Qatar banking perspectives 2020

Disruption and opportunities

June 2020

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Foreword

It is my pleasure to introduce the second edition of our annual Qatar Banking Perspectives report. Our authors explore a range of topics of critical importance to the industry. We are living in challenging times, with the COVID-19 pandemic dramatically altering the economic and social landscape resulting in changes that our generation has never witnessed before. It remains to be seen whether banking will respond in a way that amplifies or dampens the acute economic challenge, however from what we have seen in the past few months, banks have been quick to respond to the crisis with proactive regulatory and state level support.

In addition, the banking sector is facing unprecedented disruption in the face of developments as varied and far-reaching as the phase-out of LIBOR, increased scrutiny over AML, the rising prominence of Fintech and the emergence of unconventional competitors.

The standing of Qatar's banks in the international market remains firm, with the sector remaining in a strong position, regardless of potential geopolitical uncertainty. Despite the challenges, banks continue to demonstrate resilience, as evidenced by the positive first quarter results and encouraging statements from rating agencies. There are some headwinds; nevertheless managing NPLs, stabilizing liquidity, and maintaining costs at some of the lowest levels in the region amongst others, yet despite this, banks are investing heavily in technology and innovation, as explored further in this publication.

While there are wide-ranging views on how this situation will affect the financial markets, one point over which there is unanimous agreement is that we will be dealing with the effects of the COVID-19 pandemic for the foreseeable future, and the banking sector as a whole will most certainly evolve as a result of this.

Those banks that are agile, flexible and willing to transform their business models will be the ones that succeed and secure their financial strength for future growth, while those that rest on their laurels will be left behind.

Our subject matter experts shed light on major trends, challenges to overcome, and opportunities to harness. They examine issues falling under the umbrellas of four broad themes: market & business; technology & innovation; risk & regulation and governance & controls. These articles complement our GCC listed banks' results report published in May 2020, a comprehensive analysis of key financial indicators and issues relating to banks in the region.

We were delighted with the heartening response to last year's Banking Perspectives; thank you for your overwhelming interest and positive feedback. I hope you find the 2020 report equally stimulating, informative and engaging. I remain eager to hear your views, answer your queries, and discuss the contents of this publication with you.

Omar Mahmood
Head of Financial Services

Omar is a partner based in Qatar and heads the Financial Services practice across the Middle East & South Asia region. He has over 20 years of experience spread between London, Riyadh and Doha advising some of our largest clients in the banking (conventional and Islamic) and asset management sectors.

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Executive summary

The global pandemic situation has signaled banks to accelerate their digital transformation agenda and embrace new Fintech strategies thus enabling them to develop products and services that meet existing and everchanging customer and regulatory requirements, overcome current market challenges, while building resilient systems and enhancing operational efficiencies.

2019-2020 has been a challenging year for banks operating in Qatar, however, the overall impact is expected to be cushioned by the resilience and strength of the banking system. As of 31-Mar-2020, net profit attributable to shareholders registered a nominal decrease of 0.1% when compared with previous year's net profit as a result of increased provisions, while total assets registered a growth of 1.8% to QAR 1,654 billion when compared with results as of previous year.

The COVID-19 pandemic and its subsequent impact on customer expectations, banking channels and ways of working has accelerated the Digital Transformation agenda of banks operating in Qatar.

— With the creation of the Qatar Fintech Hub and the finalization of the strategy and regulatory framework that will support its deployment, innovative initiatives are expected to thrive in the coming years.

The Fintech sector has grown to become a true disruptive force having a huge impact on customer expectations, operational efficiencies, market structure, banking strategies and their financial stability.

— Banks are now challenged by new disruptive entrants such as technology companies, global retailers, postal service companies, who are benefitting from technology developments and regulatory changes that are allowing them to provide financial services.

Banks in Qatar are at the forefront of all businesses in terms of e-Services that are essential during these times of COVID-19. However, the banking industry is one of the top targeted industries affected by hackers using malicious techniques.

— Banks in Qatar are starting to invest in employee awareness and client awareness regarding cybersecurity as well as investing in artificial intelligence-powered protection solutions to filter malware and phishing threats, thus helping them strengthen their security protocols and reduce business risks.

Qatar introduced several measures to administer fair taxation and strengthen the exchange of information and tax transparency in the last couple of years, thereby fully committing to the implementation of the OECD's BEPS measures.

— Qatar also introduced a new Income Tax Law (Law No 24 of 2018) followed by the new Executive Regulations related to taxable income, withholding tax, tax exemptions, transfer pricing and capitalization regulations. These regulations will have a significant impact on the Banking and Financial Services sector.

LIBOR has always played a key role in financial markets and underpin trillions of dollars in financial products. However, regulators globally have signaled that firms should transition away from LIBOR to alternative overnight Risk Free Rates before December 2021.

— Financial institutions, industry working groups, and regulators around the globe are now working against the clock to manage and implement this almost inevitable transition. The transition will likely trigger an upheaval within financial institutions worldwide.

Governments, central banks and regulators have all been looking at different strategic ways of minimizing the impact of the pandemic on the local, regional and global economies.

- Banks have introduced several measures such as cost reduction initiatives, process rationalization, enablement of digital channels and increased focus on their core banking activities which are proving quite effective when it comes to containing the impact on their books.

Companies will need to be proactive and recognize early signals of any commercial and financial distress, thereby requiring the need for initiating financial restructuring during this pandemic.

- Companies facing financial restructuring should make a quick, but thorough assessment of short-term cash requirements, assess their full range of internal and external options to support liquidity and engage in forward planning to build financial resilience.

Like most countries, Qatar is also witnessing quite a significant impact on the real estate segment mainly tourism, hospitality and retail sectors. Banks with high debt exposure to these asset classes may need to consider impact on provisions from expected defaults.

- Although Qatar's credit allocation towards real estate seems reasonable compared to regional peers, it is still material and demands strict vigilance on an ongoing basis.

Banks have been using Corporate Social Responsibility and Sustainability Reporting to share information on their social, economic and environmental impacts in order to increase transparency.

- Implementation of sustainability driven strategies will play an important role not just for several high-profile companies, which are the clients of banks, but it will be of high importance for banks themselves.

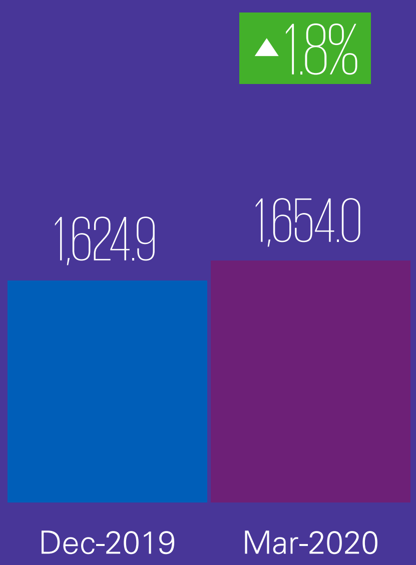
Banks in Qatar have developed an understanding of what constitutes good corporate culture and have appropriate policies in place. They do, however, face challenges in implementing these policies and assessing the strength of their corporate culture.

- In order to successfully implement culture specific policies, banks may consider including periodic culture related training and awareness sessions; disclosures of potential and actual conflicts; and periodic declaration of conformance with the policies, procedures and code of ethics.

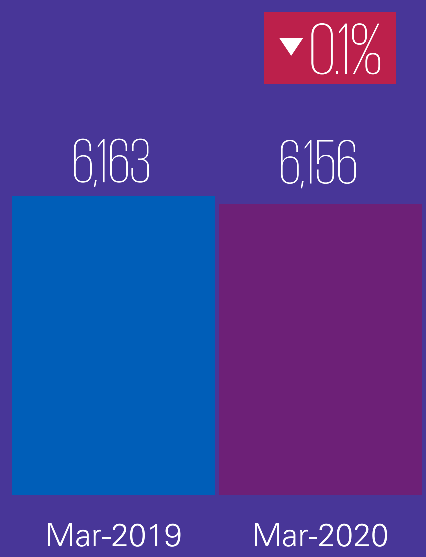
Financial highlights

The results snapshot is based on the financial analysis of eight listed commercial banks (four conventional banks and four Islamic banks) in Qatar as of 31 March 2020.

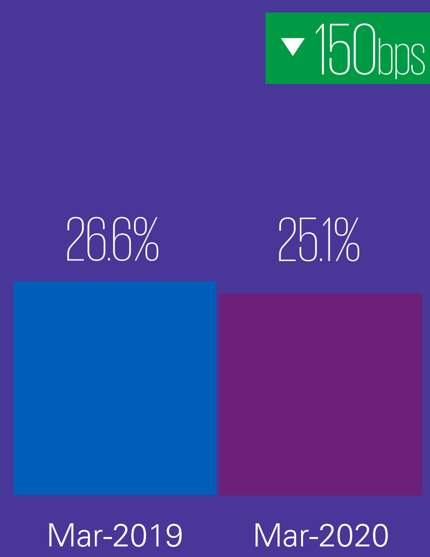
Total assets
(QR billion)



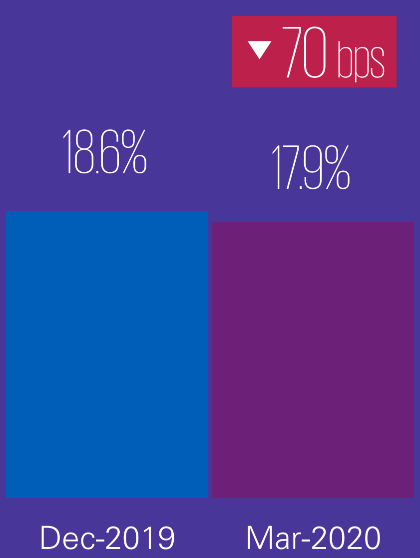
Net profit attributable to equity holders
(QR billion)



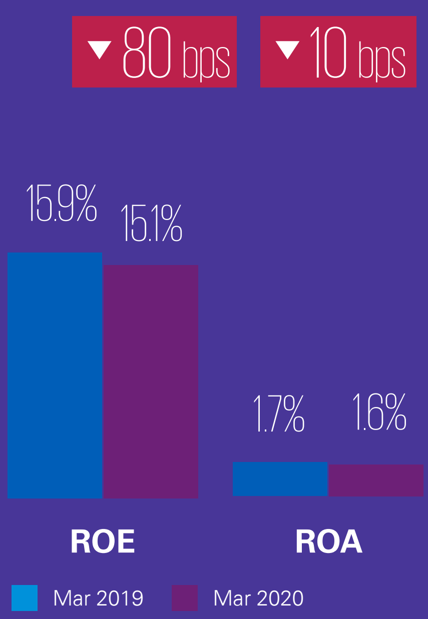
Cost-to-income ratio
(%)



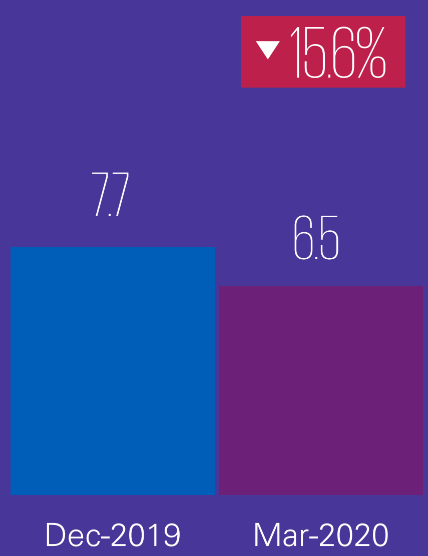
Capital adequacy ratio
(%)



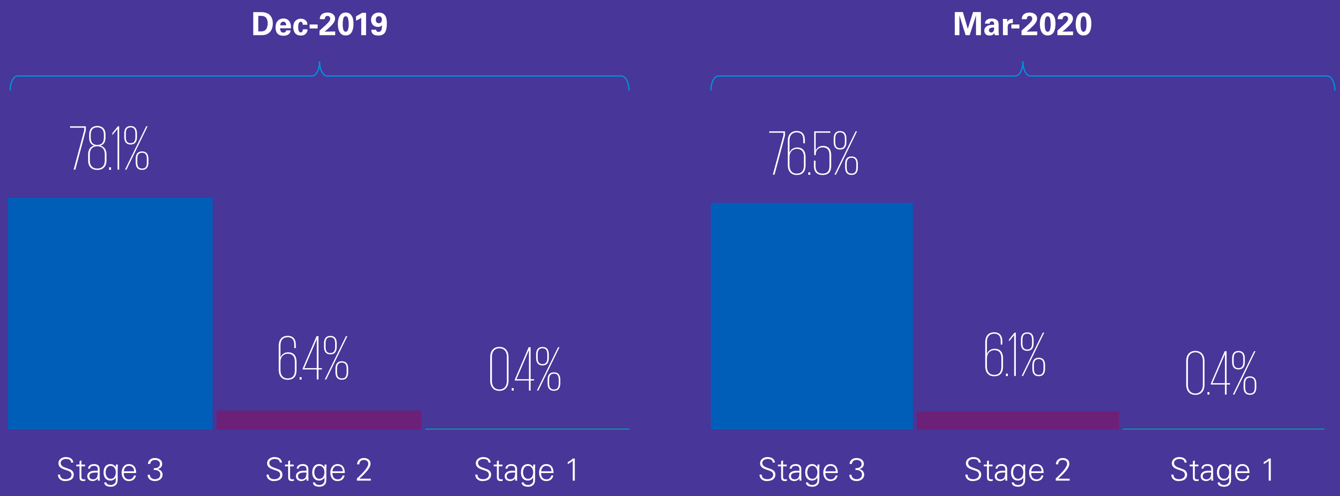
Return on equity/return on assets
(%)



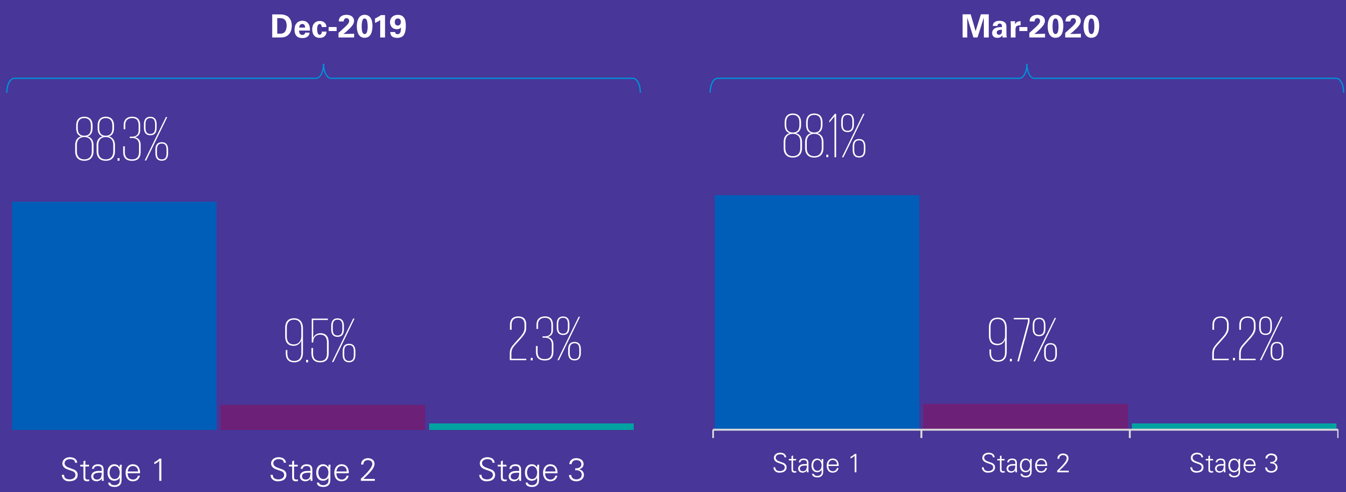
Average Share price
(%)



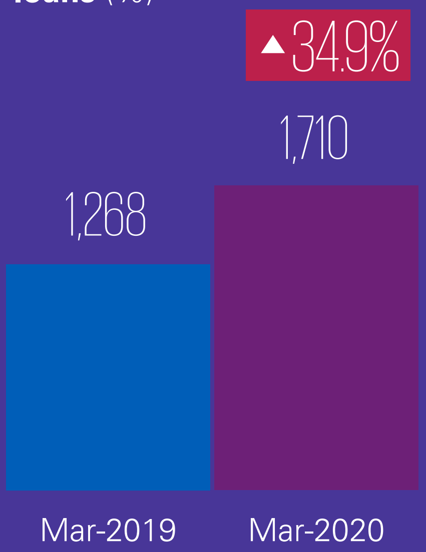
Coverage ratios on loans – by stage
(%)



Total loans subject to ECL – by stage
(%)



Net provision charge on loans (%)



Rizwan Yaseen
Audit

Rizwan focuses on audit services within the Financial Services sector. He has more than 19 years of audit experience with KPMG and specializes in the audits of banks and asset management firms, regulators and many QFC regulated entities.

I. Market & Business

I. Market & business

i. Strategic implications of COVID-19

Banks have introduced several measures such as cost reduction initiatives, process rationalization, enablement of digital channels and increased their focus on core banking activities which are proving quite effective when it comes to containing the impact of COVID-19 on their books.

Since the beginning of March 2020, the financial markets across the world have been going through an unprecedented period of volatility and uncertainty. Liquidity crunches, increased NPL ratios, significant exposure to real estate assets and cybersecurity threats, to name a few, are posing a serious challenge to the local and global banking industry.

> **"The COVID-19 pandemic has provided a much needed break for banks to take a step back from their day to day operations and spend time looking at their operating model and strategic objectives."**

Governments, central banks and regulators have all been looking at different ways of minimizing the impact of this pandemic on the local, regional and global economies. We saw financial institutes including banks receiving support in the form of liquidity injections, extensions to regulatory reporting obligations and easing out of rules and regulations around conducting their BAU operations. These external support measures combined with a number of internal steps taken by the banks in terms of cost reduction initiatives, enablement of digital channels and increased focus on their core banking activities are proving quite effective when it comes to containing the impact on their books.

We are also seeing banks using this disruption to take a step back from their day to day operations and spend time looking at their operating model and strategic objectives. The key focus of these strategy realignment exercises has been around a number of areas including:

Operating model robustness:

For banks to be able to continue serving customers while complying with lock down and social distancing rules, their business operating model needs to be robust and flexible. Banks with well-defined digital identity and e-channels are finding it comparatively easier to adapt to the new ways of operating.

There also has been a lot of focus on the resilience of banking platforms and channels. Banks who had either already invested in their cybersecurity efforts or were quick to adapt right at the onset of this pandemic are coming out as the clear winners.

People and new ways of working:

While dealing with a global crisis of this magnitude, banks across the world in general and Qatar in particular have realized that the most important factor that can help them differentiate themselves from their competition is their people. Some of the key initiatives banks have been working on in this space include helping their employees manage their work/family balance while they are getting used to the remote working environment, providing them with the right tools and technology to collaborate and maximize their productivity and giving them the necessary trainings on how to effectively deal with disruptions and manage remote relationships.

It has also been observed that a number of banks and regulators have started looking at the compensation frameworks for senior management and material risk takers. The aim is to link their total remuneration (bonus and salaries) to the bank's performance and the overall market conditions that should bring more transparency and equitability to their remuneration practices across the board.

Operational efficiency:

Cost reduction and process rationalization have been the two key elements supporting the operational efficiency agenda for most banks during this pandemic. There is a general realization that some of the banking lifecycle processes including account opening, customer onboarding, KYC and AML checks etc. can be simplified and streamlined while still achieving the underlying objectives. Significant increase in the number of personal and corporate loan applications and related processing have also brought the focus back on robotics automation and data analytics to help achieve operational efficiency.

Digitalization:

It's fair to say that the biggest implication of this pandemic has been a massive shift towards adopting digital means to conduct business and serve customers across almost all the industries and banking is no different. Usage of innovative technologies by banks and partnerships with Fintech firms have been on the rise and these trends are likely to gain further traction in the foreseeable future. Those banks who were a bit hesitant to undertake digital transformation initiatives in the pre COVID-19 phase have realized that the only way to survive and achieve sustainable growth is to embrace digitalization in everything they do.

Banks are closely monitoring and assessing any impact on their customers' expectations and buying habits and re-aligning their products and services to better serve them. Regulators have also been quite supportive in terms of relaxing the rules around the adoption of digital tools to conduct a range of customer facing transactions.

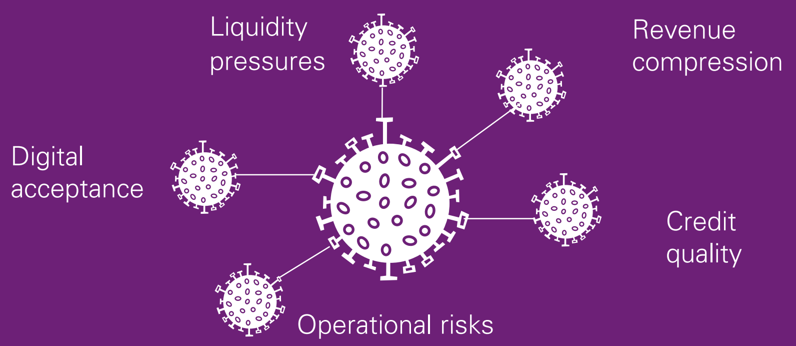
Syed Javaid
Head of Financial Services - Advisory

Syed leads the Financial Services consulting practice for KPMG in Qatar with a primary focus on retail banking, investment banking, asset & wealth management and insurance sectors. He is an experienced management consulting executive with a strong financial services and capital markets industry background with more than 12 years of business and technology program leadership experience working across the UK, US and the Middle East for global Financial Services firms.

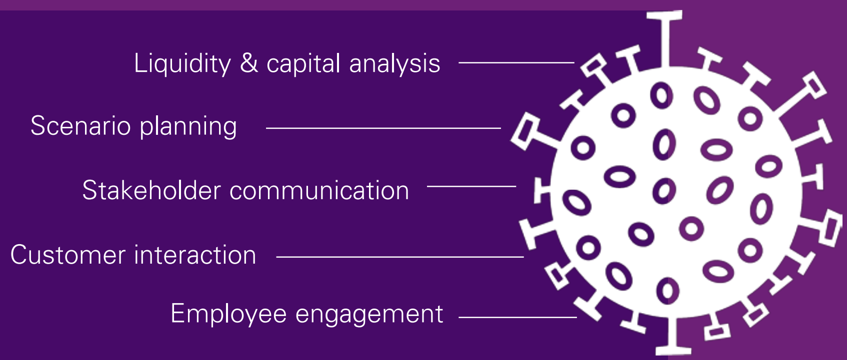
Implications of COVID-19 on the banking sector

The COVID-19 pandemic is having an unprecedented impact on financial markets globally and regionally, with implications for operating models, employees, suppliers, customers, and in turn financial results. This coupled with the effects of the drop in oil prices, has created the unique situation the industry is faced with today. While proactive economic support measures have been put in place across the region to ensure that the financial system and wider economy are protected as far as possible, there are implications that banks will inevitably face.

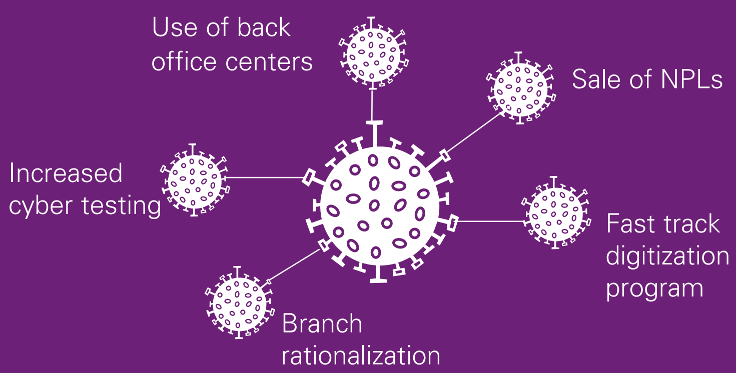
The key challenges faced by the banking sector are



As a result of these challenges banks will have to focus on the following areas



Banks are also presented with the following opportunities due to the pandemic



While there are wide-ranging views on how this situation will affect the financial markets, one point unanimously agreed upon is that we will be dealing with the effects of the COVID-19 pandemic for the foreseeable future, and the banking sector as a whole will most certainly evolve attributed to this. Banks that are agile, flexible and willing to transform their business models will succeed, and secure their financial strength for future growth, while those that rest on their laurels will be left behind.


COFFEE SHOP

ii. Managing liquidity during COVID-19

Whilst some companies might be able to maintain adequate headroom making drawdowns on their revolving credit facilities, others will find that they need to approach banks to arrange covenant waivers or limit increases. Companies will need to be proactive and recognize early signals of any commercial and financial distress thereby requiring the need for initiating financial restructuring.

The financial effects of the COVID-19 pandemic are reminiscent of the 2008 financial crisis, but with the stresses extended across every sector of the economy. It is expected that the real GDP growth for the State of Qatar will shrink 5.2% in 2020 before recovering to 3.1% in 2021 , primarily due to the impact of travel restrictions, closure of nonessential businesses and part of the Industrial Area, and banning all public gatherings on key sectors of the economy including manufacturing, retail, logistics, and construction. To counter this and in line with most countries, we have already seen that the State of Qatar has announced a QAR 75bn stimulus package (approx.11% of GDP) which is expected to provide relief to various sectors that underpin the local economy.

> **"Companies will need to be proactive and recognize early signals of any commercial and financial distress thereby requiring the need for initiating financial restructuring during this pandemic."**

Whilst the true effects may not be known for a long time, it is however safe to assume that no one country will be immune to it and the rules of the game have changed – in the way businesses operate, in the way people work and in the way people will go on about living their lives. Pressure is likely to come from all sides, as customers withhold settlement and suppliers demand faster payment. For some businesses, the likelihood of breaching financial covenants or experiencing a funding shortfall in the near term, will be a further source of concern.

What this could mean for businesses:

— Contraction in revenue putting unanticipated pressure on liquidity;

— Inventory pile up and slow-moving inventories;

— Likelihood of breaching financial covenants;

— Experiencing a funding shortfall in the near term; and

— Lack of visibility over liquidity situation and their immediate and future cash flows

Whilst some companies might be able to maintain adequate headroom making drawdowns on their revolving credit facilities, others will find that they need to approach banks to arrange covenant waivers or limit increases. The executive management will need to be proactive and recognize early signals of any commercial and financial distress thereby requiring the need for initiating financial restructuring.

Following the recognition that there is a need for financial restructuring, the executive management must consider the following:

Assessment of Requirements

1. Financial stress testing and reforecasting

The first step for a company facing a financial restructuring is to make a quick, but thorough assessment of short-term (typically, 13-17 week) cash requirements. This is crucial to ensuring that the company can meet its critical obligations while executive management and the Board evaluate and stabilize the situation. These short-term cashflows need to be forecasted at business unit as well as group level with weekly review against prior forecasts and outturn numbers. The finance managers would need to run different scenarios to test the impact of cash flows on cash reserves, facility headroom and financial covenants. The key here is to engage with the different stakeholders (shareholders and lenders) early on in the process to avoid any surprises. During this phase, the executive management and the Board together with their advisors must be able to ask uncomfortable questions and be able to identify pain points. A credible action plan (working capital optimization, divesture of non-performing business, assets etc.) for the identified pain points should be drawn up which would help preserve value.

2. Liquidity and Financing

The next step is to take a holistic view of the full range of internal and external options to support liquidity. Understand the commercial terms of the facilities you already have by thoroughly reviewing the facility documentation. Assess any potential triggers under existing financing documentation. Identify any unpledged collaterals which could be capable of supporting new funding request, should there be a need. Evaluate funding strategies, options, markets, lenders and other sources of capital in order to meet the funding needs in the timescale available – existing lenders are a good starting point. There has been stimulus measures announced by the State of Qatar- it is important to understand whether the business qualifies for these measures and if yes, act quickly to take advantage. The key here is to Identify and grade levers which can be used to accommodate different scenarios as this will demonstrate proactiveness to potential lenders.

Development of a workable plan (and a contingent plan)

Working together, executive management and the relevant stakeholders should establish a preferred outcome jointly with tolerable compromises and an effective method to determine the plan. The executive management must develop more than one plan to address any possible contingencies as new issues can arise among stakeholders and stakeholders can come forward who have not been previously identified. External factors such as market fluctuations or shifts in the competitive landscape can also introduce new complications that might require reassessments and renegotiations among stakeholders.

The key here is to always keep in mind that different stakeholders have different appetites for risk. It is important to determine key motivating factors for stakeholders and to try to identify any restrictions on their willingness to implement potential restructuring options.

Conclusion

No one planned for the current pandemic and given the uncertainty engulfing all of us, it is important that companies and the executive management act now and engage in forward planning to build financial resilience. Without financial resilience, commercial and operational resilience cannot be maintained. Keeping this pillar strong requires firms to adapt existing financial frameworks to a more hostile and volatile environment in which profitability, cash flow and access to finance are coming under simultaneous pressure.

Amit Bhardwaj
Infrastructure and Debt Advisory Lead

Amit is a Director in the Advisory practice of KPMG Qatar and leads the Infrastructure and Debt Advisory practice. He has over 18 years experience in advising private sector and public sector bodies in the infrastructure PPP, power and energy sectors.

I. Market & business

iii. Rationalizing real estate credit exposure

Qatar needs to follow a prudent real estate credit policy by sticking to the fundamentals of credit allocation, especially in light of the softening in the real estate market.

The world has seen several instances of economic turmoil over the past few decades. Unlike the dot.com bubble at the turn of the century, the 2008 crisis saw financial institutions suffer significantly, triggered by the loss of investor confidence in the value of underlying assets. Analyzing the 2008 crisis, the key reason that allowed it to turn into a global economic disaster is the non-conformity to evaluating credit risk based on fundamentals. The weakening of credit norms is not new but coupled with excessive leverage and oil price shock leads to significant strain on liquidity and asset quality of financial institutions. This has exaggerated by turning a blind eye to inflating real estate bubbles, creating complex financial instruments, poor credit risk modeling, weak regulations, and poor credit rating norms.

> **"Although Qatar's credit allocation towards real estate seems reasonable compared to regional peers, it is still material and demands strict vigilance on an ongoing basis."**

Real estate lending has traditionally seen a steady credit flow due to its inherent collateral value with a potential to appreciate in the medium to long-term. The lending norms have varied across geographies and asset classes, pricing and terms influenced by capital allocation norms apart from other risk parameters. Real estate credit is here to stay, and the economy must learn to stay alert to the vicissitudes of the real estate market and ensure reasonable levels of credit allocation.

In Qatar, the real boost in organized real estate market was witnessed around the 2006 Asian Games, and since then it has been growing steadily. In addition, winning of the FIFA bid for hosting football games in 2022 provided a significant fillip to the real estate development market. This rapid growth in real estate required huge borrowing in the form of bank funding raising the overall exposure of banks to this sector.

In this thought piece, we have tried to analyze Qatar's banking system against key parameters and set out several aspects including the proportion of real estate credit compared to total bank credit; asset quality standards, performance of the real estate market, real estate valuations, credit risk survey on real estate developers and contractors and economic impact of COVID-19.

Parameters with positive implications on the banking sector

Reasonable real estate credit to total credit

Qatar's economy is unique and is not comparable to developed/diversified economies. However, compared to its regional counterparts i.e. UAE, Oman and Bahrain which possess similar characteristics, we find that the proportion of real estate credit to total credit is lower. Qatar's real estate to total credit ratio was hovering around 16% on an average between 2015 and 2018 and reduced to 14.2% in 2019. (Table 1)

Table 1: Real estate credit as a % of total credit

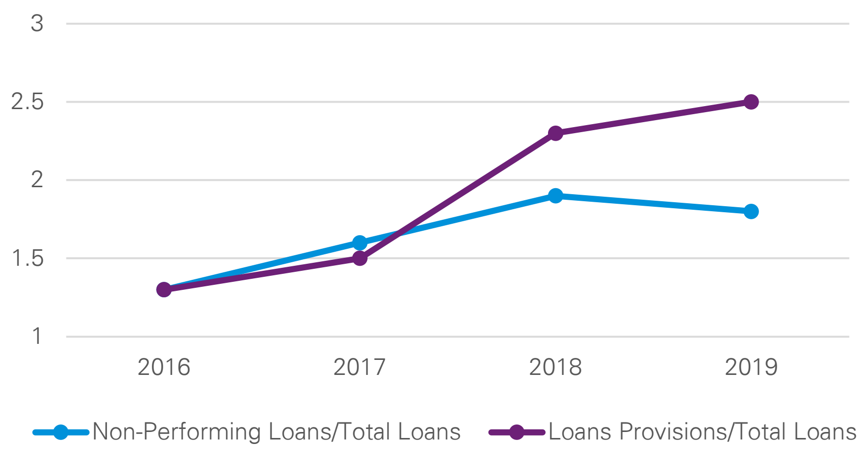
	2016*	2017	2018	2019*
Qatar	15.5%	16.2%	16.0%	14.2%
Oman	32.0%	30.0%	32.0%	n.a.
UAE	16.4%	19.9%	21.0%	17.6%
Bahrain*	22.2%	23.6%	25.2%	25.3%

Note: *Real estate credit does not include construction credit except for Bahrain*
**For Bahrain. Data is available till June 2019; 2016 & 2017 data is for the month of Sep.*
****For Bahrain. Available data is not segregated between real estate and construction*
Source: Central Bank's Financial Stability Reports & Statistical Bulletin of respective countries

Well managed asset quality standards

Over the past 3 years, NPL ratio has grown by 38%, reaching 1.8% in 2019 however they are well maintained below the level of 2% in comparison to the global average hovering around 6-7%. Further to ensure safety, banks have also made provisions to manage the risk. Looking at the provisioning trends, the loans provision ratio had mirrored the NPL ratio, however we witnessed that provisions were 1.4 times of the NPL in 2019, owing to changes in accounting standards over past 2 years. (Refer Chart 1)

Chart 1: Asset quality standard: Qatar Bank's performance



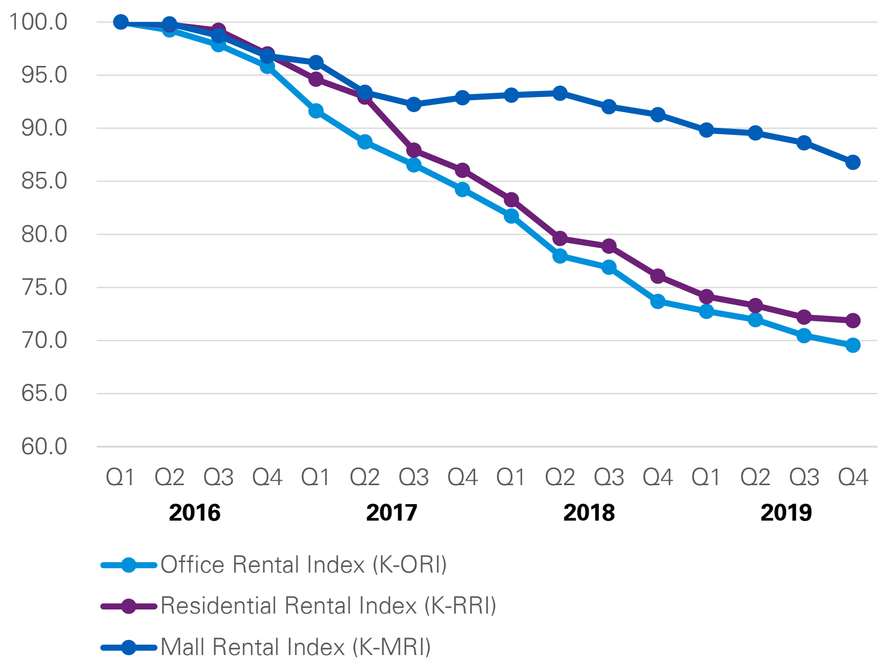
Parameters with adverse implications on Banking sector

Concerning real estate market trends

Firstly, Qatar's real estate market is mainly rental dominated due to the presence of a large expatriate population. Owing to a few recent regulatory relaxations, several new locations are announced as "freehold properties" that may bring some fundamental changes. However, as of now, the market remains subdued with most of the asset classes facing over-supply situations.

Secondly, real estate rentals in all investment-grade properties have fallen. The real estate index declined 30 points over the past 3 years in the commercial and residential asset classes. Organized retail (malls) witnessed a smaller drop of 14 points during the same period. We believe that the real estate market in Qatar is slowly entering a stabilization mode with affordability being a prime theme across asset categories. This rising affordability coupled with business-friendly government initiatives can help strengthen demand in the market. (Refer Chart 2)

Chart 2: KPMG Real estate rental index 2016-2019



Source: KPMG Qatar Real Estate Index

Descending real estate valuation levels

Valuation of real estate properties are also under stress. Both declining rentals and over-supply pressures are not working in their favor. Also, highly optimistic market assumptions have led to high valuations in the past, which are witnessing corrections. It will be difficult to estimate an average drop in valuations. However, we have witnessed properties where the value has declined as high as 45% over a 2-3 year period.

Credit Analysis (default from RE developers & contractors)

QCB's credit risk survey with banks reveal that any credit to real estate developers and contractors was identified with a very high risk level in 2018 and 2019. Given the current market conditions, it would remain high in the coming few years.

Economic impacts due to COVID-19

Like most countries, Qatar has also witnessed partial business closure since mid-March 2019. This will have considerable impact on industrial and service productivity along with possible loss of skilled manpower. If the closure is prolonged, the real estate segment mainly tourism, hospitality and retail will be highly impacted. Banks with high debt exposure to these asset classes may need to consider impact on provisions from expected defaults.

Possible measures to manage

Real estate is a long-term business proposition and hence policies developed around it should also maintain a long-term perspective. Credit allocation is one such area that calls for a long-term view. Although Qatar's credit allocation to real estate seems reasonable compared to regional peers, it is still material and demands strict vigilance on an ongoing basis. Further, banks should also ensure that borrowers have enough equity in the asset. One way to ensure the same is by ensuring a diligent review of the property valuations, that form the basis of real estate credit.

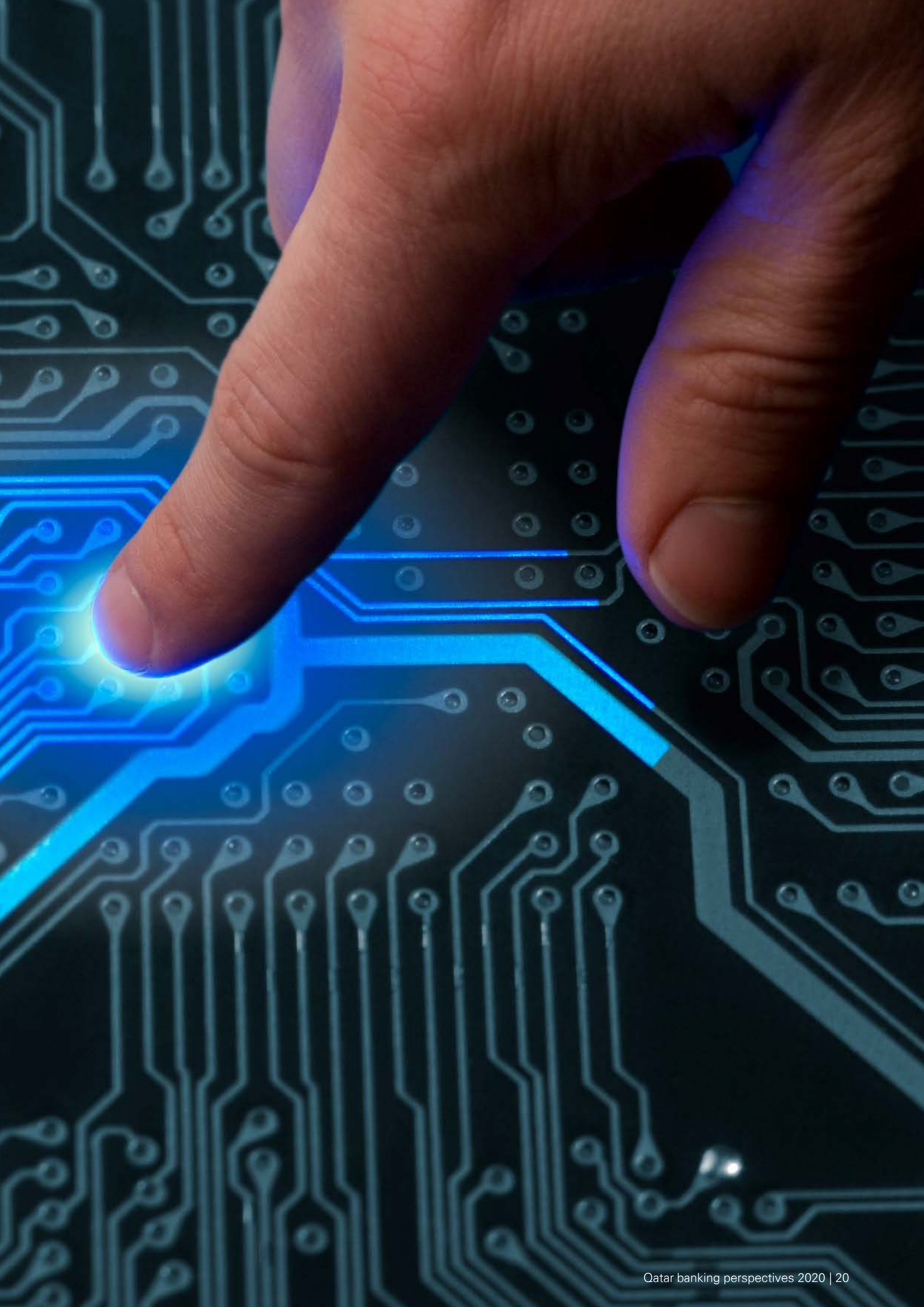
Some efforts are required from the Government as well to ensure a healthy banking system in Qatar.

These measures would include the allocation of sufficient funds for non-real estate business activities such as manufacturing, services, the export sector, SMEs, etc. that create high productivity and wage growth propelling economic growth. Additionally, measures such as the creation of a depositor protection framework in the form of a deposit insurance scheme can also be expedited. This would help to send a signal to the market that Qatar would be moving towards a market mechanism for the banking industry and in case of default, the Government may not provide full support to all commercial banks.

Anurag Gupta
Real Estate and Valuations Lead

Anurag heads the real estate and valuations advisory practice for KPMG in Qatar. With 17 years of experience, he has become a seasoned real estate professional and has assisted many clients in taking strategic decisions on their real estate ventures. He has been involved in various projects including business plan and strategy, financial modeling, feasibility studies, highest and best use studies across India, Bahrain & Qatar.

II. Technology & innovation



II. Technology & innovation

i. Hitting the Digital fast-forward button

If there was one clear post-COVID19 winner to be designated, it would certainly be the Digital Transformation agenda, as it has thrived in the midst of the crisis and will seize the opportunity to disrupt the banking sector in the coming years.

For the last few years, banks in Qatar have been embracing digital trends to achieve operational and cost efficiencies, align with changes in regulations and policies and adapt to the shifting behaviors of their customers.

Although these "classical" drivers have helped banks boost their digital maturity levels, it seems now obvious that nothing will hack the digital agenda in the coming years more than the COVID-19 pandemic and its subsequent impact on customer expectations, banking channels and ways of working.

> **"Nearly every major bank in Qatar offers an internet and mobile banking solution. Customer behaviors are rapidly shifting towards a need for more connectivity, self-service and device-agnostic digital channels."**

Shifting customer priorities

Even before the COVID-19 outbreak, 96% of businesses in Qatar ranked customer centricity and enhanced experience as a business priority for 2020. The banking sector is no exception to this trend as customer behaviors are rapidly shifting towards a need for more connectivity and self-service, device-agnostic digital channels.

In fact, nearly every major bank in Qatar offers an internet and mobile banking solution in addition to their existing "brick and mortar" services. However, the adoption of such channels has been relatively slow and limited to passive interactions such as balance consultation.

Today however, after COVID-19 response measures have been implemented by authorities, digital channels have seen a surge in the number of users, resulting in a higher number of transactions being performed through these new touchpoints.

Services such as mobile payment, credit card apps, online loan applications and mobile money transfers are replacing physical interactions between the banks and their customers and rapidly raising digital banking adoption among Qatar's population.

And with this surge comes a number of questions that banks need to address:

— How can we review and prioritize customer journeys and customer experiences to leverage the current momentum and make this shift to digital platforms sustainable?

— How can we implement a "connected enterprise" model and create a cross-businesses, cross-functions, back-to-front office consensus about customer understanding and customer-centricity?

— How can we effectively move from a multi-channel approach – that multiplies the number of touchpoints, confuses customers and increases costs – to an "opti-channel" strategy that offers more transparency and targets the right medium for the right service to the right customer.

In the long run, we believe that institutions who will effectively tackle these key questions will reap the rewards of cost effectiveness and business growth through customer retention & acquisition in a highly competitive banking market.

Leveraging the power of data

With the digital switch turned on for the banking sector, the need for managing big data and analytics becomes more critical.

Banks are indeed rapidly moving from a "one-size fits all" model where they traditionally sell products to all customers regardless of relevance or preference, to a model where customer data is intensively harvested to customize services for the needs and preferences of every customer persona.

And while business intelligence and big data solutions are now widely implemented in the banking sector, new technologies such as Intelligent Automation (IA), Artificial Intelligence (AI) and blockchain are yet to be democratized in the market in order to take full advantage of the enormous volumes of data the banks are accessing today.

Here again, COVID-19 has opened the doors for exploring use-cases to drive customer satisfaction (e.g. leveraging AI-enabled chatbots to manage customer requests regarding opening hours, closed agencies and other pandemic related questions) and generate cost and operational effectiveness (e.g. launching IA and robotics proof of concept to automate customer onboarding or KYC processes).

But we believe the best part is yet to come with more ambitious use-cases to consider such as loan application processing automation through real-time AI-based credit risk scoring engines or intelligent fund transfer pricing algorithms that use machine learning to provide decision-making support to ALCOs (Asset-Liability Committee).

As a matter of fact, in his recent announcement regarding the launch of Qatar's Fintech Hub, H.E. Sheikh Abdullah bin Saoud Al Thani, Governor of Qatar Central Bank (QCB), has stressed the turning point that we are heading to in the coming years with the significant influence that AI and blockchain will have on the digital transformation of the banking sector.

Towards the Fintech era

We can safely conclude from above that there will be a clear paradigm shift operating in the banking sector in the coming decade. Digital trends are indeed disrupting customer experience, challenging traditional service delivery models and rapidly improving cost and operational efficiency. These are all factors that will encourage the creation of a Fintech ecosystem to drive the digitization of the banking sector even further and faster.

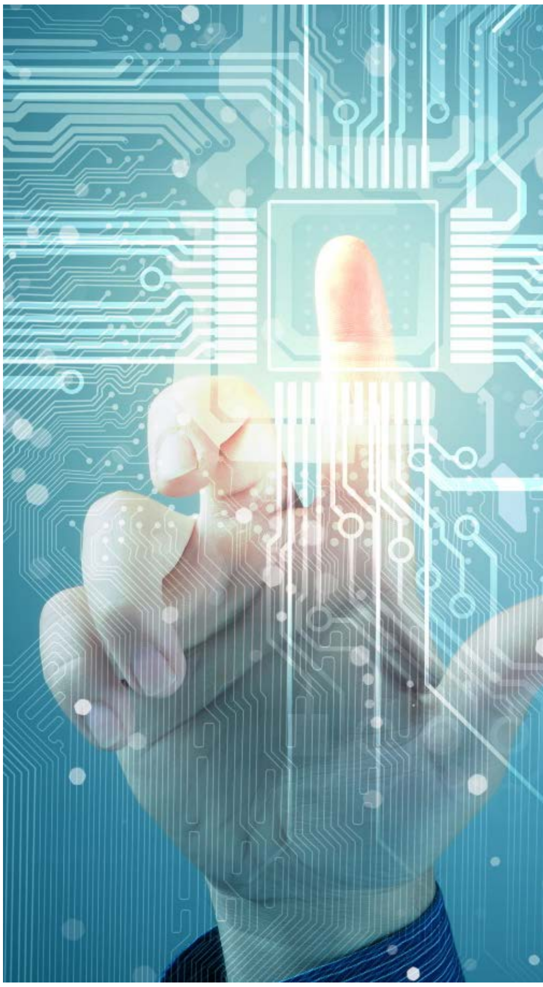
With the creation of the Qatar Fintech Hub and the finalization of the strategy and regulatory framework that will support its deployment, innovative initiatives will thrive in the coming years. Other developments such as the implementation of a Microsoft cloud hub in Qatar will accelerate such initiatives by providing them with the infrastructure needed to launch their services quickly and in a cost-effective manner.

By "starting" digital, these challengers will not face the same difficulties that existing banks are facing today in terms of costs and legacy-related complexity to "become" digital. They will be able to explore the Digital-only banking models and develop open-banking platforms with APIs that connect banking services to insurance providers, real estate companies, retailers and other service providers to create the connected, digital and customer-focused banking ecosystem of tomorrow.

The question then for traditional banks would be to internally accelerate their investment in digital transformation to remain competitive, or to consider acquisition or partnerships as an external acceleration catalyst and a means of synergy creation.

Mohamed-Chakib Ouabi
Digital & Innovation Advisory

Chakib is a market-facing manager within KPMG's Management Consulting Advisory practice. He has more than 7 years of experience working with banking groups, insurance companies, asset servicers and other corporate market clients on technology-enabled and regulatory-driven projects. Currently, Chakib is leading the Digital Transformation offerings in KPMG Qatar, as part of our broader Digital and Innovation practice.



II. Technology & innovation

ii. Can banks dismiss new Fintech contenders?

The banking sector in Qatar needs to ride the technology wave and embrace new Fintech strategies that can help them enhance their overall customer experience, increase process efficiencies and comply with the ever-changing regulations.

The Fintech term, which stands for Financial Technology, has become popular in the recent years, with the advent of internet banking, mobile banking and the new means of digital payments and e-wallets. Fintech has come a long way in the recent years, thanks to the new technology developments and healthy VC (Venture Capitalist) appetite.

The Fintech sector has grown to become a true disruptive force. Today, the influence of Fintech can be felt in the banking sector and capital markets. Fintech has a huge impact on customer expectations, operational efficiencies, banking market structure, banking strategies and their financial stability.

> **The Fintech sector has grown to become a true disruptive force having a huge impact on customer expectations, operational efficiencies, market structure, banking strategies and their financial stability."**

Fintech is affecting all banking functions, such as front-, middle- and back-office functions by introducing new and different technologies to enhance customer experience, complying and responding to regulatory change, introducing new payments and digital delivery models, providing faster service delivery and more cost effective, and improving efficiencies in back-office functions. Banks with their traditional business models, legacy systems and process inefficiencies are now challenged not only by the advent of Fintech companies, but also by new disruptive entrants to the market: Technology companies, Telcos, global retailers and postal service companies, who are benefitting from technology developments and regulatory changes that are allowing them to provide financial services. Banks can no longer dismiss those new contenders nor remain oblivious to the rapid changes happening around them in the Fintech world. They need to ride the wave and embrace new Fintech strategies that can help them enhance their overall customer experience, increase process efficiencies and comply with the ever-changing regulations.

Banks need to evolve to stay competitive. They need to change their operating model, revenue/cost model, enhance efficiencies, look for synergies, become more agile and most importantly fully focus on their source of revenue: the customer (retail, corporate and private customers). With all these changes and challenges, Banks still have two main advantages to capitalize on in their battle against their new competitors:

1. They already have the customers and need to keep them, rather than acquire them.
2. Banks have the financial means to invest in re-inventing themselves to stay ahead of competition.

Banks should embrace a customer centric approach throughout their processes and different layers. Fintech can help banks improve their customers' experience by enhancing their customer identification and online conversations with intelligent means. This means using biometrics for identifying customers (facial recognition, voice recognition) and looking at language patterns in recognition and working towards developing a conversational Artificial Intelligence (AI) model that can interact with the customers and help them to reach their financial goals.

Currently many corporations, including banks, have AI enabled chatbots to help their customers with a variety of tasks 24/7. This provides customers with convenience and flexibility that they have grown to expect these days. Customers, especially millennials, are becoming increasingly comfortable conversing with chatbots. This has led Fintech firms to invest in customizing and personalizing the online experience for each customer and has led to the creation of the hyper-personalization pattern of AI, where individuals are treated as unique individuals, rather than members of some group or bucket of broad category of classifications. The use cases being addressed include personalized content, personalized advice or guidance, behavioral profiling and providing recommendations. AI is now starting to allow corporations to provide more personalized offerings depending on where customers live, social status, age, gender, race, nationality, risk appetite, spending patterns and behavior. Fintech solutions can broaden banking offerings, make their operations more effective and efficient, and offer greater value to their growing customer base, such as: better assess the creditworthiness of loan applicants when an institution screens them, and improve the interface between the customers and their banks, provide more personalized offerings, automatic monitoring, fraud detection and fraud prevention as well as improve various back office operations using Robotic Process Automation (RPA).

Most global banks are either partnering with Fintech companies or investing in Fintech companies. However, in the Middle East and in Qatar, banks are still at early Fintech adoption stages. Banks in the Middle East are thinking of Fintech as technologies to help them streamline their processes and engage with their customers. For the most part, the focus has been on providing omni-channel/seamless customer experience, address regulatory requirements and automate back-office processes. Banks in Qatar still do not feel the disruptive nature of Fintech, as only few e-wallet and electronic payment companies have been active in the market.

However, with Qatar Central Bank's establishment of the Fintech section, Fintech Regulatory Sandbox and the launch of Qatar FinTech Hub (QFTH); the Fintech scene in Qatar is expected to grow rapidly and to start disrupting the banking sector. The expected introduction of key Fintech regulations will further facilitate the buildup of the digital banking ecosystem.

Local banks need to make the prudent decision to collaborate with Fintech firms rather than see them as a threat and trying to fight them off. The sooner banks can see Fintech firms as their ally rather than competition, the sooner they will be able to confidently embark on the banking of the future journey together. Otherwise, traditional banks risk losing their customers and current market position to the new agile, efficient and creative competitors.

Suhail Shaker
Digital & Innovation Advisory

Suhail has over 25 years of experience in consulting and technology delivery. He is a specialist in delivering large scale complex IT implementation projects.

II. Technology & innovation

iii. Any phishing vaccine for infected banks?

Talking about banking institutions in Qatar means talking about one of the most mature sectors when it comes to cybersecurity. Saying this does not mean that the banks are secure enough. Amer Bazerbachi describes how banks are being exposed during this COVID-19 situation and how to reduce the probability of getting compromised.

Banks in Qatar are considered to be at the forefront of all businesses in terms of e-Services. These online banking services are essential during these times. However, the banking industry is one of the top targeted industries in Qatar. Based on previously conducted studies, it is confirmed that the most common online banking incidents are a result of malicious techniques such as hoax emails, computer viruses, spyware, email scams, identity theft, phishing, vishing, and eavesdropping through wireless connections.

> **"Banks in Qatar are starting to invest in employee awareness and client awareness regarding cybersecurity as well as investing in artificial intelligence-powered protection solutions to filter malware and phishing threats."**

These techniques are commonly grouped and incorrectly referred to as "Phishing", when they should be referred to as "Fraud Techniques". Fraud techniques are any malicious methods and activities that seek to steal personal or business information and used to perform financial transactions (including the sale of confidential and secret information). These fraud techniques require human interaction and errors to succeed.

Qatar Awareness Strategy

The nature of these incidents makes banks realize that cybersecurity is no longer a "technology problem" that can be addressed with a "technology only" approach. Rather, it is a broader challenge that requires proper "Processes" to be in place and, the most critical point, "People" management, awareness and training. Banks realize that the cybersecurity strategies and investments cannot succeed without the right people's support and cooperation, hand-in-hand with clear and aligned support from the management.

More progressive banks recognize that "People" are no longer a secondary actor in cybersecurity, but they are becoming the main one. These banks ensure that their people are well trained and aware of all the cybersecurity risks, threats, and actors that exploit specific vulnerabilities. Chief Information Security Officers (CISOs) have generally reoriented themselves from just focusing-on-technology to being fully cognizant of the employees' vital role in cybersecurity.

Employees' awareness is being directly linked to the bank's security strategy and business risks, making it easier to justify the necessary level of investment in this area. In addition to this, banks are moving forward and taking care of another crucial actor that is out of their control: the client. Banks in Qatar are starting to invest in conducting awareness campaigns for their clients and are providing awareness from sending SMS and emails to displaying awareness campaigns using their online banking apps or websites.

What is the difference between a compromised employee and a compromised client? The main difference is the impact that these actors can have on the bank:

— A compromised client will have an impact on his own account as he only has access to this account. This incident does not compromise the bank's assets or reputation.

— A compromised employee may have a catastrophic impact on the bank's assets. The dimension of this impact will be determined by the employee's role, responsibilities, the level of access he has, and the controls in place.

How is the banking industry in Qatar targeted and fighting back?

During this pandemic, financial institutions in Qatar are being attacked through both existing methods: general and specific phishing campaigns. General phishing attacks are typically caused by script kiddies profiles (persons who use existing computer scripts or codes to phish as they lack the expertise to write their own). In contrast, specific phishing attacks are more sophisticated and are carried out by hacking groups targeting banks themselves instead of individual customers, thereby potentially gaining a more considerable windfall.

These hackers, kiddies or sophisticated, are using the overwhelming amount of news coverage surrounding the novel coronavirus as well as the eagerness that people have to get more information related to the virus, to send phishing emails related to the topic. This situation makes the employees and clients more susceptive to the hacker's trap, making the COVID-19 virus not only a real-life illness that can affect the client's and employee's health, but also a virtual virus that can affect their economic health.

Google says they observed more than 18 million daily malware and phishing emails related to COVID-19 scams during the first week of May 2020. This number is excluding the over 240 million daily spam messages they observe related to the novel coronavirus. Statistics show that more than 20% of these messages are targeting financial institutions.

Banks in Qatar are starting to invest in artificial intelligence-powered protections to filter such malware and phishing threats. These AI-based technologies are used by Google, who claim that they can block "more than 99.9 percent of spam, phishing, and malware from ending up in user's inboxes", but still cannot stop all of them. Other banks rely on the DMARC protocol (Domain-based Message Authentication, Reporting, and Conformance) to make it more difficult for scammers to impersonate individuals or institutions, but with less claimed effectiveness. Finally, there is a last group of banks that only rely on their secure email gateways which have proved to be ineffective many times in the past. The banking sector in Qatar admits that there is still much development to be done in this field.

While in real-life social distancing seems to be the only solution to preventing the COVID-19 spread until a vaccine is developed and released, awareness campaigns are the only solution to blocking phishing attempts until a new and more effective technology solution can be developed.

Amer Bazerbachi
Cybersecurity Services Lead

Amer Bazerbachi leads the Cybersecurity Services consulting practice for KPMG in Qatar. In his more than 18 years of cybersecurity program leadership experience, he has worked across Europe and the Middle East for global Cybersecurity Services firms and clients helping organizations from many different sectors such as Banking, Government, Media, Telecom, Aviation and HR Service Providers.

III. Risk & regulatory

III. Risk & regulatory

i. Navigating through tax and transfer pricing regulations

Tax and transfer pricing related regulations will have a significant impact on the Banking and Financial Services sector, given the high volume of day-to-day related party transactions, inter-dependencies between entities for various product offerings and integrated functions for corporate finance services, all coming under scrutiny.

Worldwide, the revenue authorities are addressing the globalization and digitalization of businesses by expanding tax legislation and introducing new tax concepts for related party transactions aimed at curbing avoidance of taxes and increasing transparency.

In line with this global development, Qatar introduced several measures to administer fair taxation and strengthen the exchange of information and tax transparency in the last couple of years, thereby fully committing to the implementation of the Organization for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) measures.

> **"Qatar introduced several measures to administer fair taxation and strengthen the exchange of information and tax transparency in the last couple of years, thereby fully committing to the implementation of the OECD's BEPS measures".**

The State of Qatar also introduced a new Income Tax Law (Law No 24 of 2018) followed by the new Executive Regulations (the new ER), which brought in a range of substantive changes such as determination of taxable income, application of withholding tax, conditions of claiming tax exemptions. The new ER also introduced explicit Transfer Pricing Reporting requirements and thin capitalization regulations.

Introduction of BEPS actions in Qatar

In 2017, Qatar signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, the CRS Multilateral Competent Authority Agreement (CRS MCAA) as well as the Multilateral Competent Authority Agreement for Country-by-Country Reporting (CbC MCAA).

Effective for financial years starting after 1 January 2018, Ultimate Parent Entities of multinational enterprises ("MNE"), which are resident in Qatar are obliged to report extensive information on intercompany transactions, provided that the total revenue of the MNE group reaches or exceeds a threshold of QAR 3 billion (approx. EUR 700 million or USD 824 million) based on consolidated financial statements.

However, as expected the introduction of these CbC Reporting requirements turned out to be the first step towards the introduction of broader Transfer Pricing Requirements.

Transfer Pricing Requirements under the new ER

The introduction of Transfer Pricing (TP) requirements, re-affirms the need to adhere to the arm's-length principle outlining specific compliance requirements, which was already outlined in the previous law and leads to increased reporting and documentation requirements such as:

- Determination of the price of transactions between related entities in accordance with the arm's length principle at the time of a specific transaction, and in any case no later than the time of submitting a Transfer Pricing declaration together with the annual tax return.
- Performance of a detailed functional analysis at the time of preparation of the tax returns. A search for comparable transactions/operations can be conducted once in three years, however it is expected that the financial data of the comparable operations be updated annually.
- Submission of transfer pricing declaration with the annual tax return, if the amount of total revenues or assets meet or exceed the thresholds determined by the General Tax Authority (the GTA).

For the purpose of applying the Qatar TP regulations, the term related entity shall mean any entity deemed as such under international accounting standards. Thus, effectively transactions reported as related party transactions under the financial statements would inevitably be covered under the TP regulations.

Master file and local file filing requirements have also been introduced. The respective requirements will be effective for the tax year beginning on or after the effective date to be determined by the GTA. The master file and local file requirements shall be applicable to entities meeting or exceeding a total revenues or assets threshold. This threshold will have to be determined by the GTA as well.

Even if mainly applicable of international transactions between related parties, the above-mentioned requirements shall also apply to transactions between any entity residing in the state and another entity not associated, if

— one of the two entities benefit from a preferential tax system

— the other entity resides in one of the non-cooperating countries or territories. The state or territory is considered as non-cooperative if no agreement that permits the exchange of information for tax purposes has been signed with the State of Qatar

The introduction of transfer pricing regulations will have a significant impact on the Banking and Financial Services sector, with the high volume of day-to-day related party transactions, inter-dependencies between entities for various product offerings and integrated functions for corporate finance services, all coming under scrutiny.

Banks and Financial Institutions will have to document the basis of pricing for each of the inter-bank transactions, identify similar transactions with non-related parties and measure the degree of comparability as against reasons for deviations, if any. For complex services and transactions, the contribution of each member entity will have to be analyzed and evaluated in line with transfer pricing principles.

The table below provides some examples of typical transactions in Banking and Financial Services, the basis and OECD prescribed method of determination of Arm's Length Pricing (ALP):

Nature of transaction	Common basis of determination of ALP
Purchase/sale of G-Secs, T-Bills, bonds, foreign currency, etc.	ALP is determined using Comparable Uncontrolled Price (CUP) method (internal or external). Rates of similar transactions entered by the taxpayer with third party banks, during similar time frame for similar terms are identified and compared. In some cases, external CUPs or market rates would be identified and compared (e.g. market price for derivatives, LIBOR, MIBOR, etc.)*
Interest rates derivatives	
Bank charges	
Placements, overnight borrowings	
Corporate finance and investment banking deals	Given the integrated nature of the services and functions performed typically by various teams spread across jurisdictions, the taxable revenue or profits cannot be simply determined using other transactions. Detailed contribution analysis should be undertaken (using Profit Split Method)
Global loans	
Services like back office processing	Since in most cases the entities providing these types of services act as captive service providers, it is difficult to determine direct pricing comparables. In such cases, the net margins of the entities are tested as against the performance of entities providing similar services.
Marketing of financial products	
Investment advisory	
Management fees and cost allocations	The reasonableness of common cross charges is determined based on the reasonableness of the underlying elements of costs being allocated and allocation keys being used.

*The anticipated end of the London Interbank Offered Rate (LIBOR), which is not guaranteed to be published after 2021, represents a momentous transition for the world's financial markets. This will have an impact in various intercompany financial instruments, particularly debt, which will have to be taken into consideration.

Thin capitalization provision

Besides the TP requirements, the new ER have introduced thin capitalization provisions whereby interest on the loans to related parties are restricted to the extent of loan amounts that do not exceed three times the ownership rights. The ER also requires that the loan must be necessary for the purpose of taxpayer's business.

Impact of COVID-19

With the likelihood of transfer pricing regulation to be first applied for the years 2019-2020, the impact of COVID-19 will have to be taken into consideration in the first year of analysis itself, the COVID-19 crisis has made it evident that groups will have to reconsider the existing pricing policies and benchmarking analysis. Taxpayers using internal comparable third-party prices (CUPs) may still be able to use the said comparable as one may assume the impact of COVID-19 would have been similar in both related party and third-party pricing. For external CUPs, only the data which is being updated regularly and available for the same period could still be used, e.g. market data on interest rates, derivative rates available on platforms such as Bloomberg or Thompson Reuters used to benchmark financial transactions.

For any other pricing analysis or mark-up/margin analysis, where typically data pertaining to previous years is used, cannot be directly considered to be comparable for the purpose of benchmarking 2020 results or prices. In such cases the benchmarking analysis will have to be reviewed and appropriate adjustments will have to be made. Use of alternate methods, such as profit split method will have to be explored. Review of supply chains and existing pricing policies should be done keeping in perspective short, medium and long term objectives.

Immediate action required

The rapidly changing tax landscape in Qatar and the adoption of many of OECD's BEPS initiatives (including the multilateral instrument, country-by-country reporting and the common reporting standard) has made the life of a tax practitioner increasingly complex. While the detailed TP guidelines are awaited and the approach to be adopted by the GTA is yet to be seen; it is highly recommended to take immediate actions keeping a perspective of the challenges.

It is extremely important to work out a detailed plan to develop the anticipated TP documentation, identify the related party transactions, analyze the availability of comparable data to establish the pricing of the related party transactions is at arm's length. The process should involve establishing clear responsibilities and lines of communication among the relevant stakeholders, such as tax, accounting, finance, treasury, and legal teams. It is evident that early identification of corrective actions, if any, to be taken and pricing policies to be amended, will go a long way.

Barbara Henzen
Head of Tax

Barbara leads our tax practice in Qatar. She has more than 20 years of experience in international and national tax law with a focus on indirect tax law, delivering and managing indirect tax projects for multinational clients, as well as tax litigation.

III. Risk & regulatory

ii. Handling the LIBOR transition

The transition from LIBOR to alternative overnight risk-free rates (RFRs) will likely trigger an upheaval within financial institutions worldwide. Due to its ubiquitous nature, transitioning from LIBOR to alternative reference rates will require careful considerations to limit adverse impacts on profitability, customer relations and reputation of financial institutions.

London Interbank Offered Rates (LIBOR) plays a key role in the financial markets and underpins trillions of dollars in financial products. However, regulators globally have signaled that firms should transition away from LIBOR to alternative overnight RFRs (Risk-Free Rates) before December 2021. Financial institutions, industry working groups, and regulators around the globe are now working against the clock to manage and implement this almost inevitable transition.

> **"LIBOR has always played a key role in financial markets and underpin trillions of dollars in financial products. However, regulators globally have signaled that firms should transition away from LIBOR to alternative overnight Risk Free Rates before December 2021".**

LIBOR's decommissioning may affect and pose risks to most business and support functions of financial institutions. To put the magnitude of the change in context, it is estimated that nearly USD 400 trillion worth of contracts are linked to LIBOR across the spectrum of financial instruments. RFRs have been designed to overcome the pitfalls of LIBOR, from minimizing reliance on expert judgment and ensuring a better reflection of the risk-free rate, to avoiding certain past LIBOR rate-related malpractice or misdemeanors.

LIBOR currently supports a vast range of financial products and valuations across multiple jurisdictions — from loans, mortgages and leases to bonds and securitizations, derivatives and more. In Qatar, it is estimated that about one-quarter of all financial products in banks reference LIBOR. A large GCC Bank recently noted in its annual report that approximately one-third of its contracts reference LIBOR. Global regulators have indicated that the current construct underpinning LIBOR is likely to be unsustainable and a potential threat to global financial stability. Across the GCC, regulators are preparing for the transition away from LIBOR. In January 2020, the Central Bank of Bahrain released a "Dear CEO" letter requesting Banks to identify their exposures and develop an implementation roadmap for new RFRs. Other GCC regulators are also establishing working groups to discuss the challenges. It is unclear yet how regulators will deal with regional IBORs, such as in Qatar (QIBOR), Emirates (EIBOR), Saudi Arabia (SAIBOR) and Bahrain (BHIBOR).

What Should Banks do next?

On an international level, Banks may find it challenging to navigate a largely uncertain environment and the transition's potential impact on their products, infrastructure, services, customers and reputation. This creates an imperative need to identify individual LIBOR-based references, decipher problematic legal language, and develop a solution on time. Navigating the IT changes to major applications alone could take several months. Beyond internal preparation for the transition and, how effectively they communicate those changes to the market could be critical.

Given their exposure to LIBOR based products, Banks in Europe and the US could be leading with the implementation of their transition programs. Banks in the Qatar could therefore leverage the approach taken by their international counterparts. The transition path is expected to be similar across jurisdictions and has three initial steps.

First, an internal working group could be established that includes key stakeholders across the bank. Working groups in most banks are being championed by either the Finance or Treasury function, and may include representatives from Risk, Legal, Operations, and IT, as well as customer-facing business lines such as Retail and Corporate. Most banks have formed a separate internal project management office (PMO) to help coordinate the project with internal and external stakeholders.

Second, banks can plan to undertake an initial impact assessment to identify where LIBOR exposures may exist on the balance sheet, irrespective of their size. This could be segmented in different ways (by geography, product and customer for example), and could extend to trading book activities that reference LIBOR.

In addition to the contracting and customer impact, banks may also have references to LIBOR in other non-customer facing activities such as procurement contracts, models, accounting processes and templates which are required to be identified and included in the change program. For example, banks will need to consider changes with respect to their trading books on instruments that reference LIBOR. Another consideration is how accounting teams will contend with the significant potential effect of LIBOR reform on both internal and external financial reporting.

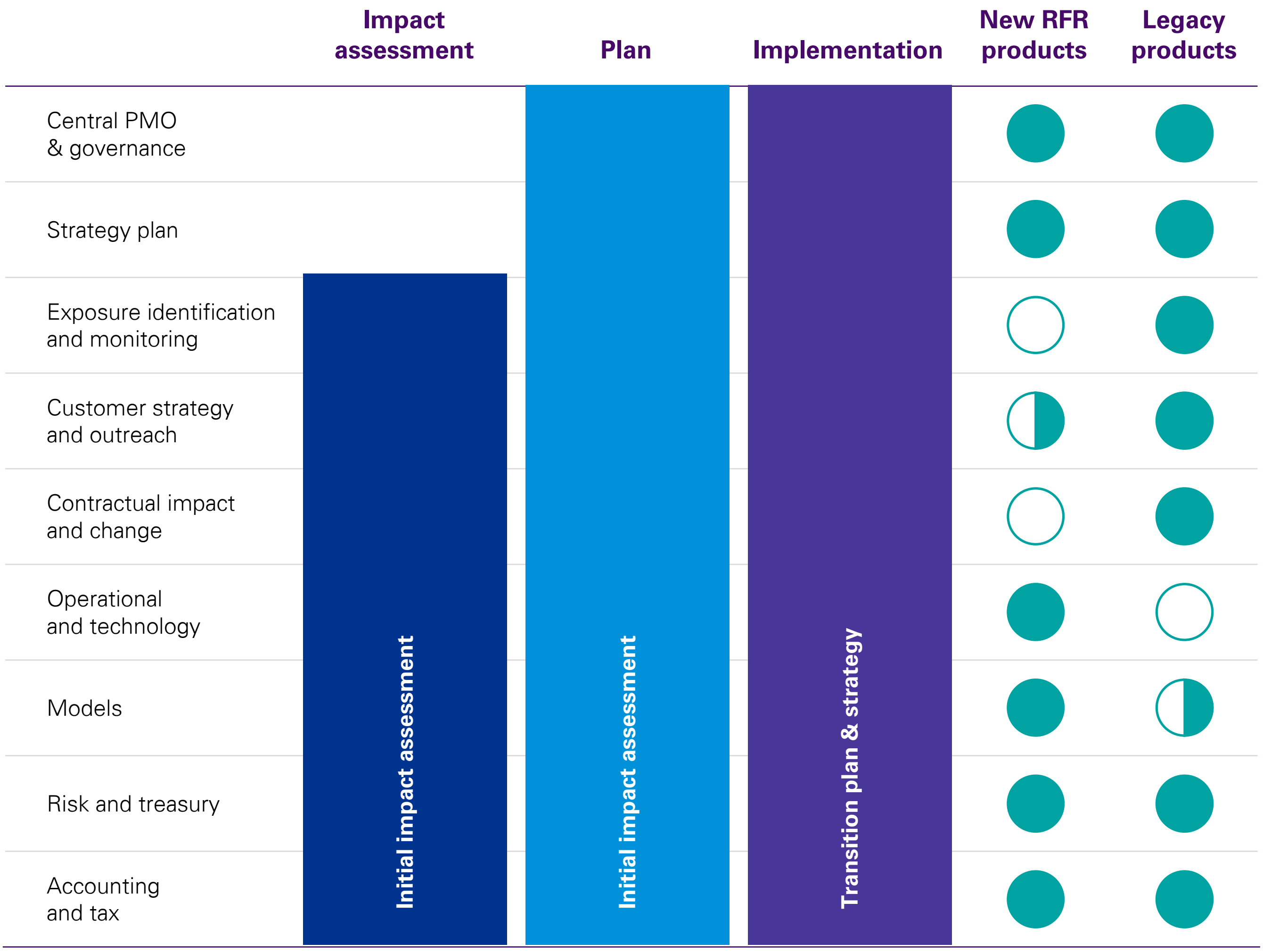
Third, after all impacts have been identified, banks could develop a transition roadmap that articulates how and when these impacts will be managed.

A framework for Banks

Before offering non-LIBOR rates to customers, banks are likely to first develop capabilities to be able to transact and book in the new RFRs. Beyond identifying LIBOR exposures, banks could focus on developing their customer communication strategy, consider how they will amend customer contracts, and identify all internal processes that reference LIBOR. All this needs to be completed before the fast-approaching December 2021 deadline.

Automation as a solution to the LIBOR challenge likely promises ongoing business benefits and advantages that go beyond identifying contracts and required changes. Digital capabilities unlocked by a smart LIBOR solution is likely to enable financial institutions to access the applicability of Artificial Intelligence (AI) in key areas such as risk management, compliance, operational resilience and more.

LIBOR transition framework - Phases



Time is running out

Experience tells us that we are not generally seeing what is considered an appropriate sense of urgency in the global banking sector, despite the formidable task ahead and its tight timeline. In the UK, for example, financial regulators recently noted their surprise over the "very different states of readiness for dealing with the transition and associated risks demonstrated by plans submitted." They also urged banks not to take a "wait-and-see" approach.

However, sector players are not entirely to blame for allegedly being slow off the mark on this complex journey. They can unfortunately face troubling circumstances given the number of dependencies associated with the transition, the necessity of clarifying guidance from standard setters, and the need for potential intervention from both regulators and legislative bodies to address significant hurdles. Nevertheless, banks should not further delay in taking actions since there is no time to lose. Tapping into AI is likely to give organizations a fast and reliable solution to today's and tomorrow's business challenges.

Shubhadip Bhattacharya
Financial Risk Management Lead

Shubhadip leads the Financial Risk Management practice for KPMG Qatar and has more than 10 years of experience in credit model development, model validation, implementation and governance. He specializes in financial services industry with a primary focus on designing and implementing risk (market, credit, operational and liquidity) scoring and assessment frameworks.

IV. Governance & controls

IV. Governance & controls

i. Future of green and sustainable banking in Qatar

All crises create a natural opportunity to adapt to new trends especially if those are transforming the world economy globally, such as the sustainability trends in business.

The 2008 global financial crisis taught the banks a lesson that trust is built very slowly, however this trust can evaporate in seconds. The role of trust is essential especially in the banking sector where client trust forms the basis of the business.

Since 2008, several industries including the banking sector, were working hard to regain client trust and have come up with innovative solutions.

One way to regain trust is by becoming more transparent. Banks have been using Corporate Social Responsibility and Sustainability Reporting to share information on their social, economic and environmental impacts in order to increase transparency.

> **"Implementation of sustainability driven strategies will play an important role not just for several high-profile companies, which are the clients of banks, but it will be of high importance for banks themselves."**

There is one similarity in all global crises: they never resemble each other; they are never identical. The world has been preparing for a crisis of overproduction, but the COVID-19 pandemic created a supply and demand crisis. This crisis is also impacting the banking sector but at the same time it creates an opportunity to strengthen trust of customers by using the aforementioned tools.

Globally, several voluntary non-financial reporting standards are available such as the Global Reporting Initiative (GRI). The European Union has introduced a directive on non-financial reporting which has already been implemented by the nation states, and several other countries have obliged companies to disclose their social, economic and environmental impacts in one way or another. Combining the GRI with reporting on Sustainable Development Goals is a common practice applied by banks and together with a meaningful Stakeholder Impact Assessment can help banks to maintain sustainable success while contributing towards support of local communities.

In Qatar the Corporate Governance (CG) reporting of banks can serve as a good pillar for future non-financial reporting as the CG frameworks cover multiple aspects of the social impacts of banks. Economic impacts are also well monitored as a result of sound Internal Controls Over Financial Reporting (ICOFR) frameworks; thus the focus can be easily shifted towards measuring environmental impacts of the bank and integration of the three impacts in a meaningful report.

Another large-scale initiative that will define the future of banks is the introduction of the Green Banking concept which means promotion of environmentally friendly practices and reducing carbon footprints from banking activities. Green Banking will transform the banking market and the integration of environmental and social considerations into product design is only a matter of time.

The way banks will financially support initiatives will be very similar to what corporate sustainable investors and investment funds are doing today: banks will pick the right initiatives with the maximum economic, environmental and social benefits while having the lowest negative economic, environmental and social impact. These complex decisions require new methods of assessment and implementation of new data collection procedures focusing on obtaining the highest quality data in order to take sound decisions. Banks will have to transform their internal procedures and have to introduce new roles and responsibilities. Early birds will benefit significantly from this transformation.

Janka Karsai
Risk Advisory

Janka Karsai specializes in Governance, Risk & Compliance, ICOFR, Internal Audit and sustainability with 13 years of experience. She has extensive experience in delivering sustainability services and setting up non-financial reporting frameworks based on Global Reporting Initiative (GRI), and SDGs. At KPMG Janka is focusing on Corporate Governance, internal audit, compliance, risk management and ICOFR.

ii. Assessing the strength of corporate culture and conduct

With FIFA World Cup 2022 fast approaching, Qatar now re-adjusts its focus towards Vision 2030, all industries, including financial services, are expected to inculcate a sense of positive culture and conduct via stronger management frameworks that can reduce the risk of misconduct and protect the value of the brand.

Tone from the top and the regulators

Much has been done in recent years by the senior management of banks and banking regulators to enhance risk management frameworks and governance practices. Notwithstanding these measures, problems continue to occur which impact public trust in the sector and the reputations of previously esteemed institutions. Fines for compliance and conduct breaches have become almost the norm.

> **"Banks must consider including periodic culture related training and awareness sessions; disclosures of potential and actual conflicts; and periodic declaration of conformance with the policies, procedures and code of ethics."**

A theme running through each of the previous mishaps that have made it to the media is that at some level, employees in the institutions involved knew that their conduct was not befitting and was inappropriate. In some cases, the senior management and the board had knowledge of the matters and chose to turn a blind eye, arguably because the profits from operations were strong. In other cases, boards and senior management may not have been willfully negligent but should have exercised better oversight and monitoring of activities.

In almost all cases, the consequences have been extreme, with CEOs, other senior management and chairmen often removed from their roles, in addition to the monetary fines and other sanctions. But, in addition to this accountability impact, institutions have often paid for the shortcomings for many years after the events through large remediation projects and significant distraction of management time.

The Qatar context

This is a time of significant change in the banking industry in Qatar. With the Coronavirus pandemic affecting Qatar as much as any other country in the region, Qatar Central Bank has introduced banking reforms for the wellbeing of the economy and the general public which are expected to have an overarching impact on the recoverability of loans and advances in the long run. The Vision 2030 agenda along with the globally changing times requires many industries, including the financial services sector, to play a supporting role. Areas of focus include sovereign debt raising, project financing, home financing and private savings. There is also the threat and opportunity of digital disruption, which becomes increasingly important in the wake of social distancing which is expected to continue for some time in the future. We have seen a recent bank consolidation, and more could come to improve the Qatar banking sector's positioning to meet these challenges. Increasing competition, with banks in Qatar and the GCC can be one of the factors which drives poor conduct, as institutions and their employees feel the pressure to deliver results.

The backdrop of these industry challenges makes it a good time to consider the impact of culture and conduct in Qatar's banking industry. At the micro level, individual institutions can be better positioned to avoid costly and distracting incidents which damage the brand and reputation. At the macro level, the safety and soundness of the sector will be bolstered by it. And this is important to ensure that trust and confidence in the industry are maintained during this period of growing competition, need and change.

Prioritizing culture and leading by example

Banks in Qatar generally have an understanding of what constitutes good corporate culture, and possess the knowledge and expertise needed to develop appropriate policies and mechanisms. Indeed, many major banks in Qatar already have these policies in place.

Banks do, however, face challenges in implementing these mechanisms and assessing the strength of their corporate culture. In order to successfully implement culture specific policies, banks may consider including periodic culture related training and awareness sessions; disclosures of potential and actual conflicts; and periodic declaration of conformance with the policies, procedures and code of ethics.

All these elements could be included as part of employees' key performance indicators (KPIs) and linked to their compensation structure. It may be advisable therefore for senior management and the board of directors to lead by example and set the tone from the top. Continuous and repetitive communication across the bank is essential for successful implementation. Banks cannot expect their employees to understand and implement the policies if they only hear about them on rare occasions.

Review procedures

All listed banks in Qatar, in compliance with the QFMA Code of Corporate Governance (the 'code') have developed relevant policies and procedures as a basic step towards ensuring good corporate governance culture. As a next step, when planning a review of corporate culture, the following indicators may be considered:

— Management's view of risk culture, results of external assessments, and employee feedback in an effort to gauge the tone being communicated from the top;

— The number and nature of customer complaints and attrition rates to ascertain whether customers are being treating fairly;

— The number and nature of employee complaints and attrition rates to ascertain whether employees are being treating fairly;

— Timeliness and accuracy of public disclosures as a measure of openness and transparency; and

— Social media and news coverage to assess the bank's reputation.

When conducting a culture assessment, reviewers should be aware that assessing these indicators in isolation to one another may lead them to incorrect conclusions.

Another approach is to assess culture through a soft-controls review while conducting internal audits. Soft controls, such as management attitude and behavior, would have an impact on the operating effectiveness of hard controls (e.g. policies, procedures, rules) and can frequently be the root causes of financial, operational, regulatory and reputational risk.

Kashif Parvez
Audit

Kashif is a Director within KPMG's audit practice in Qatar. He has a wealth of assurance and advisory experience, gathered over 17 years of his association with the Big4 firms across Qatar, UK, Ireland and Pakistan. He specializes in the audits of local and international banks, asset management firms and other financial services entities.

About KPMG in Qatar

KPMG has had a presence in Qatar for over 40 years. We opened for business here in 1978 and are now one of the largest and most established professional services firms in the country. Our 300+ professionals are led by 10 Qatar-based partners. We recruit the best and brightest from around the world and currently employ over 30 different nationalities.

KPMG in Qatar belongs to a network of independent member firms affiliated with KPMG International. KPMG member firms operate in 147 countries, collectively employing more than 219,000 people, serving the needs of business, governments, public-sector agencies, not-for-profits and through member firms' audit and assurance practices, the capital markets. KPMG is committed to quality and service excellence in all that we do, bringing our best to clients and earning the public's trust through our actions and behaviors both professionally and personally.

We lead with a commitment to quality and consistency across our global network, bringing a passion for client success and a purpose to serve and improve the communities in which member firms operate. In a world where rapid change and unprecedented disruption are the new normal, we inspire confidence and empower change in all we do.

Industry focus across Qatar

To enhance the services that we offer, many of our consultants specialize in a particular field or industry. KPMG was the first of the 'Big Four' firms to establish global, industry-focused networks which help us to provide an informed perspective on the latest trends and issues affecting our clients' businesses. In Qatar, we have professionals across most of the country's key sectors, all of whom are active members of our global networks.

Our industry groups include:

- Government
- Energy and Natural Resources
- Financial Services
- Media, Telecommunications and Technology
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Printed in the State of Qatar.

Designed by CREATE | CRT127061