Rameswurlall Basant Roi: Recent Developments in Regulation and Supervision

Speech by Mr Rameswurlall Basant Roi, Governor of the Bank of Mauritius, at the IMF's Africa Training Institute, Ebène, 29 July 2016.

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Ladies and gentlemen

Good morning

This visit is my first to the Africa Training Institute of the IMF in Mauritius and I am pleased to address you on the concluding day of the course on *Core Elements of Banking Supervision*. Thank you, Mr Ravi Mohan, Adviser to the AFRITAC, for giving me this opportunity to reflect briefly on a subject like regulation and supervision of banks that has increasingly occupied a centrally important seat in policy discussions in the past quarter of a century.

The Africa Training Institute is by now a well-established training institution for the region in economics, finance and central banking matters. I have no doubt that this well-inspired session on banking supervision has equipped you all with critical knowledge and useful professional skills to perform your job better and better.

Seventeen years ago, more specifically, in December 1998, in my first stint as the Governor of the Bank, I gave my first address to a gathering of the main players in the Mauritian economy. The Asian crisis was hitting hard a few of the Far Eastern economies. I had announced that the Bank of Mauritius would completely overhaul and recast its regulatory and supervisory framework in line with international best practices. Deposit-taking institutions would be required to adhere to a comprehensive set of prudential norms. To this effect, guidelines would be issued. On-site and off-site examinations of banks would be re-styled and would be made more rigorous than before. External auditors would be required to be familiar with the Basel Core Principles and to see to it that banks are operating in line with established prudential norms. Oblivious of the fact that banks, by the very nature of their deposit-taking activities, are the most leveraged enterprises on the planet, many disliked this initiative of the Bank of Mauritius. The Bank's initiative was perceived as an unwarranted intervention by the regulator in what was a free market-based banking industry. Bankers and external auditors had continued to comfortably hang on to the belief that markets are self-regulating and efficient. How could an unregulated individual be deemed self-regulating? In the Bank's thinking, self-regulation meant no regulation at all. Quite expectedly, regulation of banks' activities and operations attracted hateful criticisms. The tendency of some groups, like a special-forces warrior, to fight every new regulation had reached a vexing point. Despite resistance from pressure groups to resist, the Bank had proceeded with its regulatory reforms and soldiered on effectively. It took quite some time for players in our economic system to fully realise that banking is a different kind of business and financial systems are not and will never be totally free market systems. Over the years much has been achieved in terms of the health improvement of deposit-taking institutions in the country.

Effective banking supervision is an evolving discipline. Free flows of capital in a globalised world marked by all kinds of disruptions, unleashed by economic and non-economic forces, the quests for high returns by investors and quick profits by speculators, fraudulent practices, excessive risk-taking and violent economic cycles, amongst others, have made regulation and supervision of financial institutions an unprecedentedly challenging task. The regulator's job has become increasingly complex and demanding in terms of skills and clairvoyance, more so after the August 2007 international financial crisis.

As regulators, we need to constantly bear in mind that any capitalist economy inevitably progresses from conservative finance to reckless speculation. The economy has financing regimes under which it is stable and financing regimes under which it is unstable. In other words, over a period of prosperity, a capitalist economy transits from financial relations that make for a stable system to financial relations that make for an unstable system. We also need to bear in mind that it's in the personal interests of the CEOs of banks to show profits, often by any means, for the benefit of their shareholders. And it is simply not true that the pursuit of their individual interests will lead to financial stability. What's good for an individual CEO may not be necessarily good for the banking industry as a whole. The self-interests of bankers and levered investors do occasionally lead to economic contractions and a loss of human welfare.

I need not emphasise to a crowd like this one that financial stability is an indispensable pre-condition for economic growth and human welfare. There is every reason for regulatory authorities to act proactively in order to prevent financial crises from developing in the first place. With the recent experience that the Bank of Mauritius had with regard to an ailing bank, I cling to the view that regulators must broaden their scope and take initiatives to prevent the development of practices that favour financial instability. Jurisdictions that have regulatory gaps are more prone to fraudulent practices. Regulators must guide the evolution of financial institutions by favouring stability-enhancing and discouraging instability-augmenting institutions and practices.

Regulators often have to act as bomb disposal experts when confronted with a potential risk of financial instability. Those at the helm of regulatory authorities bear in mind one thing: if they don't hear any explosion, it means they are dead already.

Last year, the Bank of Mauritius revoked the banking license of a 7-year old bank that was part of one of the biggest corporate bodies in the country. It was a systemically important Group of companies. Poor corporate governance, fraudulent practices, related party transactions, poor asset quality, capital deficiency, liquidity crisis, amongst so many other factors, brought down the bank. This bank failure provided us with invaluable lessons that regulation and supervision of financial institutions cannot be taken lightly. No bank forming part of a broader group of companies should ever be overseen by the regulator in isolation from the other related entities. Regulatory framework should indispensably allow for consolidated supervision. Those who fail to learn from history are doomed to repeat it. The economic and social costs of policy errors are enormous and, indeed, very painful.

As I said earlier, regulation and supervision of financial institutions has kept evolving and will keep on evolving. As we have been progressively moving along over the last twenty five years, we have faced new challenges in terms of regulatory and supervisory improvement. I will digress here to say that in a small open economy like Mauritius, we have an additional but very tricky regulatory challenge: to get the balance right such that the solution does not become part of a bigger problem. In the wake of the 2007 financial crisis, effective regulation and supervision of financial institutions was brought back to the table with an elevated sense of seriousness. Basel III gained greater importance worldwide. This awakening has brought with it several new challenges for regulatory authorities, not only in sub-Saharan African countries but also the world over. Digital technology has made far-reaching inroads in the financial industry. The inherent risks associated with digital technology in banking and finance cannot be understated. Regulatory authorities in most parts of the world face a formidable task: to get the right kind of skills for a job that needs to be done right now!! One of the most obvious challenges is capacity building.

We, at the Bank of Mauritius, have been constantly tooling and re-tooling, equipping and re-equipping and beefing up our regulatory and supervisory capacity in the past fifteen years. It's a never-ending exercise and will never be.

I understand many of you here are from regulatory authorities in the region. I am sure, you must have acquired additional knowledge for sharpening your regulatory and supervisory skills over the past two weeks. I wish you a pleasant trip back home. Those who are from the Bank of Mauritius, get back to work.

Thank you.