



Post-pandemic banking



Banking perspectives 2021

Trends and themes shaping the
industry in Saudi Arabia

March 2021

KPMG in Saudi Arabia

Table of contents

3 Foreword

4 Executive summary

7 Financial performance

12 Culture and people

New working reality: challenges and opportunities

Accelerated diversity and inclusion efforts by major banks

Growing ESG commitment driven by consumers and regulators

22 Regulatory and compliance

Resilient SAMA sustains confidence and drives transformation

Technology-driven governance, risk and compliance

Steadily progressing anti-money laundering compliance

Automatic Exchange of Information

Assurance in the new reality

34 Digital banking

Fintech advancement picks up momentum

Future of banking demands digital leadership

Emerging tax technologies for banking

43 Evolving environment

Dynamic market shift encourages consolidation in banking landscape

Operational resilience put to the test

Key cyber considerations

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

Foreword



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



Abdullah Hamad Al Fozan
Chairman
KPMG in Saudi Arabia

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

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

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

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

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

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



Executive summary

Culture and people

New working reality: challenges and opportunities

The pandemic posed a significant test of financial resilience, as well as banks' operational, organizational, reputational, and business-model resilience. Embracing the new working reality also brought opportunities – resilient institutions not only withstand threat or change but transform for the better. Remote working is here to stay and will more than ever become an integral part of the way we work – it is an opportunity for banks to change their way of working sustainably and reap the benefits over the medium to long term.

Accelerated diversity & inclusion efforts by major banks

Banks are working hard to keep their gender inclusion efforts on track, despite some challenges unique to women presented by the pandemic. Women in Saudi Arabia started coming into the workforce more recently than the men competing for the same positions.

Additionally, it is more challenging for women to build networks than men, causing them to rely purely on professional performance rather than gatherings that are more male-dominated. However, banks are well-suited to support women's employment because they have been at the forefront of flexible work schemes, which give more opportunity to women with young children or families.

Growing ESG commitment driven by consumers and regulators

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

Regulatory and compliance

Resilient SAMA sustains confidence and drives transformation

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

Technology-driven governance, risk and internal control

Banks’ business continuity plans (BCPs) came squarely into focus last year. Those with the most flexible and cross-functional plans proved to be the most resilient to the economic impacts of the pandemic. As banks move forward and reformulate their BCPs with the lessons of 2020 in mind, many are implementing government, risk, and compliance (GRC) technologies. GRC technology-enabled products and services integrate and streamline the value of an organization’s GRC strategy, which will prepare banks for the kinds of liquidity, credit, and market risks they faced last year.

Steadily progressing anti-money laundering compliance

Saudi Arabia has made significant progress in anti-money laundering (AML) and counter-terrorism financing (CTF) measures since its acceptance into the Financial Action Task Force (FATF) two years ago. In the know your customer (KYC) area, banks have developing non-face-to-face customer onboarding processes that paired customer ease with KYC controls that have been put to the test due to physical branch closures during the pandemic.

Automatic Exchange of Information

In line with its efforts to improve international tax compliance and transparency, Saudi Arabia signed on to the Foreign Account Tax Compliance Act (FATCA), which will allow for information sharing with US authorities, and the

OECD’s Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which covers various means of exchanges. In order to address noncompliance risks associated with these automatic exchange of information (AEOI) agreements, banks should assess their onboarding and data gathering processes.

Assurance in the new reality

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

Digital banking

Future of banking demands digital leadership

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

Fintech advancement picks up momentum

With regulators pushing full-steam ahead for the development of the fintech sector in the Kingdom, banks are now viewing fintech as an enabler rather than simply a disrupter. Among other initiatives, SAMA is operating its Regulatory Sandbox Framework, has issued new Payment Services Provider Regulations (PSPR) for foreign fintechs, and has issued new licensing guidelines for digital-

only banks. In turn, banks are ramping up their investments into standalone fintechs and their own digital banking channels, increasing partnerships with fintechs, and leveraging their existing market shares to attract customers to their fintech offerings.

Emerging tax technologies for banking

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

Evolving environment

Dynamic market shift encourages consolidation in banking landscape

In line with a regional trend towards consolidation, NCB and Samba Financial Group have plans to complete a merger this year, which would create – by far – the largest lender in the Kingdom. Current consolidation, combined with increased pressure from fintechs and other market entrants, has created an environment which might turn out more M&A activity in the near future. While initially putting the brakes on M&A activity, the Covid-19 pandemic may prove to be a further catalyst for dealmaking if the bad loan pile continues to grow or if economic growth is further dampened.

Operational resilience put to the test

Banks are analyzing how their operational resilience plans held up in the face of the Covid-19 crisis and are using the lessons learned to improve their strategies. Ensuring their operational resilience frameworks are enterprise-wide, measurable, flexible, and top-down is a start. Banks have been further incentivized to invest in a sound operational resilience plan by considering it as a business

opportunity. Cost savings and efficiency gains can be realized through the effective leveraging of data, data models, and systems architecture.

Key cyber considerations

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

LIBOR transition as Covid-19 driven detour and the way forward

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



Khalil Ibrahim Al Sedais
Office Managing Partner, Riyadh
KPMG in Saudi Arabia



Ovais Shahab
Head of Financial Services
KPMG in Saudi Arabia



Financial performance

Financial performance

A year salvaged by government stimulus and cautious optimism

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

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

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

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

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



In the wake of immense uncertainty throughout FY 2020, financial positions have surprisingly thrived rather than just survived.

FY2020 financial performance of 11 listed banks

Net profit after zakat and tax*



6.32%

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

Total assets



13.14%

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

Total customer deposit



9.18%

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

ECL charge for the year



39.05%

FY2020 SAR 17.33 billion
(FY2019: SAR 12.46 billion)

SAMA stimulus program



SAR
2.41 billion

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

SAR
2.98 billion

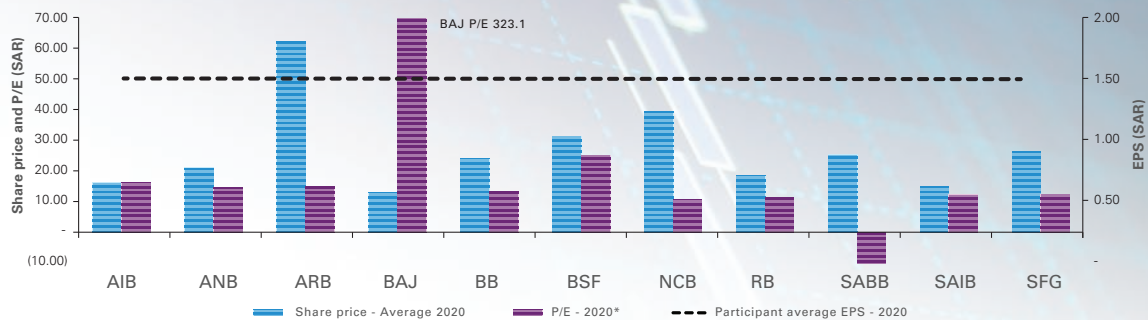
Gross Income recorded on the deposit received from SAMA

SAR
109.97 billion

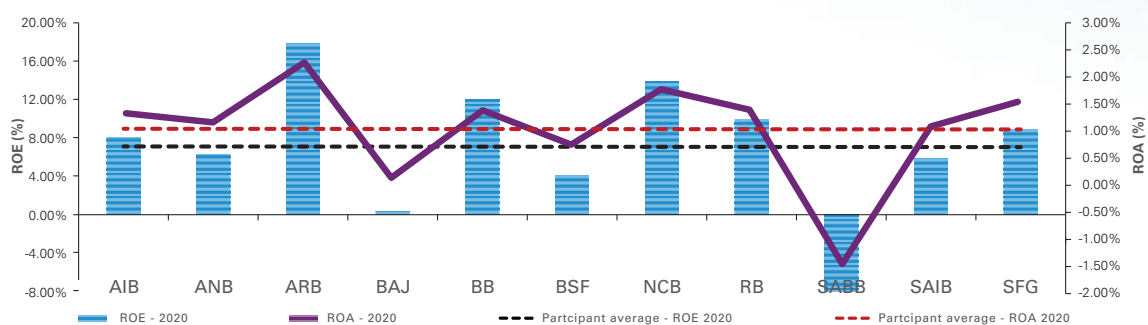
Total deposit received from SAMA as of 31 December 2020

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

Share price, P/E & EPS



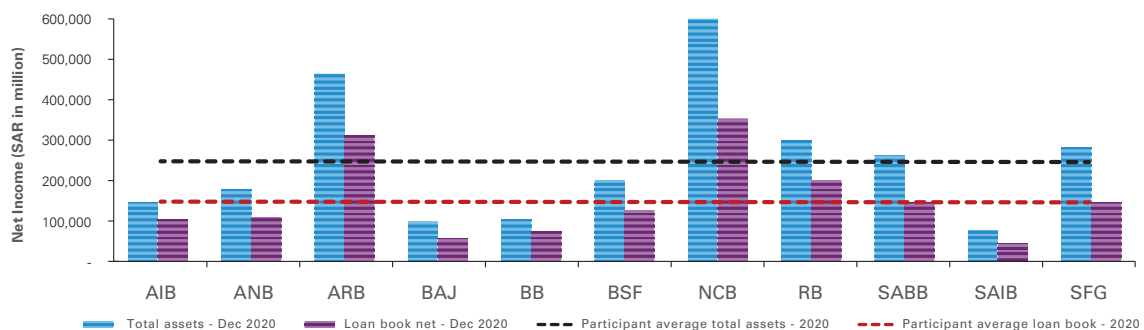
ROE & ROA



Net income



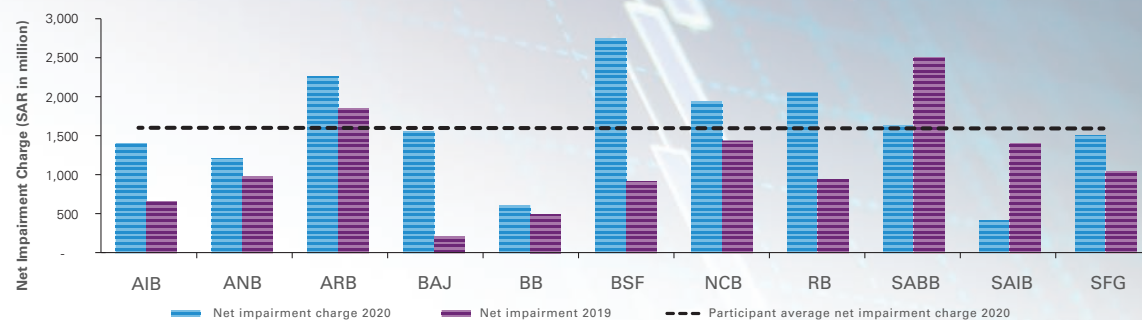
Total assets & Total loan book



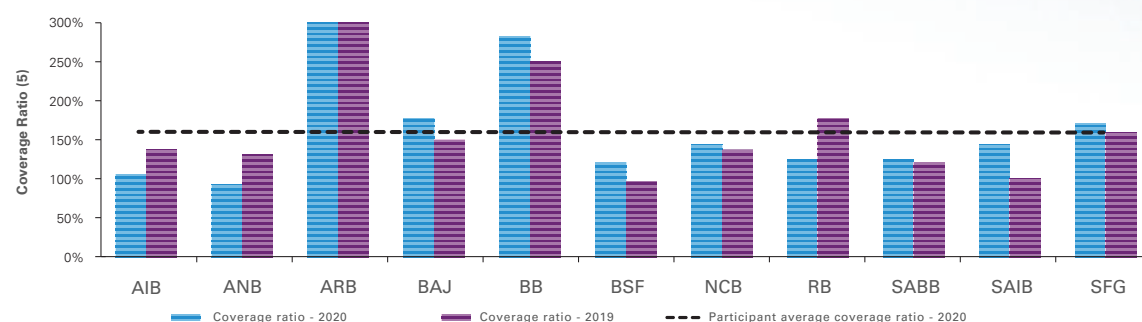
Legend:

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

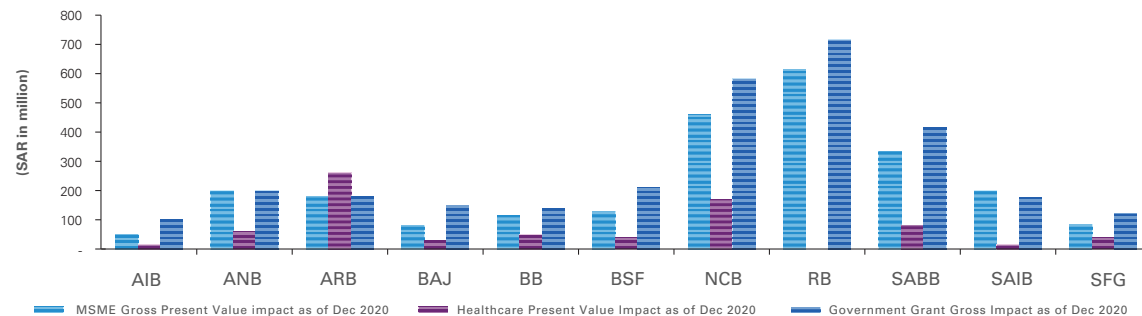
Net impairment charge



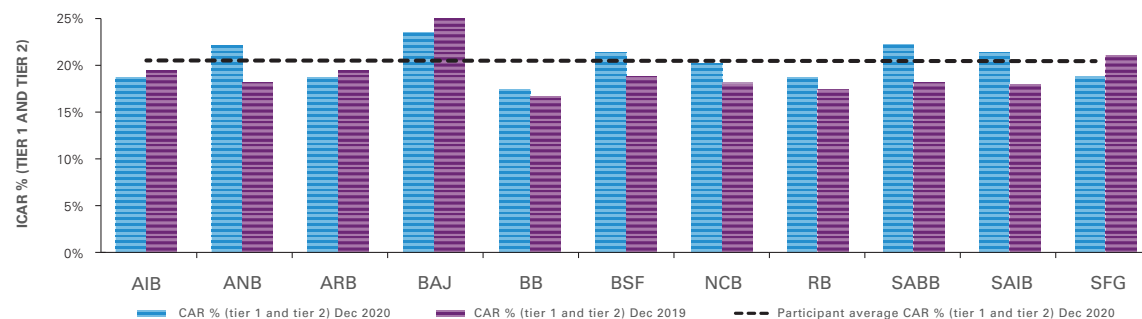
NPL coverage ratio



Impact driven by Covid-19



Capital adequacy ratio



Glossary:

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



Culture and people





Culture and people

New working reality: challenges and opportunities

The pandemic posed a significant test of financial resilience, as well as banks' operational, organizational, reputational, and business-model pliability. Embracing the new working reality has truly brought opportunities for not only withstand threat or change but transform for the better.

When Saudi Arabian authorities began restricting bank branch operations in March 2020, Saudi banks relatively seamlessly embrace the new working reality. Based on discussions with some senior banking executives, the transition was accomplished with minimal disruption due to cross-functional agility and durability demonstrated during the early days of lockdowns and movement restrictions.

While Saudi banks have successfully managed the transition in the short term, the key challenge now is to balance workable, short-term solutions with an eye toward creating a permanent strategy for digital operations.

Challenges facing banks while handling the new working reality

Resilient institutions not only withstand threats but transform for the better. The Covid-19 crisis posed a significant test of financial resilience, as well as banks' operational, organizational, reputational, and business-model resilience.

Operational resilience during Covid-19 required control testing and monitoring enhancements, and bank's reinforced their capabilities to respond to future unforeseen events. Remote

working has given hackers and state actors more "attack surface," increasing cyber risk. There has been a resulting increase in cyberattacks, both locally and globally, partly due to vulnerabilities of the systems exposed by widespread adoption of remote work. With cyber risk on the rise, banks had to beef up their cybersecurity defenses through training and hiring of skilled employees and upgrade of systems, as required.

Organizational resilience requires talent development, new measures in people management, and robust succession planning. Building reskilling capabilities to promote greater agility and scalability helps banks build the organizational capacity to cope with rapid changes. Development and succession planning for executive management is equally central for resilience. Remote working has blurred the boundary between work and private life. Actively investing in employees' well-being is for remote working to be sustained going forward.

Reputational resilience will confront significant tests in the face of Covid-19. Banks are not only the beneficiaries of government support but also major vectors for delivering

government aid. As they do so, they must take care to funnel funds appropriately, which can be a challenge under extreme pressures of time and throughput. At the same time, as loan delinquencies and defaults rise, so too will the reputational stakes. Adhering to bank rules and regulations on how to treat delinquent loans and ensuring that those who can pay do pay while also reckoning with new social movements, such as #NoRent, will be a reputational quagmire for which banks must prepare.

Finally, **business-model resilience** requires banks to adapt to potentially significant shifts in customer demand, competitive landscape, and regulatory terrain. In the banking sector, the market shift is clear and already here. Banks need to build and adhere to their digital agendas in order to remain resilient in an increasingly competitive space.

Considerations for banks while transitioning into the new working reality

Reflecting on the above-mentioned challenges, three primary characteristics will emerge among successful banks. They will digitize customer interactions to address prolonged public-health risks and changing consumer demands.



Remote work is likely to become the norm, especially in the banking sector, which is particularly well-suited for the transition of certain middle and back-office roles.

They will restructure their workforces and operations to become more agile and productive. And they will increase their pace of innovation to deliver those changes while evolving their value propositions to respond to rapidly changing customer needs.

Remote working is an opportunity for banks to transform their operations. While cost savings is an obvious and compelling reason for banks to support remote working, there are other unexpected benefits of this new working reality. In a survey conducted as part of KPMG's CEO Outlook, 73% of CEOs believe remote working has widened their available talent pool. That means in practice not only that organizations can attract talent from around the world, but also may prove an effective way to recruit local staff from around the Kingdom, despite mobility restrictions or remote living conditions.

Investing in remote working and adopting the right digital strategy and flexible operating model is likely to have far-reaching consequences for the banks and hence, banks need to carefully focus on:

1. Adjusting their operational model to provide higher flexibility and more agile and remote ways of working
2. Developing a corporate culture that is more connected internally and externally and where an analysis of collaboration can provide valuable data
3. Having an alignment of business goals to the new cultural standard and employee expectations
4. Using data-driven methods of analysis to gain deeper insights into new learning patterns and employee sentiment

To emerge stronger when the virus recedes, banks must step up their digital thinking and execution to enable employees to operate from wherever they need to be. Remote working is here to stay and will more than ever become an integral part of the way we work. Now is the time for banks to prepare for the 'new working reality'.



Kashif Zafar
Head of Audit Operations
KPMG in Saudi Arabia

Kashif Zafar specializes in the audits of financial services-based entities including banks, insurance companies, investment banks and funds. His 22-year experience with KPMG gave him insights into the culture and operations at prominent banks in the Kingdom.

Culture and people

Accelerated diversity and inclusion efforts by major banks



The Covid-19 pandemic has changed the global employment market in lasting ways. The ongoing economic downturn and lockdown restrictions have resulted in unprecedented employment loss – an impact that particularly impacted women. According to the UN’s International Labour Organization (ILO), in 2020 there were global employment losses of 114 million jobs relative to 2019 – an unprecedented figure. These losses were higher for women (5 percent) than for men (3.9 percent).

Moving forward, it is important that banks lead the charge in promoting gender diversity. Saudi Arabia has sharply changed in the last five years from being viewed as a limiting environment for women to becoming a leader in the conversation about gender equality. It should be expected that banks – some of the Kingdom’s largest, most international institutions – reflect this shifting reality. In addition, consumers are increasingly conscious about which institutions they give their business to and are choosing to bank with companies that have strong purpose-driven agendas and gender diversity.

W20 in the Kingdom

The annual G20 summit was held in the Kingdom last year, as well as the accompanying Women 20 (W20). W20 is one of the policy recommendation engagement groups of the G20, and aims to ensure that gender considerations are mainstreamed into G20 discussions and translate into the G20 Leaders’ Declaration as policies and commitments that foster gender equality and women’s economic empowerment. Through a broad dialogue facilitated by digital tools, expert meetings, roundtables and the

final summit, W20 delegates jointly formulate concrete actionable policy recommendations to advance gender equality in G20 negotiations.

Every year, the W20 develops and addresses to the G20 Leaders a communique which contains a series of actionable policy recommendations aimed at fostering gender equality and women’s economic empowerment. The W20 communique produced in Saudi Arabia had two main focuses: gender-centric measures to expedite the economic recovery and measures for the long-term economic empowerment

of women, and as actionable recommendation it added that, in partnership with public and private financial institutions and banks, innovative and easily accessible digital financial products should be developed to increase women’s access to financial services.

For its part, KPMG partnered with W20 and its host organization AlNahda Society for the summit in Saudi Arabia. KPMG is strongly aligned with Vision 2030 and the United Nations Sustainable Development Goals, especially number five aiming at ‘achieving gender equality and empowerment to all women and girls.’ As pioneers



With remote and hybrid working schemes defining the future of employment – especially in the banking sector – future gender diversity gains could be locked-in.



Saudi Arabia has proven itself to be a regional leader in gender diversity measures in the eyes of international institutions.

in hiring women, KPMG in Saudi Arabia recruited its first female employee in 2007 and appointed the first female partner in 2017.

Changing culture

Women in Saudi Arabia are playing a major factor in the future success of Vision 2030. The government's broad program of gender reforms has received international recognition, including its first ranking in the GCC and second in the Arab world in the World Bank Business and Law Report (2020) for twelve regulations pertaining to women. Examples of new laws include gender discrimination protection in employment and accessing financial services and an equalization of the retirement age for men and women to 60 years – prolonging women's employment duration, earnings, and contributions.

Such regulatory changes have translated into real results for women's employment. Indeed, according to the Saudi Arabia General Authority for Statistics, women's labor force participation rate increased from 19 percent in 2016 to 25 percent by the end of 2019, and their overall employment rose by around 9 percent during the same period.

According to KPMG's recent Female Leaders Outlook in Saudi Arabia, 23% of female leaders surveyed cited quotas for female leadership as a factor for their future success – double the figure of global female leaders. This indicates that leaders really believe in the Kingdom's regulatory efforts to encourage gender diversity. However, quotas are were cited behind an active personal network (50%), support from mentor/current boss (46%),

and strong communication skills (27%) as factors for personal success.

Getting back on track

In Saudi Arabia, the economic downturn paired with a sharp decrease in oil prices threatens gender diversity progress that has been made to date. Women in the Kingdom started coming into the workforce more recently than the men competing for the same positions.

Banks, however, are particularly well-suited to help women enter or get back into jobs, according to Rania Nashar, former CEO of Samba Financial Group and current Senior Advisor to the Governor of the Public Investment Fund (PIF).

"Given these challenges, Samba and other banks in Saudi Arabia have, wherever possible, sought to provide greater employment flexibility to their female employees," Nashar said. "This has primarily been done through greater working from home opportunities for women employees, particularly those with young children/families."

Nashar said that Samba and other banks will and should continue to use employment flexibility as a way to attract more women to their workforces after the pandemic.

With remote and hybrid working schemes defining the future of employment – especially in the banking sector – future gender diversity gains could be locked-in.

“Samba has been at the forefront of gender diversity in Saudi Arabia,” Rania Nashar said of the company she helmed. “This is driven by our belief that a diverse workforce enhances the performance of an organisation, as well as the quality of decision-making within it.”

Samba uses a “bottom-up” approach to increasing female representation, which spans all layers of its organization, from its branch network to its corporate HQ. “Over time, we hope that this greater pool of female employees will give us greater scope to choose our future leaders from,” Nashar said.

Gender inclusion for business success

Especially in this moment of lower profits for banks in Saudi Arabia, managers will be looking for factors that will increase productivity and contribute to business success. One factor can be gender inclusion, especially at the management- or board-level. With more women in decision-making roles, a diversity of opinion is brought to a firm, allowing for better decisions and a broader picture of customer and employee desires.

Female leaders in Saudi Arabia and globally feel that there is much progress to be made to

increase the involvement of women in high-level decisions. Eighty percent of Saudi and 92% of global female leaders admit that we are still a long way from gender diverse boards and management teams according to the Saudi Arabia Female Leaders Outlook.

A holistic approach is needed

In the end, cultural change may be the biggest factor in translating gender diversity into enhanced business success – ahead of legal changes or mandated gender quotas. A Harvard Business School (HBS) study of 1,069 leading firms across 35 countries and 24 industries found that “gender diversity relates to more productive companies, as measured by market value and revenue, only in contexts where gender diversity is viewed as ‘normatively’ accepted.”¹

The HBS study found that, for example, in the telecommunication industry in Western Europe (historically a gender-inclusive region), the percentage of women employees was “significantly tied to a company’s market value.” Comparatively, in the energy sector in the Middle East (historically not a gender-inclusive region), gender diversity was “unrelated to company performance.”

Saudi Arabia has proven itself to be a regional leader in gender diversity measures in the eyes of international institutions. We are expecting to see more guidelines supporting female participation in

leadership positions; in December 2020 an MOU was signed between the Ministry of Human Resources and Social Development and CMA to support and promote the presence of women on the boards of directors of companies listed in the capital market. It is through concerted effort – on an individual-, company-, and country-scale – that gender diversity will yield business success in the banking sector and beyond.



Kholoud Mousa
Partner and Head of Inclusion & Diversity
KPMG in Saudi Arabia

Kholoud Mousa is the first female Saudi Partner in Saudi Arabia and was also the first Saudi woman licensed to practice as a certified public accountant in the Kingdom. She has 21 years of audit and advisory experience across various industries and is a certified family business governance advisor. In 2019, she was named as one of the leading 20 Saudi Women in Finance, Economy, and Commerce.



¹https://www.hbs.edu/faculty/Publication%20Files/An%20Institutional%20Approach%20to%20Gender%20Diversity%20and%20Firm%20Performance_4c0479f3-9d13-4af8-82da-7f1713af940d.pdf



Culture and people

Growing ESG commitment driven by consumers and regulators

The banking sector has been one of the leaders in the growing movement to emphasize environmental, social and governance (ESG) factors as one of the *raison d'être* for the modern organization. There are many indications to that ESG will increasingly become central to the economic equation globally, and Saudi Arabia will be no exception in the 'new reality' of the post-Covid world.

It is clear that banks across the globe now recognize that their ESG agendas are a tool for returning to prosperity, as well as a deciding factor for many would-be customers and investors. New ESG-tied products and models are being developed, tested and commercialized. Banks can no longer afford to overlook ESG and must embrace it to avoid constrained growth and increased regulatory and public scrutiny.

ESG in the Kingdom

Emblematic of the changing nature of ESG programs during the pandemic was the cancellation of Hajj in 2020. In previous years, many organizations in Saudi Arabia funded Hajj for their employees or customers – a unique aspect of ESG in the Kingdom. With this expenditure removed from their 2020 ESG budgets, organizations either diverted the funds to other ESG programs or simply spared other parts of their ESG budgets from pandemic-related cuts. Banks in Saudi Arabia have long been at the forefront of the national ESG conversation. As some of the Kingdom's most international institutions, banks

have been most exposed to the global trends shaping ESG agendas, such as climate action, diversity, and the rise of the activist investor. Also, as one of the world's largest oil producers, Saudi Arabia itself has a particularly important role to play in the 'E', or environment, part of the equation.

Help arrives

In Saudi Arabia, SAMA quickly stepped in to provide support to the economy as it showed signs of unraveling due to pandemic. The unprecedented financial packages, among other support measures, include support for the banking and SME sectors, an allocation to ensure that government dues to the private sector are paid in a timely manner, a wage subsidy of 60% of Saudi employees' salaries in the private sector, generous assistance to SMEs, and measures that promote continued employment despite the restrictive work environment.

SAMA's measures set a tone in the Kingdom that banks picked up on – the pandemic is a societal crisis that can only be eased through direct support to

people. The stimulus packages also ensured the continued operability – and profitability – of the banking system, which may have proved instrumental in allowing banks to continue their ESG programs.

Pressure for change

Though future regulatory assistance and stimulus measures are uncertain, what is certain is that pressure from regulators, investors and the public for greater adoption of ESG will increase in the future. Regulators recognize that moving towards a low-carbon economy will create additional complexities for financial services firms. They are worried that banks are not fully for the types of prudential and conduct risks that could arise – both in terms of the direct risks (i.e. the physical impact of climate change on assets) and the transition risks (i.e. the challenges inherent in a wholesale move towards a low-carbon economy). Nonetheless, governments will prioritize the effectiveness of ESG-related regulations in reaching climate change goals over the difficulties faced by banks.



The introduction of ESG ratings systems and stock indexes of companies with leading sustainability programs has changed this investment paradigm.

Investors will also be ramping up pressure on banks, and will want to ensure they can continue to earn a return on their investment. Interestingly, recent data suggests that ESG-related funds outperformed the markets over the first quarter of 2020 - when the Covid-19 economic crisis started. According to Morningstar, 70 percent of responsible investment funds outperformed their peers in the first quarter.²

At the same time, 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 2020 CEO Outlook, 70% of CEOs in the Kingdom saw the most demand for ESG reporting from institutional investors and regulators, compared with only 30% from employees and customers.

Ratings clear the fog

Traditionally, investors have used banks' annual reports to judge their ESG agendas. Having few reliable reporting or rating mechanisms for ESG programs, there has been little incentive for banks to be overly forthright about the impact - or lack thereof - of their ESG programs.

The introduction of ESG ratings systems and stock indexes of companies with leading sustainability programs has changed this investment paradigm. In the ratings field, Morningstar's Sustainalytics is driving innovation through its 'ESG Risk ratings', which takes a quantitative approach to gauging a company's effort allocated to ESG initiatives. Dow Jones, MSCI, and other finance companies have introduced sustainability indexes, which have boosted appeal for the stocks of companies with strong ESG programs.

²https://www.investmentexecutive.com/inside-track/_dustyn-lanz/esg-and-covid-19-four-market-trends/

KPMG member firms' work with banks and other organizations across the financial services ecosystem suggest there are four key actions that bank executives should be addressing today.

Understand your current baseline

More than simply quantifying the financial risks and probabilities, banks should create an understanding of common ESG expectations of key stakeholders and build awareness of leading ESG practices, in particular amongst senior management and board members. This includes taking time to understand their current practices and exposures, including whether they have the right data, the right capabilities and the right processes to monitor and manage ESG appropriately going forward.

Know what's expected

While regulatory and supervisory authorities are exploring approaches as to how they might provide specific targets or expectations, bank executives should be talking to their regulatory authorities to

understand what is expected of them and how those expectations may change over the short to medium-term. They should also be working proactively with their regulators and authorities to seek out facts, develop standards and identify solutions.

Put it on your risk radar

For many banks, ESG factors remain a reputational risk. But they need to be more than that. Bank executives (and particularly boards) should be ensuring that ESG risks are a lens through which all decisions are made, especially in relation to credit and valuation risks in their portfolios, reflecting the strategic nature of these risks.

Develop a strategy

ESG risks cannot be managed off the side of a desk. It requires banks to develop a robust strategy that is integrated into the overall business strategy for the organization. While the strategy must retain a level of flexibility, it must also be actionable and measurable.



Ebrahim Oboud Baeshen
Office Managing Partner – Jeddah
KPMG in Saudi Arabia

Ebrahim Oboud Baeshen is a seasoned professional with over 20 years of experience in accounting, audit and Zakat advisory. As lead partner on various banking audits, he is also well-versed in due diligence, corporate finance and accounting advisory. He serves on the Board of Directors at the Saudi Organization for Certified Public Accountants (SOCPA).



A nighttime photograph of a city, likely Dubai, featuring a multi-lane highway with heavy traffic. The city skyline is visible in the background with several illuminated skyscrapers. A large blue rectangular overlay covers the upper left portion of the image, containing the title text. A vertical purple bar is on the far left edge.

Regulatory and compliance





Regulatory and compliance

Resilient SAMA sustains confidence and drives transformation

The pandemic has proved to be a transformative period for regulators in the Kingdom. Tasked with keeping the economy afloat during the perfect storm of lockdowns, record-low oil prices, and a near global economic collapse, the Saudi Central Bank (SAMA) proved itself resilient and capable of handling the challenges posed by these factors.

Stimulus packages

In March 2020, when the Covid-19 pandemic was rapidly spreading across the world, SAMA launched a SAR50 billion (USD13.3 billion) economic stimulus package to support the private sector, especially SMEs. Under the program, SAR30 billion was allocated for banks and financing companies to delay loan payments due from SMEs for six months. SMEs were additionally granted concessional loans of up to SAR13.2 billion from banks and financing companies to finance their operations and maintain employment. SAMA also created a SAR6 billion fund to exempt SMEs from the costs of a loan guarantee program.

Like many central banks, SAMA recognized that the health and economic impact of the pandemic would be long-lasting. In June 2020, SAMA announced further measures to ensure liquidity, injecting another SAR50 billion into the banking sector in the form of one-year profit-free deposits. This injection allowed the banks to defer loan repayments from SME obligors and protect them against an expected drop in profits and rise in non-performing loans.

Addressing global concerns that economies will suffer after the stimulus jolt subsides, SAMA extended its loan deferral program until at least the end of the second quarter this year. This move will allow lenders to continue tapping into a life-line created to cover the costs incurred by a bank in deferring payments from its SME loan customers. It remains to be seen when such programs will cease, but banks and SAMA continue to closely monitor non-performing loans.

SAMA officially becomes a central bank

Last November, SAMA officially became minted as the “Saudi Central Bank” (though it will continue to use the acronym “SAMA”). SAMA has long held the traditional role of a central bank in the Kingdom – it came at a time of unprecedented importance for SAMA, because of its role at the forefront of the Saudi economic response to the pandemic and pursuit of Vision 2030.

A new objective has been added to SAMA’s mandate: “supporting economic growth.” Not only does this lend further legitimacy to SAMA’s pandemic stimulus measures, but it opens the door for more proactive measures to

support the Saudi economy. SAMA also appointed a new governor, Dr. Fahad Abdallah Al-Mubarak, in January 2021. Al-Mubarak replaces outgoing governor Dr. Ahmed A. Al-Kholifey, who will become an adviser at the royal court and whose legacy at the central bank will be highlighted by unprecedented economic stimulus as well as a number of focused, proactive policies on digital banking. Al-Mubarak is a familiar face at SAMA, having led SAMA from 2011-2016.

Charting a digital path

SAMA has not let the pandemic distract it from its long-running plans to develop the Saudi fintech and digital banking sectors. One of the key efforts in this area is SAMA’s Regulatory Sandbox Framework. The Sandbox, directly connected to Vision 2030’s goals for the financial sector’s development, was launched in 2018 and allows local and international financial technology firms to test new digital solutions they intend to launch in the Kingdom. Services and products currently being tested or have been successfully tested include e-wallets, peer-to-peer (P2P) transfers, lending and direct international transfers. In January 2020, SAMA issued



SAMA has not let the pandemic distract it from its long-running plans to develop the Saudi fintech and digital banking sectors.

its Payment Services Provider Regulations (PSPR) to regulate Payment Services Providers (PSPs) in the Kingdom. PSPR operates alongside the existing Sandbox framework, and includes four additional types of licenses: Micro PI, Major PI, Micro EMI, and Major EMI. 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.

Soon after PSPR was launched, SAMA issued new licensing guidelines and criteria for digital-only banks in the Kingdom. The licensing conditions require a digital bank to submit a business plan as well as internal capital and liquidity adequacy assessment plans, to have a physical presence in the Kingdom, and that the founders of the bank prove their financial capacity and experience before operating.

Saudi regulators also have a keen interest in using blockchain technology in the financial sector. In June 2020, as part of its pandemic-related stimulus efforts, SAMA used blockchain technology to deposit liquidity into the banking sector. The move is in line with SAMA's ongoing efforts to explore emerging technologies and was a first among global central banks.

International regulatory efforts

SAMA's "Aber" project, in partnership with the Central Bank of the UAE (CBUAE) set out to explore the feasibility of issuing a digital currency for central banks. The Aber project released the results of its study in November 2020, coming to several

conclusions about developing a cross-border payment system. The results of the pilot project were encouraging, similar to the results of similar pilots conducted by other central banks. Specifically, the results showed that a distributed ledger technology would make a cross-border digital currency feasible, and that such a system would reduce transfer times and costs between banks.



Faisal Sana
Senior Director Financial Services
KPMG in Saudi Arabia

Faisal Sana has over 21 years of financial services experience, gained through his assurance work in the practices of KPMG in Saudi Arabia, the United Kingdom and Pakistan. He was involved in the development of SAMA's IFRS 9 guidance for Saudi banks and various regulatory risk-based inspections of banks on behalf of SAMA. He is well-versed in the review and implementation support of internal control frameworks at Saudi banks.



Regulatory and compliance Technology-driven governance, risk and compliance

Bankers in Saudi Arabia faced one of their most challenging years of risk management in 2020. Similar to the changing nature of the coronavirus, the risk profile evolved as different aspects of peoples' lives and the economy were impacted by the pandemic. Authorities in Saudi Arabia worked to mitigate risks as they arose, but moving forward banks are expected to prepare themselves for a future without such unprecedented government support.

Business continuity management

The pandemic laid bare the need for banks to practice sound and flexible business continuity planning. Flexibility proved key – there are notable differences between traditional business continuity planning and pandemic planning. In particular, many banks' business continuity plans (BCPs) were not tested for the duration of the shock to their business model brought on by the pandemic. Ensuring continuity of functions such as deposit and lending services, ATMs, and payment and settlement services only covered a bank for the initial shock. The lasting effects of the lockdown forced banks to enact continuity plans for more complex functions like counterparty exposure management, financial market operations, and workforce management.

In addition to flexibility, a key metric for business continuity success in 2020 was a bank's level of cross-functionality baked into its operations. Particularly, banks that used risk mitigation practices that broke silos within its operations proved the most resilient. Pre-pandemic silo breaking allowed for greater communication between departments as the crisis ramped up.

Three lines of defense model

As banks evaluate their internal control models with hindsight of 2020, many are finding their models would benefit from greater cross-functionality and the implementation of government, risk, and compliance (GRC) technologies.

Tracking the ongoing methodological changes to internal risk controls has been the evolution of the Institute of Internal Auditor's (IIA) three lines of defense (3LoD) model, which was broadly instituted following the 2008-09 financial crisis. The 3LoD model, which encompasses internal controls into a first line of defense of front-line management, a second line usually within compliance and risk functions, and a third line in internal audit, has come under scrutiny for a number of shortfalls. Chiefly, organizations have found the model to be too limited and too restrictive.

In July 2020, an IIA working group renamed the 3LoD model to the "three lines model," which illustrates a widespread sentiment to change internal controls from a defensive operation to a key part of governance. This move

came after organizations, already fragmented by operational separation brought on by the pandemic, failed to quickly and comprehensively respond to the pandemic. The IIA's change also follows a longer-running industry movement to enhance the cross-functionality of the 3LoD model, as illustrated by the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Internal Control – Integrated Framework. COSO's framework allows for combined assurance, which breaks down the barriers that were heightened by remote work and laid bare by the pandemic.

Liquidity risk

At the beginning of the pandemic, the major challenge for banks materialized as liquidity risk – the result of country lockdowns that caused deteriorating corporate revenues and drawdowns of credit facilities as well as national measures to ease payment pressures on individuals and businesses. SAMA stepped in and extended working capital finance to all corporates to address short-term liquidity requirements, a liquidity injection that was passed on to the corporates' banks.



Particularly, banks that used risk mitigation practices that broke silos within its operations proved the most resilient.

As time went on, utilization of funds decreased and banks' positions improved, to the extent that liquidity is higher now when compared to pre-Covid-19 levels. LDR/SLR/NSFR ratios and overall cash positions have improved as a result. This liquidity is for good measure. Over the medium term, pressure is expected on liquidity management due to drawdowns, deferral in loan repayments together with stressed equity and bond markets.

Credit risk

As the crisis continued, banks and supervisors shifted their focus to credit quality and loan impairments. With many of their previous credit risk assessments turned on their heads by the pandemic, bankers in the Kingdom were often working with unreliable financial information on their obligors. This could not be solved by broad downgrades, as the pandemic did not affect all sectors equally. Resultingly, bank's internal ratings systems downgraded credit from corporate borrowers in sectors most impacted, such as tourism, hotels, and commodities.

For ongoing credit monitoring, credit risk departments are focusing on identifying the most relevant indicators to monitor, specifying the indicator changes that should trigger downgrades, and deciding when downgrades should be applied.

Market risk

In Saudi Arabia and all major oil-producing countries, market risk was driven up last year by record low oil prices. Combined with ongoing geopolitical risk in the region and global trade tensions, banks have operated within a dizzyingly complex market in 2020. Resultingly, asset prices have

undergone unprecedented volatility, impacting trading books and increasing counterparty credit risk.

With analysts expecting a stabilization of oil prices in 2021, global supply chains repaired, and signs of regional geopolitical tensions easing, banks in the Kingdom are hopeful for decreased market risk moving forward.

Big questions remain for each of these risks. How long will government support for institutions and individuals last? What will happen to the price of oil as vaccination programs ease movement restrictions? Before any of these questions are answered, banks are preparing themselves through a number of internal control measures.

Risk mitigation through technology

Any bank's effort to increase the cross-functionality of their internal controls without GRC technologies falls short of the expectation. GRC technology-enabled products and services integrate, facilitate, streamline, and maximize the efficiency and value of an organization's GRC strategy. Specifically, they provide configurable controls monitoring, access controls/SoD (Segregation of Duties) analysis, automation of access authorization, periodic attestation of system privileges, and transaction analysis.

However, without proper planning, banks may not be using GRC technologies to their full potential. Tools designed to monitor and analyze GRC processes can become nothing more than a repository for documents, failing to support the comprehensive

GRC program the company intended. Meanwhile, tools are often implemented in silos, and a lack of process leads to conflicting opinions and efforts between business units.

With hindsight of the banking sector's internal controls failures during the pandemic, banks would be best served by diagnosing their organization's unique issues and building custom roadmaps as they reform their defense systems and implement new technologies.



Mohammad Abudalo
Risk and Compliance Lead
KPMG in Saudi Arabia

Mohammad Abudalo is specialized in GRC, internal audit and business process improvement, and has built his experience in these fields working with the firm in Jordan, Qatar, Bahrain and now Saudi Arabia. Aside from his work with financial institutions, he supported regional regulators to assess the progress in achieving the mandates of Federal Reserve and FATF workforce.



Regulatory and compliance

AML compliance steadily progressing

Saudi Arabia is approaching its two-year anniversary of its acceptance into the Financial Action Task Force (FATF). The Kingdom continues to make progress in anti-money laundering (AML) and counter-terrorism financing (CTF) initiatives.

Evaluating progress

FATF's mutual evaluation report (MER) is the primary publicly-available tool to track the Kingdom's progress in addressing its previous shortcomings in preventing money laundering and terrorism financing. FATF's expectation is for member countries to have addressed "most if not all technical compliance deficiencies" three years after adoption of their MER, which in Saudi Arabia's case was mid-2018.

In January of last year, Saudi Arabia received its first (and only, to date) follow-up report from FATF on its progress. In two areas – targeted financial sanctions related to terrorism and terrorist financing and targeted financial sanctions related to proliferation – the Kingdom's rating was upgraded from "partially compliant" to "largely compliant". However, the follow-up report also re-rated Saudi Arabia's measures against FATF recommendations that have changed since the 2018 mutual evaluation. For the three changed recommendations, FATF maintained one rating and downgraded two recommendations. In all, Saudi Arabia is currently compliant on 17, largely compliant on 21, and partially compliant on 2 of the 40 recommendations. With

a year having passed since this assessment, these ratings may not reflect the current position.

FATF road ahead

For its part, SAMA has been moving quickly to address remaining issues with the AML/CTF environment in Saudi Arabia, and to help bring banks into compliance with new standards. SAMA is likely to provide further focus around standards, monitoring and risk oversight regarding AML/CTF issues. This is likely to encompass:

- Enhanced supervision and monitoring, in so far as it relates to existing AML regulations and standards;
- A more hands-on focus on key areas of risk and risk assessment, including likely enhancement of enforcement actions; and
- New standards and developments, for example in the context of SAMA's focus on e-banking and digital banking platforms.

Covid-19 AML/CTF challenges and responses

The Covid-19 pandemic has changed the way many organizations operate – particularly their use of office space and remote working arrangements. While this has yielded some new potential

efficiencies for organizations, it also opens up new risks in the AML/CTF area.

Key challenges faced

- The risk of non-face-to-face identification due to digital on-boarding
- Increased activities of non-profit organizations in countries with a higher risk of money laundering or terrorist financing
- Controls may be weakened by disjointed processes and remote handovers
- Businesses that are suffering from the crisis may be targeted for money laundering
- New (emerging) risks are not timely and adequately identified, assessed and, where necessary, mitigated

How to respond

- Design and implement controls with respect to on-boarding in the time of social distancing, and take maximum advantage of other digital channels available to corroborate identity, source of wealth, etc.
- Communicate clear compliance processes which enable employees that work from home to maintain full compliance
- Stay focused on ongoing client monitoring to identify unusual activity, including development of new typologies relevant



Banks gather more data points than most other consumer services – as required by law and by virtue of a client's interactions.

to increased online activity. Expected client activity volumes and behaviors should also be reconsidered to reflect the Covid-19 impact on particular business sectors

- Businesses benefiting from government support schemes in response to Covid-19 should be subject to additional screening to ensure compliance with the qualifying criteria
- Update your AML/CTF risk assessment to take into account new (emerging) risks, and changes in channel activity by clients

KYC in a digital, dispersed world

Even prior to the pandemic, banks had developed non-face-to-face customer on-boarding processes that paired improved customer experience with maintaining “know your customer” (KYC) controls. Now, with social distancing restrictions and bank branch closures further shaping the on-boarding process, these efforts have been put under the microscope. Though remote on-boarding presents challenges, there are a number of benefits – both to the KYC process and to data quality and cost savings – that a savvy bank can realize.

Banks gather more data points than most other consumer / business services – as required by law, and by virtue of a client's interactions and established “footprint”. This data, if well organized and smartly analyzed, can improve a bank's AML (and anti-fraud) practices by allowing for consistency checks, statistical anomaly flagging, and suspicious pattern identification.³

Data is only as valuable as it is useful, and without using effective data analysis tools and employing capable data engineers, troves

of customer data can be wasted. Using the right technology can allow a bank to better on-board customers and more efficiently handle regulatory cases. Additionally, using the right tech can lead to cost savings of over 90%, according to Fourthline.⁴

KYC/CDD challenges

Globally, financial institutions spend an average of USD 150 million a year on KYC and customer due diligence (CDD) operations, yet many struggle with inefficient and ineffective delivery centers, and face long KYC remediation projects. Major financial institutions have increased their focus on reducing the cost of compliance by designing customer-centric changes and re-engineering processes to simplify and standardize CDD processes.

Financial institutions continue to face a number of regulatory and operational challenges with CDD frameworks. These include:

Process inefficiencies: Globally inconsistent, fragmented and non-standardized KYC/CDD processes with limited end-to-end automation, resulting in lower staff productivity and significant rework.

Fragmented data: Siloed, duplicative and inconsistent data (structured and un-structured) offers limited ability to search and access internal and/or public sources to meet compliance needs.

Unfocussed technology investments: Increased suspicious activity case volumes call for continuous investments in technical capabilities (e.g. case management, AI and machine learning) to adequately scale operations and maximize the efficiency of investments in human capital.

Negative customer experience:

Cumbersome and disjointed on-boarding and periodic customer refresh processes, resulting in redundant, inconsistent and repetitive customer outreach to collect and verify KYC/CDD data.

Labour-intensive operations:

Significant manual processing creates an unattractive workplace, with redundant activities and weak controls resulting in sub-optimal quality and higher rework, along with higher staff attrition and re-training requirements.

Fragmented controls: The response to increasing AML/KYC requirements is often to layer with additional controls, without taking a holistic approach to the control environment to ensure manual and systems controls are operating in sync – and appropriately driven by the institution's risk assessment process – to efficiently meet compliance needs.



Phil Knowles
Senior Director, Financial Services
KPMG in Saudi Arabia

Phil Knowles has extensive financial services sector experience, gained through his work in the assurance and advisory practices of KPMG in Sydney, London, Dubai and East Africa prior to joining KPMG in Saudi Arabia. He has also held senior regional compliance roles in the banking industry.

³<https://www.fourthline.com/download-kyc-remediation-white-paper>

⁴Ibidem



Regulatory and compliance

Automatic Exchange of Information

The past year has seen several notable changes to tax regulations in Saudi Arabia, part of a larger trend in the GCC that is bringing tax regimes closer in line with OECD standards. The updates have a positive benefit beyond that of diversifying government revenue; establishing standards and practices around tax encourages organizations to bring the same approach to other parts of their businesses.

Any organization, especially as large as banks, should have a strategy and known procedures upon which the tax risks associated to its operations are properly managed, controlled and reported to senior management. There are various causes of tax risks.

In this article, we will discuss operational tax risks as a result of Automatic Exchange of Information (AEOI) implementation. These risks can be as a result of a new or updated regulation, people, technology or process.

FATCA and CRS

In line with its efforts to improve international tax compliance and transparency, Saudi Arabia has signed several exchange of tax information agreements. With the United States, through the Foreign Account Tax Compliance Act (FATCA), the Kingdom agreed to share information on financial accounts held by US-specified persons and maintained by Saudi financial institutions. As a

result, compliant Saudi financial institutions will not be subject to a 30 percent withholding tax on US-source income and gross proceeds.

Saudi Arabia also joined the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) which covers various means of exchanges including the Common Reporting Standard Multilateral Competent Authority Agreement (CRS MCAA). Unlike

the FATCA agreement, which is non-reciprocal, under the CRS MCAA, Saudi Arabia has concluded a wide range of reciprocal exchange agreements.

Now after several years of AEOI implementation, it is imperative for banks to assess their onboarding and monitoring process from an AEOI compliance perspective. How effective and efficient is the process? How is it impacting customer experience? How does the entire journey end-to-end look like?



In line with its efforts to improve international tax compliance and transparency, Saudi Arabia has signed several exchange of tax information agreements.



Banks are encouraged to do a health check that will identify strong and weak points in this process.

This means assessing the onboarding, documenting, monitoring and reporting process without any disregard to the accuracy of the reports submitted.

Many financial institutions face challenges when generating their AEOI reports. These challenges range from missing data and missing or unmatching documentation. There are resulting doubts about the accuracy of the reports submitted the General Authority of Zakat and Tax (GAZT).

With the introduction of new technology, changing regulations and the competition for market share, "how fast and how many bank accounts can I open?" is the name of the game. This should not come at the cost

of proper documentation and the collection of important AEOI reporting data.

Missing data and documentation are a strong indicator of lack of effective controls to collect such data or supporting documentation. These control gaps can be in the onboarding forms, procedures, or systems.

To address these risks, banks are encouraged to do a health check that will identify strong and weak points in this process. As a result of the health check report, banks should remediate the identified gaps, build on their strong controls and most importantly create or update their operational tax risk management framework to be in line with the organization's wider tax strategy and risk management.



Mohamed Araj
Tax Lead Financial Services
KPMG in Saudi Arabia

Mohamed Araj works closely with financial institutions, multinationals, regulators and ministries of Finance on operational tax projects, supporting them to understand transparency regulations requirements and their impact on the day-to-day tax operations. He is a frequent speaker about FATCA, CRS and tax transformation.

Regulatory and compliance

Assurance in the new reality



New realities emerging from economic upheaval have enhanced the role independent auditors have to play in the economic recovery. Like many aspects of business during the pandemic, the pace and importance of technology adoption in the audit process has increased. Since there were tech-solutions always available but adoption by audit teams and clients was a mindset challenge, now overcome.

From physical to virtual audits

Globally, movement restrictions and lockdowns quickly prevented auditors from performing on-site visits – a crucial aspect of the audit process. On-site visits, during which auditors interview management and those charged with governance, observe processes, and count inventories (in the case of a bank, cash), give auditors a qualitative understanding of a bank's operations. It also gives them a chance to understand an organization's culture and assess the reasonableness of representations being made.

When on-site visits were replaced by virtual audits, the personal element of the process was largely lost, which required the clients and the auditors to adapt to this new normal to maintain the ongoing audits and start new ones, with minimal disruptions. Virtual audits don't simply entail video and teleconferencing; they require clear documented evidence; otherwise an audit is not an audit, it's a conversation. When done correctly, a virtual audit is a digital transformation of the experience, which revamps the auditing process into something entirely new. Prior to Covid-19, the winds were already changing. Accountants

had already been experimenting with new technologies and working with big data to perform higher quality and more efficient and focused audits. KPMG became an early adopter, and has been embedding digital innovation into its audits through such things as data and analytics (D&A), advanced technology enabled risk assessment tools and rules-based anomaly detection for more than a decade.

High uncertainty and lower predictive value of historical information

The uncertainty that the pandemic brought with it requires auditors to approach their work with a greater degree of professional skepticism and challenge. The Pandemic has changed the face of certain industries and sectors completely. Many business models face existential threats and some are showing great promise too. While banking business models are largely intact, many of their customers are going through transformation. The complex risk models used by banks to assess these business rely heavily on historical trends along with scenario analysis of future events. Accounting judgements or estimates that rely on forecasts or planned future activities are much harder to assess as the historical track record is no longer the

yardstick of what the future might hold.

This means that auditors would appear to be asking tougher questions and sound more demanding. Clients on the other hand would want handholding during uncertain times so they can ride this wave. This has widened the understanding gap as to what is expected of assurance providers.

Reliance on specialists

Demand for IT auditors and specialist supporting auditors in financial risk management, valuations and cash flow analysis has tremendously increased, resulting in significant change in who and where to get talent from. The traditional mix of team members has completely changed, and we now have code writer, data scientists and IT security specialists as part of core audit team. While this means additional costs at a time when many clients' ability to pay normal audit fees has decreased, this has great promise of transforming the audit profession to take it to new heights.

Data & Analytics and KPMG Clara

In recent years, technology has been reshaping the audit to make it more efficient and more



For banks, vast new regulation demands robust financial assurance processes and massive amounts of data across a wide range of operational areas.

relevant – allowing for better-informed business and investment decisions. In particular D&A is defining the future of audit. With D&A, audits become more aligned with business agendas, more real time, and more precise; it also brings exciting opportunities for benchmarking.

For banks, vast new regulation demands robust financial assurance processes and massive amounts of data across a wide range of operational areas. The new standards for bank data quantity and quality require a model of assurance that is moving from 90-95 percent confidence levels to something much higher. By developing algorithms on entire populations of data that use statistical sciences for sampling, but consider other data points as well, KPMG's analytical procedures are more robust today.

Clara, KPMG's smart audit platform, uses powerful D&A tools which are integrated into a secure and encrypted web-based platform. KPMG Clara is a digital connection to KPMG firms, providing one coherent, interconnected ecosystem. It's a collaborative and interactive environment in which two-way and interactive communication between clients and the audit team is hugely enhanced. Importantly, KPMG Clara allows for real-time access to information, insights, and alerts from the auditing team, decreasing the chance that issues become events.

KPMG Clara provides clear, understandable visualizations of unusual activity in a banks' financial data. By focusing more on the exceptions and outliers for a business, Clara enables us to have a more focused conversations about risks, and what they mean for the audit and a business.

Predictive analytics and cognitive technologies

As emerging technologies – from artificial intelligence and machine learning to the blockchain and predictive analysis techniques – become mature, there will even be more potential to reshape the audit.

KPMG Clara will evolve over time, adopting added capabilities and harnessing new technology as it matures – so that an audit's level of insight increases. Predictive analytics capabilities will be developed further, enabling auditors to take information from multiple sources and apply it to the outlook and risks facing a business.

Cognitive technologies such as artificial intelligence (AI) and machine learning will also become increasingly incorporated into the audit. Initially enabling auditors to analyze unstructured data, cognitive computing will produce evidence and insights that will enhance the takeaways from an audit and improve audit quality. In the future, cognitive technologies can also allow auditors to obtain and analyze information from non-traditional sources, such as all forms of media – print, digital and social – and, combined with other information, draw a deeper, more robust understanding of potential business risks.

Changes to forecasting and reporting

The main accounting impacts of Covid-19 are related to the general uncertainty over what the future holds for companies. For banks, expected credit loss (ECL) estimates have come under scrutiny from regulators and auditors because of their importance in ensuring banks are adequately capitalized for pandemic-related defaults.

There are also a number of first-time items for banks and their auditors to consider. Under SAMA's broad Covid-19 stimulus programs, banks have been the primary facilitators of government support to SMEs. Under IFRS Standards, the accounting for government assistance depends on the nature of the assistance. The requirements of the standards differ significantly on when to recognize that assistance and how to measure it.

In conclusion

Audit is transforming. While main purpose of audit (i.e. providing assurance) remains intact, our ability to deliver timely, efficient and robust audit is hugely dependent on new tools and technology. Technology has long been shaping the audit process, but never with as much urgency as now, during the pandemic. The role of technology will continue to increase, but – as with the introduction of any new technology – its effectiveness depends on its users' capacity to understand and manage it, both from a people and operating model perspective. Auditors will be best served by learning and acting upon the many lessons taught by auditing during a pandemic.



Muhammad Tariq
Head of Audit
KPMG in Saudi Arabia

Muhammad Tariq has been in the audit profession for 26 years and served as Senior Director/Partner in Pakistan, United Arab Emirates and Saudi Arabia – where he heads Audit since 2016. Tariq is actively involved in audit quality transformation and often engages with regulators and academia on these matters.



Digital banking



Digital banking

Fintech advancement picks up momentum

Activity in the Saudi fintech industry has ramped up in recent years and, by some measures, increased further as a result of the Covid-19 pandemic. An increased appetite for non-physical financial transactions – both with banks and with merchants – as a result of social distancing and lockdown measures paired with advancing fintech regulations created an environment for the fintech market to mature.

Environment and regulations

There is an active community of banks, universities, corporates, government agencies and investors developing the fintech sector in Saudi Arabia. From e-wallets to lending and insurance aggregation to investing, the services of fintechs have redefined the way in which businesses and consumers carry out routine transactions. The increasing adoption of these trends bodes well for Saudi Arabia, especially in the post-Covid world where physical contact is likely to be minimized for financial transactions. Going forward, there

is a keen interest from fintechs to use more technology innovation in their solutions. Fintechs in Saudi Arabia are interested in utilizing Application Program Interface (API), machine learning, artificial intelligence and blockchain technologies.

SAMA is driving the fintech industry's regulatory development through a number of initiatives, which are expanded upon in this report's Regulatory Update. One of the key efforts in this area is SAMA's Regulatory Sandbox Framework. The Sandbox allows local and international financial

technology firms to test new digital solutions they intend to launch in the Kingdom. In concert with the Sandbox is SAMA's Payment Services Provider Regulations (PSPR), which regulates Payment Services Providers (PSPs) in the Kingdom and allows existing foreign PSPs to operate in the Kingdom. SAMA also issued new licensing guidelines and criteria for digital-only banks in the Kingdom last year.

Role of the banking sector

The Banking, Financial Services and Insurance (BFSI) community is witnessing significant impact with the advent of the fintech sector. However, the incumbents are now viewing fintech as an enabler rather than a disrupter. Large banks are tapping into the start-up ecosystem to incubate and create alliances on a variety of platforms such as wallets, payments, investment intermediation, and online client acquisition. They are not only developing platforms for such start-ups to thrive, but are also beginning to invest in such platforms. To address the multi-faceted impact of a strengthening fintech industry, BFSI incumbents are adopting a three-pronged strategy.



Large banks are tapping into the start-up ecosystem to incubate and create alliances on a variety of platforms such as wallets, payments, investment intermediation and online client acquisition.



Investment driven: The BFSI sector is gearing for both acquisitions and funding-based routes to increase its presence in the emerging fintech space. For example, in 2019 Riyad Bank launched a SAR 100 million program for fintech start-ups that provides funds for capital injections and research and development.

Partnership driven: Partnerships by fintech product firms (in point-of-sale hardware, e-wallets, credit deals and social lending) with banks with a synchronized go-to-market strategy are addressing the immediate demand of digital-age consumers. For example:

- Banque Saudi Fransi partnered with fintech Hala to offer their customers the convenience of a digital wallet on their phones.
- Al Rajhi Bank has signed treasury and capital markets tech specialist Murex for its flagship MX.3 framebox platform. This platform will handle all the activities of its treasury business that will enhance its capabilities, increase efficiency and improve customer service.



Financial institutions are competing to deliver innovation including seamless, hyper-personalized user experiences.

Market driven: To counter a steady challenge by venture backed fintech firms, many incumbents are augmenting their value chain with competing offerings and leveraging their own distribution and client base. For example:

- Alinma Bank launched (AlinmaPay), which is a digital wallet that enables local and international money transfer, withdraw cash, pay bills and many other services.
- Saudi British Bank (SABB) has launched a real-time cross-border transfer service based on the Ripple blockchain network. The

technology will allow customers to gain access to faster, safer and more transparent cross-border payments.

Before Covid-19, the 2020s were already being framed as the decade for digital bank transformation. Financial institutions are competing to deliver innovation including seamless, hyper-personalized user experiences. The challenges and disruption caused by Covid-19 and changes in consumer behavior to consider new tools and technologies has accelerated this focus and digital transformation



The challenges and disruption caused by Covid-19 and changes in consumer behavior to consider new tools and technologies has accelerated this focus and digital transformation has become the top priority for banks.

has become the top priority for banks to sustain their business and reduce overheads. This is expected to drive further collaboration between banks and fintechs as banks look to fintech service providers to support them with their digital transformation activities.

Saudi Payments

Saudi Payments operates mada, a national payment system that adds flexibility, speed, security, and acceptance by connecting ATMs and point-of-sale (POS) terminals to a central payment system. When Apple Pay, a mobile wallet, was introduced in Saudi Arabia in 2019, mada was made available for use on the system, along with major credit card operators and bank cards. In 2020, digital payments transactions increased by 75 percent while cash withdrawals from ATMs and other methods of payment transactions decreased by 30 percent.⁵

Future investment trends

Though mandated lockdowns will soon be relegated to the history books, the 'new normal' is here to stay. As a result, organizations have been accelerating investments in digital channels and related enablers in order to meet customer needs. This acceleration will drive fintech investment from corporates in customer-orientated digital technologies and in the back office space as a means to improve operations and better manage costs.

Fintech investors have been focused on big bets and safer deals recently, making it difficult for smaller fintechs, even those with good business models, to raise funding. Some of them won't have the liquidity they need to make it through the current crisis. Emerging from the pandemic there is likely to be more consolidation and more opportunistic investments.



Fahad Aldossari
Partner, Audit
KPMG in Saudi Arabia

Fahad Aldossari has 17 years of experience in providing audit and advisory services to a wide range of clients in Saudi Arabia. He is a lead partner on various banks and works with several entities in the payment industry.

⁵<https://www.arabnews.com/node/1788886/business-economy>

Digital banking

Future of banking demands digital leadership

Digitalization can either take an industry by storm or take it for a ride. In the former case, digital practices quickly become the norm, and the industry melds into a mix of early adopters as well as disrupters. In the latter, the industry is supplanted by competitors with digital business models that replace, rather than transform, the market.

Broadly, the banking sector has been quick to adopt digitalization – it has, in a sense, been taken by storm. Stable and well-capitalized – unlike many industrial sectors – the banking sector steadily introduced digital products to its customers and digitalized its own processes. However, with fintech companies taking up a growing share of the banking pie, banks are realizing that their digital progress may not be quick enough.

Stepping up to the plate

The Covid-19 pandemic has been an accelerant for this mindset shift around speed and urgency as organizations work to achieve timely, efficient recoveries. There simply is not time for business as usual. Extraordinary situations require extraordinary people with extraordinary ideas – digital transformation is no different.

The emergence of flatter organizational structures in the new working reality require virtually every employee, regardless of hierarchy within the organization and across the front, middle and back office, to function as digital leaders. The role is no longer reserved just for the CTO or CIO. However, the true mavericks—whose unconventional mindsets remain

untouched by the attritional anti-value of conformity—still seem to be found at the lower levels of most organizations. And that’s a really important facet of the new digital determinism. It’s not just about emphasizing what leaders are accountable for, it’s about what leaders actually need to be capable of.

Four main drivers are motivating corporate leaders to embrace the digital maverick philosophy in an effort to ensure their organizations don’t get left behind in the digital age:



Complexity

Thinking far bigger about how to architect and build digital



Culture

Pushing boundaries and forcing people and teams to transcend



Connection

Crushing needless structures and engendering purpose



Customer

Customer obsession across the value chain

Attracting talent

Unlike in other sectors, the global banking sector has a large amount of digitally-minded talent contained within the broader industry, driven by the early emergence of fintech. In fact, banks increasingly draw from the same talent pool as fintechs. In industrial sectors this is often not the case – talent interested in digitalization often shun industry for sectors that are adopting digitalization at a faster pace, such as retail, food and beverages and banking. This paradigm means that banks are well-positioned to attract the desired talent with a digital skillset.

Banks have started adopting workplaces they see as attractive to young, digitally-minded talent. Gone are cubicles; in are open offices, free food, and wellness seminars. However, the pandemic may have exposed the banking emperors as having no clothes. With remote work a defining feature of the new reality, no longer can they use office perks as a way to attract tomorrow’s digital leaders. Banks instead must change the nature of their work and operations to attract talent.



We are seeing the unrelenting rise—and more importantly the mass adoption—of a digital maverickism.

Evolving skillset

Against this inevitable digital backdrop, a new leadership model is emerging that pivots away from the traditional qualities of corporate leadership. Old economy skills of management and supervision are indeed being replaced with new technologies that are augmented alongside humans with the skills and empowerment to make the new models work.

Of course, traits such as integrity, vision, commitment, and passion remain important, but the profile of a digital leader is increasingly skewing toward a worldview that, like the new business environment, is relatively unstructured and less predictable. Indeed, we are seeing the unrelenting rise—and more importantly the mass adoption—of a digital maverickism.

Changing of the guard

As leaders plan their banks' digital futures, they need to recognize the evolving nature of customer needs and expectations around speed, efficiency and personalization that will shape the future of commerce. Looking internally, digital leaders need to also recognize the changing needs and desires of their employees – especially the defining characteristics of digital talent.

Organizations should develop strategies that examine the evolving needs of the individual—behaviors, motivation, perceptions, attributes, attitudes, etc.—as well as consider the massive societal, geopolitical, economic, legal/regulatory, and environmental changes the world is experiencing.

The digital maverick mindset—multimodal thinking

Intellectually and practically, digital mavericks have a unique

capacity for interoperating in a multimodal fashion. As leaders, this makes them inherently agile and highly adept at designing and building solutions to complex problems—if placed in a conducive environment.

A practical framework defines four distinct, interconnected modes of thinking:

Mode 1: From strategy to solution

This mode is about recognizing that digital is about doing. There's a place for big thinking, of course, but true value is found within the deeper "solutioning" work. This is an exercise in ensuring all the new moving parts fit together at a pace and scale never previously achieved. It's also about establishing a digital strategy, getting inside and understanding that strategy, and ensuring it is incremental and flexible.

Mode 2: From production to purpose

Here, digital leaders must think about generating positive, sustainable and repeatable outputs and that means inspiring everyone to think and act digitally. This mode is about defining and exhibiting different activities across the entire enterprise. The focus is on product development and ideas that ultimately become business lines or enable improved business efficiency in existing business lines.

Mode 3: From champion to spark

Tomorrow's digital leaders must assume the role of evangelist, motivating and inspiring the organization as a whole, at every level, to move from awareness to action. The champion works to help people understand their roles, the company's technology stack, and the operating model that will

move the organization's digital transformation journey forward.

Mode 4: From marshal to ethicist

While digital mavericks may have disdain for governance as a relic of old-guard corporate thinking, they must acknowledge the importance of the ethical ramifications and inherent risks in everything the organization does from a digital perspective. This realization enables them to collect and organize different perspectives and then determine how to most effectively secure the relevant resources to keep the transformation on track.



Mazhar Hussain
Digital Science and Innovation Lead
KPMG in Saudi Arabia

Mazhar Hussain is focused on digital value creation. He helps enterprises design answers to big problems and integrates people across multi-disciplinary teams to transform business value.



Digital banking

Emerging tax technologies for banking

Digitalization is affecting every facet of banking operations, including tax accounting. Banks hold an immense amount of data about their customers – both retail and commercial – and the effective use of tax technology depends on a bank's ability to organize and use that data.

VAT as a bellwether for change

In 2018 Saudi Arabia introduced a value added tax (VAT) at a rate of 5% as part of its move towards the 2030 vision of reducing dependence on oil as a source of government revenue. Last year, in the midst of the Covid-19 pandemic, the Ministry of Finance announced an increase of the VAT rate to 15% – a measure aimed primarily at countering the adverse economic implications of the pandemic. The tripling of the VAT rate was intended to address the fiscal imbalance caused by a decrease in consumer and commercial spending, the loss of oil and tax revenues, and the cost of healthcare initiatives put into place in response to the pandemic.

As a consumption-based tax levied on most goods and services, VAT has impacted not only the tax function at banks, but is also causing a significant transformation in the way banks are run, cutting across many business operations such as IT, cash management, marketing, and accounting. VAT readiness has required banks to look at all of their business processes. For example, document management – a critical business process for accurate tax accounting – has been significantly improved in the years

since VAT was implemented in the Kingdom.

GAZT and e-invoicing

The Saudi Arabian General Authority of Zakat and Tax (GAZT) issued new e-invoicing regulations in December 2020 with an implementation date of 4 December 2021. At this stage we know that the new regulations cover the issue, storage and transmission of e-invoices and related relevant data and are already causing businesses to adopt new tax technologies and processes in order to comply.

The new e-invoicing regulations are integral and complementary to the VAT Implementing Regulations and apply to all Saudi resident taxpayers. The regulations define the terms, requirements, and conditions related to e-invoices. For example, the definition of an electronic invoice is stated to be a tax invoice issued electronically through electronic means, which excludes scans or copies of invoices. The move to e-invoicing is intended to improve compliance, tax revenue collections, the efficiency of the filing process for taxpayers and to combat commercial concealment. Overall, the aim of GAZT is also to improve the Kingdom's alignment with,

and adherence to, international standards. GAZT has committed to make further details available to taxpayers before May 2021.

Secure e-invoicing

As banks quickly ramp up their e-invoicing operations to meet GAZT's end-of-2021 deadline, it is crucial that they take action to ensure data completeness, security and privacy are integrated into the management of their VAT systems. The regulations stipulate that web access and encryption are prerequisites for implementing an e-invoicing solution.

Commercial versus retail e-invoicing

The current guidance from GAZT does not distinguish between requirements for B2B and B2C. Since many banks provide services to both commercial and retail customers, the e-invoicing systems they introduce have to fit both models. Unsurprisingly, challenges exist in both.

From a B2B perspective, banks will have to ensure that the e-invoice can be received and processed by its customers as part of their accounts payable process; while B2C customers must be prepared to receive digital invoices – this



It is now even more critical that the entire tax environment is viewed holistically and that the necessary skills and experience are acquired to manage both the output of tax information and the inevitable heightened interaction with the tax authorities.

remains a rare form of invoicing for retail clients and will require some adjustment on their part. In particular, e-invoicing faces the challenge of acquiring sufficient data to satisfy the Regulations. Typically, banks have far more retail customers than commercial customers, raising the likelihood that banks will be required to acquire substantial amounts of additional customer data, possibly leading to an overload of inadequate e-invoicing solutions. Further, e-invoicing as envisaged by GAZT may not be desirable for retail customers who are either unable to receive e-invoice data or simply have no desire to receive invoices in this way.

Regardless of the clientele, banks face a daunting task to ensure that their VAT related data is complete and accurate to minimize the likelihood of invoicing errors and adjustments and that, e-invoicing solutions are built to identify the likely formatting and syntax discrepancies that will arise – a notoriously tall order for any kind of technology.

Compounding these challenges is the uncertainty surrounding GAZT's role in the e-invoicing process. It is currently unclear at what point GAZT will access the e-invoicing data. This presents a risk for banks if they produce or receive inaccurate data which is accessed by GAZT before it can be corrected. To mitigate this risk, banks should implement sound processes to curate client data (i.e. acquire and manage) on an end-to-end basis to ensure accuracy at every point where GAZT might come knocking.

At the time of writing, we understand that it is likely that GAZT will develop a proprietary e-invoicing platform which will

validate invoice data prior to the final issue of the invoice to the customer.

A steep road ahead

Until now, the use of tax technology in the banking sector in Saudi Arabia has appeared to lag behind more widely-implemented product and accounting technologies. We understand that banks with considerable non-zakat obligations have introduced tax-specific technologies, but broadly the sector has a steep road ahead of it.

On the indirect tax side, some banks have implemented tax solutions. However, the anecdotal evidence suggests that these solutions are inconsistent in terms of effectiveness. Managing VAT in banks requires complex, unique calculations and data is often incomplete or inaccurate. To improve in this space, particularly since going forward GAZT will have access to vastly increased amounts of data, banks should re-think their tax operating models to cater for the greater detailed scrutiny. It is now even more critical that the entire tax environment is viewed holistically and that the necessary skills and experience are acquired to manage both the output of tax information and the inevitable heightened interaction with the tax authorities.

From a governance perspective, it is wise to have a voice at board-level to make sure the needs of the tax team are not ignored when adopting such systems and re-thinking operations. This could prove to be a challenging task since the breadth of taxation is still a relatively new phenomenon in Saudi Arabia.

Finally, modernizing a bank's tax accounting systems does not

often mean technology first and people and processes second, but rather the other way around – updating its operating model and processes and training its people, then introducing compatible technology is a proven approach. With more changes coming to the tax environment in the Kingdom, the need for a tax operating model to support the management of tax risk is becoming ever more urgent.



Nicholas Soverall
Head of Indirect Tax
KPMG in Saudi Arabia

Nick Soverall leads the Indirect Tax practice and has a wealth of experience in consulting on indirect tax matters in the UK, sub-Saharan Africa and the Middle East. He advises clients in all areas of indirect taxation including technical, strategy, planning, dispute resolution and tax technology.



Evolving environment





Evolving environment

Dynamic market shift encourages consolidation in banking landscape

Though the global banking sector saw M&A deal volume drop last year after a modest uptick in 2019, the second half of 2020 saw activity heating up. The early-year slowdown was largely due to broad market uncertainty, and as the picture clears, it appears to have conditions ripe for consolidation.

There are plenty of reasons to expect increased banking M&A volume in 2021 despite Covid-19, such as a scope of more rescue and restructuring deals, a surge in digital transactions, ease of regulatory transaction barriers, increased collaboration between fintechs and financial institutions, interest of private equities and a thriving NPL market. However, as regions cope with and recover from the economic downturn in different ways, a regional banking sector's specific characteristics may be the biggest determinants in deal activity.

Regional M&A environment

The GCC is often considered as an overbanked region. While healthy competition is good for a market, too much competition renders banks inefficient and unable to expand into regional players.

Fintechs could further squeeze an already tight sector. Saudi Arabia's young population has a keen appetite for the non-traditional banking sector, and they are gobbling it up as quickly as it develops, shrinking the available pie for banks. Though fintechs have not penetrated the personal finance sector in Saudi Arabia, they have proven adept at quickly winning market share in other countries like China and the U.S.

While vaccination programs have far to go globally, GCC states have jumped ahead of other regions, spelling a potentially quicker economic recovery. More than anything, a return to a semblance of normalcy will give banks some of the clarity needed for major restructuring. When they can better predict economic and asset performance – as well as set a long-term operational strategy – banks will be more comfortable making big decisions.

Combined, underlying market conditions and an early emergence from the pandemic's economic downturn, the Saudi – and regional – banking sector has characteristics prime for deal-making, and the sector should emerge from a spate of activity stronger and ready for the future. Combining operations increases cross-selling, allows

a merged bank access to new retail or commercial customers, and creates synergies to enhance financial performance especially in a low-margin environment, all while increasing the combined market share. However, with all their potential benefits, many M&As have failed in achieving their intended objectives or worse, led to the demise of both parties. As such, banks need to be wary of the critical factors that underpin a successful M&A. In this respect, robust merger planning, including a detailed readiness assessment, is fundamental. In addition, management of stakeholder expectations is equally paramount.

NCB-Samba deal

The biggest driver of change is action, and this year may prove to be action packed in the Kingdom due to a single merger, between National Commercial Bank (NCB)



Saudi's new big banks expected to increasingly compete financing regional projects.

and Samba Financial Group. The combined lender, now known as Saudi National Bank, will be by far the biggest in Saudi Arabia, with assets of USD223 billion.⁶

The deal is now approved by the shareholders, and the merged entity, Saudi National Bank, will:

- Be the number one bank in the MENA region by net income, at USD1.9 billion
- Be the third largest bank in the GCC, behind Qatar National Bank and First Abu Dhabi Bank (itself created by a 2017 merger)
- Have an approximately 25% market share across all key metrics in the Kingdom⁷

National project financing

Growing appetite for consolidation is in line with Vision 2030's goals to use home-grown capital to finance major development projects. Merged banks have more capital and know-how to engage in development projects, which have in the past needed to look abroad for financing.

An example of this vision can be found in the funding for The Red Sea Development Company (TRSDC), which is building the Kingdom's new flagship tourism project. Late last year, TRSDC laid out its financing plans, which include a \$3.7 billion loan from five domestic banks, paired with funding from the PIF, which owns the project. Without big, sophisticated banks, projects of past have had to turn to international financiers who may be more expensive or require more time, while not having as much local expertise, as domestic banks.

Regional powerhouses

Further afield, Saudi's new big banks will increasingly compete to finance regional projects. Large-scale regional projects – largely in the construction, transport, or power sectors – are usually financed by syndicates of regional and international banks.

The composition of project finance in the region can include a combination of bonds, loans, and IPOs, in addition to Sharia-compliant facilities like sukuks and murabaha. Having larger Saudi banks allows the sector to be

more competitive in both areas – traditional and Sharia-compliant financing.

Keys to M&A success

Despite integration challenges in the early stages, merged banks will gain market share and benefit from greater pricing power and cost synergies through improvement in efficiencies and rationalization of operations. However, banks should be aware of the critical factors that underpin a successful M&A. In this respect, robust merger planning, including a detailed readiness assessment, is fundamental. Management of stakeholder expectation is equally paramount, especially as it relates to employees and potential staff redundancies, which need to be handled appropriately for overall employee morale as well as sustenance of brand image.




Ali Maabereh
Head of M&A
KPMG in Saudi Arabia

Ali Maabereh is a seasoned corporate finance professional and heads the M&A advisory division within the KPMG Saudi Levant Cluster. He has been with the firm for 10 years, prior to which he obtained industry experience in various executive roles. Maabereh holds an MBA from the New York Institute of Technology.

⁶<https://www.ncbsambastronger.com/english>

⁷Saudi National Bank investor presentation (https://584b4e21-319d-4ba7-8a29-ce17fdf488d9.filesusr.com/ugd/f22955_32fae7faf90c4f059903b1aee5a66ef7.pdf)



Evolving environment

Operational resilience

put to the test

Operational resilience has always been an important consideration for banks and regulators. Usually defined as the ability of an organization to adapt rapidly to changing environments, operational resilience encompasses systems and processes, and is, more generally, the ability of the organization to continue to operate its business when a disruptive event occurs.

To state the obvious, the Covid-19 pandemic has been a disruptive event. It has tested banks' operational resilience, bending many to the brink, but in Saudi Arabia not breaking any. This is due to several factors, not least of which being SAMA's role in supporting banks through stimulus measures and regulatory assistance. Maintaining such an environment – where operational resilience is jointly held by banks and regulators – will be key moving forward.

Lessons from the pandemic
Most Saudi banks' operations performed well during the

Covid-19 crisis. Even so, the pandemic held up a mirror to institutions' resilience under pressure. Faced with an increased threat landscape, banks need to accept that it's impractical – and too costly – to prevent all disruption. Instead, their whole organizations should be ready to limit, respond to, recover and learn from a wide variety of events. This means investing in operational resilience.

A bank's operational resilience framework allows it to absorb internal and external shocks, ensuring the continuity of critical operations by protecting

key processes and resources such as systems, data, people and property. To achieve this, an effective framework for operational resilience needs to be:

Enterprise-wide

Moving away from siloed functions to develop an end-to-end view, driven by customer needs and linked to banks' goals

Measurable

Putting operational resilience on the same footing as financial resilience, with specific and quantifiable KPIs, thresholds, stress-tests and reporting



A bank's operational resilience framework allows it to absorb internal and external shocks, ensuring the continuity of critical operations by protecting key processes and resources such as systems, data, people and property.

Flexible

Enabling the bank to react appropriately to unknown situations and adapt to changing circumstances, instead of following rigid action plans

Top-down

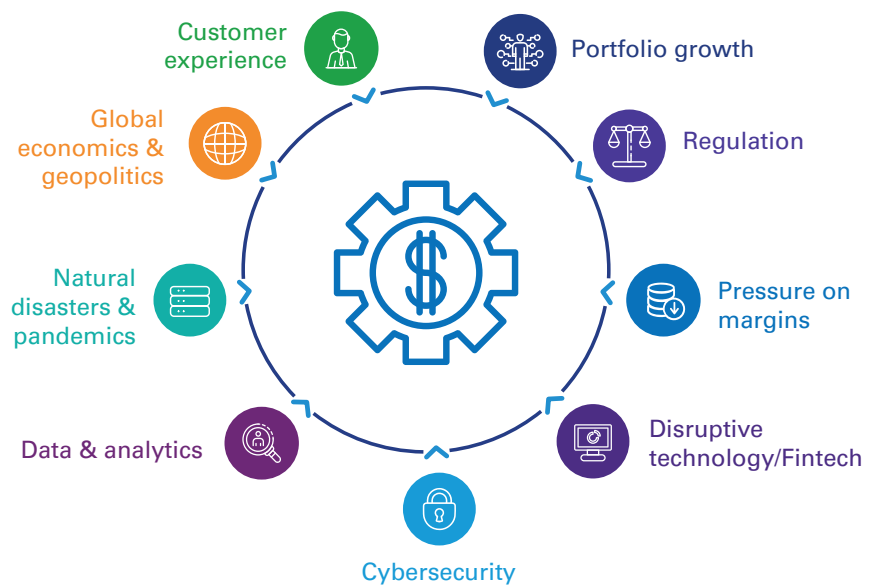
Integrating operational resilience into overall bank management, starting at the top with adequate attention from senior management

Faced with creating such an operational resilience framework – and integrating it with existing functions – banks can learn from their experience of strengthening financial resilience after the crisis of 2008. As well as enhancing financial risk management through monitoring and stress-testing, this involved a structural program to build recovery and resolution planning into day-to-day management. Institutions can use a similar approach to build the key elements of an effective operational resilience framework:

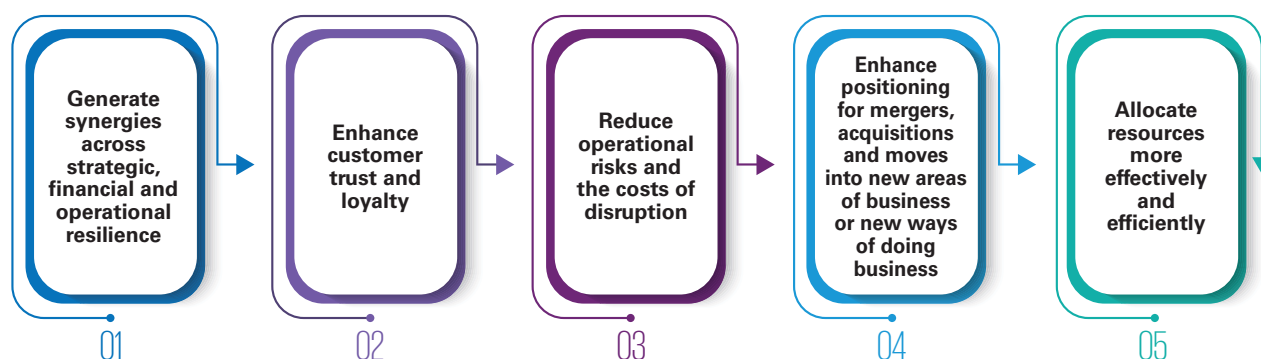
- Overarching *crisis governance* including clear roles and responsibilities among senior management, well-defined escalation mechanisms based on measurable indicators, and an effective reporting framework.
- Identifying and prioritizing important business functions, their underlying operational resources and key interconnections and interdependencies.
- Promoting enterprise-wide cooperation and strengthening existing interfaces and communication channels, for example through creating playbooks and performing dry runs.
- Creating recovery and communication strategies to deal with severe disruptions, and performing paper-based and live scenario exercises that put each element – and their interplay – to the test.

Industry disruptors in financial services

Aside from cross-sectoral disruptors and challenges that are faced by organizations, there are a set of specific ones faced by financial institutions.



Business opportunities from operational resilience



Resilience as a business opportunity

In adopting a purposeful and effective operational resilience plan, banks can realize cost savings and can boost their efficiency through effective leveraging of data, data models and systems architecture. Improved operational resilience often requires convergence, simplification and an end to duplication of regulatory, risk and control frameworks; and rationalizing service and process overlaps. Such gains have the potential to enable headcount rationalization and to unlock a broad range of efficiency savings.

Generate synergies across strategic, financial and operational resilience

At the highest level, a firm's overall enterprise resilience can be divided into strategic resilience (the resilience of the firm's strategy and market position), financial resilience and operational resilience. Elevating operational resilience to equal status to strategic and financial resilience should help firms to align their approach to operational resilience with the firm's strategic goals and to anticipate and navigate both the operational and the financial risks that emerge from increasingly complex and inter-connected business models.

Enhance customer trust and loyalty

Recovering rapidly to deliver good customer outcomes and retaining customer trust and loyalty in increasingly competitive markets should be a key driver of success for firms. Customer trust and loyalty may be enhanced through the ability of a bank to outperform its competitors in terms

of both preventing disruptions from occurring and continuing to deliver its key business services as seamlessly as possible when adverse shocks do occur. The alternative is that firms run the risk that the costs of mitigating and redressing disruptive events may be compounded by the potential damage to reputation and customer confidence and a resulting loss of business. This was notable in the customer onboarding process during the lockdown.

Reduce operational risks and the costs of disruption

A greater end-to-end focus on business services, and clearer accountabilities based on such a focus, should enable a firm to reduce its operational risks, reduce both the probability of disruption and the impact of disruptions when they do occur, and thereby drive down regulatory capital requirements and the costs of fines and other regulatory sanctions.

Enhance positioning for mergers, acquisitions and moves into new areas of business or new ways of doing business

A clearer understanding and mapping of business services and the people, data, systems and processes on which they depend should enable a firm to undertake mergers and acquisitions more efficiently and effectively, and enable a firm to move more smoothly into new areas of business or new ways of doing business.

Allocate resources more effectively and efficiently

Rebalancing efforts from trying to prevent disruption to focusing

more on response and recovery when disruption does occur should enable firms to allocate resources more effectively and efficiently. Basing investment decisions on what is most important to the continuity of key business services, on the results of scenario tests and on whether a service can be recovered within impact tolerance thresholds should reduce costs and contribute to competitive advantage.

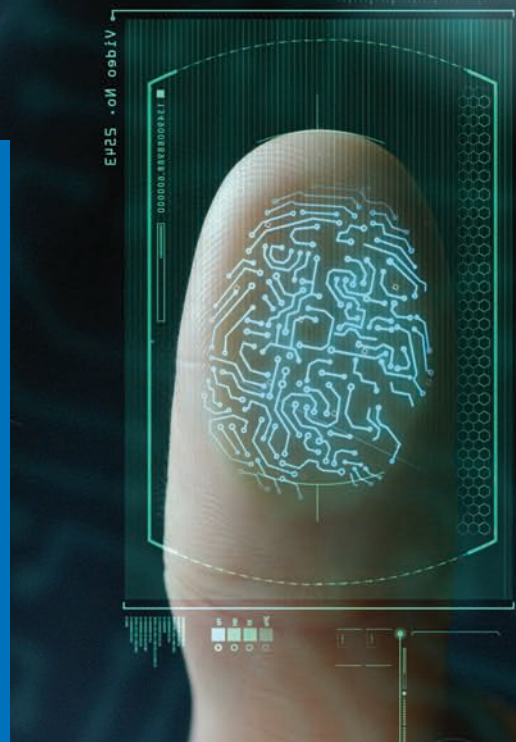


Mostafa Al Shamashergi
Financial Management Lead
KPMG in Saudi Arabia

Mostafa Al Shamashergi has been with KPMG for 20 years, working with the firms in Egypt, UAE and Saudi Arabia. He specializes in financial management services, including the implementation of ERP systems, budgeting and forecasting, shared services centers and finance process efficiency.

Evolving environment

Key cyber considerations



In line with the acceleration of digitalization and remote work, the prevalence of cybercrime has increased during the Covid-19 pandemic. For banks, the threat is pronounced and growing. Luckily, the sector has been at the forefront of cybersecurity for years and has thus been well-guarded from new threats posed by cyber perpetrators. The cybersecurity landscape is rapidly evolving, and there are several key developments that are shaping cyber in the banking sector.

Open banking

Open banking is a practice that provides third-party financial service providers open access to consumer banking, transaction, and other financial data from banks and non-bank financial institutions using application programming interfaces (APIs). It also allows for greater financial transparency for customers and uses open source technology to build the ecosystem. At each level, cybersecurity measures and policies will determine the success of open banking.

In a January 2021 policy paper, the Saudi Central Bank (SAMA) announced that it is developing an “open banking initiative” intended to help shape the rules around open banking and promote its healthy use as the fintech sector develops. SAMA plans to “go live” with open banking during the first half of 2022, after its design and implementation phases are complete.

As stakeholders in the Kingdom develop their own open banking initiatives, they should recognize the importance of security. All third-party providers have to comply with regulator and bank data protection rules, which should be focused on customer privacy protection. The provider must



Banks will have to better understand their data practices and the impact of new regulations on their business strategies and business models.

inform the bank and the customer what data it intends to use and how it will use it, as well as how long it will remain within their system.

Internal risks

Cyber in the Audit (CitA) provides a framework and guidance for a structured approach and risk-based decision making for assurance. Traditionally, auditors have tested their clients’ general IT controls (GITCs). However, as risks evolve, so too does the role of the auditor. Just as an IT audit supports a financial audit by testing automated controls, CitA supports the IT audit by testing the cybersecurity measures in place to prevent an attack on an IT system. The emphasis for CitA is a forward-looking approach where the controls are designed to provide an assurance on the IT

dependencies that a bank relies upon. It gives insight into a bank’s cybersecurity controls and makes plans for, in case of a cyberattack or compromise, what steps need to be taken to respond and recover.

Data Privacy

Whether a bank started its privacy journey because of a regulation or as an initiative, privacy is now firmly a sector-wide priority. Full engagement across the bank is key as privacy professionals look to embed privacy into the DNA of business operations and customer engagement.

Banks must chart a plan that not only encompasses the immediate regulatory challenges, but also a plan for a shifting regulatory climate and consumer expectations of greater individual control of

data. In creating a sustainable and effective data protection strategy, companies should develop a solid framework of best practices and infuse those practices—both procedurally and culturally.

While data should be viewed as a valuable asset, it should not be seen as such in and of itself. It is what a bank does with its data that gives it value – like creating better customer experiences and offering customized products. Additionally, businesses that proactively manage and protect personal data the way users expect will come out ahead of their competition. Banks will have to better understand their data practices and the impact of new regulations on their business strategies and business models. Waiting to the last minute is not a viable option, because the goal is building customer trust and loyalty.

Penetration Testing & Red Teaming

Though better prepared than most sectors, the banking sector still lags behind the cyber threats landscape. Hackers will find opportunities to exploit flaws in the way banks currently fund, manage, enable, organize and implement their information protection capabilities. Thus, it is important to stay ahead of the threat by testing what your defenses are capable of.

Accordingly, banks are expected to take action, best by simulating potential cyber attacked, for example from real attackers (including phishing and malware),

testing the Tactics, Techniques and Procedures (TTPs) and the overall incident response and threat management.

Secure DevOps

DevOps is a philosophy based on combining the traditional roles and responsibilities of development teams and IT operations teams to accelerate the delivery of business value through the two teams. When work flows smoothly through development and IT operations, new software features come to market more frequently and the business becomes more competitive and adaptive in a constantly shifting market.

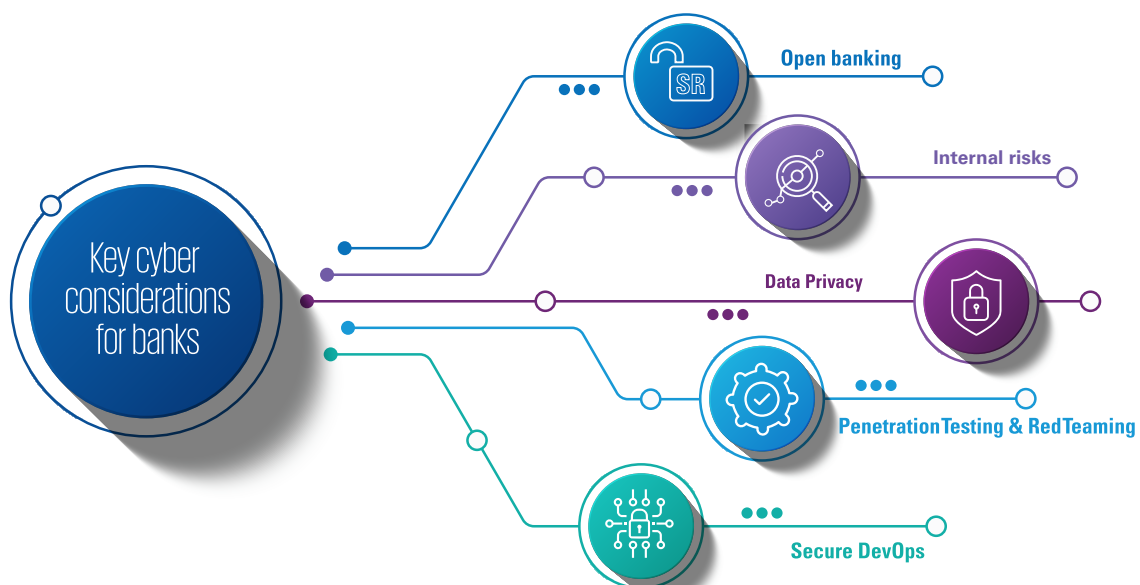
The central concept of Secure DevOps is the integration of security into the development and IT operations teams. By adding security into the original mix, the velocity for security changes increases as well. The likelihood of vulnerabilities being introduced is reduced, and banks are able to more quickly mitigate risks that remain. It is paramount that banks focus on custom implementations for their environment and goals. This includes discussing tangible actions within IT, development and security to enhance the existing culture, processes and technologies in the transition to Secure DevOps capabilities. Across the three groups, necessary changes to the cultures of the groups are similar. Because of the vast changes to various processes, the individuals involved must be

willing to undertake new programs and processes and different approaches to traditional work. And because of the assortment of new processes and technologies adopted in order to support Secure DevOps, it is crucial banks encourage their workforce to share challenges and failures.



Ton Diemont
Cybersecurity Lead
KPMG in Saudi Arabia

Ton Diemont has vast experience in cybersecurity, IT and Operational Risk Management and Financial Services. He worked over 21 years with leading financial institutions in the Netherlands, most recently as CISO. He worked with many central banks, regulators on the implementation of cybersecurity measures and risk governance customer-centric transformation programs.





Evolving environment

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

It is said that all good things come to an end – a notion that the legacy proponents of LIBOR would endorse about this benchmark that has underpinned billions of dollars worth of financial products and trades annually over the last four decades. Until recently it was estimated that at least USD 350 trillion in derivatives and other financial products are tied to LIBOR – a number that has gradually declined ever since the LIBOR scandal of 2008-12 period. The scandal led to LIBOR reforms followed by UK's Financial Conduct Authority's decision in 2017 to no longer compel panel banks from making LIBOR submissions after FY 2021.

Initial reporting relief

Since that time it has become evident that global regulators' preferred LIBOR replacement is a risk-free benchmark rate that is based on actual transactional data. Consequently, the corresponding regulatory and corporate space has been rife with activity in this regard with a focus on matters such as determination of term-rates, assessment of fallback provisions, and system and process changes to tackling financial reporting challenges. To facilitate the transition, a phased project by the International Accounting Standard Board and concluded in August 2020, has granted various financial reporting exemptions in the wake of transitional uncertainty providing much needed relief to reporting entities across the globe. The exemptions enable entities to insulate their books from the exclusive impacts of transition on affected financial instruments and hedge relationships.

Moreover, in July 2020, Bloomberg began calculating and publishing fallback rates to be used to calculate the adjusted risk-free

rates (RFRs) for IBOR derivative fallback, whereby entities can begin to use this data to test their system readiness for the derivative fallbacks. In October 2020, the International Swaps and Derivatives Association (ISDA) launched the IBOR Fallbacks Supplement to the 2006 ISDA Definitions and the ISDA 2020 IBOR Fallbacks Protocol, to take effect from 25 January 2021. This was warmly welcomed by the Financial Stability Board, UK Regulators and Working Group and the US Alternative Reference Rates Committee (ARRC),

encouraging prompt adherence to the protocol to assist the transition of derivatives away from LIBOR and help avoid disruption to derivative contracts held by financial and non-financial firms when LIBOR ceases or is considered unrepresentative. Another key development during the second part of 2020 was the switch from the Effective Federal Fund Rate (EFFR) to Secured Overnight Financing Rate (SOFR) by clearing houses, like the Chicago Mercantile Exchange (CME) and the London Clearing House (LCH) for all outstanding cleared USD-denominated swap products.



The key to successfully manage the transition process lies in proactively transitioning away from legacy rates with continued focus on operational, process and systemic changes to address the phased cessation events.



The switch is expected to encourage the build-up of liquidity in SOFR products.

Covid-19 impact

However, amidst the economic and operational turmoil caused by Covid-19, apprehensions began to grow that the transition from LIBOR to Alternative Reference Rates by the end of 2021 may prove to be more challenging than initially anticipated. Consequently, in November 2020, LIBOR's administrator, the ICE Benchmark Administration (IBA), made an announcement signaling that while almost all non-USD Libor maturities would cease to be published post December 2021, the publication is expected to continue for most USD LIBOR liquid maturities until June 2023.

Subsequently, the Finance Conduct Authority (FCA) in UK announced that there would be a case for using the proposed new powers to ensure an orderly wind down of LIBOR. This transition includes the continued publication of some critical benchmarks via a change in methodology to produce a "synthetic LIBOR" that is based on a forward looking risk free rate, already chosen by the national working group for the relevant currency, plus a credit spread.

USD LIBOR

Across the Pacific, the US authorities highlighted that

the envisaged extension in the timelines for the transition of various USD LIBOR maturities would result in most legacy USD contracts maturing before the cessation of USD LIBOR. Notwithstanding, the authorities have placed an emphasis for entities to discontinue issuing USD LIBOR contracts, by December 2021 to facilitate the eventual transition.

The foregoing changes require careful assessment for entities affected by the LIBOR transition and their related plans. It is essential to remember that the timelines for cessation of non-USD LIBOR have not changed while at the same time corporates may take comfort in the notion of synthetic LIBOR for those GBP LIBOR referencing products that are extremely difficult, or even impossible, to transition. On the other hand, entities have been granted a 'breather' vis-à-vis USD LIBOR products to ensure an orderly transition of legacy assets and trades. Nonetheless, despite the change in timelines, the developments of past year have all but cemented an imminent future without LIBOR and therefore, for entities around the globe, the key to successfully manage the transition process lies in proactively transitioning away from legacy rates with continued focus on operational, process and systemic changes to address the phased cessation events.



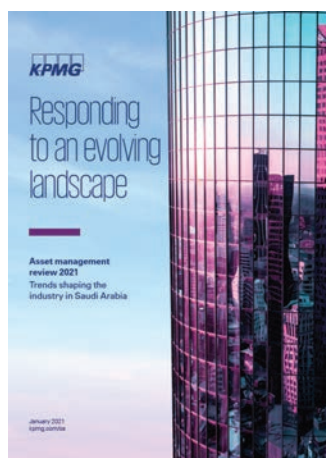
Farid Memon
Director, Assurance and DPP
KPMG in Saudi Arabia

Farid Memon has 16 years of experience with the KPMG network, providing assurance and accounting advisory services to banks and other financial services clients. Through his membership of the Department of Professional Practices (DPP), he has specialized in resolving complex financial reporting and accounting issues

Further reading

Stay tuned for our regular thought leadership on the financial services industry in Saudi Arabia. Click on the links below to access these publications.

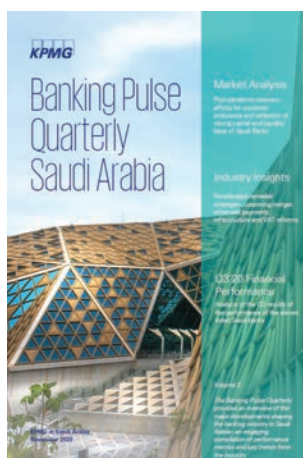
In the spotlight



Asset management review

Performance review of twelve large asset management firms and trends shaping the industry

Quarterly series



Banking pulse quarterly

Market insights and forward-looking perspectives for financial services leaders and professionals



Insurance pulse quarterly

Financial performance of the Saudi insurance industry and trends to watch in 2021

Contacts



Ovais Shahab
Head of Financial Services
KPMG in Saudi Arabia
T: +966 50979 1636
E: oshahab@kpmg.com



Khalil Ibrahim Al Sedais
Office Managing Partner- Riyadh
KPMG in Saudi Arabia
T: +966 11874 8500
E: kalsedais@kpmg.com

Contributors:

Peter Bannink
Thought Leadership Lead

Shahzaib Zia
Manager, Financial Services

Farid Ahmed
Senior Manager, Financial Services

kpmg.com/sa

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Disclaimer

This report is solely for information purposes and prepared based on financial details as reported in the published financial statements of the respective asset management firms and certain other information available publicly including from CMA and Tadawul's respective websites. Accordingly, KPMG does not and shall not assume any responsibility for the information presented herein or the nature and extent of use of this report.