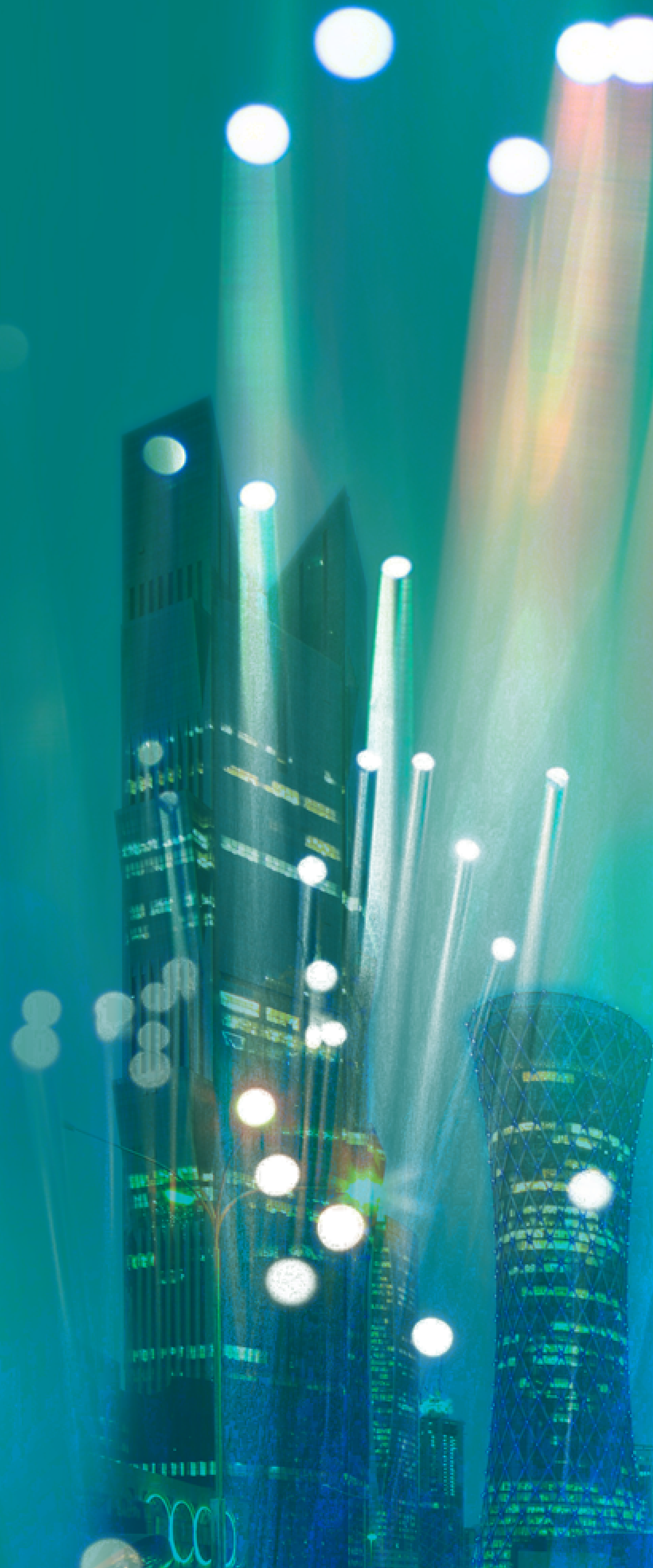
KPMG

Qatar Banking Perspectives 2021

Technology, Innovation and Sustainability



September 2021

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Foreword

Omar Mahmood
Head of Financial Services

It gives me great pleasure to present KPMG's "Qatar Banking Perspectives Report" for 2021. This edition comes with enriching and valuable contributions from KPMG's financial services professionals along with some of the most prominent leaders in Qatar's banking sector, all of whom have shared their views on the topics and issues that are shaping the industry in the country today.

We have been honored with contributions from **H.E. Sheikh Abdullah Bin Saoud Al Thani** (Governor, Qatar Central Bank), **Mr Fahad Al Khalifa** (Group CEO, Al Khaliji Commercial Bank), and **Mr Joseph Abraham** (Group CEO, Commercial Bank). They have generously provided their thoughts and insights into some of the most pressing issues and opportunities that the banking sector is facing today.

A significant amount of thought has been put into defining the list of topics that were discussed during these inspiring interviews, which we hope will give market leaders insights into:

The articles authored by KPMG financial services professionals complement the wealth of insights we captured from our prominent guests in this year's edition. They have been categorized over three main themes for ease of exploration as follows:

- Technology and Innovation;
- Regulatory Landscape; and
- Markets and Customers.

In the first section of the report covering 'Technology & Innovation', we explore the potential of crypto-assets in an Islamic banking environment. We then provide an overview of the main use-cases that have benefited from intelligent automation to reduce costs and gain more efficiency. Lastly, we conclude with the opportunity for disruption that digital-only banks could have in Qatar.

The second section, 'Regulatory Landscape', provides insights on the latest AML trends sweeping the industry along with analyzing the possible impact of emerging Tax regulations and ESG on the sector.

The last section of the report, 'Markets and Customers', concludes with an overview of the consolidation trends and post-merger integration challenges being managed by banks in Qatar, analyzes the evolving IBOR regulations, and provides an analysis of the new emergent hybrid working practices because of the pandemic.

I hope you find this edition of Qatar's Banking Perspectives timely and insightful for addressing your current and future business needs. Our team looks forward to connecting with you to discuss these themes and trends in greater detail.

Point of view

H.E. Sheikh Abdulla Bin Saoud Al-Thani

Qatar Central Bank Governor

1) What are the biggest challenges and learnings you have observed during the pandemic over the last 18 months?

Response: A year and half into the pandemic, global economies are still grappling with its negative impacts while growth prospects remain uncertain. With comprehensive support measures and an efficient vaccination rollout, Qatar's economy is back to normalcy in almost all sectors. Several lessons emerged from the COVID-19 crisis. The pandemic necessitated the accelerated implementation of technology in work operations and services. Fintech has become a bigger enabler to the financial sector industry. Central banks experienced challenges in upgrading the risk management framework to address the plausible risk from the alignment of technology with the financial sector industry. The mitigation of operational risks to ensure business continuity became issues of paramount importance. Nevertheless, the major global lesson from the COVID-19 crisis is that investments in public health infrastructure must be continuously maintained to safeguard economies and protect human capital from this type of health crisis in future.

2) What are your views on the feasibility of the QCB issuing a digital currency in the near future?

Response: : The Covid-19 pandemic prompted a shift towards digital payments and an increased discussion on the development of the Central Bank's digital currencies. This included fostering financial inclusion and generating opportunities by lowering the barriers to access financial services, reducing customer cost, and improving cross border trade and integration. However, challenges to the public payment systems, monetary policy and financial stability need to be studied in detail and the trade-off between risk and opportunities must be assessed.

In the case of Qatar, close to ninety percent of the broad money in the system is already in the digital form of deposits with commercial banks. The share of currency in circulation is expected to reduce further with the introduction of additional national digitalization initiatives. QCB, therefore, does not anticipate any immediate requirements for a retail digital currency for Qatar. However, QCB does monitor the developments in digital currencies by central banks in various other jurisdictions and will make appropriate policy decisions based on emerging information.

3) What are the key reasons for the restrictions on cryptocurrency in the State of Qatar and is this expected to be eased anytime soon?

Response: : Cryptocurrencies are in general considered as speculative assets and the probability of its use for unwarranted transactions cannot be ruled out. The restrictions are imposed due to the inherent risks associated with cryptocurrencies since they pose significant challenges to the stability and integrity of the financial system. However, QCB is closely monitoring technological and regulatory cryptocurrency developments and will take appropriate decisions in due course.

4) The QCB has been very proactive and supportive to the banking sector in recent months due to COVID-19 challenges. How long do you expect this support to continue?

Response: At the outbreak of the pandemic, QCB implemented monetary and financial regulatory measures to support affected sectors. These measures were introduced in March 2020 and were extended in response to the evolving circumstances. These comprehensive support measures in the form of financial and economic incentives across all sectors was essential during the pandemic. The continuation of these support measures depends on the evolving circumstances and the high-level directives from the State.

5) Do you expect to see the emergence of digital only banking players in the State of Qatar or simply more digitization of existing banks?

Response: QCB is open to any innovation in the financial sector, including digital only banks. At the same time, QCB is committed to address any challenges they pose to the incumbent banks and other financial service providers to ensure a level playing field. QCB will therefore follow a more calibrated approach in promoting digital banking among existing banks and new entrants.

6) Given the recent successful merger of Masraf Al Rayan and Al Khaliji Bank, do you expect to see further consolidation in the Qatar banking sector?

Response: Response: The recent mergers of some banks in the Qatari banking sector was mainly originated as a business strategy of the participating banks to reap the benefits of improving efficiency, through diversification of balance sheets. Accordingly, the proposals were submitted by the banks, and QCB provided the necessary approval after conducting legal and financial due diligence. As the regulatory authority, QCB is concerned about the proposal's viability as well as its impact on the banking sector's systemic stability. The possibility of additional bank consolidation is fully dependent on each bank's business strategy and strive for efficiency.

7) How confident are you for growth in the banking sector in a post pandemic world?

Response: The Government and QCB took proactive steps to contain the impact of the Covid-19 pandemic, with a particular focus on support for small and medium enterprises. A distinct part of these measures included injecting capital into systemically important sectors, thereby to an extent, neutralizing the short-term impact on the financial market. It is important that our banking sector has sufficient space to perform its intermediation function, while addressing the unfolding risks. The sector has a high capital cushion level while the loan delinquency levels are low. At the same time, liquidity improved as banks were able to obtain funds from both external and domestic sources. Overall, the banking sector in Qatar remains safe, sound and solid. Thus, we expect the banking sector to post sustainable growth, supported by favorable a macroeconomic environment in the post pandemic era.

8) What are QCB's priorities in the short, medium and long term to further strengthen the local banking sector?

Response: : Recent projections by the IMF signal a gradual economic recovery in 2021, though the recovery appears to be uneven. Concerted efforts on vaccination and other support measures facilitated Qatar's economy to rebound back to normalcy. Given the strength of our banking system, the supportive measures initiated by QCB will make the sector resilient enough to withstand pandemic-induced stress. QCB's strategy and priorities are broadly based on the framework provided in our Second Strategic Plan (SSP). The focus of SSP has been to create a regulatory framework that fosters growth, promotes innovation and financial technology whilst dealing with the issues of cybersecurity. On the regulatory front, in the short term we are focusing on updating the Basel requirements, IFSB criteria and governance structure. In the short to medium term, we are focusing on enhancing the liquidity structure of the banking sector, with an emphasis on stable financial resources and mitigating foreign currency and market risks. The management and mitigation of credit risk in cooperation with Qatar Credit Bureau and consolidating Shari'ah-compliant criteria for Islamic banks are also in the pipeline. In the long term, taking on board the evolving domestic and global macroeconomic developments, QCB will be focusing on strengthening the financial sector infrastructure as envisaged in the Qatar National vision 2030.

9) Do you think ESG will be a priority for the banking industry in the coming period and will we see QCB playing a role in this?

Response: Environmental Social and Governance (ESG) issues are increasingly gaining a foothold in the banking industry. The pandemic has also accelerated the need for rebuilding the world focusing on sustainable and environment friendly investments. The banking sector has a greater role to play though it is still in the evolving stage. However, there are some initiatives already in place in this direction like green bonds, green loans, standardization of ESG disclosure etc. QCB in its Second Strategic Plan for Financial Regulation had highlighted the need to promote sustainable investment and green finance. Some of the Qatari Banks have already adopted green initiatives in their business practices as they issue green bonds, provide green loans/ mortgages and green credit cards. These are small stepping-stones towards developing a more focused and sustainable framework.

Content

Point of view

H.E. Sheikh Abdulla Bin Saoud Al-Thani
Qatar Central Bank Governor

Fahad Al Khalifa
Al Khalij Commercial Bank
Group CEO

Joseph Abraham
Commercial Bank
Group CEO

Financial highlights

Snapshot as at June 30th

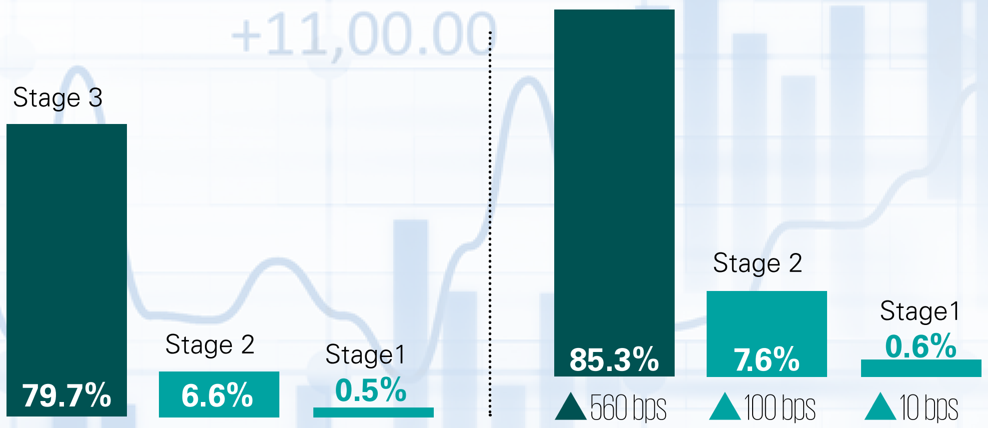
This results snapshot is based on the financial analysis of eight listed commercial banks (four conventional banks and four Islamic banks) in Qatar as at 30 June 2021.

Rizwan Yaseen
Audit

Results snapshot – 30 June 2021

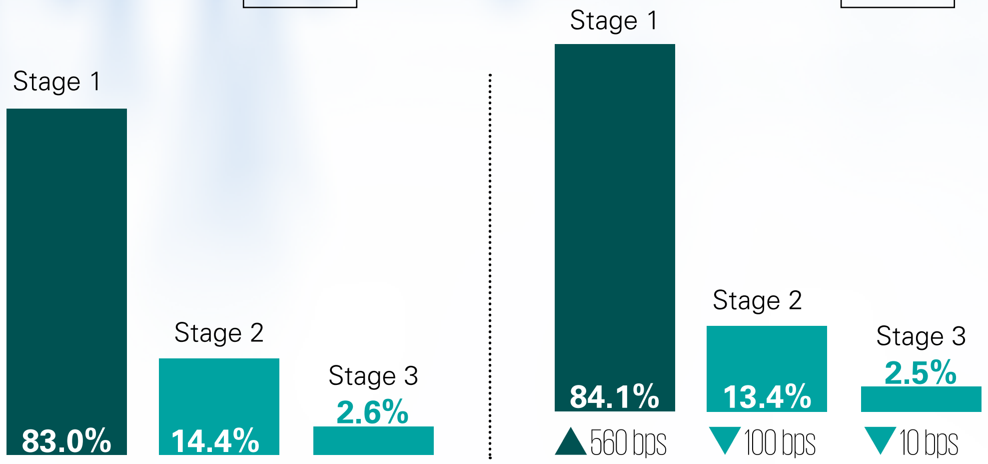
2020 | 2021

Coverage ratios on loans by stage (%)
(31 Dec-20 vs 30 Jun-21)



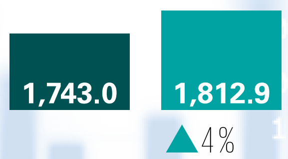
2020 | 2021

Total loans subject to ECL by stage (%)
(31 Dec-20 vs 30 Jun-21)

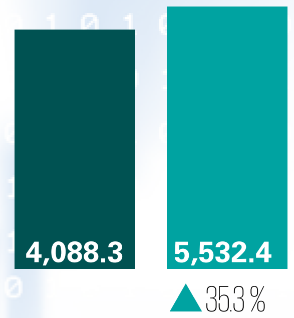


2020 2021

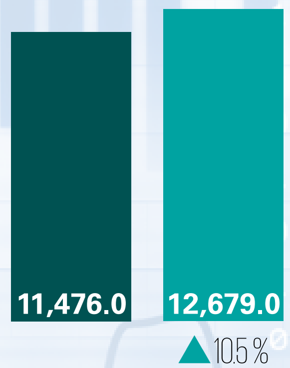
Total assets
(QR billion)
(31 Dec-20 vs 30 Jun-21)



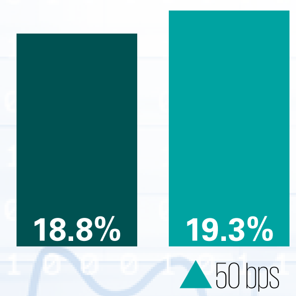
Net provision charge on loans
(QR million)
(31 Dec-20 vs 30 Jun-21)



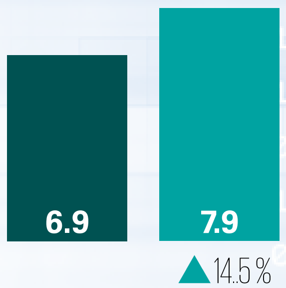
Net profit attributable to equity holders (QR million)
(30 Jun-20 vs 30 Jun-21)



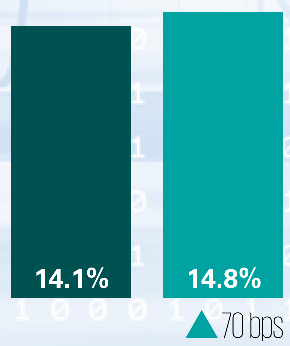
Capital adequacy ratio (%)
(31 Dec-20 vs 30 Jun-21)



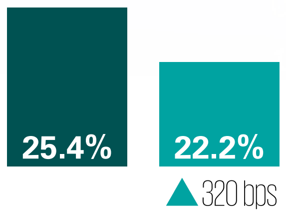
Average share price
(31 Dec-20 vs 30 Jun-21)



Return on equity (%)
(31 Dec-20 vs 30 Jun-21)



Cost-to-income ratio (%)
(31 Dec-20 vs 30 Jun-21)



Return on assets (%)
(31 Dec-20 vs 30 Jun-21)

Technology and innovation

Market potential for an Islamic crypto asset

“Islamic cryptocurrency assets have the potential to create new investment opportunities for both the Muslim community and the non-Muslim ethical investors looking for alternative instruments. However, the lack of consensus on what constitutes a Sharia compliant cryptocurrency makes it difficult for these assets to induce the same appetite as conventional cryptocurrencies.”

Suhail Shaker
Digital and Innovation Advisory

Many customers and financial institutions who seek Sharia compliant financial instruments, are generally skeptical of cryptocurrencies. The Muslim scholars have had major differences on the current cryptocurrencies. Some allowed it and stated that it is Halal, while the majority have deemed it prohibited (Haram). The main reasons for the debate around the existing cryptocurrencies are:

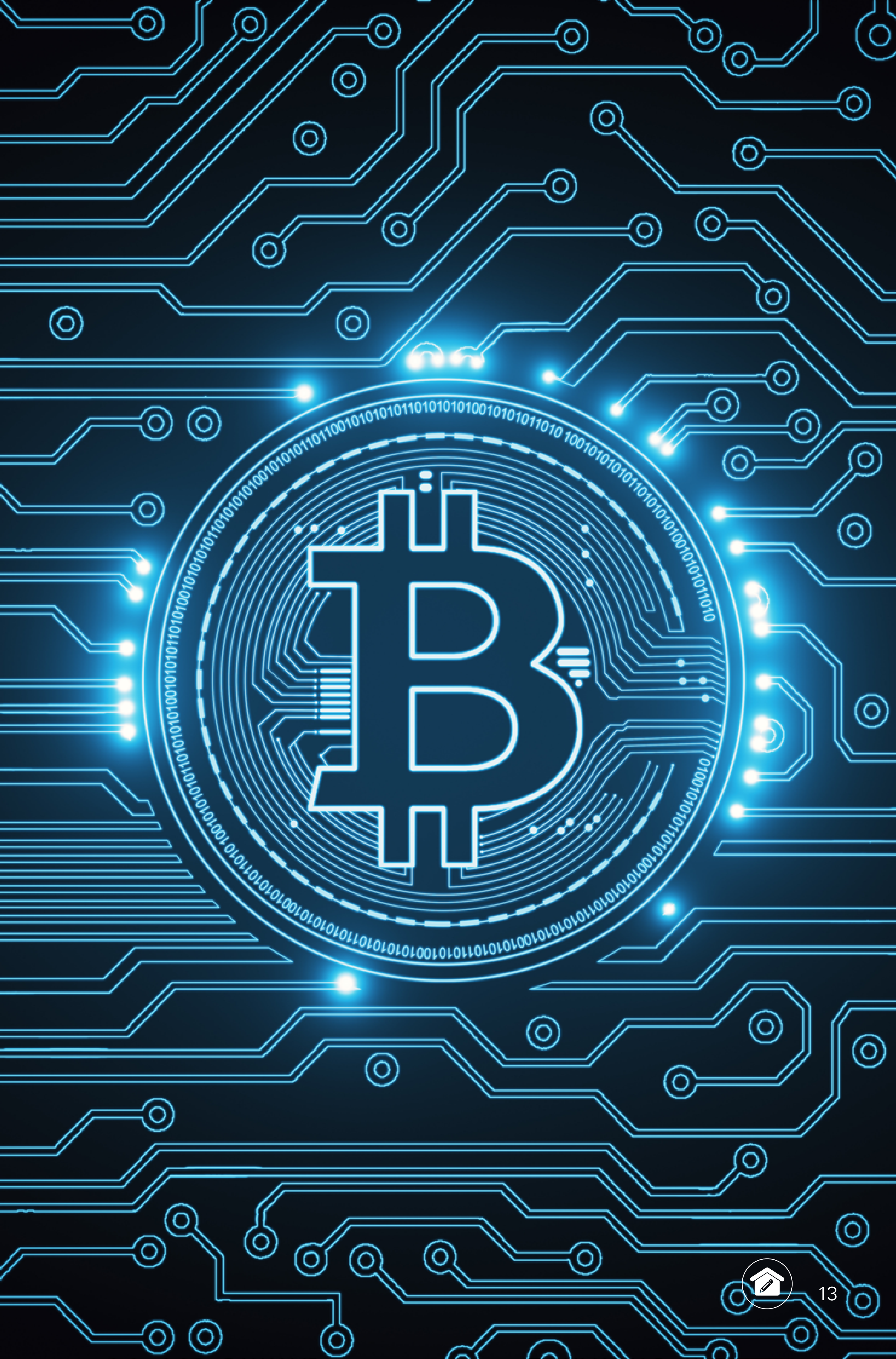
1. Volatile and Highly speculative.
2. Not backed by real assets.
3. Interest mechanism is involved in the issuance of cryptocurrency.
4. Holding money for pure speculative motives is prohibited in Islam (Haram), and only allowed for transactional (e.g. trade) or precautionary motives.
5. It is still not fully accepted as a form of wealth (maal), which has implications on Zakat and inheritance laws.

What adds to the confusion of the existing debate is the fact that there are hundreds of digital cryptocurrencies (coins and tokens) each with unique application and features related to its distribution, mining, and trading. They are also very different in terms of their underlying commodities, projects, or businesses. Currently, most of the existing Sharia rulings, either deal only with bitcoin, or include all types of cryptocurrencies in one ruling, disregarding the intrinsic differences and peculiarities between them.

This debate and confusion in the Sharia compliant financial system, created an opportunity for designing Sharia compliant cryptocurrencies. This will be an exciting innovation for Muslims, and for non-Muslims who are interested in ethical investing since Sharia compliant investments bans investment vehicles in any business that has usury (riba), gambling (maisir) and ambiguity (gharar). It also excludes investments in companies or sectors primarily involved in Sharia non-compliant activities such as products or services related to conventional banking, conventional insurance, gambling, alcoholic beverages, non-halal food products, tobacco industry, etc.

There are many attempts at launching Sharia compliant cryptocurrencies (e.g. OneGram, HelloGold), which are backed by physical assets (gold in this case) to make sure it is compliant with Sharia's definition of money. Although, these Sharia compliant cryptocurrencies received the approvals from Sharia compliance advisory firms, there is still no consensus on what constitutes a Sharia compliant cryptocurrency. Furthermore, no authoritative body has provided clear guidelines on cryptocurrencies or on how to issue one that is Sharia compliant. In fact, many central banks in the Muslim world have warned against trading in cryptocurrencies but have not issued an outright ban on them.

Until there is a definitive Islamic ruling from a recognized authoritative body(s) or institution(s), Islamic investors are left to choose between conflicting judgements by Muslim scholars, Sharia advisory firms, financial and monetary regulators, and their eagerness not to miss out on the cryptocurrency opportunities.



Intelligent automation use-cases for banking

> **Banks, Fintechs and Consumers have been riding the digital transformation wave for a few years but with the COVID-19 pandemic accelerating the digital agenda, it is no longer a choice to make. It is imperative for survival.**

Devesh Vijay
Digital and Innovation Advisory

Leading Banks in Qatar are embracing the power of digital transformation for building resilience, offering contactless payments, self-service solutions, and a pragmatic experience for the customers. A report from one of the leading Banks showed that 98% of their retail customer are leveraging digital and remote channels; this is an incredible growth for Qatar and shows the right commitment from the banking community and leadership.

Keeping the need of the customers at the forefront and the evolutionary nature of change, Banks must rapidly evolve vis-à-vis the customer service; thus, a need for enabling intelligent automation powered by Artificial intelligence and Machine learning. Creating a unique experience for the customers by having pre-defined customer journeys, personas, loyalty programs and others will impact the customer segmentation and penetration. Qatari Banks can even leverage the intelligent automation for looking at portfolio rationalization and even consider deeper penetration within other regions.

A very important link for banking is the omni-channel experience and integration vis-à-vis the customer choice. Not all customers would enjoy promotions or alerts on traditional SMS; imagine checking on the user preference for communication (like whatsapp, facebook messenger, or others) as part of the onboarding process which will lead to offering a personalized sense of communication.

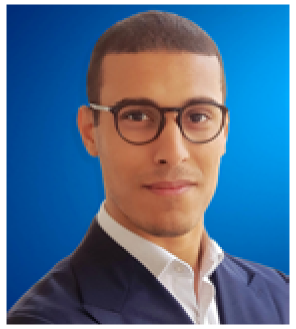
Further, Qatar's recently established AI council will deeply benefit from the use cases that the banking industry can bring for intelligent automation. Banks are and will always be leaders in digital transformation and empowering the AI council can benefit other sectors and boost other Qatari sectors as well.

Different types of use cases in the banking industry:

- Customer Retention Analytics
- Cross Sell and Up-Sell of Loan Products
- Lead Scoring and Management
- Sales Engagement Analytics - Next Best Actions
- Collection Analytics and Management
- Nostro EoD Balance Forecasting
- ATM Cash Forecasting
- Customer Journey Analytics
- Credit Limit Optimization

Neo-Banks: an opportunity for disruption

> **"Neo-Banks can disrupt the banking eco-system through personalized customer experience, aggressive pricing strategies, and cutting-edge innovation. However, in order to drive funding and achieve sustainability, they will have to overcome regulatory challenges and leverage open-banking platforms to create an integrated ecosystem."**



Chakib Ouabi
Digital and Innovation Advisory

The switch towards digital banking has accelerated the change in regional customer behaviours and demands, aided by several other factors. The first catalyst of this acceleration was the COVID-19 pandemic, which caused the closure of many branches and the enforcement of social-distancing measures over an extended time period. This pushed banks to re-direct their customers towards digital banking windows and the customers to develop a clear preference for digital banking services such as remote and mobile payment solutions.

The second main driver is the rise in fintech innovations in Qatar with entities exploring new ways of delivering banking services to the new-reality customers. These innovations attracted significant funds in the region with USD 55 million invested in fintech companies in the GCC region in Q1 2021 [1].

Today, traditional banks are transforming digitally to cater for these changes. However, challenging existing business models with others (e.g. digital-only branches and Neo-Banks), could further disrupt the sector as it did in other regions across the globe.

Neo-Banks could indeed focus on a differentiation in products and services by targeting part of their consumers' needs for everyday banking products and launching brands that are breaking the traditional codes of the banking industry's commercial communication.

They can also use AI enabled technology, fraud detection algorithms and other customer-centric innovations to offer new delightful digital experiences ranging from the opening of accounts in only a few minutes to chatbots that can answer customer queries 24/7.

This will create a completely different positioning compared to traditional banks and give target clients, especially millennials, that highly sought-after autonomy they seek.

Additionally, by focusing on specific elements of the value chain and reducing their costs through automation and platforms, they can generate savings translated into their pricing strategies. They can also expand their offerings by adopting open banking strategies and partnering through APIs with traditional industry and non-financial organizations (e.g. aggregators, loyalty programs, travel, etc.).

The challenge in adopting these new business models in Qatar will be choosing the right customer target (e.g. one that is digitally savvy) and providing basic banking services that do not require a banking license. Neo-Banks will also need to invest in their compliance and cyber security controls to generate a perception that instills financial confidence and reliability with customers and regulatory authorities. Lastly, Neo-Banks need to continuously invest in innovation to drive funding and growth, while ensuring the sustainability and profitability of their business model in the long run.

(1) KPMG Tech –Start Up Investments Round Up

Point of view

Fahad Al Khalifa
Group CEO at Al Khaliji Commercial Bank

1) What are the biggest challenges and learnings you have observed during the pandemic over the last 18 months?

Response: One of the main challenges we have faced is uncertainty. With other events in the financial world, such as defaults or market crashes, there is an understanding of what happened and how to deal with it. We know the playbook for dealing with these cases. A global pandemic is something that none of us have dealt with before and positioning ourselves to cope with it has been a new experience.

The biggest learning has been the increased need for adaptability and agility. The ebbs and flows of the pandemic, with different waves and changing restrictions, means that companies must be able to adjust to new circumstances very quickly. We formed a Covid 19 task force, which allied to the Bank's existing flexibility meant that we could adapt quickly to the new environment - whether that was by increasing remote working or meeting our customers' changing requirements.

2) Do you expect to see more consolidation in the Qatar banking sector?

Response: We are currently in the middle of part of this consolidation (the second one in Qatar) as we bring together Masraf Al Rayan and Al Khaliji to form one entity. This will lead us to becoming one of the top 3 banks in the country. The collective market share of the Top 3 banks will be in the range of 80-85%.

3) How do you think banks in Qatar compare to their regional counterparts when it comes to the adoption of digital?

Response: : I don't really believe it's a case of banks in Qatar compared to the region, as all banks have different digital strategies and move at different speeds. For Al Khaliji, our mission was always to be a next generation bank, so we embraced digital elements from the very beginning. We have always focused more on this side than the physical, and indeed many of our customers are banking with us fully digitally.

4) How confident are you for growth in the banking sector in a post pandemic world?

Response: The world will continue to need financial services in a post-pandemic world, whether those needs are met with traditional banks, fintech, or a combination of the two. Banks that are not prepared for the immediate aftermath will suffer. However, I expect economic growth to rebound strongly and confidence to be restored. Growth in the economy will inevitably mean growth for the banking sector.

5) How importantly are you taking ESG?

Response: : I think ESG is very important. Our stakeholders are increasingly aware of and focused on ESG. Our shareholders and investors want to see it as the bedrock of a well-run company, while our customers and staff (especially millennials) want to see us a good corporate actor. I feel it is an important way of differentiating the Bank and contributing to social causes throughout Qatar.

Many of the key industries in Qatar such as Oil & Gas and aviation are at the forefront of environmental sustainability issues, and as a bank we support these companies' focus on these matters.

We also contribute to many social causes throughout the country, and along with other local companies support the Qatarization initiative to bring the next generation of Qatari leaders into the workforce.

Finally, the banking sector in Qatar is well-governed by a strong Central Bank and a framework based on international guidelines, giving confidence in the resilience of governance in the sector.

6) What are the biggest risks for Banks in Qatar in the near future?

Response: One of the biggest risks any company faces is the risk of complacency, i.e., sitting back instead of constantly seeking to address new challenges and customer demands. For banks, this includes ensuring our people continue to develop themselves professionally, increasing our technological abilities and safeguards, and continuing to introduce new and innovative products to the market.

Credit risk, especially arising from concentration of exposures, is also an issue for banks in Qatar given the level of resources in a relatively small country. However, in general banks here are highly capitalized, well in excess of minimum regulatory requirements, which helps to mitigate the potential concentration risk.

Another risk we see growing every year is cybersecurity. As more business is conducted online, and customers become increasingly used to web and phone-based transactions, it is imperative that banks ensure their cyber resilience. This resilience of course takes into account the technical systems side, but we also strive to ensure people (both our staff and customers) are educated on the threats facing us every day from bad actors online.

7) Which sectors of the economy are you focusing on?

Response: As Al Khaliji, our primary focus has been on government and GRE-linked projects, as well as large corporates across sectors. We have focused more on the private banking side of personal banking rather than the mass retail. This is one of the reasons the merger with Masraf al Rayan makes sense – the strong Rayan book includesa mass retail portfolio and a large SME portfolio, which mesh nicely with the Al Khaliji book.

Even after the rapidly-approaching World Cup, infrastructure will continue to be a focus as the country builds towards the 2030 National Vision. Development will continue in areas such as Msheireb and Lusail, as well as areas from Wakra to Al Khor, and the west coast of the country. There will also be increased business opportunities with the North Field Expansion program, both for infrastructure and for trade finance related to the increase in gas exports.

In addition, I expect the increase in smaller local companies to continue - the success of many manufacturing and food production companies that originally began during the blockade has demonstrated the customer appetite for local goods.

8) What are your top 3 priorities for the Bank?

Response: The number one priority at present is the successful completion of our merger with Masraf al Rayan. We are striving for a seamless customer transition and bringing together our capabilities in the shortest possible time to emerge as one strong entity rather than the two individual banks. This will enable the team and myself to deliver a strong and stable set of results to our shareholders in order to drive shareholder value and build a best-in-class Islamic bank in the region.

Regulatory landscape

AML transformation through new technologies

“Emerging technology is the key to improving the effectiveness of anti-money laundering and counter-terrorist financing programs in the banking sector.”

Saleh Sailik
Risk Advisory

One of the main challenges hindering the effective implementation of Anti-money Laundering (AML) and Combating the Financing of Terrorism (CFT) measures is poor understanding of money laundering (ML) and terrorist financing (TF) threats and risks. Decision-making is sometimes inaccurate and irrelevant, relying heavily on human input and defensive box-ticking risk approaches, rather than applying a purpose-fit risk-based approach. This is where new technologies can provide the most added value.

Most respondents to the FATF’s Digital Transformation questionnaire agreed that AML/CFT effectiveness in general and better risk management are the most significant benefits of the use of new technologies.

The use of Artificial Intelligence (AI), Machine Learning and Big Data Analytics in the identification, assessment and management of ML and TF risks allows for real time analysis of data and the modeling of interdependencies, network relationships and clusters to provide a more accurate view of emerging risks and their expected combinations.

Developing the capability for intelligent risk analysis is even more critical to understand and combat ML which emerge from crimes such as cybercrime, wildlife and forest crime, and maritime crime and piracy. This will enable financial institutions to be more confident in their business decisions and help them gain a competitive advantage by finding opportunities in risk.

Finally, in deciding whether to adopt a new technology, financial institutions must take several factors into account, such as cyber and privacy risk (which is deeply connected to operational risk), reputational risk, regulatory risk and financial risk.

1. FATF (2021), Opportunities and Challenges of New Technologies for AML/CFT, FATF, Paris, France, https://www.fatf-gafi.org/publications/fatfrecommendations/documents/opportunities-challenges-new-technologies-for-aml-cft.html

The strategic importance of ESG for banks

“Banks in Qatar now recognize that their ESG agenda is a tool for growth, confidence and sustainability. They simply cannot ignore something that is now a fundamental part of banking.”

Kashif Parvez
Audit

ESG in Qatar

As one of the world’s largest natural gas producers, Qatar has a particularly important role to play in the ‘E’, or environment, part of the equation. The State of Qatar has indeed implemented several projects and initiatives to contribute to efforts aimed at reducing carbon dioxide emissions and increasing reliance on renewable energy.

Symbolic of the changing nature of ESG programs during the pandemic was also the ‘S’, or social support provided by the Government / Qatar Central Bank, comprising of the following support measures and stimulus packages which have been fully embraced by Qatari banks:

- Deferment of payments for loans in affected sectors without additional fees or penalties;
- New loans for affected sectors at a maximum rate of 1.5% with no repricing for the next 6 months;
- Provision of zero cost repo facilities for funding affected sectors; and
- Guarantees to banks for support to affected sectors within soft loan and waiver package.

When it comes to the ‘G’ component, and with the introduction of QFMA’s Code of Corporate Governance, listed banks in Qatar have repositioned themselves with relevant policies and procedures as a basic step towards ensuring a good corporate governance culture with more to be expected, particularly in terms of bringing diversity to their Board and equivalent committees.

New ESG-tied products and models are now being developed, tested and commercialized by banks in Qatar. One of the leading banks has indeed issued green bonds last year and more banks are expected to follow. In addition, the investment and treasury arms of banks have started considering ESG indices while deciding which products to invest in. With new ESG related international benchmarks and frameworks expected to be introduced soon, ESG is expected to become an important determining factor for these decisions.

Pressure for change

Though future regulatory assistance and reporting requirements are uncertain, what is clear 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 prepared 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). Therefore, almost all components of banks’ risk management will need revision to incorporate sustainability risks. This includes all levels of policies, procedures, methodologies, and infrastructure.

Following are some of the key steps, banks will need to take to address ESG related matters:

- Understand and manage the social and environmental impacts of own business activities;
- Position the firm in the market and seize business opportunities;
- Ensure regulatory and international standards compliance; and
- Identify and efficiently manage ESG risks in line with the bank’s ambition and ESG strategy.

Taxation from a banking perspective

> **"The new tax and transfer pricing regulations introduced by the General Tax Authority in Qatar will impact banks and financial institutions, as scrutiny and transparency requirements will likely increase in the coming years."**

Abhishek Jain
Tax

The reform of the local and global tax environment is moving at a much faster pace than in the past and complexity continues to increase.

The General Tax Authority (GTA) introduced Transfer Pricing (TP) related regulations which have a significant impact on the banking and Financial Services sector due to the following factors:

- High volume of day-to-day related party transactions, and
- Inter-dependencies between and scrutiny of multinational enterprises (MNEs) group entities for various product offerings, guarantees, syndicated loans, corporate financing and similar banking products

In addition to the documentations to be maintained for tax returns, the Executive Regulations have brought in detailed transfer pricing regulations. The regulations require entities to:

- Determine the price of related party transactions in accordance with the arm's length principle and file a transfer pricing declaration along with the tax returns;
- Keep a master file for the MNE group; and
- Keep a local file from Qatar perspective.

The above documentations shall be applicable to entities meeting or exceeding the total revenue or asset thresholds determined by the GTA for this purpose.

These recent tax and transfer pricing related legislative changes resulted in an increase in tax scrutiny from the Qatar GTA. Based on our recent experience, we have seen that the GTA has opened previous year's tax assessment files for banks and financial institutions and are requesting a significant amount of information and documents.

In the future, we will likely see increased transparency between taxpayers and the GTA due to the introduction of the new online Portal "Dhareeba". Therefore, banks and financial institutions need to be well-prepared in advance to comply with the tax requirements in Qatar.

Point of view

Joseph Abraham
Group CEO at Commercial Bank

1) What are the biggest challenges and learnings you have observed during the pandemic over the last 18 months?

Response: Providing our clients with the same high level of service they have come to expect from us while protecting the health and safety of both our clients and staff at the height of the pandemic was the greatest challenge. COVID-19 has fundamentally shifted the way we interact with our customers, with more and more transaction banking done digitally through mobile, internet and self-service channels. Our goal is that customers should be able to seamlessly do 100% of their banking without having to visit a branch and all with a great client experience.

COVID-19 has reaffirmed the investments we have made in digital, people and technology under our strategic plan, as it has given us a degree of resilience and the ability to adapt quickly to capture the changes in customer behaviour that have been accelerated by COVID-19.

2) Do you expect to see more consolidation in the Qatar banking sector?

Response: The Qatari banking sector is very competitive, which is positive for customers and the economy. Consolidation can bring cost synergies which benefits shareholders as well as clients and in the long-term further consolidation makes sense given Qatar's relative size. However, given the strength of Qatari banks, their strong performance and the fact that consolidation requires a meeting of minds on valuation and control between different boards, then in the short-term I do not think this will be a priority for banks.

3) How do you think banks in Qatar compare to their regional counterparts when it comes to the adoption of digital?

Response: Qatar is a strong regional leader in digital banking supported by the QCB's regulatory sandbox initiative and more widely, government programs promoting digital society and digital government. COVID-19 has accelerated Qatar's transition to digital banking and all banks have positively adapted to the new environment.

4) How confident are you for growth in the Banking sector in a post pandemic world?

Response: We see positive growth momentum in Qatar as a result of higher natural gas prices, continued government spending on projects such as the North Field Expansion and the forthcoming World Cup. Qatar's GDP growth for 2021 is anticipated to be around 3.0%, one of the best in the GCC, due to an increase in demand supported by very high domestic vaccination coverage.

The benefits of the removal of the blockade have not yet fully flowed through to sectors such as hospitality and tourism due to COVID-19 and these are expected to recover as vaccines continue to roll out globally and restrictions on the movement of people ease.

The global banking outlook is positive overall due to a resurgence in demand post pandemic and an acceleration in consumer discretionary spending and mortgages is expected from the huge amounts of accumulated savings that were built up during lockdowns.

5) How importantly are you taking ESG?

Response: COVID-19 has intensified discussions about the interconnectedness of sustainability and the financial system. With the growth in sustainable investing and the increasing importance that mainstream investors attribute to ESG, having strong ESG credentials is important. We take ESG seriously at Commercial Bank and we are looking at how we can further embed ESG across our business.

6) What are the biggest risks for Banks in Qatar in the near future?

Response: Credit risk remains fundamental for Banks and embedding a strong risk culture is a key part of Commercial Bank's strategic plan. Beyond this, the transition to digital banking has meant there are new channels and methods that can be used for money laundering and at the same time increased cyber security risks. Banks are having to enhance their efforts to protect themselves against direct cyber attacks and to protect their customers from fraud through methods such as social engineering, fake websites and fake social media.

7) Which sectors of the economy are you focusing on?

Response: Our focus remains on re-shaping the profile of the lending book and diversification of risk across a range of sectors including decreasing real estate exposure and increasing exposure to the government and public sector. Our government and public sector exposure has increased to 20% in H1 2021 up from 10% in 2016 but we are still underrepresented versus the market and this continues to be a strategic priority. In addition, we are enhancing our products and services to maintain our leadership position in transaction banking in Qatar as well as building new revenue streams from retail mortgages, wealth and brokerage services.

8) What are your top 3 priorities for the Bank?

Response: We view client experience as a competitive advantage and it's at the centre of our strategy. In this context, we are continuing to invest in our digital technology capabilities to seamlessly provide the right products to the customer and enhance our customer communication to empower customers to self-serve without having to contact the bank.

We also continue to invest in our people to get the top skills and talent needed to build new revenue streams and meet the changing needs of our customers, all within the context of providing the bestclient experience.

Markets and customers

PMI best practices and consolidation trends

“ We are witnessing a rising trend in the M&A activity in the region as the banks continue to fight for market share in order to create a larger and a robust bank. The path to success for any M&A goes through an effective post-merger integration plan for which the most important elements to consider are People, Business, Experience and IT. ”

Himanshu Bhatla
Deal Advisory

GCC is an overbanked region where the working age population per local bank is significantly lower than the median of emerging countries. The five largest banks in the region account for approximately 70 percent of the total assets, making it highly competitive for the remaining banks fighting for market share and customer base. For instance, in Qatar, the top five banks have a market share (based on total assets as on 31 Dec 2020) of approximately 85%, while the remaining four banks share the remaining 15%.

We witnessing a rising trend in M&A activities in the banking sector which is most likely due to the competitive local market, stressed global economy, reduced profitability, increasing regulatory pressure for capital requirements, and compliance costs. The latest noteworthy merger agreement is Masraf Al Rayan and Al Khaliji Commercial Bank.

Year	Country	Announcement date	Target	Buyers / Investors	Transaction value (USD Mn)
2021	Qatar	7- Jan 21	Al Khaliji Commercial Bank	Masraf Al Rayan	2,232
2020	KSA	11-Oct-20	Samba Financial Group	National Commercial Bank	14,858
	Bahrain	14-Sep-20	Bahrain operations of Ithmaar Bank	Bank of Bahrain and Kuwait B.S.C.	Undisclosed
2019	Kuwait / Bahrain	12-Sep-19	Ahli United Bank B.S.C	Kuwait Finance House	7,080
	Bahrain	22-Aug-19	Bahrain Islamic Bank (78%)	National Bank of Bahrain	164
	UAE	10-Jun-19	Noor Bank PJSC	Dubai Islamic Bank	893
	UAE	29-Jan-19	Union National Bank	Abu Dhabi Commercial Bank	3,986
	UAE	29-Jan-19	Al Hilal Bank	Abu Dhabi Commercial Bank	272
2018	Oman	4-Oct-18	Oman Arab Bank SAOC	Alizz Islamic Bank SAOC	179
	Qatar	28-Aug-18	International Bank of Qatar	Dukhan Bank	1,212
	KSA	16-May-18	Alawwal Bank	The Saudi British Bank	4,963

How mergers can help?

Mergers can indeed be perceived as a solution to consolidate a stronger bank which will address the stakeholder's concerns towards stability, solvency and liquidity. Conventionally, the primary objective for bank mergers fall into four main broad groups:

- Cost benefits (economies of scale, efficiency, cost of funding, risk diversification);
- Revenue benefits (economies and scope for large deals);
- Economic conditions (up and downswings in business cycles); and
- "Other" motives (valuation, managerial benefits, pre-empting possible takeovers, etc).

The importance of post-merger integration

Post merger planning is critical in any sector and can fail if not managed effectively. During the merger or acquisition process, companies experience massive disturbance. Having focused heavily on the transaction, firms tend to neglect the importance and complexity of the post-merger integration phase. A successful post-merger integration is crucial to realize and maximise the value of a deal.

The disturbance is a natural part of most mergers, as key functions and employees are to be operationally integrated in a cohesive manner across multiple areas of the business which includes supply chain, production, back-office functions (Finance, HR, IT, Legal) and more. The softer aspect of differing cultures also results in a disturbance as both legacy organization aim to find FinTech's common ground.

In achieving these objectives, post-merger integration projects can pose significant challenges to banks that typically will need to consider the people, business, IT and overall experience components early in planning their post-merger efforts.

Our KPMG experience guides us to the following key aspects for a successful journey towards achieving optimal synergies and cost reductions for any post-merger operation and should at least be considered:

Potential benefits of a bank merger

- Creation of larger / stronger bank
- Enhanced profitability
- Cost rationalization
- Customer demands
- Shareholder specific needs
- Talent & technology
- Greater growth potential

Typical things that need to be covered in post-merger integration

1 Historical vs. new data

- Successful migration of Data
- Seamless integration of both the systems and/ or transfer to one updated system

2 Human resources

- Effective resource planning, mobilization and cross-functioning of employees
- Effective internal communication plan to mitigate concerns
- Training and team building

3 Specific vs. shared customer and product vision

- Updating system and processes ensuring alignment with revised customer strategy, product portfolios etc.
- Creating a strong digital customer experience

Growth Retain both IS while creating bridges for communication harmonizing organizations	**Absorption** Retain one of the two IS that will be used by both entities maximizing synergies
Outsourcing Outsource the IS features to an external service provider as a managed service	**Transformation** Adopt a new IS to which both legacy IS data will be migrated

One traditionally optimal integration strategy is to opt for one back-bone information system (IS) from one bank while bridging identified gaps through connections to the necessary additional systems from the second bank.

4 Legacy vs. target systems and processes

- Maximizing tooling and automation
- Standardization of policies, process and procedures
- Targeting higher efficiency while reducing risk

5 Individual vs. Combined infrastructure

- Planning transition logistics
- Integration and update of physical hardware

New ways of working and impact on banking culture

"Big questions arise as banks are implementing new ways of working for their connected workforce. Solving an equation where employees collaborate remotely, live and work from different parts of the world and have increasing needs for flexibility is key to answering these questions."

Syed Javed
Financial Services Advisory

As the world is starting to get back to normal or should we say "the new normal", we are seeing businesses across all industries including the banking sector focusing on what the working culture would look like in the post pandemic world. Currently, there appears to be more open questions than answers, all of which require serious thinking and planning:

1. Is it more productive to reduce the working week to 4 days as is already being considered by some countries including Japan or should it be kept to 5?
2. Do we need to adopt a rigid "back to office" policy for all our employees or a more hybrid "work from anywhere" policy?
3. If most of our employees are working from home (in case of firms with international workforce that will be different countries), how does it impact our remuneration and benefits policies? Employees who have originally been hired in high-cost locations and are now working from low-cost locations may need to go through a potential review of their overall remuneration package to bring it more in line with the market they operate in.
4. Do we need to consider any tax implications for employees working from other countries for prolonged periods of time?
5. How do we align our operating model with remote working so that there is minimal disruption to client service and business? This might require significant investment in technology, infrastructure and up-skilling of customer facing employees.
6. How do we ensure our employees across the firm feel engaged and motivated in these difficult times? Lack of social and physical interactions is having a toll on our employees' mental health and this directly impacts their ability to be productive at work.
7. With physical meetings and seminars getting replaced with virtual webinars, more emphasis on social media marketing and reduced travel for business and training, how does this all impact our budget planning and cost projections?
8. Do we need to revisit our location strategy and limit our physical presence by reducing the number of branches/ offices and focus more on digital only presence to adapt to the new working culture?

As always, there will be firms bold enough to take the initiative across these areas to further establish themselves as the market leaders while others wait and follow in their footsteps. The certainty however is that significant change is coming to the way we work, and that we must adapt to survive and grow.

Beyond LIBOR : The risk of the rate switch

“ The sooner banks begin to prepare for the changes that are likely to come, there is a lesser likelihood of disruption and unnecessary risks. The banks should also start designing products that reference alternate rates and work with market participants to build liquidity. ”

Shubhadip Bhattacharya
Financial Risk Management

Transitioning away from LIBOR is likely to be complex, expensive, and a multi-year process which entails high risks that could impact profit margins of the bank, liquidity, system and policy changes, and customer communication.

LIBOR transition needs to deal with structural differences between LIBOR and new rates. SOFR for example is not a rate-for-rate replacement. It has been observed that the spread between LIBOR and rates like SOFR varies over time. It means that transitioning from LIBOR requires the banking industry to either replicate the credit and the term features or restructure products, bank funding and internal processes.

We expect the transition from LIBOR to the new risk- free rates (RFRs) to lead to considerable cost and risks for banks if not managed properly. The banks need to carefully consider the interaction between the transition and product design, valuation models, hedging strategies, systems, and conduct risk.

Lessons learned from previous remediation programs suggest that significant conduct risk arises from way in which the transition engagement with the clients is managed. Banks should establish a conduct risk assessment framework to identify all potential touchpoints and then determine the relevant mitigation. It is critical that there is an effective governance and management information framework focused on review of product design, sales, and post sales processes to confirm positive customer outcomes.

Transition from LIBOR to the RFRs is also likely to produce a noteworthy turmoil within bank’s trading books, potentially over a prolonged period.

The expectation is that market participants will consider when and how they rebase their books, how they manage information flows within their organization, and actions taken in establishing capabilities to identify instances of market misconduct.

GCC Local IBORs

Currently, there is no visibility of any plans to discontinue the main local IBORs used in the GCC markets for financing transactions denominated in local currencies (i.e. QIBOR, EIBOR, SAIBOR, OMIBOR and BHIBOR), and these will continue to be published for the foreseeable future. However, since the local GCC benchmarks are pegged to the US dollars, the discontinuation of USD LIBOR may still have an impact on their ongoing use.

Lenders in the GCC have been working to update their operating systems, financial modelling, and documentation to be able to transition their loans as necessary when the time comes. For some, the extension of key USD LIBOR tenors until mid-2023 may provide a welcome reprieve.

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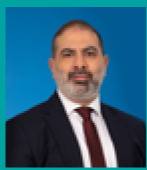

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