Oman banking perspectives 2019

A digital, regulated and sustainable future

April 2019

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Foreword

Our evaluation of the key financial indicators for the past year suggests a positive outlook for the banking sector in Oman, with promising profit growth that has only slightly been tempered by the introduction of new accounting standards.

I am pleased to introduce you to the second edition of our annual Oman banking perspectives publication. We examine pertinent issues and trends affecting the global banking industry today, with a particular focus on Oman. Our subject matter experts have shared their views on key topics, identified the main challenges faced by the banking sector and proposed strategies to combat these. We are grateful for the high level of interest generated by the previous edition; in this publication we elaborate on a broad spectrum of themes, ranging from effective governance to Islamic finance.

In the constant drive for growth, banks would do well to swiftly adapt to a shifting regulatory and consumer landscape. Banks need not, however, be overtly cautious of venturing into uncharted territory. Rather, they can pioneer practices and products that cater to gaps in the market or improve operational efficiency and competitive positioning.

Technological innovation and a flourishing demand for Islamic financial institutions can disrupt the industry, while risk functions must contend with challenges like the replacement of the London Interbank Offered Rate (LIBOR).

Over the past few years, the Central Bank of Oman has issued a range of directives that clearly signal Oman’s intent to align with global best practice in terms of prudent market regulation and consumer protection. In addition, the Financial Action Task Force (FATF) evaluation of Oman is expected to begin in 2021, and will trigger an independent review of anti-money laundering (AML) and sanctions compliance rules.

Banks could consider encouraging a healthy corporate culture, and practices that are in line with the sustainability agenda. Strides in digital innovation can be exploited to their full potential as traditional banking methods are transformed by processes like customer identity and access management (CIAM).

This publication complements our GCC listed banks results report, which sets out some of the key financial indicators and issues of the day for the banking industry in the region.

On behalf of KPMG Lower Gulf, we look forward to delving deeper into the topics discussed within this publication, and exploring how your organization can make the most of the opportunities that lie ahead.

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Partner and Head of Financial Services

Emilio leads KPMG’s financial services practice in the Lower Gulf (the UAE and Oman). He has worked in the financial services industry – both as a consultant and as a banker – for almost 30 years and has been based in the UK, the Middle East and Africa. He has led a number of risk, finance and credit advisory engagements, including leading governance and cost-efficiency reviews. Emilio has been the lead partner on the external audits of a number of major, bluechip financial institutions in Africa and in the region. He was a member of the IAASB’s ISA540 task group with a focus on revising the standard in preparation for the audit of IFRS 9.
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A strong focus on innovation, regulatory compliance, rigorous self-review, risk management and creating a fair corporate culture, will likely stand banks in good stead as they navigate an evolving banking environment.

While economic growth has been somewhat muted over the past year\(^1\), the top eight Omani banks have enjoyed a healthy surge of 11.5% in net profits. This occurred in the wake of the replacement of IAS 39 with IFRS 9 at the beginning of 2018. It transformed banks’ approach to the assessment of impairments in their loan portfolios. Higher current provisions and more stringent Liquidity Coverage Ratio and Net Stable Funding Ratio calculations seem to have led to a spike in the cost of liquidity. There was improvement in the Capital Adequacy Ratio and Return on Equity, despite IFRS 9 adjustments being passed through retained earnings. Despite a promising financial year, financial institutions must contend with an incursion of new regulations and a burgeoning demand for innovative new products and systems to meet consumer demands in a market that is increasingly digitally enabled.

Across the banking sector, companies have embraced innovation teams. However these can suffer from limited authority, lack of resources, and inadequate support from senior stakeholders. A structured management process, and a more open-minded approach to solving problems may help drive the innovation agenda. Improved communication and collaboration between departments and with regulators will help banks remain agile in the face of the gamut of technological advances like fintech.

With the advent of the digital revolution, many banks are turning to customer identity and access management (CIAM) to build stronger relationships with their customers. CIAM’s features facilitate addressing numerous customer needs, delivering personalized experiences, intelligent solutions, protection against cyber fraud and ease of digital interaction. The success of implementing CIAM, however, will depend on factors like the ability of a vast variety of stakeholders to work together, and how readily users embrace learning new software.

Meanwhile, risk functions of banks must exercise constant vigilance to cope with an influx of challenges: the London Interbank Offered Rate (LIBOR) is being phased out, gradually being replaced with alternatives such as risk-free rate (RFR) benchmarks. There are likely to be operational issues in the early stages, and banks will need to reduce LIBOR exposures and build demand for RFR-linked products. Information strategy, and outstanding hedge relationships and other agreements may need to be amended. Along with changes to valuation tools and risk models, banks would be well advised to consider the interaction between LIBOR transition and the implementation of the Fundamental Review of the Trading Book (FRTB).

Operational risk is becoming an increasingly significant area of focus. Headwinds may take the form of cyber threats, third-party concerns, trading, conduct and culture issues, anti-money laundering fines and sanctions, or stress-testing requirements. The fraud Risk regulations laid out by the Central Bank of Oman (CBO) provide detailed clarity on what banks should be doing to achieve best practice. They point out the main areas for banks to focus on: governance, identification and assessment, control and mitigation, business continuity management, information technology and systems, and reporting.

To an extent, a specific subset of risk, financial crime risk, can be reduced via a step-by-step method. This would involve reviewing the compliance risk assessment framework and the monitoring program, to validate the annual compliance plan, transaction monitoring and know-your-customer procedures. Technological developments like machine learning could be leveraged to maximize operating efficiencies, and risk mitigation measures designed and implemented to ensure compliance with the regulatory provisions on AML and sanctions. Oman is anticipating its Financial Action Task Force (FATF) Mutual Evaluation to be held in 2021, and independent evaluations of local banks’ AML and sanctions compliance frameworks have been undertaken to prepare for this.

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1. Increase of 1.9% as per the IMF World Economic Outlook Database, October 2018, https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/weorept.aspx?sy=2017&ey=2018&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=60&pr1.y=10&c=449&dsd=NGDP_RPCH&grp=0&a=

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Executive summary
The waxing crescent of the Islamic financial market is becoming systemically important as the GCC consolidates its position as a globally significant economic hub. The growth of Islamic finance may be sustained by addressing some key points. These include the ‘form over substance’ debate and the need for harmonization of standards. There is a pressing need for greater transparency, more Islamic banking experts, and strengthening the public’s confidence in the Shari’ah compliance of the products and services being offered.

With the arrival of a number of new local and international regulations, the scope of the compliance function is broadening, requiring skills that can consider risks facing the banks more holistically. Banks should update their compliance policies and procedures accordingly and ensure that they have implemented a comprehensive monitoring program. Self-evaluation of the board committee’s effectiveness will assist those charged with governance in the bank to formulate a clear plan of action to bring its operations in line with best practice, a process which may be aided by the appointment of an independent facilitator.

In conjunction with a strong control environment and robust regulatory procedures, equally vital is management’s approach to corporate culture. To restore or maintain public trust, it is imperative that organizations implement business strategies that place the interests of customers and the integrity of the markets ahead of profit maximization.

Finally, as banks internationally now include certain performance measures beyond key financial indicators, sustainability reporting is emerging as an essential consideration within Oman. While there may be some regulatory and policy gaps, banks are beginning to include environmental and social data to exhibit greater responsibility towards their stakeholders. Sustainability disclosures may help banks access new markets, and implement more rounded risk management processes. Stakeholders tend to no longer want their banks to simply exceed their financial targets, but to formulate a canny, forward-looking strategy for the long term.
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Ravi specializes in IFRS audit and advisory engagements, primarily in the investment management and banking sectors. He is a director in the financial services audit department and is registered with DFSA as audit principal. He is currently a part of the IFRS technical group which assists audit teams in addressing complex IFRS and auditing issues. Ravi also leads the investment management audit segment of KPMG in the UAE. Ravi has been consulted as a subject matter expert in various advisory engagements including financial due diligence, process and procedures reviews and development of a group accounting manual in the Lower Gulf. Harris spent seven years providing energy and natural resources-related advisory services at KPMG in Canada.
Key

- 2017
- 2018
- Yo-y improvement
- No change
- Yo-y deterioration

**Capital Adequacy Ratio (%)**
- 2017: 16.9%
- 2018: 17.0%
- Improvement: 0.1%

**Return on equity (%)**
- 2017: 6.6%
- 2018: 8.4%
- Improvement: 1.8%

**Return on assets (%)**
- 2017: 0.9%
- 2018: 1.1%
- Improvement: 0.2%

**Liquidity ratio (%)**
- 2017: 14.6%
- 2018: 18.7%
- Improvement: 4.0%

**Total loans subject to ECL – by stage as at 31 December 2018 (%)**
- Stage 1: 76.2%
- Stage 2: 20.7%
- Stage 3: 3.1%
- Stage 2 and Stage 3: 23.8%

**Non-performing loan ratio (%)**
- 2017: 2.2%
- 2018: 3.1%
- Improvement: 0.9%

**Coverage ratios on loans – by stage (%)**
- Stage 1: 57.7%
- Stage 2: 56.6%
- Stage 3: 4.5%
- Stage 2 and Stage 3: 61.1%
Innovation and technology
Most banks and other financial institutions have increasingly been recruiting specialists to spearhead innovation as a formal business discipline. Meanwhile, the financial regulators are also assessing the prospects of setting up regulatory sandboxes to encourage the development of new and innovative financial products and services.

Whilst the financial industry harbors a sincere intent to innovate, it appears there is still some way to go, before this desire becomes a tangible and visible reality from a customer experience perspective. Across the financial services spectrum, from basic retail and commercial banking, to wealth management, it is observed that there has generally been a paucity of innovation in the products and services being offered in the market.

Today, digital banking appears to be more of a ‘renovation’ of the service delivery channel than true ‘innovation’, a process that has long since occurred in other industries such as e-commerce. Banking services that were accessible at physical branches or websites are now being offered through smart phone apps. In essence, many banks have emulated and replicated what was happening elsewhere, albeit with a time lag, than having truly innovated.

**Innovation factors**

Cognizant of the challenges and opportunities for banks to enhance their innovation capabilities, KPMG launched its Digital Village in the region as an Innovation Centre. Based on extensive experience of working with banks in Oman and other parts of the world, there are some factors that we believe may lead to accelerating innovation for here:

1. **Senior stakeholder commitment:**
   While some banks have verbally committed to driving innovation, they have not always dedicated adequate funds and human resource support for the innovation team. Most innovation teams set up by banks are still largely a one-person show. In the absence of resources to work with, there is only so much the lone innovator can do on their own.

2. **Empowerment:**
   Although the Head of Innovation is given the responsibility of – and accountability for – driving the innovation agenda, he or she often has limited influence or authority over the different ‘siloes’ of customer experience, business development, and digital channels, which can further exacerbate the issue.

3. **Process for managing innovation:**
   Whilst innovation requires some unstructured and unconventional thinking, there is nevertheless a need for a structured process to manage innovation. It is advisable that banks ensure innovation of products and services have an appropriate lifecycle, passing through the stages of ‘ideation’ (ideas creation), acceleration (proof of concept), pilot and finally implementation, rather than taking a haphazard approach.

4. **Proactive collaboration:**
   For innovation to happen, internal and external stakeholders ought to be collaborating proactively. Internal turf battles, apprehensions with approaching the regulator, and limited know-how on how to truly engage customers through the product design and delivery life cycle, can all hinder the innovation process.

5. **Fear of failure:**
   For organisations to excel at innovation, employees should not have a fear of a failure or retribution. Senior stakeholders can encourage employees to “try and eventually succeed” rather than not try at all.

In an era where traditional banking methods are gradually being usurped by fintech and digital banking, the industry must remain alert and responsive to technological developments. Umair Hameed explores strategies to enable innovation in the sector.
6. Key performance indicators (KPIs) and metrics: Employees tend to perform in line with how they will be measured. Introducing specific KPIs and metrics that track performance and progress of the innovation agenda, not just of the Head of Innovation, but rather of every single employee in the bank, could go a long way to making the workforce more conscious of the need to innovate.

7. One size does not fit all: Innovation is about solving problems. Just as there are many problems to solve, there are many possible solutions. As problems evolve, the way in which we solve them also ought to evolve.

As both FinTech and the proliferation of Islamic financial institutions disrupt the banking industry, the need for banks to rapidly adapt to change, by pioneering and testing new practices, has become more pressing than ever before.

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The future of banking looks to be customer centric. As digital transformation has gathered pace, effective CIAM has become a key business driver within the GCC banking sector. Clients would like to have faster and more frequent access. There are five key customer needs that make CIAM a strategic enabler for the Omani banking sector:

1. **Ease of digital interactions:** Customers expect their banks to enable a seamless user experience in terms of onboarding and authentication across multiple channels e.g. internet banking, mobile banking, call centers, automated teller machines, and augmented reality interface. Mature CIAM environments may enable customers to complete identity verification or know-your-customer (KYC) processes online, saving Omani banks cost and time to maintain an offline KYC process.

2. **Personalized experiences:** The viability of modern banking institutions relies on their ability to adapt to shifting customer expectations. Not all expectations are alike, so they are looking for personalized experiences that reflect their individual security preferences. Mature CIAM environments enable seamless use of preferred authentication techniques across different channels, with enhanced contextual security and behavioral analytics capabilities.

3. **Intelligent solutions:** Omani customers expect faster solutions to their unique financial needs. Through the precept of a single digital identity that connects customer relationships across different channels, banks’ intelligent platforms can offer customers the products best suited to their financing needs. Such capabilities may transform the competitive landscape within the banking sector.

4. **Exercise privacy needs:** Customers want to exercise their privacy rights – for example, consent management and personal data access rights – seamlessly across different banking channels. Legislative changes also require Omani banks to implement robust data privacy capabilities (e.g. General Data Protection Regulation (GDPR)). Regulators around the world are enforcing harsher penalties for banks that allow personal data loss and unauthorized use of personal data.

5. **Protection against cyber frauds:** Cyberattacks and fraud techniques, internationally and in Oman, are increasing in terms of sophistication and impact, adding complexity to the balance between customer experience and security. Single identity can help build better oversight and control by Omani banks over any cyber security breaches by removing the overhead costs of managing multiple identities and associated access rights.

**Many benefits**

CIAM plays an integral role in providing a secure interface between the customer and banking applications through a seamless customer experience at extreme scale and performance, no matter which channels customers use to engage with the bank. It enables multiple functionalities to turn mere customer experience into true customer engagement, for instance:
Unified identity – A single identity is used to manage access to accounts and preferences across multiple channels. This provides a ‘360-degree view’ of the customer by tracking not only customer identity but also the customer’s relationship within the bank’s ecosystem, such as interfaces with the sales team, business partners and other banking units.

User registration: An easy to use registration interface spans multiple channels, allowing customers to register once and use services across web, mobile, automated teller machine (ATM), call center or any other emerging channels.

Single sign-on: Users may move between screens and applications seamlessly, without interruption.

Advanced authentication: Balancing security requirements with the customer experience requires advanced authentication techniques, e.g. biometrics and voice recognition, for high risk banking transactions.

Preference management: An easy to use interface allows users to manage their account profile and preferences, such as credentials, notifications, consent, access grants.

Device Profiling: Out-of-band validation of customer devices at the time of registration would validate a device that belongs to an authorized user (separate from user authentication).
Unification of functions

CIAM involves multiple business and risk management functions. Its transformation can be initiated by business functions to improve the customer experience, or by risk management to address fraud risk, cyber risk, or compliance risk.

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Managing headwinds
By investing in CIAM capabilities, Omani banks may elevate their digital identity management to enhance the way they provide value to customers. However, there are several challenges to consider:

– Involvement of a wide variety of stakeholders: CIAM implementation will involve stakeholders from different business units, including legal, compliance, cyber security and privacy. The success of CIAM implementation will depend upon common understanding and clear expectations amongst all the stakeholders of the bank. This can be a daunting task for any project manager.

– Too many priorities: Involvement of stakeholders from different areas, background, mindsets and viewpoints can lead to multiple and conflicting priorities. Prioritizing demands at an early stage in the process is critical to avoiding project delays. An essential part of the planning process is drawing a distinction between what people want and the actual outcome that is important for the bank, bearing in mind the constraints of time, effort and money.

– Lack of business involvement in the actual implementation: Business stakeholders play a larger role at the outset of the process. IT departments are, however, held accountable when it comes to actual implementation of the CIAM solution. The end result may often be a CIAM solution that does not quite meet the expectations of business users. It is important to keep all stakeholders well informed during every stage of development and implementation, so that course corrections can be made as needed.

– Lack of product training: Because CIAM impacts so many aspects of a bank, it is not possible for every affected party to have experience working with the platform. If business users are unable to effectively navigate the CIAM platform, it is unlikely they will want to continue using it on a regular basis.

– Poor user experiences: Legacy systems are designed primarily around security for well-established reasons. However, personalized experience is key to engage with today’s customers. It is not only important to store customer information in a centralized and secure manner, but also to ensure that this data is available for use in real-time in an optimum manner that serves the needs of the customer.

– Lack of scale: Whilst employee, partner and vendor identities are generally measured in the thousands, customer identities are often measured in the millions. Lack of an architecture that can deliver performance requirements regardless of the volume, variety or velocity of incoming data streams, may degrade the user experience.

– Security and privacy of personal data: Customer data often contains personal information which is sensitive and subject to a variety of laws and regulations, both Oman-specific and international. So the CIAM technology that collects and manages this data is likely to be a major concern for security, compliance, legal, and audit departments. Thus it is vital to adequately plan CIAM implementation with a defined set of priorities (use cases) and the ultimate objectives of an enhanced customer experience clearly delineated. Continuous involvement from different stakeholders within the bank should be encouraged, while concurrently ensuring compliance with security, privacy and other legal requirements.

“CIAM plays an integral role in providing a secure interface between the customer and banking applications through a seamless customer experience.”

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Regulation and risk
Headwinds as banks prepare for LIBOR transition

The phasing out of the London Interbank Offered Rate (LIBOR) will likely trigger an upheaval within the operations of financial institutions globally. Steve Punch addresses how the risks associated with its replacement could be managed.

LIBOR is currently the reference interest rate for millions of contracts globally, ranging from syndicated loans and retail mortgages to complex derivative products. However, LIBOR’s central role in the financial system appears to be coming to an end. Following the 2012 rate-fixing scandals, substantial efforts have been made to improve rate setting. However, significantly reduced volumes of interbank unsecured term borrowing, which is the basis for LIBOR, is calling into question its ability to continue playing this central role. Consequently, LIBOR is now based on less reliable expert judgment, which may inherently be vulnerable to manipulation.

Risk-free rate benchmarks

In 2017 the UK’s Financial Conduct Authority (FCA) announced that after 2021 it would no longer persuade or compel panel banks to submit the rates required to calculate LIBOR. In its stead, there is now a clear global direction of travel towards alternative risk-free rate benchmarks (RFRs) based on actual transactional data.

The transition from LIBOR to RFRs could introduce considerable costs and risks for financial institutions if not managed properly. The proposed alternative rates are calculated differently and payments under contracts referencing the new rates will likely differ from those referencing LIBOR.

The phasing out of the London Interbank Offered Rate (LIBOR) will likely trigger an upheaval within the operations of financial institutions globally. Steve Punch addresses how the risks associated with its replacement could be managed.
## Identification of key potential risks

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<th>Potential early mitigants</th>
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| The broader impact of transition, including operational issues and existing regulatory rules, may lead to delays. | - Educating senior stakeholders about requirements of the transition program  
- Ring-fencing adequate time and resources in their transition plans to address operational issues and the ways in which LIBOR may be integrated into other processes |
| Financial exposures to LIBOR continue to grow and lead to systemic risk by issuing new LIBOR-linked contracts. | - Target reducing LIBOR exposures and consider ways in which they can build demand in RFR-linked products over the course of the next few years |
| There are information asymmetries, inadequate disclosures and conflicts of interest as moving from legacy products to RFR-linked product give rise to conduct risk. | - A client communication strategy, underpinned by rigorous programme controls, is required  
- Implement segmentation of customers impacted by transition |
| Contractual continuity gives rise to legal risk as methodologies for calculating LIBOR and RFRs differ. LIBOR may become unavailable even though products referencing it remain in force. | - When identifying financial exposures, firms should analyze the contractual language used and the counterparties that will be affected. The vast majority of contracts that run beyond the end of 2021 will need to be amended to deal with the permanent discontinuation scenario. |
| Insufficient RFR liquidity makes it difficult to build a curve and price products. As the proposed alternative rates are mostly overnight rates, derivation of term structure for new rates is not defined. However, even if term-adjusted reference rates are produced, payments will still differ from the LIBOR rates, creating significant valuation differences. | - Banks should monitor liquidity in both legacy LIBOR and new RFR linked products across jurisdictions and should also assess whether a term rate is essential for all parts of the market.  
- The preferred Alternative RFR for US jurisdictions would be secured overnight financing rate (SOFR), having the Federal Reserve as the RFR administrator, while the UK would have the reformed sterling Overnight Index Average (SONIA) with the Bank of England as the administrator. |
| Accounting implications may result in de-recognition of contracts or discontinuation of hedge relationships. | - Banks should identify their LIBOR exposures and outstanding hedge relationships, consider whether amendment is needed and, if it is, evaluate how their existing hedges might be affected by it. |

The process of moving from IBORs to the new RFRs does not appear to be straightforward or without risk as uncertainties remain about the practicalities of transition – including whether IBORs will remain in existence post 2021. LIBOR transition is expected to be unlike any other transformation program and the risks are significant. Boards would do well to devise a planning strategy for individual banks, as well as the wider financial industry. The complexity and scope of the task ahead does not look to allow room for complacency or inertia.

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“**The transition will likely change banks’ market risk profiles.**"
Managing operational risk effectively

The hazards of various types of operational risk are wide ranging. Steve Punch takes a look at how bankers and regulators navigate compliance with a new standard, the identification of control weaknesses that leave institutions susceptible to fraud, and the need for stronger governance frameworks.

In recent years, banks globally and in Oman were occupied by the implementation of IFRS 9. This tended to dwarf all other competing priorities for the Risk and Finance teams. Regulators, too, appeared to be significantly engaged in the implementation of IFRS 9 and spent considerable time and resources reviewing calculated expected credit loss (ECL) charges under the new rules. Operational risk has now become a heightened area of focus for financial institutions as the industry wrestles with challenges arising from cyber threats, third party concerns, trading, conduct and culture issues, anti-money laundering fines and sanctions, stress-testing requirements, and technological innovations driving greater opportunities for process automation and digitization.

The Basel Committee on Banking Supervision (BCBS) first released Principles for the BCBS 195, Sound Management of Operational Risk in 2011. A review by the committee undertaken in 2014 highlighted that banks globally had not sufficiently implemented these principles which culminated in an additional BCBS paper, Review of the Principles for the Sound Management of Operational Risk, BCBS 292.

Taking notice of this, the Central Bank of Oman (CBO) issued more specific guidelines pertaining to fraud under Circular BM 1153. This is part of a growing trend across the GCC, with several regulators recently issuing new rules or refining existing rules relating to operational risk and fraud Risk that are in line with international best practice.

**Capital and guidance from Central Bank**

Operational risk is often regarded as the most challenging risk for both regulators and banks. The rationale for this is that nothing can prevent a bank from experiencing a significant adverse event. Ultimately, allocation of Pillar 1 capital (the regulator’s core measure of a bank’s viability, usually common stock and disclosed reserves) is designed to at least encourage bank boards and senior management to discuss how best to manage operational risk.

In most cases, Pillar 1 capital will likely be lower than the loss history for nearly all banks. The first reason is that ‘boundary events’ tend to get lumped 100% under credit risk losses, with no allowance for apportionment for related operational risk failures involved in credit losses, such as inappropriate models, insufficient monitoring or fraud. Secondly, losses resulting from operational risk generally tend to be under-reported, primarily due to the potential consequences and lack of awareness by bank staff.

Due to the inherently qualitative nature of managing operational risk (through implementing a robust internal control environment coupled with strong process-level controls), many banks tend to believe that they are already “best in class” with respect to their operational risk framework. Accordingly, regulators often see the need to spell out principles, standards and rules for banks to follow.

KPMG’s recent experience working with several GCC banks on operational risk initiatives implies there may be room for improvement in enhancing operational risk frameworks and how the seven operational risk event types (as defined by the Basel Committee) are managed. The event types comprise:

- Internal fraud
- External fraud
- Employment practices and workplace safety
- Clients, products, and business practice
- Damage to physical assets
- Business disruption and systems failures
- Execution, delivery, and process management
Next steps
It seems there is much work for banks to do as they strive toward operational risk excellence, including:

- Further positioning the operational risk management framework so that it is fully aligned with the banks’ strategy and viewed as an enabler of strategic change, business performance, and customer experience
- Elevating first and second lines of defense (LOD) involvement and results in strengthening risk culture
- Enhancing first LOD communication and escalation of issues outside of established risk appetite
- Improving the communication between the first and second LODs on emerging risks and changes to the internal and external environment
- Deploying end-to-end process risk assessments across business lines and divisions to develop a more complete picture of risk, dependencies, hand-offs, and redundant controls
- Expanding convergence efforts beyond risk taxonomies and rating scales to drive increased efficiencies and more effective analysis and management of risk
- Establishing robust operational risk dashboards supported by integrated data and tools to deliver consistently meaningful reporting to business lines, risk teams, executive management, and the board.

In particular, mitigating internal and external fraud losses is an area that is receiving significant focus from regulators and banks. The fraud risk regulations laid out by the CBO provide detailed clarity on what banks should be doing to achieve best practice. Some of the key areas for banks to focus on are the fraud risk framework, governance, systems, prevention and detection, alerts and reporting. Whilst banks have made some progress on meeting the requirements under the circular, there is still a long way to go.

Several Omani banks have already undertaken fraud risk framework reviews, whilst others are identifying material processes susceptible to fraud and undertaking fraud risk assessments. The CBO will undoubtedly include fraud risk reviews in its inspections in the future and banks need to be prepared for them.

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Steve has 25 years’ experience in Australia, UK, Japan, New Zealand and Hong Kong. He has worked for several blue-chip, international investment banks and has also been an independent consultant to a number of other, large global banks across Finance, Risk and Compliance. Before joining KPMG in 2011, Steve was a Director at UBS Investment Bank in Hong Kong leading a regional ASPAC initiative covering 16 countries from Japan to India to Australia. He has a particular interest in evolving banking regulation as a means to building stronger banking systems.
Financial institutions in Oman may soon start preparing for the country’s FATF Mutual Evaluation, which has been tentatively scheduled for 2021. The publication of the results would be critical for the image and reputation of the country’s financial services sector, as the outcome is likely to play a profound role in determining the way Oman’s anti-money laundering (AML) regime is perceived globally.

In pursuit of ensuring that the financial services sector is ready when the FATF evaluators arrive, it is possible that the Central Bank of Oman (CBO) may require an independent evaluation of their AML and sanctions-compliance frameworks similar to that mandated by the Central Bank of the UAE.

Having completed the assessments for multiple financial institutions between 2017 and 2018 in the UAE, KPMG gained some insight into the AML programs adopted by financial institutions. Most financial institutions performed well in terms of governance, training and assurance, and two areas were highlighted for potential improvement: risk assessment and monitoring.

The reality is that compliance functions have been striving to strike a balance between ensuring effective management of regulatory developments and reducing compliance cost. This appears to be turning into an increasingly challenging task, as the cost of compliance is rising exponentially with the accelerating pace of regulatory change.

**A step-by-step method**

The question arises how organizations can simultaneously prepare for the FATF evaluators, meet strategic compliance objectives, minimize compliance cost and effectively manage financial crime risk.

The answer may lie in a three-fold approach:

a) Prioritize a review of:
   i) the compliance risk assessment framework, to ensure it covers all business areas and enables financial institutions to identify and adequately prepare for money-laundering risks. These are continuously evolving with the entry of new financial products and players in the competitive market, as well as with Fintech developments such as digital finance and cryptocurrency
   ii) the monitoring programme in order to validate that the annual compliance plan, transaction monitoring and know-your-customer (KYC) processes address regulatory requirements and are aligned with the firm’s risk profile

b) Achieve operating efficiencies through, for example, integration of intelligent automation and innovative technology into the existing technology infrastructure. Compliance leaders could explore and leverage new technology capabilities to automate their compliance activities alongside similar transformations being undertaken by their business counterparts. For instance, robotic process automation (RPA) can assist in retrieving data for money-laundering investigations and scanning public databases for changes to laws, rules and regulations. Machine learning may be used to identify risks using public information and historical outcomes of previous investigations. Meanwhile, cognitive technology may be used, capable of mimicking aspects of human judgment to, for example, interpret transaction activity.

c) There should be a greater focus on effectiveness by ensuring that key risks are clearly understood, and mitigation measures are designed and implemented to ensure compliance with the regulatory provisions on AML and sanctions.
Clear protocol and canny investment
Moreover, in the process of re-assessing their AML regime, financial institutions should not overlook their conduct risk management programme. Money-laundering scandals and the ensuing enforcement actions continue to plague the financial sector. We can therefore expect regulators to remain keenly focused on business ethics and the demonstrable actions taken by financial institutions, both proactively and reactively, to prevent and manage misconduct. In order to be operational and effective, the compliance risk management and conduct risk management programmes should be aligned and governed by clear escalation and reporting protocols.

Banks are likely to benefit from compliance-driven investment in technology, systems and innovation that will equip them for fighting increasingly sophisticated financial crime. This should complement business-driven investment in strategic tools that empower sustainable growth and revenue.

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“The question arises how organizations can simultaneously prepare for the FATF evaluators, meet strategic compliance objectives, minimize compliance cost and effectively manage financial crime risk.”
The future of Islamic finance

The demand for Islamic finance is growing substantially, creating opportunities for experts to enhance industry standards and develop market-leading innovative solutions. Abbas Basrai ponders the steps that need to be taken to retain the momentum of the industry’s expansion.

Islamic financial assets were estimated to be valued at USD 2 trillion² in 2018, and are expected to grow in excess of 30% over the next two years, reaching USD 3.2 trillion by 2020³. Some of the fastest growing economic hubs include the Gulf Cooperation Council (GCC) region, Indonesia and Turkey. Muslims constitute approximately a quarter of the world’s population⁴, and are expected to grow to 29.7% by 2050⁵. Research indicates, however, that there is a significant opportunity worldwide to include Muslims in the formal financial system, and Islamic finance is also an attractive alternative for non-Muslims.

Islamic finance has become widely accepted in global financial markets with sukuk (Shari’ah-compliant bonds) issuance totaling USD 44.2 billion worldwide in the first half of 2018⁶. Several conventional banks have set up Islamic windows. With significant growth over the last 30 years, Islamic finance is well established as an alternative finance offering in global markets. As the sector matures, however, there are a number of areas requiring attention in order to sustain and accelerate this growth. These can include the ‘form over substance’ debate, the need for increased transparency, a requirement for harmonization of standards, more Islamic banking experts, and reinforcing the public’s confidence that the products and services being offered conform to Shari’ah principles. These issues are examined below.

Towards compliance
External Shari’ah audits can address the last challenge. Compliance with Shari’ah is the backbone of the global Islamic financial industry and a unique value proposition offered by the industry to its stakeholders.

Generally, internal Shari’ah auditors have the task of providing assurance over whether the financial institutions’ activities are performed in accordance with the rules set by the institution’s Shari’ah board. While this model has provided an additional layer of control, details are not typically disclosed to the public.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) has already made significant strides in enhancing standards. Some local regulators have implemented more robust governance frameworks and several have created a central Shari’ah authority. A centralized model is increasingly being adopted across the industry, with Oman, Bahrain, Malaysia, Indonesia and Pakistan having established unified, government-established Shari’ah boards in recent years. This is a trend that is anticipated to spread to other jurisdictions, which are likely to learn from one another.

We believe greater Shari’ah governance efforts will be high on the agenda of regulators as the industry becomes systemically important in certain countries. This will in turn increase the credibility of the industry and boost stakeholder confidence.

Towards harmonization
Increased transparency is likely to help address the ‘form over substance’ debate. In theory, deposit holders are entitled to share not only the profits related to the activities that their deposits finance, but are also required to shoulder their burden of the losses. This principle has likely not been applied consistently in the past and no Islamic bank has transferred any losses to customers over the past 30 years. Nevertheless there has been steady progress towards the implementation of this principle in recent years. An example is the Malaysian authorities’ decision to make such accounts truly loss absorbent from June 2016, giving customers the option of choosing between loss-absorbent accounts and non-loss absorbent accounts.

In addition, we understand that only a handful of Islamic banks disclose their profit and loss sharing formulae, profit equalization reserves, or investment risk reserves. The latter were created to help smooth the return on deposits during volatile economic conditions and reduce liquidity risk.

If the Islamic finance marketplace is to achieve a measure of global unity as regards its legal framework, the standards should be harmonized. At present, basic transactions, including sukuk issuance, can be complex and time consuming due to a lack of standardized legal and Shari’ah documentation. This is made more challenging by the fact that different markets may have different definitions of what is and is not Shari’ah-compliant. Which means Shari’ah documentation cannot be easily applied across borders. The process of issuing a sukuk should be as straightforward as issuing a conventional bond but this is not usually the case at present.

Towards innovation
The shortage of Islamic banking experts and a possible lack of innovation have created a gap in the market for the creation of new products that do not have a similar counterpart in conventional finance. There seems to be a strong imperative for new blood in the industry. Innovation requires expertise, including dedicated and well-trained personnel to research new ideas, their commercial application and the development of novel concepts.

Necessity can be the mother of invention: a problem may encourage stakeholders to exert every creative effort to solve the problem. The Muslim world is ready for pioneering banking solutions that will fulfil their financial requirements while allowing them to remain true to their religious values. It is the collective responsibility of scholars, regulators, bankers and government legislators to take heed of and respond to its needs.

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“Islamic finance has become widely accepted in global financial markets with sukuk issuance totaling USD 44.2 billion worldwide.”

7 https://gulfnews.com/business/banking/governance-structures-of-islamic-finance-needs-fine-tuning-1.1932448
Culture and sustainability
Globally, the regulatory environment is becoming more stringent for financial institutions, and Oman is no exception. Over the years, the Central Bank of Oman (CBO) has issued a number of regulations all in line with the regulator’s aim to enhance the governance, risks and controls environment across the banking sector, and to encourage financial institutions to adopt international leading practices.

Regionally, the regulations and standards pertaining to internal controls, compliance, and internal audit have been subject to development. We have seen several central banks across the GCC move to strengthen the internal control environment of banks in order to meet the changing market conditions and ensure the soundness and stability of the banking sector.

While the regulations do not specifically make reference to any internationally recognized frameworks, elements can closely be aligned to that of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Although most large banks in the region have defined internal control processes, they would be well advised to reassess their frameworks by conducting a diagnostic review of their existing target operating model, policies and procedures across the three lines of defense.

Keeping pace with regulatory changes
Additionally, banks should also revisit their board and board committees’ (particularly the audit committee) terms of reference and agendas. Along with adequacy of coverage, the board and board committees need to reassess the quality of discussions surrounding internal controls, compliance and internal audit. It is important to determine whether the board committees have access to senior management, are asking the right questions and receiving appropriate information on areas such as the impact of new technologies, emerging risks, risk limits, compliance observations and upcoming regulatory changes. This should enable the board and board committees to set the correct tone at the top and take relevant and timely strategic decisions.

Another key requirement is to have a strong and capable compliance function that can keep pace with the increasing regulatory obligations. Banks should update their compliance policies and procedures, streamline their activities and ensure they have an effective and comprehensive monitoring program in place. In order to maintain independence and objectivity of this function from the operations of the bank, it is important to clearly articulate the dual reporting lines to the chief executive and board or board committee. The compliance function is also required to be audited by the independent internal audit function.

Preventing money laundering and terrorism financing
With greater international pressure on the region to counter terrorist funding, the accountability and responsibility of compliance functions has also increased. Traditionally, job descriptions of compliance officers have been limited to reporting of suspicious transactions pertaining to anti money laundering (AML) and combating financing of terrorism (CFT). Without a complete regulatory repository, skilled compliance personnel and experienced head of compliance, banks may find themselves struggling to cope with an evolving regulatory environment.

Internal Audit’s traditional role is also evolving from performance of appraisals to that of a strategic partner to the stakeholders of the bank. The function is required to stay abreast of the emerging risks, rapidly changing regulatory requirements and business challenges.
Areas subject to assessment
Carrying out annual assessments of the internal control framework, compliance function, and internal audit function by the board is another area that banks should think about addressing in the short term. The board of directors/board committees may be well advised to obtain independent external evaluations of the compliance and internal audit functions. The potential elements subject to such a review may include the following:

“Along with adequacy of coverage, the boards need to reassess the quality of discussions surrounding internal controls, compliance and internal audit.”
### Internal Audit

- **Perception:** Does Internal Audit meet the expectations of its stakeholders (i.e. Audit committee, executive management, senior management, etc.) by adding value to the bank and enhancing business processes?

- **Positioning:** Is internal audit independent and objective, and is the function viewed as a valued contributor to the bank’s strategy?

- **People and skills:** Does Internal Audit have the right people strategy (internal auditing skill sets, relevant qualifications, technical expertise in the core and support functions of the bank – including IT, cyber security, regulatory compliance, risk management) to achieve its objectives?

- **Technology:** Does the Internal Audit use technology (e.g. testing and filing of work plans)?

- **Processes:** Are Internal Audit’s processes efficient, effective, and aligned with the Institute of Internal Auditors (IIA) standards and leading practices?

  *NB: internal audit processes subject to the review may include the following:

  - Is there an annual risk assessment process (in collaboration with Senior Management and the Board)?
  - Does the risk based internal audit plan cover potential emerging risks, new projects which are prone to high risks? Does the risk based internal audit plan include an appropriate mix of audits between the core and support functions and consulting engagement?
  - Is there sufficient time spent in audit planning? Is the audit scope comprehensive, relevant and appropriate? Does internal audit utilize data analytics in the audit planning phase?
  - Are the entrance and exit meetings effective in communicating the purpose, scope and results of the Internal Audit?
  - Are audits executed in line with the IIA standards and leading practices?
  - Are audit observations clearly, objectively and adequately reported in the Final Internal Audit Report (e.g. was the IA Report clearly understood, well-written, and organized?)
  - Are follow up audits conducted regularly and are the results communicated to the Board Audit Committee on a timely manner?

### Compliance

- **Policies and procedures:** Does the Compliance function have comprehensive and up-to-date policies and procedures?

- **Communication and training:** Does Compliance engage in regular and frequent communications and training programs for all of the bank’s key stakeholders (including board and employees)?

- **Technology:** Does Compliance use technology to support its compliance program (testing, training records, etc.)?

- **Compliance monitoring:** Does Compliance monitor and track regulatory change on a timely basis? Is a compliance risk assessment conducted to evaluate the residual risks of all regulations? Does it conduct transactional, process and control testing? Is third party and employee compliance due diligence included in Compliance’s monitoring program?

- **Issues management and investigations:** Does Compliance respond to government investigations/exams/inspections in an effective and timely manner? Are response plans and processes for investigating alleged non compliance appropriate and formally approved?

- **Reporting:** Is there periodic reporting to management and the board/board subcommittees on relevant compliance matters? Are all required regulatory reporting submitted completely, accurately, and in a timely manner?

- **People and skills:** Are the roles and responsibilities pertaining to compliance clearly defined and communicated to all stakeholders? Are performance management and compensation/incentives of those charged with compliance matters in line with the applicable regulatory requirements?
Strong self-review processes
Another area of importance is annual self-evaluation of board and board committee’s effectiveness. In Oman, the Capital Markets Authority has made it mandatory to conduct a board and board committee self-assessment via its Code of Corporate Governance. With increasing responsibility, it is imperative that the board and board committees measure performance against their set objectives. Rather than being a tick-box exercise, the results of the evaluations should provide actionable plans to improve effectiveness of agendas and discussions. The board may consider appointing an independent facilitator to ensure transparency of the process and unbiased results.

The changing regulatory requirements mark a clear shift to a more regulated environment as prevalent in American, European and some Asian financial sectors. Not only should banks ensure compliance with the current regulations but forward-looking banks may try to adopt leading practices from developed markets to meet the demands of key stakeholders.

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Harris is a director within the Advisory (Risk) function with experience in large scale business transformation and assurance projects in the leisure, hospitality, real estate, manufacturing, energy and natural resources sectors. Prior to joining KPMG in the Lower Gulf, Harris spent seven years providing energy and natural resources-related advisory services at KPMG in Canada.
The one common thread through the myriad of regulatory and innovation challenges facing the banking sector today is that an adequate response is only possible if you have a strong and positive corporate culture. This goes well beyond legalistic conformity to detailed rules. Banks also need to ask themselves some fundamental questions about their desired culture and values, and how these are reflected across their organization—and be prepared before regulators ask them much the same questions.

It is now widely accepted that a less than desirable culture was at the root of the 2007-2008 global financial crisis and that the ‘soft stuff’, i.e. poor leadership, behavior and informal norms, can no longer be ignored. The response by global regulators and the business community largely missed the fact that a focus on ‘hard controls’ is not enough: culture plays a significant role.

Instances of misconduct, for example professional misbehavior, ethical lapses and compliance failure, have also been reported with troubling frequency, many of which have resulted in negative financial impact on customers and markets, with significant monetary and reputational costs to financial firms. The underlying reasons for this misconduct lie principally in the underestimation or ignorance of the role of culture and conduct in any given organization.

Now some banking regulators, such as the Dutch Central Bank, have responded by incorporating culture considerations into their supervisory (oversight) guidance. These developments are triggering a sea change in governance, risk management, and internal audit focus.

**Increasing focus on culture**
The opportunity to deliver value and improve risk management through more focused attention on culture is significant. What is ‘culture’ and why does it matter? Culture is the intangible that is reflected in the choices and behavior of a firm’s employees. The values, goals, and priorities chosen by a firm to define ‘business success’ work together to create a firm’s culture. ‘Good culture’ is marked by specific values—integrity, trust, and respect for the law—carried out in the spirit of a fiduciary type duty toward customers. That means keeping the customer’s best interest at the heart of the business model and having a social responsibility toward maintaining market integrity.

It embodies the ethics of reciprocity (treating others as you yourself would wish to be treated) at all points of interaction between a firm and its customers, and between the employees of the firm. This would foster an environment that is conducive to timely recognition, escalation, and control of emerging risks and risk-taking activities that are beyond a firm’s risk appetite. A strong and positive culture can help address some of the challenges, as shown in the diagram.

Culture is a complex but highly valuable asset for organizations operating in competitive markets such as Oman. It is therefore important to observe, monitor and change their culture over time to support the successful realization of the organization’s vision and strategic priorities. The focus here is on the risk culture of a firm and related behavior, and not on all other aspects of corporate culture.

> “Board members and senior management, as the leadership of their organizations, are directly responsible for establishing and maintaining their firms’ culture.”

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**Culture: the root of misconduct?**

Culture has moved rapidly up the global agenda of financial institutions in recent years, with increasing interest in Oman. The opportunity to deliver value and improve risk management by paying more attention to culture is significant, argues Kenneth Macfarlane.
Given the current industry challenges, it is the right time for Omani banks to ask themselves some fundamental questions about their desired culture and values and how these are reflected across their organization. In order to set up the tone of culture within a financial institution, we believe that the board members and senior management, as the leadership of their organizations, are directly responsible for establishing and maintaining their firms’ culture. Regulators consider that to restore or maintain public trust it is imperative that each firm implements business strategies that place the interests of customers (retail, commercial, and wholesale) and the integrity of the markets ahead of profit maximization. That is, they must conduct business in the ‘right’ way (right price, right allocation, right product, fair treatment followed by ongoing execution) – doing what they should rather than what they can. Beyond this directive, limited regulatory guidance has been made available and firms are largely responsible for defining their own parameters of a ‘good culture’.

Creating truly sustainable, ethical cultures may mean in some cases abandoning policies and practices that have served Omani banks well in the past. This will require some tough decisions for banking executives, as they look to create the culture of their institutions for generations to come. Culture change will take years, perhaps a generation. Decisions made by banking executives today have the potential to shape the future success of their institutions. The banking leaders of today have a unique opportunity to create a cultural framework that will last a lifetime. Only by grasping this opportunity can banks provide the basis upon which trust can be restored and maintained in the coming years.

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Kenneth has worked in the Middle East for over 20 years, and has been based in Oman, Saudi Arabia and Bahrain. He was previously the Senior Partner for another Big 4 firm in Oman and Bahrain, and is now Partner in Charge for KPMG in Oman. Kenneth’s primary focus is providing audit and related accounting services to financial services clients; he also has extensive experience in advisory and compliance engagements.
Several factors have contributed to the recent, heightened awareness of the importance of sustainability and its social, economic and environmental effects – particularly in the banking sector. The Paris Agreement on climate change and the UN’s sustainable development goals (SDGs) have resulted in a USD 12 trillion market each year, and the potential for USD 90 trillion investment opportunities before 2030.

Changing investor concerns and increasing engagement in environment and social issues has given rise to emerging mandates and legislation. These include: the European Union’s mandatory disclosure on sustainability performance by the financial services sector for large public-interest companies and the Financial Stability Board’s Task Force on Climate Related Financial Disclosures (TCFD).

Larry Fink, CEO of Blackrock, one of the world’s largest investors, in his 2017 letter to investees stated “As wealth shifts and investing preferences change, environmental, social, and governance issues will be increasingly material to corporate valuations.”

In the Middle East, the Boursa Kuwait Stock Exchange, the Tadawul Stock Exchange (Saudi Arabia), the Qatar Stock Exchange, Abu Dhabi Exchange and Dubai Financial Markets are all now members of the Sustainable Stock Exchange Initiative (joining 83 global stock exchanges globally including the New York Stock Exchange and London Stock Exchange). This initiative aims to enable peer-to-peer learning for exploring how stock exchanges can enhance transparency and environmental, social and governance (ESG) related performance in order to encourage sustainable investment.

So what is the banking sector’s role in supporting the growing space of sustainable finance, and how is sustainability reporting supporting this trend?

“Sustainability reporting could also improve stakeholder engagement, brand reputation and social license to operate for banks, beyond the carbon footprint.”

Barriers to sustainable development

Although there has been an increase in the dialogue and rhetoric regarding sustainable finance in the region, the mobilization of both private sector and government capital continues to be measured. Some of the key barriers to sustainable finance include:

- Regulatory and policy gaps (including uncertain and inconsistent regulatory/policy regimes and differing regulatory regimes across regions)
- Transfer of knowledge and skills from the developed world to the developing world, particularly in the area of project generation
- Technology innovation to reduce cost (new technology/improvements)
- Challenges of attracting and mobilizing finance/investment into emerging economies given the level of inherent risk and risk/reward balances
- Challenges and costs associated with relevant small ‘micro’ projects and/or the lack of large scale projects in the region
- Need for sound transparent disclosures (most importantly data) to support investment decisions and due diligence processes, analysis and emerging new valuation methodologies.
The role of sustainability reporting
With credit risk and valuation approaches increasingly shaped by environmental, social and governance-related input, there is a pressing need for better reporting and market disclosures. Financial data alone is no longer sufficient.

In the Middle East, banks are only beginning to leverage the available environmental and social data to inform actionable business insight. At the same time, they are gradually putting more emphasis on sustainability reporting – though there is room for improvement. In KPMG’s 2017 Corporate Responsibility Reporting Survey, of the companies surveyed in Oman, only 30 percent of all entities were reporting their sustainability performance.11

In the banking sector, sustainability reporting may be useful in the following key areas.

- Sustainability considerations and analysis may allow banks to access new markets and explore new client engagement approaches. Examples include the Australian New Zealand Banking Group, which announced a sustainable finance12 target of USD 7.1 million, and appointed a head of sustainable finance. First Abu Dhabi Bank issued the only green bond in the MENA market in 2017. We have also seen banks begin to introduce ‘green loans’ and SDGs social bonds.

- Banks are aiming to implement sound risk-management processes, which involves aggregating, managing and integrating sustainability data and metrics with financial data to help understand and reduce their risk exposure. The assessment of climate risk exposure across lending portfolios is an example.

- New sophisticated in-valuation approaches have emerged, where banks look to incorporate non-financial considerations into valuations, recognizing that the ability to see the whole picture is fundamental to valuing a company or asset. Considering sustainability related performance has been found to identify potential upsides, ‘alpha’, where companies manage such issues better than their peers.13

- Sustainability reporting could also improve stakeholder engagement, brand reputation and social license to operate for banks. Other stakeholders such as consumers, governments and non-governmental organizations (NGOs) are demanding greater transparency and accountability.

Going beyond the minimum
Sustainability reporting goes beyond the carbon footprint and health and safety initiatives. Frameworks prescribe that companies should report on topics that are material to their company and their stakeholders. Financial institutions differ from most organizations in that their main impact is indirect, through their investments or lending portfolios, so sustainability performance should include both indirect and direct effects. Considerations include:

- Disclosure of sustainability or the environmental, social and governance (ESG) policy of the bank.
- Disclosure of the exposure to environment and social risks through lending and investments.
- Set targets and report on the impact made through lending and investment activities.

The lack of disclosure of sustainability data can represent a challenge. However this is gradually being addressed by governments in the region and stock exchanges. Christiana Figueres, former head, United Nations Framework Convention on Climate Change (UNFCCC), said that “Rivers of capital need to flow to assets and projects that are the right ones for the 2050 world we have to build.”14 Organizations would be well advised to include sustainability reporting within this list of projects, as it can act as an enabler for sustainable finance and facilitate the promotion of sustainable development. Increasingly, investors, employees, customers, and other stakeholders are calling for greater focus by banks on the long term, as set out in KPMG’s ESG strategy, and the long view – a framework for board oversight 2017.15

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Daniel joined KPMG Lower Gulf in 2018 as a Senior Manager in the Sustainability services team as a subject matter expert specializing in Global Reporting Initiative (GRI) reporting, strategy implementation development, corporate social responsibility, health and safety, and environmental management. Daniel has extensive industry experience working in the financial services, minerals and mining, logistics and consumer manufacturing industries.

Key banking indicators

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<td>16.3%</td>
<td>16.3%</td>
</tr>
</tbody>
</table>

### ROE/ROA

<table>
<thead>
<tr>
<th>Bank</th>
<th>ROE</th>
<th>ROA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahli</td>
<td>10.7%</td>
<td>11.3%</td>
</tr>
<tr>
<td>Alizz</td>
<td>3.8%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Dhofar</td>
<td>1.6%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Muscat</td>
<td>6.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Nizwa</td>
<td>0.9%</td>
<td>0.9%</td>
</tr>
<tr>
<td>Sohar</td>
<td>0.8%</td>
<td>0.8%</td>
</tr>
<tr>
<td>HSBC</td>
<td>8.2%</td>
<td>8.2%</td>
</tr>
<tr>
<td>NBO</td>
<td>1.4%</td>
<td>1.4%</td>
</tr>
</tbody>
</table>
The ECL numbers presented within this report are on loans and advances (including financing assets for Islamic banks) for the top 8 listed banks in Oman.

All the Omani banks mentioned, except the National Bank of Oman (NBO), report net impairment of financial assets which includes recoveries. Recoveries are presented separately in NBO’s statement of profit or loss.

Source: KPMG analysis of released figures for the top 10 listed banks.
<table>
<thead>
<tr>
<th>Bank</th>
<th>Tier 1 capital FY17</th>
<th>Tier 2 capital FY17</th>
<th>Tier 1 capital FY18</th>
<th>Tier 2 capital FY18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahli</td>
<td>0.7</td>
<td>0.1</td>
<td>0.9</td>
<td>0.1</td>
</tr>
<tr>
<td>Alizz</td>
<td>0.2</td>
<td>0.0</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Dhofar</td>
<td>1.4</td>
<td>0.2</td>
<td>1.7</td>
<td>0.2</td>
</tr>
<tr>
<td>Muscat</td>
<td>4.3</td>
<td>0.4</td>
<td>4.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Nizwa</td>
<td>0.3</td>
<td>0.0</td>
<td>0.3</td>
<td>0.0</td>
</tr>
<tr>
<td>Sohar</td>
<td>1.0</td>
<td>0.2</td>
<td>1.0</td>
<td>0.1</td>
</tr>
<tr>
<td>HSBC</td>
<td>0.8</td>
<td>0.0</td>
<td>1.0</td>
<td>0.0</td>
</tr>
<tr>
<td>NBO</td>
<td>1.3</td>
<td>0.1</td>
<td>1.3</td>
<td>0.1</td>
</tr>
</tbody>
</table>
### Net impairment charge on loans and advances (US$ million)

<table>
<thead>
<tr>
<th>Bank</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahli</td>
<td>9.3</td>
<td>17.4</td>
</tr>
<tr>
<td>Alizz</td>
<td>5.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Dhofar</td>
<td>12.9</td>
<td>30.0</td>
</tr>
<tr>
<td>Muscat</td>
<td>18.2</td>
<td>57.1</td>
</tr>
<tr>
<td>Nizwa</td>
<td>5.0</td>
<td>5.4</td>
</tr>
<tr>
<td>Sohar</td>
<td>4.5</td>
<td>45.4</td>
</tr>
<tr>
<td>HSBC</td>
<td>14.4</td>
<td>62.8</td>
</tr>
<tr>
<td>NBO</td>
<td>48.5</td>
<td>62.8</td>
</tr>
</tbody>
</table>

### CIR

<table>
<thead>
<tr>
<th>Bank</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ahli</td>
<td>35.3%</td>
<td>40.8%</td>
</tr>
<tr>
<td>Alizz</td>
<td>83.1%</td>
<td>113.1%</td>
</tr>
<tr>
<td>Dhofar</td>
<td>50.5%</td>
<td>50.5%</td>
</tr>
<tr>
<td>Muscat</td>
<td>42.6%</td>
<td>73.3%</td>
</tr>
<tr>
<td>Nizwa</td>
<td>61.5%</td>
<td>61.5%</td>
</tr>
<tr>
<td>Sohar</td>
<td>42.2%</td>
<td>64.2%</td>
</tr>
<tr>
<td>HSBC</td>
<td>47.9%</td>
<td>47.9%</td>
</tr>
<tr>
<td>NBO</td>
<td>73.3%</td>
<td>73.3%</td>
</tr>
</tbody>
</table>

### Credit rating

<table>
<thead>
<tr>
<th>Bank</th>
<th>Credit rating agency</th>
<th>S&amp;P</th>
<th>Moody's</th>
<th>Fitch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Credit rating agency</td>
<td>Outlook</td>
<td>Long-term issuer rating</td>
<td>Outlook</td>
</tr>
<tr>
<td>Ahli</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Alizz</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Dhofar</td>
<td>NA</td>
<td>NA</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td>Muscat</td>
<td>BB</td>
<td>Stable</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td>Nizwa</td>
<td>NA</td>
<td>NA</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td>Sohar</td>
<td>NA</td>
<td>NA</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td>HSBC</td>
<td>NA</td>
<td>NA</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td>NBO</td>
<td>NA</td>
<td>NA</td>
<td>Ba2</td>
<td>Negative</td>
</tr>
<tr>
<td><strong>Overall country rating</strong></td>
<td>BB</td>
<td>Stable</td>
<td>Ba1</td>
<td>Negative</td>
</tr>
</tbody>
</table>

Note: NA = Rating not available on ThompsonOne database, checked on 29 March 2019. Islamic banks have been presented in italics.

For source data refer to the data table (page xxx) in the Appendix section.
The information in this report is based on our authors’ in-depth knowledge of Oman’s financial services industry, allied with detailed analysis of banks’ financial performance. The GCC listed banks results report compares the performance of approximately 60 of the GCC’s leading listed banks. A snapshot of those findings is included on pages 36-39.
KPMG Lower Gulf Limited provides audit, tax and advisory services to a broad range of domestic and international clients across all sectors of business and the economy. We work closely with our clients, assisting them to mitigate risks and highlight opportunities. Established in 1973, KPMG Lower Gulf now consists of approximately 1,250 staff members, including more than 100 partners and directors, across six offices: Muscat, Dubai (three), Abu Dhabi and Sharjah. The KPMG member firm in Oman, along with the member firm in the United Arab Emirates, form KPMG Lower Gulf.

KPMG is widely represented in the Middle East and also has offices in Saudi Arabia, Bahrain, Qatar, Egypt, Kuwait, Jordan and the Lebanon. As well as having many of the region’s leading organizations and government-related entities as its clients, KPMG in the Lower Gulf has been party to numerous milestone engagements in the Middle East.

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KPMG was proud to be an Official Supplier of the Special Olympics World Games Abu Dhabi 2019 and the Official Sponsor of the Global Youth Leadership Summit. We were delighted to contribute to the world’s largest humanitarian sporting event and global movement. This aligns directly with our values of inspiring confidence and empowering change, of inclusion and diversity, of passion and purpose. We are honored to be associated with such a momentous and meaningful event, and for the opportunity to contribute to making it a life-changing experience for everyone.

About KPMG
KPMG’s dedicated financial services practice in Oman offers access to various key financial marketplaces. It delivers best practice advice and recommendations through an up-to-the-minute understanding of the vital issues facing the local and international financial services industries.

KPMG has experience in providing audit and other business services on a range of risk and financial issues to local and major multinational banks and insurance companies operating in Oman.

Globally KPMG member firms provide professional services to:

- 64% of the World’s 500 largest banks
- 77% of the top financial services companies in the Global 1200
- 73% of the financial services companies in the Financial Times Global 500
- 92% of the largest banking companies in the Fortune Global 500

Details of all the services we offer can be found on our website:

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