

2 Regulation and Supervision

The regulation and supervision of banks and deposit-taking activity of non-bank financial institutions were carried out by the Bank under the provisions of the Banking Act 1988 and the Bank of Mauritius Act 1966. The Bank was also empowered to regulate and supervise the operations of money-changers and foreign exchange dealers in accordance with the provisions of the Foreign Exchange Dealers Act 1995. As from 10 November 2004, the banking laws in Mauritius have been consolidated and overhauled through the promulgation of the Banking Act 2004 and the Bank of Mauritius Act 2004. The Bank remains the supervisor and regulator of banks and deposit taking activity of non-bank financial institutions, but has been given additional responsibilities and powers.

The regulatory and supervisory functions are entrusted to the Supervision Department of the Bank and include:

- Processing applications for Banking Licences as well as licenses for non-bank deposit-taking activity, money-changers and foreign exchange dealers;
- Issuing prudential regulations to be observed by authorised institutions; and
- Carrying out on-site inspection and off-site surveillance of such institutions.

Two of the objectives of the Bank are to ensure the safety and soundness of financial institutions falling within its supervisory oversight and the protection of depositors' interests. In this respect, the Bank has maintained its efforts towards the establishment of effective working relationships with financial institutions and their external auditors.

In line with international trends and international standards set out in the 25 Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision (BCBS) to which the Bank has committed itself, the Bank further affirmed its commitment to risk-based regulation of financial institutions. The Core Principles provide the

essential framework for the conduct of the relevant risk-based regulation and supervision.

In its continued effort to enhance the regulatory environment, the Bank issued the following guidelines to banks and non-bank deposit-taking financial institutions during the year under review:

- (i) Guideline on Credit Risk Measurement and Income Recognition;
- (ii) Guideline on Operational Risk Management and Capital Adequacy Determination; and
- (iii) Guideline on Segmental Reporting under a Single Banking Licence Regime.

During the year, the Bank also revised the following:

- (i) Guideline on Fit and Proper Person Criteria; and
- (ii) Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism for Financial Institutions.

Under the Banking Act 1988, there were two categories of Banking Licences – Category 1 and Category 2. Following the promulgation of the Banking Act 2004, this distinction was removed. However, up to 30 June 2005, banks continued to maintain a distinction between their Category 1 and Category 2 banking activities, and reported their performance separately. These banks are referred to as former Category 1 banks and former Category 2 banks.

As at end-June 2005, there were twenty banks operating in Mauritius – eight formerly held a Category 1 Banking Licence only, nine formerly held a Category 2 Banking Licence only and three formerly held both Category 1 and Category 2 Banking Licences. In addition, fourteen non-bank deposit-taking institutions, four money-changers and five foreign exchange dealers were in operation as at that date.

A list of authorised banks, non-bank deposit-taking institutions, money-changers and foreign

exchange dealers as at 30 June 2005 is given in Appendix VI.

Legislative changes and regulatory measures

Relevant legislative changes effected during the year under review and regulatory measures taken to enhance the operational efficiency of financial institutions are set out below.

Legislative Changes

A new Bank of Mauritius Act relating to the central bank and a new Banking Act to regulate the banking industry were enacted on 12 October 2004. With the exception of a few provisions of the Banking Act 2004, both Acts are operative in Mauritius as from 10 November 2004.

The new Bank of Mauritius Act 2004 and Banking Act 2004 have repealed and replaced the Bank of Mauritius Act 1981, Banking Act 1988 and the Foreign Exchange Dealers Act 1995.

Both the Bank of Mauritius Act 2004 and the Banking Act 2004 enhance compliance with the Basel Core Principles for Effective Banking Supervision and take into consideration the recommendations made by the Financial Sector Assessment Program Team in the detailed assessment of compliance of the Basel Core Principles for Effective Banking Supervision and Transparency of Banking Supervision. The Banking Act 2004 and the Bank of Mauritius Act 2004 also enhance the supervisory powers of the Bank of Mauritius.

A. Bank of Mauritius Act 2004

The main objective of the Bank of Mauritius Act 2004 is to repeal and replace the law relating to the Bank of Mauritius, and to provide for related matters.

The Bank of Mauritius Act 2004 strengthens the central bank's institutional framework, endows it with more powers and gives it greater independence.

Some of the main provisions of the Act are highlighted below :

Section 4 – Objects of the Bank

The primary object of the Bank of Mauritius is to maintain price stability and to promote orderly

and balanced economic development while the other objects are (a) to regulate credit and currency in the best interests of the economic development of Mauritius, (b) to ensure the stability and soundness of the financial system of Mauritius, and (c) to act as the central bank for Mauritius.

Section 12– Board of Directors

In accordance with the new Act, the Board of Directors of the Bank consists of the Governor of the Bank, who is also the Chairman, a First Deputy Governor, a Second Deputy Governor and between five to seven other Directors and is not, in the exercise of its functions, subject to the direction or control of any other person or authority.

Section 33 – Transparency

With a view to enhance transparency in the conduct of its operations, the Bank is required to promote open discussions and comments on its monetary and financial stability policies. In this context, the Bank will have to publish at least once a year, statements on its monetary policy and at least twice a year, statements on price stability and on the stability and soundness of the financial system.

Section 50 – Power to issue instructions

The Bank of Mauritius is empowered, for the efficient achievement of the purposes of the Bank of Mauritius Act 2004, by notice in writing to banks or to other financial institutions, to issue instructions or guidelines or impose requirements on or relating to the operations and activities of and standards to be maintained by banks and other financial institutions.

Section 52 – Credit Information Bureau

For the purpose of ensuring the operation of a sound credit information system in Mauritius, the Bank has been given the power to establish, in conjunction with banks, a Credit Information Bureau and to require, on such terms and conditions as it may deem fit, any bank or other financial institution to furnish at such time and in such manner such credit information as it may require for the purpose of, inter alia, maintaining a data base on borrowers and guarantors.

Section 54 – Monetary Policy Committee

Section 54 of the new Bank of Mauritius Act provides for the setting up of a Monetary Policy Committee, consisting of the Governor as

Chairman, the two Deputy Governors, two other Directors of the Board and three other persons, not being Directors or employees of the Bank, having recognised experience in the field of economics, banking or finance, with responsibility to conduct the Bank's monetary policy and manage the exchange rate of the rupee and to determine, with the concurrence of the Minister of Finance, the accepted range of the rate of inflation.

Section 60 – Deposit Insurance

Provision is made in this section of the Bank of Mauritius Act for the Bank to advance funds to the deposit insurance scheme which may be established pursuant to section 93 of the Banking Act 2004, on such repayment terms and conditions as it deems fit for the administration of the scheme.

The Bank would also, in the event that the entity responsible for the administration of the deposit insurance scheme is a company, be entitled to purchase share capital of that entity.

B. Banking Act 2004

The Banking Act 2004, *inter alia*, amends and consolidates the laws relating to the business of banking and other financial institutions. The Banking Act 2004 captures under its umbrella financial institutions, which have been defined in the Act as meaning banks, non-bank deposit taking institutions and cash dealers. Cash dealer in the Act refers to a foreign exchange dealer or a money-changer.

The dichotomy which existed between offshore and domestic banks has ceased to exist under the new legislation which provides for the issue of a unique banking licence for all banking institutions.

Some of the main provisions of the Act are given hereunder.

Section 12 – Licensing of deposit taking business

Whereas, under the Banking Act 1988, non-bank deposit taking institutions were issued with an authorisation to carry on deposit taking business, those institutions are now, by virtue of the new Banking Act, required to take out a licence from the Bank of Mauritius.

Section 13 – Licensing of cash dealers

Cash dealers which were formerly regulated under the Foreign Exchange Dealers Act 1995, will

henceforth be licensed and supervised by the Bank of Mauritius under the Banking Act 2004.

Section 19(b) – Other restrictions (significant interest)

The Banking Act 2004 prohibits a financial institution from causing or permitting any person from holding any significant interest in any class of shares in its stated capital, except with the prior approval of the central bank.

'Significant interest' is interpreted in the Act as 'owning, directly or indirectly, 10 per cent or more of the capital or of the voting rights of a financial institution or, directly or indirectly, exercising a significant influence over the management of the financial institution, as the central bank may determine'.

Sections 20 & 102(a) – Minimum capital requirements of banks

By virtue of sections 20 and 102 (a) of the Banking Act 2004, banks are required to maintain in Mauritius, an amount paid as stated capital or an amount of assigned capital of not less than 200 million rupees or the equivalent amount in any freely convertible currency held in assets in or outside Mauritius, as may be approved by the central bank or such higher amount as may be prescribed, after deduction of the accumulated losses of the bank.

In the case of a bank having a capital of less than 200 million rupees, it has been given up to 1 July 2005 to raise its capital to not less than 150 million rupees and up to 1 July 2006 for the capital to be raised to not less than 200 million rupees, after deduction of the accumulated losses of the bank.

Section 36 – Credit assessments and asset appraisals

The central bank has been given powers to require a bank, by notice, to, *inter alia*, undergo an independent assessment of its credit worthiness or financial stability or to assess the value of its assets, in particular real estate and other related assets, by a person or organisation nominated or approved by the central bank.

Section 43 – Special examinations

Where it appears expedient or necessary to determine whether a financial institution is in a sound financial condition and is complying with the banking laws or any enactment relating to anti-

money laundering or prevention of terrorism or guidelines and instructions issued by the central bank, as the case may be, the central bank may appoint one or more of its officers or such other duly qualified person to conduct a special examination in respect of the affairs of the financial institution.

Section 52 – Electronic Delivery Channel

Banks may, under this section of the Act, provide services to customers through electronic delivery channels such as the Internet. They are however, required by the Act to have such systems to identify, monitor, and control transactional risk from the bank's use of technology and provide security for their internet platforms, including systems for customer authentication and for physical and logical protection against unauthorized external access by individual penetration attempts, computer viruses, denial of service, and other forms of electronic access, as the central bank considers adequate.

Section 54 – Internal control systems

Every bank is required to maintain adequate internal control systems, commensurate with the nature and volume of its activities and various types of risks to which it is exposed, regarding (i) operations and internal procedures, (ii) the organisation of accounting and information processing systems, (iii) risk and result measurement systems, (iv) documentation and information systems and (v) cash flow transactions monitoring systems.

Section 57 – Bank's obligations towards customers

A bank upon which cheques have been drawn by its customer is required to send or make available to the customer a statement of account in written or electronic form, showing payment of the cheques for the account and shall either return or make available to the customer the cheques paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the cheques paid.

Section 64 – Confidentiality

Financial institutions have a duty to maintain confidentiality of information. However, the duty of confidentiality ceases to apply, inter alia, where the information is required for transmission to the Credit Information Bureau established under the Bank of Mauritius Act 2004 or where the bank is required to

make a report or provide additional information on a suspicious transaction to the Financial Intelligence Unit under the Financial Intelligence and Anti-Money Laundering Act 2002.

The Commissioner under the Prevention of Corruption Act 2002, the Chief Executive of the Financial Services Commission established under the Financial Services Development Act 2001, the Commissioner of Police, the Director-General of the Revenue Authority, the Revenue Commissioner under the Unified Revenue Act, or any other competent authority in Mauritius or outside Mauritius, who requires any information from a financial institution relating to the transactions and accounts of any person, has to apply to a Judge in Chambers for an order of disclosure of such transactions and accounts or such part thereof as may be necessary.

Section 96 – Ombudsperson for banks

The Banking Act 2004 also provides for the appointment of an Ombudsperson to deal with complaints by customers.

C. The Financial Reporting Act 2004

The Financial Reporting Act 2004 was enacted on 10 December 2004 with a view to setting up the appropriate legislative framework for the establishment of:

- (i) the Financial Reporting Council, which shall have the responsibility of monitoring the truth and fairness of financial reporting and of overseeing auditing practices;
- (ii) the Mauritius Institute of Professional Accountants with the responsibility of regulating the accountancy profession in Mauritius;
- (iii) the National Committee on Corporate Governance, which shall act as the national coordinating body responsible for all matters pertaining to corporate governance; and
- (iv) the Mauritius Institute of Directors, which shall act as the responsible body for promoting the highest standards of corporate governance, and of business and ethical conduct of directors.

In order to promote cooperation between regulatory bodies, the Financial Reporting Act 2004 makes provision for the Financial Reporting Council to enter into a Memorandum of Understanding with

such regulatory body as it considers appropriate in order to exchange or share information for the purpose of discharging its functions under the Act.

The Act is operative in Mauritius since 20 January 2005.

D. Bills of Exchange Act

One of the consequential amendments brought about by the Banking Act 2004 is the inclusion in the Bills of Exchange Act of a new provision which enables the presentment of cheque for payment by electronic means.

Another new provision entitled 'Non-transferable cheques' has been added to the Bills of Exchange Act which provides that where a cheque is crossed and bears across its face the words 'account payee' or 'a/c payee', either with or without the word 'only', the cheque shall not be transferable, but shall only be valid as between the parties thereto.

E. The Finance Act 2005

The Finance Act 2005, enacted on 20 April 2005, brought amendments, *inter alia*, to the Banking Act 2004, Bank of Mauritius 2004, Companies Act 2001, Financial Intelligence and Anti-Money Laundering Act 2002, Income Tax Act 1995, Prevention of Corruption Act 2002, Prevention of Terrorism Act 2002 and Value Added Tax Act 1998, as follows:

The Banking Act 2004

Section 7(6)(a) has been amended to provide for a banking licence to specify only the name of the licensee and the place or places at which the licensee is authorised to conduct banking business and not the financial activities which a bank may be authorised to conduct.

The heading of section 14 has been changed from 'Granting of cash dealer licences' to 'Granting of licences to cash dealers'. The words 'for a cash dealer licence' in section 14(1) have been replaced by the words 'for a foreign exchange dealer licence or a money-changer licence, as the case may be'.

The words 'in Mauritius' in section 33(3)(c) have been deleted so that records of every transaction that a financial institution conducts shall be kept at the principal office of the financial institution, or at such other place, as may be approved by the central bank.

The words 'a bank' and 'the bank' wherever they appear in section 59 have been respectively replaced by the words 'a financial institution' and 'the financial institution'.

Bank of Mauritius Act 2004

The words 'provide advice to the Bank in the discharge of its functions' in section 25(1) of the Act have been deleted and replaced by the words 'provide such services to the Bank as it thinks fit'.

While the Bank of Mauritius Act 2004 and Banking Act 2004 have, upon their enactment, made consequential amendments to certain statutes, others still had been missed out. To remedy the situation, the Finance Act 2005 brought about amendments to the following enactments in order to align certain provisions of those Acts with the new provisions found in the Banking Act 2004 and Bank of Mauritius Act 2004.

Financial Intelligence and Anti-Money Laundering Act 2002

The definitions of 'bank', 'Bank of Mauritius' and 'cash dealer' in section 2 have been deleted and replaced by the following definitions:

- 'bank' has the same meaning as in the Banking Act 2004 and includes any person licensed under the Banking Act 2004 to carry on deposit taking business.
- 'Bank of Mauritius' means the Bank of Mauritius established under the Bank of Mauritius Act 2004.
- 'cash dealer' has the same meaning as in the Banking Act 2004.

The words 'the Banking Act' and 'the Bank of Mauritius Act' in the definition of 'relevant enactments' in section 2 have been replaced by the words 'the Banking Act 2004' and 'the Bank of Mauritius Act 2004'.

Paragraphs (a), (b) and (c) of section 18(2) which relate to regulatory action in the event of non-compliance by any bank or cash dealer, have been repealed and replaced by two new paragraphs. As per the new paragraphs, in the event of any failure by a bank or cash dealer to comply with the provisions of the Financial Intelligence and Anti-Money Laundering Act 2002, the Bank of Mauritius may, in the absence of any reasonable excuse, in the case of a bank, proceed against the bank under sections 11 and 17 of the Banking Act 2004 on the ground that it is carrying

on business in a manner which is contrary to the interest of the public and likewise, in the case of a cash dealer or a person licensed to carry on deposit taking business, proceed against him under sections 16 and 17 of the Banking Act 2004 on the ground that he is carrying on business in a manner which is contrary to the interest of the public.

Income Tax Act 1995

In view of the fact that the dichotomy between Category 1 and Category 2 banks has been removed and a single banking licence is now being issued under the Banking Act 2004, the definition of 'non-resident' in the Income Tax Act 1995 has been deleted and replaced by a new definition which provides that 'non-resident', in so far as it applies to a bank holding a banking licence under the Banking Act 2004, means a person whose centre of economic interest is located outside Mauritius and includes a company incorporated in Mauritius in so far as its banking transactions carried out through a permanent establishment outside Mauritius are concerned, but does not include a company incorporated outside Mauritius in so far as its banking transactions carried out through a permanent establishment in Mauritius are concerned.

This amendment is deemed to come into operation as from the year of assessment commencing 1 July 2006.

Prevention of Corruption Act 2002 and Prevention of Terrorism Act 2002

The definitions of 'bank' and 'cash dealer' in section 2 of each of the Prevention of Corruption Act 2002 and Prevention of Terrorism Act 2002 have been deleted and replaced by new definitions. As per the new definitions 'bank' has the same meaning as in the Banking Act 2004 and includes any person licensed under the Banking Act 2004 to carry on deposit taking business and 'cash dealer' has the same meaning as in the Banking Act 2004.

Value Added Tax Act 1998

A corresponding change in the definition of 'non-resident' as carried out in the Income Tax Act 1995 has been made in the Value Added Tax Act 1998.

Paragraph (g) of section 21(2) relating to credit for input tax against output tax has been

deleted and a new provision inserted which provides that no input tax shall be allowed as a credit in respect of goods and services used by banks holding a banking licence under the Banking Act 2004 for providing banking services other than to non-residents and corporations holding a Global Business Licence under the Financial Services Development Act 2001.

Similarly, a new paragraph (ga) has been inserted in section 21(2) to provide that no input tax shall be allowed as a credit in respect of banking services provided by banks holding a banking licence under the Banking Act 2004 other than to non-residents and corporations holding a Global Business Licence under the Financial Services Development Act 2001.

In the first schedule, where a list of goods and services which are exempted from VAT is provided, in item 50(a) the words '(other than services supplied by holders of a Category 2 Banking Licence)' have been deleted and replaced by the words '(other than services supplied by a bank holding a banking licence under the Banking Act 2004 in respect of its banking transactions with non-residents and corporations holding a Global Business Licence under the Financial Services Development Act 2001)'.

Regulatory Measures

Sixteen prudential guidelines regulating the banking sector were in force as at 30 June 2005, as follows:

- (i) Guideline on Credit Concentration Limits;
- (ii) Guidance Notes on Risk Weighted Capital Adequacy Ratio;
- (iii) Guideline on General Principles for Maintenance of Accounting and other Records and Internal Control Systems;
- (iv) Guideline for Calculation and Reporting of Foreign Exchange Exposures of Banks;
- (v) Guideline on Liquidity;
- (vi) Guideline on Internet Banking;
- (vii) Guideline on Corporate Governance;
- (viii) Guideline on Related Party Transactions;
- (ix) Guideline on Transactions or Conditions respecting Well-Being of a Financial Institution Reportable by the External Auditor to the Bank of Mauritius;
- (x) Guideline on Public Disclosure of Information;

- (xi) Guideline on Credit Risk Management;
- (xii) Guideline on Credit Impairment Measurement and Income Recognition;
- (xiii) Guideline on Fit and Proper Person Criteria;
- (xiv) Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism;
- (xv) Guideline on Operational Risk Management and Capital Adequacy Determination;
- (xvi) Guideline on Segmental Reporting under a Single Banking Licence Regime.

Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism

The Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) have been reviewed in the light of legislative changes brought about by the enactment of the Bank of Mauritius Act 2004 and Banking Act 2004, experience gathered and constant dialogue between the Bank and stakeholders. The new Special Recommendation IX on 'Cash Couriers' and new Recommendation 19 of the Forty Recommendations issued by the FATF have also been incorporated in the revised Guidance Notes.

The Bank has in terms of Section 18(1)(a) of the Financial Intelligence and Anti-Money Laundering Act 2002, Section 100 of the Banking Act 2004 and Section 50 of the Bank of Mauritius Act 2004, formally issued the revised Guidance Notes on AML/CFT to the Industry.

The revised Guidance Notes supersede the Guidance Notes issued by the Bank in December 2003 and are effective since 7 June 2005.

Guideline on Credit Impairment Measurement and Income Recognition

In June 2003, a draft Guideline on Credit Impairment Measurement and Income Recognition was issued to deposit-taking financial institutions for consultation. The Guideline was finalised and was issued in November 2004 to all deposit-taking financial institutions falling under the purview of the Bank of Mauritius.

The Guideline focuses on the International Accounting Standard 39 (IAS 39), entitled 'Financial Instruments: Recognition and Measurement'. The Standard that deals with, among other things, the impairment and uncollectability of financial assets

has been subject to revisions recently. The revised Standard now applies to annual periods beginning on or after 1 January 2005.

The objective of the Guideline is to ensure that:

- (i) financial institutions have adequate processes for determining allowance for credit losses;
- (ii) the carrying amounts of credit portfolio represent recoverable values, and
- (iii) there is timely recognition of identified losses.

The derecognition and impairment provisions of the Standard also apply to lease receivables recognised by a lessor.

The Guideline on Credit Impairment Measurement and Income Recognition replaces the previous Guideline on Credit Classification for Provisioning Purposes and Income Recognition.

Guideline on Operational Risk Management and Capital Adequacy Determination

The Guideline on Operational Risk Management and Capital Adequacy Determination issued in February 2005 is applicable to all banks. For the purpose of determining capital adequacy, the requirements of the Guideline are supplementary to those of the Guidance Notes on Risk Weighted Capital Adequacy Ratio, which pertain to credit risk.

Recognising that banks across the world have installed more specific structures and processes aimed at managing operational risk, the Basel Committee on Banking Supervision (BCBS) has given operational risk similar importance and stature as credit and market risks and required that banks apply similar level of rigour and resources to controlling and managing operational risk. In line with the recommendations made by the BCBS, the Guideline on Operational Risk Management and Capital Adequacy Determination requires each bank to establish an appropriate, comprehensive approach to the identification, measurement, monitoring and control of operational risk and to make an adequate provision of capital to protect against operational risk.

In this respect each bank should establish a written policy on operational risk management that should clearly set out, inter alia, the principles for identifying, assessing, monitoring and controlling/mitigating operational risk and directives for managing risks associated with outsourcing activities.

The Guideline also requires foreign banks operating branches in Mauritius to implement a management framework for operational risk. The head office of the branch should, however, ensure, at the consolidated level, that the branch complies with the capital adequacy requirements for operational risk as well as other applicable regulations, guidelines and instructions.

Guideline on Fit and Proper Person Criteria

The objective of the Guideline on Fit and Proper Person Criteria issued in March 2005 is to set out a framework for assessing a person's capacity to act as a fit and proper person and to provide for a basis for decision in the matter. The Guideline, which applies to banks, non-bank deposit-taking institutions, foreign exchange dealers and money-changers, collectively referred to as financial institutions, supersedes the Guidance Notes on Fit and Proper Person Criteria issued by the Bank in October 2003.

The Guideline requires that shareholders with significant influence, directors and senior officers of financial institutions be and be seen as fit and proper. It is the responsibility of the board of directors of the institutions to ensure that this is actually the case.

The criteria outlined in the Guideline for assessing fitness and propriety of a person are categorised under three captions:

- (i) Honesty, integrity, diligence, fairness and reputation
- (ii) Competence and capability; and
- (iii) Financial soundness

The criteria are to be applied individually but it is their cumulative effect that will determine whether a person meets the test. Failure to meet one criterion will not, of its own, necessarily mean failure to meet the test of fit and proper person. The process involves a good measure of judgement, which needs to be exercised in a fair and judicious manner in the best interests of the institution and the sound conduct of its business.

Guideline on Segmental Reporting under a Single Banking Licence Regime

Following the promulgation of the Banking Act 2004 in November 2004, separate licensing of Category 1 banks and Category 2 banks has been eliminated. Accordingly, all banks may transact in all currencies, including the Mauritian rupee.

The Guideline on Segmental Reporting under a Single Banking Licence Regime issued to banks in June 2005 highlights the following issues:

- (i) the choices that banks have respecting their principal lines of business;
- (ii) the concept of 'foreign source income' for tax purposes;
- (iii) the treatment of specific deposit liabilities for the cash reserve ratio requirement under section 49(1) of the Bank of Mauritius Act 2004;
- (iv) the exemption from the maintenance of the capital adequacy ratio under section 20(2) of the Banking Act 2004; and
- (v) the reliance on home regulator global capital adequacy assessment in respect of banking business when conducted by an unincorporated branch of a foreign bank.

The Guideline lays emphasis on the need for banks to comply with the requirement of International Accounting Standards regarding disclosure of financial information on distinguishable segments of their business.

For the conduct of the entire banking business by one entity operating under a single banking licence, banks will have to maintain appropriate accounting systems and controls so as to ensure accuracy and integrity of information, which will, for example, determine the 'foreign source income' and to facilitate efficient flow and extraction of information for reporting to the Bank of Mauritius in connection with its supervisory and monetary control responsibilities.

For the purpose of the implementation of the above requirements, the banking business of a licensed bank has been divided into two segments, Segment A and Segment B. Segment B relates to the banking activities that give rise to 'foreign source income'. All other banking activities will be classified under Segment A. It is recognised that some banks will operate exclusively in Segment A, some exclusively in Segment B and others in both.

The Guideline defines 'foreign source income' as in the Income Tax (Foreign Tax Credit) Regulations 1996, as subsequently amended by section 103 of the Banking Act 2004, as income which is not derived from Mauritius and includes in the case of a bank holding a Banking Licence under the Banking Act 2004 income derived from its banking transactions with non residents or

corporations holding a Global Business Licence (GBL) under the Financial Services Development Act 2001.

Services provided to non-residents and/or GBL holders will generate 'foreign source income'. However, the funds utilised to finance these services may come from either non residents/GBL holders or residents.

Cash Reserve Ratio

As from 1 July 2005, the effective date of the Guideline, all deposits of non-residents and/or GBL holders which are used exclusively for financing Segment B activity will not be subject to the minimum cash reserve ratio requirement under section 49(1) of the Bank of Mauritius Act 2004.

Deposits of other units, except Government deposits, will be subject to the minimum cash reserve ratio requirement.

The Guideline stresses the fact that any deliberate shifting of deposit liabilities by banks with a view to avoiding the minimum cash reserve requirement will be dealt with as an infringement in the manner prescribed under section 49(6) of the Bank of Mauritius Act 2004.

Capital Adequacy Ratio

Former Category 2 banks that were unincorporated branches of foreign banks were not required to maintain the minimum risk weighted capital adequacy ratio of 10 per cent as they were considered as falling under the responsibility of the home regulator of their parent bank. This treatment will now apply to Segment B operations of unincorporated branches of foreign banks only.

On the other hand, an incorporated subsidiary of a foreign bank that has opted to carry out Segment B business will continue to be subject to the minimum capital adequacy ratio.

In the context of capital adequacy determination banks that are related to large global banks are expected to opt eventually for specific approaches to capital adequacy under the different options available under Basel II. The model adopted should show an improvement on the current Basel Accord approach.

Segmental Reporting

The Guideline requires banks to report data on both Segment A and Segment B banking activities

as appropriate. In this respect the Bank of Mauritius has revisited reports to be submitted by banks.

Under section 34(2) of the Banking Act 2004, the central bank is empowered to require a financial institution to prepare, in respect of its distinct types of business, its financial statements in such distinct basis as may be determined. In this respect, banks will have to draw segmental financial statements as set out in the Guideline, commencing with the next financial year as from 1 July 2005.

Other Supervisory Development

CAMEL Rating

CAMEL is a common rating system used by many regulators around the world for evaluating the financial condition of a financial institution. It is a collection of five components namely, Capital adequacy, Asset quality, Management, Earnings or profitability; and Liquidity. Each of these components is analysed and a rating of 1 to 5 assigned. Eventually a composite rating for the institution is determined.

The Bank has been using the CAMEL rating system for a number of years for off-site monitoring and for identifying risk areas. It has been of considerable assistance to the Bank in sharpening its focus on the financial health and well being of an institution. As from January 2005, the Bank started informing former Category 1 banks about the rating assigned to them. While the rating cannot be expected to cover all risk areas faced by a bank, it is expected that it will serve as guidance to management in identifying areas for improvement. The rating is communicated to former Category 1 banks under the strict condition that it will not be published or disclosed to any third party without the written consent of the Bank.

Domestic Banking Sector

Banking Activity

During 2004-05, the on-balance sheet assets of former Category 1 banks increased by Rs16,487 million, or 9.4 per cent, from Rs174,641 million as at end-June 2004 to Rs191,128 million as at end-June 2005, compared to a growth rate of 13.0 per cent in the preceding fiscal year. Off-balance sheet items, consisting of acceptances, documentary

credits and guarantees, increased by 22.1 per cent, from Rs17,766 million as at end-June 2004 to Rs21,686 million as at end-June 2005.

Banks' foreign currency assets went up by Rs7,445 million to Rs29,291 million as at end-June 2005 and represented 15.3 per cent of their total assets compared to 12.5 per cent as at end-June 2004.

Shareholders'/Head Office funds went up by 23.4 per cent to Rs19,885 million as at end-June 2005 compared to a growth rate of 13.5 per cent in 2003/04. Shareholders' funds accounted for 10.4 per cent of total resources of former Category 1 banks as at end-June 2005.

Banks' total advances, including financing by way of subscription to debentures, increased by Rs9,270 million, or 10.2 per cent, from Rs91,267 million as at end-June 2004 to Rs100,537 million as at end-June 2005, compared to a rise of 6.3 per cent in the preceding year. The ratio of total advances to total assets stood at 52.6 per cent as at end-June 2005 compared to 52.3 as at end-June 2004.

Total deposits of former Category 1 banks went up by Rs10,452 million, or 7.9 per cent, from Rs132,778 million as at end-June 2004 to Rs143,230 million as at end-June 2005, compared to a growth rate of 14.2 per cent in the previous fiscal year. Deposits accounted for 74.9 per cent of banks' total funds as at end-June 2005 compared to 76.0 per cent as at end-June 2004.

Banks' investment in Treasury Bills, other Government securities and Bank of Mauritius Bills increased by Rs891 million, from Rs44,792 million as at end-June 2004 to Rs45,683 million as at end-June 2005 compared to a more significant increase of Rs11,620 million, or 35 per cent in 2003/04. The share of such investment in banks' total assets went down from 25.6 per cent as at end-June 2004 to 23.9 per cent as at end-June 2005.

Banks' investment in equity and quasi-equity of other companies increased by Rs335 million, or 7.4 per cent, to Rs4,852 million as at end-June 2005 compared to a significant growth of 65.1 per cent in 2003-04. As at end-June 2005, they represented 2.5 per cent of total assets.

Institutional Developments

During 2004-05, two additional banks introduced the use of plastic money in the form of

credit and debit cards, bringing the total number of banks providing such services to eight. Phone-banking facilities are offered by four banks. With the approval of the Bank of Mauritius, Internet banking services (transactional) are being provided by two former Category 1 banks through their web sites.

Customers have been making increasing use of service units, more specifically Automated Teller Machines (ATMs) and electronic delivery multi-channels that include Internet banking services. The number of customers having recourse to the use of Internet banking increased from 16,884 at end-June 2004 to 24,812 at end-June 2005. Over the same period, the number of customers making use of phone banking increased from 42,378 to 52,830.

Between end-June 2004 and end-June 2005, the number of ATMs in operation in Mauritius rose by 20, from 273 to 293 and the number of cards in circulation increased from 831,386 to 908,676. Outstanding advances on credit cards increased from Rs822 million as at end-June 2004 to Rs907 million as at end-June 2005. The monthly average number of transactions involving the use of credit cards, debit cards, ATMs and Merchant Points of Sale amounted to 2.6 million for a total value of Rs4,451 million for the period July 2004 to June 2005 compared to a monthly average of 2.4 million for a total value of Rs3,943 million in 2003-04.

Bank Performance

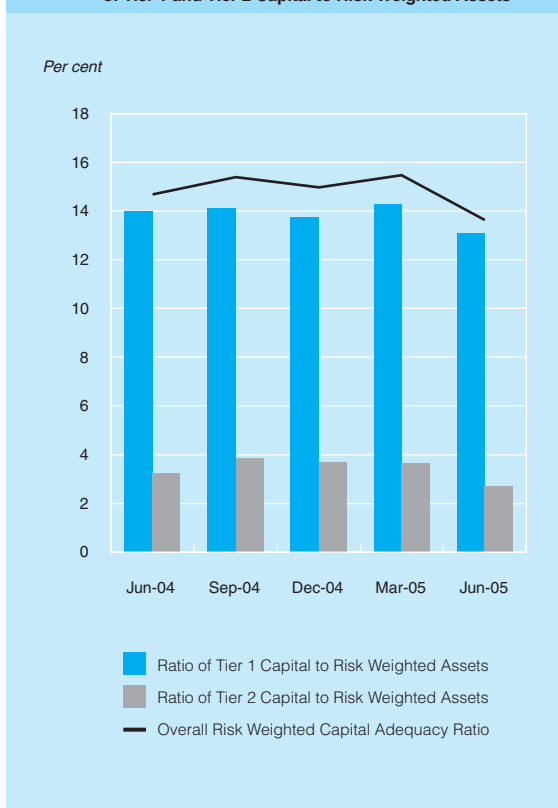
The assessment of a bank's performance is based on the following four main criteria:

- Risk Weighted Capital Adequacy Ratio;
- Foreign Exchange Exposure;
- Concentration of Risk and Large Exposures; and
- Profitability

Risk Weighted Capital Adequacy Ratio

Capital is the main determinant of a bank's lending capacity and also the first element used to assess the solvency of a bank. A strong capital reduces the risk of failure because it provides the first cushion against risk exposures and thus maintains the confidence of depositors.

As from 1 April 2005, as per the Guideline on Operational Risk Management and Capital Adequacy Determination, banks are required to maintain a capital buffer to protect against operational risks. They were given the possibility of

Chart 2.1: Overall Risk Weighted Capital Adequacy Ratio and Ratios of Tier 1 and Tier 2 Capital to Risk Weighted Assets

choosing among three main approaches for calculating the capital charge for operational risk; namely the Basic Indicator Approach; the

Standardised Approach; and the Advanced Measurement Approach. Banks were encouraged to move along the ascending spectrum of approaches as they achieve increasing sophistication in their operational risk systems and processes. As a minimum, however, banks have to implement the Basic Indicator Approach. Ten of the former Category 1 banks have opted for the Basic Indicator Approach, while one bank has chosen the Alternative Standardised Approach, which is a slightly simplified version of the Standardised Approach.

As at end-June 2005, all former Category 1 banks reported risk weighted capital adequacy ratios above the prescribed minimum of 10.0 per cent.

Chart 2.1 shows the overall risk weighted capital adequacy ratio and ratios of Tier 1 and Tier 2 capital to risk weighted assets.

The overall risk weighted capital adequacy ratio maintained by former Category 1 banks went down from 14.7 per cent as at end-June 2004 to 13.6 per cent as at end-June 2005. This drop was due to the inclusion of risk weighted assets for operational risk of Rs11,419 million in the June 2005 calculation. Had this figure not been included, the weighted capital adequacy ratio as at 30 June 2005 would have been 15.0 percent. In 2004-05, the overall ratio varied within a range of 13.6 per cent to 15.5 per cent compared to a range of 12.6 per cent to 15.0 per cent in 2003-04.

Table 2.1: Former Category 1 Banks: Maintenance of Risk Weighted Capital Adequacy Ratio

	(Rs million)				
As at end of period	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
Tier 1 Capital	14,533	14,943	15,008	15,748	16,363
Tier 2 Capital	3,352	4,050	4,049	4,031	3,386
Total Gross Capital	17,885	18,993	19,057	19,779	19,749
Capital Deductions	2,658	2,680	2,711	2,716	2,693
Total Net Capital (A)	15,227	16,313	16,346	17,063	17,056
Total Risk Weighted Assets (B)	103,767	105,946	109,152	110,386	125,211
of which:					
Risk weighted on-balance sheet assets	92,399	95,029	98,221	99,345	102,312
Risk weighted off-balance sheet assets	9,179	9,735	10,549	10,445	10,874
Foreign exchange rate and interest rate related contracts	78	78	70	77	82
Foreign currency exposure	2,111	1,104	312	519	524
Risk weighted assets for Operational Risk *	N/a	N/a	N/a	N/a	11,419
Risk Weighted Capital Adequacy Ratio (A/B)	14.7%	15.4%	15.0%	15.5%	13.6%

* N/a: Not applicable

The aggregate capital base of former Category 1 banks is made up of Tier 1 capital (Core Capital) and Tier 2 capital (Supplementary Capital) net of capital deductions. Aggregate capital base increased by Rs1,829 million, or 12.0 per cent, from Rs15,227 million as at end-June 2004 to Rs17,056 million as at end-June 2005. The share of Tier 1 capital in total gross capital (Tier 1 and Tier 2) increased marginally from 81.3 per cent as at end-June 2004 to 82.9 per cent as at end-June 2005.

Up to the third quarter of 2004-05, total risk weighted assets comprised risk weighted on-balance sheet assets, risk weighted off-balance sheet exposures, foreign exchange and interest rate related contracts and foreign currency exposure. As from the last quarter of 2004-05 the total risk weighted assets also include risk-weighted assets for operational risk. During 2004-05, total risk weighted assets (excluding risk-weighted assets for operational risk) increased by Rs10,025 million, from Rs103,767 million as at end-June 2004 to Rs113,792 million as at end-June 2005. This was mainly due to risk weighted on-balance sheet assets and off-balance sheet assets increasing by Rs9,913 million and Rs1,695 million, respectively. The inclusion of risk-weighted assets for operational risk had the effect of increasing the total risk weighted assets by Rs11,419 million, to Rs125,211 million.

During the year 2004-05, banks' investment in high-risk assets remained almost unchanged while investment in low-risk assets registered a drop. Assets in the 100 per cent risk weight bucket as a proportion of total risk weighted assets fell marginally from 51.9 per cent as at end-June 2004 to 51.4 per cent as at end-June 2005 while the share of zero-risk weighted assets also declined from 36.3 per cent to 33.6 per cent during the same period.

Table 2.1 shows the risk weighted capital adequacy ratios maintained by former Category 1 banks on a quarterly basis from end-June 2004 through end-June 2005.

Foreign Exchange Exposure

Pursuant to section 7(2) of the Foreign Exchange Dealers Act 1995, banks were required to observe limits on their foreign exchange exposure in relation to their Tier 1 Capital. The Banking Act 2004 maintained this requirement. This measure is meant to ensure that banks manage their foreign exchange positions in a prudent manner. In July 1996, the Bank of Mauritius issued guidelines for the calculation and reporting of foreign exchange exposures on a daily basis.

The overall foreign exchange limit is defined as the ratio of the higher of the sum of all spot and forward short or long positions in different currencies to Tier 1 Capital. Effective April 1997, banks are required to observe a daily foreign exchange exposure limit not exceeding 15 per cent of their Tier 1 Capital and to report to the Bank of Mauritius, on a daily basis, their foreign exchange exposure in major currencies as well as their overall foreign exchange exposure. This limit was increased to 30% as from July 2005.

Table 2.2 shows the maturity pattern of foreign currency assets and liabilities of banks as at end-June 2004, end-December 2004 and end-June 2005.

As at end-June 2005, banks carried an overall excess of foreign currency liabilities over assets amounting to Rs1,895 million for all maturities of assets and liabilities taken together. Banks had a short position of Rs 6,235 million in the shorter maturity period of less than one month with the net exposure shifting to a net long position of Rs 6,580

Table 2.2: Banks: Maturity Pattern of Foreign Currency Assets and Liabilities

Maturity Period	(Rs million)								
	End Jun-04			End Dec-04			End Jun-05		
	Foreign Currency			Foreign Currency			Foreign Currency		
	Assets (1)	Liabilities (2)	Net Assets (1) - (2)	Assets (1)	Liabilities (2)	Net Assets (1) - (2)	Assets (1)	Liabilities (2)	Net Assets (1) - (2)
Less than 1 Month	13,195	17,678	-4,483	14,826	21,390	-6,564	16,809	23,044	-6,235
Over 1 Month and Up to 3 Months	1,860	2,466	-606	2,710	3,960	-1,250	2,273	2,786	-513
Over 3 Months and Up to 12 Months	947	2,778	-1,831	1,760	1,494	266	1,479	3,206	-1,727
Over 12 Months	5,843	1,449	4,394	8,210	2,213	5,997	8,729	2,149	6,580
Total	21,845	24,371	-2,526	27,506	29,057	-1,551	29,290	31,185	-1,895

million in the longer maturity period of over 12 months.

Concentration of Risks and Large Exposures

Under section 29 of the Banking Act 2004, the Bank is empowered to regulate the level of banks' credit exposures to any one customer, or group of closely related customers. The Bank has issued a guideline on credit concentration limits to former Category 1 banks in 2000 and this is still applicable as at date. However, with the coming in force of the Banking Act 2004, the Guideline now also applies to former Category 2 banks.

Under the Guideline, all credits of a bank that are individually over 15 per cent of the bank's capital base, shall not in aggregate exceed the regulatory concentration limits of 600 per cent of its capital base.

In cases where a bank decides to grant credit facilities exceeding the applicable regulatory limits, it must obtain the prior written authorisation of the Bank and must provide such information to the Bank as it may prescribe. Such authorisation is granted in very exceptional circumstances and the Bank may impose such terms and conditions, as it deems necessary, including an increase in the capital adequacy ratio to be maintained.

The aggregate credit exposure of a locally incorporated bank, together with its subsidiary, associated and related companies as defined in section 3 of the Companies Act 2001, to any entity and its related parties, shall not exceed 25 per cent of the total capital base of the bank. As for a subsidiary or branch of a foreign bank, the credit exposure to an entity and its related parties, shall not exceed 50 per cent of the capital base of the subsidiary or branch.

Section 29(4) of the Banking Act 2004 provides the option to banks to seek exemption from the above requirements to that part of their banking business or investment banking business that is conducted in currencies other than Mauritius currency. In that respect, banks have been formally advised that concentration of risks in respect of their lending in currencies other than Mauritius rupee to members within their own group are exempted from compliance with the regulatory limit.

As at end-June 2005, the total fund and non-fund based facilities of former Category 1 banks, exceeding the threshold of 15 per cent of their capital base, totalled Rs39,331 million and

represented 31 per cent of the overall on and off-balance sheet commitments of former Category 1 banks. The corresponding figure and ratio as at end-June 2004 were Rs38,637 million and 35 per cent, respectively.

Non-Performing Advances

In November 2004, the Bank of Mauritius issued a new Guideline on Credit Impairment Measurement and Income Recognition in which it is laid down that banks should, inter alia:

- establish credit risk management policy including credit impairment recognition and measurement policy, the associated internal controls, documentation processes and information systems; and
- assess at balance sheet date whether there is any objective evidence that a financial asset or group of assets is impaired.

Credit constitutes the largest part of a bank's business in Mauritius and its mismanagement can cause a serious threat to an institution's safety and soundness, impacting on the interest of depositors and other stakeholders. The determination of non-performing loans and provision for bad and doubtful debts are an essential tool for prudential credit risk management. Banks should set aside adequate provisions on loans that represent more than a normal risk of loss.

Where banks have established that there is objective evidence that a financial asset is impaired, they have to determine the amount of impairment loss. To compute the amount of impairment loss, the recoverable value of the financial asset should be estimated. Estimated recoverable value of loans is determined either individually or on a portfolio basis.

Individually Assessed Credits

The estimation of recoverable amount of an individually assessed credit is based on the future cash flows on the credit. The calculation of the future cash flows is based on reliable evidence for determining the amount recoverable.

In respect of large credits that are past due 180 days or more, the estimation of future cash flows is based on reliable business plan, with attributes outlined in the Guideline.

Regarding the calculation of the recoverable value of collateral, the latter should not exceed 50

per cent of the appraised value of the collateral, discounted to its present value using the loan's effective interest rate.

Ultimately, in determining the provisions for credit losses on individually assessed credits, the carrying amount of the loan should net off the present value of expected future cash flows and the discounted net realisable value of the collateral. The result is the amount of provision to be made under individually assessed credits.

Portfolio Assessed Loans

Loans that have not been individually assessed for impairment are assessed on a 'portfolio' basis. 'Portfolio' loans are divided into groups with similar characteristics and loss attributes and evaluated for impairment.

In determining provisions for credit losses for the groups, factors such as past loan loss experience and current economic and other relevant conditions,

including known adverse economic conditions likely to affect sectoral financial performance, should be taken into account. However, the percentage of loan loss provision to aggregate amounts of loans in the entire 'portfolio' should not be less than 1 per cent.

General Provision

The Guideline made provision for the establishment of a general provision. It is designed to cover potential losses that are not captured in the allowances for individually assessed loans and 'portfolio' loans. Factors in support of a general provision are normally future-oriented.

Banks should exercise their best judgement to determine the amount of the general provision.

Non-performing advances, based on combined audited financial statements of former Category 1 banks, rose from Rs6,901 million in 2003/04 to Rs6,921 million in 2004/05, or 0.3 per cent. The ratio of non-performing advances of former Category 1

Table 2.3: Former Category 1 Banks: Charge for Bad and Doubtful Debts and Total Advances¹

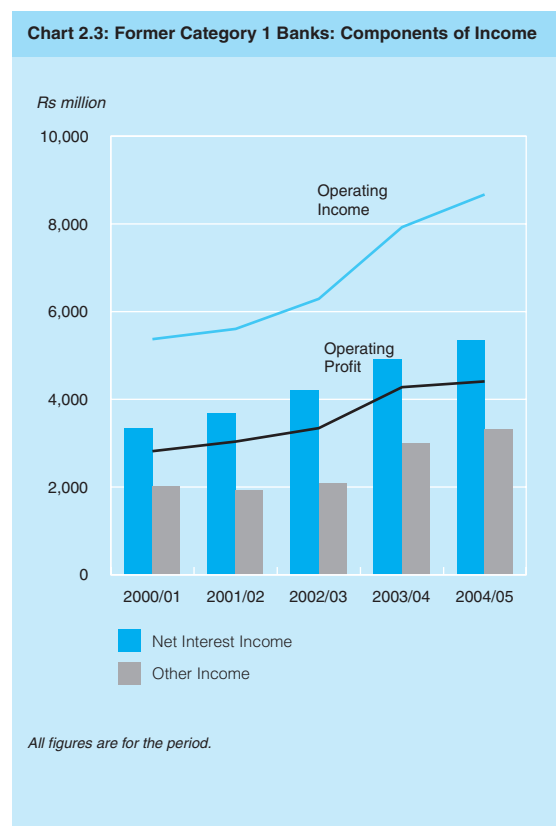
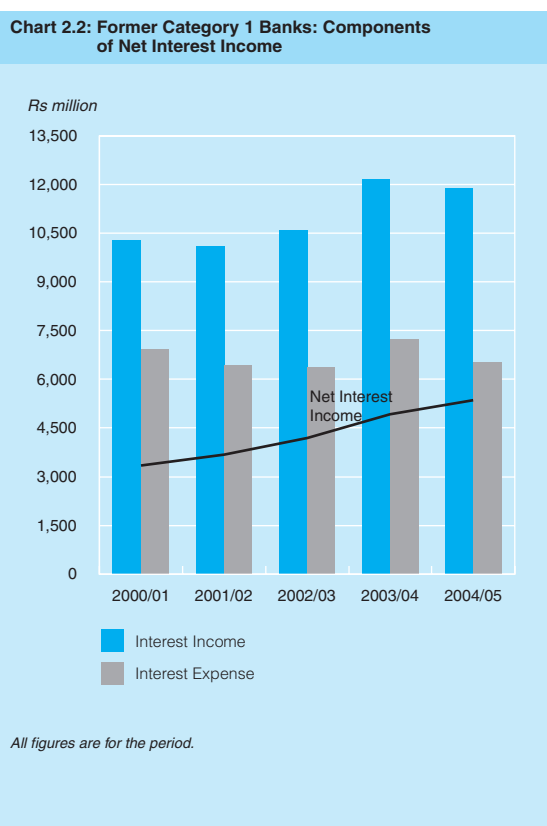
	(Rs million)			
	2001/02	2002/03	2003/04	2004/05
Charge for Bad and Doubtful Debts (for the period)	685	939	805	907
Total Advances of Banks (as at end of period)	74,715	85,629	89,474	97,385
Ratio of Charge for Bad and Doubtful Debts to Total Advances (Per cent, for the period)	0.9	1.1	0.9	0.9

¹ Based on combined audited data for financial years ended 30 June, 31 December and 31 March.

Table 2.4: Former Category 1 Banks: Consolidated Profit Performance¹

	(Rs million)	
	2003/04	2004/05
Interest Income from Advances, Placements and Investments	12,154	11,883
Less Interest Expense on Deposits and Borrowings	7,232	6,529
Net Interest Income	4,922	5,354
Add Non-interest Income	3,006	3,323
	7,928	8,677
Less Staff and Other Operating Expenses	3,653	4,267
Operating Profit before Bad and Doubtful Debts and Taxation	4,275	4,410
Less Charge for Bad and Doubtful Debts	805	907
Exceptional Items	520	129
Operating Profit before Taxation	2,950	3,374
Share of Profits in subsidiaries and associates	163	216
Profit before Tax	3,113	3,590

¹ Based on combined audited data for financial years ended 30 June, 31 December and 31 March.



banks to their total advances dropped from 7.7 per cent in 2003/04 to 7.1 per cent in 2004/05.

Total provisions (inclusive of general provisions) for bad and doubtful debts increased from Rs3,341 million in 2003/04 to Rs4,514 million in 2004/05. As a proportion of total non-performing advances, total provisions for bad and doubtful debts went up from 48.4 per cent in 2003/04 to 65.2 per cent in 2004/05.

The total charge for bad and doubtful debts increased by 12.7 per cent, from Rs805 million in 2003/04 to Rs907 million in 2004/05.

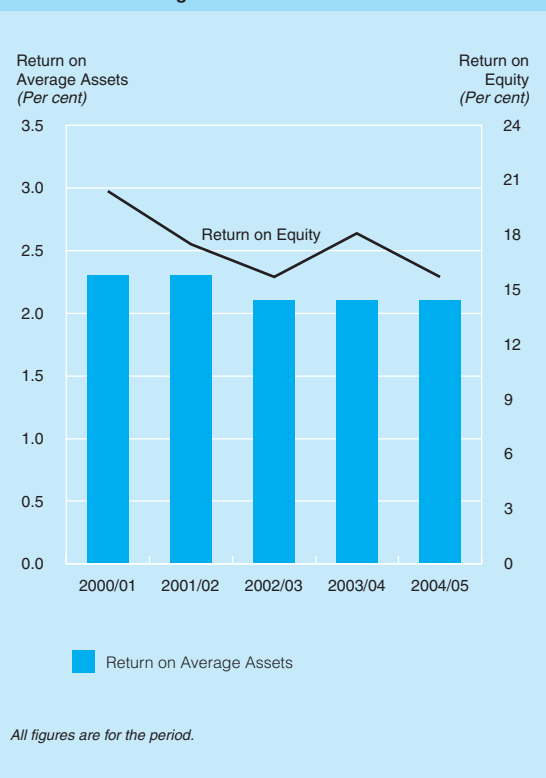
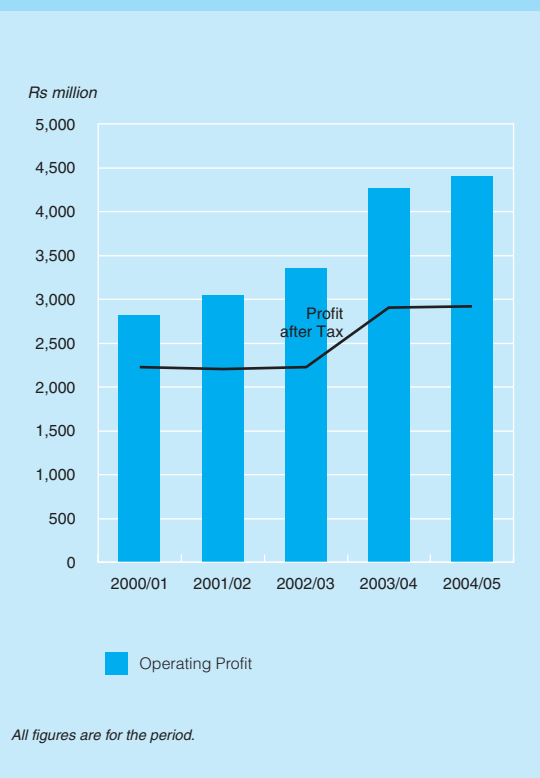
Table 2.3 shows the charge for bad and doubtful debts and total advances of former Category 1 banks for the period 2001/02 through 2004/05.

Profitability

Four former Category 1 banks close their accounts on 30 June, six on 31 December, and one on 31 March. The consolidated position of the profit and loss accounts of the eleven former Category 1 banks are thus based on the combined audited data available at these different financial year-ends and is referred to as 2004/05.

Table 2.5: Former Category 1 Banks: Financial Performance

	(Rs million)	
	2003/04	2004/05
Profit after Charge for Bad and Doubtful Debts but before Tax	3,113	3,590
Profit after Tax	2,904	2,923
Pre-tax Return on Average Assets (Per cent)	2.08	2.13
Pre-tax Return on Equity (Per cent)	19.30	19.29
Post-tax Return on Equity (Per cent)	18.01	15.70

Chart 2.4 : Former Category 1 Banks: Returns on Equity and on Average Assets**Chart 2.5: Former Category 1 Banks: Consolidated Operating Profit and Profit after Tax**

The consolidated profitability of former Category 1 banks for 2004/05 includes that of Banque Des Mascareignes Ltée Ltd (BDM), which was issued a Category 1 Banking Licence in March 2003 and started operation on 14 June 2004. During 2004/05, with the exceptions of two banks, all banks have realised profits.

The aggregate pre-tax profits of former Category 1 banks went up by Rs477 million, or 15.3 per cent, from Rs3,113 million in 2003/04 to Rs3,590 million in 2004/05, mainly due to lower exceptional losses and higher share of income in associated companies. In fact, aggregate pre-tax profits before exceptional items and share of profits in associates experienced an increase of only 1.0 per cent, from Rs3,470 million in 2003/04 to Rs3,503 million in 2004/05.

Net interest margin, that is interest received on advances, placements and investments net of interest paid on deposits and borrowings, increased by Rs432 million, or 8.8 per cent, from Rs4,922 million in 2003/04 to Rs5,354 million in 2004/05. This increase is lower than the 12.3 per cent increase in the aggregate average assets of former Category 1 banks.

With the successive reduction in Lombard rate during 2004-05, both interest income and interest expense experienced a decline. Total interest income, which represented 78.2 per cent of total income, went down by Rs271 million, or 2.2 per cent, to Rs11,883 million in 2004/05. This is reflected in a lower interest per Rs100 of advances, down from Rs9.72 in 2003/04 to Rs8.54 in 2004/05. However, income derived from investments in Treasury/Bank of Mauritius Bills and Government securities experienced an increase of Rs142.9 million, or 3.9 per cent, mainly due to higher investments in these assets.

Total interest expense fell by Rs703 million, or 9.7 per cent, to reach Rs6,529 million in 2004/05. The average cost of deposits fell from Rs6.00 per Rs100 of deposits in 2003/04 to Rs4.70 per Rs100 in 2004/05.

The spread in interest rate between advances and deposits increased marginally from 3.72 per cent in 2003/04 to 3.84 per cent in 2004/05.

Charts 2.2 and 2.3 depict the trends in the components of net interest income and income of former Category 1 banks, respectively, for the

period 2000/01 through 2004/05. Table 2.5 gives the consolidated profit performance of former Category 1 banks in 2003/04 and 2004/05.

Non-interest income, comprising mainly fee-based income, profits from foreign exchange transactions, dividend income and net profit on sale of securities, improved by Rs317 million, or 10.5 per cent, to reach Rs3,323 million in 2004/05. This improvement was mainly due to higher income realised from dealings in foreign currencies and higher income from fees and commissions.

The charge for bad and doubtful debts went up by Rs102 million, or 12.7 per cent, from Rs805 million in 2003/04 to Rs907 million in 2004/05.

The profitability of former Category 1 banks, as measured by the pre-tax return on average total assets, rose from 2.08 per cent in 2003/04 to 2.13 per cent in 2004/05, reflecting higher returns on assets. The pre-tax return on average assets of individual banks ranged between -15.9 per cent and 3.4 per cent in 2004/05. Five former Category 1 banks achieved a pre-tax return on average assets over 2.0 per cent during 2004/05.

Despite the increase in the pre-tax return on average assets, post-tax return on equity of former

Category 1 banks fell from 18.01 per cent in 2003/04 to 15.70 per cent in 2004/05 due to an increase in the tax charge. The amount of tax was higher in 2004/05 compared to 2003/04 because in the latter period the Mauritius Commercial Bank Ltd made a lower tax provision following the NPF fraud. For individual banks, the post-tax return on equity ranged between -47.06 per cent and 24.22 per cent in 2004/05. Two former Category 1 banks achieved a return on equity of over 20 per cent during 2004/05.

Chart 2.4 shows the returns on equity and on average assets for former Category 1 banks for the period 2000/01 through 2004/05. Chart 2.5 depicts the evolution of the consolidated operating profit and the profit after tax of former Category 1 banks for the period 2000/01 through 2004/05.

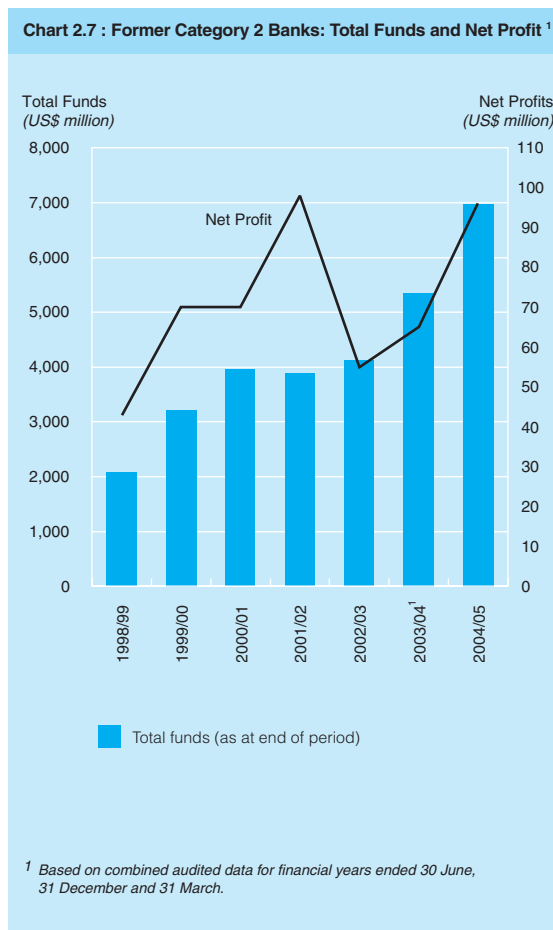
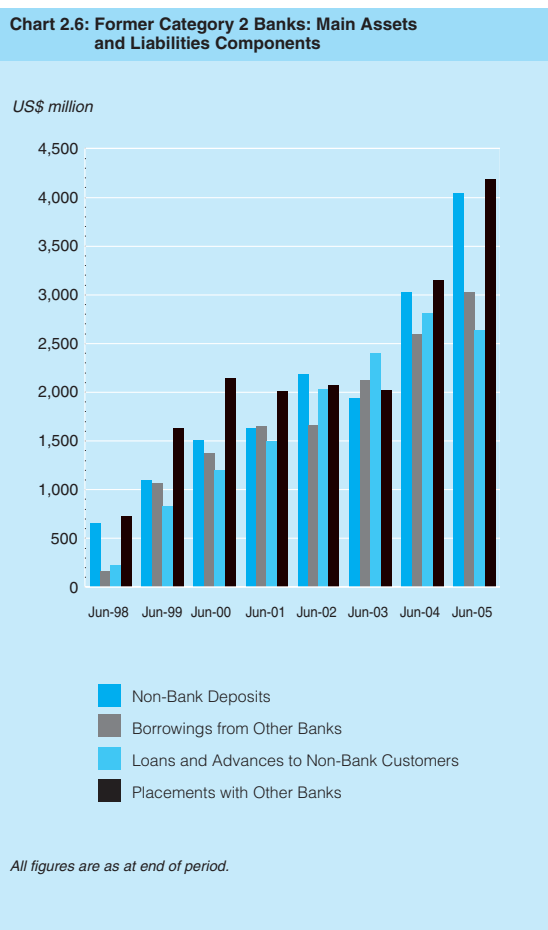
Non-Bank Deposit Taking Institutions

As at 30 June 2005, fourteen non-bank deposit taking institutions were authorised, under section 13A of the Banking Act 1988, to undertake deposit taking business in Mauritius. On 26 April 2004, GML Leasing Ltd of Groupe Mon Loisir was granted authorisation under section 13A of the Banking Act 1988 to carry on deposit taking

Table 2.6: Former Category 2 Banks: Profit Performance ¹

	(US\$ million)	
	2003/04	2004/05
Interest Income	187.7	207.1
Less Interest Expense on Deposits and Borrowings	103.8	113.3
Net Interest Income	83.9	93.8
Add Non-interest Income	2.8	16.9
Operating Income	86.7	110.7
Less Total Operating Costs	15.3	16.3
Staff Expenses	5.3	6.7
Other Expenses	10.0	9.6
Operating Profit	71.4	94.4
Less Charge for Bad and Doubtful Debts	7.1	(2.0)
Net Profit	64.3	96.4
Interest Income as a Percentage of Total Income (Per cent)	98.5	92.5
Cost to Income Ratio (Per cent)	19.2	14.5
Return on Average Assets (Per cent)	1.4	1.4

¹ Based on combined audited data for financial years ended 30 June, 31 December and 31 March.



business, which subsequently changed its name to Capital Leasing Ltd on 29 June 2004. It started its operations on 1 September 2004.

Total assets for the fourteen non-bank deposit taking institutions in operation as at end-June 2005 amounted to Rs25,418 million, of which net owned funds accounted for 14.9 per cent, or Rs3,800 million. Total deposits raised from the public stood at Rs15,911 million, representing 62.6 per cent of their resources. Debenture holdings as at end-June 2005 stood at Rs435 million and long-term loans availed of by these institutions amounted to Rs1,037 million. Advances extended to customers aggregated to Rs11,616 million, while an amount of Rs7,407 million was invested in leased assets, representing 45.7 per cent and 29.1 per cent of total assets, respectively. Total investment in Treasury/Bank of Mauritius Bills and other Government securities amounted to Rs3,012 million as at end-June 2005 and represented 11.9 per cent of total assets.

Global Business Banking Sector

At end-June 2005, twelve banks previously holding a Category 2 Banking Licence were in operation. The African Asian Bank Limited, which ceased its operations on 16 June 2003 surrendered its Banking Licence on 8 October 2004. As mentioned above, the Banking Act 2004 removed the distinction between Category 1 and Category 2 banks by introducing a single banking licence in respect of all banking activities. This section reviews the performance of banks holding a Category 2 banking licence before the coming into force of the Banking Act 2004.

The asset base of former Category 2 banks recorded an increase of 19.2 per cent during 2004-05, compared to a much significant increase of 41.1 per cent in 2003-04. Total assets increased by US\$1,269 million, from US\$6,617 million as at end-June 2004 to US\$ 7,886 million at end-June 2005.

Chart 2.6 shows the main assets and liabilities components of former Category 2 banks'

consolidated balance sheets from end-June 1998 through end-June 2005.

Loans and advances to non-bank customers recorded a slight decrease of 6.3 per cent, from US\$2,817 million as at end-June 2004 to US\$2,640 million as at end-June 2005, representing 33.5 per cent of total assets.

Placements with other banks went up by US\$1,037 million, or 32.9 per cent, from US\$3,151 million as at end-June 2004 to US\$4,188 million at end-June 2005. Investment portfolio increased significantly by US\$476 million, or 125.4 per cent, from US\$379 million at end-June 2004 to US\$855 million at end-June 2005.

As at end-June 2005, former Category 2 banks derived most of their resources from two main sources, namely, deposits of non-bank customers (51.2 per cent) and borrowings from banks (38.4 per cent). Borrowings from banks grew further by US\$427 million, or 16.4 per cent, from US\$2,600 million as at end-June 2004 to US\$3,027 million as at end-June 2005. Similarly, for the same period, deposits increased by US\$1,013 million, or 33.5 per cent from US\$3,025 million as at end-June 2004 to US\$4,038 million as at end-June 2005.

Profitability

Of the twelve former Category 2 banks, eight close their accounts on 31 December, three on 31 March and the remaining one on 30 June. The consolidated position of the profit and loss accounts of the twelve former Category 2 banks, based on the combined data available at these financial year-ends, is referred to as 2004/05. For 2004/05, all former Category 2 banks reported net profit figures for the period.

Table 2.6 gives the consolidated profit performance of former Category 2 banks for 2003/04 and 2004/05. Chart 2.7 shows the evolution of pre-tax profit of former Category 2 banks in relation to their total funds from 1998/99 through 2004/05.

Aggregate net pre-tax profit of former Category 2 banks improved from US\$64.3 million in 2003/04 to US\$96.4 million in 2004/05. This increase was mainly due to higher interest income earned in 2004/05 as compared to the previous period, which is largely attributable to interest on placements with and loans to banks (34.0 per cent) and other interest income (195.5 per cent).

Interest income went up by US\$19.4 million, or 10.3 per cent, from US\$187.7 million in 2003/04 to US\$207.1 million in 2004/05, compared to an increase of US\$17.8 million, or 10.5 per cent in 2003/04.

Interest earned on placements with banks rose from US\$52.6 million in 2003/04 to US\$70.5 million in 2004/05, and accounted for 31.5 per cent of total income in 2004/05. Interest earned from loans and advances to non-bank customers fell from US\$121.4 million in 2003/04 to US\$116.8 million in 2004/05, representing 52.1 per cent of total income. Interest on investments and other interest earning assets increased from US\$13.7 million in 2003/04 to US\$19.8 million in 2004/05.

Non-interest income, including profit on translation of foreign currencies and fees and commissions, recorded a significant increase, from US\$2.8 million in 2003/04 to US\$16.9 million in 2004/05. Non-interest income accounted for 7.5 per cent of total income in 2004/05, compared to 1.5 per cent in 2003/04.

Total interest expenses rose by US\$9.5 million, or 9.2 per cent, from US\$103.8 million in 2003/04 to US\$113.3 million in 2004/05. Interest paid on borrowings from banks fell by US\$6.4 million, or 8.8 per cent, from US\$72.6 million in 2003/04 to US\$66.2 million in 2004/05. Interest paid on deposits of non-bank customers increased significantly by US\$12.5 million, or 43.2 per cent, from US\$28.9 million in 2003/04 to US\$41.4 million in 2004/05.

Staff and other operating expenses increased marginally by US\$1.0 million, or 6.5 per cent, from US\$15.3 million in 2003/04 to US\$16.3 million in 2004/05, compared to an increase of US\$4.8 million in 2003/04.

The overall pre-tax return on average assets remained stable at 1.4 per cent in 2004/05. For individual banks, the overall pre-tax return ranged from 0.74 per cent to 2.59 per cent in 2004/05.

