How can MENA banks pursue transformational growth amid uncertainties?

MENA banking trends for 2024

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Executive summary

Charlie Alexander
EY MENA Financial Services
Managing Partner

Neelanshu Bhardwaj
EY MENA Financial Services
Client Executive Leader

The MENA banking sector has made significant progress while witnessing significant changes throughout 2023. Despite the challenges of rising inflation and evolving regulatory landscapes, banks have started to focus more on responsible banking and sustainability. They have proactively responded by investing more in technology-led innovation to address customer needs. As MENA banks look to the future, they must consider seven specific trends to continue on their transformation journey and deliver long-term value for all their stakeholders.

1 The expanding regulatory perimeter and emerging regulatory shifts

Sector convergence, geopolitical risk and operational resilience will expand the regulators' sphere of interest. Hot topics will include new regulatory risks coming from Basel III implementation (including IRB models), digital transformation, partnerships with FinTechs, artificial intelligence (AI) and lastly open banking. We expect to see a regulatory shift of focus to "conduct of business" risks and more attention on the fair treatment of customers and on enhancing corporate culture.

2 Pressures mount to act on climate change and sustainability

The COP28 in UAE highlighted the significant influence of the financial services sector, through mobilizing capital, MENA governments, regulators and investors will expect banks to drive decarbonization, sustainable finance and the wider sustainability agenda.

3 Technology-led drive toward new products

Banks are being encouraged to explore and deploy new technologies as the MENA financial services sector forges ahead with innovative new products. Digital assets including mobile money and central bank digital currencies (CBDCs) will enhance the efficiency and functionality of payments and other financial services.

4 Evolving SME banking customer expectations and wider FinTech opportunity

SME customers are increasingly digital-driven and banks must deliver on augmented experiences (everyday digital vs. someday branch). Based on the way small-and-medium enterprises (SMEs) engage and interact with their banks, there is an opportunity for banks to collaborate with the increasing number of players providing SME financial services (FinTech, RegTech, PayTech, InsurTech) to innovate at scale and serve SME customers better.

5 Financial services in experience age: embedded finance and open-ecosystem models

Sector convergence is leading forward-thinking banks toward infusing in-the-moment embedded Financial Services (EmFi) into customers' digital journeys. Banks are exploring platform-based strategies as Banking as a Service (BaaS) and open-banking ecosystems models to unlock new revenues beyond traditional banking.

6 Competition for talent intensifies as multiple priorities impact the talent proposition

Competition for MENA-based skilled professionals in financial services remains strong due to ongoing growth. Banks will have to redefine their talent proposition to increasingly prioritize nationalization efforts. This will be done through cultivating new skills and capabilities, and fostering the leadership necessary to navigate the rapid evolution in the regulatory environment and technology landscape and to handle the high levels of business innovation.

7 The rise of generative AI will drive further banking transformation

The AI landscape in MENA banking is rapidly evolving with a notable shift toward generative AI (GenAI) models. This will open up transformational opportunities for risk assessment, fraud detection, hyper-personalization and new intelligent virtual assistants. MENA has a chance to be at the cutting edge of these new innovations and solutions.

Section 02

Banking sector insights

1

Rising need for ESG frameworks

COP28 happened, reflections and predictions

Dusko Dincov
EY MENA Financial Services
Sustainable Finance Leader

United Nations Climate Change Conference 2023

The 28th United Nations Climate Change Conference (COP28), held in Dubai in December 2023, marked a historic juncture in international climate action. Attended by over 85000 people, it stands out as the largest summit ever convened on climate change. Not only does the sheer scale of the event stand out, but also the unprecedented level of engagement from the private sector, particularly the high level of collaboration between public and private entities.

Financial institutions (FIs) are set to benefit significantly from the UAE consensus established at COP28. The consensus emphasizes a swift transition away from fossil fuels, offering clearer direction for investments in renewable energy and sustainable infrastructure. It recognizes the need for increased financing, paving the way for massive investment opportunities. Moreover, the consensus promotes collaboration, innovation and regulatory clarity and facilitates responsible investment practices. FIs that align with these principles will be well-positioned to capture emerging opportunities and contribute to a sustainable future. Challenges remain, but proactive strategies aligned with the UAE consensus promise a resilient and impactful approach to climate finance.

Transition away from fossil fuels

The COP28 agreement heralds a significant shift away from fossil fuels, presenting both opportunities and challenges for the FIs in the Gulf Cooperation Council (GCC).

While diversification promises new markets and enhanced reputation, it also demands strategic planning and adaptation to evolving regulations. MENA FIs possess a strong financial base and government support yet lacks experience in green finance, and can face bureaucratic hurdles. Collaboration and innovation will be key to navigating the transition successfully. Ultimately, embracing sustainability will not only mitigate risks but also position MENA FIs as leaders in the global shift toward a sustainable future.

Global fund for loss and damage

An operationalized global fund for loss and damage emerged as a pivotal outcome of COP28, offering crucial support to vulnerable developing countries grappling with climate change impacts. The global loss and damage fund is a financial mechanism established to assist developing countries, particularly those most vulnerable to climate change, in addressing the economic and non-economic losses and damages they experience due to climate change's impacts. These impacts can include extreme weather events like floods and droughts, as well as slow-onset events like sea level rise and desertification. Financial pledges from various nations, including Germany (US$100m), the EU (US$245.39m), the UK (US$51m), Japan (US$10m), the US (US$17.5m) and the UAE (US$100m), underscore the commitment to address loss and damage concerns. These contributions bolster the fund's objectives, enhancing resilience and fostering adaptation measures in climate-affected regions.

Renewable energy and efficiency commitments

COP28 witnessed 116 countries commit to tripling renewable energy capacity by 2030, with a targeted expansion to at least 11,000 gigawatts (GW) globally. To achieve this ambitious goal, investment in renewable energy needs to more than double, exceeding US$1.2t annually by 2030. Such commitments signal a collective effort to accelerate the transition toward renewable sources, essential for achieving net-zero emissions by 2050 and combating climate change effectively.

Mobilizing sustainable finance and digitization

The Central Bank of UAE (CBUAE) spearheaded efforts to mobilize US$270b in sustainable finance by 2030, aligning with COP28's sustainability goals. Collaborating with the COP28 presidency, the CBUAE organized a finance day event to drive global climate finance solutions. Banks like First Abu Dhabi Bank (FAB), Mashreq, Emirates NBD, and others pledged to contribute to this target, totaling over US$270b. The CBUAE emphasized the pivotal role of digitalization and advanced technology in driving sustainable finance and highlighted COP28 UAE TechSprint's innovative solutions to scale up climate action.

The COP28 UAE TechSprint, orchestrated by the CBUAE, propelled innovation in sustainable finance through technology. Partnering with international financial institutions, the initiative aimed to fast-track solutions for green financial challenges. With 126 submissions globally, 15 teams were shortlisted and supported to develop their ideas. Winning solutions included AI-driven environmental, social and governance (ESG) data analysis and blockchain-based carbon tracking. The TechSprint showcased technology's potential, fostered collaboration and inspired further adoption of sustainable finance solutions. However, scaling and implementation remain ongoing challenges in realizing its full impact and achieving a sustainable financial ecosystem.

Climate solutions investment platform

Investcorp launched a US$750m climate solutions investment platform, partnering with the "Innovate for Climate Tech" coalition. The initiative aims to nurture global climate technology ecosystems, supporting ventures focused on decarbonization and climate resilience. The COP28 in Dubai marked a pivotal moment for the MENA region, offering both opportunities and challenges in the fight against climate change.

What happens next

The 29th session of the Conference of the Parties (COP29) to the United Nations Framework Convention on Climate Change (UNFCCC) will be held from 11 November to 14 November 2024, in Baku, Azerbaijan. The conference will focus on advancing the goals of the UNFCCC and the Paris Agreement, including the efforts to limit global warming, adapt to the impacts of climate change and mobilize financing for these activities. The conference will encompass several key meetings: the COP 29, the 19th meeting of the COP as the Meeting of the Parties to the Kyoto Protocol (CMP 19), and the sixth meeting of the COP as the Meeting of the Parties to the Paris Agreement (CMA 6). A primary focus of these gatherings will be to finalize the first enhanced transparency framework and establish a new collective quantified goal on finance, among other critical issues.

2

SME banking: driving innovation

Overcoming challenges in the MENA's SME landscape

Serkan Memisoglu
EY MENA Financial Services
Customer and Growth Leader

The MENA region is an active hub for SMEs.

More than 90% of the businesses in the MENA fall under the SME category. These enterprises are pivotal to the economy, making up to 60% of the non-oil GDP and creating numerous job opportunities. Despite their significance, SMEs often face growth challenges, particularly due to financing issues.

According to EY teams' research, less than 10% of all lending in the MENA region goes to SMEs, one of the lowest rates worldwide.

However, numerous SMEs in the MENA region are optimistic about their growth in 2023, with SMEs in the KSA, Qatar, and the UAE leading this positive outlook.

Challenges confronted by SMEs in MENA

Our detailed analysis uncovers the daily struggles that SMEs, the key drivers of the economy, deal with. Primarily, SMEs wish for more business advice from banks to better understand and use their products and services. The onboarding process is often difficult due to time-consuming paperwork requirements and varying procedures across different banks. Secondly, SMEs are struggling with the inflow of cash. In addition to this, high interest rates are testing their profits. It is becoming challenging for SMEs to survive in the long run considering the high cost of borrowing. The SME segment gets the hardest hit when it comes to loan rejections and they express dissatisfaction about the explanation provided for their rejection. Despite these hurdles, SMEs are looking forward to advancements. Considering existing challenges, SMEs are voicing the necessity for digitalization in banking processes, heightened efficiency and fostering innovation. Conversely, banks are persistently aiming to reduce costs while exploring avenues to optimize their operations. SMEs are hopeful that banks will offer more than just loans, providing additional value-added services to ease their journey.

Recent trends in SME financing

Banks are using digital platforms to make onboarding and loan processing simpler, seeking to improve overall customer satisfaction. Data analytics and AI support these platforms, transforming loan processes and offering tailor-made banking solutions for SMEs. Banks are also crafting a supportive ecosystem involving government agencies and industry bodies to stimulate partnerships between SMEs, suppliers and buyers. This collaboration aims to encourage innovation and growth.

As this unfolds, banks are improving their services, becoming more than just sources of funding. They are turning into strategic partners, mentoring SMEs, offering business advice, and even resources for better financial understanding. The end goal is to help SMEs make smarter financial choices and increase their financial knowledge. Additionally, alternative forms of funding like crowdfunding and peer-to-peer lending are becoming popular. These novel funding sources, facilitated by FinTech solutions, provide SMEs with flexibility in raising capital.

Next to this, the spotlight is on sustainability. As SMEs move toward greener products and services, banks are supporting them by offering specialized loans, grants and incentives. Collaborations with environmental organizations are guiding green financing strategies, giving financial support to SMEs on their path to sustainability.

Improving bank services for SMEs

Envision a future where banks are not just places for financial transactions but act as powerful platforms guiding the growth of SMEs. Banks, especially the large and global ones, can provide a network where SMEs can build their success stories globally.

User-friendly services not only strengthen customer relationships but also provide data to improve services and efficiency. With the adoption of emerging technologies, banks are providing digital platforms to streamline onboarding processes, improve efficiency and reduce physical paperwork to benefit SMEs in their banking journey. Clear and transparent communication regarding loan applications, approvals, rejections and potential changes in interest rates or terms will further improve customer experience for SMEs. To achieve this, it is essential to have accurate and reliable data that can be accessed throughout the banking ecosystem.

These days, offering generic services for all, simply doesn't suffice. Banks are focusing on value-adding services designed specifically for businesses within certain industries. They aim to be a daily part of an SME's operations rather than being there just for occasional transactions. By using industry benchmarking and other data-focused services, banks are helping SMEs effectively navigate competition. For small businesses dealing with various systems like payments, accounting, HR and bank transactions, they need an integrated system that is more simple. Banks deliver this through a one-stop solution. They are also moving from relying purely on past data to using automated services based on real-time transactions. This allows them to pinpoint exact moments when SMEs require different services.

With the evolving banking landscape, relationship managers (RMs) are becoming key business advisors instead of just sales-oriented roles. With digital tools powered by GenAI, RMs can gather important insights specifically for medium enterprises. This knowledge allows them to offer personalized advice, which solidifies their role as a trusted advisor in the industry. Banks are additionally providing workshops, webinars and mentorship programs to help SMEs understand different financial products and how they can benefit in their business.

By using these new strategies, banks are not just making SMEs more loyal, but also increasing their market share.

What happens next

Key pillars to reimagine SME banking transformation in order to better serve SMEs are:

- **Digitization to meet evolving SME expectations:** SME lifecycle journeys require SME banks to achieve an optimum balance with a unified omni-channel strategy and augmented experiences (everyday digital vs. someday branch).
- **Leverage new technology to transform into SME specialists:** Leverage AI and analytics to offer greater personalization and deliver compelling, contextual offerings across a broad range of solutions to run, control and grow SMEs business.
- **Leverage SME ecosystem to strengthen "beyond banking" solutions:** Based on the way SMEs engage and interact with their banks, this provides banks an opportunity to define their role in this ecosystem, collaborate through alliances to innovate, challenge sector boundaries and serve SMEs better.
- **Emergence of embedded finance and BaaS platform to unlock revenue streams:** Forward-thinking SME banks are moving toward infusing in-the-moment EmFi in SME journeys, where SMEs can buy core (e.g., credit) and non-core services (e.g., ESG), and monetize white label versions of their digital tech platform.

3

Mergers and acquisitions (M&A)

Prospects for more consolidation in MENA banking

Mayur Pau
EY MENA Financial Services
Strategy and Transactions Leader

MENA banks of the future: mergers and international expansions

Overview

In the last few years, we have seen several bank mergers take place in the MENA with further mergers either rumored or announced in the market. Bank mergers are not a new concept, but with the growing economies and economic diversification taking place in the region, they are starting to make more sense for local institutions that want to become prominent global players.

Bank mergers are on the rise as banks face the pressures of their home market and begin to consider promising opportunities in new markets which acts as a key to the drive of international expansions. With foreign operations now accounting for approximately 15% of banking assets in the MENA, international business is gaining significance as a key avenue of long-term growth.

Home market challenges include slow growth, profit struggles from market saturation and tough competition, the need to diversify globally, meet international corporate demands, and leverage trade and expatriate opportunities. We discuss below the opportunities with respect to both banking mergers as well as the international operations and expansion plans that MENA banks may be considering in the future.

International operations of banks and future expansion plans

Many MENA banks note attractive long-term growth potential in emerging markets, as a result of exits by certain European banks that are creating inorganic opportunities for MENA banks, as well as due to the weakening of currencies in select target international markets.

Most small-to-mid-sized banks, whether conventional or Islamic have operations in five or lesser countries with a global footprint mostly limited to MENA countries. Select large banks, all conventional, have built a more aggressive footprint to create a global proposition.

Furthermore, several MENA banks observe a healthy capital position, requisite scale and supportive shareholders which provides the necessary foundations for international expansions.

However, not all international expansion strategies have yielded the desired returns. In the past few years, one of three MENA banks incurred losses in their international operations. For many banks, international operations have become a drag on overall profitability as their returns are below home-market operations and internal hurdle rates. Nevertheless, history has shown that MENA banks can create greater shareholder value through optimization of their existing country portfolios and through selective investments in new strategic markets.

A portfolio review can reveal significant value creation opportunities that would boost a bank's return profile. Moreover, it can identify where capital and resources can be freed up for investment in more promising markets.

> History has shown that MENA banks can create greater shareholder value through optimization of their existing country portfolios which may involve merging with another bank as well as through selective investments in new, strategic markets.

There are seven primary factors for under-performance of an international portfolio which could be mitigated against by performing a meaningful portfolio review. These are:

- Lack of clarity on long-term strategy and aspirations
- Sub-scale operations
- Business risks that are not adequately factored
- Continuing unviable product lines
- Limited offerings with no differentiation
- Limited management focus and/or investment from the headquarters
- Inappropriate set-up with a sub-optimal licence

MENA banks can significantly improve returns by addressing these sources of value leakage. If banks can successfully address the factors of an under-performing portfolio and mitigate risk, they will see the benefits in both the local and global markets.

Banking mergers and market consolidation

While bank mergers may be tempting due to cost and revenue synergies, the strategies to execute such a consolidation vary significantly and there is no "one size fits all" approach.

Each division has its role to play in securing the success of the merger. For example, to ensure governance, a steering committee must be created to represent all parties early on in the process. This steering committee would typically resolve the key merger issues on a continuing basis, drive the overall integration process and synergy realization. It would also have a defined integration plan that lists the resourcing structure for each of the main workstreams.

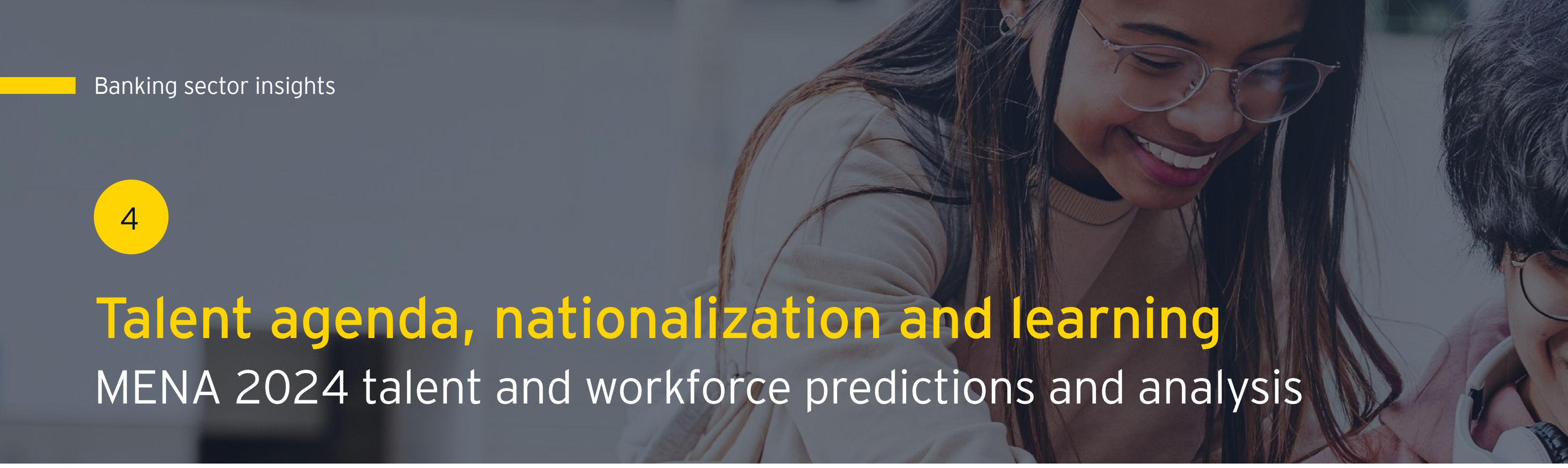
The opportunities for bank mergers are high, especially since financial institutions will continue to face the pressure of cost reductions and an increased focus on cost-to-income ratios for the next several years. To accommodate these challenges banks are looking at the potential optimization of their international operations and determining the markets to grow and remain in when compared to the markets that wind down operations in or completely exit (as noted above). In addition, bank mergers increase the potential ability for the new combined bank to raise funds as a result of an increase in public confidence and a potential improvement in the credit rating of the new entity. The merged bank's cost of funds may potentially decrease because of a wider range of correspondent banking relationships and a potential decrease in the risk profile of the entity.

Perhaps the biggest benefit is the cost synergies banks will experience as the result of a merger, which is typically driven by the consolidation of overlapping branches between banks, operation efficiencies through the combination of international offices based in common geographies and other core and non-core functions. Combining correspondent banking relationships also result in a wider network of correspondent banks and proportionally lowers the minimum relationships required. requirement. In addition to cost synergies, revenue synergies will also be driven by complementary products and services that can be offered to the combined customer base. Finally, there is also the opportunity to benefit from funding synergies. There are several key considerations that must be evaluated ahead of a bank merger. They include facets such as:

- Strategy
- Finance
- Accounting
- Regulatory
- Governance
- Operations
- Communication

What happens next

Banks can create greater shareholder value through optimization of existing country portfolios which may involve merging with other banks as well as selective investments in new strategic markets.



4

Talent agenda, nationalization and learning

MENA 2024 talent and workforce predictions and analysis

James Chouffot
EY MENA Financial Services
People Consulting Leader

Vivek Sharma
EY MENA Financial Services
People Consulting Leader

Multiple factors impacting the workforce throughout 2024

For financial services in the MENA region, the continued expected growth and the limited pool of fully qualified, future local employees means organizations are having to find new ways to invest in their workforce. Several factors are consistently high on our client's agenda from a workforce and talent perspective. These include managing the implementation of new regulations, ongoing digitization of banking, harnessing the potential and managing the risk of GenAI, accelerating and embedding sustainability within the sector sector and its clients, all while meeting nationalization targets.

Effectively addressing these impacts and designing the ultimate employee and candidate experience are high on every clients agenda and necessitates their leadership to be robust, agile and engaged. We have identified three key themes that every financial services organization in the MENA region must navigate.

Those who succeed will excel in the ongoing competition for talent, build a workforce tailored for the future, and effectively execute their business strategy.

In the next section we will provide an overview of the challenges and risks associated with these impacs. We will discuss how organizations can navigate the turbulent and volatile world of work.

1 Delivering nationalization targets

2 New skills and capabilities require the acceleration of learning-at-scale

3 Developing leadership What can manage these impacts

1 Delivering nationalization targets

Aligned with the nationalization objectives, MENA countries face a significant responsibility to engage a considerable portion of their domestic workforce within both the public and private sectors. Recognizing the pivotal role of the financial services sector in the future growth of the MENA, it will be a focal point for supporting nationalization goals. The CBUAE has established a target Emiratization rate of 45% within the banking sector and 30% in related sectors such as insurance, exchange and finance. Similarly, the Central Bank of Kuwait (CBK) aims to achieve a 70% Kuwaitization rate in senior and middle management roles. The latest annual report from the Saudi Central Bank (SAMA) indicates a commendable Saudization rate of 86% within finance sector companies, surpassing its counterparts in MENA. There are a number of actions that all organizations can take now to help deliver the nationalization targets.

Demographic shifts, new technologies and regulations are changing how, why and where people work. The requirements and expectations of both the employer and employee is evolving. Below are some talent trends seen across Financial Services Operations (FSO) sector:

Key skills statistics from the EY work reimagined survey

Skills shortage

77%
of financial services CEOs are concerned about the availability of key skills.

2030
is the year where in-demand skills will become widely unavailable.

Reskilling

77%
of leaders indicated that reskilling is important for the future of organization where

40%
of workforce needs to be reskilled.

Upskilling

40%
employers prefer upskilling to address labor shortage.

AI

95%
AI or machine learning (ML) is the highest-rated technology to be implemented in banking and investment industry.

Remote working

45%	39%	38%
Gen Z	Gen X	Millennial

workers prefer to work fully remote.

Job loss

20.8%
of UK FSO workforce are at risk of displacement due to current market trends.

Jobs at risk

Data clerk, bank teller, and **insurance underwriter** jobs are increasingly displaced and they are replaced by **data analyst** and **data scientist** roles.

Business imperatives for FSO

Digitalization

As financial firms digitize and adopt technology they will struggle to meet the growing demand for tech talent unless they demonstrate innovative thinking to attract, grow and engage IT professionals.

Flexibility

Factors like the COVID-19 pandemic and growth of Gen Z and millennials in workforce will lead organizations to shift to more flexible and remote working paradigms.

Future skills

Many skills will be soon replaced by technology. Firms will need to prepare their workforce by various workforce planning, learning and development strategies.

Employee value proposition

Organizations will need to personalize employee experience that drives higher sense of engagement in employees, retention and creates a unique employer brand.

2 New skills and capabilities are required for the acceleration of learning-at-scale. For example as a result of AI, the digitization of banking, ESG and regulatory changes have accelerated.

The displacement of workers due to automation is expected to be balanced by the creation of new jobs within the region. In the financial services sector, this impact is substantial and has already commenced. This has further intensified due to the swift integration of digital currencies in the MENA region and the continuous digitization of banking and wealth management platforms.

While substantial job cuts are not currently prevalent, there is a notable shift in roles, necessitating the development or acquisition of new skills and capabilities e.g., ML, AI, blockchain, data science, customer experience, UI/UX etc.

ESG topics are at the top of the financial services agenda with increasing expectation from employees and shareholders for organizations to be successful. Furthermore, in 2024, we are expecting regulatory changes such as unified-robust ESG standards for all businesses across the MENA region to achieve net-zero targets. Both ESG and the upcoming regulatory changes are forcing organizations to design and roll out learning-at-scale across their enterprises.

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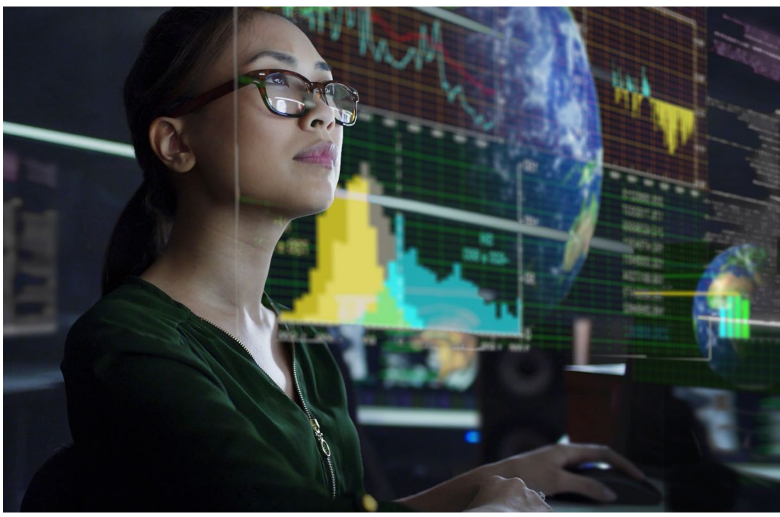
A pivotal question arises concerning whether these new capabilities will be acquired through training (and if so, by whom) or through new recruitments (albeit with a potentially high-associated cost).

The skills needed to work in the financial services sector have changed dramatically and will continue to keep pace with evolving business processes, technology and a stringent regulatory environment. The half-life of skills is shrinking faster than ever before due to hyper disruption and lack of skills will risk organizations business transformation, innovation and future growth. Identifying what skills will be required in the future, analyzing the skill gap, and incorporating potential talent interventions to upskill or reskill the workforce will be the logical next steps for the organizations.



EY work reimagined survey bridging the skills gap

Declining skills

Skills that will no longer be required in the next three to five years

- Bookkeeping and data entry
- Administration
- Financial analysis
- Basic accounting skills
- Mathematical skills

Emerging skills

Skills that are new and will be required in the next three to five years

Technical

- Digital literacy
- Data analytics
- ML or AI
- Compliance and regulation
- Sustainable finance
- Risk management
- Agile

Behavioural

- Emotional intelligence
- Managing diversity
- Creative thinking or innovation
- Empathy
- Coaching

Skill gaps

Areas that will be having relevant skills shortage in the future

- Data analytics
- Machine learning
- Digital transformation
- Risk and compliance
- Leadership
- GDPR or cybersecurity

Bridging the gap

Talent interventions required to bridge the skills gap identified

Buy and borrow: talent acquisition

- Capability acquisition to assess timing, cost and fit
- Attract and employ contingent talent while building new, optimal long-term total talent mix

Bind: talent retention

- Succession plans based on known strengths and needed growth
- Personalized career development plan with learning scheduled to be market ready

Build: talent development

- Tailored leadership development to meet future workforce demands
- Personalized continuous development plans
- User-generated and social learning journey

3 Developing leadership that can manage these impacts (this is not purely an HR issue)

As we have stated, the financial services industry has been undergoing a transformative phase marked by rapid technological advancements and dynamic regulatory changes, fundamentally reshaping the sector. Leaders are concurrently grappling with ESG responsibilities, evolving customer expectations, and the ambiguous implications of AI. Not surprisingly, these developments have triggered a transformation in the essential skill sets and behaviors expected from leaders. In navigating these multifaceted challenges, leaders must exhibit heightened adaptability and flexibility, and be adept at balancing conflicting demands and expectations.

The evolving nature of this sector demands leaders to strike a nuanced equilibrium between human-centric skills and the continuous acquisition of new technical competencies because never before has a leader's role in financial services had to evolve more quickly. This creates a huge demand for new skills and capabilities to create the leaders of the future.

What happens next

The competition for skilled professionals remains strong particularly in financial services in the MENA region due to ongoing growth. Our clients are increasingly prioritizing nationalization efforts, pinpointing and cultivating new skill sets, and fostering the leadership necessary to navigate their organizations through rapid evolution. Success hinges on adeptly managing these interconnected components.

Those who emerge victorious will have effectively navigated the evolving talent landscape and will reap the benefits of successfully executing their organizational strategies.

5

Decoding digital assets

From cryptocurrencies to tokenized securities

Suruj Dutta
EY MENA Financial Services
Digital Leader

Digital assets refers to a collection of seven different types of financial instruments that are typically created and settled digitally using distributed ledger technologies (DLT), such as blockchain. DLT uses complex cryptographic computations that ensure immediacy and irrevocability of transactions, and thereby remove settlement risks associated with more traditional financial instruments.

Cryptocurrencies such as Bitcoin and Ethereum are the most commonly known type of digital assets, associated with a high degree of volatility and several well-publicized controversies (e.g., as in the case of the FTX and Binance exchanges). More recently, they have undergone a renaissance of sorts, with the US Securities and Exchange Commission (SEC) authorizing the issuance of Exchange Traded Funds (ETF) linked to cryptocurrencies. In MENA, regulatory attitudes toward cryptocurrencies vary, but individual trading in these volatile assets remains widespread, as they are enabled by platforms such as Coinbase and Binance.

Global financial institutions have focused on two other types of digital assets such as digitally-native securities and tokenized assets, which includes tokenized bank deposits, as well as physical assets such as real estate or commodities. The Dubai Virtual Assets Regulatory Authority (VARA) has a well-defined framework for regulating such digital assets. Several international firms are exploring issuing bonds backed by tokenized assets under these regulations. Banks across MENA are also exploring Shariah-compliant Islamic finance versions of tokenized assets and securities.

Non-fungible tokens (NTF) are another class of digital assets relevant for ultra-high net worth (UHNW) clients at MENA banks and asset managers, but with potentially lucrative mass-market applications, such as unifying disparate loyalty programs for consumers.

Seven different types of digital assets

Cryptocurrencies	Stablecoins	CBDC	Tokenized assets	Digital native securities	Non fungible tokens (NFT)	Other blockchain
Native	**Fiat-backed**	**Retail CBDC**	**Tokenized deposits**	**Digital native securities**	**NFT art**	**KYC or digital IDV**
Bitcoin ethereum	USD coin (USDC)	eNaira	Onyx	Allied Irish banks	First 5000 days	
Governance	**Crypto-backed**	**Wholesale CBDC**	**Tokenized securities**		**Metaverse**	**Treasury, cash management**
Maker (MKR)	Dai	E-CNY	Blockchain capital		Decentraland	
Utility	**Commodities-backed**	Focus for CBUAE digital dirham initiative	**Tokenized real-world assets**		**Loyalty and branding**	**Insurance claims, fraud**
Basic attention token	Tether gold		RealT		Nike Cryptokicks	
	Algo-backed		Global banks primarily focus on tokenized assets			
	Ampleforth (AMPL)		J.P. Morgan, Citibank, UBS, Goldman Sachs, HSBC, Societe Generale			

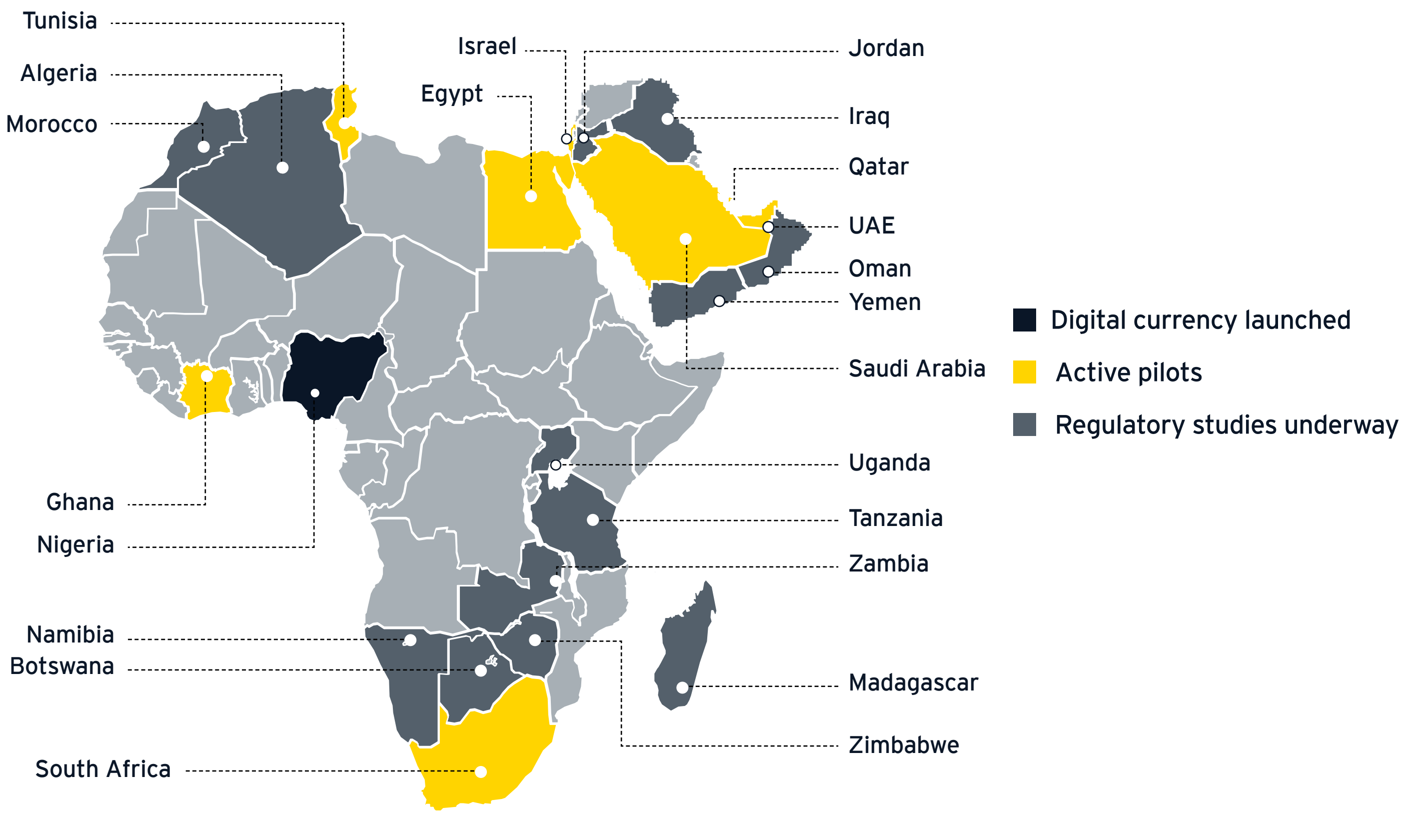
Opportunities for MENA financial institutions

Many regulators across the Middle East and Africa (MEA) are focused on CBDC, with active pilots in the UAE, Qatar, the KSA, Israel, Egypt, Ghana and South Africa, and a live implementation in Nigeria called eNaira. Across MENA, regulators are exploring CBDC as a means to drive innovation in payments, reduce the high cost of payments for merchants (interchange costs in MENA remain one of the highest in the world), make cross-border payments more affordable, and increase the transparency and traceability of payments. Beyond the more affluent MENA, other MENA regulators are also keen to improve financial inclusion, e.g., with offline CBDC payments in rural areas with patchy mobile connectivity, as well as increase accountability and traceability of social welfare payments.

Regulators across MENA are focusing on operationalizing CBDC and encouraging domestic commercial banks and payments processors to participate in pilot programs with the central bank nodes for issuing CBDC, beyond fulfilling the terms of the regulatory mandates for the pilots, however, most banks are adopting a wait-and-see approach. While CBDCs resolve the inherent volatility of cryptocurrencies with a fixed peg to a fiat currency, commercial banks are still unclear on its impact on their deposit base and increased volatility in times of crisis, e.g., if consumers rush to convert their holdings into the CBDC guaranteed by the central bank. CBDCs are typically also designed to be non-interest bearing and most commercial banks are still thinking through their business cases for supporting digital currencies.

In contrast, mobile money operators such as MTN in Africa, du and etisalat in the UAE are moving ahead with plans to support CBDC as a natural extension to their mobile money offerings it creates new transaction fee-based revenue opportunities by extending mobile money to more remote rural customers and increasing the immediacy of cross-border remittances.

National regulators across several MEA countries exploring CBDC



Initial perspectives on value, feasibility of digital assets use cases in MENA

		Revenue potential	Cost of implementation	Time to profit	Implementation feasibility
1	**Retail, wholesale CBDC:** focus for CBUAE Digital Dirham	High	Medium	Short Two to five years	Medium[2]
2	**Asset tokenization:** tokens (e.g., real estate) rights to physical assets on blockchain using tokens	High	Medium	Medium Two to five years	Medium[2]
3	**Custody:** the process of storing crypto, NFTs and other digital assets safely and securely	Medium	Medium	Medium Two to five years	High[1]
4	**Trading:** allowing investors to buy, sell and hold cryptocurrencies with enhanced security and insurance	Medium	Medium	Medium Two to five years	High[1]
5	**Stablecoin issuance:** pegged to fiat currencies	Medium	Medium	Medium Two to five years	Medium[2]
6	**Trade finance:** tokenized invoices, allowing investors to purchase and trade them, providing capital to businesses	High	Medium	Medium Two to five years	High[1]
7	**Syndicated loans:** easier access financing, improved fractional ownership, liquidity, transferable ownership	High	Medium	Medium Two to five years	Medium[2]

[1] Building blocks exist, are tested and can be lifted and shifted
[2] Building blocks exist but need additional work

EY teams have developed an initial perspective on the potential value and feasibility of several digital assets use cases beyond CBDC, for financial institutions across MENA, based on discussions with several banks and payments processors across the region, and drawing upon our experiences elsewhere, e.g., with the Regulated Liability Network (RLN) in the UK.

To start exploring the opportunity from these use cases, it is essential for MENA financial institutions to establish a common understanding of CBDC and digital assets across their stakeholders with targeted education and alignment programs. EY teams can help with the EY Digital Assets, Insights and Analytics (DAIA) platform which is currently being used by 15 of the largest FIs across the world to track the development of digital assets across markets, to define and explore new use cases, to assess risks across the value chain, and to suitably adapt their financial models and risk appetite frameworks.

The next priority should be to create functional knowledge within each financial institution on different aspects of digital assets across product management, finance, risk, operations and technology functions. Banks are exploring opportunities for setting up digital assets labs as a locus for broadening and deepening such functional knowledge. They are also focusing on setting up clear governance for digital assets product roadmaps and commercialization.

Finally, a digital assets lab would also provide the initial technology assets and sandboxes required for bank stakeholders to tangibly explore CBDC and digital assets use cases, e.g., using the EY Tokenization platform, and the EY Starlight platform for helping manage privacy and security issues. The EY organization has been at the forefront of digital assets industry alliances, e.g., with the CBDC Tracker initiative, as well as through collaborations with technology providers, through which we can help clients to rapidly set up and operationalize digital assets lab infrastructures.


2011 January
2012 January
Team 1
Team 2
GROUP A
GROUP B

6

AI in MENA banking

Innovations and transformations

Sheikh Shadab
EY MENA Financial Services
Cyber, Privacy & AI Leader

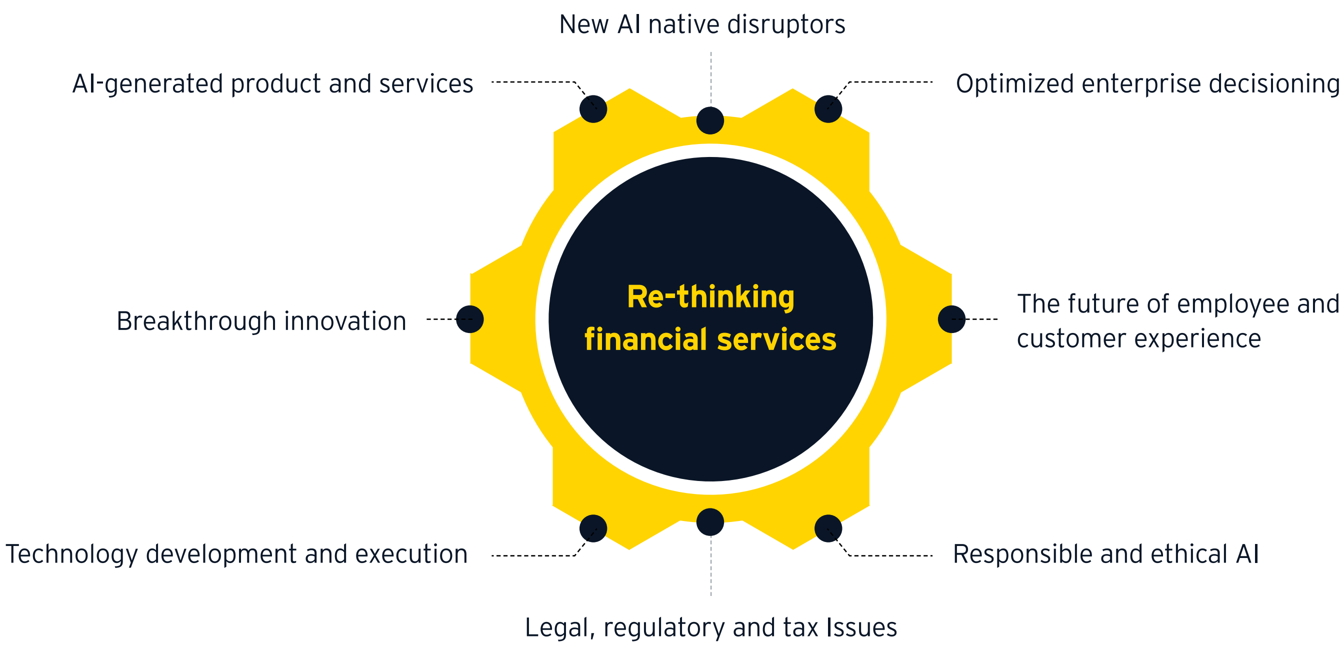
Summary

AI is revolutionizing banking in MENA, enhancing customer experiences and risk management. From personalized recommendations to fraud detection, AI adoption is widespread. By 2030, AI is forecast to significantly contribute to the GDP of countries like the UAE and the KSA, reflecting substantial economic impact. Government initiatives, such as the UAE's National AI Strategy and Saudi Arabia's Vision 2030, underscore the region's dedication to harnessing AI's potential. The EY organization's broad framework facilitates responsible AI adoption in the evolving regulatory landscapes in MENA.

AI in MENA banks

The advent of AI is reshaping the banking landscape across MENA, ushering in efficiency, enhanced customer experiences and robust risk management. From retail and consumer banking to corporate and SME banking, AI is revolutionizing traditional practices and driving innovation. In retail and consumer banking, AI technologies transform the customer experience by leveraging vast data sets to provide personalized product recommendations, streamlined customer service operations, and predictive analytics that empower financial institutions to anticipate customer needs. Corporate and SME banking witness significant

Setting the context: areas of impact in financial services

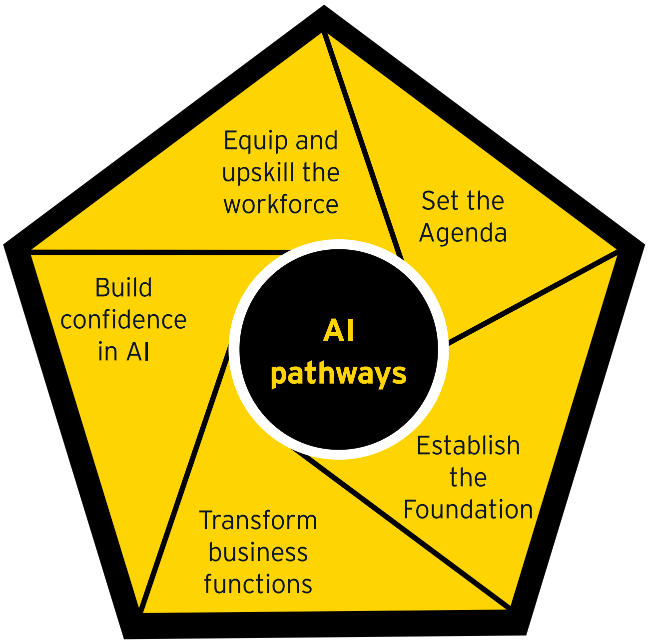


advancements with AI playing a pivotal role in risk management, trade finance automation and informed decision-making, particularly in treasury operations for liquidity management and risk hedging. The payments sector relies on AI-driven fraud detection and prevention systems for transaction security, with real-time analysis fortifying measures and biometric authentication technologies enhancing payment security. In conclusion, AI represents a transformative force in MENA banking, offering unprecedented opportunities for innovation and growth, with collaborative efforts, innovation and regulatory compliance essential for harnessing AI's full potential and driving sustainable growth in MENA's dynamic financial landscape.

Potential impact to economy

MENA is poised to experience significant economic transformation through the adoption of AI. By 2030, AI is predicted to make substantial contributions to the GDP of countries like the UAE and the KSA. In the KSA, AI is projected to contribute over US$135.2b, accounting for approximately 12.4% of the country's GDP. Similarly, the UAE expects around 14% of its GDP to derive from AI by 2030, reflecting substantial economic impact. Across the broader MEA region, AI adoption is estimated to yield an economic impact of US$320b by 2030, driving gradual GDP growth over the coming years. Initiatives such as the UAE's National AI Strategy and the KSA National Strategy for Data and AI underscore concerted efforts to harness AI's potential for economic advancement.

Moving to action: AI pathways for value creation opportunities



Re-thinking the enterprise across five AI pathways

The UAE and the KSA are at the forefront

The UAE and the KSA are actively driving the adoption and development of AI. In the UAE, the government has unveiled a comprehensive AI strategy and appointed a Minister of State for AI, highlighting its dedication to technological advancement. Similarly, the KSA's Vision 2030 and National Transformation Program 2020 prioritize AI for economic diversification and digital transformation, backed by substantial government investments. Both nations aim to attract foreign investment and foster innovation, reflecting a shared commitment to AI-driven growth and societal progress.

Regulatory landscape

The regulatory landscape of AI in the MENA region is undergoing a rapid transformation, reflecting the diverse approaches that shape the future of technology and innovation.

In Egypt, the introduction of the Egyptian Charter for responsible AI marks a significant milestone, setting ethical standards and embracing Organisation for Economic Co-operation and Development (OECD) principles. The KSA, with its focus on innovation and ethical AI use, has established a robust intellectual property law, aligning with the ambitious Vision 2030 goals.

The UAE, particularly the Dubai International Financial Centre (DIFC), has emerged as a leader in AI governance, enacting updated "Data protection regulations" that underscore the region's commitment to ethical AI practices. Qatar is leveraging its existing legal structures for AI governance while making strategic investments in smart city initiatives. Kuwait is exploring AI regulation, while Morocco aligns its data protection laws with GDPR, and Tunisia lays the groundwork for national AI policies.

AI regulation trends reflect a commitment to core principles such as human rights, sustainability, transparency, and robust risk management. Regulations encompass both sector-specific and sector-agnostic AI use cases, aligning with broader digital policy priorities like cybersecurity and data privacy.

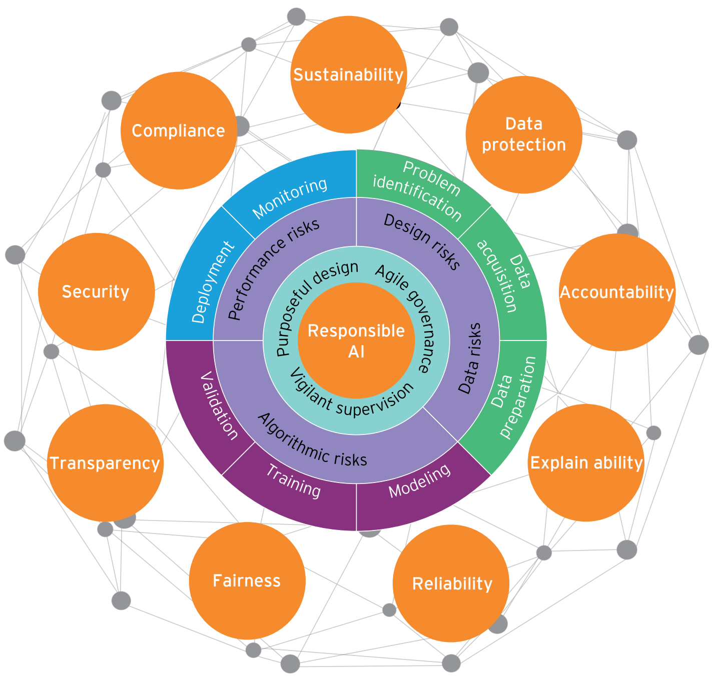
Policymakers must ensure regulators have sufficient knowledge in the field to effectively implement, monitor, and enforce AI policies. Clarity in policy formulation distinguishes between regulating AI technology properties and its application.

Companies should proactively understand AI regulations in their operating markets, aligning internal policies with regulatory standards. Establishing robust governance and risk management structures enhances AI technology management, including accountability mechanisms.

As AI governance continues to evolve, collaboration among companies, policymakers and stakeholders is paramount. Open conversations and cooperation are essential for striking the right balance between government oversight and innovation.

Responsible AI

EY teams approach to Responsible AI is founded on a broad framework that addresses various dimensions of AI development and deployment. This framework systematically evaluates AI risks and establishes controls across seven critical areas. These include helping ensure explainability of decision criteria, initiating clear accountability over AI systems, maintaining reliability in performance, designing systems with respect to privacy considerations, promoting fairness and inclusiveness, providing transparency in system operations, and aligning AI deployment with safety and environmental goals. By adopting this holistic approach, organizations can effectively navigate regulatory requirements and ethical considerations, thereby fostering trust and confidence in AI technologies. Through an emphasis on transparency, fairness and accountability, The EY organization's framework facilitates responsible AI adoption, reducing potential risks while enhancing societal benefits.



What happens next

The AI landscape in MENA banking is rapidly evolving, with a notable shift toward GenAI models. This opens up transformative potential in areas such as risk assessment, fraud detection, hyper-personalized customer experiences and intelligent virtual assistance. As MENA banks continue to adopt and refine these advanced AI capabilities, the region is poised to lead the way in innovative, AI-driven banking solutions that cater to the evolving needs of the customers.

7

Key tax trends in banking

Shifting sands with 5Ts (Transparency, transition, transfer pricing, technology, talent)

Peter Dylewski
EY MENA Financial Services
Indirect Tax Leader

Hannah Shipley
EY MENA Financial Services
Tax Leader

As the other articles in this publication amply demonstrate, the MENA region generally, and the banking world is undergoing a dynamic evolution. Having enjoyed often extraordinary growth in recent years, banking leadership teams are now looking at how to sustain this, for instance by entering new markets and countries. At the same time, they are having to come to terms with the profit and loss (P&L) impacts of increasing regulatory pressures, non-traditional financial services providers increasing their market share and of the burgeoning significance of the ESG agenda for product offerings . The recent dawn of AI and the renaissance of digital assets have also made it clear just how critical it will be for their organizations to keep up in the race for the best talent and technology.

Against such a dynamic backdrop the tax authorities and the tax systems in the region have been evolving quickly too, adding another layer of commercial challenge and opportunity for banks.

We provide below a brief outline of the key emerging trends for the sector from a tax perspective which we have grouped into 5 T's. They are "Transparency, transition, transfer pricing, technology, talent".

Transparency

The OECD's well-known Base Erosion and Profit Shifting (BEPS) initiative was aimed at tax planning strategies perceived to be used by multinational enterprises to exploit gaps and mismatches in tax rules to avoid paying tax. As a result of this and given also the fallout from offshore tax evasion scandals, we have seen a drive for ever greater transparency with the burden of increasing tax reporting measures falling on banks. As well as the cost of compliance, there are impacts on the customer journey and relationship i.e., ensuring the banks collect, maintain and report accurate information on their customers and the banks' reputation as fully compliant taxpayers and good corporate citizens is also at stake.

Transition

As the MENA countries seek to pivot their economies away from dependency on fossil fuels, we have seen value-added tax (VAT) introduced to the region from 2018 and, more recently, new corporate tax regimes have been introduced or proposed for the UAE and Bahrain along with various freezone and special economic zone (SEZ) initiatives. The shift in the fiscal landscape, along with countries signing up to minimum tax rates under the BEPS initiative means that banks need to consider more carefully how their structure and business mix impacts their effective tax rate and overall burden. This is particularly important when considering expansion into new countries and we note the challenges already seen in the region around corporate tax deductions and profit allocations in respect of overseas branches. The increasing interest in fiscal measures to combat climate change is also an issue banks will continue to need to monitor in the mid-term.

Transfer pricing (TP)

With the introduction of corporate tax into more MENA countries and the increasing competition for foreign inward investment between major players like the UAE and the KSA, we expect an ever-greater focus on TP going

forward with the increasing possibility of disputes over the proper allocation of profit. As regional tax authorities become more accustomed to this area, banks will need to make sure that their TP documentations are up-to-date. They also have to check if they have been consistent with the representation of taxes across certain activities and the relative importance of different teams.

Technology

In addition to introducing new tax regimes and refining existing ones, the MENA tax authorities have been turning to technology to help them police the system. They also intend to use technology to secure the expected revenue from certain taxpayer bases, especially those who find it difficult to understand the concept of taxation. E-invoicing for VAT has been introduced in Egypt, Jordan and the KSA, with further rollouts expected in the UAE and Oman. Significant expenditure on data analytics is also in evidence with regulatory reporting being used now in the KSA to inform draft VAT assessments and initiate operational tax audits for the FATCA and CRS regimes. The gradual shift toward real-time reporting has led to an increasing interest in the banking sector in tax technology, often looking to leverage broader financial transformation programs. More recent innovations such as AI have opened up new possibilities for tax compliance and planning and we expect this trend to continue.

At the same time, the special status of financial services has eroded somewhat, so that they could soon perhaps be seen as just another digitally delivered service for tax purposes. For instance, the recent Emirates-level VAT reporting rules in the UAE denied an automatic carve out for banks and we have seen authorities seek to tax certain banking services where used and enjoyed — akin to software.

Talent

Tax authorities in the region have been upskilling their officers with various training and professional qualification initiatives to complement large-scale investments in data analytics and other technologies. Given this and the major shifts in the fiscal legislative landscape, MENA banks have been starting up or expanding their in-house tax teams. In line with broader global trends, they are starting to look beyond tax technical knowledge at broader data and technology skill sets and experience. However, the most versatile candidates can be hard to find and come at a significant premium given market demand across tax authority, practice and in-house roles. The battle for talent is clearly underway and looks likely to continue.

In summary, the tax trends outlined above are an accurate reflection of a sector undergoing rapid and dynamic change. The changes underway offer banks both challenge and opportunity arising from a more complex fiscal landscape as countries in the region seek to balance the need to attract business and inward investment with diversifying their tax revenue. The best-in-class players are building solid foundations by reviewing their tax cost base and compliance model and refining their governance, while in parallel re-assessing their technology and talent mix.

8

New regulations and regulatory changes

Major changes in banking regulation

Bryan Stirewalt
EY MENA Financial Services
Regulatory Leader

We continue to see evolution in the MENA region's banking risk profile and regulatory outlook.

Starting from a global perspective, H2 2023 started with heightened worries regarding the causes of bank failures in the US and in Switzerland and ended with increasing worries about rising geopolitical risk due to escalating and conflicts in the region.

The Financial Stability Board (FSB), in their 2024 work plan, are focused on addressing the issues brought forward by the banking failures mentioned above, including how these events affected resolution reforms, as well as issues related to cross-border payments, cyber resilience, crypto-assets activities, markets and digital innovation, and climate change. The FSB is also focused on supporting global cooperation on financial stability, which is welcome given the recent thoughts on challenges of global fragmentation on several fronts.

The Basel Committee on Banking Supervision (BCBS) is also focused on the causes of the banking failures mentioned above such as the digitalization of finance and other climate-related financial risks. We believe it is important to note that the causes of these bank failures are generally considered to have been isolated to their domestic markets or the risks related to the specific institution. Therefore, the pace of the standard setter's responses will be deliberate and thoughtful. Nonetheless, the areas of emphasis by the key standard setters are important to highlight when discussing the regulatory trends in the MENA region.

The 2024 EY Global Financial Services Regulatory Outlook, coupled with the 13th Annual EY or IIF Global Bank Risk Management Review, provides considerable food for thought on global directions in terms of regulatory agendas and chief risk officers' outlooks. We believe it is important to note that chief risk officers view cyber risks as, by far, the most pressing risk area facing financial institutions around the world. This is certainly the case for financial institutions in the MENA region as well.

Historically sound, banks and regulators in the MENA region have been laser-focused on the future of finance.

Banks in the MENA region have historically shown conservative balance sheets, with ample balance sheet liquidity and core capital positions. This remains the case today, as can be seen throughout this report. Economic expansion activity in the region over the past several years, particularly in the UAE and the KSA, remains robust. Non-performing loan portfolios remain well managed. The region has also shown global leadership in many new areas of the future of finance, which we will highlight below.

During H2 2023, there were some elevated geopolitical risks relative to new areas of conflict. Forecasts indicate these conflicts could expand significantly but can be controlled making sure of a non-zero chance of economic damage, particularly relative to globally important trade routes. If trade routes are disrupted further, costs of trade might keep inflation higher, which would also contribute to a higher-for-longer interest rate scenario in global economies. Regulators in the region are focusing more attention on requiring stress testing scenarios for loan portfolios and funding avenues if geopolitical risks escalate outside of baseline scenarios.

While prudential risks remain under control for banking regulators, many are now turning their attention to deeper investments into conduct of business risks and digital transformation agendas. Traditional risk areas such as credit risk and liquidity risk remain a focus. Regulators throughout the region, particularly in the UAE, have devoted significant resources to improving effectiveness of their regimes to combat money laundering, terrorist financing and proliferation finance. Qatar recently highlighted its electronic Know Your Customer (e-KYC) regulation, showing the advancements in technology in this traditional conduct risk area.

We do note several new areas of focus, including AI, cyber risk and resilience, cross-border payment platforms, CBDCs, crypto currencies and digital assets, non-bank financial institutions and FinTech entrants, and third-party outsourcing of key functions such as cloud services. Several regulators have also launched digital banking licenses, most recently announced by Egypt and other financial technology programs.

The KSA recently announced a program called "Makken" to support and develop the FinTech sector. The CBUAE earlier kicked off their FIT program. The KSA and the UAE joined Qatar and Bahrain in developing regulations for buy now, pay later (BNPL) products. The Financial Free Zones in the UAE have focused on start-up and scale-up innovation programs for several years as well.

Over the past several years, many regulators in the region have created new organization-structure verticals verticals to boost financial innovation in a way that maintains stability and consumer protections. This response to the evolving financial services industry places issues such as consumer protection, financial inclusion, data protection or privacy, and digital fraud at the forefront. Regulators will soon need to turn their attention to the increasingly popular topic of AI, which is being used for both front office operations as well as risk management. Given the speed in which AI, particularly GenAI. is being discussed and adopted, we expect more emphasis on this issue from regional regulators in the coming months.

Another example of a non-traditional financial risk is sustainable finance. Regulators in the region were focused on this issue well before COP28, but this global event hosted by the UAE accelerated the sustainable finance reform agendas. We see clear evidence of direct climate risks around the world on almost a daily basis. Regulators are now discussing a variety of measures including proper disclosures of climate risks and how best to implement a path toward positive transition finance. According to the inaugural EY ESG MENA Bank Tracker Report, nearly three-quarters of the MENA banks analyzed have developed ESG strategies, showcasing the growing recognition of the significance of ESG factors in the region's banking sector and underscoring the commitment of MENA banks to sustainability and responsible financial practices.

9

New legal frameworks in MENA banking

Understanding new legal frameworks in MENA's financial sector

Chris Sioufi
EY MENA Financial Services
Law Leader

Overview

The year 2023 saw regulators across the MENA region respond to an urgent need for reform in the wake of evolving market dynamics and changing investor requirements. Regulators in the KSA and the UAE have presented a slew of new rules and amendments aiming to promote market stability, investor protection and business growth. In the KSA, the Capital Market Authority (CMA) and SAMA continue to actively refine their regulatory landscape, introducing and approving numerous key amendments and new rules throughout 2023 and at the start of 2024.

These strategies align with the Kingdom's Vision 2030 goals, driving increased investor protection, market stability and sector growth. From introducing favourable regulations for foreign investors to providing the blueprint for robust governance in financial institutions, the CMA and SAMA have initiated pivotal changes that are anticipated to significantly elevate the attractiveness and operational efficiency of the KSA capital market and financial sector.

The public and investors are encouraged to stay updated and actively participate in the public consultation process to seize the benefits from these regulatory enhancements. The CMA in the KSA has made substantial modifications to its institutional regulations, foreign investment rules, instructions for direct financing investment funds, and other significant considerations. At the same time, the SAMA has released drafts for general rules for savings products, proposed adjustments to governing principles in financial institutions, and formulated regulations for BNPL providers, among other crucial changes.

Meanwhile in the UAE, the CBUAE has launched the Financial Infrastructure Transformation (FIT) initiative, which aims to accelerate digital transformation in the financial sector. This initiative encourages innovation, collaboration, and competition among financial institutions to promote digital transactions. The CBUAE recognizes the importance of modernizing the financial sector and emphasizes financial inclusion, robust anti-money laundering (AML) and counter-terrorist financing (CTF) measures, as well as enhanced consumer protection. The Securities and Commodities Authority (SCA) has also taken significant steps to enhance the regulatory framework in the UAE mainland. It has focused on opening the market for foreign investors and new technologies. These changes aim to present confidence in the market and attract more investors.

KSA developments

SAMA has been busy in 2023 issuing new laws dedicated to relatively new innovative products in the market, including the rules for regulating BNPL companies, the implementing regulations for "Law of Payments and Payment Services", instructions for practicing aggregation activity, updated rules of engaging in microfinance activity and updated rules for engaging in debt-based crowdfunding. These new and updated rules are evidence of SAMA's ongoing efforts to provide added structure and certainty to the financial sector.

Draft rules have also been issued by SAMA for public consultations on savings products offered by banks and the implementing regulations of the "Systemically important financial institutions" law. These proposed new rules encourage banks to offer innovative savings

products and motivate clients to have effective financial planning, as well as align with SAMA's mission to ensure monetary stability, promote financial stability and foster economic growth.

The CMA issued key new rules in May 2023, relating to "Foreign Investment in Securities", whereby the procedure and criteria for qualified foreign investors (QFIs) to enter the KSA market have been simplified and relaxed, respectively. These changes are expected to increase liquidity, market attractiveness, and the world standing of the KSA stock market. Since the last amendment in 2018, the number of QFIs has increased by 179% and foreign investors' ownership of the free-market value has grown to 14.2%. The CMA's strategies align with KSA Vision 2030, aimed at positioning the KSA stock market as a leading financial market worldwide.

In addition, the CMA has been actively issuing public consultation papers, most notably for regulating foreign investors' ownership of shares in KSA-listed companies that have investment properties in the holy cities of Makkah and Madinah. The prized ownership of property in the holy cities of Makkah and Madinah has historically been off-limits to foreigners, and the proposed new rules look to authorize foreign investors to purchase shares in the KSA-listed companies with Makkah and Madinah investment properties, under specific criteria and ownership restrictions. This move is predicted to increase the attractiveness of the KSA capital market, stimulate investment, and elevate the real estate sector regulation.

A public consultation has also been issued on regulating post-IPO follow-up public offerings (FPOs) on the stock exchange. Until now FPOs on the KSA stock exchange have not benefited from a dedicated regulatory framework. That could be about to change as the CMA considers introducing a new regulatory framework specific to FPOs. This is great timing given the increase in the KSA FPOs we are witnessing from US$3.2b KSA Telecom FPO in 2021 to US$11b for Aramco in June 2024.

UAE developments

The CBUAE has been concentrating on digital transformation and the FinTech sector. It introduced the FIT program to speed up digital transformation. This program includes a strategy for a new digital currency. The CBUAE also introduced the Retail Payment Services and Card Schemes Regulation, which brings in new license categories. The CBUAE has signed memorandums of understanding (MOUs) with the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC). These MOUs are for a co-sandbox program. This program allows FinTech companies to test their innovative solutions within the UAE mainland's existing sandbox regime. The FIT program outlines many strategies, of which the Central Bank Digital Currency (CBDC) is a key strategy. This strategy is a significant step in preparing the UAE for a tokenized financial system. It will be used for cross-border payments and domestic transactions.

Meanwhile, the SCA has primarily focused its efforts on investment funds, virtual assets and green bonds. The new Investment Fund Regulations were introduced in 2023 to revamp the existing legislative framework relating to the incorporation and governance of public and private funds established in the UAE. This also introduced new categories of recognized-fund structures, including family funds and self-managed funds, real estate development funds, precious metal funds, direct-financing funds, ESG funds, capital-protection funds, protected-cell funds, charity investment funds and commodities investment funds. Capital requirements of fund management companies have been reduced drastically from AED50m to AED1m and fund administration companies from AED5m to AED1m, foreign ownership restrictions have been removed, allowing 100% foreign ownership of such companies.

However, there has also been some tightening of the investment fund rules, as public offering of foreign funds in the UAE is no longer permitted and foreign funds can no longer be registered with the SCA for a public offering.

Foreign funds may now only be marketed in the UAE on a private placement basis to professional investors and must be registered with the SCA for a private offering.

On the virtual assets front, the SCA has issued the "Regulation of the virtual asset platform operator", which sets out the rules applicable to virtual asset service providers and their licensing in the mainland UAE. In the green bonds space, the SCA issued the "Regulation of green and sustainability-related bonds and Sukuk", which sets out the rules applicable to such investment products.

In particular, the new rules allow public shareholding companies to issue green bonds and sukuk whose entire subscription proceeds are used to finance or refinance eco-friendly sustainable projects.

Common regulatory trends across the UAE and the KSA markets

In relation to banking business, the following common trends have emerged across both the UAE and the KSA:

- Promotion of regulatory sandbox regimes, open banking and emerging technologies (new payment systems or instant payments or e-KYC)
- New finance activities and incorporation of new types of financial institutions (for example for microfinance and financial aggregation)

In relation to securities business, the following common trends have emerged across both the UAE and the KSA:

- Tightening the promotion of foreign funds and incentivizing establishment of domestic funds, with the introduction of new types of funds and fund structures.
- Virtual assets and foreign investment in securities have been made less restrictive by opening up the market to foreign investors and new technologies.

What happens next

In summary, 2023 witnessed a regulatory transformation in MENA's financial sector, with the UAE and the KSA leading the way. Their initiatives aimed to enhance market stability, attract foreign investment, and embrace technological advancements. While the KSA focused on simplifying foreign investment and opening up new sectors, the UAE concentrated on digital transformation and expanding its investment fund landscape. These reforms reflect a growing commitment to modernization and financial inclusion, positioning the region as a dynamic hub for financial growth.

Section 03

Banking sector performance

Banking sector performance in 2023

Ivica Stankovic
EY MENA Financial Services
Risk Consulting Leader

Overview of MENA banks with focus on key performance and growth indicators (2013-23)

Table 1: (MENA banks growth indicators 2022-23)

Key indicators*	Assets	Loans	Investments	Revenue	Deposits	Operational expense	Loan reserves	NPL**
Growth (2022-23)	8.5%	6.9%	14.4%	16.6%	7.3%	7.9%	1.7%	-2.2%

*The reported measures represent a relative change of the respective indicator from 2022 to 2023, where the indicator is calculated on a combined weighted portfolio level (i.e., as a consolidated MENA B/S).

**Non-performing loans

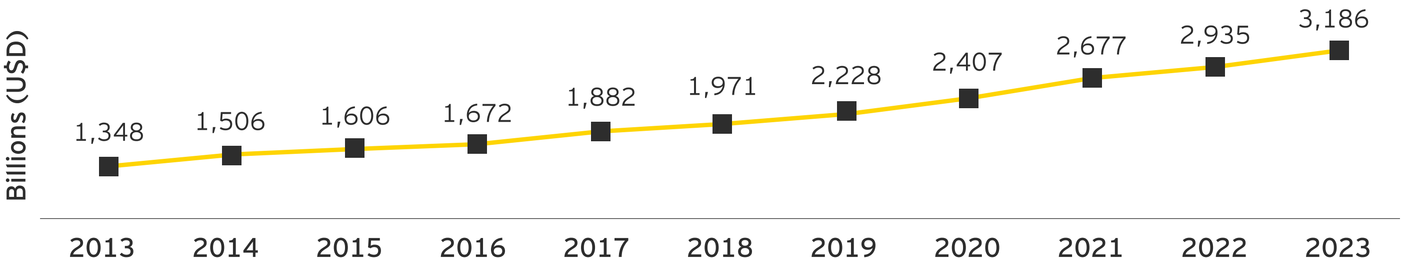
1 Overall growth factors

MENA banks continued the consistent growth of their B/S at an astonishing CAGR of ~9% within a period of 2013-23. The growth in 2023 alone **(8.5%)** was in line with the 10-year CAGR **(8.8%)**. At country levels, we observe the UAE, Qatar and the KSA 10-year CAGR at 10.8%, 9.2% and 8.8%, respectively. We observe Kuwait and Oman at ~7%, and Bahrain trailing with 4.3%.

Interestingly, the COVID-19 pandemic did not interrupt the growth of MENA banks. This can be attributed to the government measures and support in the post COVID-19 pandemic period. This added to the attractiveness of MENA markets to foreign investors (primarily the UAE and the KSA).

While loans and deposits have grown in line with the assets growth, financial indicators show banks have increased focus on investments assets at the growth rate of **14.4%.**

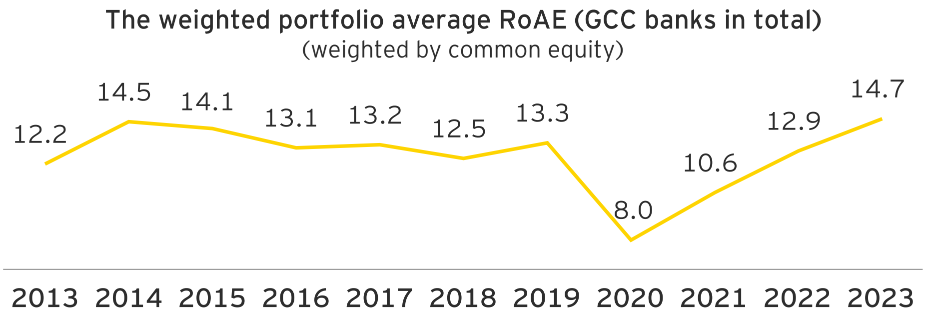
We also observe significant growth in revenue at 16.6% and a relative decrease in NPL at **-2.2%.**



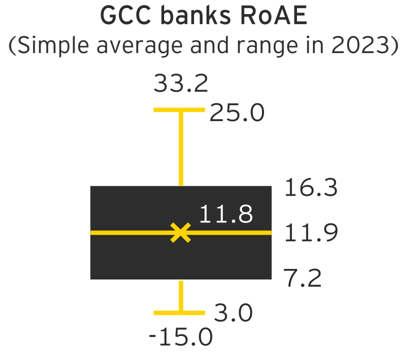
2 Financial performance

Regarding the financial performance and the Return on Average Equity (RoAE), the overall banking sector shows a 10-year high in 2023 at **14.7%** of RoAE (representing the portfolio weighted view). This sets the region among the highest performing banking sector globally. A very strong and consistent recovery observed from the COVID-19 pandemic deep of **8%** in 2020 (table 4).

Graph 3: (MENA banks weighted portfolio average RoAE indicator)



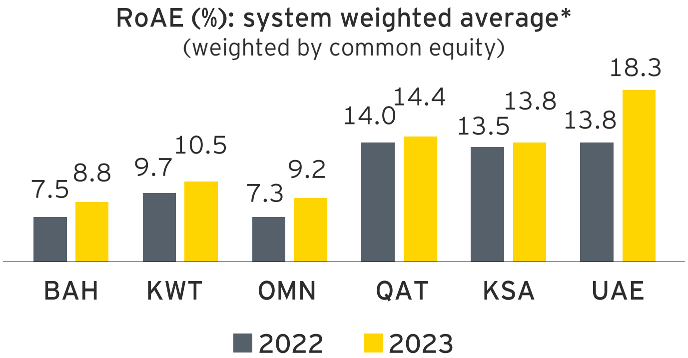
Graph 4: (MENA banks RoAE, simple average)



The statistics of individual banks' RoAE performance, shows variations across the sample of 55 banks, with an interquartile range (7.2%-16.3%), and top quartile reaching out to **25%** RoAE. The median and the mean (average) of individual banks' RoAE are almost overlapping, indicating a symmetrical distribution of banks (by number) on each side of the median. Comparing the median of **11.9%** to a weighted portfolio average RoAE of **14.7%**, it is evident that larger banks (by assets and common equity) have performed significantly above the median.

Looking at individual countries weighted average RoAE performance (graph five), the UAE leads with an outstanding RoAE of **18.3%,** primarily contributed by excellent performance by larger banks, followed by Qatar and the KSA at the range of **~14%** and the rest of the countries at the range of **9%** to **1.5%**. The UAE also shows significant jump compared with 2022, whereas the rest of the countries are at the levels of 2022 or moderately higher.

Graph 5: (Weighted average RoAE by country)

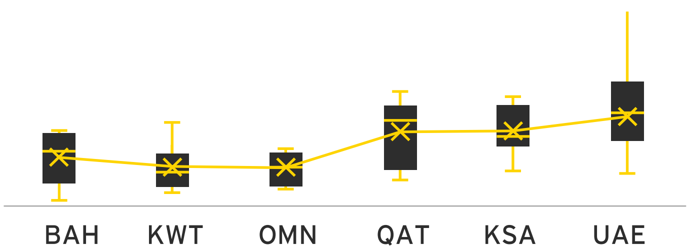


While the overall distribution of banks' RoAE performance across all countries appears to be symmetrical around the median, at individual countries' level we observe the element of skewness. This is most likely contributed by the small number of banks in each countries' sample.

The UAE, KSA and QAT clearly lead the market in terms of financial performance.

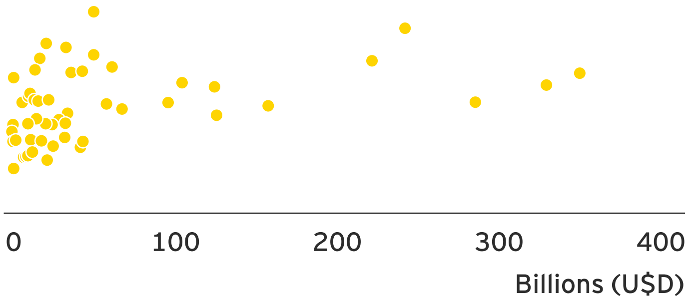
The KSA, KWT and OMN show the least variations of RoAE across the banks within the respective country, with a narrow interquartile range.

MENA banks RoAE% (2023) (simple averages or medians)



Further details show that large-and-medium sized banks have achieved the average RoAE of around 15%, whereas the two out of top five banks reached 22.7% and 18.1% RoAE. The small size banks (i.e., less than US$50b in asset size are more skewed toward below 10% RoAE in 2023.

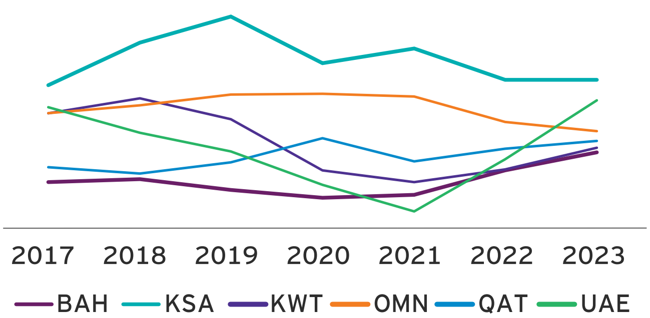
MENA banks RoAE by asset size (2023)



3 Key financial metrics: net interest income (NII)

The reported NII in 2023 shows significant variations across the countries and within the countries. This reflects different positions in the market, different funding strategies and different risk appetite across certain key or risk metrics.

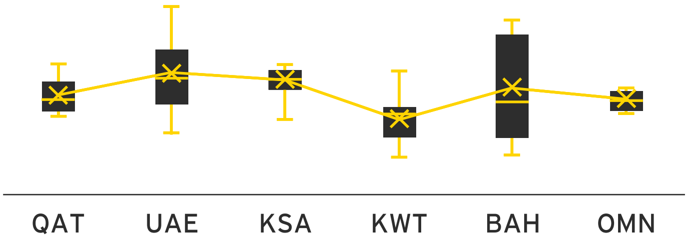
Weighted average net interest income % by country (weighted by earning assets)



Looking at the portfolio-weighted NII% by country, the KSA shows historically the highest NII% with the 2023 reported NII% more than 3%. The UAE shows significant uplift from the COVID-19 pandemic low of 2%, reaching almost the 3% in 2023. Most of the countries show an upward trend and growth of NII% in 2023, except Oman that declined from a range of 3% in 2021 to around 2.65% in 2023.

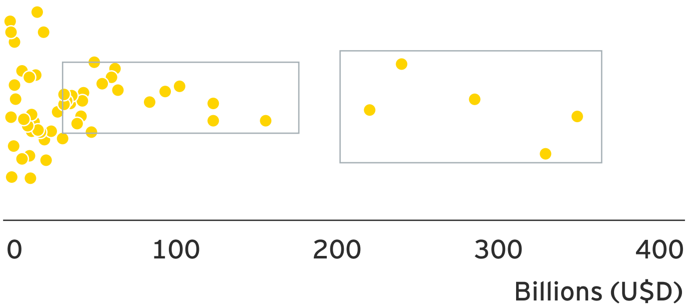
As per individual banks' reported NII% for 2023, the most consistent and homogenous markets are Qatar, the KSA, Kuwait and Oman, having the narrowest interquartile ranges, while the UAE and Bahrain show more variations across the market.

NII by country (2023)



The analysis of banks' NII% compared to the assets size shows significant variations at both ends of the NII% spectrum, and more consistency in the middle of the spectrum. The top five MENA banks by assets size have their NII% within the **1.75%** to **4%** range, the pool of 20 mid-sized banks shows more consistent NII% in range of **2.5%** to **4%**, and the medium-small banks pool shows larger variation in a range **1%** to **5%**.

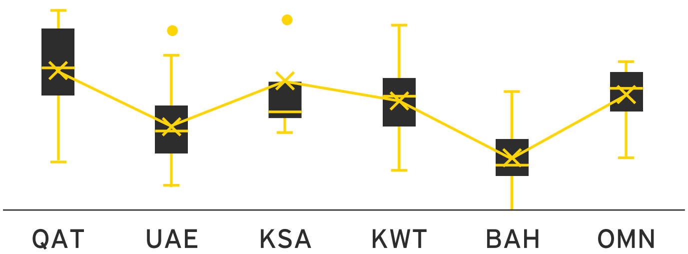
NII% by banks' asset size (2023)



4 Structural indicators: LDR

The reported loan-to-deposit ratios (LDR) vary significantly across countries and the banks' asset size. This reflects the differences in banks' funding structure. It also highlights the differences in national regulators stance and maximum limits set with respect to this structural, and deposit leverage indicator.

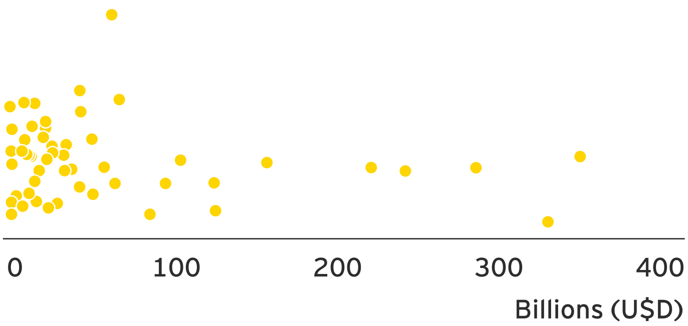
LDR: by country (2023)



BAH and UAE banks are the most conservative in the ranges of **70%** and **80%** on average, respectively (2nd and 3rd quartile), KWT and KSA at the range of **90%** and OMN and QAT exceeding **100%,** with QAT being the highest with interquartile range of **100%** to **120%.**

Looking at individual banks' LDR by asset size, top 10 banks are operating in a range 60% to 100%, while the rest of the banks in the pool are distributed almost symmetrically in the range 60% to 140%.

Loan-To-Deposit Ratio: by asset size



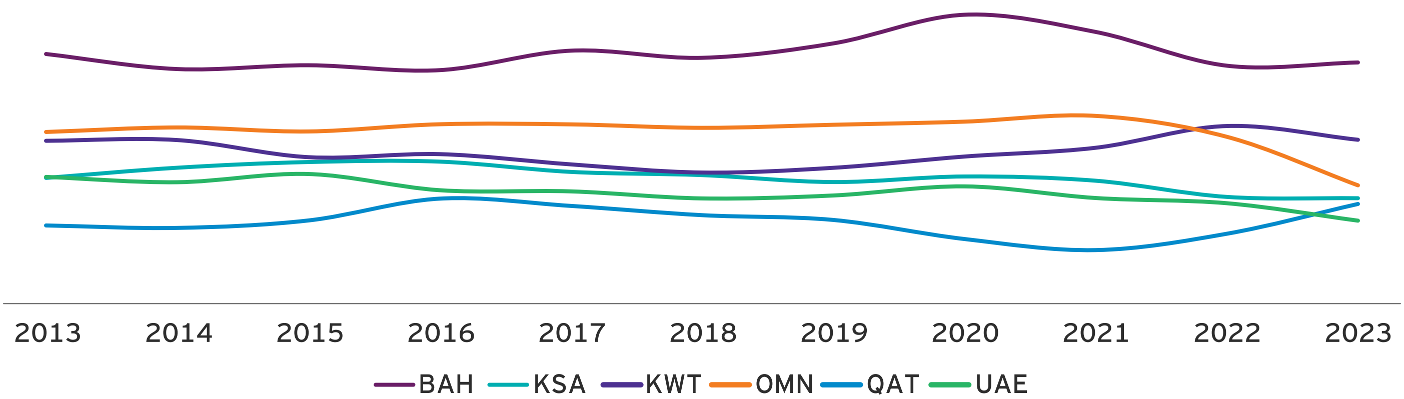
5 Efficiency metrics: C/I ratio

The reported weighted cost-to-income ratio (C/I ratio) shows variability across countries, where more consistency is observed within the country in the period 2013-23. Banks with the most efficient cost management are QAT, the KSA and the UAE (range of 30%), with Oman showing significant improvement in 2023, and Bahrain remaining high in the range of **55%**.

The cost management remains a "pain point" for many of the banks in the region, while those who invested in efficient cost management, shows evident better financial performance (i.e., RoE).

Cost optimization is on the priority list of many of the banks in the region, despite the challenges due to increasing costs of services and goods in the last few years.

MENA banks weighted C/I ratio (2023)



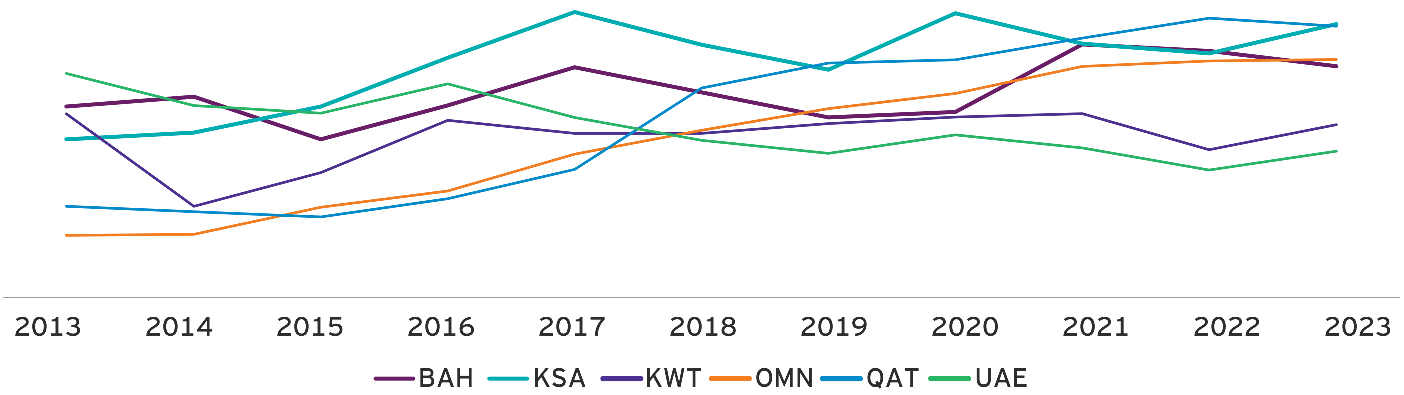
6 Capitalization and capital ratios

The MENA banks remain well capitalized with an average CAR (weighted by RWA) at **18.9%** (an increase of **0.4%** from 2023), and with the weighted ratio fluctuating within a range **18.2% to 18.9%** since 2016.

The average countries' ratios are grouped in two clusters with BAH, the KSA, QAT and OMN in a range of **19% to 20%,** and KWT and the UAE at **17.9%** and **17.3%** respectively.

The five countries show evident increase of weighted CAR since 2013, whereas the UAE's weighted CAR has deteriorated from **19%** in 2013 to **17.3%** in 2023.

The average CAR by country (weighted by RWA)



Looking at the average common equity-to-assets ratio ratio of MENA banks (in a range of 12%), it is twice as high compared to, for example, the US and UK average ratios (range of 6.5%). The difference is primarily coming from the approach to capital adequacy in MENA i.e., standardized approach, whereas the banks in the US, the UK and other jurisdictions (such as EU, HK, Singapore, AUS, Canada, etc.) have adopted Internal Ratings Based (IRB) approaches to regulatory capital estimates.

7 Performance drivers

Analysis of reported financial information for a period 2013-23 of selected 55 GCC banks shows an interesting result with respect to the possible (at least statistically identified) drivers that can explain the ultimate banks financial performance i.e. the RoE to a certain extent.

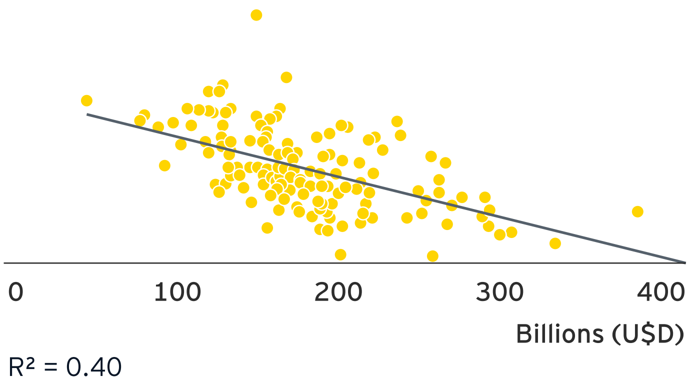
The analysis of NII%, NPL%, as a commonly expected impact factors, shows no statistical association with RoE within the sample. Even though the banks have quite different NII% margin and NPL%, these factors do not sufficiently explain banks' RoE performance.

However, the two factors that materially impact RoE are C/I ratio and capital adequacy ratio (CAR).

Banks with optimal C/I ratio (i.e. lower values of the ratio) shows consistently better RoAE results (explained by the R2 of 0.40).

The similar analysis performed for CAR shows that ratio explains RoAE to the tune of R2 of 0.12 for 2023, and lower evidence when analysis is extended for the period 2013-23.

RoAE vs C/I ratio (2013-23) (Top 25 MENA banks by asset size)



8 Strategic outlook for 2024

With a performance in 2023, MENA banks are looking for further growth and expansion within the region, and beyond the MENA. Despite several global and local challenges and risks, the outlook for 2024 is positive, based on market indicators and consistent investor interest. The primary drivers are ambitious plans, projects and supportive governments' budgets across the region. The MENA is seen as an alternative safe haven from an investor's perspective, compared to major global economies that are contending with several issues, including high inflation and high energy prices. The key focus for banks will be on several aspects and themes, which include digital assets and digital currencies, climate risk assessment, the utilization of AI and ML, asset optimization, expense consolidation, the continuous revision and improvement of banks' fundamentals with respect to funding, FTP, optimal balance sheet management, and risk-adjusted pricing.

Some MENA regulators may consider initiating projects for the implementation of IRB regulatory capital provisions in their respective countries. Once and if implemented, this could provide a significant opportunity for MENA banks to align with global banks operating under the IRB Capital Regime, optimizing their (expected) capital relief for further growth and enhanced financial performance (i.e., RoE).

MENA financial services
Author contacts

Charlie Alexander
EY MENA Financial Services
Managing Partner
charlie.alexander@ae.ey.com

Neelanshu Bhardwaj
EY MENA Financial Services
Client Executive Leader
neelanshu.bhardwaj1@ae.ey.com

Mayur Pau
EY MENA Financial Services
Strategy and Transactions Leader
mayur.pau@ae.ey.com

Serkan Memisoglu
EY MENA Financial Services
Customer and Growth Leader
serkan.memisoglu@ae.ey.com

James Chouffot
EY MENA Financial Services
People Consulting Leader
james.c.chouffot1@ae.ey.com

Vivek Sharma
EY MENA Financial Services
People Consulting Leader
vivek.s@ae.ey.com

Sheikh Shadab
EY MENA Financial Services
Cyber, Privacy & AI Leader
sheikh.shadab@ae.ey.com

Suruj Dutta
EY MENA Financial Services
Digital Leader
suruj.dutta@ae.ey.com

Bryan Stirewalt
EY MENA Financial Services
Regulatory Leader
bryan.stirewalt@ae.ey.com

Chris Sioufi
EY MENA Financial Services
Law Leader
chris.sioufi@ae.ey.com

Peter Dylewski
EY MENA Financial Services
Indirect Tax Leader
peter.dylewski@sa.ey.com

Hannah Shipley
EY MENA Financial Services
Tax Leader
hannah.shipley@ae.ey.com

Dusko Dincov
EY MENA Financial Services
Sustainable Finance Leader
dusko.dincov@bh.ey.com

Ivica Stankovic
EY MENA Financial Services
Risk Consulting Leader
ivica.s@kw.ey.com

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