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TOP BANKING TRENDS IN THE MIDDLE EAST

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Banking in the Middle East is evolving fast to keep pace with young, mobile-oriented consumers and a more competitive fintech-friendly banking services ecosystem. Forces of change include national plans to build modern innovative and open digital economies, a shift towards responsible and sustainable banking, the arrival of new forms of artificial intelligence including generative AI, and a push for value-driven data strategies and technology transformations that can support more personalized, customer-centric products and services.

The need to formulate a strategic response has been heightened by the digital-first retail and SME challenger banks springing up across the region, focused on innovation and improving the customer experience. Meanwhile, the region's central banks and regulators are considering central bank digital currencies – the introduction of which would be a game changer for the payments landscape.

Here we identify six top banking trends and offer our analysis of the implications for the banking industry including recommended strategic considerations.

> *With Middle Eastern banks embarking on a period of rapid change and innovation driven by changing customer needs and emergent technologies, banks will need to look ahead to prepare themselves – not least, by refining and democratizing data strategies, managing technology transformations, taking advantage of opportunities such as ethical GenAI, and rolling out more responsible, climate-friendly banking.*
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> **Naim Alame,** Managing Partner, Capco

CONTENTS

RESPONSIBLE BANKING AND CLIMATE FINANCE

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RESPONDING TO COP28

The 2023 United Nations Climate Change Conference (COP28) saw global leaders gather in Dubai at the end of last year to assess progress towards the 2015 Paris Agreement goals of significantly cutting greenhouse gas emissions and limiting global warming to 1.5°C above pre-industrial levels.

With temperatures in 2023 hitting 1.43°C above the pre-industrial average,[1] the pressing need for immediate action on climate change had become clear. The Conference opened with ground-breaking agreement on operationalizing the ‘loss and damage’ fund, and concluded with the signing of an agreement to “transition away” from fossil fuels – the first time such language has been included in 30 years of climate negotiations.[2]

Yet massive challenges, and financing gaps, remain. A UN report published last autumn says that the goal of limiting global warming to 1.5°C requires significant climate investment opportunities amounting to up to US$275 trillion by 2050 for the transition of the entire global economy. Failing to make this transition poses serious risks, including potential annual GDP losses of up to US$4-6 trillion by 2050.[3]

COP28 President Dr Sultan Al Jaber emphasized the importance of climate finance in his closing remarks to the conference: “We have reframed the conversation around climate finance. We have integrated the real economy into climate action. And we have moved to a new mindset, where solutions to the climate challenge become the drivers of a new economic age.”

As climate financing takes centre stage through 2024 and beyond, banks have a vital role which includes using innovative green and sustainable finance instruments to leverage emerging private sector financing sources. However, they must translate initial strategies for providing sustainable finance, and measuring financed emissions, into concrete action.

Next steps for financial institutions

Plan your journey towards a net zero transition – Banks and other financial institutions should commit to aligning their lending and investment portfolios with the global goal of achieving net zero emissions by 2050. A fundamental step in this journey is to measure the emissions associated with financed activities, enabling the tracking of investments across different sectors. This will help identify the starting point and the formulation of a credible transition plan and sector-specific decarbonization policies.

Develop expertise and knowledge in sustainable finance – By developing a deep understanding of sustainable finance principles and practices, financial institutions can align their product offerings with the expectations of investors and regulators. This involves creating strategies incorporating sustainable investment options and integrating sustainability criteria into risk assessment and decision-making processes.

Invest in robust data management capabilities – Prioritizing data collection, analysis, and reporting is essential for financial institutions to measure and report the impact of their sustainability-related activities accurately. By doing so, they can provide transparent and credible information to clients and stakeholders, and meet the growing demand for greater transparency and accountability in sustainable finance.

Beyond COP 28

As the world’s investors shift their focus from the COP28 event to its outcomes and practical implications, sustainable investment will continue to gain significant attention. This presents substantial opportunities for financial institutions, including the chance to develop new products.

However, we can also expect a rise in investor expectations for greater transparency and regulatory oversight to combat deceptive environmental claims (greenwashing). Taking proactive measures can position Middle Eastern banks as leaders in responsible banking and sustainable finance – and meaningful contributors to the global effort to address the climate challenge.

KEY TAKEAWAY

With the climate challenge evolving fast, banks must ready themselves to translate high-level goals into concrete actions and respond to emerging regulation. This includes strategizing their roadmap to net-zero transition with measurable outcomes, expanding sustainable products portfolios, and preparing data management and methodological foundations to quantify key climate-related metrics and support any changes in required reporting.

1. World Had Warmest October on Record, WMO, November 2023. Link.
2. Cop28 Agreement Signals ‘Beginning of the End’ of the Fossil Fuel Era, UN, December 2023. Link.
3. Unlocking Investment in Net Zero, UN Environment Programme, September 2023. Link.

REFINING DATA STRATEGY TO UNLOCK VALUE

REFINING DATA STRATEGY TO UNLOCK VALUE

Unlocking the value of data is crucial for Middle Eastern banks and other financial services firms as they seek to differentiate themselves from competitors and overcome industry challenges. For example, data management is the key to personalizing products in real-time for today's mobile-oriented Middle Eastern consumers, to making the most of advances in artificial intelligence, and to measuring climate change impact in the wake of COP28.

As an integral part of a bank's success roadmap, data management should be embedded into every decision, interaction, and process. This means answering questions about the bank's business goals in relation to its data experiences, data economy (i.e. principles and practices), and data ecosystem, while addressing three key imperatives.

Decentralized architectures for data sharing and data products

Data exchange and data sharing platforms continue to emerge, enabling institutions, customers, and regulators to analyze and share insights without distributing the underlying data, while privacy enhancing technologies are reducing the risk of sharing data externally. Two complementary concepts – data mesh and data fabric – are being increasingly adopted to help Middle Eastern banks address the pitfalls of traditional data architectures.

Data fabric describes a centralized architecture that supports metadata designed to integrate disparate platforms and pipelines and simplify access to data assets. On the other hand, data mesh is a decentralized, self-service architecture in which datasets are managed or controlled by business units across enterprises. Data mesh supports the idea of each data domain maintaining control over the data and data products that it understands best, while enabling business lines to share each other's data and reuse data products across use cases.

While both concepts address the concept of domains and data products, they can be applied together, or separately to help banks in the Middle East democratize data access and accelerate data-based innovation. However, implementation involves the careful consideration of domain data ownership, data integration, data product lifecycle management, and data security, as well organizational culture.

Democratized, composable analytics and AI enablement

The ever-increasing demand for higher quality and more timely insights continues to challenge analytics leaders in Middle Eastern banks. More democratized, 'self-service' approaches to analytics models are increasingly seen as the answer, implemented through on-demand analytics platforms and cloud architectures.

An efficient way to build on-demand analytics platforms is to break analytics solutions into components that can be reused to build different business applications. However, the cost of delivering analytics at scale can be daunting. Additionally, as machine learning comes of age and artificial intelligence becomes pervasive, modern data architectures and new types of flexible data storage are becoming increasingly important.

We anticipate a cautious yet deliberate integration of GenAI. To make the most of this and other AI advances, organizations should pinpoint relevant use cases within their specific business context and maintain data of high reliability and accuracy. Crucially, firms must ensure adherence to data privacy regulations and ethical guidelines to protect sensitive information and maintain trust, as highlighted in the recent Dubai Assembly for Generative AI.

Value-generating role for the modern CDO/CDAO

The pace of change means the role of the chief data officer (CDO) is evolving. Enterprises are considering giving CDOs more expansive responsibilities centered around value creation. We are observing a growing demand for a Chief Data and Analytics Officer (CDAO) who can assume responsibility for analytics and AI. This role should be focused on bringing intelligence, data, and analytics together to derive optimal value from data assets and to create an environment that drives customer-centric, data-based innovation.

However, CDOs/CDAOs should also cultivate an organizational culture that is data-literate and values information as an asset. This will mean developing a better understanding of the personas/roles that the bank must tailor training towards, embedding data literacy initiatives into departments, and augmenting these initiatives with structured post-training support.

KEY TAKEAWAY

Data strategies focused on value creation offer powerful ways to differentiate Middle Eastern banks. Unleashing this power means finding better ways to share data, democratize analytics, and support AI-driven innovation.

CORE TRANSFORMATION TO MAXIMIZE REWARD AND MINIMIZE RISK

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In the Middle East's fast-evolving market landscape, banks need to adapt to the rapidly changing needs of customers. Retail banks, for example, need to design new digital products, services and customer journeys that offer a more seamless, personalized experience for mobile-oriented consumers. However, core banking systems could prove a key constraint in the region.

The core processes of many Middle Eastern banks are based on legacy technologies more than 25 years old – limiting and slowing the ability to adapt as well as reducing bank efficiency and increasing maintenance costs and resource dependencies.

Core transformation, the process of migrating to a modern micro-services and cloud-oriented technology platform that is easier to maintain and offers more agility and connectivity, has therefore become a critical bank strategy. That said, the risks of transformation remain daunting for many banks in terms of the strategic decisions that must be taken, the complexity of managing such a large bank-critical project, and the dangers inherent in any 'Big Bang' transition.

Around the world, we have observed a diverse set of core transformation and re-platforming strategies that aim to deliver transformation benefits while reducing these risks.

Some of these strategies attempt to reduce the risk by first 'hollowing out the core', through abstracting bank functions away from legacy mainframes. Others involve setting up greenfield 'side-car' digital-first banks, running new cores in parallel with legacy cores for extended periods – or even banding together with peers to pursue a shared service model in the case of smaller banks.

There is no single right or wrong approach. Instead, institutions should select a strategy based on a thorough understanding of where the bank is now and where it wants to go.

Capco's experience in the UK and around the world in planning bank core transformation strategies, as well as in setting up greenfield digital-first neo banks, suggests that banks should clarify and strengthen the three pillars of transformation:

- **The bank-specific business case for change** so that this can act as a 'North Star' during both planning and implementation
- **Strategy selection** based on a deep knowledge of the universe of different approaches, platforms and technology partners
- **Execution planning and roadmaps** that include robust governance, KPI tracking, and early delivery of value, combined with the flexibility to cope with fast-changing markets and technologies during what can be multi-year transitions.

For large institutions, overcoming the change management challenge can prove an even bigger factor than technology selection in determining success, as we explore in more detail in our recent white paper.[1] Middle Eastern banks that make the right choices and manage change proficiently, however, will be in a position to make step changes in innovation, disrupt local markets, and capture global opportunities.

KEY TAKEAWAY

Core transformation can be fundamental to future bank agility, efficiency and customer-centric innovation and the strategies for achieving it are evolving fast. To maximize the rewards while minimizing the risks, banks may need fresh strategic thinking to help them identify an optimal bank-specific approach, technology strategy, and the right change management program.

1. Transforming Core Banking: A Middle East Perspective. July 2023. Capco. Link.

TRANSFORMING BANKING WITH GENERATIVE AI

TRANSFORMING BANKING WITH GENERATIVE AI

Generative artificial intelligence (GenAI) has the potential to unlock huge competitive benefits in Middle Eastern financial services, for example, through enabling the hyper-personalization of bank products and services and making back-office processes more efficient and insightful.

Its adoption could be surprisingly rapid, supported by continuing investment in the region's technology ecosystems and national strategic programs that aim to create modern, digital-led economies. However, the opportunities arrive with significant operational and regulatory risks in relation to data management, privacy, and model risks – including biased outcomes and the danger of model 'hallucinations' when GenAI plausibly presents false information as fact.

While conventional AI is already used in the region to draw insights from structured data, the advantage of GenAI is that it can mine vast amounts of unstructured data – for example, to better understand nuanced customer behavior, preferences, and needs – and rapidly generate new content in the form of text, images, videos, and audio. The content can then be employed to try to improve a range of front- and back-end bank activities, from constructing next-generation customer-facing chatbots to automating complex back-end processes such as fraud detection, know your customer (KYC) analysis, and risk modeling.

Potential front-end applications include analyzing a great range of customer data to identify customer needs and ambitions, and then engaging customers with relevant marketing and content that improves selling, cross-selling and upselling. GenAI offers the potential for sophisticated real-time responses to customers and customer segments, though there are key quality and governance hurdles for the banking industry to overcome. An example of a back-end application is leveraging GenAI to create synthetic data for intricate risk modeling scenarios such as when determining the creditworthiness of institutional and retail borrowers. GenAI also offers efficient ways to explore data (including text data) associated with market and financial risks.

This kind of middle- and back-office application will speed up bank decision making but may require more transparent collaboration between banks, fintech firms, payment, and technology providers to enable knowledge sharing and joint innovation.

GenAI could also, potentially, speed up project management including software development. Capco's recent study on the potential for using GenAI to help transform software delivery at financial institutions has identified significant benefits, particularly in relation to time savings and code writing.[1]

Financial institutions engaging with GenAI will require a set of developed compliance policies that align with regional and national regulatory approaches and fast-evolving ethical frameworks. Vast quantities of data go into foundational GenAI models and so using the latest techniques to avoid bias, discrimination and privacy concerns will become a critical activity, as will making sure the models are used in a principled and transparent way to ensure consumer protection.

Firms must stay ahead of emerging regulations in these fields. They will also need to consider how best to keep 'humans in the loop' for many GenAI-informed processes, while at the same time preserving GenAI's benefits.

The key insight here is that governance and controls need to be applied from the start, as the solution is uncovered, rather than being tacked on at a later stage. Institutions would also be well advised to develop a tightly focused set of use cases that can be shown to be motivated by a desire for improved customer outcomes.

Embracing GenAI early has the potential to give banks a competitive advantage by enhancing real-time customer experiences, leveraging human expertise and opening new revenue streams. However, avoiding the many potential pitfalls will mean rapidly applying the right talent, data management, governance, and oversight – as well as prioritizing the most rewarding and defensible initial set of use cases to make sure the program gets off to a good start.

KEY TAKEAWAY

GenAI could rapidly unlock competitive benefits in the Middle East but must be deployed on the right data, model risk management and ethical foundations and for use cases that demonstrably benefit customers and financial institutions alike.

1. Generative AI's Potential for Industrializing and Scaling Software Delivery. July 2023. Capco. Link.

DIGITAL-FIRST BANKS

CHARTING THE PATH TO SUSTAINED SUCCESS

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CHARTING THE PATH TO SUSTAINED SUCCESS

While the emergence of new digital-first 'challenger' banks has been relatively slow in the Middle East compared to the UK, Europe and Asia-Pacific, contenders are now appearing more rapidly and the fundamental drivers of digital disruption are strong.

The region possesses a relatively young, mobile-oriented population focused on convenience and speed, regulators that are keen to support digitally-led financial services as part of their blueprint for reformed economies, and vibrant fintech centers.

So far, while momentum is growing and some digital-first banks are gaining traction, it is difficult to point to many contenders that have both grown fast and that are on a secure path to profitability. Banking and fintech CEOs continue to face the challenge of developing a successful, sustainable digital-first bank model that is fit for a more competitive and connected Middle Eastern digital economy.

United only by their lack of physical branches, digital-first banks are arriving from a number of directions. Some have evolved from fintechs offering payments solutions and other financial services, while others have been set up by large corporations, consortia or incumbent banks – as greenfield operations with new technology stacks or as separate brands that remain dependent on a parent bank's legacy systems.

The strategies adopted are equally diverse, with some attempting to gain traction through offering either a unique service (such as digital Islamic banking) and others by focusing on specific customer segments (including millennials/Gen-Z and SMEs). However, the challenge is not simply how to attract a critical mass of customers through differentiated customer value propositions, but how to turn that initial success into sustained profitability.

With the next wave of digital-first banks incoming, three key success factors should be considered.

Planning for profitability

Digital-first banks would be wise to identify a strategy to ease the path to the ultimate objective of profitability, beyond simply building customer headcount. Certain key enablers – often including the technology stack, the degree of customer engagement and trust, and regulatory relationships – will determine how easily digital-first banks can magnify and extend initial or core offerings.

After all, the shift towards a sustainable business might involve persuading customers to move their primary account and deposits to the bank, or turn to the bank for other purposes that might include new propositions in wealth management, microfinance products, BNPL, or enabling ecommerce marketplaces of various kinds. Balancing growth and profitability requires fundamental planning as well as ongoing management.

Collaborative excellence

The second key factor is the adoption of a collaborative business culture, including a technology platform and data strategy that eases connectivity with multiple partners. Digital-first banks will need to easily plug into a series of market ecosystems using technology architectures that promote easy connectivity through features such as robust API architectures and rapid third-party and partner integration.

However, the point of collaboration is not only to open up markets but to encourage innovation. So the bank will need the capability to rapidly take new products to market through adopting agile business cultures in terms of both decision making and partnership-enabling technology projects.

Customer-centricity

Digital-first banks need to build a customer-centric proposition that leverages advanced data analytics and technology including the use of AI. Their technology and data platforms must help them understand customers and their lives, and support the creation of hyper-personalized products and services. Depending on the nature of the bank, it should be able to provide customers with insights and convenient ways to take action, for example:

- Proactively offer solutions that help customers manage life events, such as the need to finance a child's university education abroad.
- Generate financial tips and pre-agreed actions based on data from across financial product areas, such as advice on savings based on the amount held across current and other accounts.

The path to sustainable profitability cannot be separated from the ability to understand customers and innovate rapidly around their needs. The ultimate aim should be to make customers' lives, rather than simply their banking journeys, easier and more successful based on a real-time understanding of their lifestyles and priorities.

KEY TAKEAWAY

Digital-first banks will change the face of banking in the Middle East. However, creating sustainable business models means identifying key enablers that ease the transition to profitability as well as applying new technologies and data strategies to build collaborative business cultures and to hyper-personalize products and services.

EMERGING CBDCS AND STRATEGIC BANKING IMPLICATIONS

EMERGING CBDCS AND STRATEGIC BANKING IMPLICATIONS

Middle Eastern central banks are moving rapidly to explore and develop central bank digital currencies (CBDCs), with the aim of supporting more efficient, secure and cash-free economies and promoting future digital innovation and financial inclusion. They are exploring two fundamental use cases: retail CBDCs used by consumers and businesses; and wholesale CBDCs that facilitate large-ticket transactions such as financial institution transfers and securities settlements.

In early 2023, for example, the central bank of the UAE (CBUAE), as part of its wider-ranging Financial Infrastructure Transformation (FIT) program, launched implementation work towards its CBDC – the 'digital dirham'.[1] The first phase, including work on cross-border CBDC transactions for international trade settlement and proof of concept work for domestic wholesale and retail usage, is expected to complete by mid-2024.[2]

The CBUAE's work builds on the earlier success of Project Aber in 2020, a partnership between the CBUAE and the Saudi central bank (SCB, formerly SAMA) that explored a single dual-issued digital currency for wholesale domestic/cross-border settlement between the two markets.[3]

Meanwhile, the SCB is currently focusing on domestic wholesale CBDC use cases, with the aim of using the CBDC to accelerate digital transformation and support the country's 'Vision 2030' objectives.[4] Other Middle Eastern nations, including Bahrain and Oman, are exploring their own digital currencies.

Plans are still evolving and the design of each CBDC will determine the extent to which the benefits of, and worries about, CBDCs – whether they will respect privacy, can be used coercively by governments, or destabilize the financial system – are realized. The designs will also determine the role of commercial banks within any CBDC system.

CBDCs implemented through the 'direct dissemination' model – where consumers can maintain CBDC directly with central bank – pose a more profound threat of disintermediation than 'indirect' CBDC, where the bank maintains the consumer's CBDC deposit. At the extreme, the direct model could displace banks from the payments value chain and significantly impact customer deposits and therefore bank funding.[5]

Policymakers seem more likely to choose an 'indirect' model that keeps responsibility for dissemination and maintenance of CBDCs with banks. However, this model still has potentially important disintermediation effects, for example, in terms of consumers choosing to switch bank deposits into their CBDC wallets. It could demand a degree of technological adaption in terms of banking and transaction systems. If indirect CBDCs proved popular, banks might still have to innovate their business models to stay relevant.

At the same time, indirect CBDCs provide banks with an unprecedented opportunity to distribute and manage a digital currency, introduce new CBDC-linked services such as smart digital wallets, and leverage insights enabled by real-time information, for example, in terms of consumer spending. Bank leaders should consider enhancing their data management infrastructures to prepare for this opportunity. They should also identify how wholesale CBDCs might help their global corporate clients by providing a platform for innovative global liquidity and cash management products.

Most of the region's CBDCs are still at the consideration stage. However, they represent such a profound shift towards a digital economy that banks must monitor the rate of progress carefully and plan now in terms of assessing their technology capabilities and infrastructure, the potential impact on their business and operating models, and the most relevant use cases within their markets.

KEY TAKEAWAY

CBDCs represent a significant step forward in the evolution of the digital economy. Banks need to look ahead to assess potential business impact, required capabilities and strategic opportunities so that they can take the right action as CBDC designs and implementation timelines evolve.

1. CBUAE Launches a FIT Programme. February 2023. CBUAE. Link.
2. CBUAE Launches the CBDC Strategy 'The Digital Dirham'. March 2023. CBUAE. Link.
3. Project Aber: Final Report, p.8. Sama/CBUAE. Link.
4. Saudi Central Bank Continues CBDC Experimentations. January 2023. Sama. Link.
5. A Breakdown of the Different CBDC Models. February 2023. Cato Institute. Link.

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy focused in the financial services industry. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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