# Post-pandemic banking

## Banking perspectives 2021

Trends and themes shaping the industry in Saudi Arabia

*Executive summary*

**KPMG in Saudi Arabia**

March 2021

# Foreword

While banks had to weather Covid-19, they were also at the front lines of implementing financial support measures, instigated by the government and SAMA.

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Chairman
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I am pleased to present the second edition of KPMG's Saudi Arabia Banking perspectives, a diverse mix of articles from our financial services team, encompassing a dynamic shift in society and preferences of people, regulatory measures and digital acceleration that was widely observed in last twelve months and expected to continue during 2021. The report also comes very timely, issued shortly after the last of the 11 Tadawul-listed banks publishing their 2020 audited financial results allowing us to complete our performance review of the banking sector over the past year.

Needless to say, 2020 was a turbulent year in many respects. The global economy faced novel challenges, and organizations – banks included – were forced to rethink their business models and roles in society. In Saudi Arabia, the government swiftly launched support programs to mitigate the economic impact of the pandemic on individuals and local businesses. Within these programs the Saudi Central Bank (SAMA) played a pivotal role, extending liquidity support against payment deferral program, providing guarantees and other mitigation measures. Banks facilitated the government and SAMA's financial support mechanisms, while at the same time weathering their own storms though business continuity management systems.

In this report, we have categorized our articles over four main themes: **Culture and people, Regulatory and compliance, Digital banking,** and **Evolving environment.**

In a newly-created opening chapter we discuss the new working reality that resulted from the pandemic, digging into hybrid working models, widened talent pools and digital collaboration tools. As indicated in our recent KPMG CEO Outlook, the pandemic brought a renewed sense of purpose for many executives; we assessed how this trend impacted ESG programs in the Saudi banking sector. We have also reviewed gender diversity, drawing on insights from our recent and first Female Leaders Outlook.

In the remaining chapters, we elaborate the pertinent issues that banking executives face in today's world, including evolving cybersecurity threats, regulatory compliance, and assurance needs, along with the challenges and opportunities posed by technology and digital banking – including fintech, tax technology, and what it takes to be digital leader.

I hope you find this edition of Banking perspectives timely and insightful for addressing your current challenges. Our team looks forward to connect with you to discuss these themes and trends in greater detail.

# Executive summary

## Culture and people

### *New working reality: challenges and opportunities*

The pandemic posed a significant test of financial resilience, as well as banks' operational, organizational, reputational, and business-model pliability. Embracing the new working reality has truly brought opportunities for not only withstand threat or change but transform for the better. Remote working is here to stay and in all likelihood expected to become an integral part of the way we will work in future. It is an opportunity for banks to change their way of working sustainably and reap the benefits over the medium to long term.

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### *Accelerated diversity and inclusion efforts by major banks*

Banks are working on keeping their gender inclusion efforts on track, despite some challenges unique to women presented by the pandemic. Women in Saudi Arabia started coming into the workforce more recently than the men, competing for the senior positions. Additionally, it is more challenging for women to build business network, causing them to rely purely on professional performance rather than male-dominated social gatherings. Fortunately, banks are well-suited to support women's employment because they have been at the forefront of employing women and offering flexible work schemes, which provides more opportunity to women with young children or families.

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### *Growing ESG commitment driven by consumers and regulators*

Having faced initial uncertainties at the onset of the pandemic, Saudi banks' ESG programs are now recognized as essential tools for assisting in the economic recovery. Executives have indicated they are increasing their focus on the 'S', or Social, aspect of their ESG agendas – a nod to the immense human impact of the pandemic. As ESG ratings systems and ESG-focused stock indexes gain popularity, banks can get ahead of the game by better understanding stakeholder desires and by putting ESG on more than just their reputational risk radar.

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# Regulatory and compliance

### *Resilient SAMA sustains confidence and drives transformation*

The Saudi Central Bank (SAMA) had a whirlwind 2020, which saw it unveil unprecedented stimulus packages to soften the economic impact of the pandemic. These packages have been extended to allow banks to give more leeway to their customers. In November, SAMA was officially minted as the “Saudi Central Bank” and a new objective was added to its mandate: “supporting economic growth”. Simultaneously, SAMA made big strides in its long-running plans to develop the Saudi fintech and digital banking sectors.

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### *Technology-driven governance, risk and compliance*

Banks’ business continuity plans (BCPs) came squarely into focus last year. Those with the most agile and cross-functional plans were proved to be the most beneficial for the organizations against the economic impacts of the pandemic. As banks move forward and reformulate their BCPs with the lessons of 2020 in mind, many are implementing governance, risk, and compliance (GRC) technologies. GRC technology-enabled products and services not only integrates and streamline the value, but it also prepares banks for the kind of liquidity, credit, and market risks experienced during the last year.

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### *Steadily progressing anti-money laundering compliance*

Saudi Arabia has made significant progress in anti-money laundering (AML) and counter-terrorism financing (CTF) measures, especially since its acceptance into the Financial Action Task Force (FATF) two years ago. In the know your customer (KYC) area, banks have recently implemented digital customer on-boarding that paired customer ease with KYC controls. Its adoption has been accelerated during to physical branch closures during the early days of pandemic.

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### *Automatic Exchange of Information*

In line with its efforts to improve international tax compliance and transparency, Saudi Arabia signed on to various agreements to provide automatic exchange of information (AEOI). Now after several years of AEOI implementation, it is imperative for banks to assess their onboarding and monitoring process and address noncompliance risks. Banks are encouraged to do a health check that will identify strong and weak points in this process.

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### *Assurance in the new reality*

Like many business functions, the external audit process was largely virtualized during the pandemic due to lockdowns and social distancing precautions. This movement quickened the pace of technology adoption across the audit process. Firms like KPMG have been imbedding data and analytics (D&A) technologies into the audit process for years. KPMG Clara, a smart audit platform, uses D&A tools integrated in a secure and encrypted web-based platform to create an interactive communication channel between client and auditor. Functions such as Clara will define the future of the audit, even after lockdowns end.

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# Digital banking

### *Future of banking demands digital leadership*

In order to compete with fintechs, traditional banks are pairing digital banking practices with an emphasis on attracting and developing their organization’s digital leaders. A new leadership model is emerging that pivots away from the traditional qualities of corporate leadership, towards qualities that are less-structured and more creative. The digital maverick mindset involves multi-modal thinking and is inherently agile – qualities that, if broadly adopted and promoted, will allow banks to remain competitive in an increasingly dynamic market.

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### *Fintech advancement picks up momentum*

With regulators pushing full-steam ahead for the development of the fintech sector in the Kingdom, banks are now viewing fintech as enablers rather than simply disrupters. Among other initiatives, SAMA is operating its Regulatory Sandbox Framework, has issued new Payment Services Provider Regulations (PSPR) for foreign fintechs, and has issued new licensing guidelines for digital-only banks. In turn, banks are ramping up their investments into standalone fintechs and their own digital banking channels, increasing partnerships with fintechs, and leveraging their existing market shares to attract customers to their fintech offerings.

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### *Emerging tax technologies for banking*

Saudi Arabia’s tax authority, GAZT, will implement new e-invoicing regulations later this year, having issued guidance last year. The move will improve compliance, tax revenue collections, and the efficiency of the tax filing process, and will combat commercial concealment. Until now, the use of tax technology in the banking sector has lagged behind product and accounting technologies. However, GAZT’s e-invoicing regulations are likely to be a signal of change for the use of technology in tax practices more broadly.

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# Evolving environment

### *Dynamic market shift encourages consolidation in banking landscape*

In line with a regional trend towards consolidation, NCB and Samba Financial Group are already at an advance stage and expecting a merger during the first half of this year. This is expected to create – by far – the largest lender in the Kingdom. The GCC is widely viewed as overbanked. That fact, combined with increased pressure from fintechs and other market entrants, has created an environment which might turn out more M&A activity in the near future. While initially putting the brakes on M&A activity, the Covid-19 pandemic may prove to be a further catalyst for deal making if economic growth continues to dampen or the doubtful loans pile continue to grow.

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### *Operational resilience put to the test*

Banks are analyzing how their operational resilience plans held up in the face of the Covid-19 crisis and are using the lessons learned to improve their strategies. Ensuring their operational resilience frameworks are enterprise-wide, measurable, flexible, and top-down is a start. Banks have been further incentivized to invest in a sound operational resilience plan by considering it as a business opportunity in low interest rate environment. Cost savings and efficiency gains can be realized through the effective leveraging of data, data models, and systems architecture.

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### *Key cyber considerations*

Several key developments are shaping the cybersecurity landscape for banks. Open banking, which allows data access up to third-party financial service providers, is required to be be developed with stringent cybersecurity measures in mind – one of the goals of SAMA's "open banking initiative". Cyber in the Audit (CitA) supports a traditional IT audit by testing the cybersecurity measures in place to prevent an attack on an IT system. Similarly, penetration testing and RedTeaming are two efforts aimed at beefing up banks' cyber defenses. Finally, with data proving to be a prized asset among banks, it is only right that its security becomes paramount to a bank's operations.

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### *LIBOR transition amidst Covid-19 driven detour and the way forward*

Lastly, LIBOR will soon be relegated to the history books, heralding in a new era for benchmark rates. It has become evident that global regulators prefer a replacement rate that is based on actual transactional data. However, the transition away from LIBOR has been marked by differing methodologies and pushed-back deadlines. The key to successfully managing the transition lies in proactively transitioning away from legacy rates with a focus on operational, process, and systemic changes to address the phased cessation events.

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# Financial performance

## A year salvaged by government stimulus and cautious optimism

**A cursory glance at the FY2020 financial highlights of the Saudi Arabian banking sector reveals the unmissable effects of Covid-19. However, there is absolute unanimity that the full year numbers are a significantly better end to a year that has generally been compared to the financial crisis of the recent past or when compared with regional or global economies.**

Barring the one-off impairment of goodwill incurred by SABB, the overall industry has done exceptionally well to recover from the looming uncertainty during the height of the pandemic, essentially stalling the hike in expected credit losses (ECLs) to under 40% from prior year culminating into a net decline of 6% in the operating results across the sector. This is a direct consequence of the commendable government support through SAMAs relief programs, along with conscious measures that were invariably taken by the banks. Those included, but not limited to, asset protection via restrained and cautious credit underwriting and re-balancing of prop books.

Despite these factors, the lending book has been the proverbial silver lining of the year with a healthy 12.6% net increase relative to prior year fueled by a strong growth across mortgage finance. On the other front, SAMA's generous injections of deposits under the support program and overall liquidity protection by corporates and individuals alike has enable an impressive 9.2% growth across bank and non-bank deposit base.

This effectively means that in the wake of immense uncertainty throughout FY 2020, financial positions have surprisingly thrived rather than just survived. In lieu of the optimism generated by the introduction of various vaccines and overall improving fundamentals, it is up to the individual banks to sustain the asset growth without compromising credit quality while maintain adequate liquidity and capital levels.

These factors also drove an increase of 13.3% in total assets and 7.8% in total equity for the Banking industry while average return on assets and equity stands at 1.02% and 7.46% respectively as compared to 1.84% and 13.44% respectively for FY 2019. The average NPL coverage ratio has also increased to 164% during FY 2020 as compared to 160% for FY 2019 on the back of significant increase of 39.4% increase in the impairment charge for FY 2020 as compared to FY 2019.

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# FY2020 financial performance of 11 listed banks

## Net profit after zakat and tax*

6.32%

FY2020 net income SAR 42.27 billion
(FY2019: SR 45.12 billion)

## Total assets

13.14%

As of YE-2020 SAR 2,771 billion
(YE-2019: SAR 2,449)

## Total customer deposit

9.18%

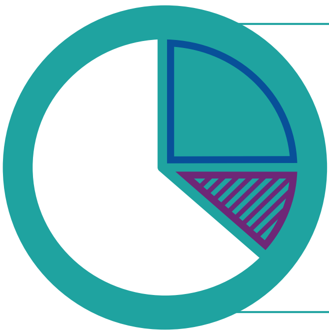
As of YE-2020 SAR 1,975 billion
(YE-2019: SAR 1,809 billion)

## ECL charge for the year

39.05%

FY2020 SAR 17.33 billion
(FY2019: SAR 12.46 billion)

## SAMA stimulus program



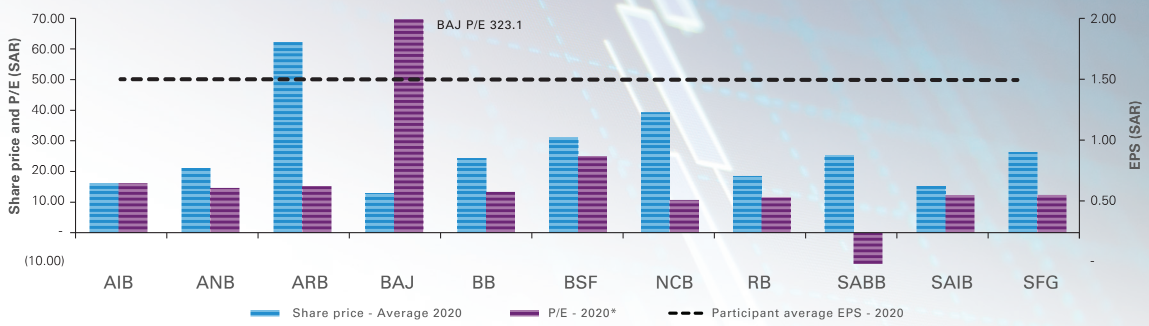
SAR
2.41 billion
Gross modification loss recorded on deferral of installment due from MSME sector

SAR
2.98 billion
Gross Income recorded on the deposit received from SAMA

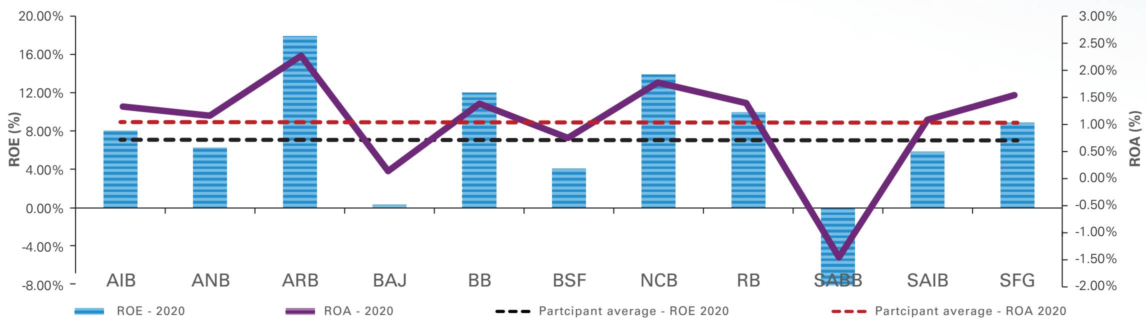
SAR
109.97 billion
Total deposit received from SAMA as of 31 December 2020

** Net profit after zakat and tax is calculated excluding theimpact of goodwill impairment in SABB. Had it been included, overall net profit after zakat and tax would have reduced by **22.76%** to **SR 34.85 billion.***

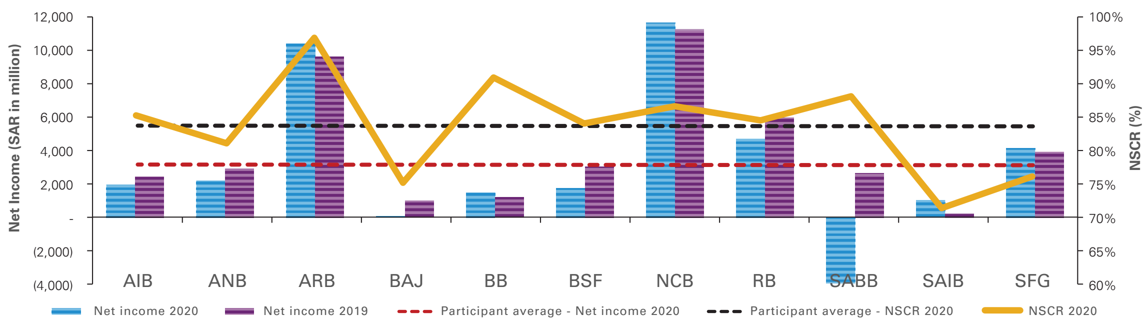
## Share price, P/E & EPS



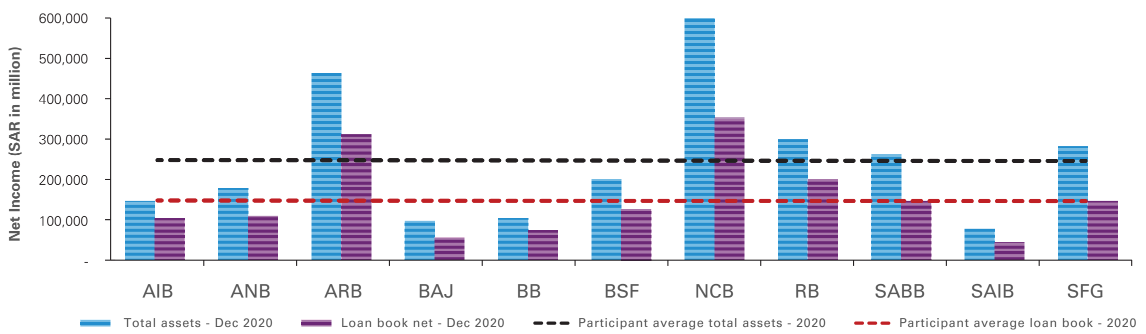

## ROE & ROA




## Net income



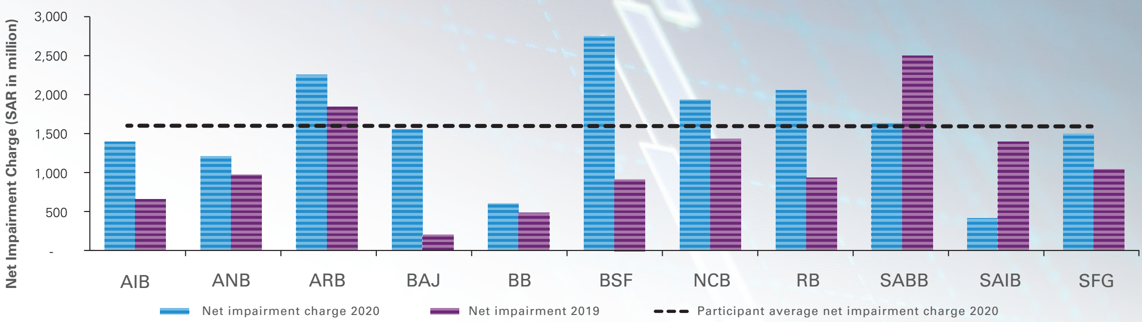

## Total assets & Total loan book



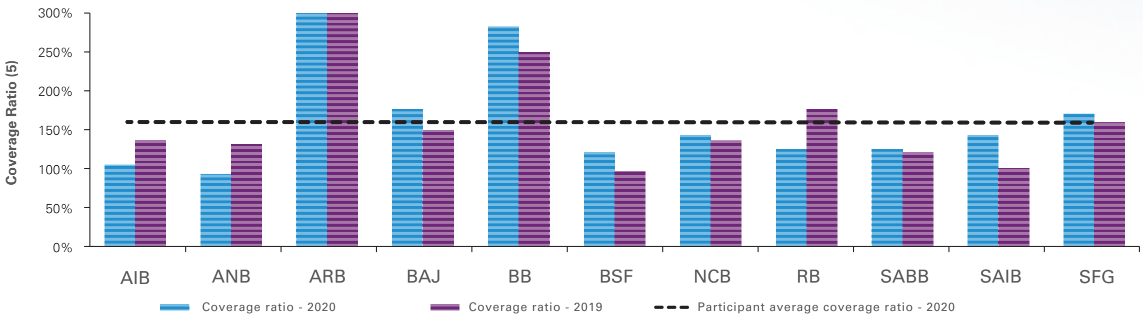

**Legend:**

| | | | | | |
|---|---|---|---|---|---|
| Alinma Bank | AIB | Bank Al Bilad | BB | Saudi British Bank | SABB |
| Arab National Bank | ANB | Banque Saudi Fransi | BSF | Saudi Investment Bank | SAIB |
| Al Rajhi Bank | ARB | National Commercial Bank | NCB | Samba Financial Group | SFG |
| Bank Al Jazira | BAJ | Riyad Bank | RB | | |

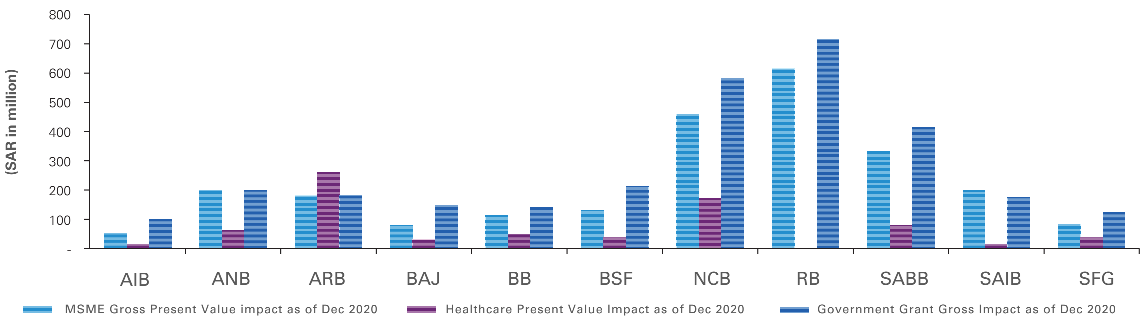
## Net impairment charge



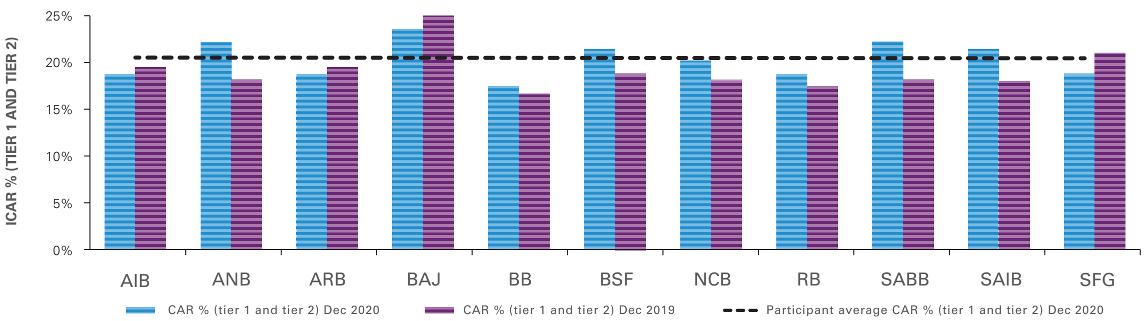

## NPL coverage ratio




## Impact driven by Covid-19




## Capital adequacy ratio




## Glossary:

**P/E ratio** is calculated as the average closing price (as derived from Tadawul) divided by the earnings per share (EPS). **ROE** is the ratio of net income for the year to total equity. **ROA** is the ratio of net income for the year to total assets. **Interest margin** is the ratio of net special commission income to total special commission income. **Coverage ratio** is the ratio of total ECL for loans and advances to total NPL. **Loan to deposit ratio** is the ratio of total loans and advances to total deposits.

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