

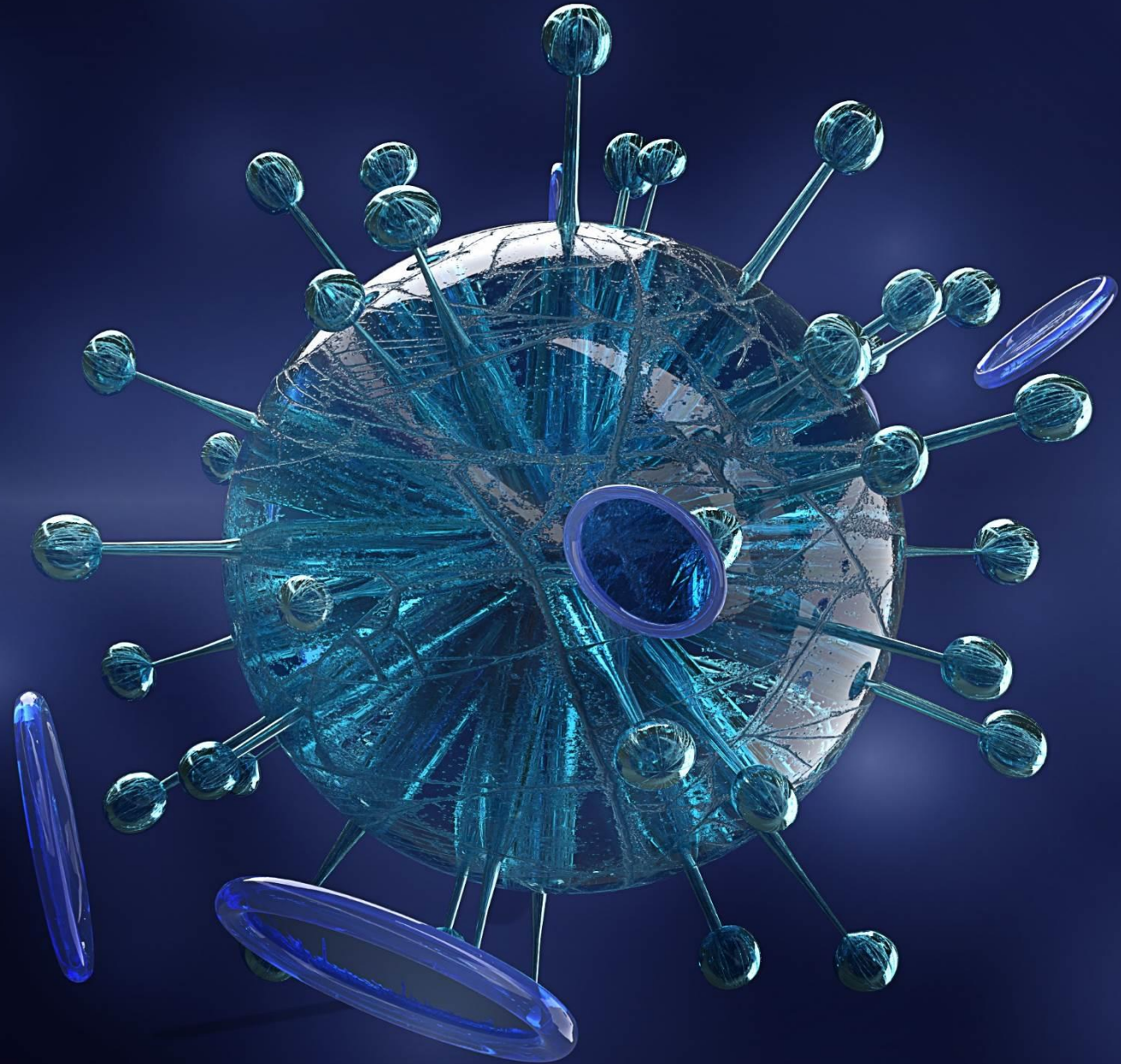


The impact of Covid-19 on the banking sector of Saudi Arabia

Redefining priorities in uncharted waters

23 April 2020

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Introduction

The consequences of the Covid-19 pandemic for the global economy and financial sector in particular are to a large extent still unpredictable. The consensus amongst most economists is that we will continue to see the slowdown in activities and, as a consequence, a downward revision in GDP growth targets for 2020. Most governments have already resorted to inducement measures to sustain the economy and the people, and banking systems are at the core of instigating these measures.

During last few weeks, KPMG has spent a large amount of time on analyzing the main implication for the banking sector industry, focusing on financial, business and operational risk perspectives. We held engrossed conversations with leading bankers and obtained responses through anonymized surveys. The results of these exercises have revealed more precise impacts, feedbacks on countermeasures and a common theme of a dynamic shift in the business plans and operating models. This report intends to share these insights with the wider community and help banks to navigate in turbulent waters and run their risk assessments in the current, rapidly changing environment.

Our team is available to speak to you for further details.

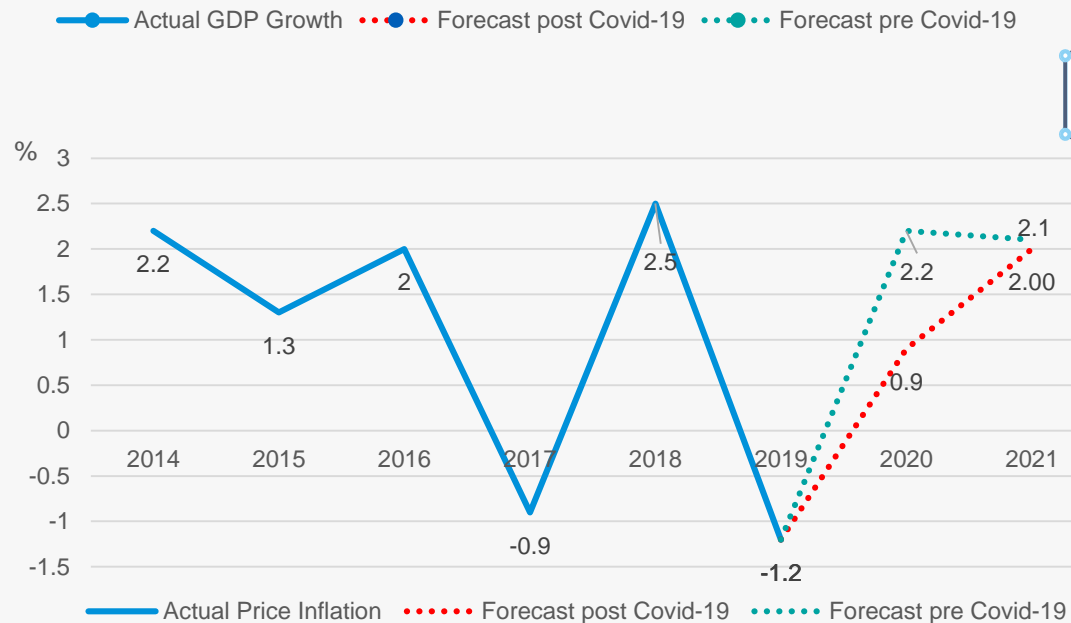
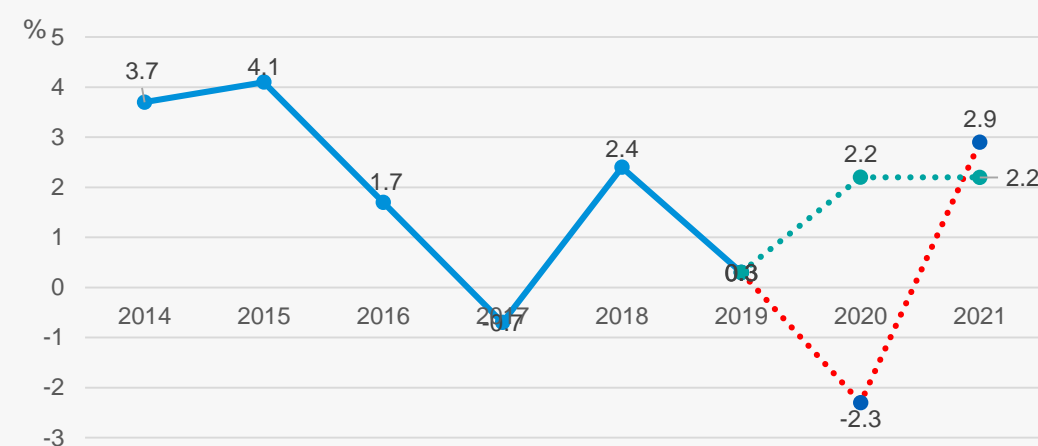
- ❑ **Economic outlook and regulatory measures**
- ❑ **Banking pulse**
- ❑ **Revised agenda for operational resilience**

Economic outlook



- ➔ Oil prices have plummeted due to falling global demand (caused by lock-down measures adopted by governments) and skyrocketing supply, which in turn triggered a price war between suppliers settled by OPEC Plus deal on 12 April.
- ➔ Equity markets are down across the Middle East since February and Sovereign spreads have widened, with global risk resentment at a historic high.
- ➔ Production and manufacturing are also disrupted and investment plans put on hold. These adverse shocks are compounded by a plunge in business and consumer confidence, as observed in economies around the world.

Source: IMF, World Economic Outlook (October 2019, April 2020); <https://knoema.com/sicllbb/saudi-arabia-gdp-growth-forecast-2019-2024-and-up-to-2060-data-and-charts>; <https://www.statista.com/statistics/268062/inflation-in-saudi-arabia/>



Saudi approach to curb spread of Covid-19 and mitigate economic impact

Prudent measures aimed at containing the virus, including curfew and movement restrictions, have a direct impact on spending and economic activities. **Economic relief packages** are provided to soften economic impacts and stimulate economic recovery.

IMPACTED SECTORS

(RELIGIOUS) TOURISM & LEISURE

Suspension of Umrah, travel restrictions and closure of all airports takes a toll on the travel and tourism, while the emerging leisure and entertainment sector is impacted by the movement restrictions.

TRANSPORT & AVIATION

Globally, there has been a decline of 70% in air traffic as compared to last year, with nearly all air travel grounded in the Kingdom. With a strict curfew in major cities and intercity movement restrictions, demand for transport reached to very low levels.

ENERGY

As market shut down and lockdown situation continues, the impact has already started to feel in the form of declined oil demand and other sources of energy resulting in the overall decline in oil prices and production level.

RETAIL & TRADE

With the exception of certain segments of retail, notably groceries, trade is impacted due to decreased spending caused by the movement restrictions and closure of shopping facilities.

KEY MEASURES TAKEN BY THE GOVERNMENT

FISCAL MEASURES

The government announced various fiscal initiatives, including the refund of fees of unused issued work visa and exemption from the expat levy for three months period.

EMPLOYMENT MEASURES

The government announced to pay 60% of the salaries of Saudi employees working in the private sector for a period of three months with a ceiling of SAR9 billion. The compensation will be paid in accordance with conditions stipulated in the unemployment insurance system (SANAD).

TAX MEASURES

Measures announced to provide relief for taxpayers include easing tax return filing and tax payment requirements for a limited time. This include the extension of three months for filing of tax returns and payment of related tax

PRIVATE SECTOR SUPPORT

The government has announced an additional economic package of SAR50 billion This mainly covers accelerating the payment of the dues of private sector and discount / deferral in the payment of electricity bill for the subscribers in industrial, agricultural and commercial sectors..

SAMA stimulus package

Main Approach

The Saudi Arabian Monetary Authority (SAMA) has issued a series of measures and guidelines for banks and financial institutions in response to the coronavirus pandemic. SAMA has announced the introduction of Private Sector Financing Support Program with a total value of about SAR 50 billion.



Key financial support programs

- **Allocating a stimulus package of SAR 30 billion** for banks and financing companies to delay the payment of the dues of the financial sector **from SMEs for a period of six months as of its date.**
- **Providing concessional finance of approximately SAR 13.2 billion for SMEs** by granting loans from banks and finance companies to the SME sector to support business continuity and sector growth during the current stage.
- **Allocating an amount of SAR 6 billion for the MSME sector** to enable them to take secured financing from banks and financing companies under the Kafalah SME Loan Guarantee Program.
- **Supporting the e-commerce sector** by bearing the cost of fees for point of sales and ecommerce services for stores in Kingdom of Saudi Arabia for a period of 3 months with an amount exceeding in total **SAR 800 million.**

Qualitative measures through commercial banks

- Extending **working capital finance** to all corporates to address short-term liquidity requirements.
- Instigating **Private Sector Job Retention Schemes (PSJRC)** for corporate customers to maintain the employment at these customers and providing **concessional bridging loans for at least six months.**
- **Flexibility in repayments of Consumer Finance to individuals** who have lost their job due to Covid-19, including relief of loan repayment or mortgage payment for a period up to six months at no additional cost.
- **Waiver of all fees and other charges resulting from the use of digital banking** for a period up to six months.
- **Waiver of the minimum deposit balance requirement** for the period of up to six months.
- **Reviewing credit card interest rates** and adjusting them to reasonable APR rate.

Banking pulse - Severity, duration and business continuity management effectiveness

To grasp the current sentiment in the banking sector, we conducted **a limited survey amongst C-suite executives** to gather insights on the **severity and expected duration** of the Covid-19 impact, the **banks' preparedness and initial response strategies**, the **most affected functions and segments, measures taken, potential of accelerated digitalization, effective measures undertaken by SAMA and the government** and the **key priorities** going forward.



Impact on overall business is considered at medium to high levels and is expected to be felt for a **duration of 3-9 months** as per our survey

For more than half of the banks **10-20 percent of the loan book needs to undergo some amount of restructuring**

According to nearly all respondents, the **most impacted segment is SME financing** almost all respondents, followed by consumer and corporate banking where approximately half of the respondents reported significant impacts.

Across the board, **banks consider SAMA's plan as very comprehensive, timely and focused** on covering all segments of business.

Banking pulse - Severity, duration and BCM effectiveness (continued)

All respondent banks have resorted to a **deferral of discretionary** projects with 75% on them focusing on **rationalizing overhead costs**. 50% of the respondents are looking at **divested and/or curtailing growth targets**.

Most of the respondents felt that the **business continuity measures adopted were largely considered effective during the first two weeks** of the outbreak. Although most of the BCM scenarios did not include a pandemic like the Covid-10 outbreak, most of the banks started testing BCM since early January, and accordingly, **back-office support and digital channels are operating at more than 90% expectations**.

The respondents mentioned that while **Limited branches and remittance centers** are operational; **ATMs are replenished** at high cash levels and cash in transit is optimized. **Digital channels are enhanced** to carry out activities that were done through branches or remittance center. Customers are already switching to these channels.



Banking pulse - Impact on segments



Retail banking

- **Deposits are intact and liquidity is high at Banks** as utilization of funds decreased in current times. With declining interest rates, banks are discouraging the roll over of time and savings deposits when call deposits are growing organically.
- Suspension of travel, hospitality and leisure activities have significantly affected the **utilization of credit cards** and an increase in online purchases does not compensate for the substantial decline in average daily spend in domestic markets in pre-COVID times.
- **Car-lease segment** has been severely impacted by a lockdown in major cities and therefore volumes have been reduced.
- The volatility in interest rates, deterioration in real estate prices and other uncertainties concerning the outbreak and its consequent containment measures, and possible unemployment situations caused a **significant slow-down in mortgage financing**. Banks are reviewing the existing processes and replacing manual activities with automation.
- Changed consumer behavior and closing of bank branches have contributed towards the current **slowdown in personal finance**. Banks are actively pursuing digital authorization of new disbursements or rollovers. **Various fees and charges have been withdrawn** voluntarily by banks or based on the instructions of the regulator, that is likely to add pressure on their earnings.
- **Digitalization has become the Top-priority** for all the banks for sustaining business and reducing overheads in the current low volumes situation.

Banking pulse - Impact on segments



Corporate banking

- The **most impacted industries and market segments have already been identified** by SAMA and banks, and they are part of the initial stimulus program. However, an extension of the lockdown has caused multiple industries to face financial difficulties and therefore a customer-centric approach is being developed for identifying specific requirements.
- While we may see a large customer base requesting for debt restructuring; there is a small new segment that is evolving and reporting growth in their business. Accordingly, a **fresh customer review based on current equity position and forward-looking performance for the borrower** will lead banks to offer customized solution at appropriate pricing.
- **Trade finance will continue to be the life line for major essential industries** and therefore certain relaxation or automation in the process is expected in the execution. Simultaneously, withdrawal of fee and rebates for corporates is likely to impact the bottom line of the banks in the short term.

Treasury and investments

- **Banks are relatively high on liquidity** compared to pre-Covid-19 situation. **LDR/SLR/NSFR ratios** and overall cash positions have improved since the year end. Coupled with the downward revision in the interest rates; Banks are expected to renegotiate their liabilities for a long term at a lower rate and pursue a possible **interest rate arbitrage**. Simultaneously, banks and customers are expected to terminate their existing IRS and enter **new hedging relationships**.
- In capital markets, we have seen dislocation of investors due to the credit crisis. Moreover, as **High grade investment bonds are available at discounts**, banks are expected to improve overall investment portfolio risk in the near future.

Banking pulse – Imminent Financial Reporting matters

Consequences include various ramifications on expected credit losses, fair-valuations, hedge accounting and asset impairment testing in general

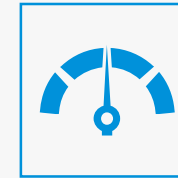


Assessment of Significant Increase in Credit Risk (SICR)

Banks need to **assess at each reporting date** whether the credit risk on a financial instrument has increased significantly since initial recognition, being an integral part of ECL measurement.

The challenge for banks is to **incorporate predictions relating to the economic impact** of the Covid-19 outbreak available without undue cost or effort at the reporting date, into the SICR assessment

If a bank is not able to identify key drivers of credit risk on an individual instrument basis, then it may need to **assess SICR on a collective basis** (IFRS 9.B5.5.16).



Measurement of expected credit losses (ECL)

ECLs represent an **unbiased probability-weighted amount**, determined by evaluating a range of possible outcomes. It takes into account reasonable and supportable information that is available without undue cost and effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Banks need to consider **how much the current uncertainty in short-term outlook is expected to impact the entire life of a financial instrument**. Banks will face challenges in developing reasonable forecasts and how government support might mitigate the shock.

In its recent publication, the International Accounting Standards Board (IASB) cited that, if the effects of Covid-19 cannot be reflected in models currently due to the prevailing uncertainty then, **post-model overlays or adjustments** may need to be considered.

Banking pulse – Imminent Financial Reporting matters (continued)

Consequences include various ramifications on expected credit losses, fair-valuations, hedge accounting and asset impairment testing in general



Central bank support measures

Banks need to assess the impact of SAMA support measures for **the borrowers and banks separately**, considering:

Alteration to loan cashflows, such as payment holidays, granted by banks as a result of the central bank measures would require an assessment of financial asset modification.

Banks need to assess **to what extent government assistance provided directly to borrowers might reduce the probability of a borrower defaulting** and so avoid SICR occurring in some cases.

Central bank support to banks, like low cost or interest free funding, is likely to qualify as a government grant. Accordingly, banks need to assess the appropriate timing of recognition of such assistance if a link can be established between central bank's support and customer relief measures taken by the Bank



Fair valuation and hedge accounting

Stock markets have declined sharply and volatility has increased, while treasury bond yields have reached record lows and credit-default-swap indices have been surging, reflecting concerns of increased defaults.

For many assets and liabilities, **fair values may have changed significantly**, reflecting changes in cash flow forecasts, higher uncertainty and elevated risks. A valuation that uses significant unobservable inputs is challenging, especially when markets are volatile and the economic outlook is highly uncertain.

Banks need to **carefully consider and assess pre COVID 19 hedges in light of potential ineffectiveness**, changes in terms of the instruments involved and distortion in hedge relationship.

Revised agenda for operational resilience - First steps

The key question for the banking sector is how to respond to its operational and regulatory challenges while contributing in a positive way to the economy recovery. Banks play a key role in implementing SAMA and government stimulus packages to support the businesses to weather the storms.

1. Perform a gap analysis to the "new normal"

Perform a gap analysis on the crisis management framework and the operative needs, considering the different time horizons



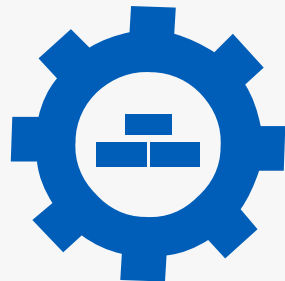
2. Implement change and aligning with government stimulus

Preparation of the systems, organization structure, products, digital assets in order to offer government stimulus supports to clients



3. Review Digital Transformation Plan

Review the Digital Transformation Plan to reassess priorities and consider the launch of new services and products



Make a 'triage' of the credit portfolio

Identify potential risky counterparties (individuals, sectors, geography, etc)

01

Make adjustment to provisions

Perform assessments of the provisions coverage and risk models outputs

02

Update the liquidity plans

Get ready for potential liquidity restrictions taking in consideration the actual situation

03

Manage recoveries plans

Take a close look to the bank recovery plans and prepare a proactive approach in case of KPIs breaches

04

Review and implement cyber protection

Many organization have experience a higher activity of cyber attacks

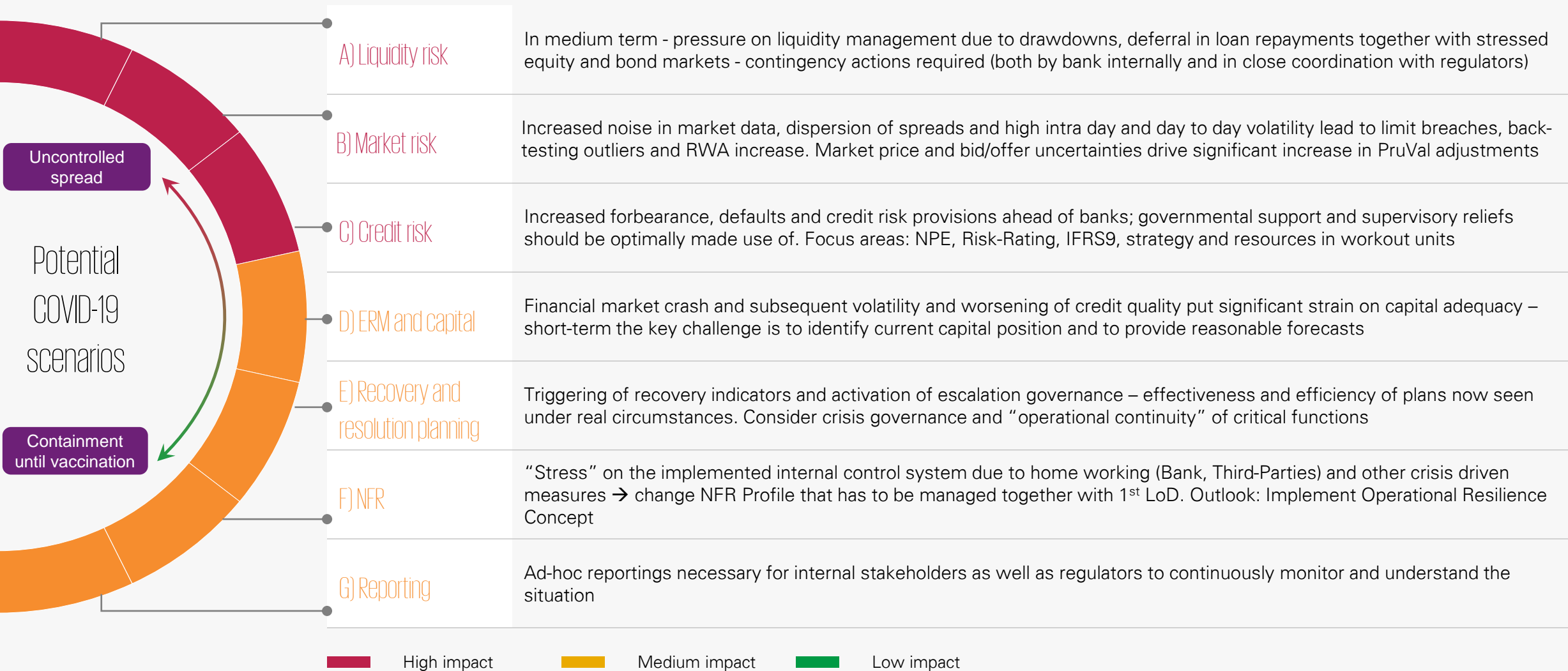
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Communication

Banks should have a clear and strong communication plan with shareholders, clients and employees

06

Revised agenda for operational resilience - Bank steering & risk management



Revised agenda for operational resilience - Scenario exercises

COVID-19 Scenarios

1 Preparation of different stress scenarios taking in consideration products, segmentation and duration

2 Preparation of "new ways to serve"

Assessment of potential impacts



Identification of sectors and geography exposed to virus

Identification of affected profiles in terms of revenue at risk

Understand the supply chain and identify in-house stakeholders

Create Models and run simulations on portfolio and individual cases based on potential impacts on revenue

Assessment of Bank Balance sheet, Liquidity and Capital

Branch Limitations (staff protection)

Avoid cash handling Areas delimitation Services limited

Deliver more digital services and other channels

More pressure on the digital channels

Improve the role and capability of call center

Potential Action Points



Classification of Clients and Counterparties

Low Risk

Stable clients with low default probabilities, create commercial campaigns to estimate the economy

Medium Risk

Clients able to overcome the crisis and assessment of longer terms debts and new financial support

High Risk

Clients in trouble before the crisis and stressed sectors, provide restructuring instructions, write-offs ,etc

Perform adjustment in the pricing, risk, impairment model

Alignment of the governance model to the business requirements

Assess impacts on bank strategy and business models

Assess impacts on liquidity

Assess impacts on regulatory requirements (risk, capital)

Keep track of customer experience

Readjust process and procedures

Evaluate alignment front to back

Revisit priorities on Digital Project

Assess resilience of IT architecture and People teleworking (SLAs, performance, incentive models)

Redefine and assess partnerships, supplier relationships and third party dependency

Keep proactive track of clients claims

Define Communications and transparency Plans

Make adjustments on the bank's security processes, tools and policies (cyber, fraud, AML, etc)

Revised agenda for operational resilience - Accelerated digital transformation

The Covid-19 pandemic crisis will also be a test to all banks Digital Transformation Programs, digital interaction with banks will be the first option for clients.

A demand of digital assets will be a challenge for banks, though more digitally-mature banks have advantage

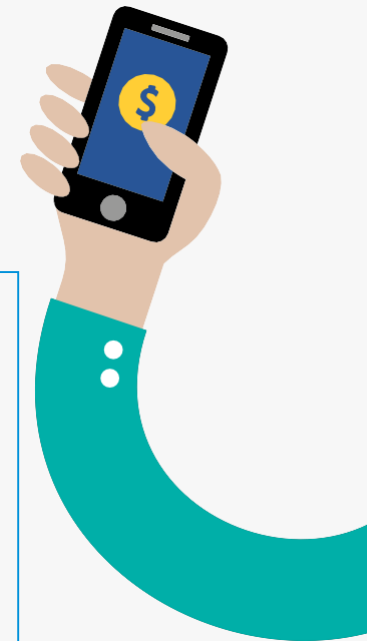


Banks must keep offering services and products which without branches can become a challenge



e.g. client communication through a smartwatch or WhatsApp

More sophisticated fraudsters to take advantage, thus increased cyber risks for digital products



The digital transformation plans are put it into test and this situation may required **banks to revisit the priorities and try to launch new services with new products** in order to stay alive.

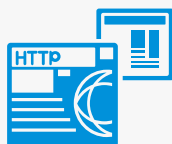
This situation will create a live **test of the Customer Experience, customer digital requirements, omni channel functionalities and capabilities, mobile app functionalities and internet banking.**

To get advantage of the situation Banks must be **sensitive of this opportunity and create mechanisms to collect, analyse and identify all the improvement opportunities** that results of this massive use of digital banking.

Revised agenda for operational resilience – Awareness of financial crimes and scams

Covid-19 has led to the (re-)emergence of a number of classic and novel financial crimes and scams, targeting customers and employees alike. The banking and its IT executives should be aware of the creative approaches fraudsters may use to get confidential information or financial gain:

Re-emerging financial crimes and scams



Fraudulent websites

A significant rise in new fraud risk typologies, related to the registration of large numbers of Covid-19 internet domains.



Email compromises

Fraudsters attempt to trick employees to hand over their credentials by requesting they login to a fake company Covid-19 portal.



Supply scams

Fake online shops that purport to sell medical supplies currently in high demand, such as surgical masks and hand sanitizer.



Provider scams

Fraudsters posing as doctors or hospital administrators, typically claiming to have successfully treated a friend or relative for Covid-19 and demanding payment.



Mobile app scams

Fraudsters are developing or manipulating mobile phone applications which outwardly look as if they track the spread of Covid-19



Investment scams

Similar to a classic investment scam, this scam purports to generate significant returns from investing in a company that has services or products that can prevent, detect or cure Covid-19.



Charity scams

Fraudsters prey on individual's sense of responsibility to help reduce the impact on the community, soliciting donations for non-existent charities claiming to help contribute towards the development of a vaccine to fight the infection.

Revised agenda for operational resilience - Cyber threats

During the Covid-19 pandemic it is paramount to be specifically aware of the increase of specific cyber threats which are aimed at compromising the banks critical and customer facing processes. This is also identified and repeatably communicated by multiple monetary authorities, including SAMA.

Two key recommendations:

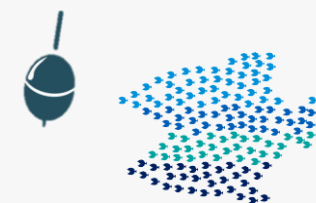
Proactively assessing and testing the capacity of existing IT infrastructure, also in light of a potential increase of cyber-attacks and potential higher reliance on remote banking services



Covid-19 has presented an unprecedented live test of banks ability to work in a completely different manner (e.g. working remotely from home, shifting more services online, surges in data demands). Cyber criminals may seek to exploit any failures in the maintenance of IT systems during the pandemic, banks more than ever need to assess whether they are in a position to guarantee at a minimum the technical and application security measures to ensure as strong an IT environment as possible, and let's not forget the remote access facilities of your staff.



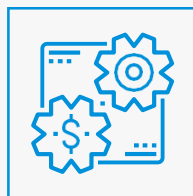
Assessing the specific threats and risks of increased cybersecurity related fraud, aimed both to customers or to the institution via phishing e-mails, spear phishing emails or whaling (these are focused on C-level and specific targets)



Since the start of the pandemic, regulators have been warning the general public regarding the variety of cyber-attacks related to the pandemic that could occur, raising awareness of instances such as phishing emails to trigger the download of malware, which link to fake copies of legitimate websites in order to solicit users' credentials and passwords. Cybercriminals may also craft urgent emails pretending to be someone from the bank requiring the user to take immediate action, such as processing the payment of an invoice. Providing security awareness to both staff and customers is key.

Further reading: Other KPMG thought leadership related to Covid-19

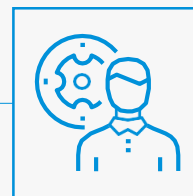
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[CIO/CISO guide](#)



[Cyber in the Boardroom](#)



[Economic impact of Covid-19 on Saudi Arabia](#)



[Saudi government response measures](#)

Covid-19 related portals

[KPMG International Covid-19 resources](#)

[KPMG in Saudi Arabia Covid-19 resources](#)

[Financial reporting implications](#)

Notable articles

[How have economic forecasts used to measure expected credit losses been updated?](#)

[How has the credit risk of borrowers and other debtors been reassessed?](#)

[Have borrowers considered changes to the terms of their liabilities?](#)

[Four key risks banks face in balancing the speed of loan processing with compliance checks](#)



KPMG contacts



Khalil Ibrahim Al Sedais

Office Managing Partner -
Riyadh

KPMG in Saudi Arabia
T: +966 118748500
kalsedais@kpmg.com



Ovais Shahab

Head of Financial
Services Sector

KPMG in Saudi Arabia
M: +966 509791636
oshahab@kpmg.com

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We lead by example

We work together

We respect the individual

We seek the facts and provide insight

We are open and honest in our communication

We are committed to our communities

Above all, we act with integrity