

World Islamic Banking Competitiveness Report 2016

New realities
New opportunities

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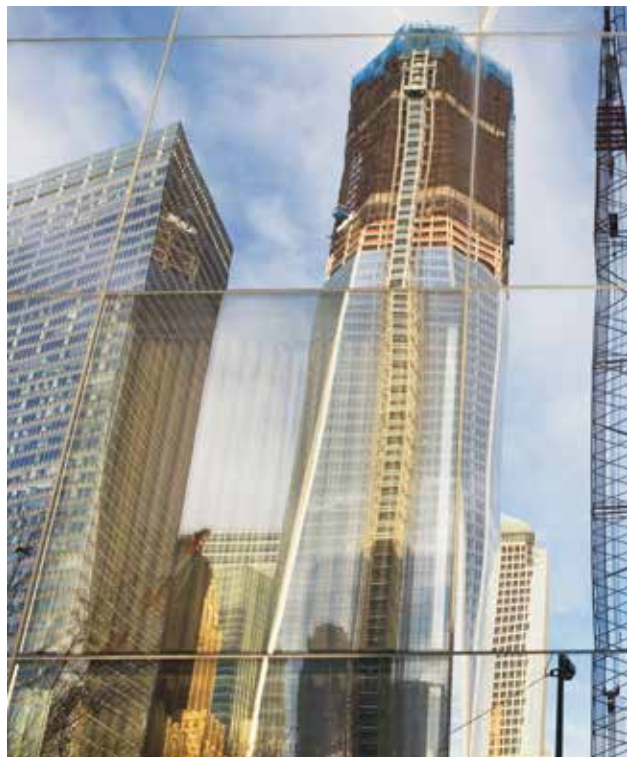
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Foreword



Abdulaziz Al-Sowailim
Chairman and CEO, MENA Region

The pulse of the international Participation banking industry are the nine core markets – Bahrain, Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates, Turkey, Kuwait and Pakistan. Together, they account for 93% of industry assets, estimated to exceed US\$920 billion in 2015. Forward looking industry projections are generally positive, driven by the significant unmet demand, and despite the prevailing macroeconomic and political situation across a number of emerging markets.

The boardroom focus is now shifting, and rightly so, to improve the quality of this growth. EY research has identified a group of 40 leading banks that are systemically important to the progress of the global Participation banking industry. Collectively, the nine core markets and the group of 40 banks are the '*growth engine*' of the industry.

There are a number of extraordinary opportunities in the making that will influence the regionalization of the industry. Emerging markets will remain central to global growth over the next decade. A group of 25 rapid-growth markets (RGMs) are reshaping the world economy and the global trade flows; and 10 of these 25 RGMs have large Muslim population. In Southeast Asia, the coming together of ASEAN Economic Community (AEC) in 2015 is one of the key milestone towards a larger, integrated financial market. In GCC, falling oil prices, jobs-for-nationals and economic diversification drive is set to transform the role of financial institutions in the region. In addition, the China-led Asian Infrastructure Investment Bank (AIIB) is readying for launch with US\$100 billion capital from 56 shareholder countries. And China's ambitious development framework, the **Belt & Road Initiative**, has accelerated economic activity in the region, notable initiatives being the China-Pakistan Economic Corridor (CPEC) and the Bangladesh-China-India-Myanmar (BCIM) Economic Corridor.

In the local market context, Participation banks are still attempting to transform their rather generalist business model to more direct integration with priority sectors of the Islamic Economy. There is increasing pressure on these banks to demonstrate their purpose of existence – specifically their role in enabling important sectors such as transportation, retail, telecommunication and SMEs to name a few – that have the greatest impact on the economy and on creating employment alternatives.

Finally, the industry infrastructure – talent development, advocacy, applied research, regulations, capital markets, product design, accounting and rating amongst others – is not fit to support the exciting journey ahead. This requires immediate attention, funding and political will to make it happen. This is also an opportunity for each of the nine jurisdictions to carve a more specialized 'hub' positioning for themselves.

The purpose of this report is to inspire and inform the business strategies of Participation banks through specific, actionable insights. We hope you will find it useful in your forward journey ahead.

Participation banking assets with commercial banks in Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey (QISMUT) are set to cross US\$801 billion in 2015 and will represent 80% of the international Participation banking assets. Approximately two-thirds of new industry assets are from three markets of Saudi Arabia, Malaysia and UAE. On the same note, Saudi Arabia, Qatar, Kuwait and Bahrain are seeing Islamic banks capturing market share by outgrowing their traditional peers.

In UAE and Malaysia, the growth appears to be converging to that of traditional banks. This demands fresh thinking and a more differentiated business proposition going forward.

Twenty-two international Participation banks now have US\$1 billion or more in shareholder equity, making them better positioned to lead the future regionalization of the industry. In relative terms though, they are still one-third the size of their largest traditional peers in home markets, and also lag in terms of return on equity. In our conversations with boards and senior management of these banks, it was clear that a more inclusive business strategy and digital-first approach can easily help close this gap.

Will you be the one to lead?



Robert Abboud
Financial Services Advisory Leader, MENA

Foreword



Ashar Nazim
Partner – Global Islamic Banking Center



Muzammil Kasbati
Director – Global Islamic Banking Center

Leading participating banks have done well to mainstream with a competitive, sizeable business in their home markets. The combined profit pool of Participation banks across QISMUT-plus-three markets crossed US\$12 billion in 2014, which is a notable milestone. Analysts, however, also point out that the return on shareholder equity could be significantly enhanced, by at least 15%-20%, and this need becomes more pressing in the context of prevailing macroeconomic environment.

The next big opportunity is for Participation banks to regionalize. But the challenge is this has to be done in the context of lagging industry infrastructure that could potentially put shareholder value at risk.

Fortunately, the progression of fintechs and the digitization of banking business means that banks will have to completely reinvent their business model. The future of retail banking in emerging markets is a smartphone experience that delights. EY conversations with a large number of banking customers confirms that cyber-trust, convenience and personalization will be the core of customers' relationship with their bank – and technology is the enabler.

Participation banks need to focus on a few high-impact opportunities: payments, mortgages and small investment accounts appear to have the highest payoff. The boards of most of the 40 systemically important banks have been generous in sanctioning spend on digital initiatives – between US\$15 million and US\$50 million over next three years – well aware that inaction could cost up to 50% of their retail banking profit in next few years. The bigger challenge is the implementation of the digital strategies. Majority of banks appear to be struggling to adapt to new customer decision journeys, prototyping of new technologies and the time to market.

The industry today is yet to reach 100 million customers. The potential captive market is six times bigger but requires a different banking model. A digital-first strategy has to be the stimulus for Participation banks to sign up the next 100 million customers over the next decade. This exciting journey is only just beginning.



Participation banking performance review

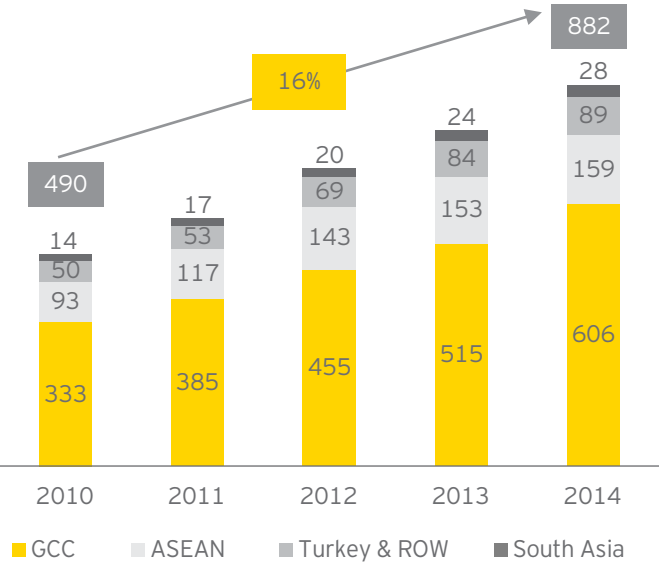




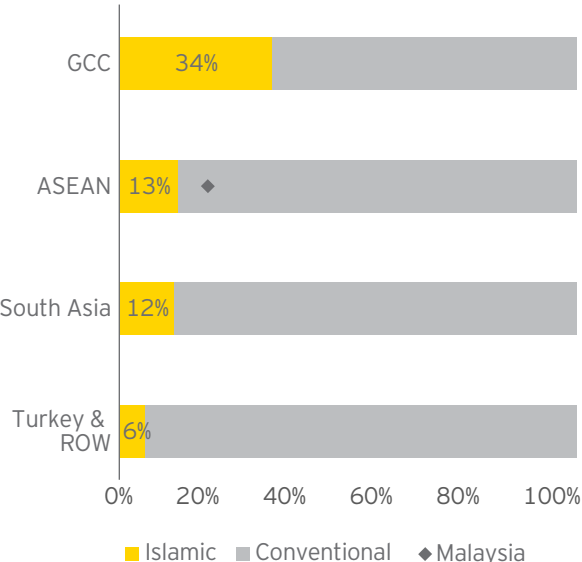
International Participation banking assets*

Participation banking assets grew strongly in 2014 with GCC gaining above average growth rate.

International Participation banking assets* (US\$b)



Share of Participation banking assets*



Participation banking continues to show strong growth of c. 16%, despite political and economic volatility in the major regions.

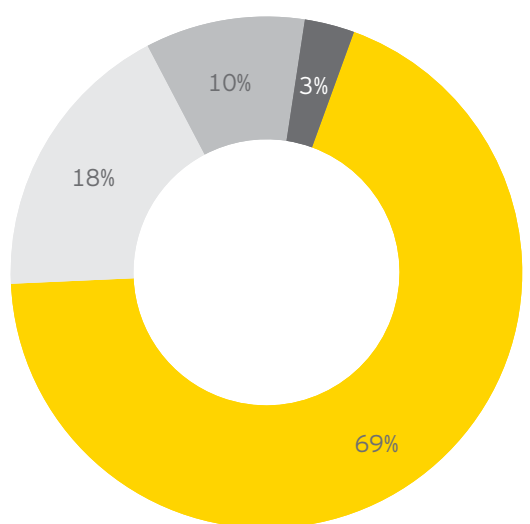
Sources:
 Central banks, EY analysis
 *International Participation banking assets exclude Iran which has a unique domestic industry.
 ROW includes Jordan, Egypt, Sudan and South Africa.

Regional market contributions

Saudi Arabia and Malaysia are the respective leading markets in GCC and Asia Pacific.

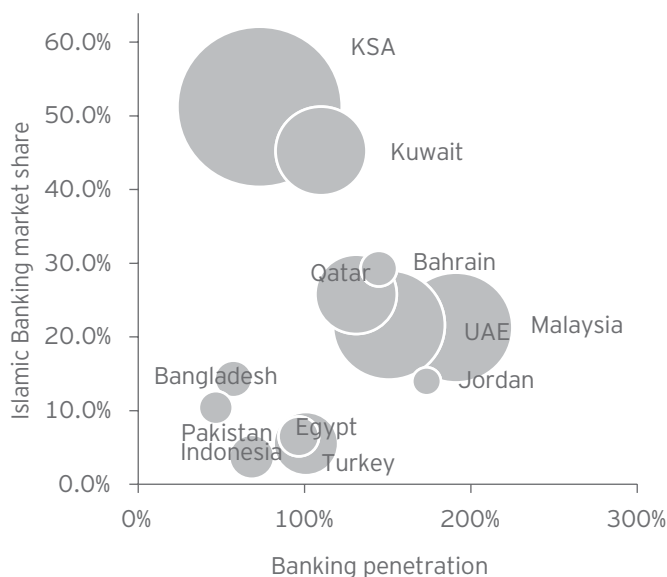
GCC region has accelerated its growth by achieving a YoY** Growth of c. 18%, driving the overall CAGR*** to 16.1% (2010-14).

Regional contribution to growth in 2014



■ GCC ■ ASEAN ■ Turkey & ROW ■ South Asia

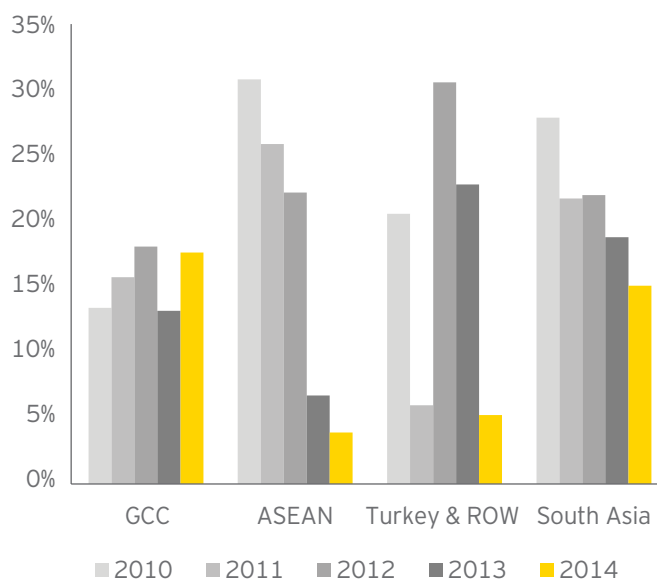
Banking penetration and Participation asset market share



● Size of circle = Islamic Banking Assets

Note: For the Bahrain market, analysis is based on domestic banking assets.

Growth rate by region



Sources:

Central banks, EY analysis

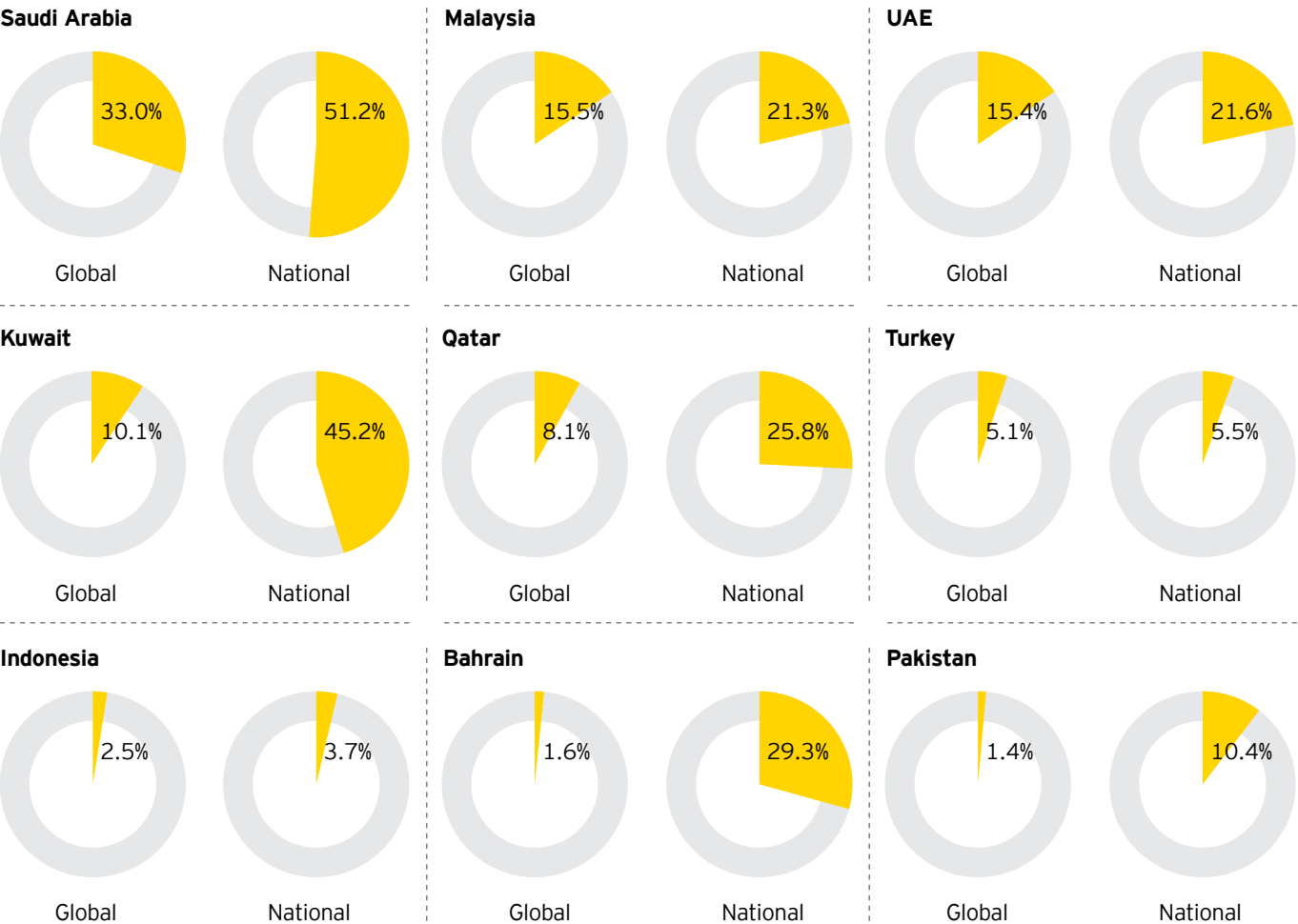
*International Participation banking assets exclude Iran which has a unique domestic industry.

**Year-over-year.

***Compound annual growth rate.

Participation industry footprint

Approximately 93% of international Participation banking assets* are based out of nine core markets, while QISMUT share stands at 80%.



More than 50% of Saudi assets are from Participation banking.

Turkey Participation banking growth has eroded due to prevailing political situation having a global impact on the Participation banking.

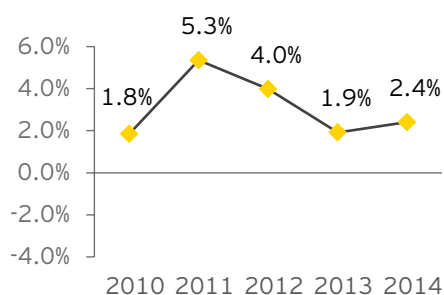
Kuwait Participation banking assets now comprise 45% of the national banking system assets.

Sources:
Central banks, EY analysis
*International Participation banking assets exclude Iran which has a unique domestic industry.

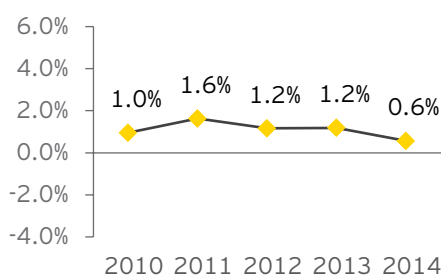
Market share changes

Saudi Arabia continues to dominate the growth share of the market with strong come back by Kuwait and Qatar. Bahrain is also steadily gaining market share over traditional banks.

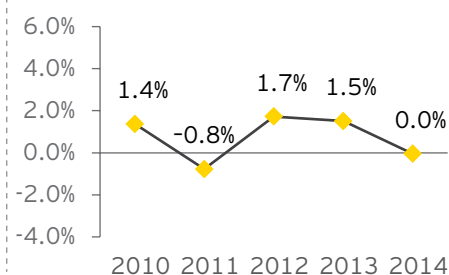
Saudi Arabia



Malaysia



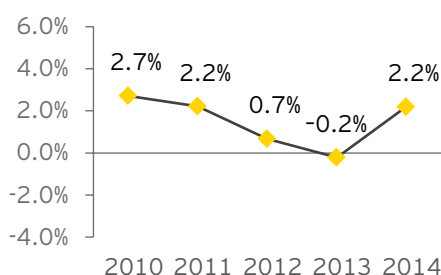
UAE



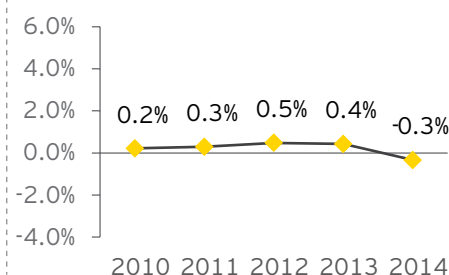
Kuwait



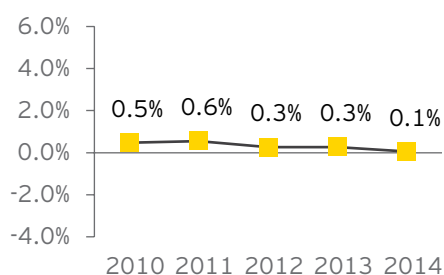
Qatar



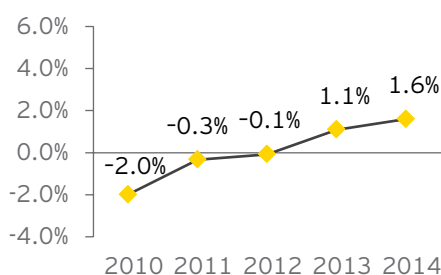
Turkey



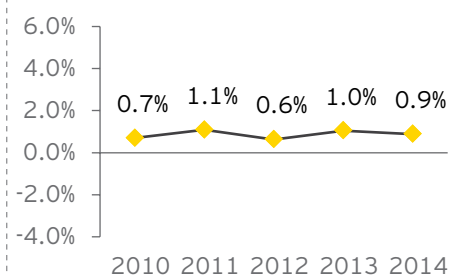
Indonesia



Bahrain



Pakistan



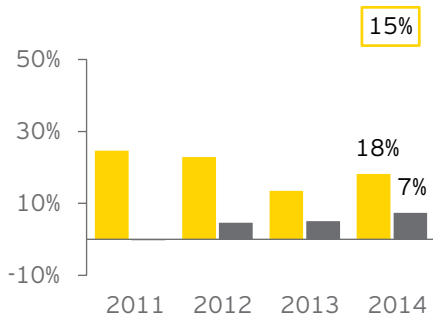
Sources:

Company financial reports, EY universe, EY analysis

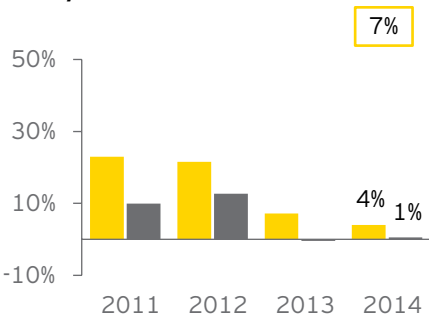
Asset growth

Saudi Arabia, Qatar and Pakistan are enjoying double digit median banking growth (2010-14).

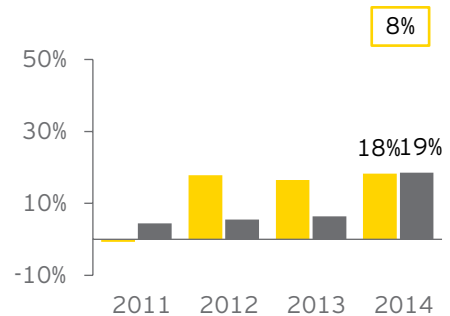
Saudi Arabia



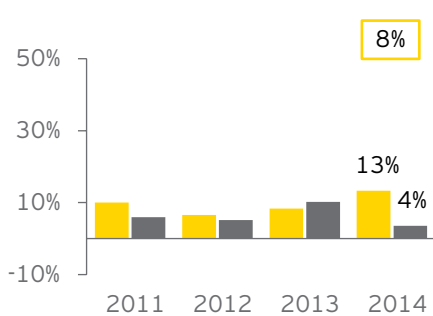
Malaysia



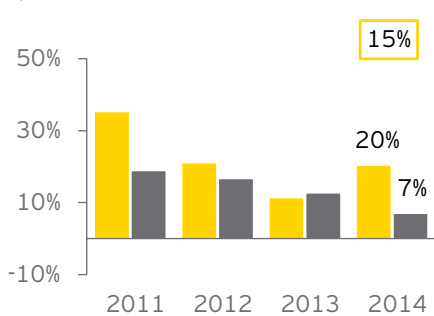
UAE



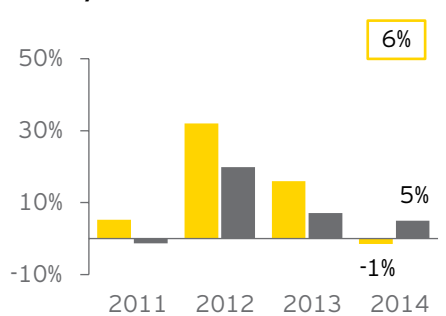
Kuwait



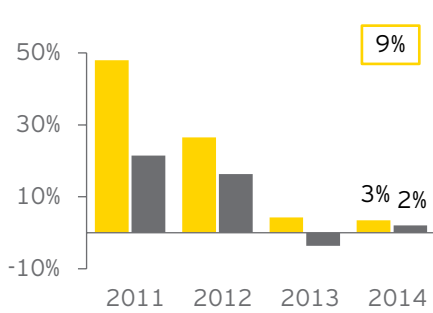
Qatar



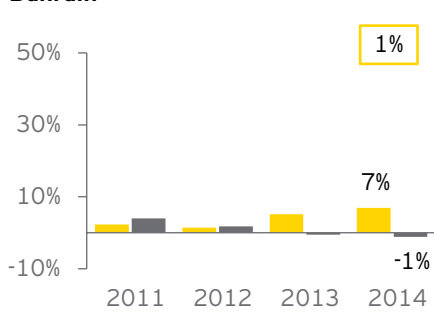
Turkey



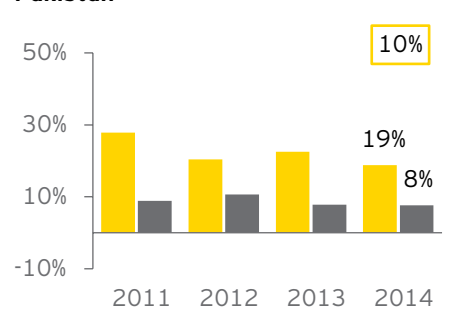
Indonesia



Bahrain



Pakistan



Conventional banking
 Participation banking
 Median banking growth 2010-14

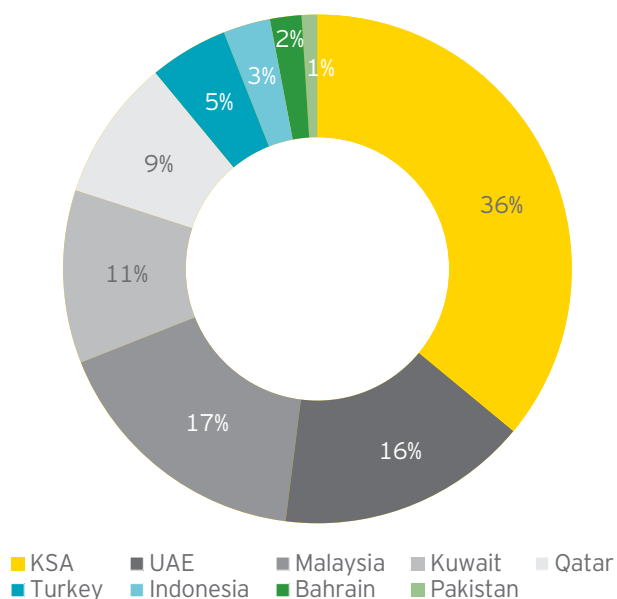
Sources:
Company financial reports, EY universe, EY analysis

QISMUT+3 contributions

The nine core markets are the growth engine for global industry and require tailored strategies.

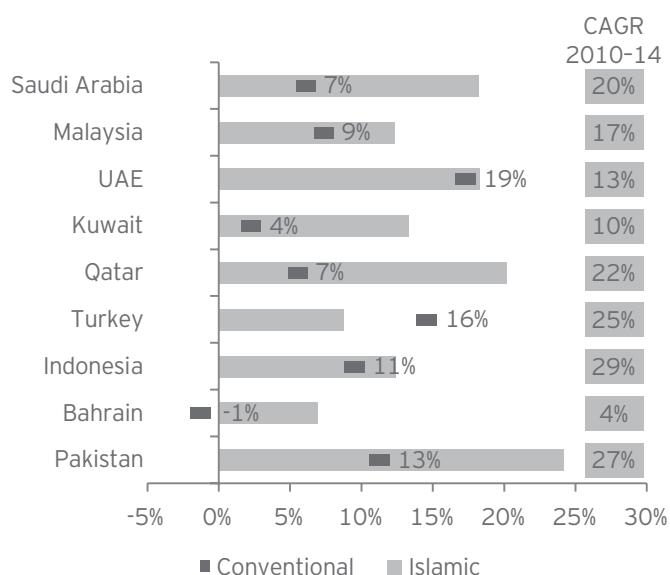
KSA at 36% is the highest contributor in total Participation banking assets followed by Malaysia at 17% and UAE 16%.

QISMUT+3 contribution in 2014 for total assets



Participation banking has maintained its higher growth rate as compared to conventional banking despite the challenges in Turkey.

YoY growth rate of assets, 2014 (in local currency)



Length of bars represents YoY growth rate of assets in 2014 (in local currency)

Sources:
Central banks, EY analysis

Leading 20 Participation banks by capitalization

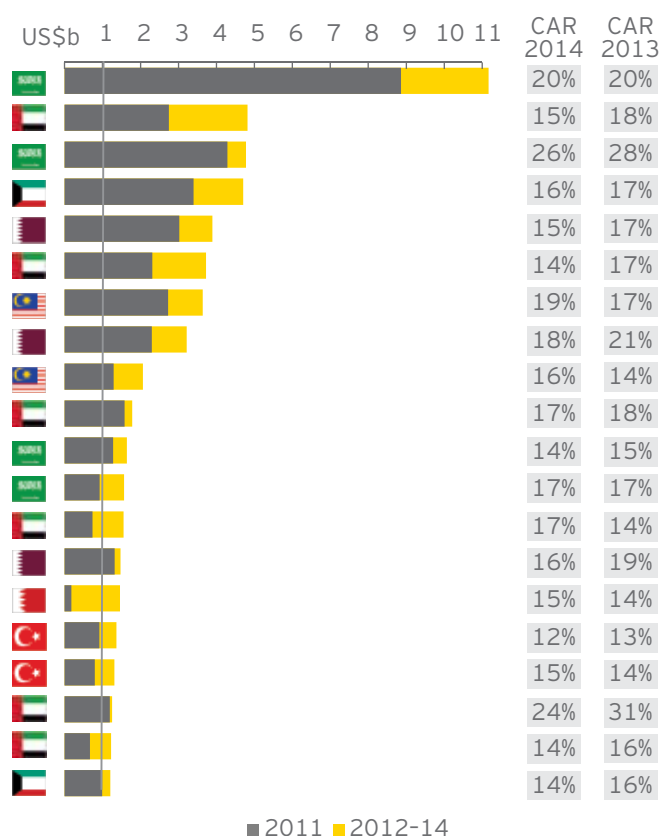
17 out of 20 top banks by capitalization are based in QISMUT.

Strengthening of capital base

22 Participation banks now have US\$1b or more in shareholder equity as compared to 21 in 2013.

The largest Participation bank has grown its equity by nearly US\$1b in just one year, to reach US\$11b.

Capitalization of top 20 banks



CAR – Capital adequacy ratio

Sources:

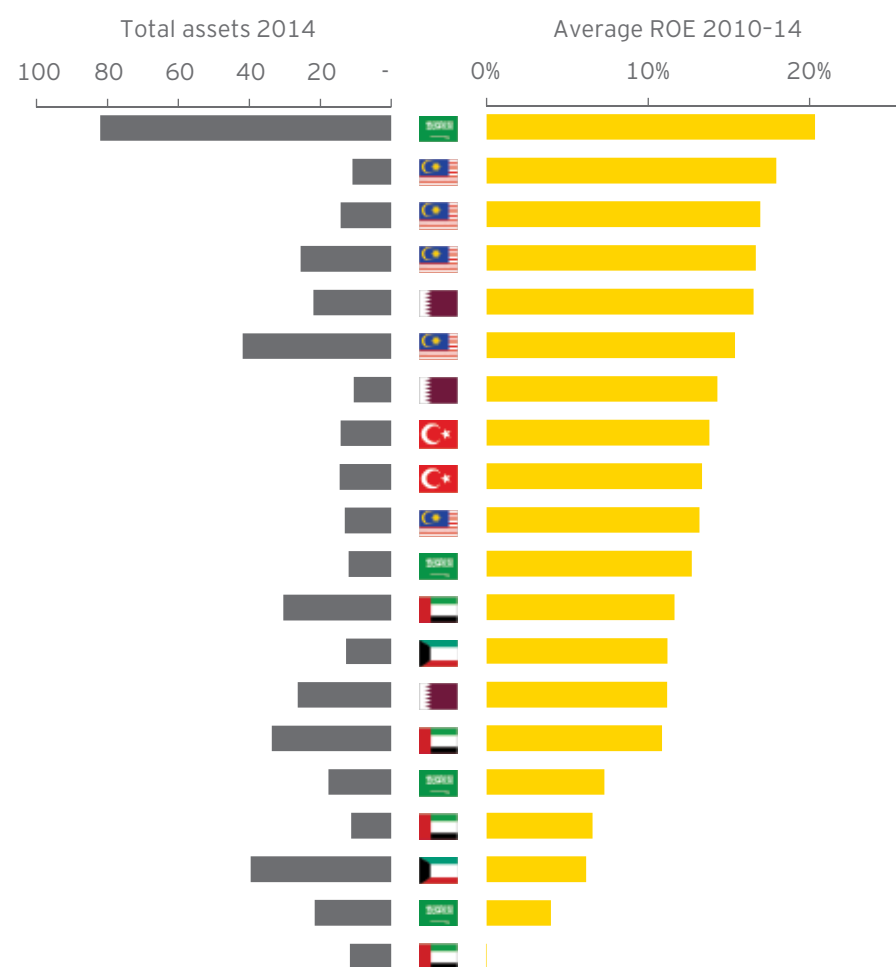
Company financial reports, EY universe, EY analysis

Note: Top 20 Participation banks data excludes Iran and country flags represent the home market of the Participation bank.

Profitability and shareholders' equity in focus

Combined profitability of the top 20 Participation banks has increased during the year by US\$1b to cross US\$7b in 2014, growing with a CAGR of 14% (2010-2014). This resulted in healthy growth of ROE, which has positively contributed towards increasing shareholders' equity (22 banks have crossed the equity landmark of US\$1b).

Top 20 Participation banks



	Average ROE* (2014)	Average assets	Average growth 2010-14
Leading Participation banks by assets	12.6%	US\$23b	14.0%
Comparable conventional average	14.5%	US\$87b	11.0%

Sources:

Company financial reports, EY universe, EY analysis

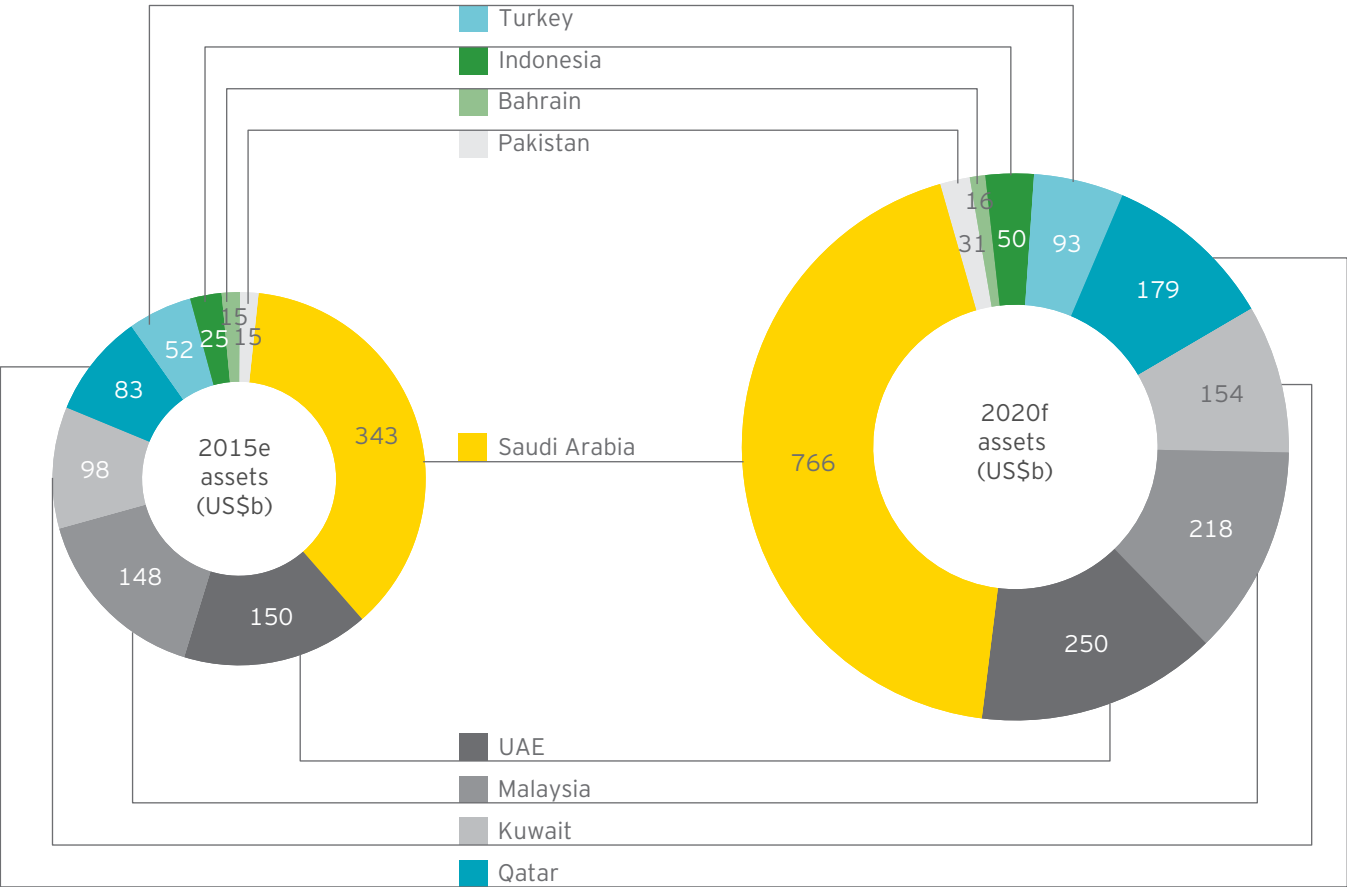
Note: Top 20 Participation banks data excludes Iran and country flags represent the home market of the Participation bank.

*Return on equity.

Industry in 2020: a potential scenario

QISMUT+3 Participation banking assets are set to cross US\$920b in 2015.
Expect a CAGR of 14% through 2015-20, with total assets reaching US\$1.8t across these nine important markets.
QISMUT will remain the key driving market with GCC providing the additional acceleration.

QISMUT on flight to achieve US\$1.6t by 2020

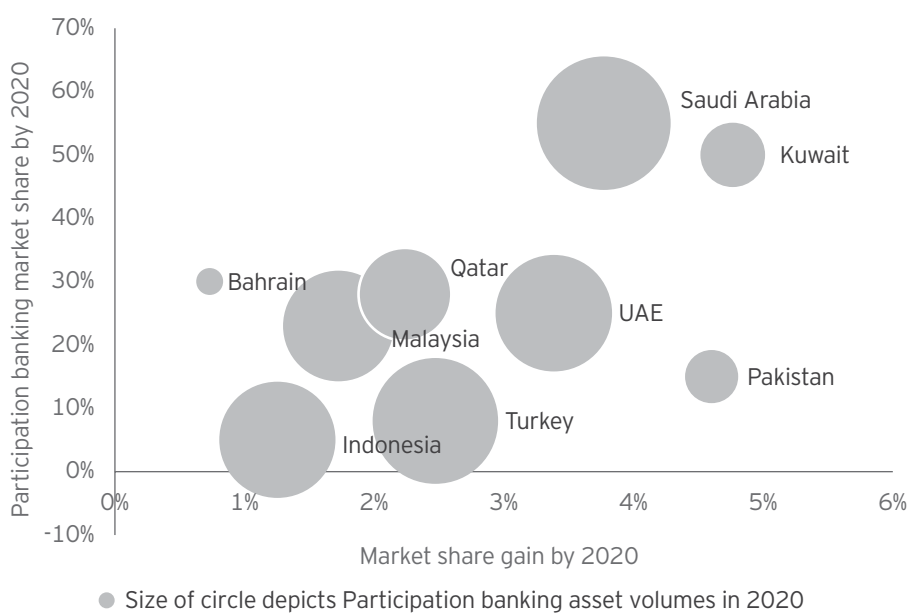


Sources:
Central banks, IMF, BMI, EY analysis
e – estimate, f – forecast

Future outlook

QISMUT and other core markets are to drive the future growth of the industry with Turkey expected to recover from the current temporary setback.

Participation banking sector projections

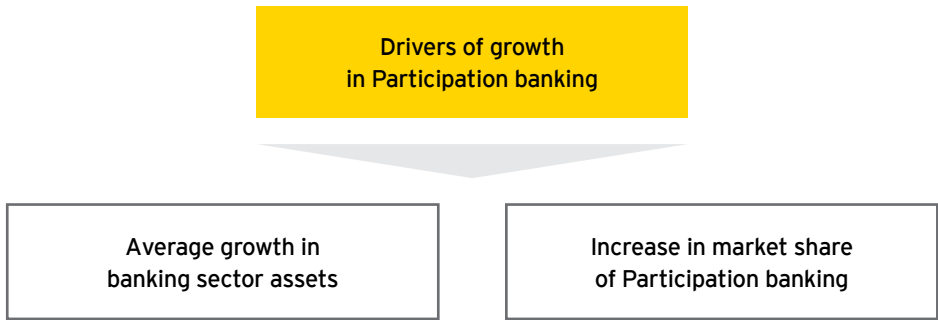


Based on banking sector asset projections, key players identified on account of “average annual growth rate” and “banking sector assets” are Saudi Arabia, Qatar, Pakistan, UAE and Turkey.

On the other hand, for Participation banking, Saudi Arabia, Kuwait, Bahrain and Qatar will be the major players in terms of banking market share by 2020.

Growth drivers

Participation banking continues to drive high growth over traditional banks and capturing market share in all key markets with the exception of Turkey.

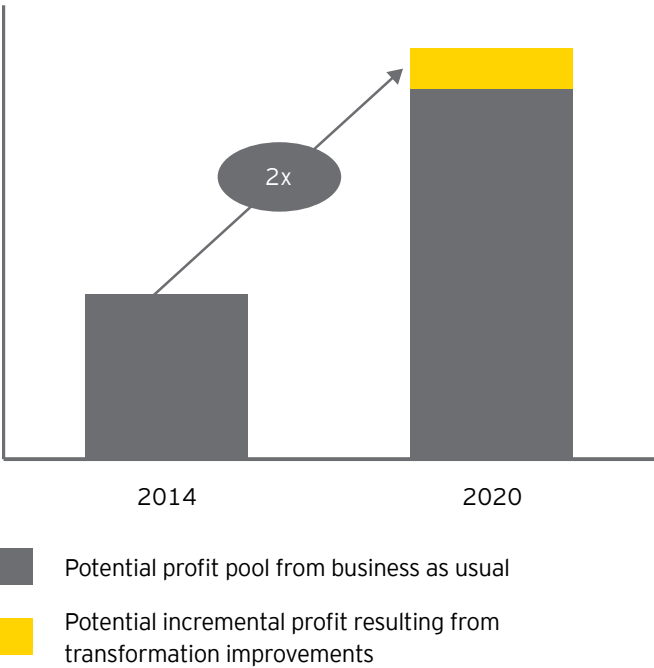


Participation banking profit pool across QISMUT estimated at US\$10.8b in 2014

By 2020, Participation banking profit pool would reach US\$30.3b, out of which US\$27.8b is expected to come from the QISMUT markets.

Primary growth drivers will be regionalization, digital acceleration and innovative business models for emerging markets.

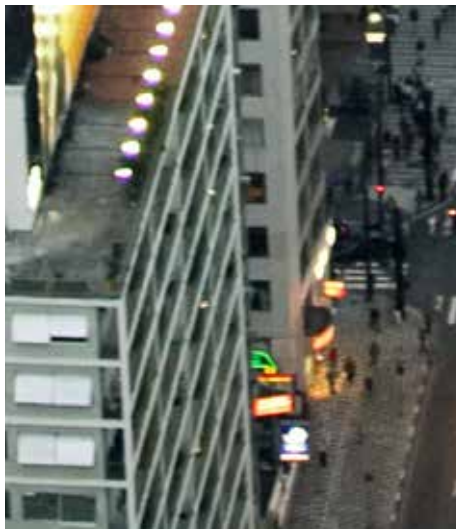
Participation banking profit pool



Sources:
Company financial reports, EY universe, EY analysis, Central banks, IMF, BMI



Focus on GCC: reimagine banking business





In the Gulf Cooperation Council (GCC), our social attitudes and expectations have changed at an incredible pace. This is influenced by a mostly youthful population of near 50 million, which is increasingly mobile and has greater access to international media and technologies. As a result, the disconnect between what we expect as customers and what banks in the GCC can deliver is more distinct than ever.

This is the message from EY's conversations with more than 2,000 customers across Saudi Arabia, the UAE, Qatar, Kuwait, Bahrain and Oman; analysis of 700,000 sentiments on social networks; and discussions with 28 leading banks and 80 banking industry leaders.

This wealth of customer data is now informing new product and service design for several of our banking clients. Addressing your customer needs in an increasingly digital world means disrupting and rewiring existing business models for a fresh customer experience. But this investment has to be made wisely. Our experience suggests that up to 50% of retail banks' net profit could be at stake.



The GCC digital banking disruption



Ashar Nazim



Paul Sommerin

"The first question that the ATM asks is for me to choose my preferred language.

Really? I have been with the same bank now for over 17 years and they still want to know my language preference" commented a customer, mirroring what we all experience.

"The mortgage process, no matter what they say, takes at least two months from start to finish. I wish I had a choice," shared another affluent customer we interviewed.

These are just two examples from the EY GCC digital banking report that highlight the changing expectations of banking experience in the region. Digital is enabling this lifestyle transformation.

EY's study has confirmed that the future of retail banking in the GCC is a smartphone experience that delights. This customer desire for a "bank in your pocket" is notably visible. However, mobile banking usage in the UAE stands at 34%, followed by 27% in Kuwait, 19% in Qatar and 15% in Saudi Arabia. Customers are generally not impressed with the mobile proposition on offer, it appears, and this holds true for both traditional and Islamic banks. Among reasons cited for this low take-up is the lack of convenience and simplicity. Less than half of the customers surveyed were happy with their mobile banking experience.

Clearly, it is not enough for banks to introduce new digital channels. They must completely reinvent their customer processes to offer technology-enabled, simple end-to-end experiences. Key solutions in demand are payments, account opening and mortgages, with the potential for banks to increase value per customer significantly. Digitization of these would entail a combination of connectivity, user experience, automation, decisioning, collaboration and execution.

The other astonishing finding was the dwindling loyalty among customers. Three out of four customers surveyed felt comfortable to transition to a digital-first relationship and were willing to switch banks for a better digital experience.

How will you respond?



The digital effect?

The customer decision journey has changed with the proliferation of digital technology and mobile devices. No surprise, therefore, that more GCC banks see digital transformation as reinvention, and not incremental enhancement to their existing offering. A case in point is the start-up, digital-first, Sharia-compliant retail bank in Saudi Arabia.

Just under half the banks surveyed have budgeted between US\$5 million and US\$20 million for digital initiatives (channels, customer journeys, automation, new technologies, etc.). Some of the larger banks are demonstrably willing to spend more.

Popular new technologies include payment solutions, customized alerts and efficient account opening. In one instance, the account opening process of a bank is targeted to take less than seven minutes from the time the customer walks into the branch.

By contrast, banks have seen muted demand for voice-driven banking, pre-login balance and gamification. Another observation is the exceptionally long time it is taking banks to prototype and bring to market, as well as the costs being incurred.

The boards are generally generous in sanctioning spend on digital, but the sheer scale and complexity of transformation is making the management of some banks nervous.

As yet, there is no clear leader in the digital banking space in the GCC. Banks are positioning themselves to create value using a range of approaches, from digitally enabling their existing business to adopting new disruptive propositions focused on customers and service design. This exciting journey is just beginning.



Dominique Corradi



Hammad Khan



The five principles of digital acceleration

1

You know your customers, but you're not treating them as if you do.

2

The future of GCC retail banking is a smartphone experience that delights; think beyond a killer app.

3

Not every technology is right for the GCC; place your bets wisely.



Retail banking customers today have more choices than ever on how, where and when to bank – and they are turning to a digital experience for convenience. Currently, only one in four customers are convincingly happy that their smartphone banking experience enables them to achieve their financial goals. But then, digital banking concepts are only just emerging in the GCC. As the pace accelerates, we expect a winner-takes-all trend to emerge. There are five helpful lessons for leading banks, based on our customer conversations.

4

Get better at executing.

5

Digital shift is a cultural shift;
collaborate to win.

The verdict on mobile banking

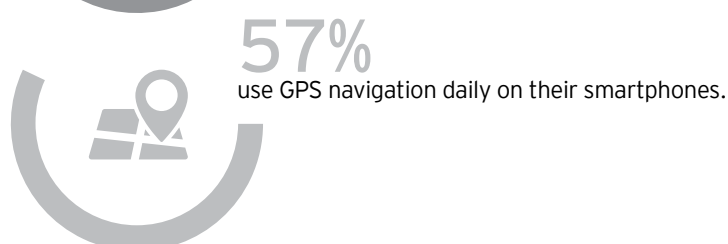
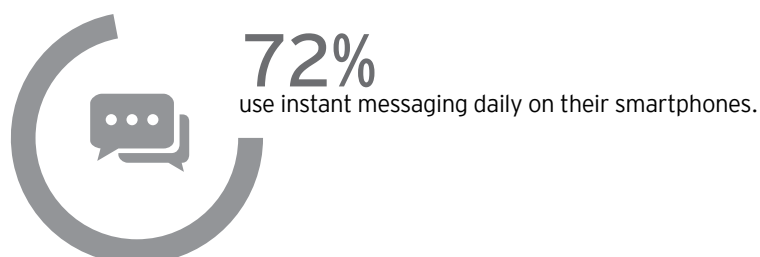
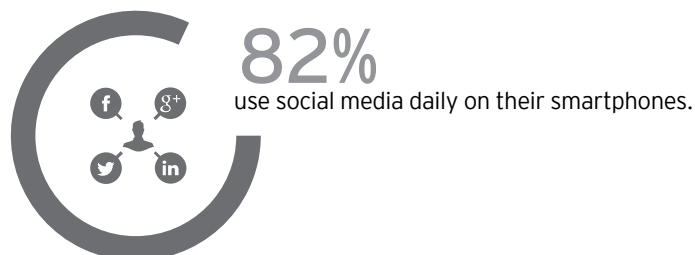
The GCC enjoys a unique combination of highly educated people, high levels of income and uptake of digital equipment. Mobile usage is very developed in the region, which is a fertile ground for mobile banking. However, uptake has still not reached its full potential, mainly because the proposed solutions are falling short of customer expectations.

In the GCC, smartphones are “a way of life” for a dominant majority of banking customers ...

98% of surveyed banking customers are equipped with modern smartphones.

The market is almost evenly split between the two leading smartphone device vendors, with respectively 46% and 49%.

A large number of the surveyed banking customers use smartphone apps daily and build their digital expectations based on these interactions.

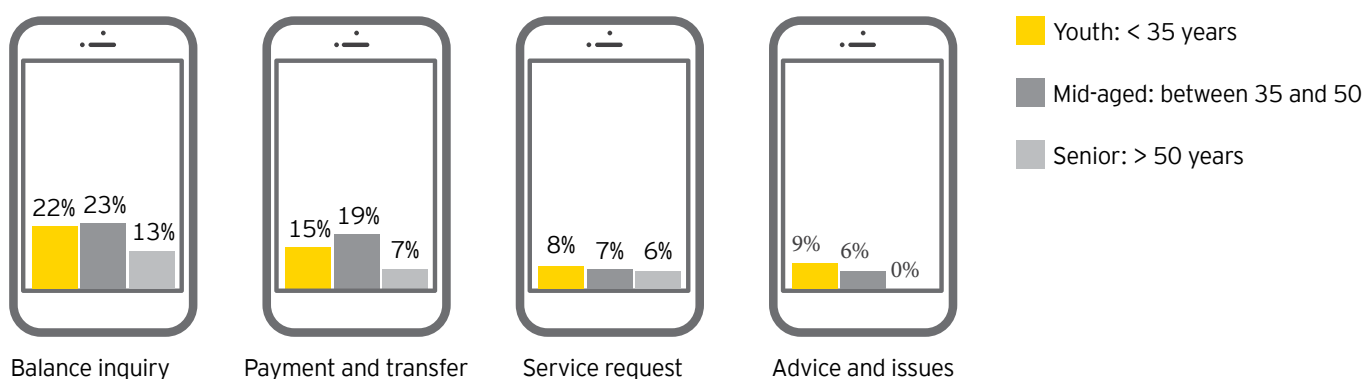


... yet mobile banking has not fully taken off.

A large number of transactions are still made on home computers or at ATMs, or through traditional channels involving human interaction, such as branches or call centers.

Only a limited number of banking transactions are completed via mobile banking.

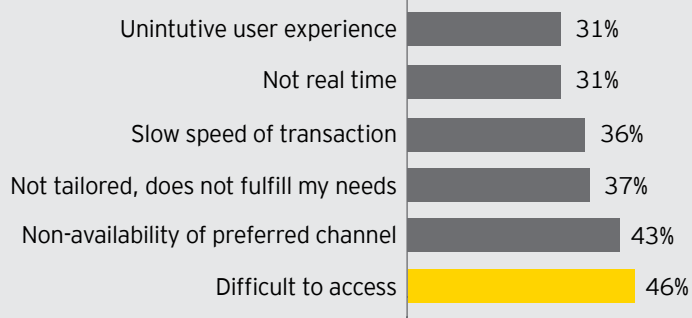
Smartphone penetration for main banking interactions is low.



Why?

Customers speak of a lack of convenience that is holding them back

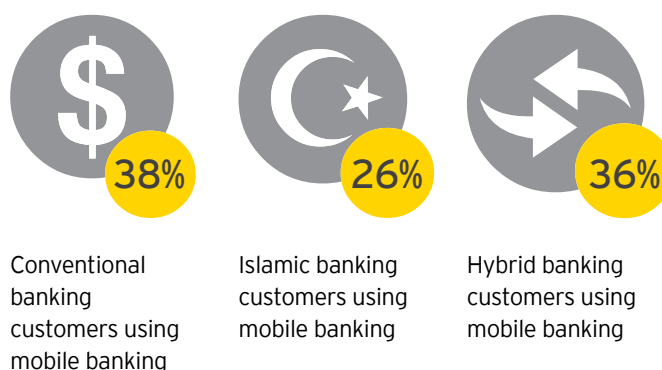
"I am not satisfied with my mobile banking. It is difficult to access, not always available and sometimes not tailored to my needs."



Traditional banks appear to have a slight edge over Islamic banks.

The survey highlighted some differences in mobile banking usage between conventional and Islamic banks.

Mobile banking users



GCC country demographic comparison.

	Bahrain	Kuwait	Oman	Qatar	KSA	UAE	GCC	UK	France	Singapore
Population (millions)	1.4	3.9	4.5	2.2	31.5	9.2	52.7	64.7	66	5.6
Percentage expat	52%	69%	44%	86%	33%	88%	48%	12%	11%	39%
GDP per capita (US\$)	26,205	35,159	35,159	82,680	23,099	39,767	37,274	43,900	42,503	48,867
Transparency ranking (Based on CPI index)	55	67	64	26	55	25	NA	14	26	7
Three-bank asset concentration	91%	88%	70%	67%	52%	64%	20%	45%	30.8%	84%
Five-bank asset concentration	97%	100%	100%	96%	76%	84%	30%	64%	43.3%	100%
Size of largest bank (US\$b assets)	32	66	22	121	100	93	121	2,634	2,526	401
Remittance market 2014 outflows (US\$b)	2.2	19	9.5	11.2	37	18	97	2.5	13	NA
Level of competition (based on H-index)	8%	40%	43.6%	NA	48.8%	43.5%	NA	66.4%	51.5%	65%

Transparency results 2014 – 0-174 ranking Ranking (0 – Highly transparent/100 – Lack of transparency)
<https://www.transparency.org/cpi2014/results>

Percentage expat: OECD input

Migrant Remittance Outflow Report – World Bank

<http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data>

Total assets, US\$b

Source Annual Reports

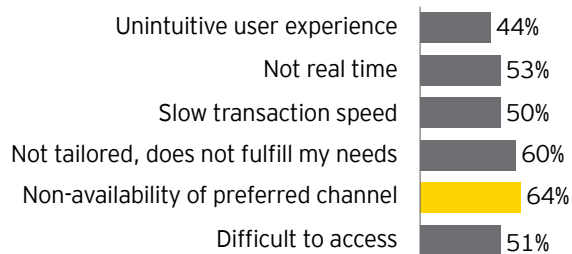
H-Statistic: measure of the level of banking competition in a market, (0: no competition – 1: perfect competition) src. www.bluenomics.com

Kuwait customer findings

27% banking customers use mobile banking in Kuwait.

50% are satisfied with mobile banking experience.

What is preventing customers from using more mobile banking?

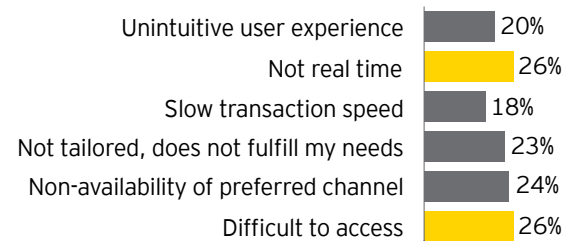


Saudi Arabia customer findings

15% banking customers use mobile banking in Saudi Arabia.

34% are satisfied with mobile banking experience.

What is preventing customers from using more mobile banking?

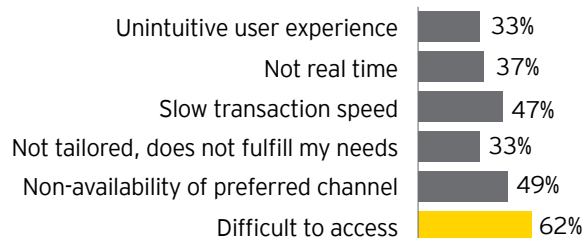


Qatar customer findings

19% banking customers use mobile banking in Qatar.

42% are satisfied with mobile banking experience.

What is preventing customers from using more mobile banking?

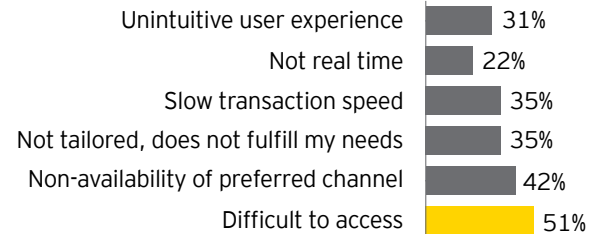


UAE customer findings

34% banking customers use mobile banking in UAE.

45% are satisfied with mobile banking experience.

What is preventing customers from using more mobile banking?



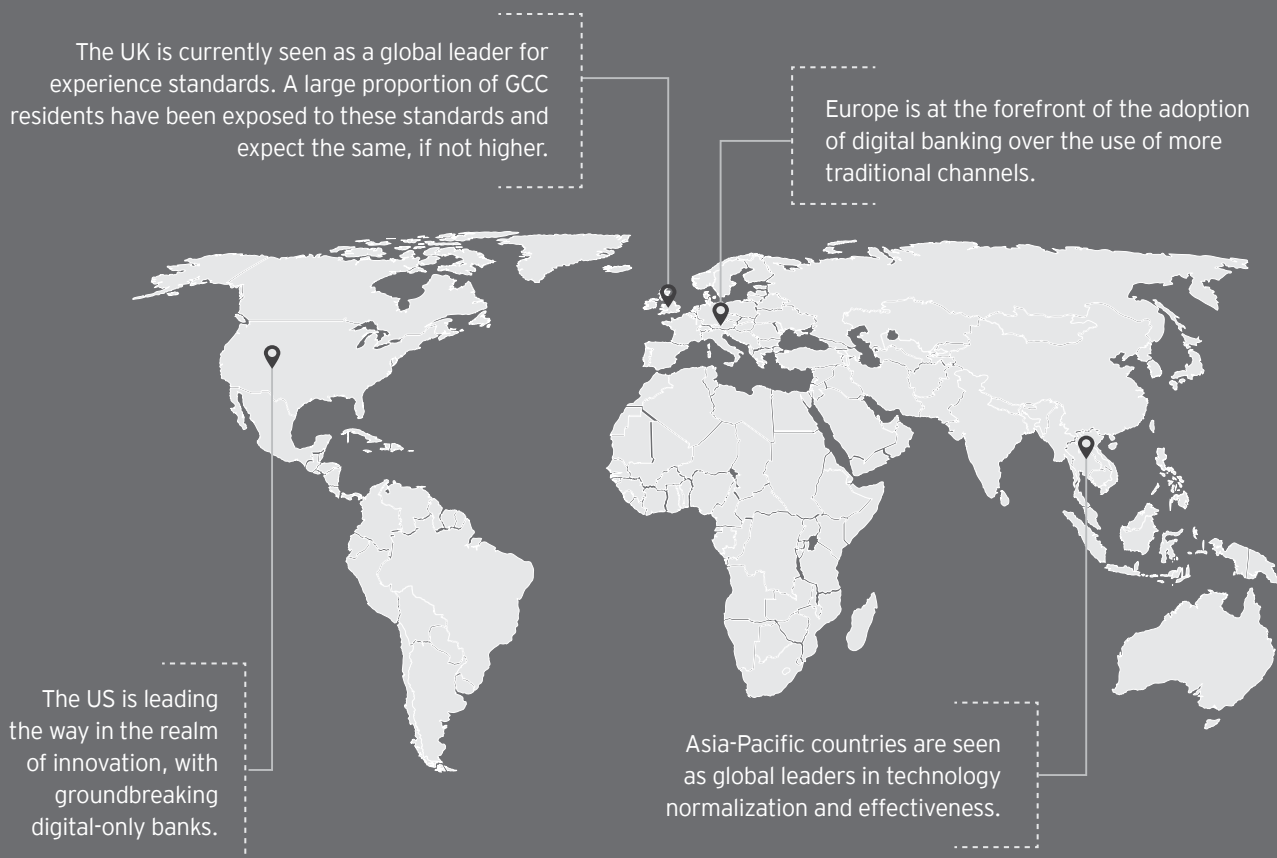
EY view: challenge yourself to co-create digital solutions

It is only six years since apps first appeared on mobile devices, and customers now expect to be able to check their balance and make transfers through their phones, at the minimum. Specifically, increased use of smartphones is set to transform the c.US\$100b remittance business in the GCC – for which combined transaction fees and exchange rate margins can still cost more than 10%.

Beyond the transactional mindset, the future lies in reinventing mobile banking journeys by asking yourself: “How would a start-up do this?” The typical customer experience starts long before the transaction. Be there. Play a bigger role in the customer’s life and continue to reward and support them through the life cycle of specific financial decisions.

In the meantime, smart branches and reskilled branch staff are taking up the critical advisory and sales roles.

Global context



Across the GCC, we are seeing early signs of smartphone onboarding. Capabilities such as photographing ID and authentication documents, or using fingerprint scanning, are bringing down the onboarding time dramatically.

Your customers speak out

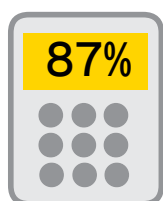
Banks have much at stake with digital; customers have a good understanding of the benefits digital can provide and are ready to spend more with their bank if more digital convenience is provided. On the other hand, they are also ready to switch to another institution if their expectations are not met.

We asked your customers what banking digitization would do for them.

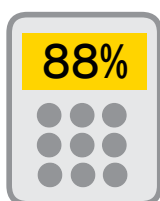
They expect their bank to provide more convenience and speed, less paper, pinpoint accuracy and a friendly service environment.



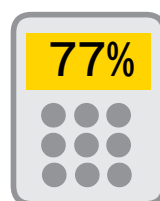
We heard customers praising the introduction of digital across the GCC ...



of mobile banking users strongly agreed that their banking app allowed for improved control over their finances.



of mobile banking users strongly agreed that their banking app allowed them to get closer to their financial goals.



of mobile banking users strongly agreed that their banking app facilitated easier payments.



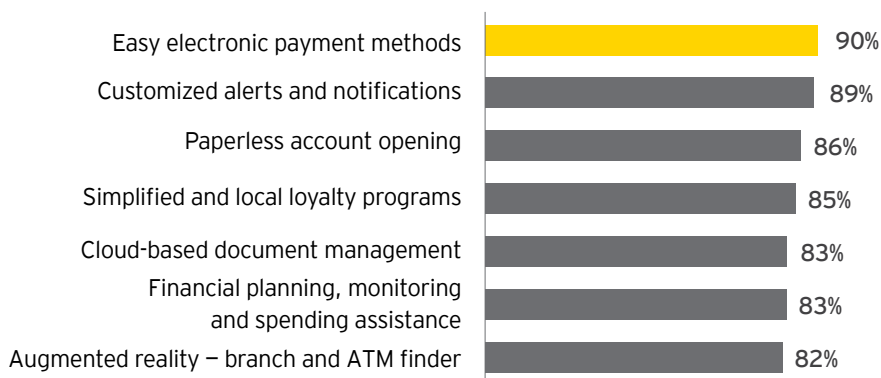
... but this was neutralized by an overwhelming majority asking for an improved banking experience.

Digital banking amounts to much more than adding another channel to a bank's offering; it signifies completely new propositions. The wealth of data that banks hold on their customers should facilitate a deeper understanding of customer patterns and behaviors. A robust analytics engine can generate "next conversation" and also "next product" offers.

Consumer expectations of banking relationships are increasingly shaped by other digital industries.

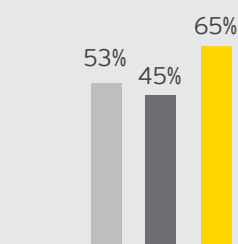
The future of retail banking in the GCC is a mobile app that delights, integrated with the individual's lifestyle and everyday banking needs.

Customer expectations for innovation



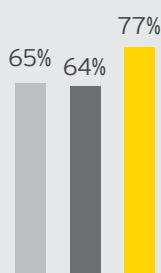
Social media has become a key influencer for your customer's financial decisions ...

55% of customers follow their bank on social media.

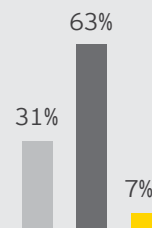


■ Youth ■ Mid-aged ■ Senior

64% rely on social media as a source of information for their banking decisions.



Mid-aged customers are most active in discussing their bank on social media.

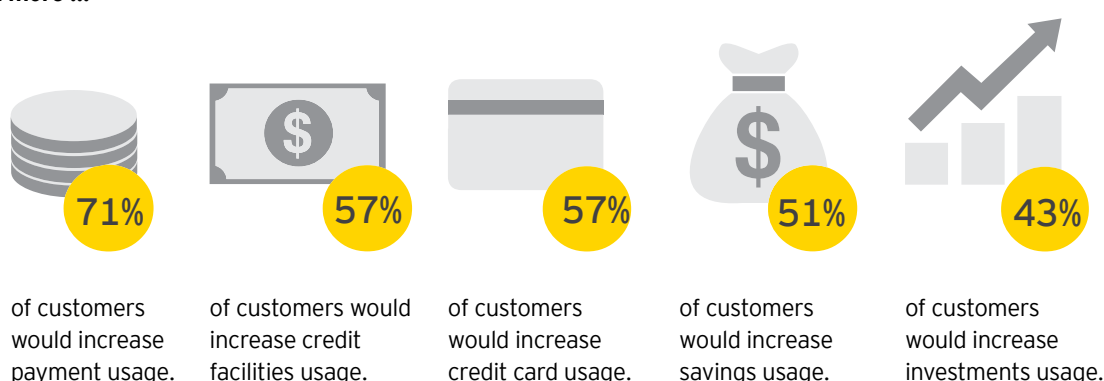


... however, it is important to consider it as a mechanism for dialogue with customers, rather than a medium for sales and marketing.

The survey evidenced a strong correlation between the customer's digital experience and the bank's revenue.

Enable me and I will bank more ...

GCC banking customers would significantly increase their banking relationship if this experience was made convenient, simple and accessible.



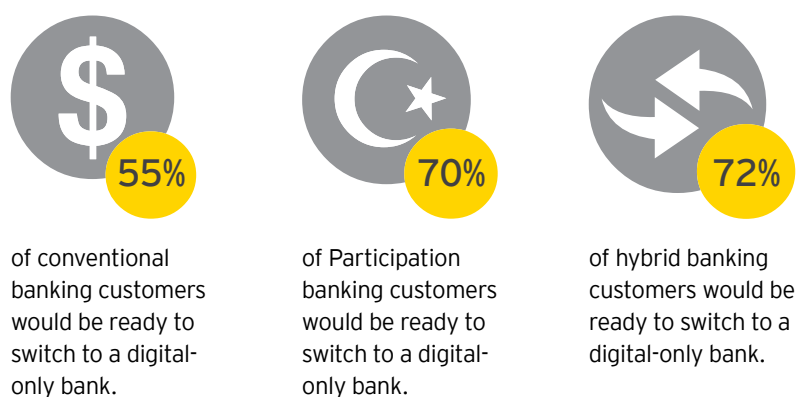
... or I would prefer to switch to a digitally stronger bank.

Three out of four GCC banking customers would be ready to switch banks for a better digital experience.



My bank needs to invest in better digital services rather than more branches.

64% of GCC banking customers would feel comfortable switching to a digital-first relationship.



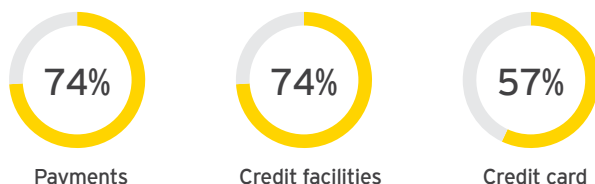
EY experience suggests that up to 50% of retail banks' net profit could be at stake.

Kuwait customer verdict

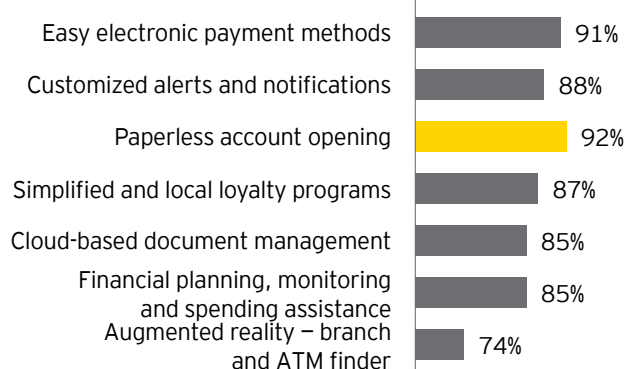
89% customers would shift if they were offered a better digital experience.

80% customers would be willing to shift to a digital-only bank.

Willingness to increase banking service usage



Which innovations your customers are looking for:

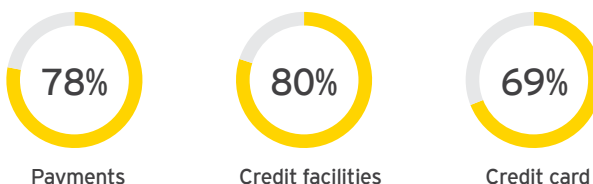


Qatar customer verdict

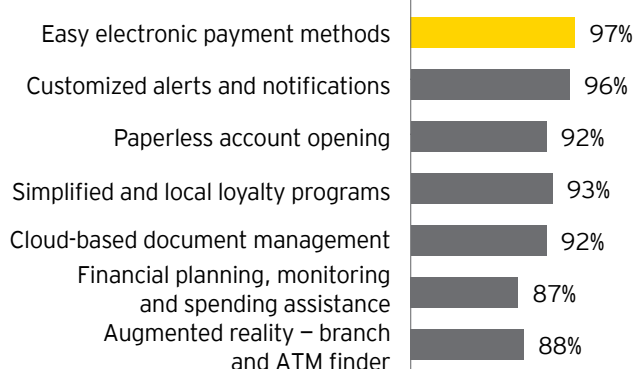
89% customers would shift if they were offered a better digital experience.

83% customers would be willing to shift to a digital-only bank.

Willingness to increase banking service usage



Which innovations your customers are looking for:

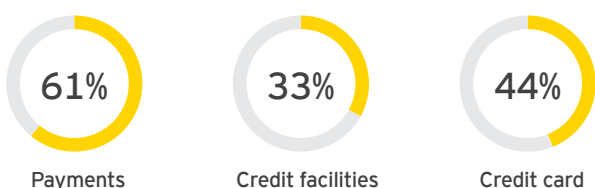


Saudi Arabia customer verdict

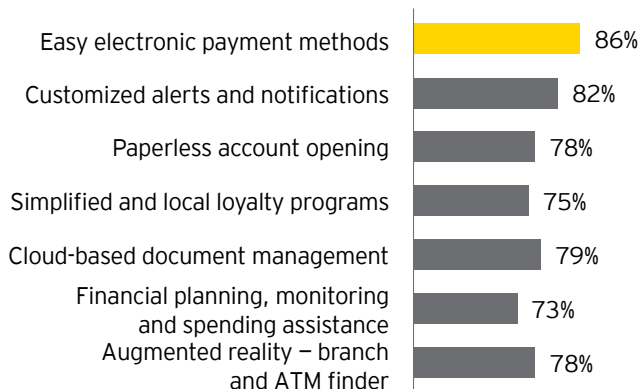
57% customers would shift if they were offered a better digital experience.

45% customers would be willing to shift to a digital-only bank.

Willingness to increase banking service usage



Which innovations your customers are looking for:

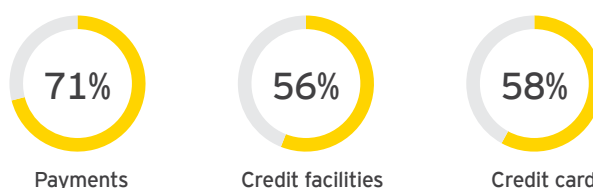


UAE customer verdict

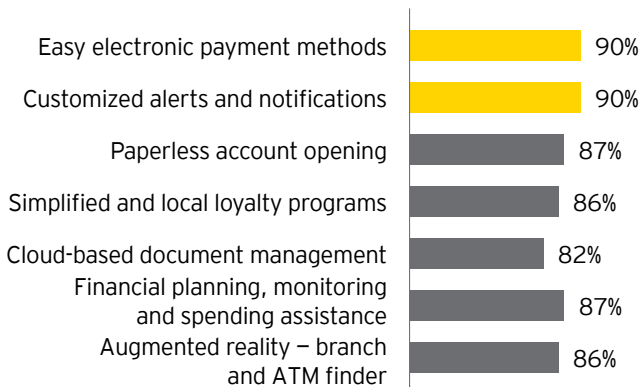
81% customers would shift if they were offered a better digital experience.

60% customers would be willing to shift to a digital-only bank.

Willingness to increase banking service usage



Which innovations your customers are looking for:



EY view: the challenge of putting customers first

It may seem counterintuitive, but technology is in fact enabling banks to have a closer relationship with their customers. The average users of online or smartphone banking log into their app several times a week, significantly more than their visits to bank branches.

Payment solutions top our list of seven leading innovations that GCC customers expect from their banks. Payment is one of the most contested areas, representing a sizeable share of bank revenues in some cases. Ongoing innovation could have a direct impact on the bottom line of these banks.

Banks have to show rigor when considering which technology to invest in and the expected impact it delivers. In one of our sessions, a Saudi bank that was expecting 30% of its customers to migrate to online and mobile channels said it is experiencing a “disappointing uptake.” This several million-dollar experiment could have been avoided, in our view, by first understanding the source of value for the bank. For example, in another case, a bank in Kuwait has very specifically prioritized salary transfers, as its penetration rates were significantly below that of its peers.

The lesson learned is that, although banks have a great deal of customer data, it can be quite complex to organize across channels and get that “360-degree view” of customers. Applying this 360-degree view for smarter targeting of customers and sharper assessment of risk, consistently, can be a true game changer.

Reliability of new technology is crucial. While we don't expect many GCC banks to replace their core banking system, we do believe that achieving a digital transformation will require continued high investment in middleware.

It is not enough to introduce new digital channels and tools. Banks must do so in the context of transforming the end-to-end customer banking journey. Digital is an enabler of this transformation, not an end in itself.

Banks are keen, but ...

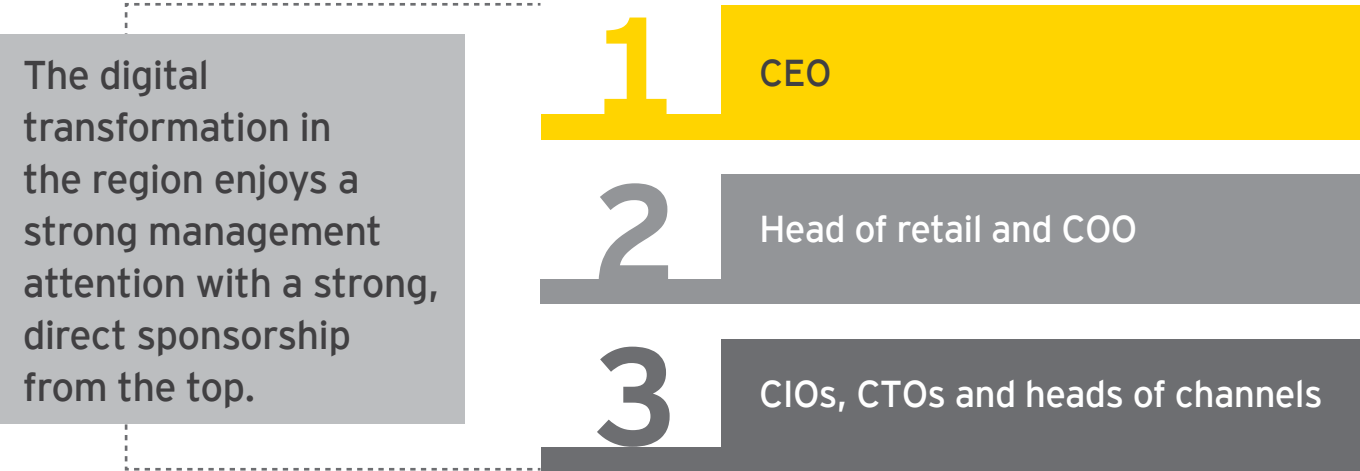
Although the budget is there, together with the willingness, the priority and the sponsorship, it appears that regulations, IT legacy and lack of process automation are slowing down the digital transformation. In many cases, banks are also facing some challenges articulating a clear path to digital success.

Game on!

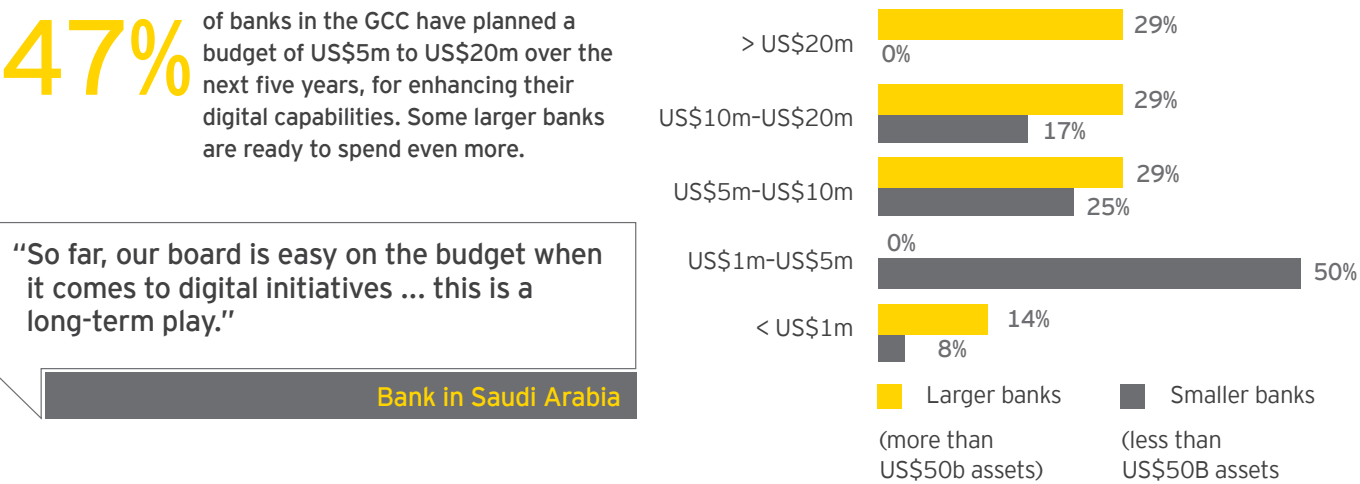
Ranking of digital objectives



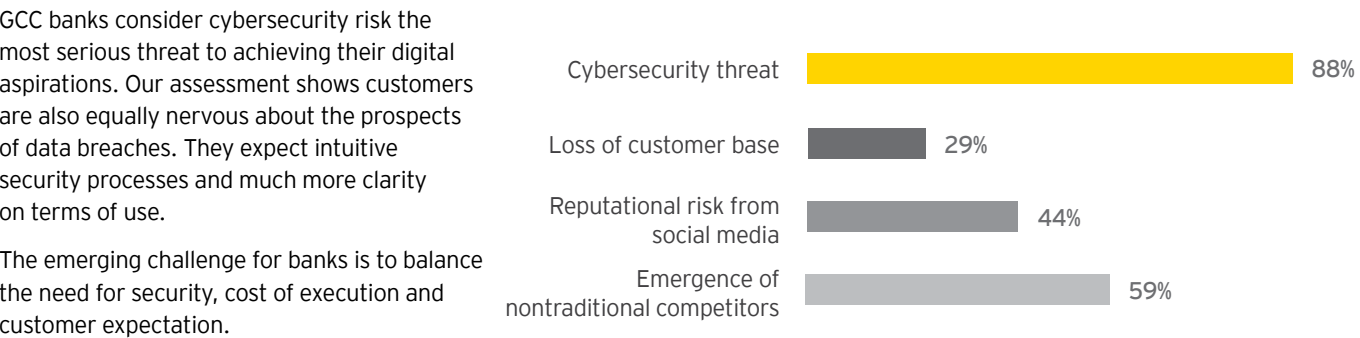
Management support is in place.



Resources are allocated.

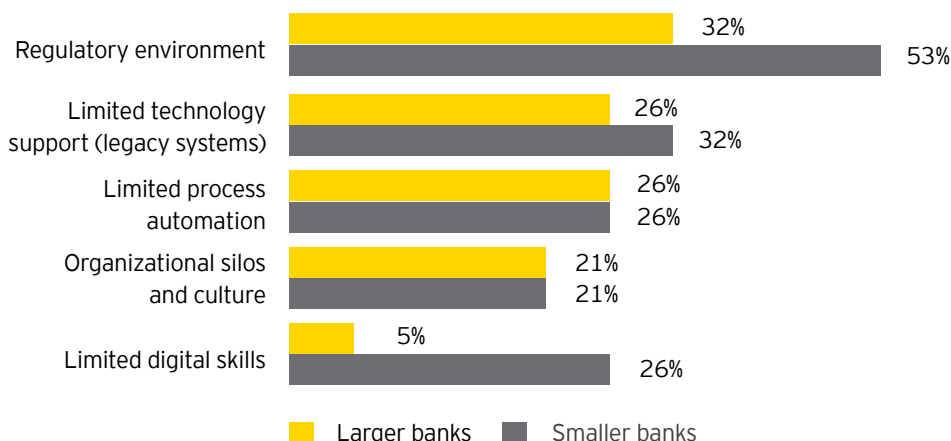


Risks are identified and often mitigated ...



... but the digital transformation across the region is proving tougher than many had hoped.

Major hurdles faced by financial institutions in the GCC in their digital transformation



When asked about the key challenges they are facing with digital transformation, a staggering majority of the banks' leadership cited lack of regulatory clarity and direction as a major impediment.

"Banks should not see regulators as an inhibitor of innovation, but as a partner in helping to develop digital banking in a secured way."

"We only focus on security to protect the financial health of our residents and, as soon as it is demonstrated that a function is secured and that it is supported by an appropriate legal framework, such as electronic signature, we don't analyze the relevance any further to approve it."

"Unfortunately, we have often had to reject some requests in the past that were insufficiently developed and demonstrated."

A GCC central bank Vice Governor

The majority of banks also appear frustrated with managing legacy technologies and the painfully slow progress they are making in automating key customer processes.

A limited technology support, including the burden of IT legacy and application complexity resulting from duplicated functions, point-to-point interfaces, and heterogeneous and outdated technologies, is slowing down the deployment of digital services.

To increase IT agility, the following is recommended:

- ▶ Upgrade core banking system to gain access to out-of-the-box digital functionality and technologies
- ▶ Rationalize the application portfolio
- ▶ Modernize IT architecture (middleware, SOA, BPM) and eliminate point-to-point interfaces
- ▶ Upgrade the IT operating model to gain agility and enable faster time to market for new evolutions
- ▶ Hire and acquire digital talents

EY view: rising to the challenge

At the core of the digital bank lies a fundamentally different approach to how business and IT work together. In the new model, the business-technology integration permeates across the organization. Critically, as customers expect greater real-time services, some improvements will require further cross-industry collaboration.

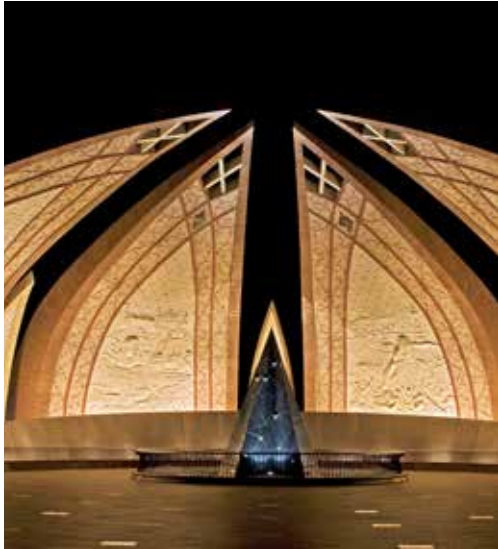
Given the size of GCC banks, there are 15 to 20 major processes that would be highly compatible with rapid automation, and that would deliver significant cost savings and scalability. Among them are account openings, mortgages and customer inquiries. The end-to-end process redesign should not take more than 8 to 12 weeks, and a full rollout should be possible within 6 to 8 months for complex processes. This could be a significant opportunity for local banks, many that are struggling, either due to capacity or digital capability issues. Our discussions with banks revealed that, in a number of cases, the time to market could drag up to 12 months, and in some cases, the launch was still not error free. In one case, the board has not ruled out exiting digital retail banking if the operational execution fails to live up to the bank's quality standards. The stakes continue to rise.

It is early in the transition, but Saudi Arabia is getting its head around this very well. It has a central innovation strategy and has begun engagement with the leading local banks. It is expecting industry-wide innovation and for the regulator to set the agenda and provide governance.



Country outlook







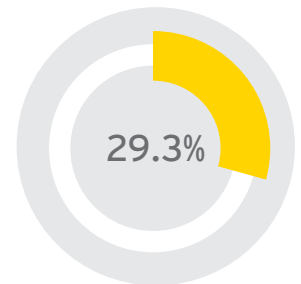
Bahrain

- ▶ Participation banking has loyal retail and corporate followers in Bahrain that have maintained a stable investment accounts and financings in the face of contraction in conventional banking. This phenomenon has noticeably boosted Participation banking's relative market share during 2014.
- ▶ Participation banking in Bahrain suffers from ROE underperformance primarily driven by its high relative cost base and lack of scale benefits. There is a case for consolidation to reduce the cost base.
- ▶ On the other hand, Bahrain is showing signs of recovery witnessing a slight increase of 1% in their share of Participation banking assets. Furthermore, it has maintained a stable investment accounts and financing assets. Growth in 2014 for total assets, financing assets and investment accounts exceeded CAGR (banking assets 4%, financing assets 5%, investment accounts 6%) over the past 4 years.

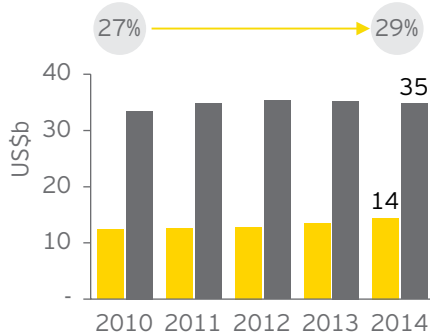
Participation banking penetration in Bahrain

The industry is stabilizing at the current level.

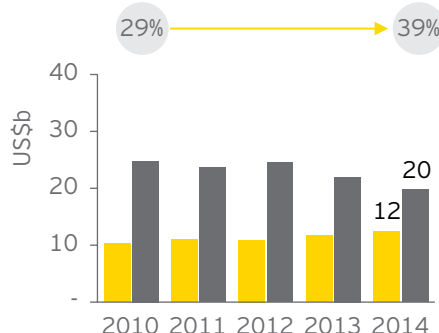
Participation banking sector's national market share in terms of domestic banking assets has remained broadly stable during the past five years.



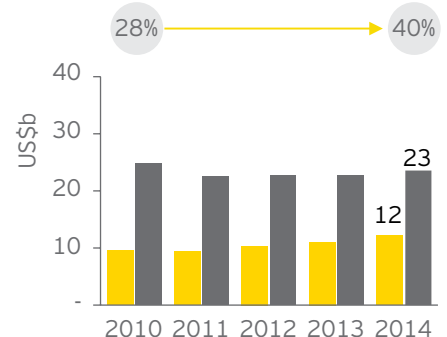
Total banking assets



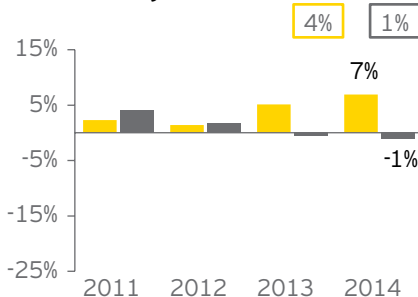
Total financing assets



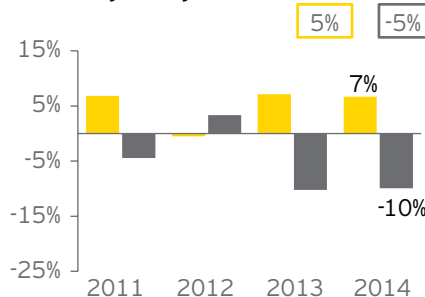
Total investment accounts



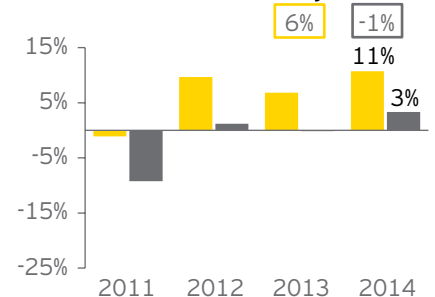
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth



Participation banking CAGR 2010-14

Conventional banking CAGR 2010-14

X% Participation banking share

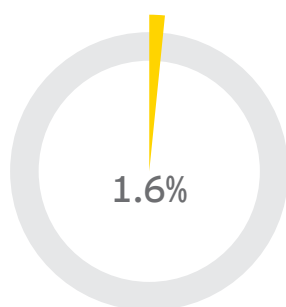
Conventional banking

Participation banking

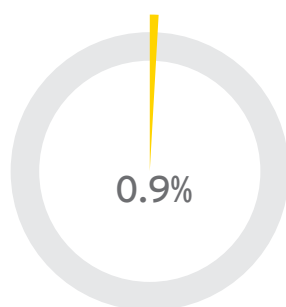
Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks
For the Bahraini market, analysis is based on domestic banking assets.

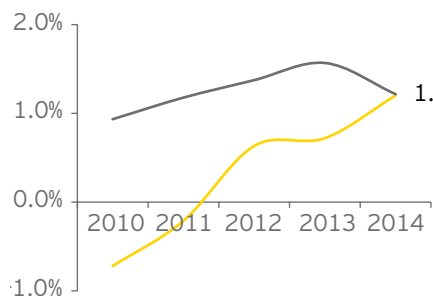
Share of global market*



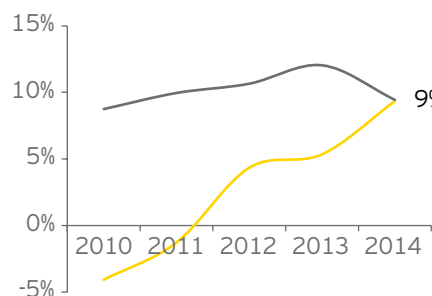
Share of Participation banking growth in 2014



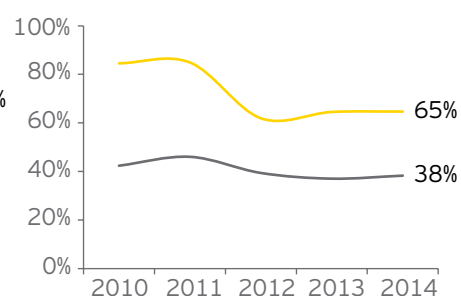
Return on assets



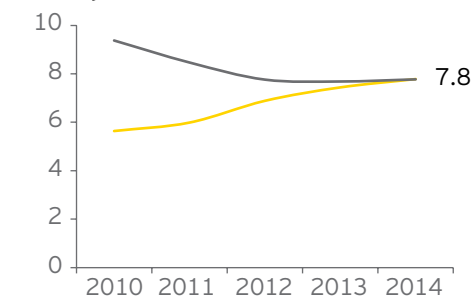
Return on equity



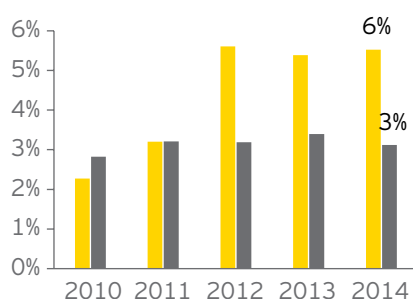
Cost to income ratio



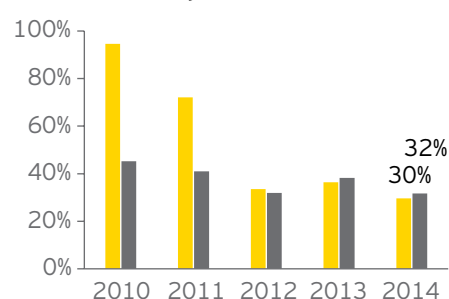
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

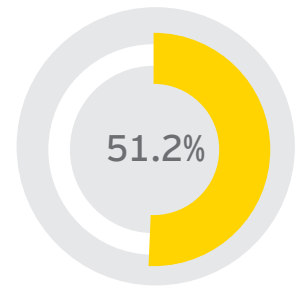


Saudi Arabia

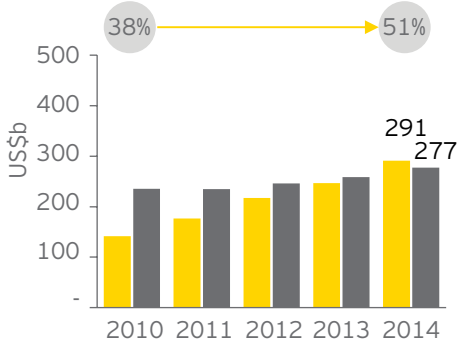
- The recent phenomenal growth in Saudi Arabian Participation banking has been the primary engine of global growth rates. Having gained a majority national market share and considering the fact that the government will continue to spend on development of projects, despite reduced government revenues due to decreasing oil prices, there is no reason to believe that exceptionally high annual growth in Saudi Arabian Participation banking could not continue for long. In view of the above, we expect positive trend to continue with promising future of Participation banking.
- High relative cost base and lower fee-based sources of income represent a noticeable shortcoming for Participation banking players in Saudi Arabia.

Participation banking penetration in Saudi Arabia

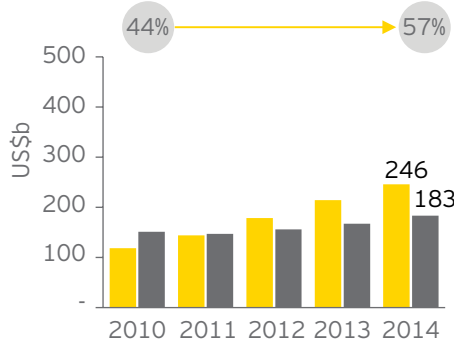
Participation banking sector gains a majority national market share in terms of banking assets making Saudi Arabia the first country to achieve this milestone.



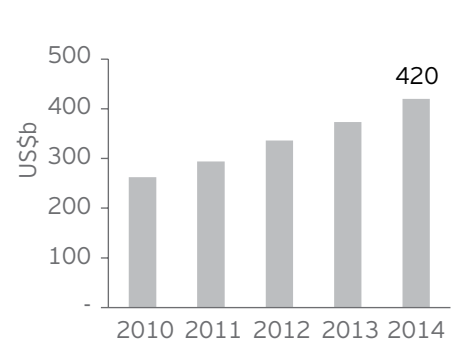
Total banking assets



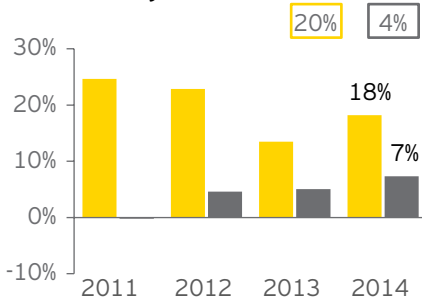
Total financing assets



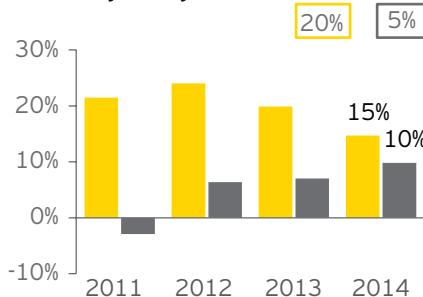
Total investment accounts



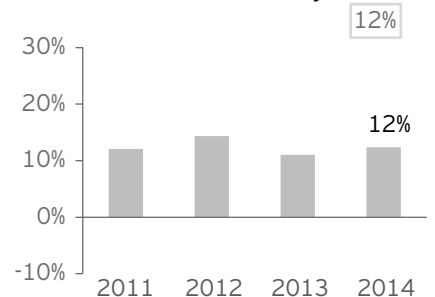
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth*



Participation banking CAGR 2010-14

Conventional banking CAGR 2010-14

Total banking sector CAGR 2010-14

X% Participation banking share

Conventional banking

Participation banking

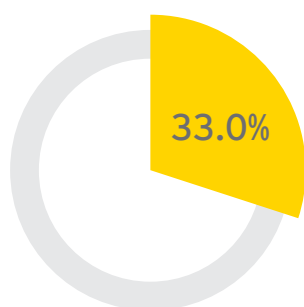
Total banking sector

Sources:

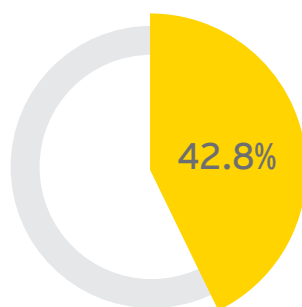
Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Saudi Arabia investment accounts are for the entire banking sector as the split is not available.

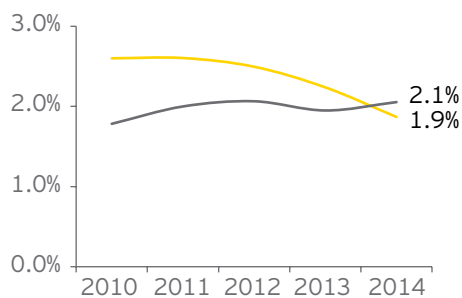
**Share of
global market***



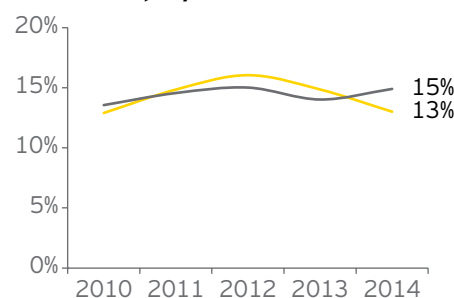
**Share of Participation
banking growth in 2014**



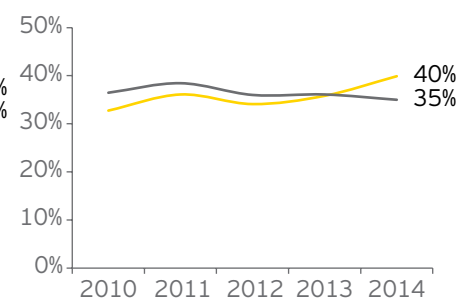
Return on assets



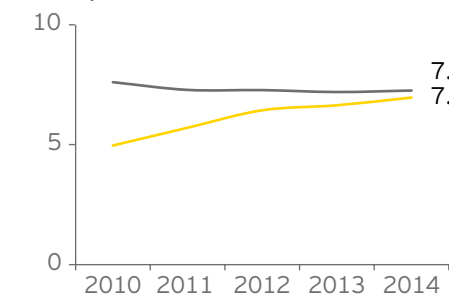
Return on equity



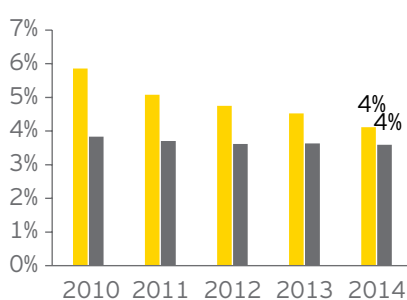
Cost to income ratio



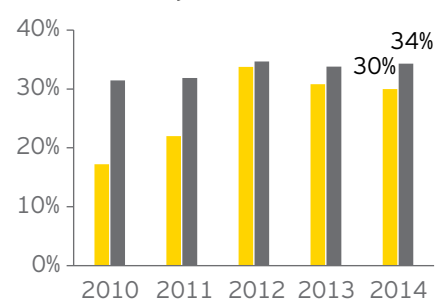
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

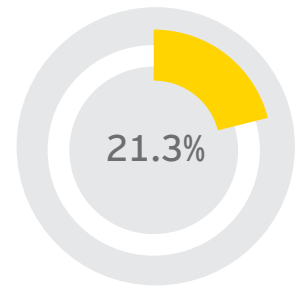


Malaysia

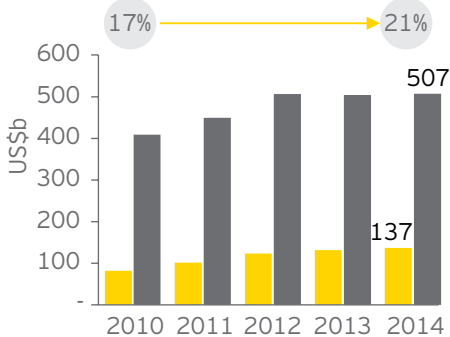
- After a median 1.2% market share gain during each of the previous four years, the Participation banking only gained 0.6% market share during 2014. Are we reaching a stable Participation banking market share in Malaysia somewhere close to the current penetration level?
- The Malaysian Participation banking needs to diversify its sources of income by substantially enhancing its low risk, fee-based income streams to address its under-performance in terms of ROE.

Participation banking penetration in Malaysia

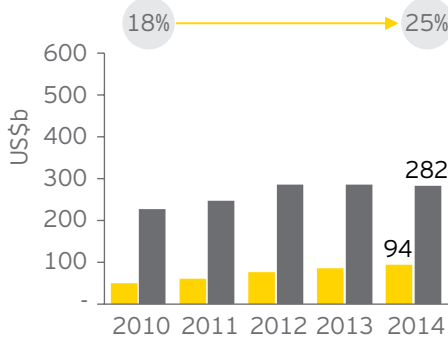
What disruptive innovations are needed to help Participation banking in Malaysia to break the 33% market share barrier?



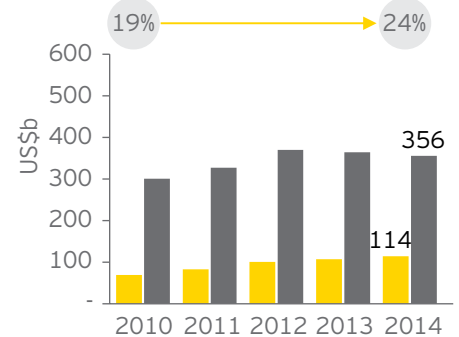
Total banking assets



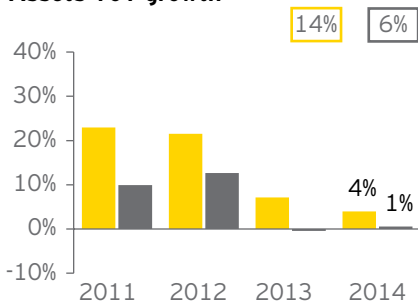
Total financing assets



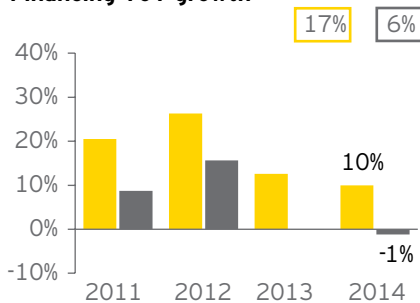
Total investment accounts



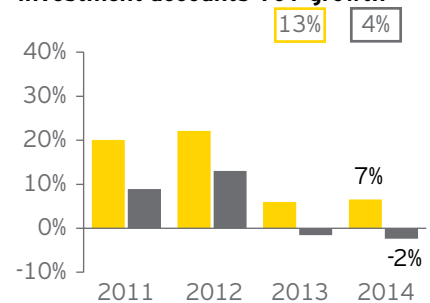
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth



Participation banking CAGR 2010-14

Conventional banking CAGR 2010-14

X% Participation banking share

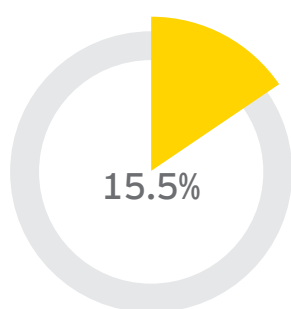
Conventional banking

Participation banking

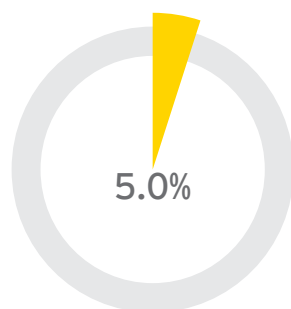
Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

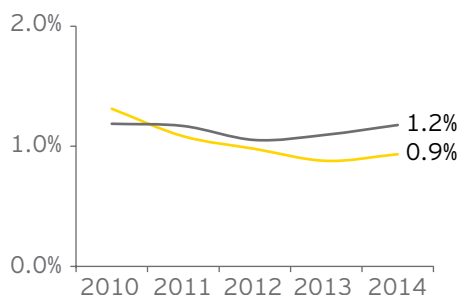
**Share of
global market***



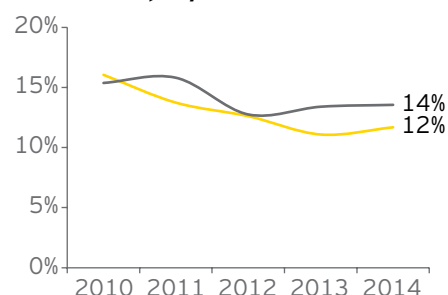
**Share of Participation
banking growth in 2014**



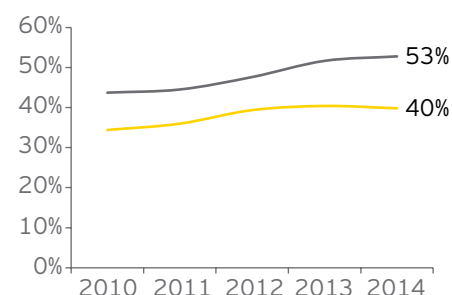
Return on assets



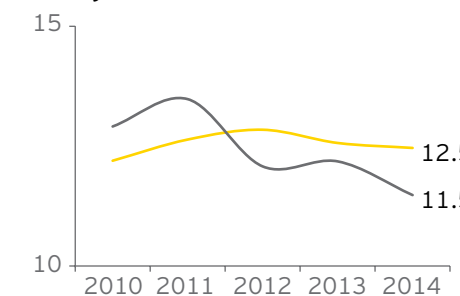
Return on equity



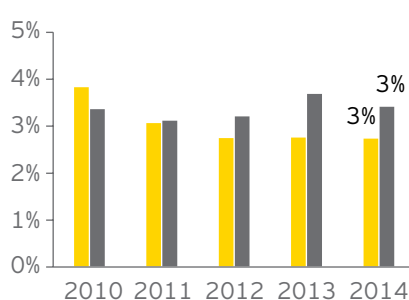
Cost to income ratio



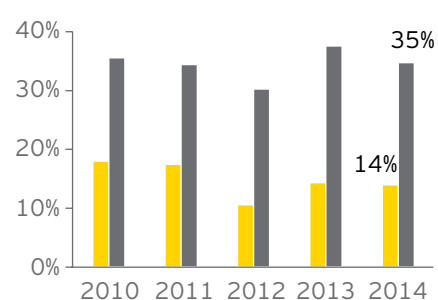
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

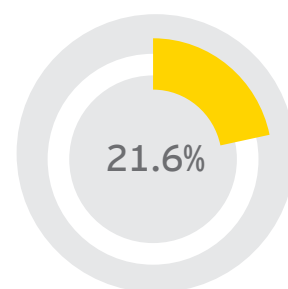
*Market share calculated excluding Iran.



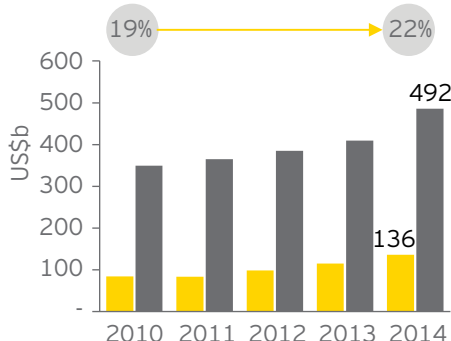
- ▶ Participation banking was unable to gain any incremental market share during 2014 after noticeable increase in national market share in the previous four years. UAE's noticeable contribution towards global growth of Participation banking was fuelled by a surging real estate market during 2014 and a steep rise in the UAE banking assets.
- ▶ Lower leverage and lower non-financing sources of income are magnifying the relative cost disadvantage of Participation banks in the UAE.

Participation banking penetration in UAE

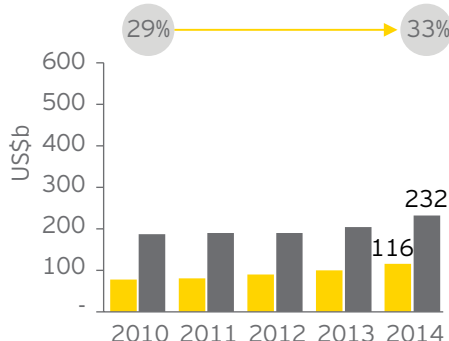
Is Participation banking's market share likely to stabilise in the UAE at somewhere near the current level of penetration?



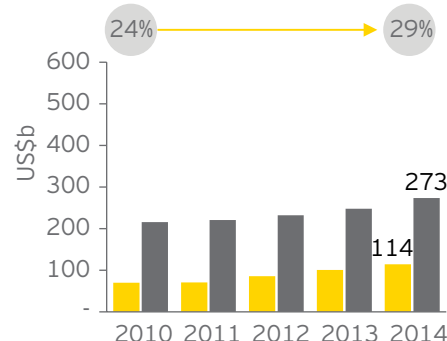
Total banking assets



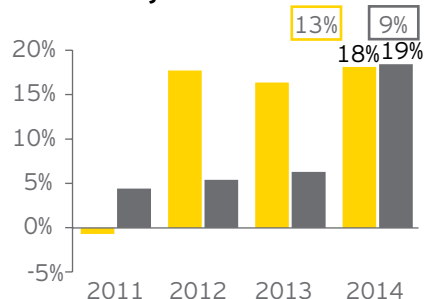
Total financing assets



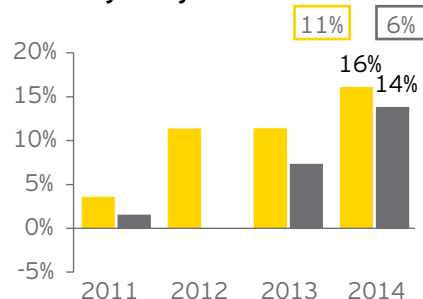
Total investment accounts



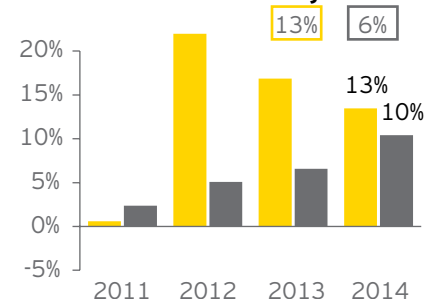
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth



Participation banking CAGR 2010-14

Conventional banking CAGR 2010-14

X% Participation banking share

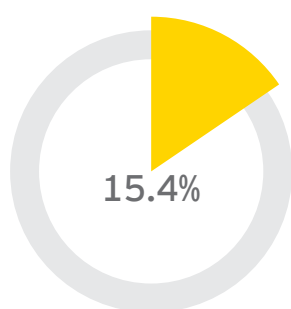
Conventional banking

Participation banking

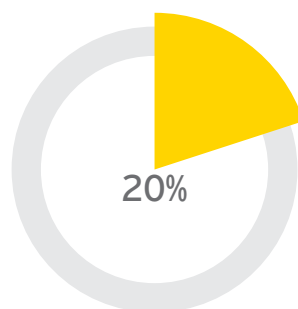
Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

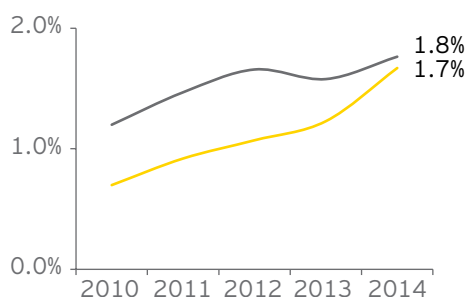
**Share of
global market***



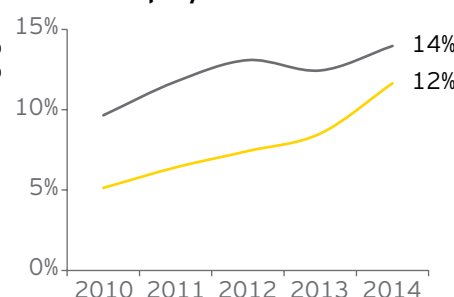
**Share of Participation
banking growth in 2014**



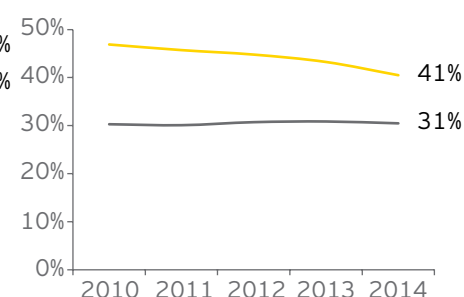
Return on assets



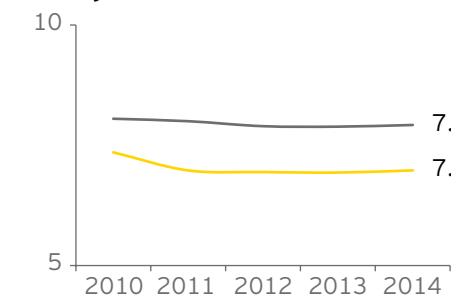
Return on equity



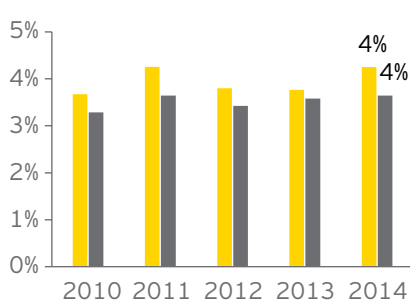
Cost to income ratio



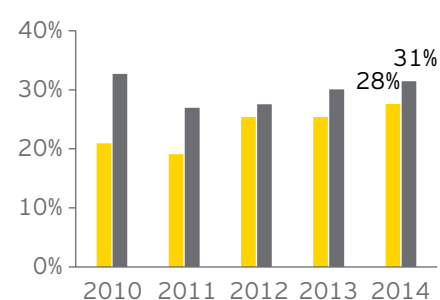
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

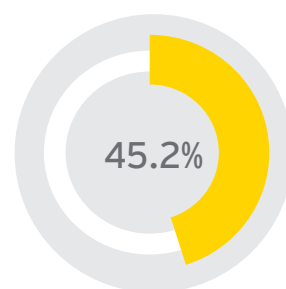


Kuwait

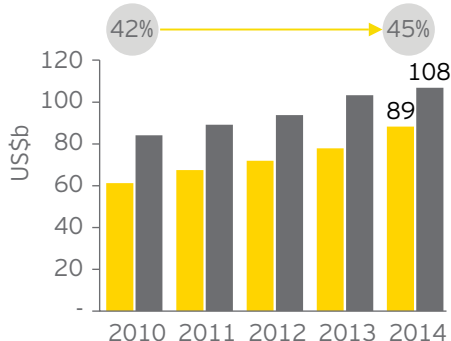
- After plateauing during the previous three years, Participation banking national market share increased noticeably in 2014, as the trend for conventional banks to transform into Islamic banks continues to meet consumer preferences. Kuwait is expected to remain a key contributor to global growth in Participation banking.
- Participation banking in Kuwait needs to address its historic cost inefficiency that worsened noticeably during 2014. Technology-based growth initiatives could potentially play a meaningful role.

Participation banking penetration in Kuwait

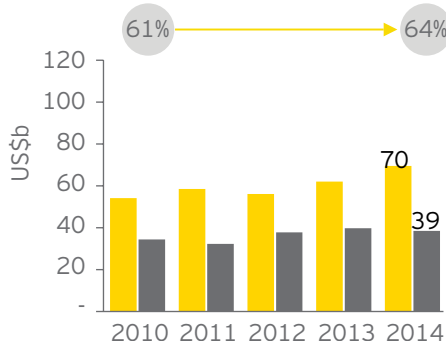
Participation banking potentially heading towards gaining a majority national market share in Kuwait.



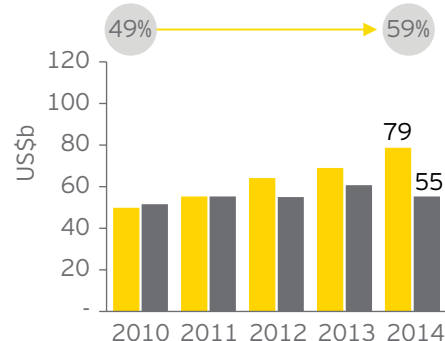
Total banking assets



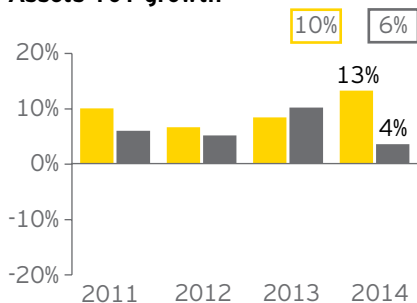
Total financing assets



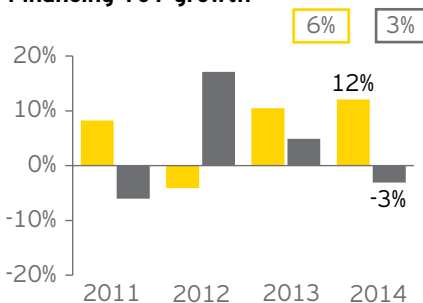
Total investment accounts



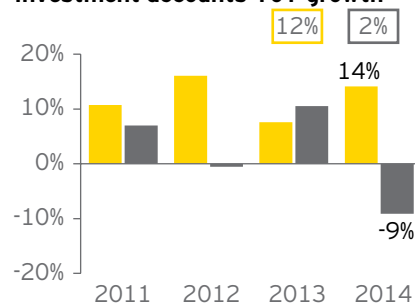
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth



Conventional banking CAGR 2010-14

X% Participation banking share

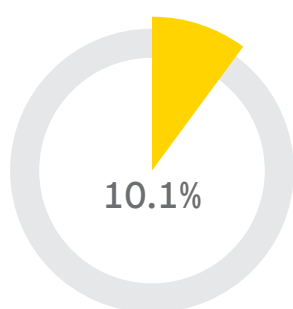
Conventional banking

Participation banking

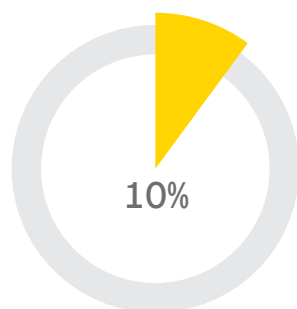
Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

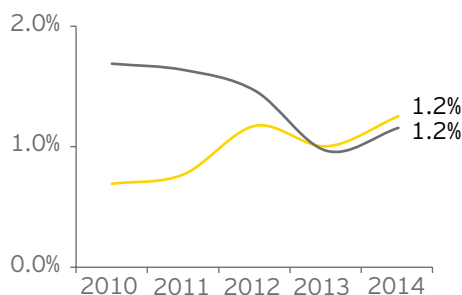
**Share of
global market***



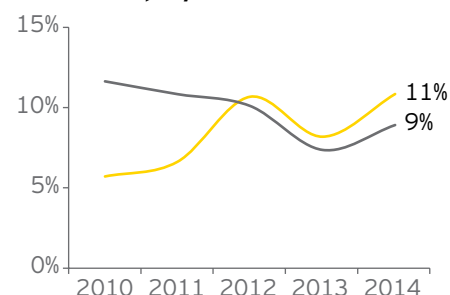
**Share of Participation
banking growth in 2014**



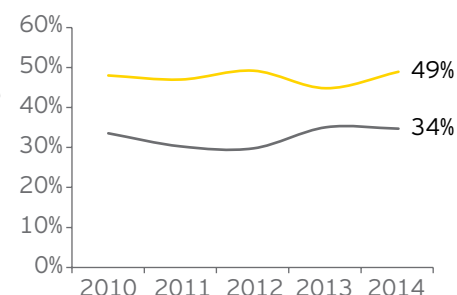
Return on assets



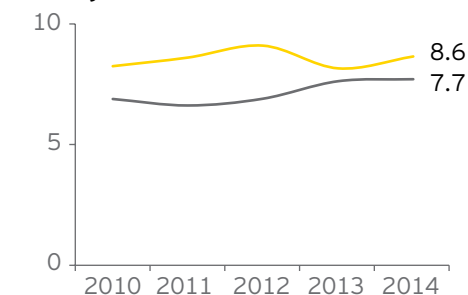
Return on equity



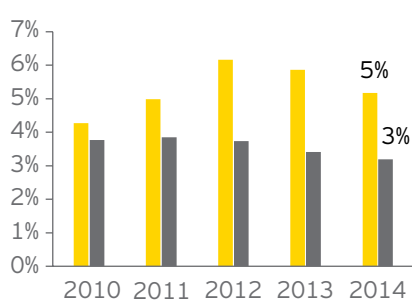
Cost to income ratio



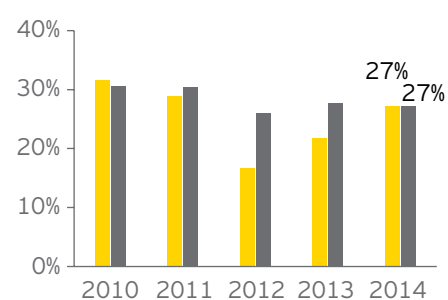
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

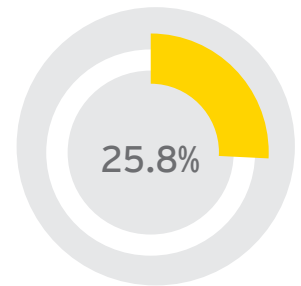


Qatar

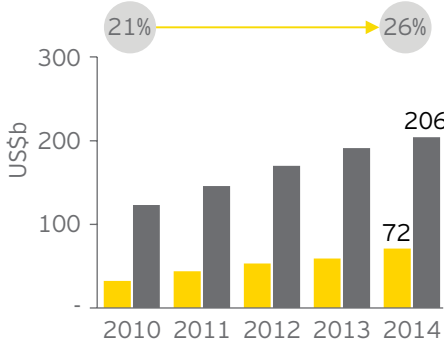
- In the backdrop of regulatory changes, Participation banking's national market share plateaued in the recent past. This changed during 2014 when it achieved a noticeable increase in its national market share and became the third largest contributor towards global growth in Participation banking.
- Supply-side initiatives involving transformations or set up of new Participation banks are needed if Participation banking in Qatar wishes to go mainstream.

Participation banking penetration in Qatar

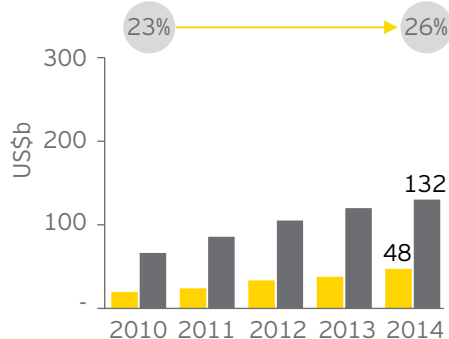
Participation banking grew at three times the rate of conventional banking in Qatar during 2014.



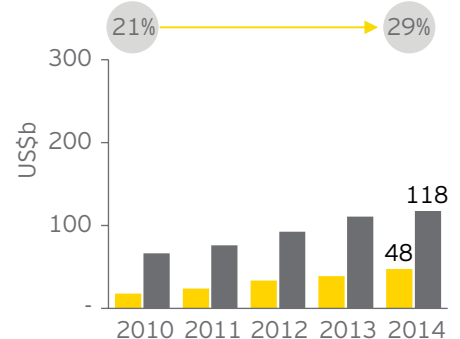
Total banking assets



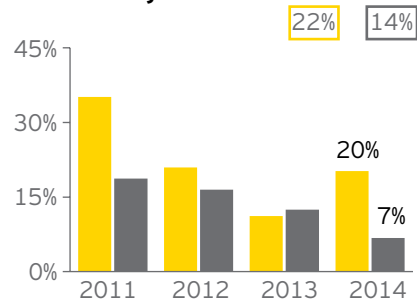
Total financing assets



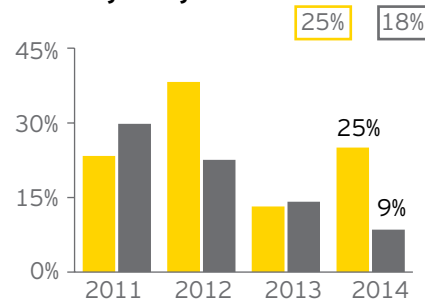
Total investment accounts



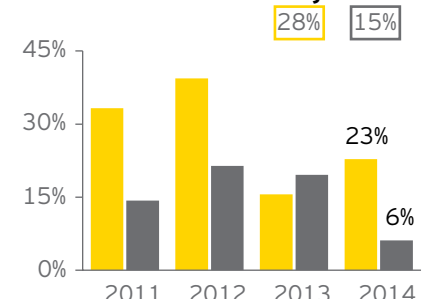
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth



Participation banking CAGR 2010-14

Conventional banking CAGR 2010-14

X% Participation banking share

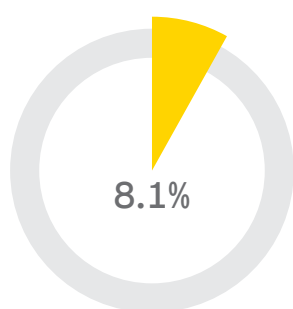
Conventional banking

Participation banking

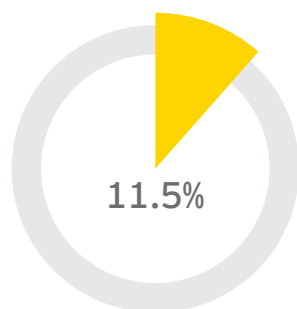
Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

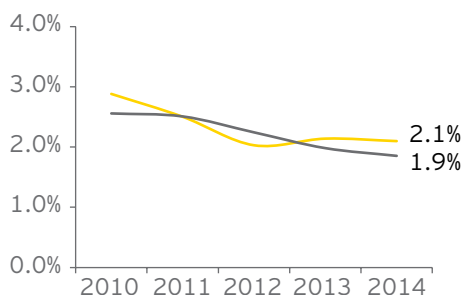
**Share of
global market***



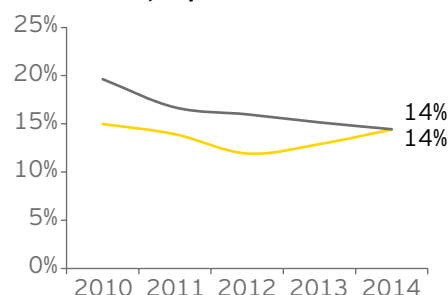
**Share of Participation
banking growth in 2014**



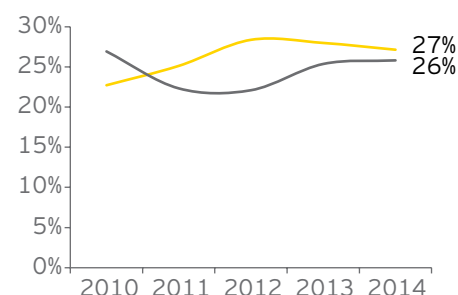
Return on assets



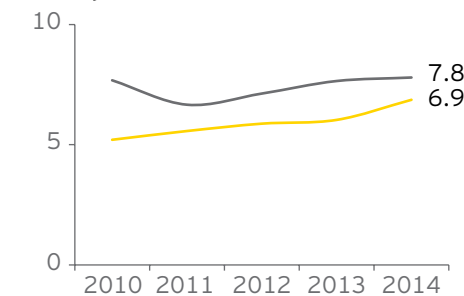
Return on equity



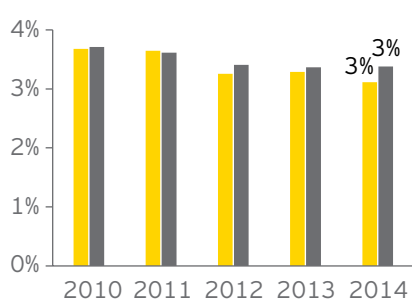
Cost to income ratio



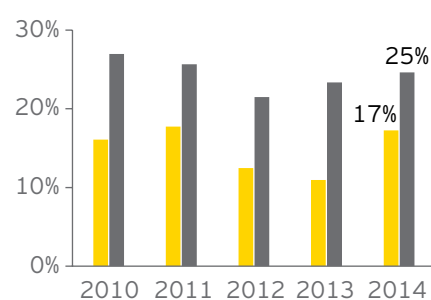
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

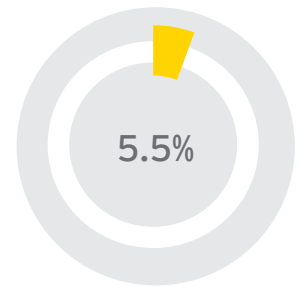


Turkey

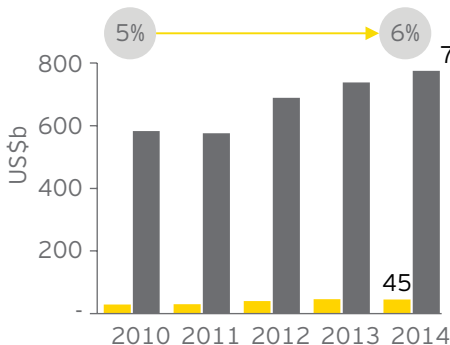
- ▶ Given the size of its economy, Turkey is the big prize for the global Participation banking. However, meaningful growth in its national market share requires clarity in the regulatory requirement for Participation banking in Turkey.
- ▶ Regulatory reforms will encourage new market entrants, including some who might use technology-based market entry strategies, thereby enhancing the sophistication in the Turkish financial sector as a whole.

Participation banking penetration in Turkey

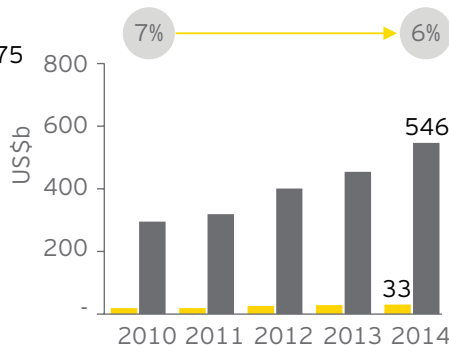
In a growing banking sector, Participation banking assets in Turkey decreased during 2014.



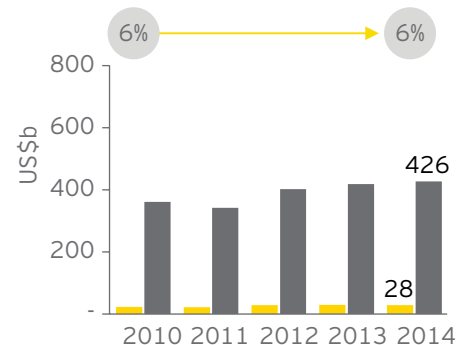
Total banking assets



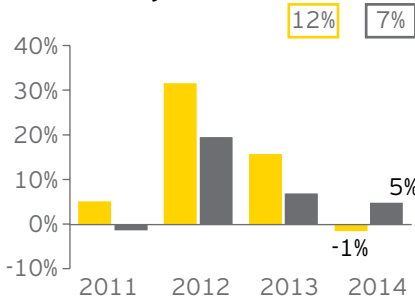
Total financing assets



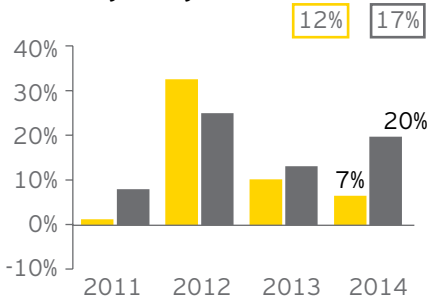
Total investment accounts



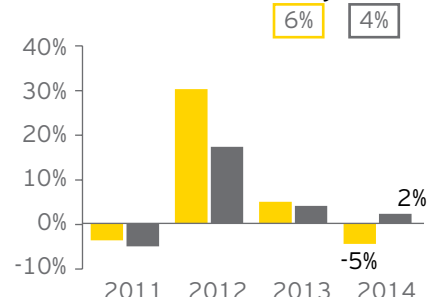
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth

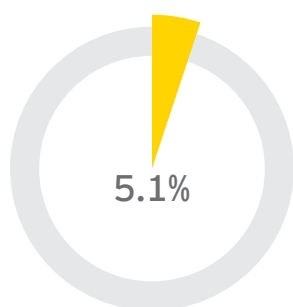


Participation banking CAGR 2010-2014 Conventional banking CAGR 2010-2014

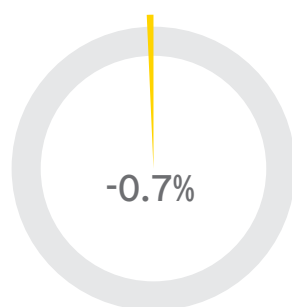
X% Participation banking share Conventional banking Participation banking

Sources:
Central banks, company financial reports, EY Universe, EY analysis of selective banks

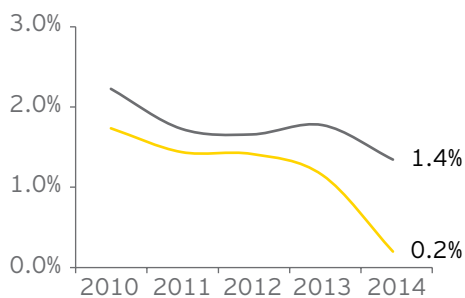
Share of global market*



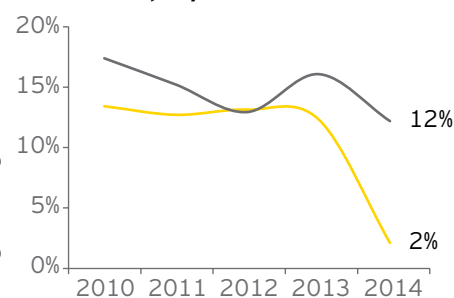
Share of Participation banking growth in 2014



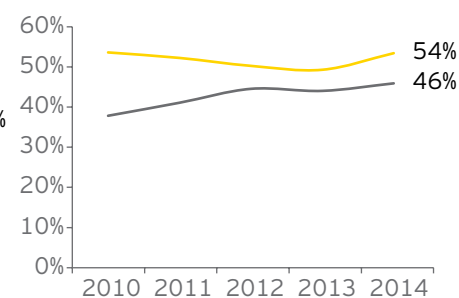
Return on assets



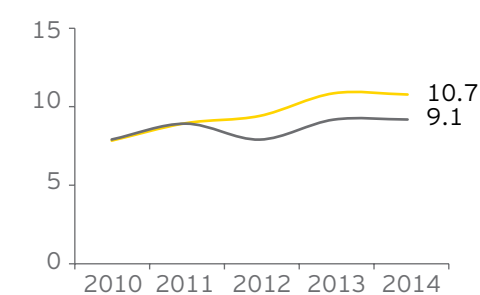
Return on equity



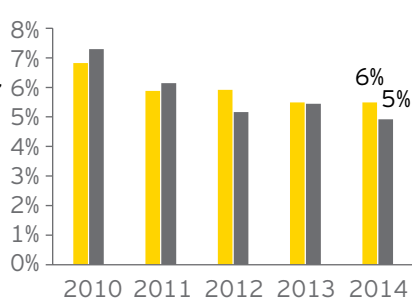
Cost to income ratio



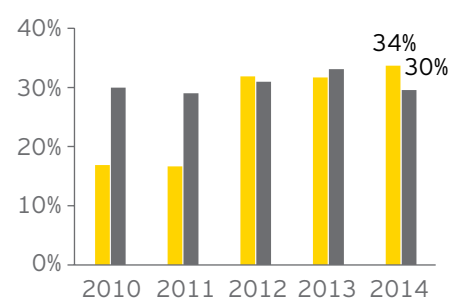
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

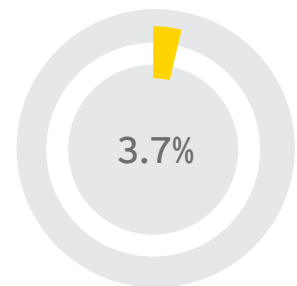


Indonesia

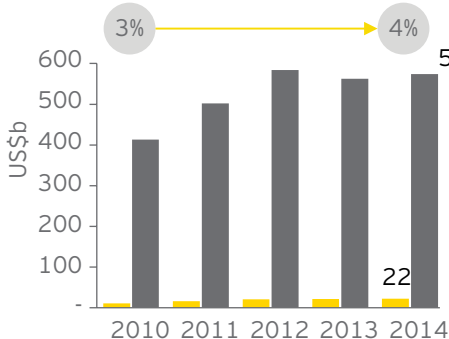
- ▶ Like Turkey, Indonesia is a promising market for global growth in Participation banking but the sector is still in its infancy and its national market share is growing at a snail's pace.
- ▶ Without an initiative from the regulatory authorities to nurture and grow Participation banking, this sector could remain stuck in its infancy for years. A regulatory environment that attracts new entrants from the more established Participation banking markets could potentially create a spark to help Participation banking grow in Indonesia.

Participation banking penetration in Indonesia

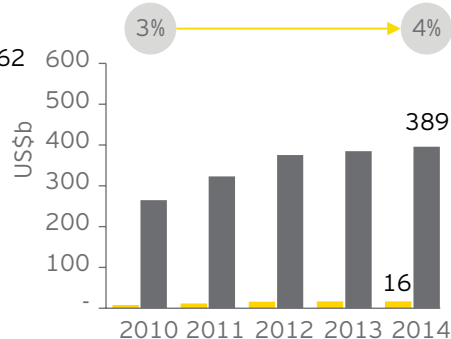
Participation banking in Indonesia seems to be reaching a plateau in its infancy.



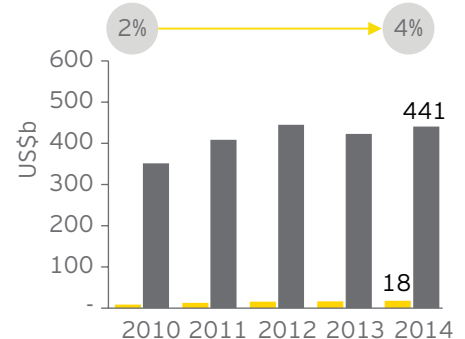
Total banking assets



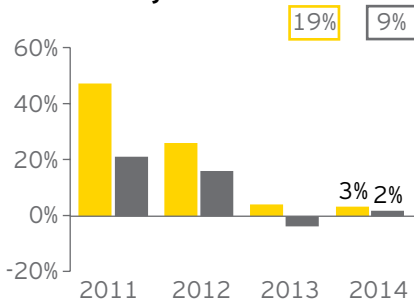
Total financing assets



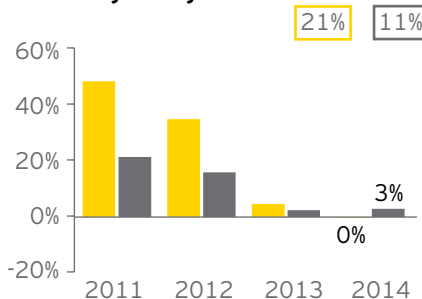
Total investment accounts



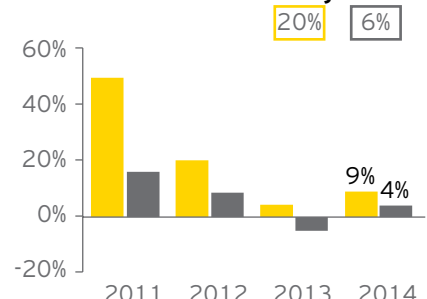
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth

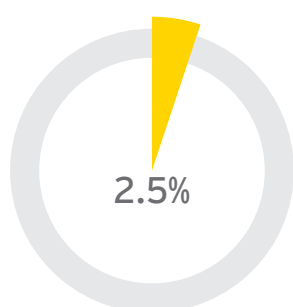


Participation banking CAGR 2010-2014 Conventional banking CAGR 2010-2014

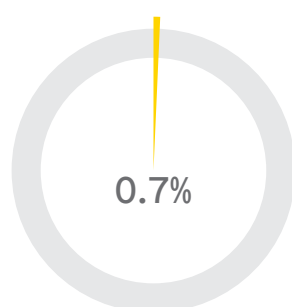
X% Participation banking share Conventional banking Participation banking

Sources:
Central banks, company financial reports, EY Universe, EY analysis of selective banks

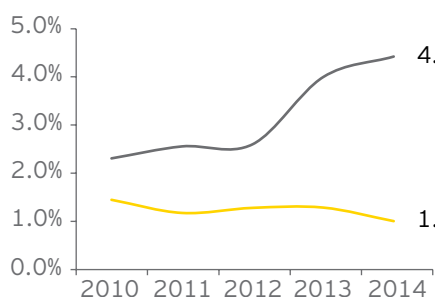
**Share of
global market***



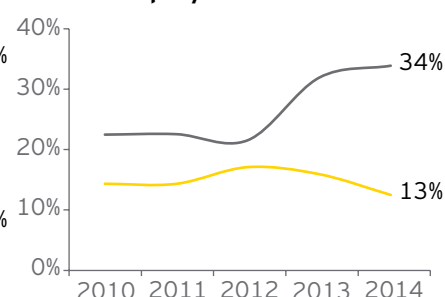
**Share of Participation
banking growth in 2014**



Return on assets



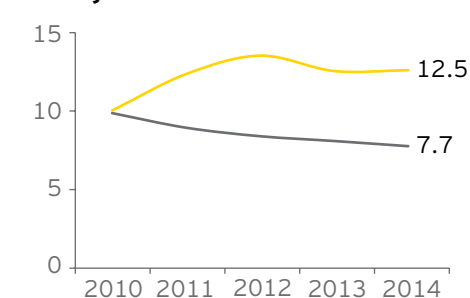
Return on equity



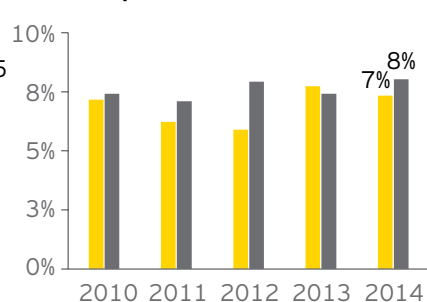
Cost to income ratio



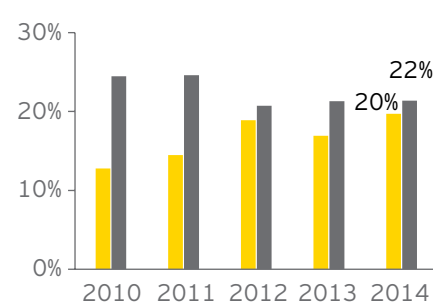
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

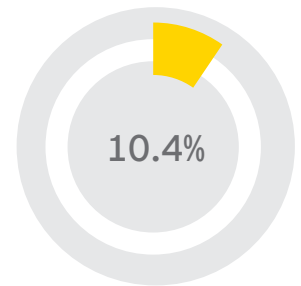


Pakistan

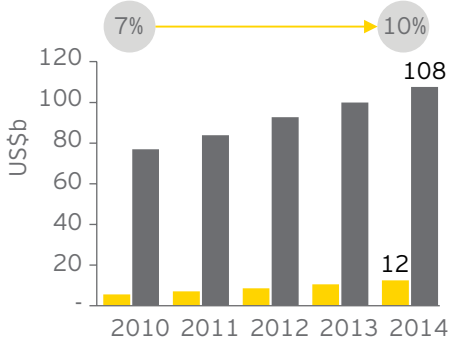
- ▶ The development of the Participation banking sector in Pakistan demonstrates how regulatory authorities can nurture this sector in other promising markets.
- ▶ With a five years strategic plan prepared by the State Bank of Pakistan working as the driving force, the Participation banking sector has continued to grow at a rate faster than conventional banking and has achieved a median 1% gain in national market share during each of the past few years. The sector is on course to achieve its targeted 15% national market share in the next few years.

Participation banking penetration in Pakistan

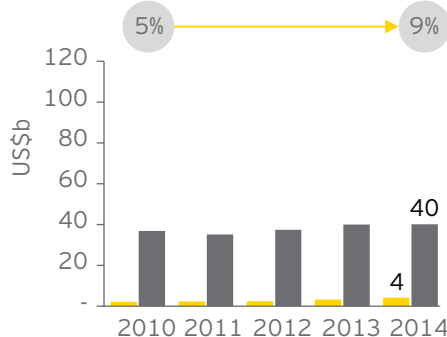
Participation banking in Pakistan continues its steady growth to pass the 10% market share milestone.



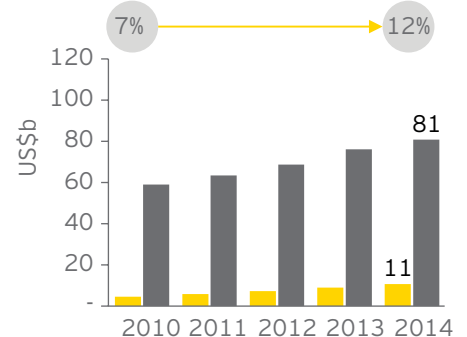
Total banking assets



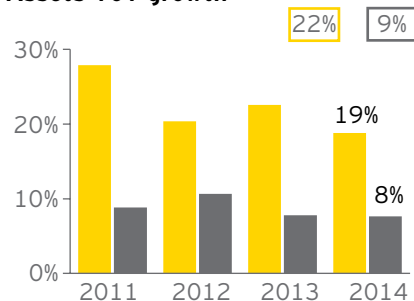
Total financing assets



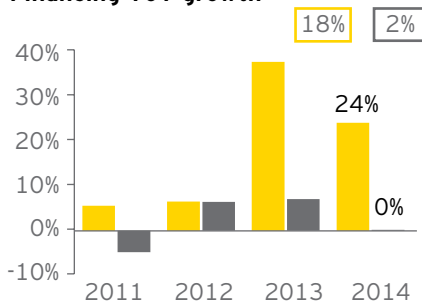
Total investment accounts



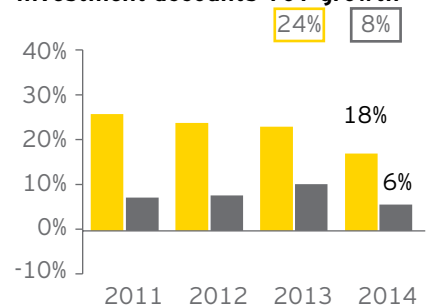
Assets YoY growth



Financing YoY growth



Investment accounts YoY growth

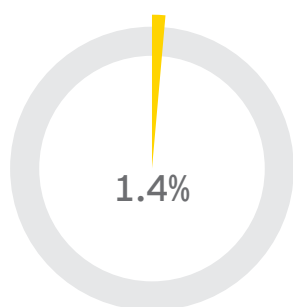


Participation banking CAGR 2010-2014 Conventional banking CAGR 2010-2014

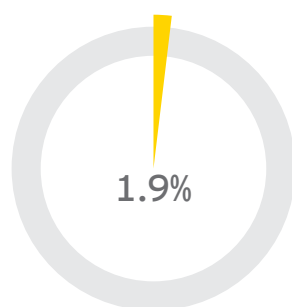
X% Participation banking share Conventional banking Participation banking

Sources:
Central banks, company financial reports, EY Universe, EY analysis of selective banks

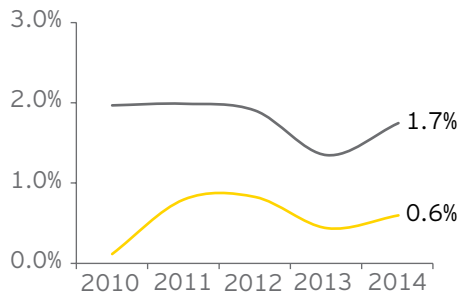
**Share of
global market***



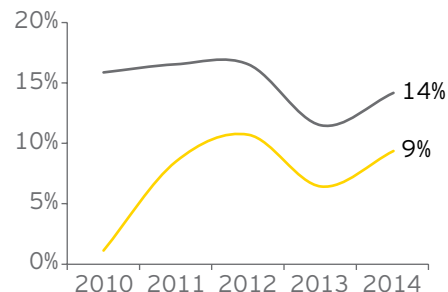
**Share of Participation
banking growth in 2014**



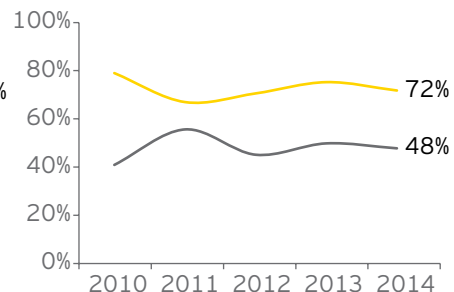
Return on assets



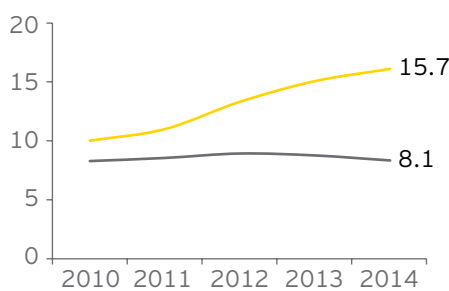
Return on equity



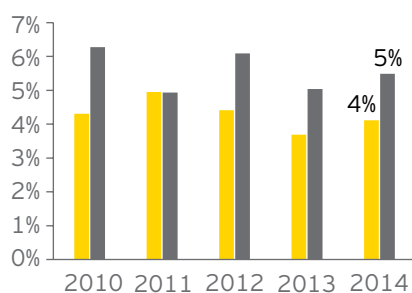
Cost to income ratio



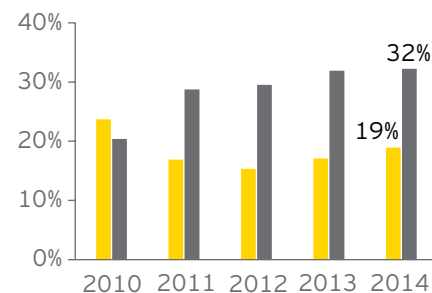
Leverage



Revenue/asset ratio



Non-financing income ratio



■ Conventional banking ■ Participation banking

Sources:

Central banks, company financial reports, EY Universe, EY analysis of selective banks

*Market share calculated excluding Iran.

Our leadership team



Ashar Nazim



Robert Abboud



Gordon Bennie



Jan Bellens



Mayur Pau



Asim Sheikh



Nadeem Shafi



Muzammil Kasbati

Our Industry awards

**Best Islamic
Advisory
Firm, 2014**

Euromoney Islamic
Banking Award

**Best Islamic
Advisory
Firm, 2014**

8th International
Takaful Summit
2014

**Thought
Leadership
Award, 2013**

20th Annual World
Islamic Banking
Conference
Awards, Bahrain

**ADIB –
Appreciation
Award, 2013**

1st Annual Global
Islamic Economy
Summit, Dubai

**Best Islamic
Advisory
Firm,
2013/2011/
2010/2009**

10th International
Real Estate Finance
Summit Awards –
London

**Best Takaful
Advisory
Firm,
2011/2009**

3rd International
Takaful Summit,
London

**WIBC
Leading
Islamic
Financial
Services
Provider, 2008**

World Islamic
Banking Awards,
Bahrain

**Best Islamic
Finance
Advisory Firm,
2009/2008/
2007**

World Islamic
Banking Awards,
Bahrain

Report methodology and tools

Global Participation banking assets are estimated based on publicly available data from 15 Participation banking markets.

The research and insights are primarily based on EY Participation Banking Universe (EY Universe), which is proprietary, based on sample and is not meant to be fully exhaustive.

The EY Universe analysis covers 69 Participation banks and 45 conventional banks across Participation banking markets.

For the purpose of this report, the analysis excludes the Iranian market because of its unique characteristics.

QISMUT+3 covers approximately 93% of the estimated international Participation banking assets in 2014 (excluding Iran market).

Insights are also based on interviews with banking executives and industry observers, to identify key trends, risks and priorities.

Limited disclosures on Participation banking windows, subsidiary operation and offshore businesses was a limiting factor.

The EY Universe is categorized as follows:

- ▶ QISMUT – Qatar, Indonesia, Saudi Arabia, Malaysia, UAE and Turkey
- ▶ GCC – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE
- ▶ ASEAN – Malaysia, Indonesia
- ▶ SOUTH ASIA – Pakistan, Bangladesh
- ▶ Turkey and rest of the world – Egypt, Jordan, Turkey, South Africa, Sudan, etc.

The breakdown of banks for each country is as given below:

- ▶ Qatar – 3 Participation and 3 conventional banks
- ▶ Indonesia – 6 Participation and 4 conventional banks
- ▶ Saudi Arabia – 4 Participation and 5 conventional banks
- ▶ Malaysia – 12 Participation and 4 conventional banks
- ▶ UAE – 8 Participation and 4 conventional banks
- ▶ Turkey – 4 Participation and 5 conventional banks
- ▶ Bahrain – 7 Participation and 4 conventional banks
- ▶ Kuwait – 4 Participation and 3 conventional banks
- ▶ Pakistan – 5 Participation and 3 conventional banks
- ▶ Bangladesh – 5 Participation and 2 conventional banks
- ▶ Egypt – 2 Participation and 4 conventional banks
- ▶ Jordan – 2 Participation and 2 conventional banks
- ▶ Oman – 4 Participation and 2 conventional banks
- ▶ South Africa – 1 Participation bank
- ▶ Sudan – 2 Participation banks

Caveat

This insight and research data used in this report have been inserted and analysed on the basis of certain assumptions. Therefore, the information or remarks made are for guidance purpose only and not to be construed as conclusive.



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(Qatar)



Hammad Younas
(Bahrain)



Rashid S Al Rashoud
(Saudi Arabia)



Yasir Yasir
(Indonesia)



Houssam Itani
(Qatar)



Shahid Mughal
(UAE)



Shoaib A Qureshi
(Saudi Arabia)



Omer Odeh
(Saudi Arabia)



Mohd Husin
(Malaysia)



Ken Eglinton
(UK)



Naseeha Mahomed
(South Africa)



Murat Hatipoglu
(Turkey)



Merisha Kassie
(South Africa)



Sanjay Kawatra
(Oman)



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Nordling**
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BUSY ↓↓

www. www. www. www.

PER ANNUM

93,400
4,500
671 312,000

http://www



OK!

AGREED.

Yes?

pardon?

let's meet.
come
in for a chat

Let's
Talk:

SET UP A MEETING

Notes

MY COMPANY

snaps

U.S. Ltd.

how much?

HAVE

CARD

INTRODUCE ME
Research

SLIP
ACT NOW

Actions

- ✓ 1) Prepare
- ✓ 2) Actualise
- 3) Release

REPORT



today!



12:45 PM

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