



Purpose-led banking

Banking perspectives Saudi Arabia 2022

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KPMG Professional Services



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Foreword

I am pleased to present the third edition of our Banking perspectives publication. In this edition, our financial services team covers the evolving landscape that we have observed and that banks had to grapple with. Centered on the theme on purpose-led banking, these articles encompass regulatory and digital transformation that banks and financial institutions need to contend with, while also bracing themselves from emerging challenges.

Saudi Arabia has ambitious goals to achieve through Vision 2030, with a leading role for the government and regulators in pushing the agenda of digitalization and transformation. The Saudi Central Bank (SAMA) has been a proponent of change and development in the financial sector, in line with the objectives of the Financial Sector Development Program (FSDP). SAMA has taken new players in the financial sector under its wing and has embraced a positive attitude towards new technology to usher banking into the future. Banks are responding to this shift and to the requirements of the government to achieve greater economic development, while considering the threats and opportunities permeating an evolving technological and risk environment.

We categorized articles in this edition across four themes: People-centered banking, Governance and compliance, Transformational technologies, and Enabling excellence. In the opening chapter, we discuss the future of the banking sector through purpose and opportunities afforded to banks and financial institutions when tackling ESG requirements, new technology, disruptors, such as the FinTech sector and digital banking, and values-based banking. We then delve into regulatory matters to explore how banks can utilize compliance to drive business outcomes.

As the undercurrent for any talk of the future must include a dive into technology, our third section covers strategies and tools that enable banks to maintain a competitive edge in a shifting financial landscape. This evolving environment includes new and old risks as well as cybersecurity and data privacy threats that



Banks are responding to the requirements of the government to achieve greater economic development, while considering the threats and opportunities permeating an evolving technological and risk environment.

banks need to consider. As such, we dedicated the final section of this publication to tackling these topics and raising key considerations and recommendations for the banking sector.

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



Dr. Abdullah Hamad Al Fozan

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Executive summary

People-centered banking

ESG commitment driven by investment opportunities

ESG factors remain a reputational risk for many banks, but they need to be more than that. The Saudi banking sector can face potential losses due to the lack of ESG reporting as growing segments of investors expect banks to adhere to ESG standards and acquire an evaluation by recognized ESG rating providers. As both regulators and investors in Saudi are pushing the ESG agenda, banks must attempt to improve their reporting practices.

Customer expectations driving disruption

SAMA has been a proponent of change and development in the financial sector, in line with Vision 2030. The Central Bank's forward-looking stance has increasingly embraced disruptors in the banking scene and has led to a push for digitalization. SAMA's plans include the development of an Open Banking framework due to go live in 2022, the support of the FinTech sector through the Regulatory Sandbox, and the licensing of digital banks. Regulators must still consider new disruptors in banking, though, such as 5G and blockchain technologies, which can reap benefits for the sector if managed efficiently.

The role of banks in creating a savings culture

Embracing a savings culture can be challenges, and in Saudi Arabia many factors have prevented the development of such culture and the accompanying financial literacy. Banks play a key role in promoting savings by providing a range of deposit products and mechanisms with varying combinations of liquidity and rate of interest tailored to needs and preferences of different depositors and many other direct and indirect banking solutions. Hence, providing people with the tools to save and raise financial awareness will be beneficial for both banks and consumers, and will benefit the objectives of Vision 2030's FSDP.

Governance and compliance

Reimagining external audit through digital enablement

The Covid-19 pandemic has accelerated the adoption of new technology, which brought about a reimagined audit experience. The banking sector can benefit from increased audit transparency and collaboration with

the auditing team. The use of cloud-based platforms to exchange important information with the client, including valuable insights into the status of the audit, creates greater interaction. At KPMG, the launch of KPMG Clara is the firm's response to the need for reimagined technology to upscale auditors' client approach and to step into the future. In this evolving business landscape, the accounting industry must try to stay ahead and continue to invest in cognitive, machine learning, and AI capabilities.

Technology governance in an evolving regulatory landscape

With the opportunities and challenges posed by the new upcoming technologies, SAMA is acting as a catalyst to governing and promoting digital financial growth in Saudi Arabia. SAMA has introduced laws, regulations, policies and frameworks to maintain resilience and mitigate risk in line with Vision 2030 and the FSDP.

Transfer pricing for improved business outcomes

Saudi Arabia introduced transfer pricing regulations in 2018. TP compliance and requirements vary based on the tax profile of the bank or financial institution. But beyond compliance, transfer pricing can be a meaningful instrument to ensure that standalone Income Statements reflect optimal business outcomes. These considerations work in tandem with seamless adherence to Saudi Arabia's transfer pricing arm's length principles.

Transformational technologies

Cloud technology as a critical enabler for digital banking

Cloud-based software is a game changer for banks and can make operations seamless, flexible, and accessible at the press of a button. Whether it is for financial or non-financial risks, cloud computing allows the risk team to react rapidly to threats and dive deeper into data analysis. However, challenges remain that hinder cloud adoption such as migrating sensitive data and functions in such a regulated industry. Despite potential risks, SAMA and commercial banks in the Kingdom are moving towards adopting the new technology in line with Vision 2030's push for digitalization.

Building robust data management strategies

Building a proper data management foundation is essential, because data management can enable

banks to offer a superior customer experience, mitigate risks, and comply with regulations. Regulations in Saudi Arabia, such as the Interim Regulations for data protection and the new Personal Data Protection Law, provide a structure and environment in which individual banks can build robust data management strategies. However, it is up to individual banks to develop their own data management practices, tailor-made to the type and quality of their data, to drive business value.

Payment service providers create banking transformation opportunities

As FinTech investments in Saudi Arabia poured into payments in 2021, SAMA is aiming to provide a regulatory framework to support innovation in the sector, as well as attract foreign PSPs to operate in the Kingdom. Due to these developments, new players or disruptors are emerging through the FinTech sector and banks are having to contend with a new way of conducting business that is heavily consumer-centric. Inflexible legacy systems and extensive regulations can hinder innovation, but banks cannot afford to remain static within this increasingly digitized environment.

Enabling excellence

Increased expectations of data privacy

The banking industry is based on trust, so the main risk of cybersecurity and data privacy threats is compromising the trust of clients and their personal information. Saudi Arabia has faced increasing security threats, especially with Covid-19 and remote working, the brunt of which has befallen the financial services industry. Banks in Saudi Arabia must consider various avenues to mitigate these threats while also complying with regulations, such as the new Personal Data Protection Law.

Seeking procurement excellence and cost reduction in retail banking

Procurement in retail banking has the potential to optimize costs across the organization as well as address complex problems emerging from a changing banking landscape. Banks in the Kingdom face an array of challenges to their procurement function that may be hindering their ability to cut costs and increase their reach in the market. In order to leverage procurement's cost-saving potential, Saudi banks

need to ensure that the function develops from an executor of operational processes to a strategic value partner by increasing its maturity level.

Leveraging technology in an evolving risk management landscape

Banks face a set of risks and governing responsibilities both old and new. Evolving climate change and conduct risks deserve fresh attention and have become more prominent and pressing. Climate change is a top risk for financial firm growth as governments outline new corporate requirements and move to a low-carbon economy. Banks are also starting to feel pressure from their customers and from the public at large to address climate risk. Another imminent change to the risk landscape for banks is the January 2023 deadline for adherence to the Basel accords. To respond to this evolving landscape in risk management, banks must be ready to embrace new technology such as AI to improve efficiency and productivity while reducing costs.



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Financial performance

Financial performance underpins optimism in the boardroom

A cursory glance at the quarterly financial performance of the banking sector in the first quarter of 2022 reflects a sturdy industry performance, particularly highlighted by an increase in net profit for this three-months period by 22.83% as compared to first quarter of 2021, and with a total assets growth of 3.75% since 31 December 2021. We have witnessed the revival in economic activities as many countries emerged from lockdowns and movement restrictions and global supply chains were largely restored — also a prolonged increase in oil price has helped the Saudi economy to thrive and the banking industry to capture the benefits.

Quarterly results 2021

The improved financial performance was mainly fueled by continued growth in the lending book across the industry as well as declining trend in estimated credit losses (ECL) period after period. The ECL charge for the three-months period that ended 31 March 2022 has declined by 11.47% when compared with respective period ended 31 March 2021. The total customer deposit also reported modest growth of 3.90% since 31 December 2021 evidencing that the liquidity has not been a challenge to date. These factors drove an overall increase in total equity for the banking industry.

Annual results 2022

At the close of 2021, the banking industry showed resurgence of the era of severe impact by the

pandemic was passed, with an increase in profit of 40.15% (including a one-off impairment at SABB) and increase in total assets of SAR262 billion 9.46% when compared to 2020. The industry closed the asset base of SAR3,033 billion at the end of 31 December 2021, yielding the average return on assets of 1.6% against 1.02% during 2020. The total equity stands at SAR474 billion, yielding an average return on equity of 10.3% against 7.46% in 2020. The substantial growth in net income was largely achieved at the back of a decline in the impairment charge by 29% for FY2021 compared to FY2020. This was duly evidenced by a reduction in average non-performing loans (NPL) coverage ratio decreasing to 161% at the end of FY2021, compared to 164% for FY2020.

The trend of surging residential finance started to show maturity since the second quarter 2021, with a number of new contracts that started to decrease relative to previous year. This has been a major growth area for some of the largest banks.

The outlook for the banking sector looks promising, owing to product innovation and conscious efforts on deploying digital solutions for improving efficiencies. Moreover, the entry of new digital banks that are gearing up for innovative and customer-centric products is expected to bring more liquidity in the banking system and enhance economic activity.



The substantial growth in net income largely achieved at the back of a decline in the impairment charge by 29%, evidenced by a reduction in average NPLC ratio.

Industry performance of 10 listed banks

Net profit after zakat and tax



Q1 – 2022 net income SAR14.76 billion (Q1 – 2021 SAR12.02 billion)

Total assets



As of Q1 – 2022 SAR3,147 billion (YE – 2021 SAR3,033 billion)

Total customer deposit



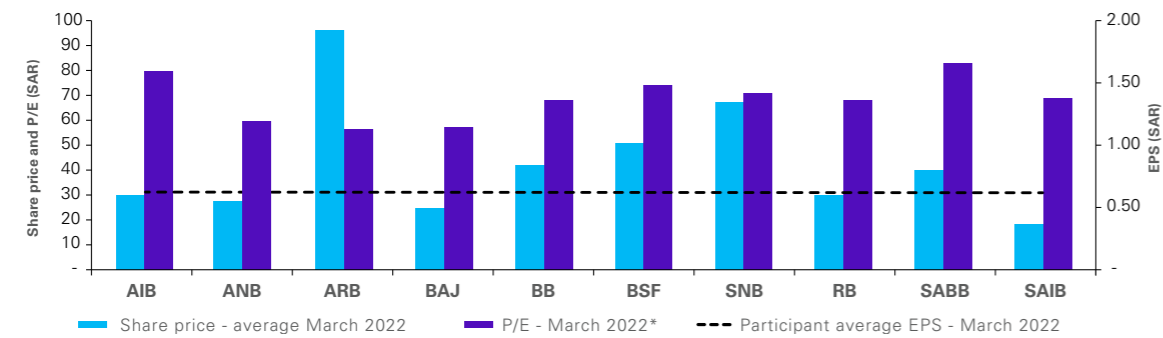
As of Q1 – 2022 SAR2,200 billion (YE – 2021: SAR2,117 billion)

ECL charge for the period

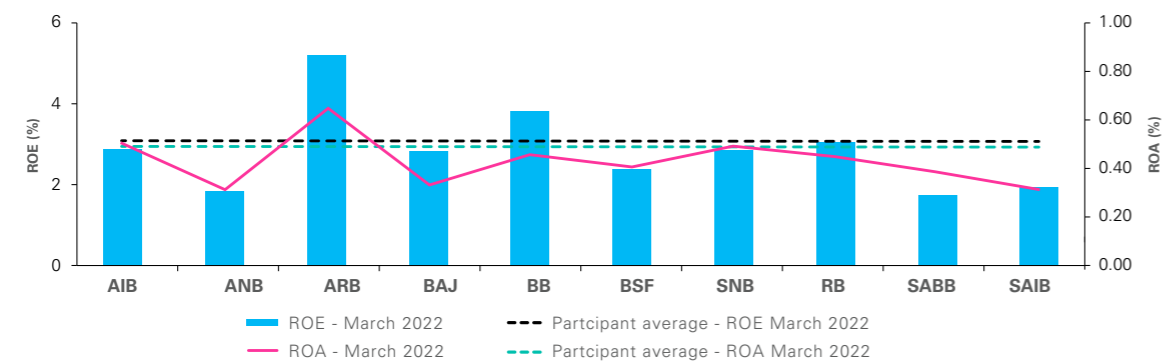


Q1 – 2022 SAR2.24 billion (Q1 – 2021: SAR2.53 billion)

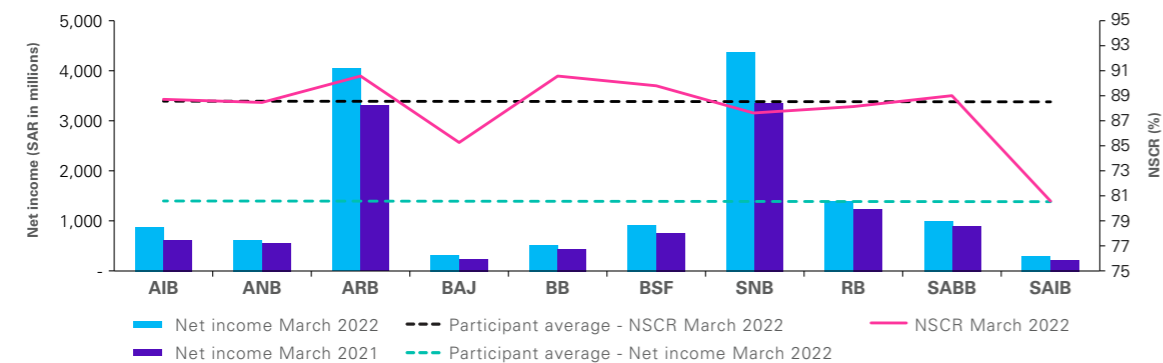
Share price, P/E & EPS



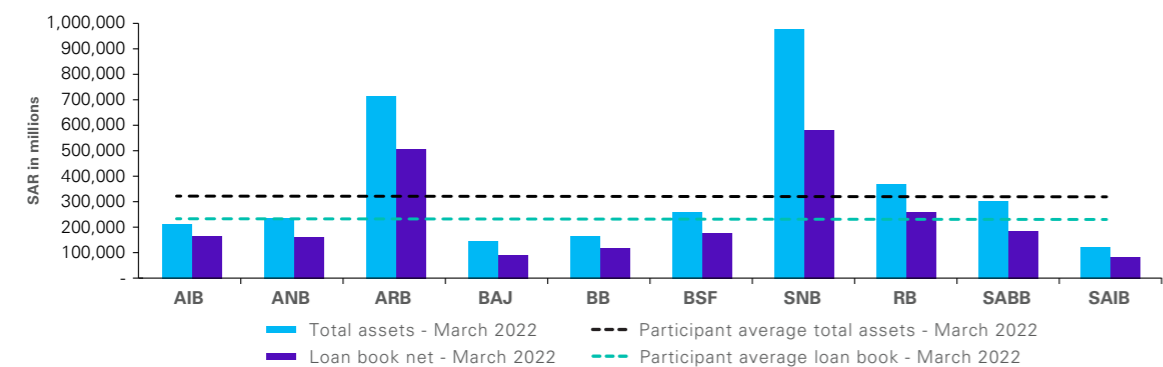
ROE & ROA



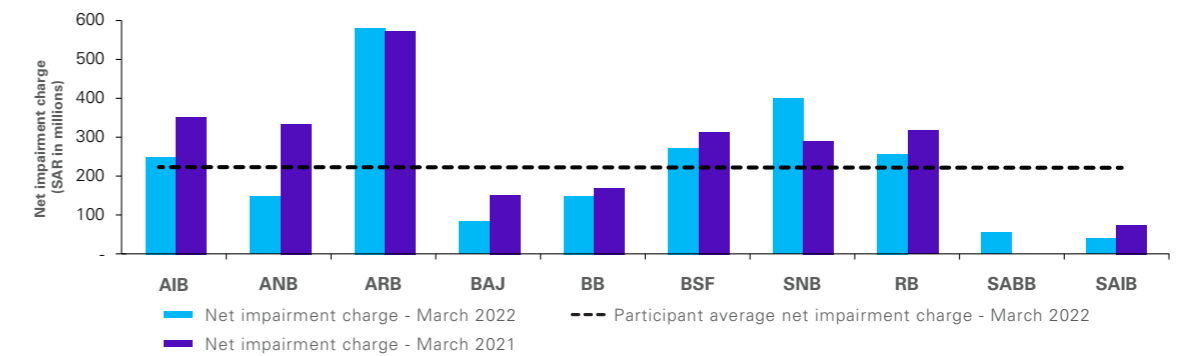
Net income



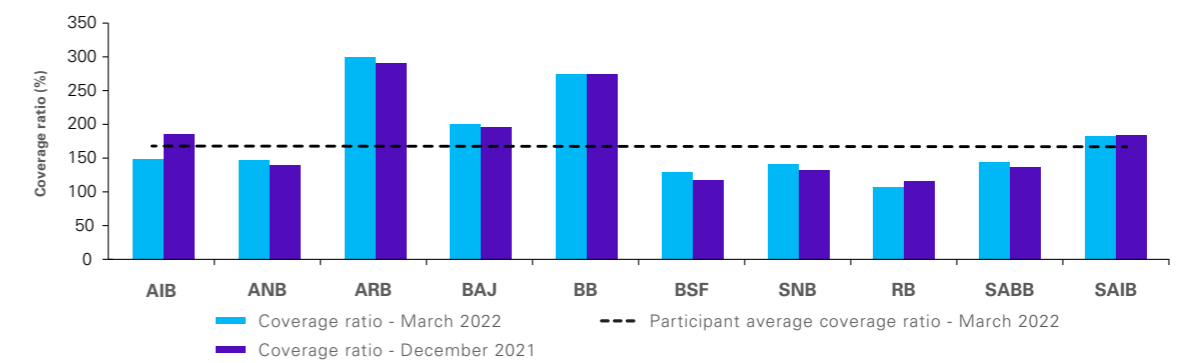
Total assets & Total loan book



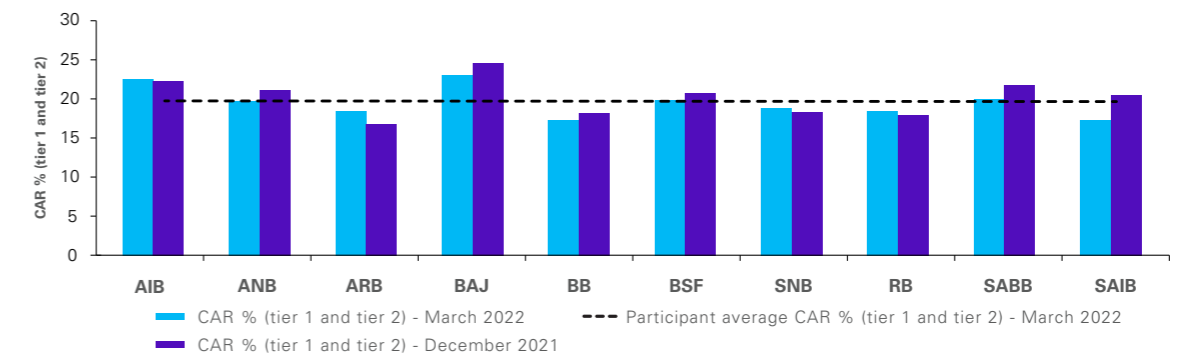
Net impairment charge



NPL coverage ratio



Capital adequacy ratio



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	Saudi National Bank	SNB		
Bank Al Jazira	BAJ	Riyad Bank	RB		

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 three-months period that ended 31 March 2022 to total equity. **ROA** is the ratio of net income for the three-months period that ended 31 March 2022 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. **NCSR** is the net special commission rate.

People-centered banking

ESG commitment driven by investment opportunities

Environment, social, and governance (ESG) programs have increasingly become part of the corporate agendas globally. One factor that pushed for this adoption was the Covid-19 pandemic, during which investors realized that they need to invest in the most sustainable and safe corporate environment to lower their risks. The concept of ESG has gained traction and pushed companies towards more transparency and broader reporting. The banking sector has been one of the leading industries influencing the movement of ESG. In Saudi Arabia, the growing exposure to global financial markets and the heightened attention from ratings agencies have incentivized banks to prioritize ESG.

ESG agenda of regulators and investors

As one of the world's largest oil producers, Saudi Arabia has a particularly important role to play in the environment part of the ESG equation. The Kingdom has responded to the trend by joining the Global Methane pledge to reduce 30% of carbon emissions by 2060, as a part of its long-term commitment and aim to achieve net carbon neutrality by 2060. The government has also committed to the Sustainable Development Goals through proposals to improve productivity and efficiency in the public and private sectors.

In addition to the government's response, a growing segment of investors expect banks to avoid industries with high-carbon emissions or low-corporate rating on the social and sustainability agenda. As a result, ESG-related funds that are currently generating financial returns at par are expected to outperform the market in the near future.

In Saudi Arabia, this drive toward ESG seems to be driven equally by regulators and investors. According to KPMG's 2021 CEO Outlook, CEOs in Saudi Arabia stated that they see increased demand for ESG reporting and transparency coming from regulators (44%), institutional investors (41%), and customers (10%).¹

The introduction of ESG rating systems and stock indices of companies with leading sustainability programs has further entrenched this investment paradigm. The Saudi Capital Market Authority (CMA) is now emphasizing ESG values through Tadawul, the Kingdom's stock exchange. CMA established principles for responsible investment in addition to promoting ESG initiatives by publishing an updated



Bank executives need to ensure that ESG risks are a lens through which all decisions are made, especially in relation to credit and valuation risks in their portfolios and customer-pricing.

version of the disclosure guidelines to help companies navigate ESG. The CMA wants to ensure that the guidelines support the sustainable and inclusive growth of the Saudi capital market and aims to benefit all market participants.

The value of ESG for investments in the banking sector

Investors in emerging markets increasingly perceive compliance with ESG standards as obligatory, which is demonstrated by the growth of ESG investments over the past few years. It is projected that in 2025 the value of the total global assets will be US\$140.5 trillion, of which US\$50 trillion (35.6%) are restricted to ESG investments.

The weight of Saudi Arabia's emerging market is 3.67% and consists of 36 listed Saudi companies. Of these 36 companies there are 9 listed banks that represent a share of 1.8% of the total emerging market. Considering that the estimated 2025 global assets will be US\$140.5 trillion, Saudi Arabia should get a share of US\$5.143 trillion, with US\$2.53 trillion going to the banking sector. Given the projection that 35.6% of global assets will be restricted to ESG investments, Saudi Arabia could lose a total of US\$1.83 trillion from the emerging market, US\$0.9 trillion of which will be lost in foreign capital by the banking sector in 2025.

These potential losses stem from a lack of ESG reporting. For banks to be chosen for ESG-restricted investments, they must acquire an evaluation by ESG rating providers recognized by institutional foreign investors, such as large European and US institutional funds, pension funds, and other asset owners.² These

	ESG assets (US\$)	Growth %
2016	22.8	-
2018	30.6	34.2
2020	35	14.4
2025	50	42.9

ratings providers have not covered Saudi Arabia since there has not been sufficient publicly available data to determine the ESG ratings of Saudi companies. Less than 40% of Saudi listed banks have publicly disclosed the requested data and have mostly gotten an insufficient score. This blocks banks' chances of being chosen for the allocated funds in ESG investments.

Looking to the future

ESG factors remain a reputational risk for many banks, but they need to be more than that. Bank executives, particularly board members, need to ensure that ESG risks are a lens through which all decisions are made, especially in relation to credit and valuation risks in their portfolios and customer-pricing.

ESG will increasingly become central to the economic equation globally, and Saudi Arabia will be no exception in the post-Covid world. For listed banks in the emerging market, although they are complying with rules and regulations on both national and international levels, they need to address the lack of reporting of ESG data in annual and other publicly available reports.



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Customer expectations driving disruption

The speed of technological advancement over the past few years has led to the emergence of disruptors that are transforming the way the banking industry operates. Governments and established banks are grappling with new customer expectations and how to regulate emerging technology and new entrants.

SAMA has been a proponent of change and development in the financial sector, in line with the objectives of the Financial Sector Development Program (FSDP) that is part of Vision 2030. SAMA's forward-looking stance has led to a push for digitalization through Open Banking, the support of the FinTech sector, and licensing digital banks.

Open Banking

In January 2021, SAMA announced that it is developing its Open Banking initiative and services. The process of Open Banking will allow customers to share their financial data with third party providers (TPPs), such as FinTech companies or other banks. The sharing of customers' financial data enables TPPs to develop novel products and services, which is expected to have a positive impact on the Kingdom's financial sector.³

Banks are having to adapt to a transformed financial services space that relies on innovative information and automation technology, which has led to obsolete legacy technologies and overextended branch networks. With the rise of the FinTech and the influence of Big Tech, customers have come to expect new services, enhanced user-friendliness, and transparency, as well as accessibility. In fact, the rise of novel digital platforms has extended banking services to previously unbanked segments of the population.⁴ Open banking will result in greater efficiency and help banks bridge the gap with FinTechs. Customers will be able to securely and consensually share data with third party developers that can provide innovative solutions in areas such financial information management, frictionless transactions, real-time credit, and money management.⁵

In March 2022, SAMA announced that three FinTech companies were permitted into the Sandbox to work on open banking solutions, indicating the central bank's push to work with industry players to expedite the launch of the Open Banking framework in the first half of 2022.



With the rise of the FinTech and the influence of Big Tech, customers have come to expect new services, enhanced user-friendliness, and transparency, as well as accessibility.

Digital banking in Saudi Arabia

In addition to the forthcoming Open Banking framework, Saudi Arabia has granted digital banking licenses for stc Bank and Saudi Digital Bank in June 2021, and by November 2021, the Central Bank governor announced that the Kingdom will issue operating licenses to more digital banks. The trend continued in February 2022 when the Saudi Cabinet granted D360 Bank a digital banking license. The latter is to be established with a capital of SAR1.65 billion and with the Public Investment Fund as one of the main investors.⁶

SAMA's FinTech Sandbox

While embracing technology and seeking to regulate it, SAMA has designed a Regulatory Sandbox to welcome local and international FinTech businesses wishing to test their digital solutions in a "live" environment.⁷ SAMA will be able to understand and assess the impact of the new technologies in the Kingdom's financial sector, and companies will get a view of the environment before deploying in Saudi.

The FinTech sector has grown significantly and continues to do so in Saudi Arabia. In 2021, the FinTech sector received US\$91 million in funding and ranked first in deals, as startups accounted for 19% of all transactions registered in Saudi Arabia that year.⁸ It was also the leading industry by deals across the MENA region.

Future expectations

With the advent of 5G and the expectation that it will be widespread in the next few years, banking services will benefit from the continued efficiency and

improved fraud protection that it will bring. Mobile financial services, fueled by FinTech will become increasingly popular. Artificial Intelligence (AI) and the further roll-out of 5G will also enable physical branches to become more lightweight and intelligent while playing an important role in this new era, but their functions will have different objectives than they do now. For certain services, such as opening accounts, wealth management and consultancy, and private banking, customers often prefer face-to-face communication. Smart branches can improve customer experience and decrease labor costs, while also allowing customers access to any branch since data can be synchronized nationwide.⁹

Cryptocurrency and blockchain technology are yet other disruptive and quickly rising forces that needs to be grappled with. on cryptocurrency-related losses.

The lack of scholarly consensus on the status of the currencies creates uncertainty for investors that are looking for shariah-compliant products in the Middle East and elsewhere, but in January of 2021, Bahrain launched a state-approved Shariah-compliant cryptocurrency exchange platform available to residents of Saudi Arabia, the United Arab Emirates, Kuwait, and Oman.¹⁰ For Saudi Arabia to capitalize on the global boom in cryptocurrencies, the development of a regulatory, financial, and religious frameworks will be needed.

Despite these hurdles, blockchain technology has proven to be a viable avenue for Saudi Arabia and other countries in the region, as was demonstrated by Project Aber in 2020. But whether a Central Bank Digital Currency (CBDC) will be developed in the near future remains to be seen.



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The role of banks in creating a savings culture

In the wake of swift technological advancements and rapid growth of industrialization, the world is witnessing a growing spending culture. Economists call it the wealth effect; when people begin feeling richer, they start saving less. Banks can play a role in creating, promoting, and spreading financial literacy, and in inculcating the will and need for sufficient household savings.

After crossing the bottleneck of the 2008-2009 global financial crisis, household savings ratios started falling gradually across all major economies. Between 2010 and 2019, the household savings index in several countries witnessed either a stagnant or declining trend. Saudi Arabia and its neighboring countries have not been different. The household savings rate for Saudi nationals stood at just 1.6% of the annual disposable income in 2018, according to the latest available GASTAT figures, which is considered low in comparison with other G20 countries. A [2020 KPMG study on household savings](#) found financial literacy to be an important factor of the low rate, also explaining the lower investment rate. Further, the country's prosperity and its safety net are cited as reasons for low savings rates. Lastly, the study stated the demographic distribution of the country to have a noticeable impact on the overall household savings rate, as savings index should be higher for countries in their early stage of the life-cycle hypothesis but still shows a relatively lower savings rates despite a young population that is perhaps unconvinced of the need of savings. Nevertheless, times of economic crises, as well as the pandemic, have revived the significance of building and maintaining personal liquidity and therefore reiterated the importance of embracing a savings culture.



For financial institutions to truly help consumers achieve financial health, most experts believe that they must think of finance as a utility, a service that is continually available to support people's moment-by-moment needs, not isolated tools focused on macro decisions.

Saudi Arabia has recognized the key role household savings play in the economic development of the country, as it was formulated as a part of Vision 2030 and its Financial Sector Development program (FSDP). One of the key objectives of FSDP is to diversify the financial sector to support the development of the national economy and stimulate savings. That said, the role of modern-day banks in promoting financial literacy and enhancing savings culture cannot be emphasized enough.

Since their inception, commercial banks have directly or indirectly promoted savings by providing a range of deposit products and mechanisms with varying combinations of liquidity and rate of interest tailored to needs and preferences of different depositors. The additional benefit of security from theft and damage, and in some cases robust insurance coverage has also been contributive. As a store of value, bank deposits enjoy certain advantages over tangible assets; deposits are convenient to hold as store of value and are safer and more liquid – they can be converted into cash easily. They are also greatly divisible and often less risky.

However, despite these challenges, the extent of unbanked population, level of financial literacy and consequently savings rate are still far from optimum. For financial institutions to truly help consumers achieve financial health, most experts believe that they must think of finance as a utility, a service that is continually available to support people's moment-by-moment needs, not isolated tools focused on macro decisions. Many consumers are looking for tools or educational programs to increase financial wellness. They are asking for help in understanding complicated financial products. Accordingly, banks could consider offering awareness programs and targeted seminars.

Another key aspect pertinent to the role of banks is to ensure the availability of robust and user-friendly tools that facilitate financial literacy and savings. Unfortunately, most of the slick digital budgeting apps many institutions offer have limited functionality. Consumers need tools that go beyond just helping with life events – such as a mortgage calculator – but are integrated into customers' day-to-day lives. There is a great deal of interest among policymakers and financial services about the potential of FinTech to help savers. Possibilities include the use of machine learning to help people budget, understand



their spending and spot saving opportunities, or enabling people to 'impulse save' by moving unspent money into savings. Further research is required to develop the right tools for people and their various needs.

Banks should be mindful of the sheer diversity of the general population, including their saving attitudes and preferences. A one-size-fits-all approach has always been counterintuitive. For example, for a low-income household, there is a myriad range of challenges competing for time and attention, including the everyday problem of managing income-consumption timing mismatches. Over the long-term, there is the problem of building sufficient reserves to meet lifecycle goals such as education, housing, and marriage. For short-term consumption, liquidity is essential, so a regular bank account would suffice. For medium-term building of lump sums, a balance of liquidity and inflation protection is required; an account (such as a money market fund) that tracks inflation and has reasonable liquidity should do the trick. Further, for long-term retirement savings, significant real returns and illiquidity are the cornerstones of the mechanism. Therefore, it's critical for banks to consider, analyze, and address the preferences and needs of the public with catered advice, products, and tools that ensure a robust eco-system of savings and expenditure.

In contrast, for much of the urban mid-earning population, banks are required to devise and apply significantly different saving methodologies and strategies. Two of these are represented by 'auto-save behaviors' and 'reframing savings for non-savers.' The former focuses on making savings a 'default' behavior. Research has shown that, when borrowers opted in to making savings payments alongside a loan repayment, many continued to save after the loan was repaid

because the regular saving payment did not stop. This is known as 'auto-saving' and therefore it is pertinent to understand what other opportunities exist for people auto-save (for example, integrating rainy day savings with auto-enrollment pensions, allowing people to access some of their stash in emergencies) and to determine when and why people keep their auto-save payments going. The latter represents reframing the rewards of saving so they are more easily understood and acknowledged by the public. There is evidence that matched savings schemes (e.g., a scheme which presents returns as a quantified amount for every unit of currency, rather than a percentage interest rate) have a positive impact on savings behavior. Prize-linked schemes show some evidence of promise, but none that demonstrates a clear causal link to improved saving.

The millennial generation seems to be more cautious with their finances and savings than most people might think, it is up to the new age financial institutions, especially FinTech entities, to continue enhancing their product and solution base, digital offerings, and customer empathy. Not only to significantly enhance the banked population levels but also a financially literate and savings conscious society.



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Governance and compliance

Reimagining external audit through digital enablement

The broad emphasis on digital transformation also has its implications on the banking industry, predominantly in the form of revisiting core business processes, upgrading technology infrastructure and offerings, data management and cybersecurity. Banking audits are specifically challenging due to the underlying complexity of risk models, and large quantities of data and transactions. This in-turn necessitates reliance on strong automated and manual controls working in cohesion to ensure security, accuracy, and completeness of data and transactions being processed in the vast canvas of interconnected IT systems of the bank.

Digital transformation has thus, pushed auditors to reimagine the audit experience. Although accountants were experimenting with change before the pandemic, it certainly accelerated the process of adoption to keep up with a changing work landscape. With the temporary closing of workplaces and the need for physical distancing, auditors leveraged existing and new advanced technology to conduct audits remotely. The power of digital transformation in audit is not only about remote work though; it is about overhauling the underlying processes using technology to achieve higher quality, more efficient audits, and better insights for clients and other stakeholders.

With increased digitization of client documents, traditional barriers for auditor access to data or readiness were quickly overcome. In Saudi Arabia, Vision 2030 had a big impact on this development due to the push towards digitization. Banks are technologically up-to-speed and have increased their digital aspirations and projects. This enables them to utilize their technology to improve customer service processes, risk management, and also the audit process.

Auditors, therefore, need to upskill themselves and focus on increasing their knowledge, their risk assessment procedures and audit toolsets – not only to align with the industry but also to stay ahead of the curve and business adoption. This is imperative in the pursuit of delivering enhanced audit quality, valuable client insights, ensuring regulatory compliance and focus on delivering a reimagined, technology enabled auditing experience for all stakeholders.

Risk assessment and transparency

Risk assessment is at the heart of an audit, and due to recent advancements in the business landscape, it has become even more tech-driven with increased precision and focus on efficiency. Auditors can pinpoint problems in need of mitigation faster and more accurately. Traditionally, auditing was a process based on sampling techniques, which use a subset of data to be audited to run audit tests. Now, auditors can use advanced data and analytics, rules-based automation, and AI to move from sampling to reviewing 100% of a client's transactions.¹¹ Leaning on the technology to perform routine, rule-based tasks allows auditing professionals to get razor focus on outliers and anomalies. The power of AI allows auditors to pick up patterns that people may miss or have not seen before.

Another perk afforded by the adoption of new technology is the increased transparency of the audit and the collaboration with the client that it affords. A platform that uses a cloud-based source to exchange important information, including valuable insights into the status of the audit, with the client creates greater interaction with the audit engagement team. The client's access to the data will lead to more targeted and meaningful conversations about specific findings, risks, and insights.

Cybersecurity and data integrity

With the challenges of the pandemic and the increased reliance on cloud-based solutions for working from home setups, the pressure on entities to ensure security and integrity of datasets at all times has been amplified. As a result, cybersecurity has come centerstage with increased emphasis on end-to-end encryption, firewalls and penetration testing along with increased frequency of such controls and procedures. Auditors are not only required to consider these controls while assessing risk but also test effectiveness of design and implementation of these controls for them to be able to provide assurance on numbers extracted from these datasets.

KPMG's audit technology in Saudi Arabia

Due to the shift in public mindset with more acceptance to digital banking and constant development in FinTech globally, the banking industry



of Saudi Arabia also witnessed an increase in reliance on digital platforms. The cabinet has recently approved the license of a third digital bank in the Kingdom as customers are expected to spend more time online. With the increased focus on digital banking, the industry is likely to employ Artificial Intelligence (AI) to process data and connect the customers' information with government, private and credit agencies.

KPMG Clara is the firm's global response to a reimagined audit approach, to upskill auditors, and step into the future.¹² It was launched in 2017 and took the audit workflow to the cloud with defense grade end-to-end encryption. Based on technology from Microsoft and IBM Watson, KPMG Clara houses advanced data analytics, predictive analytics within a single, cloud-based source and seamlessly adopts the latest cognitive and AI solutions with the scope for ongoing improvements and upgrades. Clients have access to the platform throughout their audit, providing a 24/7 window into the status of an audit. As more businesses shift to virtual work, KPMG Clara's integration with Microsoft Teams and Microsoft Azure SharePoint provides a platform for audit professionals to centrally manage and securely share audit files, track audit-related activities, and communicate with clients.

Over the past few years, KPMG has also been working on risk assessment tools based on machine learning, which allows the system to ingest massive data sets and flag anomalies, or risky, unusual, unexpected transactions based on parameters that it learns building on global KPMG industry knowledge. This technology can also provide insights into a company's processes, and flag outliers that might be hidden otherwise.

In Saudi Arabia, the adoption of KPMG Clara was done in line with the Communications & Information Technology Commission (CITC) regulations that do not

allow for certain industries' client data to be kept on regional clouds. Due to these restrictions, the firm in Saudi Arabia made a significant investment to locally build the needed infrastructure and host relevant client data locally inside the Kingdom to utilize the full potential of the technology while also abiding by CITC's regulations.

The future of audit

Looking ahead, the future of audit looks towards possibilities of real-time auditing in which clients record transactions on a blockchain or similar advanced technology and the auditor reviews this information on a real-time basis to pick up any unusual, unexpected transactions, account combination and characteristics. This will open a new dimension of auditing which will eventually translate into increased efficiency and improvements along key metrics of quality, deliverables and timing which will significantly benefit all stakeholders. To meet these expectations and stay ahead in an evolving business landscape, the accounting industry must continue to invest in data analytics, machine learning, and AI capabilities. This will allow it to provide organizations with data-driven business insights as well as matching the evolving reporting and regulatory requirements.



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Technology governance in an evolving regulatory landscape

The advent of new and disruptive technologies like AI, cloud computing, decentralized ledger systems, machine learning, big data analytics, and high-speed connectivity has posed unprecedented opportunities and risk challenges to financial systems around the world.¹³

Central banks around the world internalize these changes by introducing laws, regulations, and policies to govern and provide a resilient environment to foster digital financial growth. They also recognize the urgency of looming IT and cybersecurity threats accompanying wider technology penetration in the financial services sector.

While digital transformation is vital for Saudi Arabia to accelerate economic growth, it comes with increased cybersecurity risks, especially when digital platforms are developed rapidly and adopted for sensitive activities. Preempting the rising trends in disruptions and risks, while balancing Saudi Arabia's commitment to economic development, will challenge the financial sector as it transforms.

SAMA has embraced the evolving FinTech landscape and is acting as a guardian and catalyst for financial growth and stability. SAMA understands the necessity of in-depth IT governance and regulatory compliance to bring a balance between FinTech adoption and IT risk management. Consequently, SAMA has published regulatory frameworks and policies to maintain a resilient cyber-secure environment that ensures business continuity. Collectively, the IT governance landscape will help the Kingdom achieve monetary and financial growth and stability in line with Vision 2030 and the Financial Sector Development Program (FSDP).



Preempting the rising trends in disruptions and risks, while balancing Saudi Arabia's commitment to economic development, will challenge the financial sector as it transforms.

IT governance

Technological innovation and advancement in finance exposes the financial sector to evolving risks. Due to these developments, IT governance has grown in prominence to balance the utilization of advanced technology with identifying and mitigating IT risks.

In this regard, SAMA is actively working with its member organizations to elevate their maturity across well-defined controls by year-end. The IT Governance Framework seeks to support member organizations on the effective and efficient use of technology to achieve their goals and manage risks associated with IT. For the holistic implementation of IT governance rules and guidelines across the organizations, this framework will be implemented in conjunction with other frameworks related to Open Banking, cybersecurity and business continuity.¹⁴

It is an opportune time for banks to reflect and look beyond compliance but rather towards the business value unlocked by the initiatives needed to confirm with the new IT Governance Framework. Financial institutions are adopting initiatives such as establishing an enterprise architecture practice, adopting a comprehensive Technology Risk Management Framework, developing a robust Software Development Life Cycle (SDLC), and instilling an independent Quality Assurance function. These accelerate digital transformation, improve their customers' experience, enable quicker, safer adoption of emerging technologies, and allow for better use of their data. The initiatives are paramount for banks to offer differentiated products and flourish as the financial sector transforms digitally.

Open Banking Initiative

The Saudi Central Bank envisages Open Banking as an opportunity to achieve financial inclusion and development of the financial sector in the country. Through Open Banking initiatives, SAMA provides a FinTech ecosystem to leverage data associated with account information and financial transactions to develop innovative, secure, and inclusive financial products and services.

In the first half of 2022, the Saudi Central Bank is planning to go live with Open Banking with the support of market participants.¹⁵ The Open Banking ecosystem aims to spur economic growth with the participation of the private sector in line with Saudi Arabia's Vision 2030.

Cybersecurity

The fast-growing digital economy has accelerated the need for a robust cybersecurity structure in the financial sector. With this realization, Saudi Arabia is promoting the development of cyberthreat-resilient infrastructure and processes through cybersecurity laws, regulations, programs, and awareness campaigns.

SAMA has issued a Cybersecurity Framework that addresses the principles and guidelines for regulated entities to establish cybersecurity governance and build a resilient cybersecurity system with adequate preventive and detective controls.¹⁶ SAMA recognizes the importance of maintaining confidentiality, integrity, and availability of financial services during technological disruptions and growing cyber threats. With the support of associated organizations, SAMA ensures that critical data, information, hardware, software applications, communication networks, premises, people, and overall operational infrastructure remain safe and secure.

Business Continuity Management

A well-connected and technology-led digital economy requires the continuity and availability of financial operations and services 24/7, without any disruption. The continuity of financial services is crucial for maintaining every other socioeconomic sector.

In 2017, SAMA introduced a Business Continuity Management Framework (BCMF) to ensure the continuous availability of financial services in the Kingdom during stable and disruptive times. This Framework establishes resilience among organizations to detect, prevent, and mitigate any potential threat and to continue the provision of critical financial

services to its key stakeholders.¹⁷ This framework includes Business Continuity Management best practices to ensure a minimum level of resilience is maintained by member organizations.

Future prospects

In the years ahead, disruptive financial technologies can bring forth a revolution in conducting business activities worldwide. Information Technologies are continuously evolving and dynamically changing the governance and regulatory compliance landscape.

The world is grappling with decentralized currencies and payment methods using blockchain technologies. At the same time, new cyber threats are evolving fast with increasingly malicious intentions. Remote work culture and decentralized financial systems with unhindered accessibility to organizational infrastructure have brought data and information security into focus. Therefore, continuous and more intensive efforts are required to safeguard the digital environment and achieve Vision 2030.

It is recommended for Saudi Arabia to ensure strict compliance to IT regulations in an ever-evolving digital landscape, which necessitates a specialized workforce that is well-versed in all facets of IT governance. Sustainable development will depend on innovation and transformation, which require a governed environment for conducting business.



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Transfer pricing for improved business outcomes

Changing platforms and fast-moving technologies are having a significant impact on value creation in many areas of banking and financial services. This is one of the most interesting and important elements of transfer pricing for financial services in a post-BEPS (Base Erosion and Profit Shifting) world, since the BEPS project aligns profits with value creation. With the current pace of commercial change, if a financial institution's transfer pricing does not properly reflect value creation now, this misalignment is likely to increase in the years ahead.

Transfer pricing for banks

Saudi Arabia has always adhered to the arm's length principle while dealing with group entities under its income tax laws. This means that multinational enterprises should deal with a related party as if they are dealing with an unrelated/third party in their conduct and business outcomes. Saudi Arabia further introduced comprehensive Transfer Pricing Regulations in February 2019 legislating transfer pricing compliance obligations for taxpayers in Saudi Arabia.

The tax profile of financial institutions and banks in Saudi Arabia is varied and ranges from 100% Zakat entities, to mixed companies, and branches of foreign banks. The introduction of the comprehensive new regulations means that, depending on their tax profile, banks need to prepare four transfer pricing documents and file them with tax authorities in Saudi Arabia.

These four documents are: a disclosure form and affidavit, a local file, a master file, and country-by-country reporting, including notifications. In the case of 100% Zakat entities, they are only subject to country-by-country reporting including notifications.

For banks, critical transfer pricing considerations fall under two categories of income and expense: interest and non-interest. For interest, it is important to consider the booking of loans under syndication, loan transfers, and sales credit. For non-interest, considerations include the booking of upfront non-interest income, like upfront fees in relation to advisory projects, which may include project finance, mergers and acquisitions, equity capital market, and debt capital market.

Using transfer pricing for optimal business outcomes

While transfer pricing compliance is backed by regulatory requirements, leaders of financial institutions and banks must consider the broader picture and use transfer pricing to ensure that standalone Income Statements reflect optimal business outcomes. This can be achieved by deploying arm's length principles as an instrument to ensure related party transactions between group entities are dealt with arm's length outcomes. This could begin by simply understanding the fact pattern on management and head office costs incurred by the ultimate parent company benefitting broader group companies yet never expensed to benefitting group entities.

In the event where any group entity procures services from a third-party vendor, such as human resources, legal, business controls checks, they invariably would have paid for such services and expensed them in their Income Statement. This practice can be extrapolated to the instance when one group entity seeks such services from another group entity.

Business	Item of income and expense	Transfer pricing considerations
Banks	Interest	Booking of loans under syndication, loan transfers, and sales credit.
	Non-interest	Booking of upfront non-interest income like upfront fees in relation to advisory projects (project finance, mergers and acquisitions, equity capital market, debt capital market).
Cost recharge	Operating income / expense	Management and provision of service cost recharges. Shareholders cost versus globally benefitting versus regionally benefitting versus locally benefitting.



In their considerations, banks also need to account for operational aspects like transfer pricing governance and risk management, which include withholding tax, VAT, inter-company billing, settlements, and reconciliations arising by virtue of related party transactions.

While such related party transactions will be a zero-sum game at the consolidated financial levels, at the standalone level they will reflect the cost base incurred to generate commensurate revenue and the margins will incrementally align with business outcomes. This concept complements the basic principles of accounting of a "separate entity."

In addition, tax transfer pricing can be further applied to the following areas of income and expense streams, as demonstrated in the table below.

These considerations can be initiated through the following simplified steps. First, obtain the entire cost base of the bank. Secondly, connect with a business or department leader to understand the fact pattern on the cost base versus the portion of such a cost base incurred to benefit other group entities. Thirdly, establish an internal framework and policy to ensure cost recharges take place commensurately to

benefitting group entities based on aligned cost allocation keys and backed by inter-company agreements.

In their considerations, banks also need to account for operational aspects like transfer pricing governance and risk management, which include withholding tax, VAT, inter-company billing, settlements, and reconciliations arising by virtue of related party transactions.

Transfer pricing can be a meaningful instrument to ensure that standalone Income Statements reflect optimal business outcomes. These considerations work in tandem with seamless compliance with Saudi Arabia's transfer pricing arm's length principles and the maintenance of supporting documentation to comply with transfer pricing obligations.

It is recommended to follow a simplified approach that includes fit-for-purpose inter-company frameworks, policies, and execution strategies.



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Transformational technologies

Cloud technology as a critical enabler for digital banking

There is no doubt that cloud-based solutions have become a dominant force in supporting businesses worldwide and a major pillar in the IT landscape. The days of making the case for cloud adoption are behind us and the prospects of cloud-powered businesses are today's reality.

That said, the banking industry has been slower in its adoption of cloud-based solutions despite the industry acknowledging their advantages. This rather slow adoption can be attributed to a number of possible factors; challenging migrations and regulatory constraints stand out when discussing the topic with banking CIOs. Large on-premise legacy systems are difficult to modernize, re-platform or migrate. They are, and have been for years, the backbone of secure and reliable banking. It takes careful planning, special-purpose budgeting and a dose of courage to decommission legacy systems and replace them with modern, agile and cloud-native solutions. Regulators have also been reluctant to open the door wide to cross-border hosting, citing data sovereignty and privacy concerns. Despite slowly changing attitudes, some restrictions are still in place and in demand of enhanced transparency and security for cloud computing. This in turn puts the emphasis on local service providers and foreign market entrants.

Opportunities and challenges for banks embracing the cloud

Cloud technologies can streamline banking operations and allow banks to pivot to address new market realities. Their benefits go beyond the enhanced customer satisfaction, agile product development, systems scalability, cost reductions and efficient automation. Cloud-native solutions have proven to be significantly more capable to support new business alliances within the banking industry and beyond. FinTech companies continue to disrupt established markets with their innovative offerings but their need for payment clearance and transaction fulfillment requires solid banking support. FinTech alliances in the banking industry are creating new revenue streams and this did not come without challenges and demands.

With ever rising numbers of transactions and with the introduction of instant payment clearance; architectures, AML, financial crimes and credit risks are growing higher and harder to manage. Having a

shorter transaction time requires financial institutions to enhance their financial risk capability in terms of volume and speed. Cloud-based risk solutions supported by cloud computing and data management allows the risk team to react rapidly to threats and dive deeper into data analysis.

It is also crucial to consider the challenges of migrating sensitive data and functions for the banking sector. Commercial banks have moved more slowly than other sectors due to concerns for customer and institutional data, as well as transferring risk to a third party in such a heavily regulated industry. Such concerns factor into the bank's balancing of its capabilities and resources when choosing the type of cloud services they can utilize, such as an organization-specific cloud, a public cloud, or a hybrid cloud platform. This puts the emphasis on the available supply within the Kingdom via local service providers or foreign market entrants.

Saudi banks embrace the cloud

Saudi Arabia has embraced a positive attitude toward increased digitization, in pursuit of Vision 2030. For this purpose, the Ministry of Communication and Information Technology has issued the Cloud First Policy in October 2021 mandating government owned entities to migrate to the cloud; a policy currently being regulated by the Digital Government Authority.

Similarly, SAMA issued its policy on cyber security and the use of cloud services in the financial sector. It also issued the Open Banking Policy in October 2021. Such a change in the mindset puts significant emphasis on modernizing vault-like integration protocols and brings open API concepts to the forefront. Several Saudi banks have started experimenting with open API solutions, but we are still a little far from API market offerings seen elsewhere in the world.

SAMA granted digital banking licenses to STC Bank and Saudi Digital Bank in 2021, and the PIF-backed D360 in February 2022. Further, the Governor of SAMA announced that the Kingdom will issue operating licenses to more digital banks in a clear indication of an upcoming diversified financial sector. Established banks in the Kingdom are also moving towards adopting new technology either through modernizing legacy systems or by creating modern parallel infrastructures.



Considering the challenges of migrating sensitive data and functions for the banking sector factor into the bank's balancing of its capabilities and resources when choosing the type of cloud services they can utilize, such as an organization-specific cloud, a public cloud, or a hybrid cloud platform. This puts the emphasis on the available supply within the Kingdom via local service providers or foreign market entrants.

Can cloud-based solutions expedite the transformation and the adoption of Open Banking concepts? Most certainly, yes.

Hybrid cloud architectures are able to facilitate combining the bank's legacy datacenter with solutions hosted on public clouds. Multi-cloud architectures can enable banks to keep sensitive client data on their own legacy datacenters while deploying transactional applications and API assets on public clouds. This fully integrated approach ensures data security and controls while facilitating scalability, continuous development and real-time processing.

The banking sector is currently witnessing a number of multi-cloud platform deployments with announcements made in this regard by many leading banks. Many Saudi banks have announced that they have partnered with Red Hat Inc. to kick-start their digital transformation and cloud migration initiatives. While some initiated pilot programs to proof of concept work, others committed to migrating some of their applications to a new modern platform. Although most of these initiatives are still limited to private clouds and on-prem datacenters, they will certainly lay the foundation to a full-fledged cloud adoption. Once a digital multi-cloud platform is put in place, a bank could host applications and solutions on private and public clouds without the need to worry about architecture and integration issues. Done right, such architectural designs could scale up and across and will provide a solid foundation for the upcoming transformation.

A changing role for banks

The healthy competition between FinTech, disruptive start-up financial institutions and conventional banks is starting to cultivate a new business model. An ecosystem that comprises banks, telecoms and service providers from transportation, hospitality, entertainment and others is emerging. This is shifting the way we perceive banks from account and credit managers to much more; Value-add services offerings in online banking apps are growing and becoming effective and convenient.

An example that is garnering global attention is yono, a digital bank created in 2017 by the State Bank of India (SBI), with the initial idea of yono being an online marketplace to attract the younger generation. The online platform includes a digital bank, a financial superstore offering investments and other financial services, and an online marketplace with lifestyle products from partners.¹⁸ The application grew into one of the largest digital lenders in India and the first digital bank in the world to break even within two years.¹⁹

SBI solicited the help of technology leaders to design intelligent workflows and a robust security system to support the solution. yono workflows embed technologies such as AI, automation, blockchain, 5G, advanced analytics and cloud, which provide greater visibility and real-time insights to remediate problems across multiple business functions.

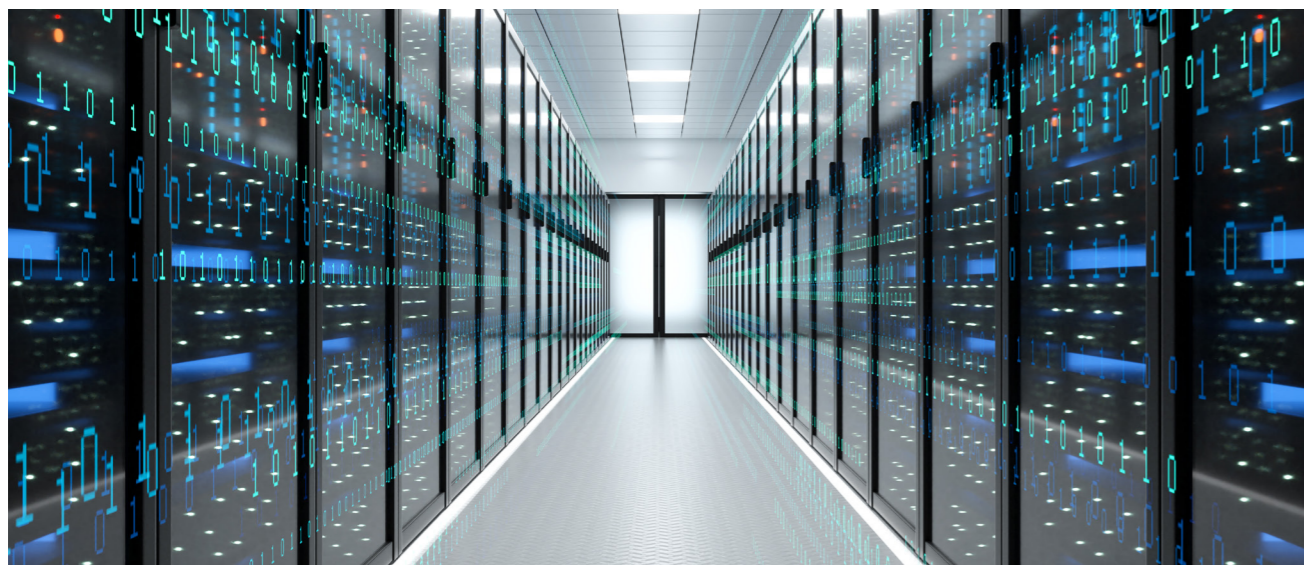
This case study is valuable for Saudi banks since it provides value-added services from within their app. It also includes and is backed by an ecosystem of partners in hospitality, sports, and entertainment. yono is able to operate as a FinTech while also being able to process payments in-house and maintain deposits; a concept that is well suited for new Saudi digital banks.



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Building robust data management strategies



Information is a major driver of business value for the financial industry. More data can provide more insights and give an edge over the competition. Although that has always been the case, the new element in this equation is the amount of relevant data that is available, which needs to be kept secure, accurate, and available for analysis to offer a competitive advantage.

In addition to offering superior customer experience, data management is at the forefront of risk mitigation and regulatory compliance for banks. Now nearly a decade ago, the Basel Committee on Banking Supervision issued eleven principles for effective risk data aggregation and risk reporting (BCBS 239), to address the weakness that led to the financial crisis, which centers around the inability to understand quickly and accurately their overall exposures and other key risk metrics influencing the risk decisions of the bank.²⁰

Building a proper data management foundation is essential for addressing the challenges of regulatory compliance as well as risk mitigation, investment, sustainability, and automation.

Saudi Arabia's data regulatory environment

In Saudi Arabia, the National Data Management Office (NDMO), which is the regulatory arm of the Saudi Data and Artificial Intelligence Authority (SDAIA), has released Interim Regulations in June 2020 for data protection that address open data, data classification,

data sharing, freedom of information, and personal data protection.²¹ More recently, in September 2021, Saudi Arabia's new Personal Data Protection Law was published.²²

These new regulations will provide a structure and environment in which individual banks can build robust data management strategies. However, regulations alone will not fulfil Vision 2030's ambitious goals around data. It is up to individual banks to develop their own data management practices, tailor-made to the type and quality of their data, to drive business value. This will pave the way to a successful future since AI is expected to contribute an estimated SAR500 billion (US\$133 billion) to the Kingdom's gross domestic product by 2030, according to the SDAIA.²³ Also, around 70% percent of 96 strategic goals under Saudi Arabia's Vision 2030 reform plan are closely related to data and AI.²⁴

Data management for banks

Banks must embrace digital transformation to protect their business. They must address a variety of challenges to become the data-driven enterprises they need to be. This transformation will enable them to deal with compliance, risk management, operating efficiencies, effective client relationships, and marketing, which all rely on the accuracy of data for effective decision making. Banks will also require a fast, secure, and robust exchange of data with external parties, such as rating agencies and the central bank.



The appropriate data infrastructure, including governance and management, is the foundational building block of a strong data culture.

This exchange can be used to assess the credit of customers and avoid black-listed individuals, since credit risk is a major concern for commercial banks.

In December 2021, Saudi Arabia's SNB Capital and BNY Mellon, the oldest bank in the US, launched a new data service for big investors in the Kingdom to manage complex investment assets efficiently. The agreement will allow SNB Capital to use BNY Mellon's data platform within its IT infrastructure in the Kingdom and will link local and foreign assets across the front, middle, and back financial offices around the world.²⁵ This will allow clients to use their own data in new ways and to use more services online.

The data management plan

Data governance has an important role to play in an organization's data gathering and management strategy. It is a set of rules that lay out an organization's strategy for using, processing and storing data. It defines data owners, data policy and metrics and helps an organization to stay compliant, minimize risk, improve security and set standards for data quality.

Data management is the implementation of the standards and policies of the data governance



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framework. It can include taking measures to minimize risks, setting protocols for storing sensitive data and creating access rights for individuals.

There are embedded risks when Saudi banks seek only manual approvals by the compliance and risk management teams, since they may not have the right tools in place to understand the data controls set by NDMO. Information may need to be shared with consultants offshore, the bank branch outside the country, or even with other banks for due diligence before merger/acquisition. Proper data management can offset these risks and ensure the correct protocols are in place.

A successful data strategy must have business buy-in throughout the organization with data becoming a 'single source of truth' to everyone.

The most important part of putting in place effective data management is to build solid foundations. The four steps below form part of KPMG's methodology for data management and are the basis for good data management practices:

1. Setting up a data strategy
2. Data management and governance
3. Metadata management and data classification
4. Data quality and master data management

To make this happen, an organization needs to instill a data culture, which has to be nurtured, from the top down and from the bottom up. This requires a data team with the right skills, training, accessibility, and management. The appropriate data infrastructure, including governance and management, is the foundational building block of a strong data culture.



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Payment service providers create banking transformation opportunities

The increased rate of technological advancements around the world is closely related to the growth of the global Payment Service Provider (PSP) market. The rise of new payment services and technology providers has been nothing short of disruptive, driven by an era of consumer centricity, and accelerated by the Covid-19 pandemic. Consumer health concerns upended daily life and trickled into spending trends and habits, pushing the payment industry to transform and digitize at a rapid pace.

FinTech vision in Saudi Arabia

In accordance with Vision 2030, the FSDP has issued new initiatives and responsibilities to be achieved by 2025, to bring the Kingdom closer to its goals for 2030. A major strategic pillar is to enable financial institutions to support private sector growth. Within it is the initiative to open financial services to new players and increase the number of licensed PSPs,

currently standing at 17, to a minimum of 30 by 2025.²⁶ Another initiative is the drive towards a cashless society, with the aim to increase cashless transactions to 70% of all transactions by 2025.²⁷

With these goals in mind, FinTech investments in Saudi Arabia poured into payments in 2021, with 93% of all venture capital invested being directed towards that area. Investments were made in point-of-sale (POS) services, mobile payments, and buy-now pay-later services.²⁸

According to a FinTech Saudi study, 74% of individuals surveyed have used at least one FinTech solution. Saudi Arabia also achieved the highest adoption of NFC contactless payments in the MENA region, at 94% of all in-store payments.²⁹ With such a high rate of adoption, companies have a significant trajectory for growth, which contributes to the attraction of venture capital investors to the sector.



Government oversight

SAMA has a mandate to license, control, and oversee the payments sector in the Kingdom following the issuance of the PSP regulations in January 2020.³⁰ The aim of this mandate is to provide a competent regulatory framework, which is capable of supporting innovation in the payments sector and financial technology. The effort was in large part to attract existing foreign PSPs to operate in the Kingdom, and it borrows many concepts from European PSP regulations, making it easier for companies to launch their services in the Kingdom if they have already been approved to operate in Europe.

SAMA's Regulatory Sandbox Framework was launched in 2018 in direct connection to Vision 2030's goals for the financial sector's development. It allows local and international financial technology firms to test new digital solutions they intend to launch in the Kingdom before going onto the market. Services and products that are currently being tested or that have been successfully tested include e-wallets, peer-to-peer (P2P) transfers, lending, and direct international transfers. The Capital Market Authority (CMA) also launched its FinTech Lab in 2018, as a legislative experimental environment that allows FinTech products and services to test their innovative business models under the supervision of the Authority.³¹

Threats and opportunities for banks

As new players or disruptors emerge through the FinTech sector, banks are having to contend with a new way of conducting business that is heavily consumer-centric. FinTechs tend to focus on customer retention and loyalty and offer their services via non-traditional channels such as social media. Digital wallets, like stc pay can offer such services as local and international transfers, sending gifts, paying bills, making business payments, sharing and tracking expenses with multiple people, and salary transfer for domestic workers. Remittances are a huge business in Saudi Arabia with SAR153.87 billion (US\$41.03 billion) reached in 2021.³² stc pay has been able to capitalize on that through the availability of international transfers at competitive prices to Western Union agents, as well as to international bank accounts and other mobile wallets.



Saudi Arabia also achieved the highest adoption of NFC contactless payments in the MENA region, at 94% of all in-store payments.

Saudi Arabia has also granted digital banking licenses to stc Bank and Saudi Digital Bank in June 2021, and to D360 Bank in 2022, which will allow them to offer more products and services to their customers.

Inflexible legacy systems and extensive regulations can hinder innovation, but banks cannot afford to remain static within this increasingly digitized environment. Already, banks like Alinma and Al Rajhi have launched digital wallets - a sign that banks are moving to adapt and remain competitive.³³ In order to better achieve that, they must consider advances in the FinTech sector as an opportunity and not just a threat, and apply a consumer-driven agenda to new services. To respond to the challenge from FinTech, banks can potentially acquire FinTech firms to enhance their services and efficiency, or they can enter into a strategic partnership with a tech firm to benefit from their expertise. Another option could be to invest in FinTech startups through VC investments.



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Enabling excellence

Increased expectations of data privacy



Cybersecurity and data privacy are often seen as different disciplines that operate in silos. However, in an environment where so much sensitive data is captured and utilized, the review of third parties, new systems, and new applications requires a multidisciplinary approach that includes both privacy and security from the design phase through to organizational change management.

Regulatory environment

In 2017, SAMA established a Cyber Security Framework to enable Financial Institutions to identify and address cybersecurity risks. The Framework is based on the SAMA requirements and industry cybersecurity standards, such as NIST, ISF, ISO, BASEL and PCI.³⁴

In addition to cybersecurity, global awareness for individual right and privacy has increased leading to global regulations such as the General Data Protection Regulation (GDPR) in Europe to various

individual regimes across Asia, North and South America. Saudi Arabia is the latest nation to act, with its Personal Data Protection Law (PDPL), which was set to go into effect on 23 March 2022, but which enforcement is postponed till 17 March 2023. PDPL applies to all corporations and public and private entities operating in the Kingdom. This new timeline should be considered as an opportunity for all entities to start preparing now.

The PDPL will be supervised by the Saudi Data and Artificial Intelligence Authority, which also developed it, and applies to the processing of personal data within Saudi Arabia and also to the handling of residents' personal data outside the Kingdom. Data transfers out of the Kingdom will also be tightly controlled.

Risks to banks

The banking industry is based on trust, so the main risk of cybersecurity threats is compromising the trust of clients. This risk manifests itself within every

transaction in the form of money being stolen from banking accounts or other kinds of fraud, which are now within the digital context since money is not physically in the branches but in the IT systems.³⁵

Data privacy concerns also come into the foray of risks faced by banks since they hold a lot of sensitive information on clients and they have the responsibility to protect it. With this, there is a threat of someone trying to obtain and use this information illegally.

Saudi Arabia has faced increasing security threats, especially with Covid-19 and remote working.³⁶ The financial services industry faces most of these cyber attacks, which increasingly target multiple banks simultaneously. Evidence also suggests that attacks on financial institutions are becoming more complex, since they have valuable and voluminous data, which gives cybercriminals the opportunity to monetize their work.³⁷

The key threats to cybersecurity and data privacy the Kingdom include:

- **Advanced phishing:** machine learning is used to quickly craft and distribute convincing digital messages which increase the threat of malware and exposure of sensitive data.
- **Internet of Things (IoT) interconnectivity:** proliferation of insecure devices on an IoT network, coupled with legacy systems, are making businesses highly susceptible to cyber-attacks and data breaches, as accessing one device opens the flood gates to accessing all devices on the same network.
- **Data infrastructure:** both cloud and physical data storage have cyber security challenges. Physical data storage facilities are susceptible to targeted attacks while cloud infrastructure can be targeted by cyberattacks.³⁸

Key actions for banks to consider

- To mitigate threats and to comply with the new PDPL, banks must make significant changes to the way they collect, store and process personal data, they must prohibit certain practices, and establish a complaints procedure.

- They can adopt a privacy-by-design standard to supplement and complement the rules, regulations, and regulatory expectations around privacy.³⁹
- They should strive to educate senior and business management on respecting consumer rights and obtaining consent for data collection.
- They can utilize AI technology to automate processes that recognize, monitor, and analyze transactions to protect capital and sensitive information. This can help banks comply with regulations, increase response speed, and reduce human error.
- AI and machine learning can also be used to secure cloud environments against malware penetration.



Data privacy concerns also come into the foray of risks faced by banks since they hold a lot of sensitive information on clients and they have the responsibility to protect it.



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Seeking procurement excellence and cost reduction in retail banking

Procurement in retail banking has the potential to optimize costs across the organization as well as address complex problems emerging from a changing banking landscape. With the rise of digital banking, FinTechs, and other disruptors in the financial services space, banks need to leverage their functions to provide the best services with reduced costs, and maintain brand image. With ambitious thinking and a robust approach to supplier and spend management, banks can enhance the maturity of procurement functions to help weather a financial environment in flux.



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Procurement challenges for Saudi banks

Banks in Saudi Arabia can potentially face an array of challenges to their procurement function that may be hindering their ability to cut costs and increase their reach in the market.

- The first major challenge is the **framing of the procurement function as an administrative one, instead of a strategic one**, with no mandate and with limited alignment with other functions. With the administrative label, procurement policies emerge with few or no consequences for non-adherence.
- The second challenge stems from a **lack of planning due to the detachment of procurement planning from business plans and budgets**. This leads to a reactive function with a high volume of low value transactions and a limited coverage of framework agreements.
- The third challenge is a **lack of data, which spans spend analysis, market analysis, and supplier management**. Spend analysis is often ad-hoc with

no clear objectives, which makes the interpretation of data and results challenging, thus limiting reporting and realization of costs savings. Another area that suffers is market analysis, which is lacking along with little or no price benchmarking activities. From a lack of data analysis stems a large and fragmented supplier base with limited supplier performance monitoring and contract management. Thus, Enterprise Resource Planning (ERP) data is compromised and cannot be used to improve business process outcomes.

Developing a strategic procurement function

In order to leverage procurement's cost-saving potential, banks in the Kingdom need to ensure that the function develops from an executor of operational processes to a strategic value partner by increasing its maturity level. This requires banks to tackle the challenges plaguing procurement and to do so they must pursue three key avenues:

Run a maturity assessment to identify the gaps in the procurement function. This includes an understanding of how mature the organization is when it comes to people, skills, size, processes, and strategy. It is important to evaluate whether the function is hiring the people with the best skills for the job, as well as whether they meet local content requirements. Specialized skills in the procurement function are becoming increasingly important with the digital transformation of banking. Acquiring the right skills and services can save the bank in the face of staunch competition, whereas failure to do so adds to the risks faced by the bank and the potential tarnishing of their brand. The procurement function must also have proper policies and procedures in place with established KPIs, planning tools, and ERP data to progress to a strategic value partner in the bank.

Ensure spend transparency to identify potential cost savings and to implement effective strategic sourcing activities. Banks must assess the purchasing entities, what is being bought by category and volume, and suppliers. Leveraging spend transparency data enables banks to identify short and long-term savings potential and procurement inefficiencies. This data can also shed light on the availability of and reliance on local suppliers.

Manage supplier relationships end to end. The Supplier Relationship Management (SRM) lifecycle includes:

- Analyzing and segmenting the current supplier portfolio to derive differentiated supplier relationships.
- Identifying potential suppliers through performance and qualification tools.
- Monitoring supplier performance consistently.
- Improving supplier performance or capabilities to value.
- Transitioning or terminating business relationships with suppliers.
- Monitoring and mitigating supply chain risks.

It is good practice for banks to keep a variety of risks in mind, such as having a single supplier for critical needs, which spells trouble for the bank if that supplier were to fail. One strategy to reduce supply chain risks, which were faced by banks during the Covid-19 pandemic, would be to contract more with local suppliers to mitigate the possibility of delays across borders. This will also contribute to a wider strategy to maximize local content across different activities of the procurement function.



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Leveraging technology in an evolving risk management landscape

Banks continuously face a set of risks and governance responsibilities. Some are standing issues such as relentless monitoring and managing credit, market, and operational risks. Along with these issues, evolving themes of climate change and conduct risk deserve fresh attention. While these themes are not entirely new, they have become more prominent and pressing. Banks should be monitoring these themes and developing plans to factor them into their strategy and operations. While governments may be addressing these issues through regulation or policymaking, banks need to develop an agile approach to mitigate these issues.

Using technology for risk management

Artificial intelligence (AI) and Machine Learning (ML) are increasingly recognized across industries for their potential to transform business and address large and voluminous transactions. In risk management, AI and ML have also become synonymous with enhanced expectations of mitigating risks at reduced costs. This has been possible due to the technologies' ability to handle and analyse large volumes of unstructured data at faster speeds with considerably lower degrees of human intervention. The technology has also enabled banks and financial institutions to lower operational, regulatory, and compliance costs while simultaneously providing them with accurate credit decision-making capabilities.

AI and ML powered risk management solutions can also be used for model risk management and stress testing, as required by global prudential regulators, and allow for superior forecasting accuracy, optimised variable selection process, and richer data segmentation.⁴⁰ This technology can be used by banks, for example for credit risk modelling, fraud detection and trader behavior in front office.

Evolving risk landscape

Climate risk

New risks to growth have emerged as the pandemic has evolved. In KPMG's CEO Outlook Saudi Arabia 2021, Saudi-based CEOs identified climate change as the top risk to growth.

Driven by the Paris Climate Accord and other factors, governments are outlining new corporate requirements tied to climate change. Regulators recognize that moving towards a low-carbon economy will create additional complexities for financial services firms. They are worried that banks are not ready for the types of prudential and conduct risks that could arise, both in terms of the direct risks from the physical impact of climate change on assets, and the transition risks inherent to a wholesale move towards a low-carbon economy. Nonetheless, governments will prioritise the effectiveness of environmental regulations in reaching climate change goals over the difficulties faced by banks.

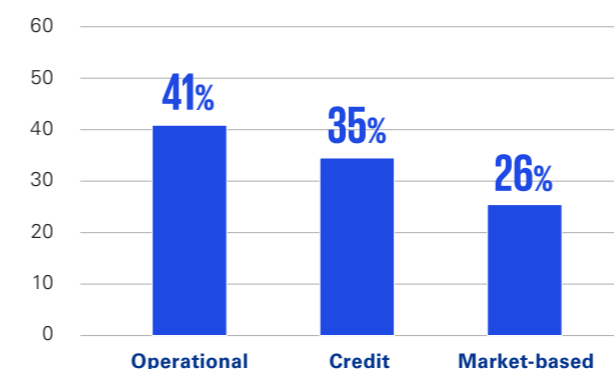


Which of the following risks pose the greatest threat to your bank's growth?⁴¹

- 1 Cybersecurity risk
- 2 Tax risk
- 3 Reputational risk
- 4 Reputational brand risk
- 5 Interest rate risk

Banks are also starting to feel pressure from their customers and from the public at large. Customers want to bank with a firm that reflects their views and beliefs. Younger generations, in particular, are said to be choosing their bank based on their ESG credentials. That said, in Saudi Arabia, most of the pressure to change is felt from investors and regulators. According to KPMG's 2021 CEO Outlook, 85% of surveyed CEOs in Saudi Arabia are feeling the most pressure for ESG reporting from regulators and institutional investors, rather than from customers.⁴²

Climate change considerations can also affect calculations in risk management that extend beyond climate risk itself. In fact, climate change is a systemic risk for the entire banking and capital markets sector. According to a recent review by KPMG of annual reports in the financial sector, financial institutions identified their climate-related risks as per the figure below.⁴³



Financial institutions are being confronted with operational and financial challenges related to:

- **Prioritization:** choosing which material risk exposures take precedence on the balance sheet, these risks involve asset valuations, changing consumer behavior, and new technologies.
- **Data:** identifying accurate and timely data to measure, monitor, and report on climate risk.
- **Alignment:** aligning climate-related public disclosures and commitments with the ability to develop and report accurate metrics against those commitments.

Conduct risk

Another risk to consider, which is also tied to mitigating the effects climate change, is conduct risk. It is broadly defined as any action of a financial institution or individual that leads to customer detriment, or has an adverse effect on market stability or effective competition. Banks and financial institutions that fail to bring conduct risk in line face regulatory action, fines, and reputational damage, which can harm business for years.

Understanding and addressing the drivers of conduct risk is essential in improving standards of behavior. While the starting point for this journey can vary, there are three core areas at the root of conduct risk:

- **Inherent factors:** characteristics intrinsic to financial markets and their participants, such as information asymmetries between firms and their clients or the financial capability of clients.
- **Structures and behaviors:** entrenched behaviors and conflicts of interests that could prevent markets from working as well as they could.
- **Environmental factors:** macro-economic developments that have the potential to impact financial markets and the long-term needs of consumers. Firms ineffectively responding to these pressures can lead to poor conduct outcomes.⁴⁴

Operational risk - Basel accords

An imminent change to the risk landscape for banks is the January 2023 deadline for adherence to the Basel accords. Following a one-year deferral due to the



Climate change considerations can also affect calculations in risk management that extend beyond climate risk itself.

Covid-19 pandemic, the Basel Committee aims to build upon the previous accords to strengthen risk management, regulation, supervision, and stability within the banking industry. Although this new accord presents changes to many of the regulated risks, the focus here is on operational risk management and on the impact of the new standardized approach for operational risk capital on banks.

Currently, banks can choose their approach to calculating operational capital, with the possibility of capital savings in return for higher investments in risk management. Under the new Basel accord, banks will have to use a revised standardized approach (SA) to calculate the minimum operational risk capital requirements. This approach will replace all three existing approaches for operational risk under Pillar 1.

As with all Basel Committee standards, the new SA applies to all internationally active banks on a consolidated basis, and national supervisors may also apply the framework to non-internationally active banks.

The new SA seeks to restore credibility in the calculation of risk weighted assets (RWAs) and to improve comparability of banks' capital ratios. It is therefore critical that banks maintain high quality operational risk teams, use processes such as risk modelling and scenario analysis to assist with business decision making and embed operational risk management mind sets into the business.

Implications and key challenges for banks

The implementation of the new SA framework will have potential impacts on the bank's data, systems and processes, business models, and capital.

- **Data, systems and processes:** Banks will have to ensure their internal loss data collection processes are sufficiently robust and cover the required ten-year history.
- **Business model and capital:** The definition of the Business Indicator Component (BIC) (as compared to gross income currently used for calculating the simpler Pillar 1 approaches) generates higher capital requirements for some business activities. Therefore, banks should analyze their different business lines to ensure they remain sustainable in all aspects (including profitability, customer expectations, capital usage, etc.).

Although the new framework is not in force until 2023, all banks should ensure they are incorporating the new approach into their capital planning process as well as in risk adjusted return measures at an early stage.



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Further reading

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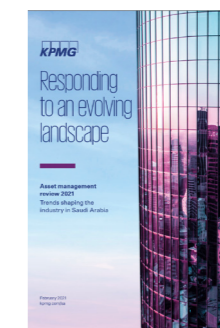
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