



Future of NBFI financing

Trends shaping the
financing industry in
Saudi Arabia in 2021

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KPMG in Saudi Arabia



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Foreword

The last eighteen months will be remembered in history as an exceptional period of unique circumstances for companies, governments and regulators around the world. In Saudi Arabia, key stakeholders acted quickly and decisively, cushioning the economic impact and allowing for restrictions to be removed rapidly.

Within the financial services industry, this trend was observed by both the banking sector and non-bank financial institutions (NBFIs). At first the Covid-19 pandemic had a considerable impact on business due to limited access to traditional means of transacting. The financing sector has quickly recovered and is on a continued growth trajectory — testament to many financing companies rearranging their operations and accelerating internal digital transformation.

Though the NBFi sector is not as large as other subsectors within the financial industry, it plays a pivotal role in the lending market. The NBFi sector is comprised of specialized financing companies that are active in specific market segments such as real estate, automotive, equipment, consumer and micro financing. With the Kingdom's ambitions toward increasing home-ownership, these companies are a critical factor of success.

In this first publication, we have analyzed the industry's financial performance through the lens of twelve financing and leasing companies regulated by the Saudi Central Bank (SAMA) in Saudi Arabia, providing a directional view. In addition, we have delved into wider trends that shape the industry, including the evolving regulatory environment of the financing sector. These findings are the result of our research and conversations with clients and industry leaders, some of which are also included in this report and to whom we are grateful for their valuable time and input.

We hope that you will find this new publication insightful and we look forward to your feedback.



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



Ovais Shahab
Head of Financial Services
KPMG in Saudi Arabia



NBFI industry at a glance

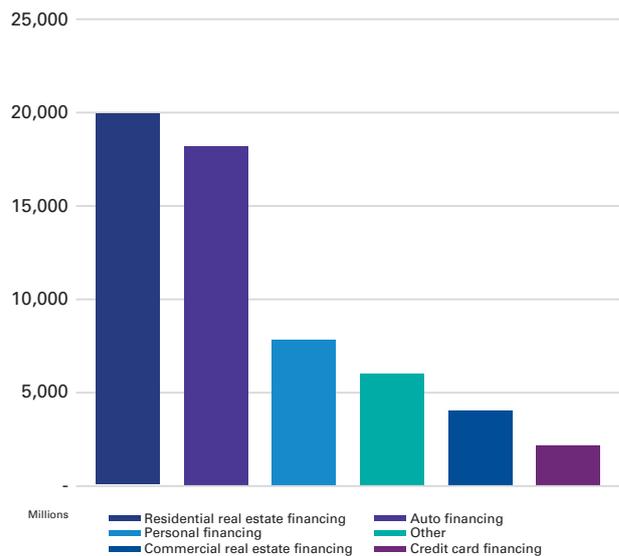
Currently, there are more than 35 licensed NBFIs in Saudi Arabia. Industry-wide assets total SAR 53 billion including the Saudi Real Estate Refinance Company (SRC) (real estate companies SAR 14 billion, non-real estate companies SAR 31.5 billion and SRC SAR 7.5 billion), and there was an outstanding loan book (on and off-balance sheet) of approximately SAR 54 billion (excluding SRC) as per December 2020.

Despite SAMA's new regulations allowing deposit-taking for finance companies, funding remains a major challenge for NBFIs as the new regulations have strict requirements to obtain no objection from SAMA. Currently, NBFIs are highly dependent on borrowing and securitization as the main source for financing their lending activities.

At the end of 2020, equity and liabilities totaled SAR 53 billion including SRC (real estate companies SAR 14 billion, non-real estate companies SAR 31.5 billion and SRC SAR 7.5 billion). Of this, liabilities accounted for 63%, while capital represented 27% and retained earnings and reserves represented 10%. SRC plays a unique role in the sector as the refinancing entity, backing up mortgage loans for the NBFIs.

Over the past two years, major developments took place in the sector, including the issuance of new regulations governing deposit-taking, debt-based and crowdfunding. Moreover, SAMA applied a new risk-based supervision approach to oversee the sector and increase the maturity level of NBFIs.

Loan book portfolio by financing segment at December 31, 2020 (excluding SRC)



Financing support programs

As part of the government's efforts to combat Covid-19 and mitigate its expected financial and economic impacts on the private sector, especially on SME sector, SAMA launched the **Private Sector Financing Support Program**. The program is aimed at supporting and enabling the private sector to promote economic growth through a package of measures that includes the following:



Deferred Payments Program

Delay the payment of the dues of the financial sector (banks and NBFIs) from SMEs which was extended until 30 September 2021.



Guaranteed Financing Program

In 2020, SAMA and Kafalah launched the Guaranteed Financing Program. This program guarantees 95% of the loan subject to approved mechanisms and intends to provide additional support and enhance the creditworthiness of micro companies.

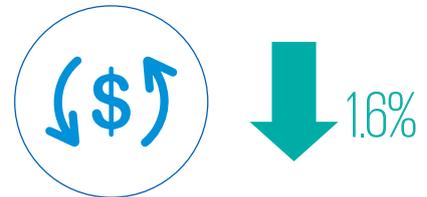
Industry performance 2020*

Total assets



As of YE-2020 SAR 45.6 billion
(As of YE-2019: SAR 38.4 billion)

ROA



2020: 1.9%
(2019: 3.5%)

Total credit portfolio (loan book, including off-balance sheet)



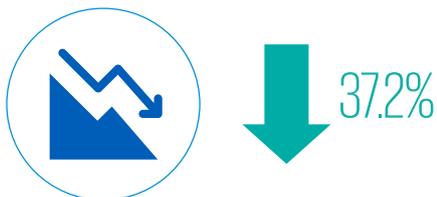
2020: SAR 54.1 billion
(2019: SAR 49.3 billion)

ROE



2020: 4.7%
(2019: 7.5%)

Profitability



2020 SAR 852 million
(2019 SAR 1.356 million)

Non-performing loans



2020: 8.2%
(2019: 13.0%)

*All figures exclude SRC

Regulatory developments

SAMA's continuing efforts to support the growth of the Kingdom's economy and safeguard financial stability resulted in the issuance of a number of new rules and regulations. The following themes are central in SAMA's recent regulatory updates to the financing sector.

Deposit taking regulations

SAMA issued deposit taking regulations for NBFIs in November 2020. Deposit taking financial companies (DTFCs) are authorized to receive savings and time deposits from non-individual customers and grant loans and advances out of such deposits. SAMA has introduced governance and risk management requirements as well as minimum capital requirements and liquidity requirements to be fulfilled in order to carry out deposit taking activities. The regulations also cover guidelines for submitting capital to risk weighted asset return and specific rules for opening accounts with DTFCs.

Debt-based crowd funding

SAMA issued rules for debt-based crowdfunding in December 2020. These rules establish licensing procedures and requirements for debt-based crowdfunding activities as well as set the minimum standards and procedures for debt-based crowdfunding companies. Such companies should apply for licensing in accordance with the requirements of the Finance Companies Control Law. Once the license is obtained, the company can raise funds from finance participants through a digital platform to be granted to an institutional beneficiary in accordance with a loan contract.

Credit risk exposure classification and provisioning

SAMA issued rules governing credit risk exposures classification and provisioning in November 2020 to set out the minimum requirements on credit risk exposure classification and provisioning. These rules also set out the governance requirements in relation to expected credit losses (ECL) provisions and credit risk practices adopted by the NBFIs for the assessment and measurement of credit risk. These rules provide quantitative as well as qualitative thresholds to classify credit risk exposures. These rules also cover the guidelines for restructured / rescheduled loans, forbore loans, write-offs, etc.

Liquidity risk management rules

SAMA recently issued draft liquidity risk management regulations for NBFIs, taking effect by 1 January 2022. These rules cover the guidelines to establish a governance structure to manage liquidity risk. These rules also require NBFIs to have a liquidity risk management framework which include liquidity risk management strategies, policies and procedures, stress testing and scenario analysis, etc. The rules also cover the requirements for Contingency Funding Plans (CFP) and internal controls relating to liquidity risk.

Emerging themes in the NBFi sector



Microfinancing

SAMA announced in 2020 it will issue licenses for microfinance activities, and in 2021 the first licenses were issued for Tamam Financing Company and Emkan Finance Company. Additionally, the new financing prospects will promote and support the sector and attract a new segment of investors and medium capitalists to work under SAMA's Supervision.

IPOs appetite of NBFIs

The market continues to recover steadily from the pandemic's implications, and many studies predict a sizeable pipeline for IPOs for the years to come. As a result of these encouraging circumstances, a number of NBFIs are currently opting for IPOs to receive funds from the market and increase their capital base. In 2020, Amlak International became the first NBFi listed on the stock exchange. The company floated 27.18 million shares, representing 30% of its share capital, of which 90% were allocated for institutions, with the remaining 10% offered to retail investors. According to the underwriter, NCB Capital, the IPO was 27 times oversubscribed - the institutional listing nearly five times. Other companies are expected to follow suit and utilize additional funds to grow their financing portfolios and to reach out to new segments of customers.

Tax developments

The tax landscape in Saudi Arabia for the NBFi sector has experienced three material changes in the past five years; the issuance of the Zakat law, the introduction of VAT coupled with the Royal Decree granting VAT relief to a segment of the market and most recently the introduction of the Real Estate Transaction Tax (RETT) replacing the VAT on real estate transactions. The introduction of these taxes has proved challenging for both the tax authorities and for real estate financing companies. The challenges have arisen mostly due to differing interpretations and viewpoints of what were initially ambiguous rules surrounding the application of such taxes. This ambiguity was particularly pronounced in the case of the VAT and subsequent granting of relief.

According to Mazin Al Ghunaim, CEO of Bidaya Home Finance, "mortgage finance companies are well equipped to comply and manage tax affairs provided the rules themselves are both clear and not subject to material and frequent amendment. In the case of both Zakat and VAT, initial implementation and compliance was problematic. As implementation of the RETT regimes have progressed, clarifications and modifications have resulted in a clear, equitable and compliant application of the rules in which mortgages finance companies can ensure all involved party's interests are protected - the authorities, developers, mortgage finance company itself and most importantly its customers."

A new challenge ahead will be the implementation of e-invoicing starting December 2021. NBFIs should be able to generate an e-invoice starting 4 December 2021 and to be ready for the integration phase with ZATCA starting January 2023.

Digitalization

The pandemic has enabled a great deal of digital innovations within the financial sector which consequentially supported NBFIs. For instance, these companies were connected to the Nafeth platform which allows companies to issue and manage executive bonds electronically. Additionally, SAMA licensed Tawtheeq which is a company for financial lease contracts (FLCs). Tawtheeq also allows registration between licensed companies that issue FLCs which in turn creates a unified platform where data regarding FLCs is gathered.

Wider themes in the financial services industry

Anti-money laundering compliance

Saudi Arabia has made significant progress in anti-money laundering (AML) and counter-terrorism financing (CTF) measures, especially since its acceptance into the Financial Action Task Force (FATF) in 2019. In the know your customer (KYC) area, financial institutions are working to further enhance KYC systems to allow automated assessments.

Fintech advancement

With regulators pushing full steam ahead for the development of the fintech sector in the Kingdom, financial institutions are now viewing fintech as enablers rather than simply disrupters. Among other initiatives, SAMA is operating its Regulatory Sandbox Framework, has issued new Payment Services Provider Regulations (PSPR) for international fintechs, and has issued new licensing guidelines. In turn, financial institutions are increasing partnerships with fintechs and leveraging their existing market shares to attract customers to their fintech offerings.

Cybersecurity

In line with the acceleration of digitalization and remote work, the prevalence of cybercrime has increased during the Covid-19 pandemic. With a rapidly evolving cybersecurity landscape, there are several key developments that are shaping cyber defence in the financial sector. The Cybersecurity Framework issued by SAMA is to be followed by all the NBFIs, in addition to the Financial Entities Ethical Red Teaming Framework (FEER) that was rolled out by the central bank to test the prevent, detection and response measures through hacking simulations.

Business continuity planning

The business continuity plans (BCPs) of financial institutions came squarely into focus last year. Those with the most agile and cross-functional plans proved to be the most beneficial for the organizations against the economic impacts of the pandemic. Financial institutions are now reformulating their BCPs with the lessons of 2020 in mind to prepare themselves for the kind of liquidity, credit, and market risks experienced during the last year.

Industry voices



Perspectives of industry leaders on emerging trends and developments

Pandemic response

The Covid-19 pandemic and its potential consequences has led us to check how we can contribute and support borrowers. Firstly, it led us to devise a forbearance regime that completed what SAMA instigated and focusing on private sector workers. Second, the pandemic raised the attention and scrutiny on the performance of the loans purchased or to be purchased. We see limited evidence at the moment of a significant worsening of the loans performance, at least in our portfolio. Credit should be given to SAMA and the government for the support provided to the economy in general. Finally, Covid-19 has led us to reconsider process and adaptations changes – remote working, digital data rooms and process digitization have all become part of the new normal.

Fabrice Susini
CEO, Saudi Real Estate Refinancing Company (SRC)

E-signatures

One of the digital acceleration objectives achieved during the pandemic was the implementation of an e-signature for real estate financing transactions. The service was developed in collaboration with the regulated digital signature provider under an initiative supported by the Saudi Central Bank. E-signatures facilitate real-time transacting between Bidaya Home Finance without the need to be present at a brick and mortar branch. A silver-lining of the pandemic has been a whole of ecosystem push towards digitalization across the government as well as the private sector which has benefited financial service offerings here in Saudi Arabia and worldwide.

Mazen Al Ghunaim
CEO, Bidaya Home Financing

Growth prospects

The scope of growth in the sector is quite tremendous with the availability of the large untapped market in both the public and private sector. As per our forecasts, the market is expected to grow by approximately 25% in the coming 3 – 5 years. The main challenge which may hinder the growth in our sector is the upcoming trend of large banks establishing their own finance companies. We understand that the regulators need to take necessary measures in this respect especially with regards to ensuring establishment of Chinese walls between the bank and their financing subsidiaries.

Gohar Iqbal Shaikh
CFO & Treasurer, Nayifat Finance Company

Customer experience

Excellent customer experience is one of the driving factors in business growth including our sales automation and after sales process. This will streamline our leasing finance process which makes us a unique leasing company in the market. In addition, economic growth and the availability of new car models will also contribute in the growth of our business.

Mashhor Al-Masudi
CEO of Saudi Fransi for Finance Leasing

Risk management

Over the past year, the risk profile of the company has evolved entirely. There are now more discussions to provide customers grace periods, payments holidays, and concessions - either mandatory or voluntarily. Concentrations to credit risks are focused more to balance the mix of customer base. Client profiles are closely monitored to identify any early difficulties. On the other hand liquidity risk has not been a problem, as due to many injections of support and lower rates, liquidity coverage has always remained more than the what we need. This opened with various investment opportunities that are being explored to reinvest the idle cash.

Ammar Abdul Latif
CFO, Alamthal Financing



Financial performance

To give a directional view of the wider NBFi industry, we have analyzed the financial statements of the twelve largest NBFIs in Saudi Arabia. In 2021, we can see that the growth pattern in the second half of 2020 has continued, particularly as consumer confidence returns. The latter is especially noticeable in the mortgage industry, where originating volumes are already higher than before.

Overall loan growth was motivated by a remarkable growth in real estate mortgage lending, which was supported by governmental initiatives to increase home ownership in the Kingdom. Further, mortgages to buy houses made up the majority of loans in 2020 due to the high demand for residential estate driven by one of the Vision 2030 objectives to increase home ownership in the Kingdom. Additionally, SAMA's Monthly Statistical Bulletin of April 2021 showed the significant growth in the number of issued contracts in the first quarter of the year, further revealing that 80% of the funds provided by banks and finance companies were for residential estates.

There was on-balance sheet loan portfolio growth of 16% compared to 2019, consisting of SAR 3.97 billion. The total loan portfolio amounted to of SAR 28.7 billion as of 31 December 2020. The loan portfolio for real estate NBFIs grew by SAR 0.68 billion (7% comparing to 2019), and SAR 4.5 billion (200% comparing to 2019) for SRC, while the non-real estate NBFIs witnessed a decline in the total loan portfolio by SAR 1.2 billion (9% comparing to 2019). This sharp increase for SRC is partly explained as the company onboarded a portfolio of loans from the Public Pension Agency in July and September 2020.

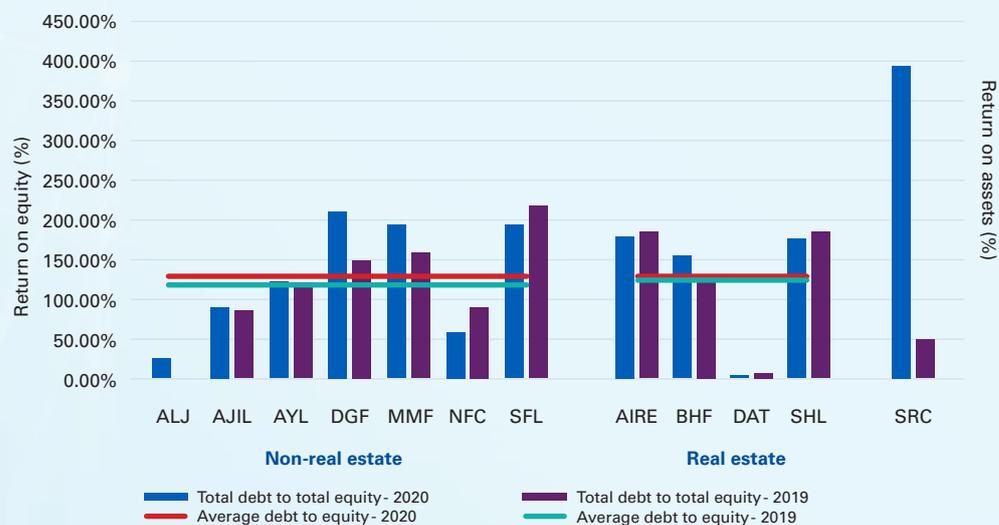
The total assets under management reached SAR 35.9 billion, a year-on-year growth of 20%. SRC contributed the most with a 230% increase in its total assets. Real estate NBFIs also showed a growth of 5% and non-real estate NBFIs witnessed a nominal increase in the total assets by 1% in 2020 as compared to 2019.

The reason for the increase in the loan book and asset base is directly related to government support programs such as those initiated by Monsha'at and the Small and Medium Enterprises Financing Guarantee Program (Kafalah).

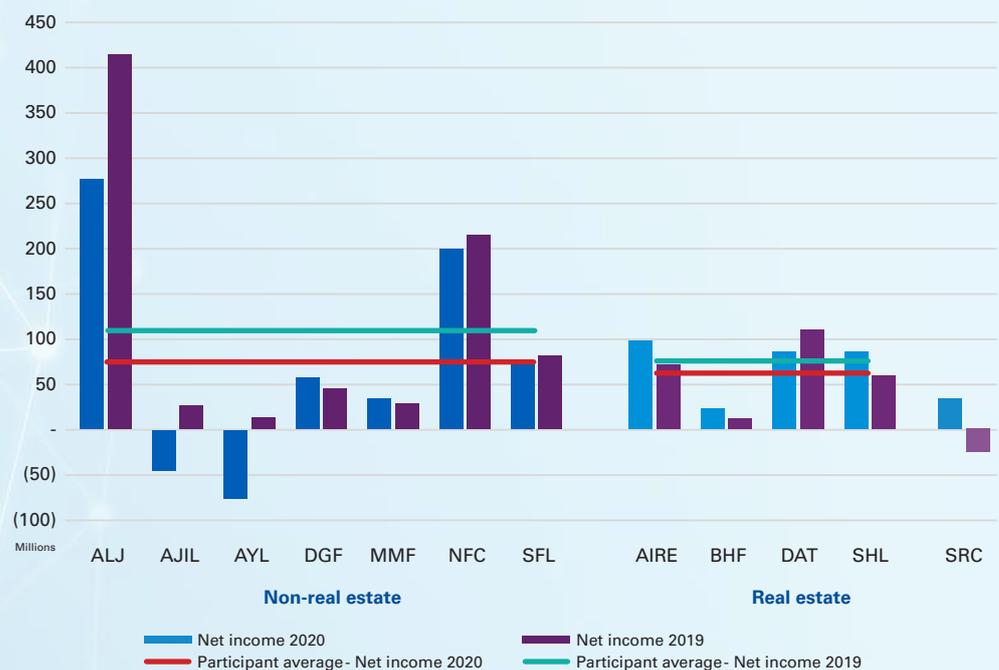
The profitability for non-real estate NBFIs declined sharply in 2020, by 36.6% comparing to 2019, which was mainly due to the decline in retail financing business, while ECL remained limited due to the SAMA deferred program. On the other hand, the profitability for real estate NBFIs grew up by 20.5% in 2020 comparing to 2019, of which particularly SRC had a tremendous growth in profitability in 2020, more than 280% comparing to 2019. Again, this was partly testament to the expansion of their loan portfolio.

Financial performance

ROE and ROA

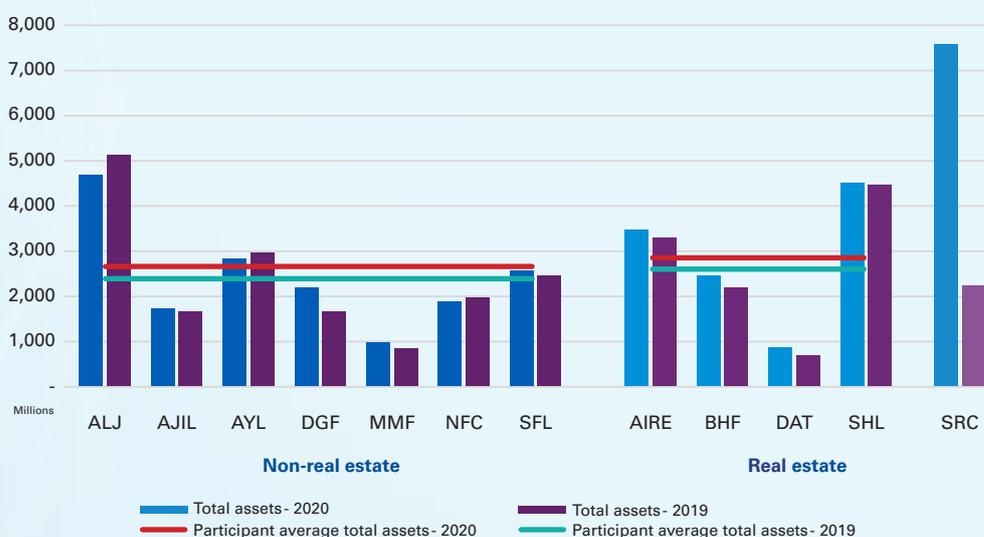


Net income



Financial performance

Total assets

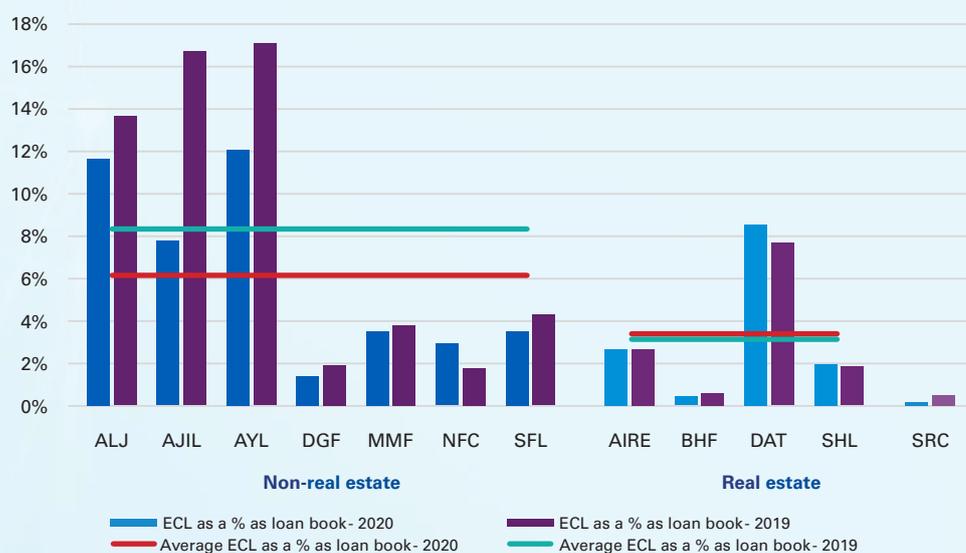


Loan book growth



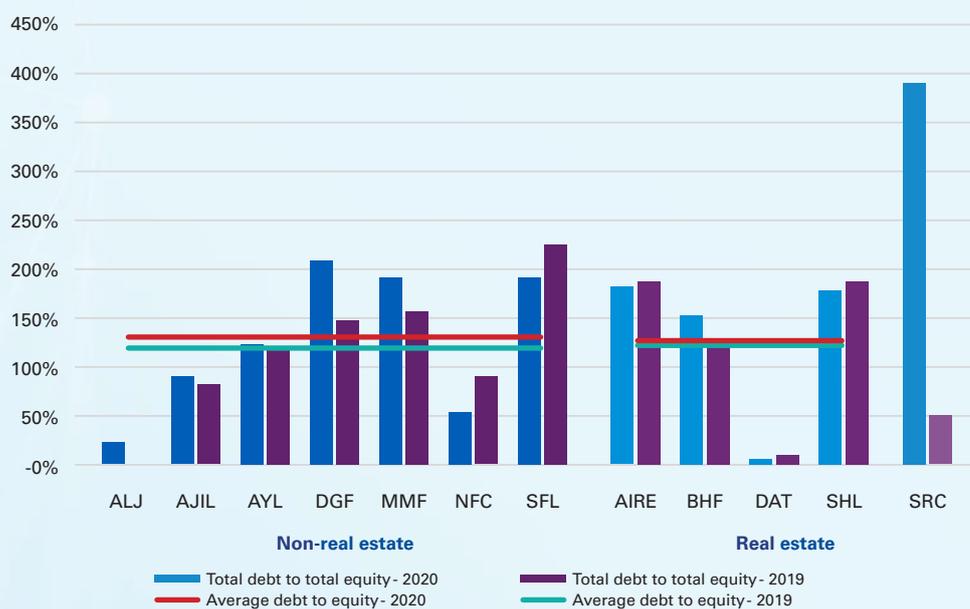
Financial performance

ECL to loan book analysis



Financial performance

Debt to equity



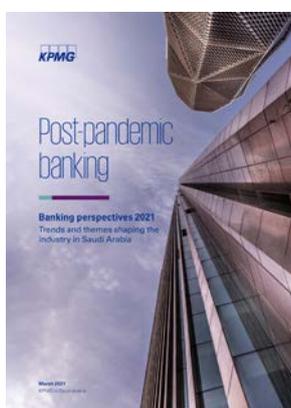
Legend

Abdul latif jameel united	ALJ	Deutsche gulf finance	DGF
AJIL financial services	AJIL	Morabaha marina	MMF
Al-yusr leasing and financing	AYIL	Nayifat finance	NFC
Amlak international	AIRE	Saudi fransi for finance leasing	SFL
Bidaya home finance	BHF	Saudi home loans	SHL
Dar al tamleek	DAT	Saudi real estate refinance	SRC

Further reading

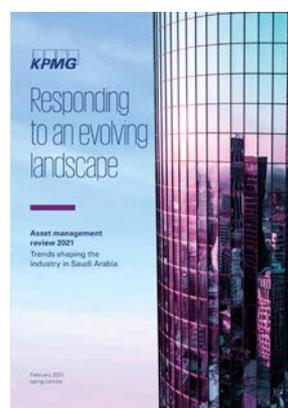
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Other publication on the financial services sector



Banking perspectives 2021

Annual flagship banking publication with a broad range of insights on the banking from our financial services team.



Asset management review 2021

Performance review of twelve large asset management firms and trends shaping the asset management industry in Saudi Arabia.



Future of insurance

Overview of macro trends that shape the global insurance industry, highlights from the recent CEO Outlook Pulse Survey interviewing 50 insurance leaders, and a performance review of the Kingdom's insurance companies.

Contacts



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



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

Financial Services team



Phil Knowles
Senior Director,
Audit



Mohamed Elswefy
Senior Director,
Tax



Faisal Sana
Senior Director,
Audit



Saleh Mostafa
Director,
Audit



Shadi Abuserryeh
Director,
Advisory

Contributors



Peter Bannink
Thought Leadership Lead



Rabee Shahid
Manager, Financial Services

kpmg.com/sa

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