kpmg.com

A dynamic management consultant with over 14 years of experience advising and collaborating with senior executives on complex business transformation initiatives across the Middle East, North Africa, South East Asia, the USA and Europe, Umair has a successful track record of delivering multi-disciplinary engagements. He has a particular focus on, and interest in, corporate strategy and transformation, operational excellence, functional enhancements, cost optimization and financial and operational due diligence. Umair is a widely published author and often speaks at prominent regional and international conferences.

Farhan Syed
Partner | Management Consulting | T: +971 56 520 5377 | E: farhansyed1@kpmg.com

Farhan leads our digital transformation practice in the Lower Gulf. He specializes in helping clients understand the implications of digital forces, determine opportunities and threats, formulate strategy, transform businesses and bridge performance gaps. His functional skills include developing digital customer experiences, determining the capabilities required to deliver a digital experience, re-architecting operating models and developing agile transformation plans.

Abbas Basrai
Partner | Financial Services | T: +971 56 683 3197 | E: abasrai1@kpmg.com

Abbas is a banking specialist and focuses on audit and advisory services within the financial services sector. He has considerable experience of working with banks (both conventional and Islamic), sovereign wealth funds, investment and asset management companies and private equity funds. He has a particular interest and experience in the accounting, regulatory and control aspects of banking operations (from risk assessments to full reviews of front office supervision, product control, treasury, risk and operations functions), including extensive work with regard to derivatives and structured transactions. Abbas qualified as a chartered accountant (ICAEW) while with KPMG in London.

Keith Buck
Director | Head of Restructuring | T: +971 50 556 5014 | E: keithbuck@kpmg.com

Keith leads our restructuring practice in the Lower Gulf. He specializes in supporting both lenders and corporates through distressed situations, primarily in relation to restructuring their long term debt profiles. Keith also specializes in advising corporates on turnarounds, cash and working capital. Keith has worked on some of the largest and highest profile restructurings in the region, including the US$15b restructuring of Dubai World. Keith was previously with KPMG in London.

Cristian Carstoiu
Director | Management Consulting | T: +971 50 619 8131 | E: cristiancarstoiu@kpmg.com

Cristian leads our Data & Analytics practice across advisory, audit and tax. He specializes in the data governance and data quality, advanced analytics, mobility, omni-channel transformation, process consulting and governance of large and complex implementations. He has extensive experience in strategy and digital transformation, having worked across Europe and the Middle East with blue-chip clients.
Source: KPMG analysis of released figures – captured in the forthcoming KPMG GCC banking report
Net impairment charge on loans and advances (US$b)

<table>
<thead>
<tr>
<th>Bank</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abu Dhabi Commercial Bank</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Abu Dhabi Islamic Bank</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Commercial Bank of Dubai</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Dubai Islamic Bank</td>
<td>0.3</td>
<td>0.5</td>
</tr>
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<td>Emirates NBD</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>First Gulf Bank</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Mashreq Bank</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>National Bank of Abu Dhabi</td>
<td>0.7</td>
<td>0.3</td>
</tr>
<tr>
<td>National Bank of Ras Al-Khaimah</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Union National Bank</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Overall country rating</td>
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<td>0.5</td>
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</table>

Regulatory capital (US$b)

<table>
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<tr>
<th>Bank</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abu Dhabi Commercial Bank</td>
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<td>62.5</td>
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<tr>
<td>Abu Dhabi Islamic Bank</td>
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<td>Commercial Bank of Dubai</td>
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<td>8.2</td>
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<tr>
<td>First Gulf Bank</td>
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<td>8.2</td>
</tr>
<tr>
<td>Mashreq Bank</td>
<td>8.2</td>
<td>8.2</td>
</tr>
<tr>
<td>National Bank of Abu Dhabi</td>
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<td>8.2</td>
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<tr>
<td>National Bank of Ras Al-Khaimah</td>
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<td>8.2</td>
</tr>
<tr>
<td>Union National Bank</td>
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<td>8.2</td>
</tr>
<tr>
<td>Overall country rating</td>
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<td>8.2</td>
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Credit rating

<table>
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<tr>
<th>Bank</th>
<th>S&amp;P</th>
<th>Moody's</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abu Dhabi Commercial Bank</td>
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<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>Abu Dhabi Islamic Bank</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Commercial Bank of Dubai</td>
<td>NA</td>
<td>Baa1</td>
<td>A</td>
</tr>
<tr>
<td>Dubai Islamic Bank</td>
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<td>Baa1</td>
<td>A</td>
</tr>
<tr>
<td>Emirates NBD</td>
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<td>A+</td>
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<tr>
<td>First Gulf Bank</td>
<td>A</td>
<td>A2</td>
<td>A+</td>
</tr>
<tr>
<td>Mashreq Bank</td>
<td>BBB+</td>
<td>Baa2</td>
<td>A</td>
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<tr>
<td>National Bank of Abu Dhabi</td>
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<td>AA-</td>
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<tr>
<td>National Bank of Ras Al-Khaimah</td>
<td>NA</td>
<td>Baa1</td>
<td></td>
</tr>
<tr>
<td>Union National Bank</td>
<td>NA</td>
<td>A1</td>
<td>A+</td>
</tr>
<tr>
<td>Overall country rating</td>
<td>AA</td>
<td>Aa2</td>
<td>AA</td>
</tr>
</tbody>
</table>

NA= Rating not available on ThompsonOne as of 8 March 2017
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