Jameel Khadaroo: Future developments in the banking and financial sector in Mauritius

Address by Dr Jameel Khadaroo, Second Deputy Governor of the Bank of Mauritius, at the University of Technology Mauritius, Port Louis, 25 August 2008.

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Good morning. It gives me great pleasure to be here, at the invitation of the Accounting, Banking and Finance Society of the University of Technology Mauritius (UTM), to address you on the future developments in the banking and financial sector in Mauritius. The Society's initiative to invite practitioners to share their experience with the academic world is certainly useful in helping to bridge the gap between academia and industry and in promoting exchange of ideas on latest issues. Well done and keep it up!

Today's theme is surely topical. The Mauritian authorities are committed to transform our island into a service-oriented economy. In a very recent speech, the Prime Minister stated that "financial services are well positioned to be the engine of growth in the development of the services sector as a whole".

Introduction

By virtue of my position, I shall reflect on the topic of the day from the central bank's perspective whilst also tracing out progress achieved to date. Basically financial sector developments refer to developments in three pillars, namely financial institutions, markets and supporting infrastructure. I shall focus on how I see the evolution of each pillar over the next few years, starting with financial institutions.

Financial institutions

The financial system in Mauritius, as in most developing economies, is still dominated by banks. For the year 2007 for Mauritius, banks held 73 per cent of total financial sector assets – the insurance sector accounted for 13 per cent, non-bank deposit taking institutions for 8 per cent. Leasing, credit finance, investment funds and other financial institutions accounted for the remaining 6 per cent. In terms of value addition to domestic output, the financial sector contributed to 10.4 per cent of 2007 GDP – banks accounted for 6.4 percentage points while the insurance sector for 2.8 percentage points. Employment in the financial sector has increased by about 25% since the beginning of the present decade. Moreover, financial sector growth has on average outpaced overall economic growth – this pattern is likely to persist in future, given the emphasis placed on development of banking and financial services in Mauritius.

The continuous development of the banking and financial sector has been the outcome of carefully designed strategies implemented over time. The Bank of Mauritius has been taking a series of policy measures, consistent with a gradual shift from a directive-based to a market-based environment, with a view to foster integration of the Mauritian banking sector with the Mauritian economy as well as with the international financial system. This process of continuous improvement is set to strengthen further, with policy geared towards enhanced transparency.

Non-performing advances as a proportion of total advances have declined steadily over recent years, helped to a significant extent by the coming into operation in 2005 of the Mauritius Credit Information Bureau (MCIB) which is housed at the central bank. The resilience of the banking sector to shocks has increased, in part due to diversification of the sources of banks' income. Indeed an increasing share of banks' income is generated by what we call in our jargon “Segment B” activities – basically foreign-source income, i.e. all lending and related activities undertaken with non-residents. Banks, which used to be very dependent on domestic economic developments, now generate as much as half of their income from foreign sources. In 2007 banks’ foreign-source income grew by 43 per cent, much higher than growth of 11 per cent in domestically sourced income. With the Mauritian economy and financial sector set to become more open, the banking sector should be able to further improve resistance to shocks provided, of course, exposures continue to be managed judiciously.

In line with the spirit of consolidation, legislation was amended in 2004 to cater for single bank licensing, implying the phasing out of separation of banking activities into offshore and onshore. The tax regime for income from domestic and foreign sources of business was made uniform. Banks licensed in Mauritius may undertake both “Segment A” and “Segment B” activities, that is, domestic as well as international banking. Legislation was also been amended in 2004 to encourage non-bank deposit taking institutions to merge into banks. Since 2007, three non-bank deposit taking institutions have been granted banking licences – one of them opened a new bank while the two others took over existing banking business. This trend is likely to become more prominent in future.

The two largest domestically-owned banks have already looked beyond Mauritian shores by incorporating branches and subsidiaries in the region. They have joined the syndicated loan business and lent substantial amounts to non-resident companies. The reputation of Mauritius as a credible financial centre, the expertise built up over time, and the favourable legislative and regulatory framework should continue to contribute to the success of the banking sector.

I shall now turn to the second pillar for financial sector development, namely markets.

Markets

The development of the financial sector cannot be envisaged without the promotion of strong, well-functioning and deep financial markets.

Significant progress has been achieved in positioning the domestic stock market on the international financial arena. The stock exchange of Mauritius (SEM) is endowed with a state-of-the-art trading infrastructure and, as a result of its good performance, was the second African exchange after the Johannesburg Securities Exchange (JSE) to attain membership status of the World Federation of Exchanges (WFE) in November 2005. Moreover, in about a month, on 1 October 2008, the Mauritius stock exchange is scheduled to join the Dow Jones Wilshire Global Index.

In 2007, market capitalisation in US dollars on the SEM increased by 70 per cent year-on-year, with non-residents’ gross inward investment in the equity market registering a record high. The remarkable track record of the SEM should induce the private sector to take better advantage in securing long-term funding. The amendments brought in 2007 to the Securities Act 2005 could give a boost to securities trading on the stock exchange.

There is significant room for improvement with regard to development of fixed income markets, which have remained rather shallow and illiquid despite recent interest from foreign investors. Traditionally, fixed income markets are important channels through which public and private institutions avail of financial resources for medium- and long-term projects. Bond markets also constitute good investment opportunities for long-term investors such as pension funds and insurance companies. There have been a few bond issues lately – including one launched by the European Investment Bank – and this should be encouraged for the benefit of all stakeholders.

In the light of limited success experienced with the secondary trading of treasury bills on the stock exchange of Mauritius, the Bank of Mauritius is currently undertaking a review of the primary dealer system. The central bank is also working on the issue of benchmark bonds in collaboration with bankers.

A commodity exchange, named Global Board of Trade (GBOT), is scheduled for launch in Mauritius in January 2009 with the collaboration of Financial Technologies India (FTI) Ltd. This commodity exchange, which intends to trade commodities and derivative products in metals, oil and agriculture, shall take the Mauritian financial system a step further by enabling better enterprise risk management and financial planning. Mauritius will also seriously need to contemplate the development of full-fledged currency futures in the near future – that would assist in formation and management of exchange rate expectations.

I shall now turn to the third pillar for financial sector development, namely supporting infrastructure.

Supporting infrastructure

Under supporting infrastructure I would distinguish three important themes, namely legal infrastructure, technological infrastructure, and human resource infrastructure.

Legal infrastructure

Recent legislations passed in the Finance Acts of 2007 and 2008 are expected to significantly impact the banking and financial sector in Mauritius.

With regard to the banking sector, the Bank of Mauritius is reviewing its guidelines to give greater operational autonomy to banks without losing sight of prudence. Further to recent amendments brought to the Banking Act 2004, banks may subject to approval by the Bank of Mauritius and authorisation by the Financial Services Commission engage in new lines of business – such as financial leasing and agency services – without having to set up a subsidiary.

With a view to broaden the array of services, new legislation allows non-bank deposit taking institutions to engage in lending and such other investment as may be approved by the central bank, while foreign exchange dealers may offer money and value transfer services. Banks may provide selective products such as private and investment banking services to high net worth customers, which complements government policy of attracting these individuals to invest and work in Mauritius.

A key legislation that could propel the Mauritian banking and financial sector to new heights relates to Islamic banking, more broadly called Islamic finance. Islamic banking adheres to Islamic law by offering banking services and products where banks earn profits and fees on financing facilities extended to customers, instead of interest. Islamic banking is one of the world's fastest growing financial segments. Financial centres worldwide are competing for oil revenues of the Middle East. The Asian Development Bank estimates total assets held under Islamic finance rules at around $1 trillion USD, with annual growth of 10 to 15 percent. London, Singapore and Hong Kong have emerged as key centres of expertise in Islamic finance, while Malaysia hosts nearly two thirds of the worldwide Islamic sukuk bond market – an estimated $100 billion. Many smaller financial centres have passed legislation to enable Islamic finance. With the drying-up of liquidity in the wake of the global financial turmoil, non-Islamic countries have been increasingly looking to issue their own sovereign sukuk debt.

Mauritius has recently revised its legislation to accommodate Islamic banking and finance. Regulatory hurdles have been removed as we move into Islamic finance. The central bank has issued guidelines for Islamic Financial Institutions (IFIs) and the Government has changed the Tax laws in order to facilitate conduct of Shariah compliant financial transactions. Banks may opt to exclusively conduct Islamic banking or offer Islamic financial products through a window. Through the Finance Act 2008, non-bank deposit taking institutions have also been authorized to offer Shariah compliant financial products. Islamic banking in Mauritius should become a reality in the near future.

A proposed Insolvency Bill seeks to amend and consolidate the law relating to insolvency of individuals and companies and the distribution of assets on insolvency and related matters. Moreover, a Netting and Intermediated Securities Bill provides for the validity and enforcement of close-out netting arrangements and giving effect to The Hague Securities Convention on the law applicable to certain rights in respect of securities held with intermediaries. With a view to promoting Mauritius as a reputable and clean financial centre, the Bank of Mauritius reviewed its Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) in July 2008 in the light of recommendations made in the report on the evaluation of the AML/CFT regime of Mauritius by the Financial Sector Assessment Program (FSAP) mission of the IMF/World Bank.

Technological infrastructure

The technological infrastructure – exchanges and systems used to clear and settle market trades or cash obligations – plays a critical role in the development of the financial sector. With the advent of modern technology, payments, clearing and settlements are effected in real-time. The Bank of Mauritius launched in December 2000 a real-time gross settlement system with guaranteed finality of payment known as the Mauritius Automated Clearing and Settlement System (MACSS). Ongoing efforts have since been made to modernise the payments system. Recent initiatives include the Port-Louis Automated Clearing House (PLACH) set up in 2002, which performs netting on cheque data that are sent to the clearing house by electronic means and the settlement at each clearing cycle on the MACSS. The Bank of Mauritius is currently working on a Cheque Truncation project, whereby clearing and settlement of a cheque will be done through images of cheques instead of physical cheques.

The Stock Exchange of Mauritius also operates a Central Depository System (CDS), which allows for delivery versus payment of stock exchange transactions on a T+3 rotating basis via the MACSS.

At a cross-border initiative level, the Bank of Mauritius is also participating in the COMESA Regional Payment and Settlement System (REPSS) which will allow cross border payments between COMESA countries. The objective is two-fold: to reduce costs of transactions and time taken for settlement by not having to route the transaction through third parties outside the COMESA region and to enhance security of payments. This system is characterised by a T+0 settlement, with possibility of real-time payment at higher fees. Banks will access this payment system through their respective central banks. The Bank of Mauritius is earmarked to act as the settlement Bank in the system.

Let me now touch on human resource infrastructure, which is of direct relevance to institutions like the University of Technology Mauritius (UTM).

Human resource infrastructure

The scarcity of skilled manpower could inhibit the development of the financial sector. In this regard the Mauritian authorities have, rightly so, opened up the island to foreign talent. In addition, tertiary institutions have been designing a range of courses to meet the exigencies of the financial sector in terms of labour requirements. I am aware, for instance, that the UTM has in the recent past set up courses in Banking and Finance at both undergraduate and graduate levels. The point I am making here is simple –academia has a key responsibility in safeguarding the sustainability of financial sector growth in Mauritius.

Concluding remarks

To conclude, I shall merely state that the Bank of Mauritius is committed to continue its leading role in the development of the Mauritian banking and financial sector.

Thank you.