STATEMENT FROM THE GOVERNOR

With a deep sense of satisfaction I acknowledge the general appreciation received for the first issue of the Annual Report on Banking Supervision in December 2000. I fervently hope the second issue of the Annual Report will provide an insight into the supervisory and regulatory activities of the Bank of Mauritius.

Our banking system is facing many daunting challenges. The number of banks and non-bank deposit-taking institutions is growing steadily. Banks are increasingly engaging in the provision of technological products. The provision of non-traditional products is likely to give additional impetus to the formation of conglomerates and hence the need for consolidated supervision. More and more cross-border banking is gathering momentum. The Basel 2 Accord which is expected to be implemented by the Basel Committee on Banking Supervision (BCBS) as from 2005, will no doubt have far-reaching implications for banks. To cap it all, international standards and norms are converging towards increased transparency and public disclosure with the view to enhancing market discipline.

With the enactment of the Financial Services Development Act 2001 and Government's avowed policy to rationalise and reinforce supervision of financial institutions in Mauritius, the Bank of Mauritius and the Financial Services Commission will need to develop the legislative framework for the financial institutions engaged in specialised activities. That framework will provide the basis for comprehensive and consistent supervisory processes.

Against the background of emerging supervisory challenges, the supervisory capacity of the Bank of Mauritius has been and is continuing to be strengthened. The Supervision Department has made significant strides in upgrading its capabilities with the invaluable technical assistance from the International Monetary Fund. A new comprehensive infrastructure for conducting on-site and off-site surveillance has been laid down. A supervision manual, as well as guides and modules for the staff have been put in place. Six new guidelines have been produced and issued to banks, in keeping with international norms and principles of banking supervision.

Corporate governance has recently been receiving much attention. The objectives of corporate governance are met through mechanisms for achieving accountability between Board of Directors, management, shareholders and auditors (external and internal). The Japanese banking crisis is illustrative of the implications of the lack of corporate governance. Weak corporate governance is generally present where few shareholders own the majority of total shares. Such an ownership structure produces a weak corporate governance system in which shareholders have only a little say over the management of the bank. Internal auditors play a crucial role in good corporate governance. Hence, the profile of internal auditors needs to be enhanced so that they may play their whistle-blowing role fearlessly. Weak internal audit cannot thwart management from acting irresponsibly. Corporate governance provides the checks and balances which enable the early detection and prevention of frauds. In recognition of the importance of this subject, the Bank issued to all the banks in Mauritius, a Guideline on Corporate Governance which came into effect on 1 June 2001.

Empirical evidence shows that poor corporate governance provides breeding grounds for obnoxious related party transactions which invariably lead to non-performing loans with its dire consequences. There has been growing concern over related-party transactions. In order to address this issue, the Bank issued a Guideline on Related Party Transactions on 30 November 2001. The Guideline, which comes into effect on 4 January 2002, prescribes limits on transactions with related parties and also requires all related party transactions to be reported to the Bank. Moreover, related party transactions need to be carried out on market terms and conditions.

The new Capital Accord which is expected to replace the existing one in the year 2005 will require banks to carry out a major overhaul of their risk management processes. The revised Accord imposes new burdens on bank supervisors who will be entrusted with the responsibility of reviewing the capital adequacy of banks. It also emphasises the importance of transparency in banks in order to enable the market to make informed judgements. In this connexion, the Supervision Department is currently engaged in the development of a Guideline on Disclosure by banks.

The Bank has committed itself to a capacity building programme for the supervisory staff. It is of paramount importance for staff to keep abreast of the latest trends in supervision. In this respect, the staff has been regularly sent on well-structured training programmes offered by the Basel Committee on Banking Supervision.

Finally, let me express my sincere appreciation for the sense of commitment and dedication with which the Supervision Department has discharged its responsibilities during the year.

Rameswurlall Basant Roi

1. OVERVIEW

The recent enactment of the Financial Services Development Act 2001 (FSD Act 2001) is designed to bring about a major uplift in the regulatory and supervisory regime of the financial services sector under the aegis of the Financial Services Commission. One of the objects of the Act is to foster an integrated regulatory and supervisory regime with the specific view to promoting the development of a non-fragmented, efficient and competitive financial services sector. In this regard, the FSD Act 2001 provides that the Bank of Mauritius may make available to the FSC infrastructure, know-how and other facilities of the Bank in order to enable the Commission to achieve its objectives. This is in recognition of the fact that the Bank of Mauritius has, over the years, adopted measures to reinforce its supervisory framework. These measures include the development of expertise in supervisory and regulatory activities with a dedicated team of supervisors and the establishment of regular contacts with regional and international supervisory bodies. The time-frame for the completion of the process of an integration and of cohesive approach to regulating and supervising the financial services sector is set at around the next three years. Thereafter, the Bank of Mauritius would become the sole institution mandated to supervise this entire sector.

Against this backdrop of integration, the Bank of Mauritius continues to license, regulate and supervise banks based in Mauritius as well as non-bank deposit-taking institutions. It also regulates and supervises money-changers and foreign exchange dealers authorised by the Minister of Finance, under the Foreign Exchange Dealers Act 1995. The policy stance of the Bank remains the promotion of a sound regulatory environment which does not act as an obstacle to the process of expansion and modernisation of the banking sector, while at the same time fostering the application of internationally recognised prudential norms in order to keep under control risks associated with the business of the institutions falling under the Bank's purview.

The banking sector of Mauritius remained buoyant during the year ended 30 June 2001. Banks maintained their high profit trend and increased their turnover.

As a member of regional and international fora, the Bank continued to participate actively in initiatives aimed at developing and implementing strong supervisory practices. Furthermore, the Bank has signed "Memorandum of Understanding" with the Commission Bancaire of France and Jersey Financial Services Commission as a basis for exchange of information between the authorities.

1.1 DOMESTIC BANKING

Ten domestic banks and twelve offshore banks licensed under section 3 of the Banking Act 1988 are currently in operation.

As at end-June 2001, domestic banks were operating 149 branches and 15 counters, 234 ATMs and 6 internet sites. Banks offer a wide array of services to personal customers, small business enterprises and corporate customers. Major advances in technology have been adapted by certain banks which have invested heavily in state-of-the-art technology to manage efficiently the volume of demand and meet the changing needs of customers. Most of the banks operating in the domestic banking sector offer sophisticated services, including plastic money, phone banking and Internet banking.

In this context, during the year ended 30 June 2001, over 1.6 million transactions aggregating Rs 2.4 billion were carried out through the use of credit cards, debit cards and other similar instruments, up from 1.4 million transactions in the previous year.

1.2 OFFSHORE BANKING

As at end-June 2001, Mauritius hosted eleven offshore banks of which five were branches of international banks, five others were locally incorporated and the remaining one was a joint venture between an international bank and a local bank. Standard Bank (Mauritius) Offshore Banking Unit Limited was licensed on 16 November 2001, bringing the total number of offshore banks operating in the financial sector of Mauritius to twelve.

Other than customary banking activities, offshore banks provide fund management, international investment, financial advisory, custodial and trusteeship services to a network of international customers.

Since the coming into operation of the first offshore bank in the 1990s, the assets of these banks have recorded an annual average growth rate of 36 per cent. The rapid expansion of activities in this segment of the market has been made supported by the various double tax avoidance treaties entered into by the Government of Mauritius with different countries.

1.3 NON-BANK DEPOSIT-TAKING FINANCIAL INSTITUTIONS

During the year ended 30 June 2001, two additional non-bank financial institutions were authorised under section 13A of the Banking Act 1988 to transact deposit-taking business, bringing the total number of such institutions to ten. The number of non-bank deposit-taking institutions grew by a further two by the end of December 2001.

As at end-June 2001, the total assets of the non-bank deposit-taking financial institutions stood at Rs 7,461 million as against Rs 5,403 million in the previous year. Total deposits mobilised from the public by the ten institutions amounted to Rs 1,802 million as at end-June 2001, up from Rs 739 million as at end-June 2000 and represented 24.1 per cent of the institutions' total resources. The rate of growth of deposits, to a good extent, is mainly attributable to the coming into operation of the two additional non-bank financial institutions. Loans and advances extended to customers by non-bank deposit-taking institutions went up from Rs 1,392 million as at end-June 2000 to Rs 1,843 million as at end-June 2001. A total amount of Rs 4,108 million was invested in leased assets in 2000-01 as compared to Rs 3,062 million in 1999-00.

A list of non-bank financial institutions authorised to transact deposit-taking business is shown in Appendix 2.

1.4 MONEY-CHANGERS AND FOREIGN EXCHANGE DEALERS

The Bank regulates and supervises non-bank institutions engaged in the money-changing and foreign exchange dealing business. The activities of these operators being particularly prone to the money laundering threat, are closely monitored by the Bank with, inter alia, returns giving details on cash transactions exceeding a threshold of USD 500 being submitted to the Bank on a weekly basis.

As at 30 June 2001, two money-changers ceased to operate and surrendered their authorisations to the Bank. One additional money-changer ceased operation on 10 October 2001. No new operators were authorised to carry on the business of money-changer or foreign exchange dealer.

Two money-changers and two foreign exchange dealers have realized profits during their last financial years.

1.5 INTERNET BANKING

Mauritian banks have joined the league of banks making use of the Internet in the provision of banking services. The Internet was widely used by banks locally during the current year.

The risks posed by Internet banking are, generally, new to both the banks and their supervisors, while being very often quite imperceptible. Accordingly, supervisors have to ascertain that all risks associated with Internet banking are well identified, assessed and managed by the banks' managements before they engage in such activities.

Also, given the cross border implications of Internet banking which virtually eliminates all geographic boundaries, it is essential that there are clear supervisory rules specifying, inter alia, which country supervisors have control over the Internet banking activities as well as the elaboration of applicable legal regime.

The Electronic Banking Group of Basel Committee on Banking Supervision has developed risk management guidance for Internet banking activities.

To keep pace with development in this line of business, the Bank issued a guideline on Internet banking in February 2001 to all banks. The guideline sets out a regulatory framework for providing Internet banking services in Mauritius and establishes the minimum standards that should be observed by banks providing Internet banking services. It further prescribes the requirements and processes to be adopted for obtaining approval of the Bank by financial institutions proposing to provide Internet banking services.

Overall, the guideline is intended to assist banks to cope in a prudent manner with their Internet banking activities.

1.6 CORPORATE GOVERNANCE

The prominence of the role played by banks in the financial sector, is such that their on-going strength, stability and soundness is a matter of public interest. Also, by the very nature of their activities, banks are highly leveraged institutions, with most of their funds being tapped from depositors and creditors. Further, during the past years, the globalisation of financial markets and emergence of conglomerates which have shed the barriers between banking and other financial activities, technological advances as well as the development of new financial products have underscored the need for adequate risk management processes at banks.

A crucial element of risk management is strong corporate governance; corporate governance is the process and structure used to direct and manage the business and affairs of an institution in order to ensure its safety and soundness. It incorporates the framework which sets out the scope of the board of directors and the mandate of senior management, with the view to enhancing shareholder value while protecting the interests of depositors and other stakeholders such as creditors and employees.

The Bank issued a guideline on corporate governance to all banks and non-bank deposit-taking institutions in April 2001. The guideline came into effect on 1 June 2001. It requires banks, inter alia, to include a statement of corporate governance practices in their annual reports.

The guideline describes the essential elements that are required for a good corporate governance system. It covers the areas relating to the establishment of risk management policies, their effective implementation, integrity of internal control and management information systems and their accountability structure.

1.7 MEETING WITH BANKS

The Bank has set up a Banking Committee chaired by the Governor and comprising Chief Executive Officers of all banks. The Banking Committee meets on a quarterly basis.

A particular decision of the Banking Committee is the holding by the Bank of regular meetings with Compliance Officers of the banks with a view to beefing up their Anti-Money Laundering practices.

In this regard, banks have been requested to submit a copy of their Anti-Money Laundering Deterrence policy to the Bank and to provide training to their relevant staff at all levels, in order to make them aware of their responsibilities in the combat against money laundering.

1.8 GENERAL

Technological advance bringing in its wake rapid innovations in the financial services sector, the globalisation of the financial world and the ever-blurring frontiers of banking and non-banking financial activities through the emergence of conglomerates pose strong challenges to bank supervisors. In this context, regulation and supervision of the banking sector have to be redirected, taking into account emerging new risks. Furthermore, supervisors are called upon in this context to acquire wide ranging knowledge on technically complex products. To avoid any diversion from the core issue, that is the ongoing maintenance of a safe and sound environment, the high risk areas are identified as an ongoing process and appropriate processes put in place to minimise and control the ensuing risks. Also, in the fast expanding sector in terms of activities and the virtual elimination of geographical frontiers, exchange of information on a real time basis between supervisors the world over is crucial if the sector is to remain sound and stable. In this regard, the move for a non-fragmented and integrated approach to the regulation and supervision of the financial services sector in Mauritius by the adoption of the FSD Act 2001, will prove to be a new milestone towards the advancement of Mauritius' image as a soundly regulated financial market.

2. A REVIEW OF THE PERFORMANCE OF BANKS-

2.1 INTRODUCTION

The banking sector comprises ten domestic banks and twelve offshore banks. Five domestic banks are locally incorporated. Of these, two are foreign owned. The remaining five domestic banks operate as branches of foreign banks. Two domestic banks holding about 70 per cent of all banking assets dominate the local banking landscape.

The twelve offshore banks are branches or subsidiaries of international banks or joint ventures between domestic and foreign banks. A list of domestic and offshore banks is shown in Appendix 2.

2.2 DOMESTIC BANKS

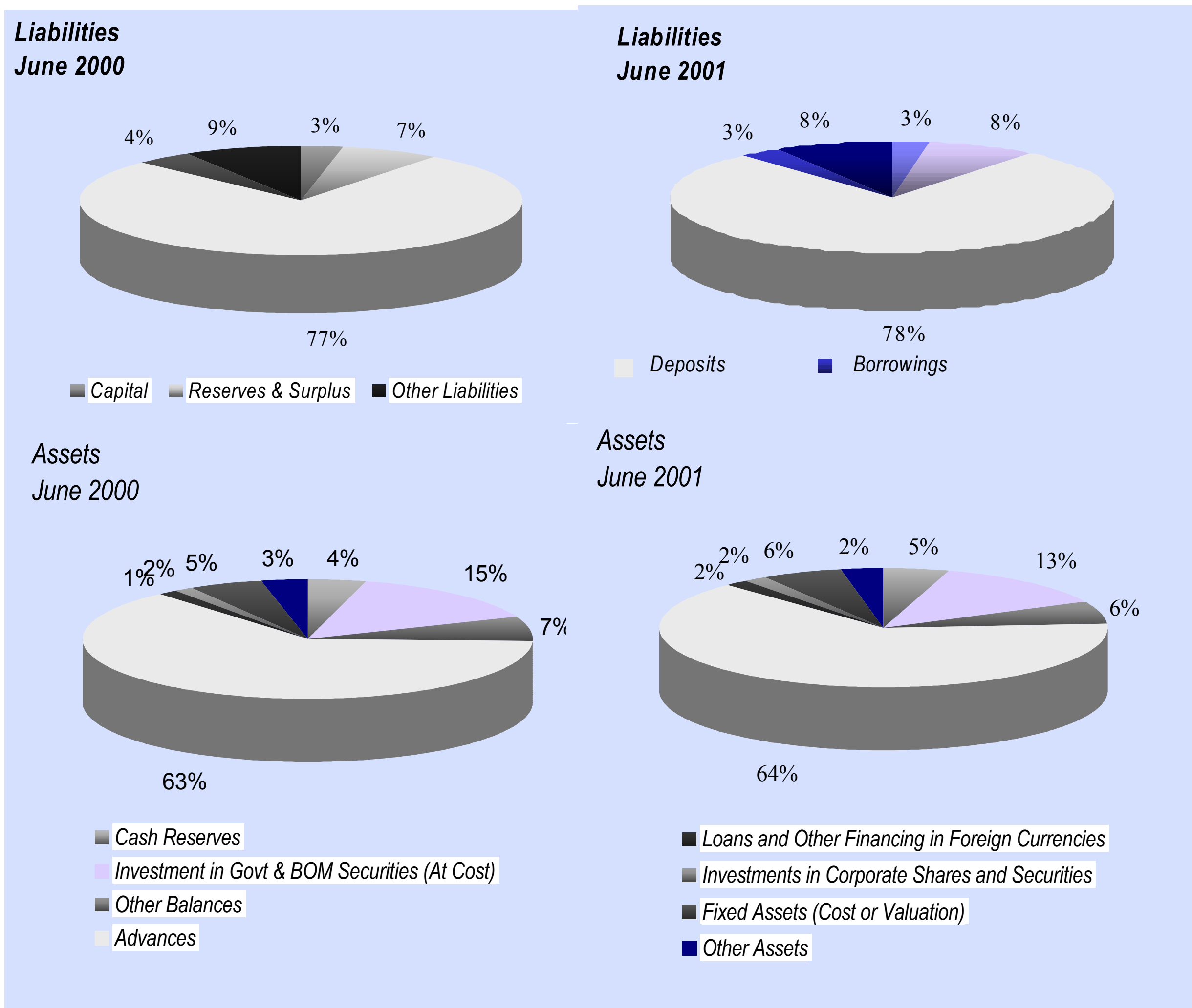
During the year ended 30 June 2001, domestic banks recorded a growth rate of 7.5 per cent in their total on-balance sheet assets, which rose from Rs110,014 million as at end-June 2000 to Rs118,264 million as at end-June 2001. A growth rate of 13.2 per cent was registered in the preceding year. The growth in the assets of individual banks ranged between -13.5 per cent and 35.0 per cent.

Foreign currency operations of commercial banks did not record significant change from the previous year's level. The share of foreign currency assets in total assets remained steady at around 15.3 per cent.

Off- balance sheet assets of commercial banks amounted to Rs14,825 million as at end-June 2001, up by Rs26 million or 0.2 per cent over the preceding year.

Chart 1 depicts the year-on-year comparison of assets and liabilities of domestic banks. The bulk of

CHART 1 : BALANCE SHEET STRUCTURE



the assets of domestic banks consisted of advances (63.9 per cent) and investment in Treasury Bills and Government securities (13.2 per cent).

A detailed review of the performance of banks over the past two years with respect to capital adequacy, asset quality, liquidity and profitability is given below.

2.2.1 CAPITAL ADEQUACY

The capital of a bank represents the buffer available to protect depositors against losses that may occur due to absence of prudent risk management. The adequacy of banks' capital is measured in relation to the risk composition of their assets, both on- and off-balance sheet.

Over the period June 2000 to June 2001, all banks operated with a risk weighted capital adequacy ratio in excess of the 10 per cent minimum. On average, the domestic banking sector maintained a risk weighted capital adequacy ratio ranging from 12.2 per cent to 13.1 per cent.

Tier 1 capital consisting primarily of paid up/assigned capital, share premium, retained earnings and other reserves, or what is usually referred to as 'permanent' or 'core' capital, went up from Rs9,291 million as at end-June 2000 to Rs10,611 million as at end-June 2001, representing an increase of 14.2 per cent.

Tier 2 capital is less permanent by nature and comprises bonus shares, general provision, subordinated debts and revaluation reserves. It recorded a growth rate of 13.8 per cent, rising from Rs1,817 million to Rs2,068 million during the same period. As at end-June 2001, Tier 2 capital represented about 19.5 per cent of Tier 1 capital, as against 19.6 per cent as at end-June 2000.

The aggregate risk weighted assets of banks went up by 9.1 per cent from Rs75,264 million to Rs82,083 million during the period June 2000 to June 2001.

Table 1 shows the comparative movement in the riskiness of banks' on-balance sheet assets as between the two years.

There has been a slight shift in the risk asset portfolio of banks. On-balance sheet assets, weighted at zero per cent, 20 per cent and 50 per cent expressed as a percentage to total assets went down from 24.2 per cent, 10.2 per cent and 5.9 per cent in June 2000 to 23.6 per cent, 8.8 per cent and 5.7 per cent in June 2001, respectively. On the other hand, assets weighted at 100 per cent went up from 59.7 per cent to 61.9 per cent during the same period.

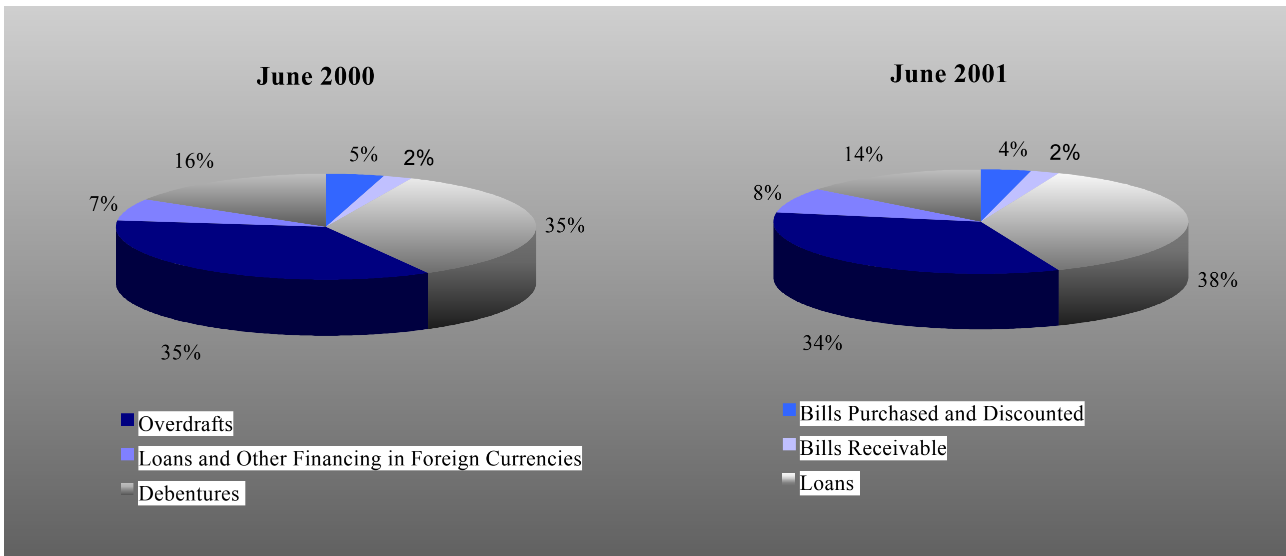
2.2.2 ASSET QUALITY

Asset quality is the single most important determinant of banks' risk exposure. The asset quality of a bank is affected by various factors such as over concentration, either by sectors or clients, insider lending, geographic or economic factors.

TABLE 1: COMPOSITION OF RISK WEIGHTED ON-BALANCE SHEET ASSETS

Risk Weight *(Per cent)*	**On-balance sheet assets June 2000** *(Rs million)*	**Percentage to total on-balance sheet assets**	**On-balance sheet assets June 2001** *(Rs million)*	**Percentage to total on-balance sheet assets**
0	25,645	24.2	26,804	23.6
20	10,758	10.2	9,998	8.8
50	6,232	5.9	6,490	5.7
100	63,212	59.7	70,211	61.9
	105,847	100.0	113,503	100.0

CHART 2 : COMPOSITION OF ADVANCES



2.2.2.1 ADVANCES

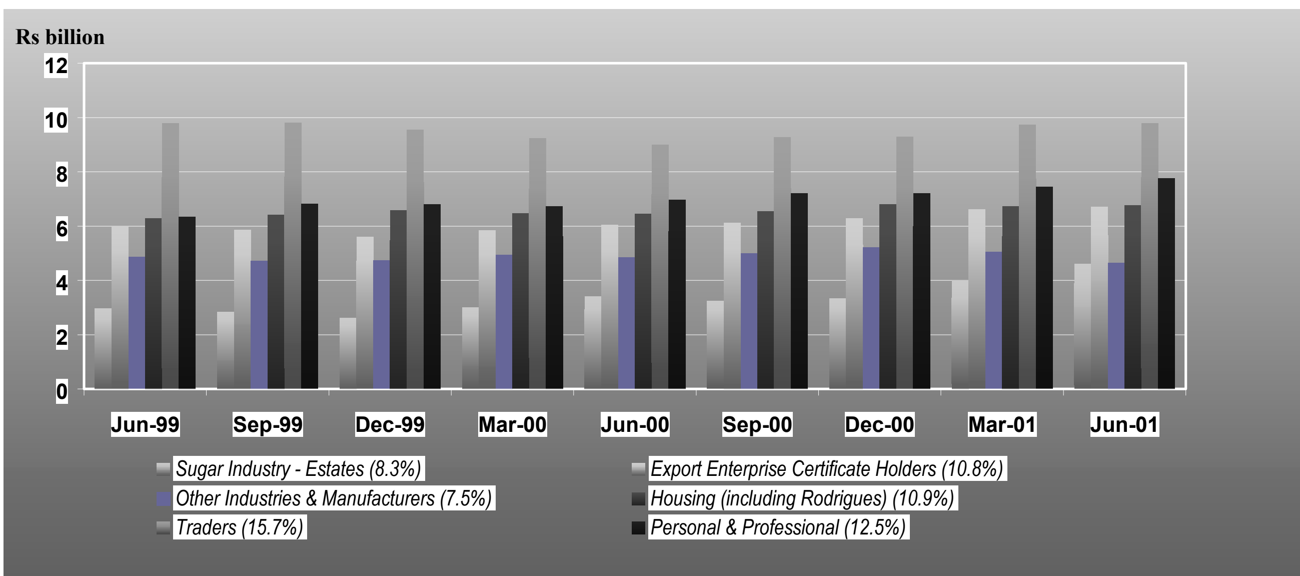
Advances represent a substantial portion of commercial banks' total assets and generate more than 80 per cent of their total income.

During the past three years, advances (inclusive of debentures) represented more than 60 per cent of banks' total assets. As at end-June 2001, advances extended by domestic banks amounted to Rs75,615 million, an increase of Rs6,388 million or 9.2 per cent from Rs69,227 million as at end-June 2000.

Chart 2 depicts the composition of advances as at end-June 2000 and 2001. As at end-June 2001, loans accounted for 38 per cent of total advances, with overdrafts and lending and other financing in foreign currency in Mauritius representing 34 per cent and 8 per cent, respectively, as a proportion of total advances. The corresponding figures as at end-June 2000 were 35 per cent, 35 per cent and 7 per cent, respectively.

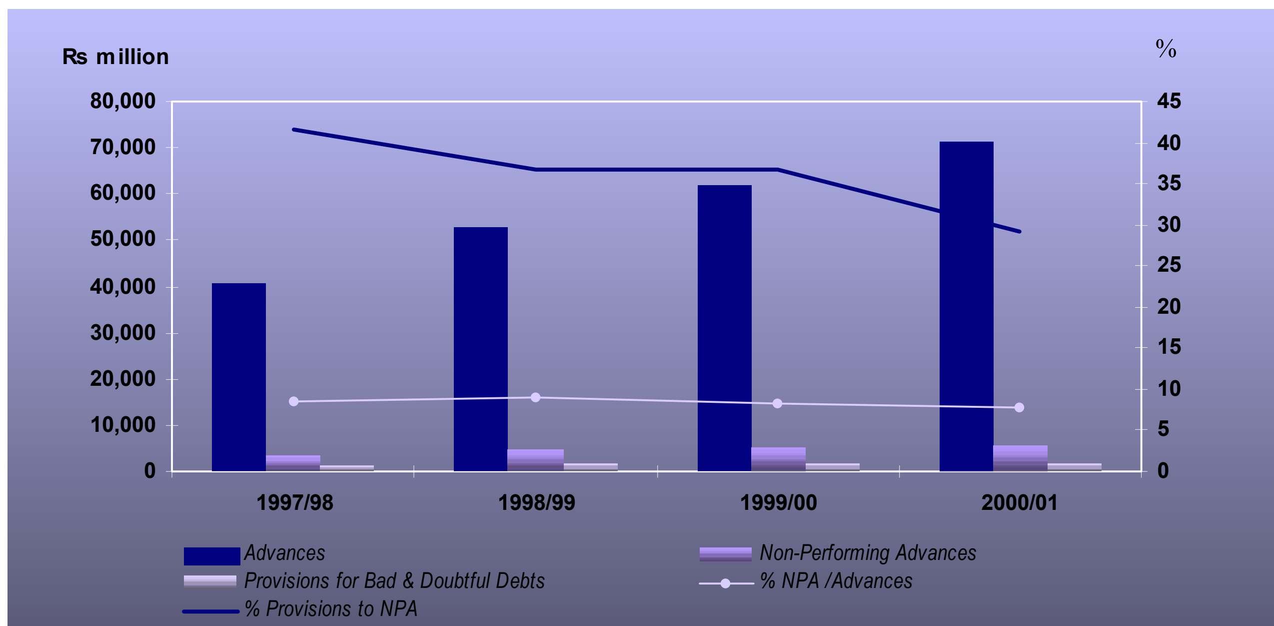
Investments in debentures stood at Rs10,868 million in June 2001, a drop of Rs438 million from Rs11,306 million as at end-June 2000. The decrease is largely attributable to redemptions of debentures by the 'Sugar Industry', 'Statutory & Parastatal bodies' and 'Financial Institutions' sectors.

CHART 3 : SECTORWISE DISTRIBUTION OF CREDIT TO PRIVATE SECTOR



Percentages in brackets are percentages of total credit to private sector as at 30 June 2001

CHART 4 : DOMESTIC BANKS : TOTAL ADVANCES, NON-PERFORMING ADVANCES AND PROVISIONS FOR BAD AND DOUBTFUL DEBTS



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are as at end of period.

CONCENTRATION OF RISKS

Each bank should have an adequate policy relating to credit concentration which should set out prudential limits for granting of credit to a single entity and its related parties, including industry sectors. In this regard, the Central Bank issued a new Guideline on Credit Concentration Limits in March 2000, replacing the previous one issued in 1992, which requires banks to establish written policy on concentration of risk. The guideline also sets out regulatory limits to be observed by banks with regard to both individual large exposures and the level of aggregate exposures.

The total credit facilities (fund-based and non-fund based) which exceeded the threshold of 15 per cent of the individual banks' capital base, amounted to Rs30,815 million as at 30 June 2001 and represented 34 per cent of the overall on- and off-balance sheet commitments of banks. As a percentage of banks' capital base, the ratio stood at 243 per cent. The corresponding ratios in June 2000 were 36 per cent and 268 per cent, respectively.

The sectorwise distribution of credit to selected sectors indicates some amount of dependence of the banking system on a few sectors. As shown in Chart 3, the 'Trade' sector accounted for the highest share of 15.7 per cent of total credit to the private sector as at end-June 2001, compared with 16.4 per cent for the preceding year. Credit granted to 'Personal and Professional', 'Housing' and 'EPZ' stood at 12.5 cent and 10.8 per cent per cent, 10.9 per cent and 10.8 per cent, respectively. These figures highlight the concentration of domestic banks' business in these four sectors, and therefore the need to monitor the exposures to these sectors more closely as a risk mitigation factor.

TABLE 2: DOMESTIC BANKS : TOTAL PROVISIONS FOR BAD AND DOUBTFUL DEBTS AND TOTAL ADVANCES

			(Rs million) *End of June**		
	1997	***1998***	***1999***	***2000***	***2001***
Total Provisions for Bad and Doubtful Debts	1,130	1,624	1,834	1,779	1,663
Total Advances	38,989	50,650	60,790	69,228	75,615
Ratio of Total provisions to Total Advances	2.9	3.2	3.0	2.6	2.2

**Based on monthly assets and liabilities*

NON-PERFORMING ADVANCES

Non-performing advances of domestic banks increased from Rs5,172 million in 1999/00 to Rs5,570 million in 2000/01. Expressed as a percentage of total advances, the ratio, however, dropped from 8.4 per cent to 7.8 per cent. This reflects that, to a certain extent, the risk management strategy adopted by some banks to improve the quality of their assets has been effective banks to improve the quality of their assets has been effective.

Table 2 shows the total provisions for bad and doubtful debts and total advances of domestic banks as at end-June 1997 to 2001.

Provisions for bad and doubtful debts, including a general provision of 1 per cent on standard advances (net of advances collateralised by cash deposits) and specific provisions on impaired advances, dropped from Rs1,779 million as at end-June 2000 to Rs1,663 million as at end-June 2001. As a proportion of banks' total advances, provisions declined from 2.6 per cent to 2.2 per cent.

In this context, it may be noted that in 1999, the Bank of Mauritius revised its existing Guideline on Credit Classification for Provisioning Purposes and Income Recognition to make the classification and provisioning of impaired advances more stringent.

Chart 4 reflects the evolutions of non-performing advances with respect to total advances and provisions for bad and doubtful debts with respect to non-performing advances from 1997/98 through 2000/01.

2.2.2.2 INVESTMENTS

Investments in Treasury Bills and Government securities, which are rated as high-quality assets, represent the second largest asset of banks. The portfolio of banks' holdings of Treasury Bills and Government securities accounted for 13.2 per cent of their total assets as at end-June 2001 compared to 14.7 per cent as at end-June 2000, as a result of a decrease in such investments from Rs16,127 million to Rs15,566 million during that period.

Banks' investments in equity and quasi-equity of other companies, which are among the least liquid assets of banks, amounted to Rs1,895 million as at end-June 2001, an increase of Rs90 million from the previous year.

2.2.3 LIQUIDITY

Liquid assets are those assets which can be realised at short notice without significant loss. Banks have to ensure that at all times they have sufficient liquid assets to accommodate expected and unexpected fluctuations in their balance sheet.

As from July 1999, commercial banks in Mauritius are only required to maintain a minimum weekly average cash reserve equivalent to 5.5 per cent of their total deposit liabilities which include both rupee deposits and foreign currency deposits. Cash reserve consists of cash in hand and balances with Bank of Mauritius.

2.2.3.1 CASH RATIO

The monthly average cash ratio maintained by commercial banks in 2000/01 ranged from 5.6 per cent to 6.1 per cent as compared to a monthly average cash ratio varying between 5.7 per cent and 6.4 per cent in 1999/00.

2.2.3.2 NON-CASH LIQUID ASSETS RATIO

There is no mandatory requirement for non-cash liquid assets but banks are encouraged to establish their own thresholds for controlling liquidity as part of prudential management.

Investment in Treasury Bills and Government securities are the most easily convertible non-cash liquid assets which banks can dispose of at any time. Such investments expressed as a percentage of total deposits have maintained a declining trend over the past years. The ratio fell from 19.1 per cent in June 2000 to 16.9 per cent in June 2001, indicating a lesser investment in near liquid assets by some banks.

2.2.3.3 ADVANCES/DEPOSITS RATIO

Advances to deposits ratio describes the extent to which banks have funded their loan activities out of deposits and is an important indicator of the liquidity management by banks, considering that loans are the least liquid assets of banks. The advances/deposits ratio has been on an upward trend over the last three years, rising from 80.2 per cent in June 1999 to 81.9 per cent in June 2000 and further up to 82.2 per cent in June 2001 and is mirrored in the declining trend of non-cash liquid asset holdings.

TABLE 3: DEPOSIT STRUCTURE

	(Rs million) End of June 1999	2000	2001
Demand	5,284 *(7.0)*	5,902 *(7.0)*	6,593 *(7.2)*
Savings	31,650 *(41.7)*	35,428 *(41.9)*	38,881 *(42.2)*
Time	28,616 *(37.7)*	32,090 *(38.0)*	34,054 *(37.0)*
Foreign Currency	8,984 *(11.9)*	10,310 *(12.2)*	11,748 *(12.8)*
Government	1,286 *(1.7)*	775 *(0.9)*	720 *(0.8)*
	75,820 *(100.0)*	84,505 *(100.0)*	91,996 *(100.0)*

Figures in brackets are percentage to total.

2.2.3.4 DEPOSITS

Deposits constitute the largest proportion of banks' total liabilities and represent the primary source of funding. The structure and stability of deposit base are of prime importance as abrupt withdrawal of funds can put banks into severe liquidity problems.

Deposits accounted for 77.8 per cent of total funding of banks as at end-June 2001, slightly up from 76.8 per cent as at end-June 2000. During the year ended 30 June 2001, deposits grew by 8.9 per cent, rising from Rs84,505 million to Rs91,996 million. Foreign currency deposits accounted for Rs1,438 million of the total increase of Rs7,491 million.

The growth rate in deposits of the domestic banks in 2001 was lower than the 11.5 per cent and 13.7 per cent recorded in 2000 and 1999, respectively.

As may be seen from Table 3, the rupee deposit mix has retained more or less the same profile over the past three years with savings and time deposits as the major components and representing about 79 per cent of total deposits. Foreign currency deposits have been growing steadily during that period and represented 12.8 per cent of the deposit base as at end-June 2001.

Chart 5 reflects the year-on-year comparison of the composition of deposits.

CONCENTRATION OF DEPOSITS

Large deposits concentrated among few accounts constitute an inherent risk to banks as they tend to be more volatile than small accounts. Sudden withdrawal from large accounts can erode banks' deposit base.

CHART 5 : COMPOSITION OF DEPOSITS

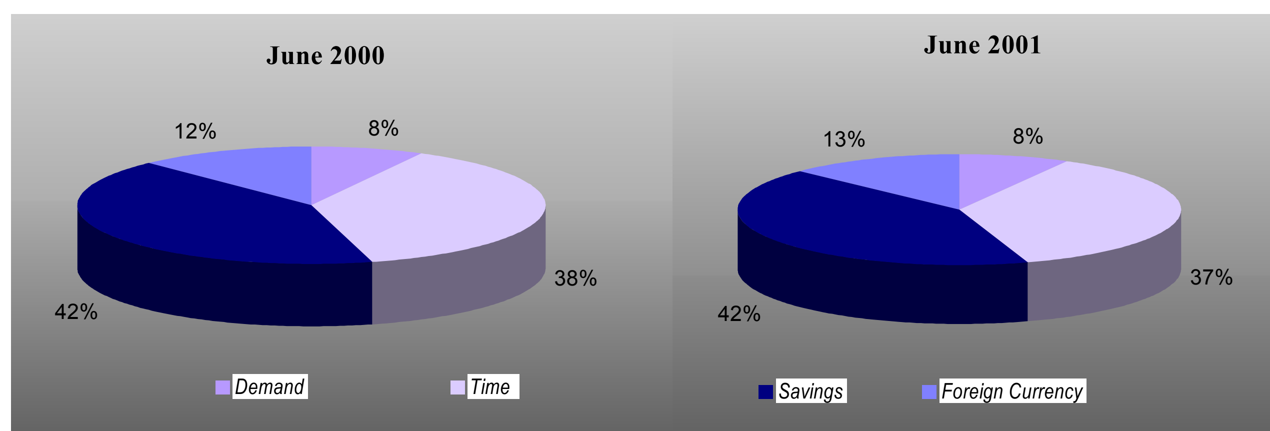


TABLE 4: VALUE RANGE OF DEPOSITS

Value range	No. of accounts	End of March 2001 Amount (Rs million)	Percentage of total deposits
Up to Rs1 Million	1,550,615	54,873	68.0
Over Rs1 Million to Rs5 Million	7,724	14,491	18.0
Over Rs5 Million	777	11,292	14.0

As may be observed from Table 4, banks hold a large deposit base of low value range accounts which provides the banking sector with a cushion against potential erosion through sudden withdrawals from large accounts. Moreover, deposits from individuals for personal and professional purposes constituted over 70 per cent of total deposits, further reducing the risk of large deposit erosion.

MATURITY OF TIME DEPOSITS

Time deposits which constituted 38 per cent of total deposits as at end-March 2001, were well scattered in terms of maturity which ranged from 7 days' notice to over 48 months. Of these, 52.3 per cent were held in deposits having a maturity of up to 12 months, 39.1 per cent within the maturity of over 12 months to 48 months while the remaining 8.6 per cent with a maturity of over 48 months.

The Bank of Mauritius has adopted various measures in order to strengthen its supervisory framework with regard to liquidity management by commercial banks. In January 2000, it issued a Guideline on Liquidity in which it sets out the broad parameters for banks to establish and implement prudent liquidity management policies. Repo transactions in Treasury Bills were also introduced in December 1999, the aim of which was to promote the development of an interbank market for government papers as well as providing banks with more efficient liquidity and risk management tools.

2.2.4 PROFITABILITY

Profitability, in the form of retained earnings, is one of the key sources of capital generation.

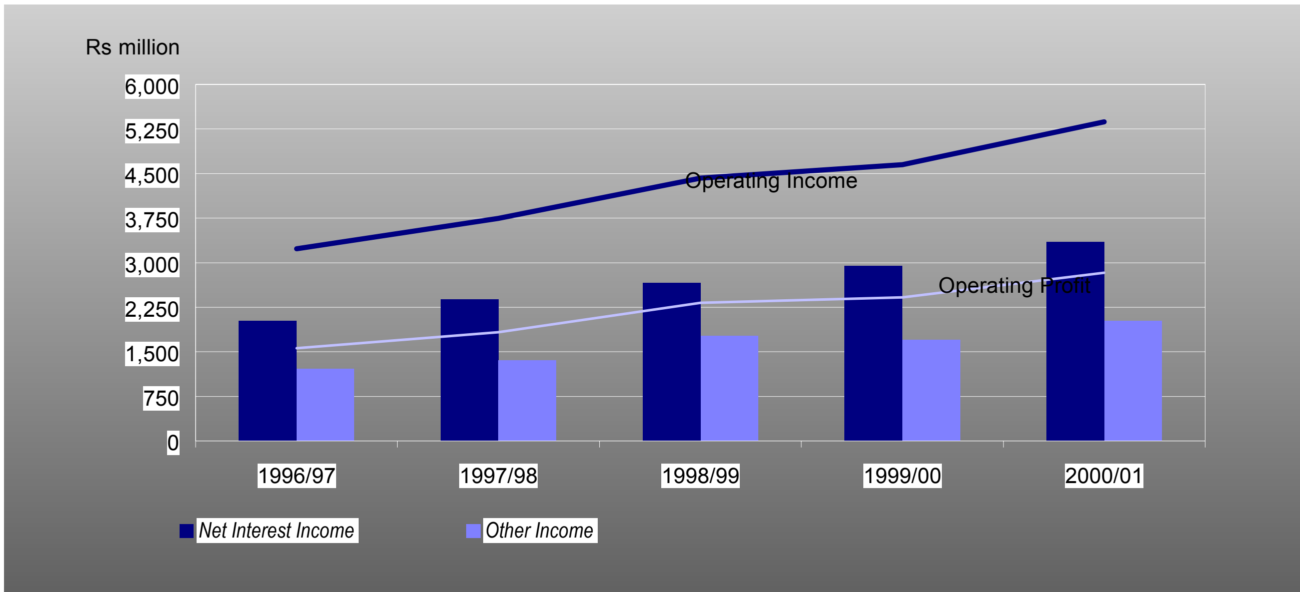
Table 5 shows the profit performance of all domestic banks over the past three years. These figures are based on the combined results for financial years ended 30 June, 31 December and 31 March for domestic banks.

Pre-tax profits of domestic banks increased by 16.1 per cent from Rs2,070 million in 1999/00 to Rs2,404 million in 2000/01. Banks' income statement has retained the same structure with net interest income continuing to be the major source of banking income.

TABLE 5: DOMESTIC BANKS : CONSOLIDATED PROFIT PERFORMANCE

	1998/99	(Rs million) 1999/00	2000/01
Interest Income from Advances and Investments in Treasury Bills and Government securities	7,627	9,036	10,274
Less: Interest Expense on Deposits and Borrowings	4,971	6,087	6,925
Net Interest Income	**2,656**	**2,949**	**3,349**
Add: Non-interest Income	1,767	1,698	2,022
Profit arising from dealing in Foreign Currencies	*821*	*781*	*871*
Fees and commissions Receivable	*627*	*708*	*776*
Income from Investments	*239*	*47*	*319*
Other Operating Income	*80*	*162*	*56*
	4,423	**4,647**	**5,371**
Less: Staff and Other Operating Expenses	2,096	2,232	2,539
Operating Profit before Bad and Doubtful debts and Taxation	**2,327**	**2,415**	**2,832**
Less: Charge for Bad and Doubtful Debts and Exceptional Items	374	345	428
Operating Profit before Taxation	**1,953**	**2,070**	**2,404**

CHART 6 : DOMESTIC BANKS : COMPONENTS OF INCOME, OPERATING INCOME AND OPERATING PROFIT



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

Chart 6 shows the impact of components of income on operating profit from 1996/97 to 2000/01.

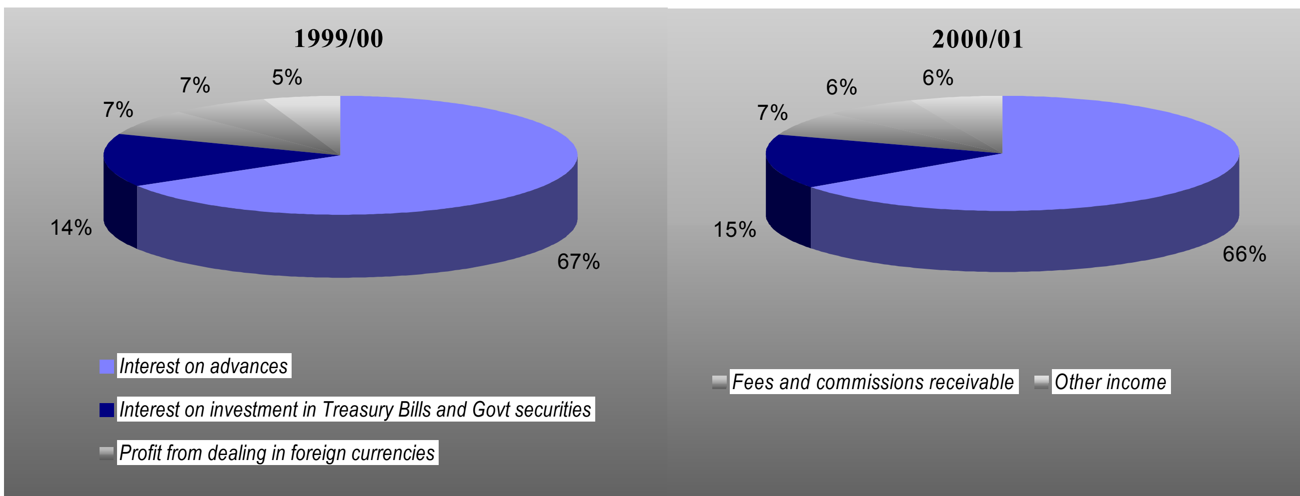
2.2.4.1 INCOME

Interest income remained the main source of income for domestic banks, accounting for an average of 83 per cent of total income over the years 1998/99 to 2000/01. However, as illustrated in Table 6, non-interest income has started to gain momentum as domestic banks have taken to diversifying their activities into investment holding and asset management. During the years 1998/99 and 2000/01, non-interest income grew by 29.9 per cent and 19.1 per cent, respectively, as opposed to a growth of only 12.7 per cent and 13.7 per cent in interest income.

Profit from foreign currency transactions and fees and commissions receivable accounted for the bulk of the non-interest income. In 2000/01, they accounted for 81 per cent of the total non-interest income.

Fees and commissions receivable, derived mostly from off-balance sheet items, have recorded a steady growth during the past three years. From 1998/99 to 2000/01, they have grown by 24 per cent. Such a class of income is normally desirable as it does not carry large exposure to financial risk.

CHART 7 : DOMESTIC BANKS : MAJOR COMPONENTS OF INCOME



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

TABLE 6: DOMESTIC BANKS: GROWTH IN INTEREST INCOME V/S GROWTH IN NON-INTEREST INCOME

	1998/99	1999/00	2000/01
Growth in Interest Income (%)	12.7	18.5	13.7
Growth in Non-interest Income (%)	29.9	(3.9)	19.1

Profit arising from dealing in foreign currencies registered a positive growth of 11.5 per cent to Rs871 million in 2000/01, after a downturn of 4.9 per cent to Rs781 million in the preceding year.

Chart 7 depicts the major components of income for years 1999/00 and 2000/01.

2.2.4.2 NET INTEREST INCOME

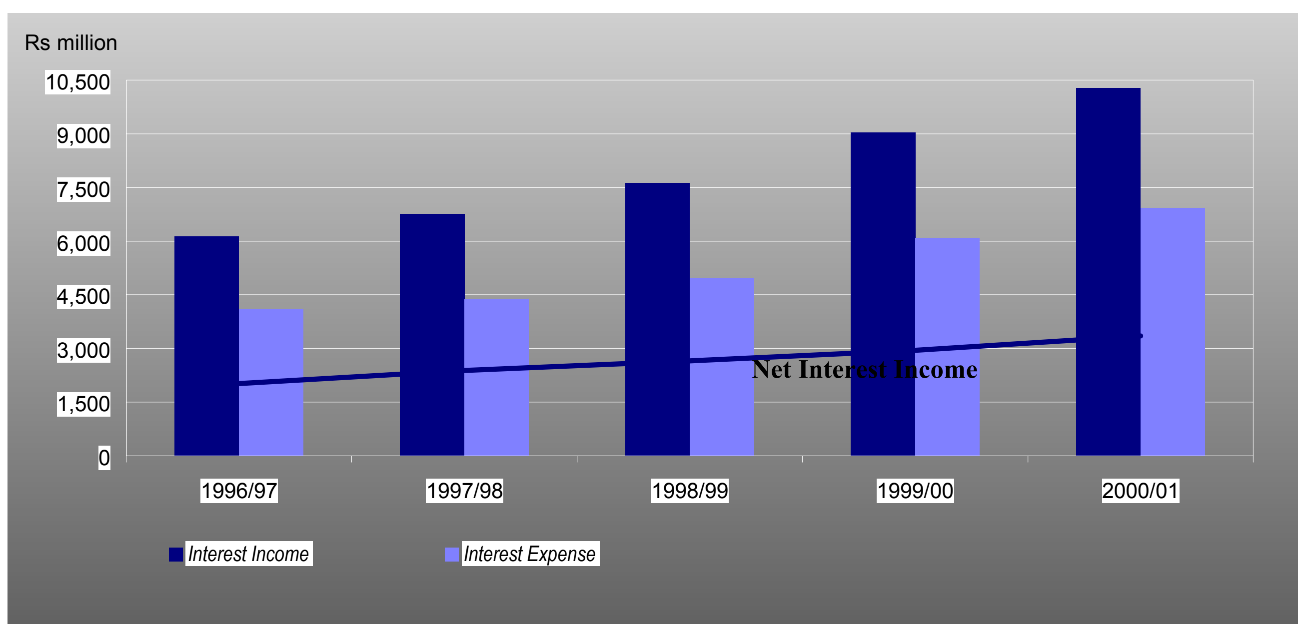
From 1999/00 to 2000/01, net interest income rose from Rs2,949 million to Rs3,349 million or by 13.6 per cent. Expressed as a percentage of average total assets, the ratio fell from 3.2 per cent to 3.1 per cent implying an element of pressure on banks' margins.

Chart 8 shows the trend of net interest income from 1996/97 to 2000/01.

Interest on advances amounting to Rs8,010 million in 2000/01, was up by 12.5 per cent from Rs7,118 million in 1999/00. Interest on Treasury Bills and Government securities together with interest on placements with other banks accounted for 21.7 per cent of total interest income in 2000/01. Income from these sources went up from Rs1,891 million in 1999/00 to Rs2,234 million in 2000/01. The average income earned by banks on advances was 11.9 per cent in 2000/01 compared to an average income of 11.7 per cent on their investments in Treasury Bills and Government securities.

It is important to note that during the years 1998/99 and 1999/00, interest from investments in Treasury Bills and Government securities registered a negative growth as opposed to a positive growth in interest earned on advances as shown in Table 7. However, this situation was reversed in 2000/01 when interest earned on Treasury Bills and Government securities recorded a higher growth of 19.5 per cent while interest on advances grew by only 12.5 per cent.

CHART 8 : DOMESTIC BANKS : COMPONENTS OF NET INTEREST INCOME



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

TABLE 7: DOMESTIC BANKS: GROWTH IN INTEREST ON ADVANCES V/S GROWTH IN INTEREST ON TREASURY BILLS AND GOVERNMENT SECURITIES

	1998/99	1999/00	2000/01
Growth in Interest on Advances (%)	15.3	26.2	12.5
Growth in interest on Treasury Bills and Government securities (%)	(2.7)	(5.4)	19.5

During 1999/00, despite a fall of 18.7 per cent in investments in Treasury Bills and Government securities, interest income on such investments fell by only 5.4 per cent as a result of higher yields. This trend was maintained during 2000/01 when interest income from Treasury Bills and Government securities registered a growth of 19.5 per cent when investments in such assets grew by 12.9 per cent only.

Chart 9 depicts the major components of expenses for years 1999/00 to 2000/01.

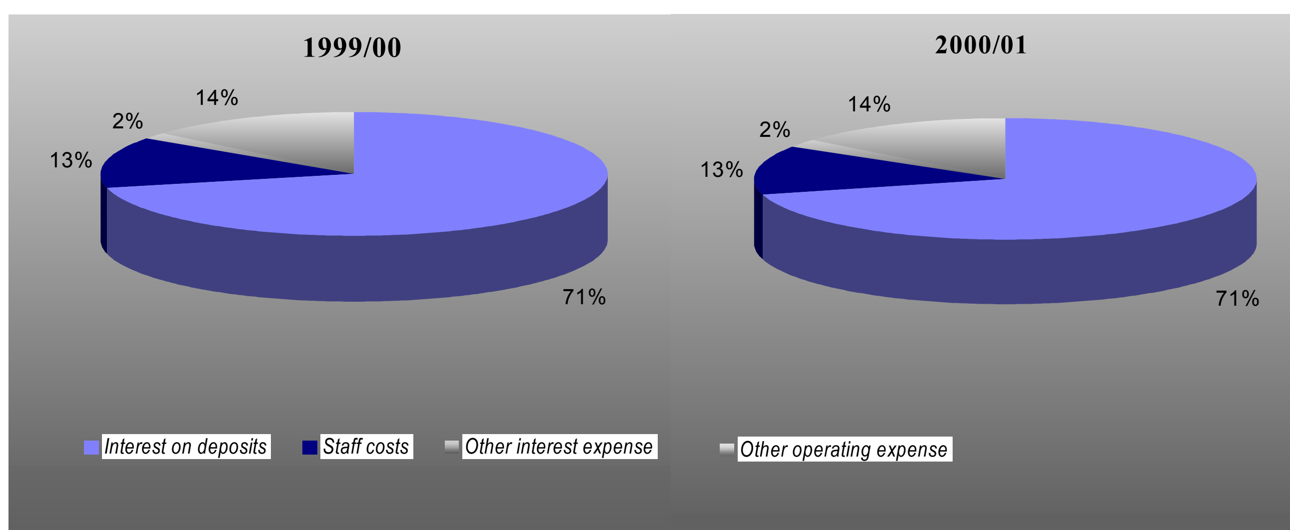
Interest on deposits which comprises the bulk of total interest expense, increased from Rs5,937 million in 1999/00 to Rs6,710 million in 2000/01, or by 13 per cent. During the period ended 31 March 1999, deposits grew at a much higher rate than the cost of deposits, 17.8 per cent as opposed to 13.6 per cent, which implies that banks were able to raise funds at a lower cost. However, during the period ended 31 March 2000, deposits grew at a much slower rate, i.e. at 14.1 per cent while interest on deposits marked a growth of 24.1 per cent. The situation was reversed during the period ended 31 March 2001 where growth in deposits fell to 13.7 per cent while interest on deposits recorded a lower growth of 13.0 per cent. This was due mainly to a fall in interest rate paid on deposits.

A comparison of interest earned on Rs100 of advances and cost on Rs100 of deposits over the past three years further indicates that interest spreads are coming under pressure. As illustrated in Table 8, the interest spread shows a falling trend from 1998/99 to 2000/01.

2.2.4.3 NON-INTEREST EXPENSES

Non-interest expenses, comprising staff and operating costs, stood at Rs2,539 million in 2000/01, up from Rs2,232 million in 1999/00.

CHART 9 : DOMESTIC BANKS : MAJOR COMPONENTS OF EXPENSES



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

TABLE 8: DOMESTIC BANKS: INTEREST SPREAD

	1998/99	*1999/00*	*2000/01*
Interest earned on Rs100 of Advances (Rs)	12.23	12.12	11.89
Cost per Rs100 of Deposits (Rs)	7.44	8.08	8.03
Interest Spread (Rs)	*4.79*	*4.04*	*3.86*

The cost to income ratio, the ratio of staff and other operating costs to gross operating income (net of charge for bad and doubtful debts), is a useful indicator of a bank's efficiency. The ratio dropped from 51.9 per cent in 1999/00 to 51.4 per cent in 2000/01, reflecting steps taken by certain banks to monitor and manage their costs more effectively. Part of the explanation for the improved ratio may be attributed to heavy investment in information technology tools, including electronic delivery channels by some banks' resulting in higher efficiency.

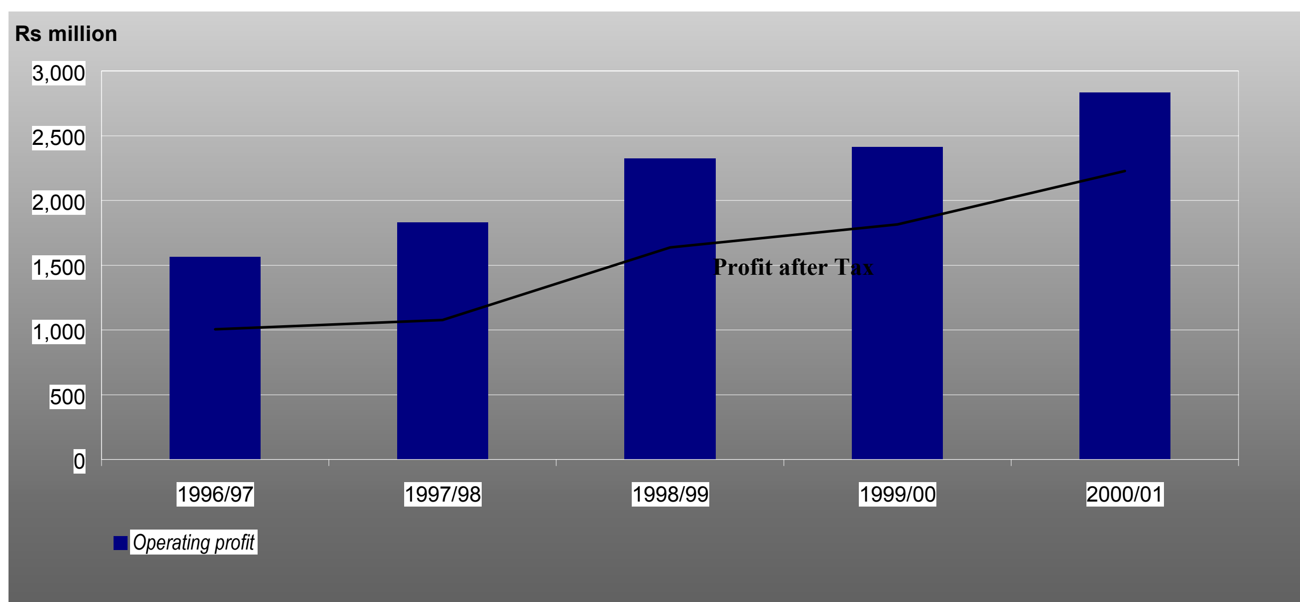
2.2.4.4 RETURN ON AVERAGE ASSETS AND ON EQUITY

Return on average assets and return on equity are important indicators of a bank's profitability. Despite a general decline in the interest spread during past years, profit performance of domestic banks was not affected. Profit before tax recorded an upward trend as shown in Table 5. During the period ended 31 March 2001, pre-tax return on average assets rose slightly from 2.22 per cent to 2.24 per cent with individual banks' pre-tax return on average assets ranging from a low of 0.2 per cent to a high of 4.6 per cent. Similarly, post-tax profit on average assets was not much affected in 2000/01 as it rose from 1.9 per cent in 1999/00 to 2.1 per cent in 2000/01.

During the same period, return on equity went up from 18.1 per cent to 20.0 per cent. Return on equity of individual banks ranged from 3.9 per cent to 29.8 per cent in 2000/01, with five banks achieving ratios of over 15 per cent.

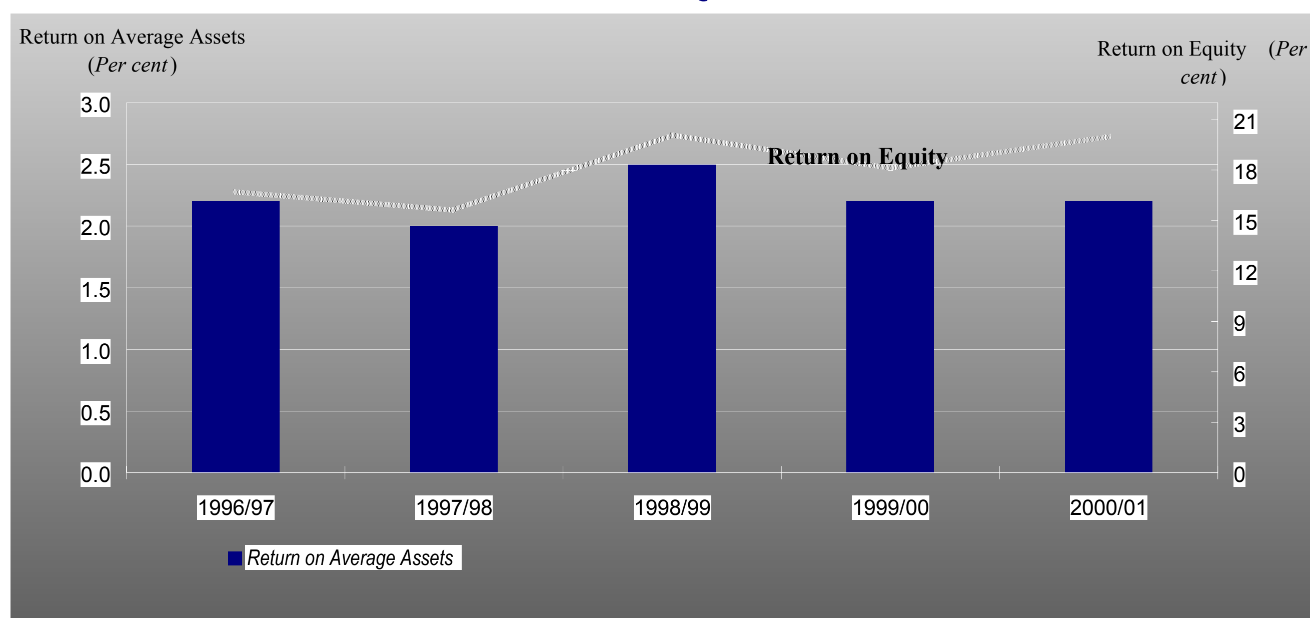
Chart 10 reflects the evolution of banks' profit for the years 1996/97 through 2000/01 while Chart 11 shows the fluctuations in return on equity and average assets for the same period.

CHART 10 : DOMESTIC BANKS : CONSOLIDATED OPERATING PROFIT AND PROFIT AFTER TAX



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

CHART 11 : DOMESTIC BANKS : RETURN ON AVERAGE ASSETS AND ON EQUITY



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

2.2.5 ELECTRONIC BANKING TRANSACTIONS

Transactions using electronic delivery channels maintained an upward trend during the year under review. Between end-June 2000 and end-June 2001, the number of Automated Teller Machines (ATMs) in operation in Mauritius increased by 13 from 221 to 234 and the number of cards in circulation went up by 84,727 from 610,849 to 695,576. The number of transactions involving the use of credit cards, debit cards, ATMs and Merchant Points of Sale increased from 1.4 million in June 2000 to 1.6 million in June 2001. The value of such transactions increased from Rs1,998 million to Rs2,361 million over that period. Outstanding advances on credit cards rose from Rs536 million to Rs636 million during the same period. Table 9 shows the quarterly positions of banks' electronic banking transactions from end-June 2000 through end-June 2001.

TABLE 9: ELECTRONIC BANKING TRANSACTIONS

	Jun-00	*Sep-00*	*Dec-00*	*Mar-01*	*Jun-01*
As at end of Month No of ATMs in Operation	221	228	231	231	234
During the Month No of Transactions :	1,415,979	1,390,368	1,884,887	1,655,737	1,579,171
Value of Transactions :(Rs mn) (Involving the use of Credit Cards, Debit Cards, ATMs, Merchant Points of Sale)	1,998	2,042	3,364	2,562	2,361
As at End of Month No of Cards in Circulation					
Credit Cards	118,198	120,657	126,416	131,452	140,885
Debit Cards and Others	492,651	505,991	521,225	538,328	554,691
Total	***610,849***	***626,648***	***647,641***	***669,780***	***695,576***
As at End of Month Outstanding advances on Credit Cards (Rs mn)	536.3	547.1	598.0	599.4	635.6

2.3 OFFSHORE BANKS

Offshore banks act primarily as intermediaries for transactions on international markets and as such, conduct their activities in currencies other than the Mauritian rupee. With globalisation, business has become increasingly internationalised and demands for international financial services have grown. Offshore banks offer a wide range of such services which include, inter alia, foreign exchange trading, fund management, trade financing, custodial services, investment advisory services, trusteeship of offshore trusts and other off-balance sheet transactions.

Tax laws and free movement of funds are among the crucial factors attracting international business. The network of double taxation treaties signed with 26 countries has promoted Mauritius as a base for international investment by providing tax planning opportunities to investors. The volume of transactions routed through offshore banks in Mauritius has increased significantly as indicated by transactions other than money market operations which grew by 38 per cent from USD 52,432 million in 1999/00 to USD 72,607 million in 2000/01.

Offshore banks which, by law, have to be a branch or related corporation of a foreign bank of international repute or a bank incorporated in Mauritius, are licensed and regulated by the Bank of Mauritius.

2.3.1 ASSETS

Total assets of offshore banks expanded by 7 per cent to USD 3,788 million at end-June 2001, down from a 37 per cent growth in the previous year which had seen the coming into full operation of three banks.

Placements with banks and loans and advances to non-bank customers are two major asset items of offshore banks and together accounted for 93 per cent of total assets as at end-June 2001.

2.3.1.1 PLACEMENTS WITH BANKS

Placements with banks which continued to be the main income generating business of offshore banks, dropped by 10 per cent from USD 2,327 million as at end-June 2000 to USD 2,100 million as at end-June 2001. In June 2001, offshore banks deployed only 55 per cent of their total funds for placements as against 66 per cent a year earlier. The funds were lodged mainly with their head office, parent bank, subsidiaries and fellow subsidiaries.

2.3.1.2 LOANS AND ADVANCES TO NON-BANK CUSTOMERS

On an overall basis, there was a shift of funds towards loans and advances during the year ended 30 June 2001. As at end-June 2001, offshore banks advanced 37 per cent of their total funds to non-bank customers by way of loans and advances which registered a growth of 39 per cent during the year to reach USD 1,410 million.

Lending to residents outside Mauritius and to offshore companies domiciled in Mauritius constituted 88 per cent of offshore banks' total loans and advances, down from 92 per cent as at end-June 2000. The percentage share of loans and advances to residents in Mauritius increased from 8 per cent to 12 per cent during the same year, or from USD 78 million as at end-June 2000 to USD 173 million as at end-June 2001. The increase is mainly attributable to syndicated loans raised by some parastatal institutions.

2.3.2 FUNDING

Offshore banks' two main sources of funds continued to be non-bank deposits and borrowings from banks. As at end-June 2001, 87 per cent of offshore banks' activities were funded by deposits raised from non-bank customers and bank borrowings in almost equal proportion. Non-bank deposits and borrowings from banks, respectively, contributed 43 per cent and 39 per cent of total funds held by offshore banks a year earlier.

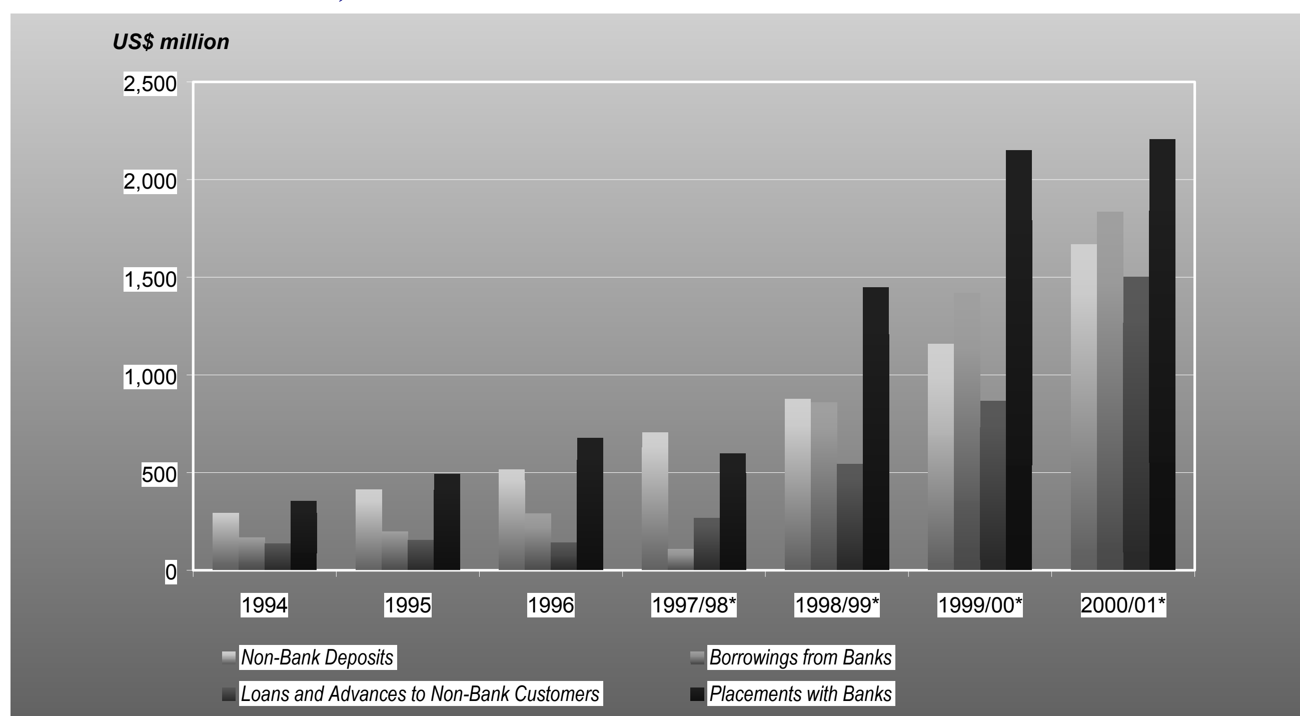
2.3.2.1 NON-BANK DEPOSITS

During the year ended 30 June 2001, total non-bank deposits recorded a growth of 9 per cent, rising from USD 1,504 million as at end-June 2000 to USD 1,635 million as at end-June 2001. Fixed deposits which constituted 63 per cent of total deposits, accounted for 73 per cent of the total increase whereas there was a decline of 34 per cent in the overall savings deposits of banks.

2.3.2.2 BORROWINGS FROM INTERNATIONAL MONEY MARKET

Borrowings from the international money market, at USD 1,650 million as at end-June 2001, were 20 per cent above the level of USD 1,379 million as at end-June 2000.

CHART 12 : OFFSHORE BANKS : NON-BANK DEPOSITS, LOANS AND ADVANCES TO NON-BANK CUSTOMERS, BORROWINGS FROM BANKS AND PLACEMENTS WITH BANKS



** Based on combined audited data for financial years ended 31 December and 31 March.*
All figures are as at end of period.

Funds borrowed from banks outside Mauritius accounted for 98 per cent of total borrowings while the remaining 2 per cent were raised from banks in Mauritius. Offshore banks borrow mainly from their head office, parent bank, subsidiaries and fellow subsidiaries. As at 30 June 2001, borrowings from these sources constituted 91 per cent of total borrowings compared to only 80 per cent as at end-June 2000 while borrowings from banks in Mauritius and other banks outside Mauritius dropped by 48 per cent.

2.3.3 LIQUIDITY

The Bank of Mauritius closely monitors individual banks' maturity transformation structures to protect against any major mismatches. On 11 January 2000, it issued a Guideline on Liquidity requiring offshore banks to establish and implement prudent liquidity management policies. No minimum cash requirements are imposed on the deposit base of offshore banks although the banks are required to maintain a minimum capital equivalent to USD 4.5 million in any freely convertible currency.

Offshore banks usually deal in relatively short-term assets and liabilities on roll-over basis except for some borrowings for on-lending towards specific fixed maturity investments.

Chart 12 depicts non-bank customer deposits, loans and advances to non-bank customers, borrowings from banks, and placements with offshore banks for years ended December 1994 through 2000/01.

2.3.4 PROFITABILITY

The financial year-end of eight offshore banks is 31 December and that of the remaining three banks is 31 March. The consolidated position of profit and loss accounts of all offshore banks thus involves different financial year-ends. During the period ended 31 March 2001, all offshore banks were profitable. Individual banks' profits ranged from USD 0.1 million to USD 63.4 million.

Table 10 gives the profit performance of offshore banks from 1998/99 to 2000/01.

Aggregate net profit earned by the offshore banking sector as a whole maintained its rising trend and at USD 96.6 million in 2000/01, was 38.0 per cent above the net profit of USD 70.0 million achieved in 1999/00.

TABLE 10: OFFSHORE BANKS : PROFIT PERFORMANCE

	1998/99	*(USD million)* *1999/00*	*2000/01*
Interest Income	104.0	210.6	285.0
Less: Interest Expense on Deposits and Borrowings	63.0	148.3	205.1
Net Interest Income	**41.0**	**62.3**	**79.9**
Add: Non-Interest Income	8.5	20.8	34.1
Operating Income	**49.5**	**83.1**	**114.0**
Less: Total Operating Costs	5.1	7.6	8.9
Staff Expenses	*1.5*	*2.1*	*3.1*
Provision for Depreciation	*0.7*	*-*	*0.4*
Other Expenses	*2.9*	*5.5*	*5.4*
Operating Profit	**44.4**	**75.5**	**105.1**
Less: Charge for Bad and Doubtful Debts	1.0	5.5	8.5
Net Profit	**43.4**	**70.0**	**96.6**
Interest Income as a Percentage of Total Income (per cent)	92.4	91.0	89.3
Cost to Income Ratio (Per cent)	10.5	9.8	8.4
Pre-tax Return on Average Assets (Per cent)	3.6	2.6	2.7
Pre-tax Return on Equity (Per cent)	32.2	39.2	42.2
Post-tax Return on Equity (Per cent)	18.4	16.4	27.9

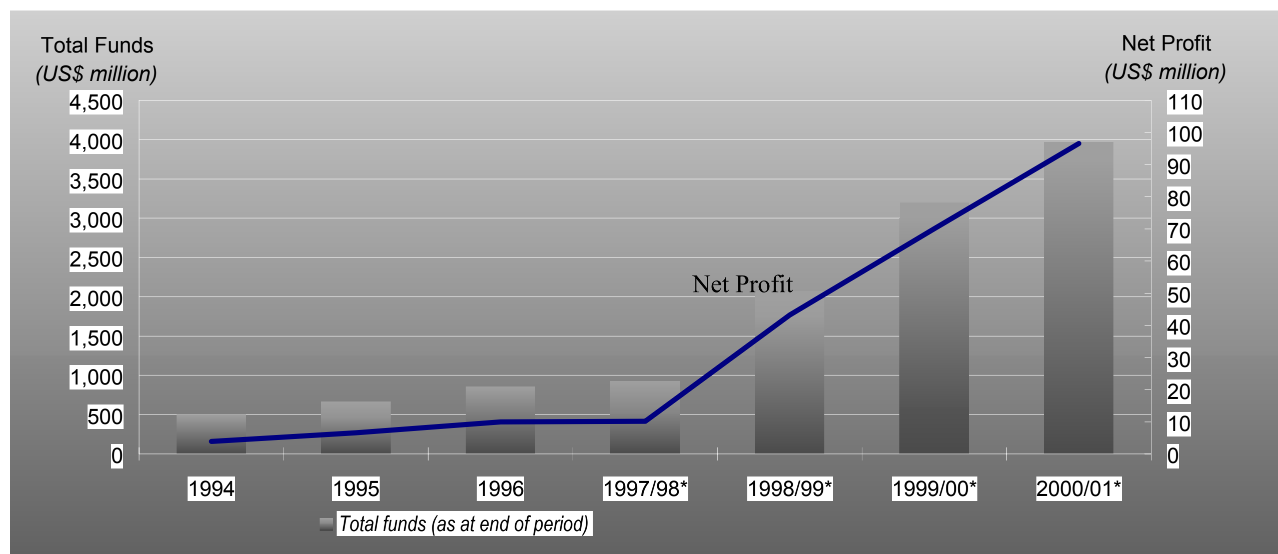
Chart 13 depicts the total funds and net profits of offshore banks for the years ended December 1994 through 2000/01.

2.3.4.1 NET INTEREST INCOME

Net interest income grew by 29 per cent from USD 62 million to USD 80 million in 2000/01 as against a growth of 52 per cent in the previous year. However, interest income as a percentage of total income, marked a decline from 92.4 per cent in 1998/99 to 91.0 per cent in 1999/00 going further down to 89.3 per cent in 2000/01, mainly as non-interest income grew at a higher pace during the past two years.

The bulk of offshore banks' earnings is generated by placements with banks and loans and advances to non-bank customers. In 2000/01, interests from these two sources contributed to 87 per cent of the banks' total

CHART 13 : OFFSHORE BANKS : TOTAL FUNDS AND NET PROFITS



** Based on combined audited data for financial years ended 31 December and 31 March.*
All figures are as at end of period.

earnings. Interest earned from placements with banks and loans and advances amounted to USD 177.7 million and USD 101.1 million, respectively, during that period.

During the past two years, interest paid on borrowings from the international money market rose sharply and had an effect on the net outturn since offshore banks rely significantly on these funds for their activities. Cost of borrowings rose sharply from USD 22.7 million in 1998/99 to USD 99.1 million in 1999/00, but grew by a lower rate of 27.5 per cent to USD 126.4 million in 2000/01. Interest paid on deposits from non-bank customers recorded a 59.6 per cent increase from USD 49.3 million to USD 78.7 million during the period under review, reflecting the growth in non-bank deposits.

2.3.4.2 NON-INTEREST INCOME

Other income, comprising mainly profit from translation of currencies and fees and commissions, registered a significant increase from USD 20.8 million in 1999/00 to USD 34.1 million in 2000/01, after a rise of USD 12.3 million in the previous year. At the end of 2000/01, non-interest income constituted 10.7 per cent of total income compared to 9.0 per cent for the previous year. Profit from translation of currencies accounted for 56.9 per cent of total non-interest income in 2000/01.

2.3.4.3 NON-INTEREST EXPENSES

Total operating expenses relating mainly to staff expenses and other expenses, registered an increase of 17.1 per cent and this was accompanied by a significant increase in the volume of transactions during the year 2000/01. Total operating expenses went up from USD 7.6 million in 1999/00 to USD 8.9 million in 2000/01 mainly as a result of an increase in staff expenses.

2.3.4.4 RETURN ON AVERAGE ASSETS AND ON EQUITY

Table 10 outlines the financial performance of offshore banks in terms of their pre-tax returns on average assets and equity in 1998/99, 1999/00 and 2000/01.

After a decline from 3.6 per cent in 1998/99 to 2.6 per cent in 1999/00, the overall pre-tax returns of offshore banks on average assets picked up slightly to 2.7 per cent in 2000/01. Individual banks' return on average assets ranged between 0.14 per cent and 5.2 per cent as against -0.66 per cent and 5.4 per cent a year earlier. Pre-tax returns of five offshore banks stood below 1.5 per cent in 2000/01.

The overall post-tax return on equity of offshore banks rose sharply from 16.4 per cent in 1999/00 to 27.9 per cent in 2000/01 on account of the higher growth rate of 117 per cent in post-tax profit which outpaced by far the 28 per cent growth rate in equity. In 2000/01 individual banks' post-tax returns on equity ranged from 2.7 per cent to 135.4 per cent as against 3.2 per cent to 74.9 per cent a year earlier. Returns on equity of six banks exceeded 20 per cent in 2000/01.

2.3.4.5 PROVISION FOR BAD AND DOUBTFUL DEBTS

Offshore banks are required to hold a general provision equivalent to at least one per cent of their standard advances (net of advances collateralised by cash deposits) in addition to specific provisions for losses in respect of individual impaired credits.

Table 11 shows the trend of the provisions for bad and doubtful debts with respect to total advances of banks over the past years. In absolute terms, provisions for bad and doubtful debts have been increasing steadily over the past four years but in terms of percentage to total advances, the pace of growth is lower.

TABLE 11: OFFSHORE BANKS : PROVISION FOR BAD AND DOUBTFUL DEBTS AND TOTAL ADVANCES *

			(USD million) *As at end-June*	
	1998	***1999***	***2000***	***2001***
Provisions for Bad and Doubtful Debts	7.0	8.7	13.7	20.1
Total Advances of Banks	229.6	833.7	1,013.0	1,410.5
Ratio of Provisions for Bad and Doubtful Debts to Total Advances (Per cent)	3.05	1.04	1.35	1.42

* Based on monthly assets and liabilities

Potential for loan losses is minimised by the very nature of the activities of offshore banks. Their main income generating business is placements of funds in the international market and the bulk of their transactions is carried out with their head office, parent bank, subsidiaries and fellow subsidiaries. A large proportion of the banks' loans and advances is granted to non-bank customers against cash collaterals, which provide a cushion against any default in repayment. Moreover, in the granting of such facilities, branches of foreign banks have recourse to their head office for clearance beyond established thresholds. These pre-conditions reduce loan casualties to a large extent.

3. MONEY LAUNDERING

Money launderers have been using all possible ways and means to disguise the sources of illegal transactions in order to pass them off as originating from a legitimate source. Over the past decade, money laundering has assumed alarming proportions. By its inherent nature, money laundering is an activity shrouded with secrecy and it is thus virtually impossible to measure exactly the amount of money that is being laundered locally or globally. The International Monetary Fund estimates that some USD 500 billion to USD 1.5 trillion generated by illegal activities is laundered through the international financial system annually. Given that the financial system is the main conduit through which illegal proceeds are laundered, effective anti-money laundering deterrence policies in the financial system assume paramount importance in combating money laundering.

The 1980s witnessed a widespread liberalisation of world financial systems, culminating into virtually free capital movements. The volume and variety of cross-border transactions in goods and services and accompanying international financial capital flows have witnessed a spectacular increase. To cater for payment needs, high speed international payments systems operating through networked global systems have been developed. Consequently, the movement of dirty money has become easier, resulting in the mind-boggling amounts of illicit proceeds being laundered.

With globalisation of financial services companies, money deposited in a bank branch in a less regulated jurisdiction can easily be transferred to a branch in a more regulated jurisdiction. Sophisticated launderers are perpetually on the look out for opportunities available anywhere across the world. The efforts made by one jurisdiction to combat money laundering can be frustrated by the loopholes existing in other jurisdictions. Therefore, money laundering is a problem of global concern and no country's financial system is immune from it. In order to tackle the problem and its ever increasing magnitude, international cooperation must be stepped up. The United Nations, the Basel Committee on Banking Supervision and the Financial Action Task Force (FATF) have leagued together to check the laundering of illicit proceeds across the world. The International Monetary Fund (IMF) has also joined in and it met recently to discuss the problem and also how it could enhance its own contribution to the global efforts.

The FATF remains the main force spearheading the movement against money laundering globally. In fact, the FATF which was set up by the G7 countries in 1989 has emerged as the most influential body in coercing countries to implement measures to combat money laundering. The 40 recommendations issued by the FATF and which set out the basic anti-money laundering framework are widely acknowledged as the key set of standards to hedge against money laundering even though these standards are currently undergoing a review process. Moreover, the FATF carries out evaluations of countries in respect of their anti-money laundering measures. Where weaknesses are identified, countries are urged to remedy the shortcomings at the earliest. Where countries fail to take appropriate measures, they are threatened with being blacklisted as non-cooperative jurisdictions. In June 2000, the FATF published a list of 15 countries as being non-cooperative in cracking down on money laundering.

By naming and shaming non-cooperative countries, the FATF achieves its intended objective of bringing countries to adopt appropriate anti-money laundering measures. The progress of countries in clamping down on money laundering is monitored and banks in countries not showing satisfactory progress run the risk of being debarred from dealing with international banks in other jurisdictions. The risk of being ostracised from the world's financial system spurs the blacklisted nations to take the remedial action expected of them. It may be observed that Standard and Poor's, a rating agency, recently downgraded the credit rating of a country that has been blacklisted by the FATF.

At the beginning of the year, a team of examiners carried out an FATF type mutual evaluation review of Mauritius, under the aegis of Offshore Group of Banking Supervisors (OGBS), of which the Bank of Mauritius is a member since 1989. The evaluation team had the opportunity to assess the anti-money laundering measures in place and their effective implementation. The evaluation included meetings with senior ministers of the Government who are fully committed to maintaining Mauritius as a clean and reputable financial centre. The report of the evaluation team is expected towards the end of this year. It is expected that the publication of the report of the team's findings should dispel the negative effects that could have been produced by the adverse publicity following a couple of money laundering allegations made in the press.

The Economic Crime and Anti-Money Laundering (ECAML) Act, was passed on 13 June 2000. It reinforced the existing legislation in the prevention of and fight against money laundering. The ECAML Act 2000 incorporates the basic tenets of the 40 recommendations laid down by the FATF. It provides for a set of anti-money laundering regulations, including the criminalisation of money laundering, and sets out a suspicious transaction reporting system. Financial institutions are required to report to the Bank, suspicious transactions as defined in the Act, together with specified particulars.

Following the enactment of the ECAML Act 2000, the Bank of Mauritius had consultations with representatives of banks, financial institutions, cash dealers, members of relevant professions and other associations and organisations, such as the Mauritius Bankers' Association, the Association of Offshore Banks and the Association of Offshore Management Companies. As a result of these consultations, the Bank of Mauritius issued draft Guidance Notes. Besides outlining the requirements of the ECAML Act 2000 and Regulations made thereunder, the Guidance Notes provide practical information and also examples of best practice. The ultimate objective of the Guidance Notes is to help practitioners develop policies and procedures appropriate to combat money laundering. Given that money launderers are coming up with increasingly ingenious set-ups to defeat established anti-money laundering systems, it is understood that the Guidance Notes will be reviewed regularly to address changing circumstances. It is observed that the Guidance Notes focus on the “Know Your Customer” ("KYC") principle which all financial sector operators and members of the relevant professions are to abide by.

Supervisors have a fundamental part to play in the global fight against money laundering. National supervisors have a duty to ensure that banks have minimum standards and internal controls that allow them to adequately know their customers. By ensuring that banks implement acceptable “KYC” standards, supervisors protect the integrity of the national financial system.

Adverse publicity regarding a bank's business practices, whether founded or not, will engender a loss of confidence in the integrity of the institution. Banks are particularly vulnerable to reputational risk whenever unfounded public allegations are made as to their possible involvement in any money laundering activity. The law provides for the filing of suspicious transactions reports with the authorities and hence provide an opportunity for banks to defend themselves against possible abuse. Efforts are currently being made to ward off the damage caused by publication of unwarranted allegations.

Banks are expected to have in place adequate controls and procedures to prevent any abuse made of them as vehicles for criminal or fraudulent purposes. Adequate due diligence on new and existing customers is an essential factor in the control system to be put in place. Furthermore, supervisors have a duty to ensure that financial institutions abide by standards and implement adequate internal controls that allow them to “know” their customers. Maintenance of high “KYC” standards by the banking system represents an ongoing task in as much as existing precautions would need to be reviewed from time to time in light of changing techniques adopted by money launderers.

The Basel Committee on Banking Supervision (BCBS) issued, in 1997, the 25 Core Principles for Effective Banking Supervision which is widely accepted as the benchmark for effective supervision. One of the core principles states that, as part of a sound internal control environment, banks should have adequate policies, practices and procedures in place that promote “high ethical and professional standards in the financial sector and prevent the banks from being used, intentionally or unintentionally, by criminal elements”.

The BCBS issued in October 2001, a final document on Customer Due Diligence by banks. The document provides more precise guidance on the essential elements of KYC standards and their implementation. It is expected that the KYC programme will become the benchmark for supervisors to establish national practices and for banks to discuss their own programme with a view to reducing the likelihood of banks becoming a vehicle for or a victim of financial crime and suffering consequential reputational damage. The essential elements of a bank's KYC programme should include policies and procedures for customer acceptance, customer identification and on-going monitoring of high risk accounts.

The Bank of Mauritius carries out on-site inspections at the financial institutions on a regular basis. During the on-site inspections, the anti-money laundering policies and practices of each institution are examined. Much emphasis is laid on whether or not the institutions carry out due diligence with respect to new customers opening accounts with banks. Banks are required to closely monitor cash transactions and satisfy themselves as to the source and provenance of funds.

With a view to keeping regulators abreast of the latest techniques used by launderers and to sensitise the financial sector professionals and practitioners, the Bank of Mauritius undertakes the provision of regular training to market operators on anti-money laundering techniques. Furthermore, under the provisions of the ECAML Act 2000, suspicious transactions reports (STRs) are filed by operators with the Bank of Mauritius. The Bank examines those reports with a view to carrying on follow-up sanction at the level of the Economic Crime Office and eventually for prosecution. The Bank also chairs on a regular basis a Committee of Compliance Officers of financial institutions. This forum enables valuable exchange of notes among the participants while also helping to form a common front against the risk of money laundering. Mauritius is one of the four countries in the region which explicitly recognize the legal offence of money laundering and take action against it.

A regional grouping known as Eastern and Southern Africa Anti-Money Laundering Group, with the objective of developing comprehensive national and regional anti-money laundering strategies, was set up on 27 August 1999 at Arusha in Tanzania. Amongst others, the regional group has decided to set up a register of national points of contact and to establish a national Multi-disciplinary Anti-Money Laundering Committee. The Managing Director of the Bank of Mauritius is the national contact person for Mauritius and the Chairman of the national Multi-disciplinary Anti-Money Laundering Committee. The Bank looks forward to cooperate fully in this regional effort.

To develop Mauritius into a key financial centre in the region, it is necessary to establish a sound and untainted reputation for its financial sector. No country's financial system can claim to be invulnerable to attempts from money launderers to make inroads into its system. However, regulators and operators need to watch the system relentlessly to minimise any such inroads. The Bank of Mauritius and other regulators in Mauritius are committed to cooperate in the global fight against money laundering.

4. THE NEW BASEL CAPITAL ACCORD II AND IMPLICATIONS FOR BANKS IN MAURITIUS

4.1 INTRODUCTION

In June 1999, the Basel Committee on Banking Supervision, which is responsible for the setting up of global standards and benchmarks on regulatory/supervisory practices released a consultative paper on a New Capital Adequacy Framework for comments by central banks and market players. The Committee received more than 200 comments, which were reflected in the second consultative document, released in January 2001. The proposed New Capital Accord contained refined proposal of the three pillars of the Accord – Minimum Capital Requirements, Supervisory Review Process and Market Discipline.

The second consultative document takes into account several concerns expressed and recommendations made by emerging markets on the first consultative document.

4.2 SALIENT FEATURES OF THE SECOND CONSULTATIVE PAPER

The second consultative paper is based on the three mutually reinforcing pillars, namely the minimum capital requirements, the supervisory review process and market discipline. It offers a comprehensive approach that will bring regulatory and economic capital more closely into line and narrow the gap between regulatory requirements and the banking industry's risk management practices.

The first pillar sets out minimum capital requirements and introduces alternative approaches for calculating capital requirements for credit risk and operational risk. Capital requirements for the market risks in the trading book are not a core part of the New Accord but the interest rate risk in the banking book is addressed in the second pillar.

The proposed approaches for quantifying credit risk are the Standardised Approach (a modified version of the existing approach) and Internal Ratings Based (IRB) Approach.

The Standardised Approach is conceptually the same as that proposed in the 1988 Basel Accord. However, this modified Standardised Approach is more sensitive to risk undertaken by the banks as the risk-weights will be determined according to the rating provided by external credit assessment institutions that meet strict standards.

The IRB Approach is based on banks' own qualitative and quantitative assessment of credit risk and forms the basis for setting capital charges. It evolves between the foundation approach and the advanced approach. In the foundation approach, both banks and supervisors provide inputs in the determination of the rating while the advanced approach allows banks to make greater use of their own estimates to determine the credit rating.

The second pillar requires that the supervisors ensure that each bank has sound internal processes in place to assess the capital adequacy needs relative to the risks taken by the bank. The new framework stresses the importance of a bank's management setting capital targets that are commensurate with the bank's particular risk profile and control environment.

The third pillar aims at helping the "reasonable" investor to get a picture of a bank's risk profile and capital position in order to assess its ability to absorb losses. However, there is much concern about excessive disclosures, which could potentially confuse the investor and lead to misinterpretations. In order to ensure a level playing field, Basel II disclosure requirements may be made consistent with internationally accepted accounting principles.

In June 2000, the Basel Committee published a consultative paper setting out the detailed guidance on disclosures to be made to enhance market discipline. The paper provides guidance on the disclosures required in the areas of capital structure, risk exposures and capital adequacy.

4.3 RESPONSES OF BANKS IN MAURITIUS TO THE NEW ACCORD

The Bank of Mauritius requested banks operating in Mauritius to submit their views on the second consultative document issued in January 2001. Responses received from banks were consolidated and forwarded to the Basel Committee. The views of the banking industry in Mauritius are summarized in the following paragraphs.

4.3.1 GENERAL COMMENTS

4.3.1.1 CAPABILITY OF REGULATOR

The new regulations will require a substantial input from the regulator. The capacity and capability of the regulator will therefore have to be of a standard that allows compliance within the framework of the Accord. In countries where the required skills are in short supply, the ability of the regulator to meet these standards may be constrained.

4.3.1.2 COMPETITIVE EQUALITY

Although the Accord aims at "competitive equality", the bigger and more advanced banks may have access to options that will give them a market advantage, whereas the smaller banks may find it difficult to afford the necessary infrastructure and resource investments.

4.3.1.3 TOO MUCH DISCRETION TO REGULATORS

The Accord leaves too much discretion to local regulators. Local regulators, therefore, have a collective responsibility to act in concert with banks to ensure that the proposals in the Accord are implemented in such a way as to keep the additional burden to a minimum. This will be in the interests of bank customers who ultimately bear the costs of regulation, and will help to maintain the competitiveness of banks vis-à-vis non-banks. Keeping the cost burden down will have the added advantages of shortening the necessary time period for implementation and motivate banks to move to an Internal Ratings Based Approach more quickly.

National supervisors will exercise broad discretion on a wide range of issues in implementing the New Accord. Inconsistent approaches and standards applied by national supervisors will result in an unlevelled playing field among banks and between banks and other non-bank competitors.

The broad discretion to be exercised by national supervisors under Pillar 2 will undercut efforts to improve management accountability and govern corporate governance standards. There is a risk that national supervisors will become intrusive in areas which should be left to management and boards.

4.3.1.4 NATIONAL REGULATORS VERSUS LEAD REGULATOR OF BANKING GROUP

Banks hold the view that all national regulators should accept the principle of deferring to the lead regulator of a banking group that is subject to multiple regulatory jurisdictions, or else consult with the lead supervisor and agree on a common approach. This will avoid the significant additional costs of multiple interpretations that are, of themselves, likely to produce at best marginal risk management benefits.

4.3.1.5 COSTS OF IMPLEMENTING THE ACCORD

The Basel proposals will result in significant additional costs for most banks. The costs will only be justified if there are significant benefits from improved credit risk management practices.

4.3.1.6 SMALL BANKS/NON-INTERNATIONALLY ACTIVE BANKS

The ability of small banks to implement the New Accord is limited compared to large and international banks. It is therefore felt that it would be more appropriate for regulators to adopt a 2-tier approach, whereby:

- the large, international banks implement the Accord in the envisaged time, and
- the current system be maintained for the small, non-internationally active banks, with some modifications and improvements.

4.3.1.7 TIME FRAME

The January 2004 time frame to implement the Internal Ratings Based Approach is not realistic for most banks in Mauritius as the final Accord will not be published until end 2001 but will require a minimum of 2 years of data to be held as of January 2004.

It may prove impossible to commence capture of all required data from January 2002 for all 6 asset classes when the requirements will only become due from late 2001 and even then may undergo

further refinements between publication of final Accord and January 2004.

4.3.1.8 PRONOUNCED EFFECT ON BORROWERS WITH DETERIORATING RISK PROFILE

It is recognised that banks, by and large, manage capital on a forward looking basis with adequate cushion to absorb down-side risks. However, it is felt that the implementation of the Accord might have an adverse effect on individual industries and individual borrowers with deteriorating risk profiles in the event that all lending banks limit their exposure to them simultaneously. As a result, the situation of the sectors concerned may be exacerbated.

4.3.1.9 FACILITATOR

In view of the complexities inherent in the New Accord, banks have expressed the view that an operating body be set up to facilitate interaction in order to remove all the hurdles in the implementation of the Accord.

The tasks of facilitator would be assigned to regulators/supervisors.

4.3.2 COMMENTS AND QUERIES SPECIFIC TO THE PILLARS

4.3.2.1 PILLAR 1: MINIMUM CAPITAL REQUIREMENTS

- *External Credit Assessment Institution (ECAI)*

– Which ECAIs will be acceptable?

– Will unsolicited ratings be allowed? Public information ratings are considered to be unsolicited. One of the banks does not support the use of unsolicited ratings.

- *Treatment of unrated corporations*

The circumstances under which risk ratings in excess of 100 per cent will be applied to unrated corporations need to be stated clearly and consistently applied by all national regulators.

- *Treatment of counterparties with ratings B- and below*

The risk weightings will be based on external credit ratings, with the inclusion of a 150 per cent weighting for those counterparties rated below a B-.

The fact that unrated counterparties will carry a weighting of 100 per cent, but those that are rated B- and below will be weighted at 150 per cent must also be questioned. Will not such counterparties prefer to be unrated in order to be weighted at 100 per cent instead of 150 per cent?

- *150 per cent risk weighting*

Will a 150 per cent risk weighting be applied to additional categories of assets such as venture capital and private equity investments?

- *Annual valuation of residential mortgage*

The requirement for annual valuation of residential mortgages is unreasonable and the cost of this is likely to be passed directly to customers.

- *Internal Ratings Based (IRB) Approach*

(i) Lack of resources to implement the IRB model.

Only global banks have the financial and human resources to implement the IRB system. Smaller banks would need time and would incur huge additional costs to build up the specialised skills in risk management and develop IT systems in order to implement the IRB model by January 2004.

(ii) Lack of data

To move to the IRB Approach, banks need to develop and collect data on borrowers' grades, type of collateral, historical loss experience. The data will have to cover an observation period of 5 years.

It is difficult, if not impossible, to build up a reliable database of clients because of inadequacy of information from clients.

The timeframe scheduled by the BIS for the implementation of the Accord will not allow banks to move to the IRB Approach by January 2004.

(iii) Extension of time frame for implementation

In view of the implications mentioned at (i) and (ii) above, banks have requested for a more extended time frame for the implementation of the IRB Approach. The extension in timeframe will incidentally allow banks to spread the costs involved.

(iv) Assistance from the World Bank

Assistance from the World Bank or any other international financial organisation may be requested for by regulators, to assist local banks with the relevant package or software.

(v) Lack of incentive to move to IRB Approach

The proposed Benchmark Risk Weightings (BRW) for IRB Approach act as a disincentive for banks to incur the expenditure to implement it in the January 2004 time frame, given that the BRW for higher risk assets are much higher than under the Standardised Approach. Consequently, banks applying the standard approach will gain a competitive pricing advantage relative to banks applying an IRB Approach.

4.3.2.2 PILLAR 2: SUPERVISORY REVIEW PROCESS

Certain banks hold the view that the second pillar confers too much discretion on national supervisors. That discretion may cause some supervisors to become too intrusive in managements' decisions.

Pillar 2 should not be used to impose higher capital charges on a bank that is otherwise managing its credit risks and capital prudently merely in order to exact a penalty for not moving to implement an IRB Approach within a time frame arbitrarily defined by the supervisor.

While additional capital requirements are not in all cases the appropriate solution to address deficiencies in the risk management processes of banks, banks disagree with the view taken by the Basel Committee on capital increases, namely to suggest that "increased capital might be used as an interim measure while permanent measures to improve the bank's position are being put in place". It should be well understood that capital measures cannot instantaneously be switched on or off without causing potentially severe distortions. Rather, capital is nothing but permanently available liquidity.

4.3.2.3 PILLAR 3: MARKET DISCIPLINE

It is held by banks that Pillar 3 disclosure standards for IRB Approach are onerous and counterproductive. Instead of improving market transparency, they will confuse market participants with voluminous, complex information that would be difficult to interpret.

The disclosure standards will also require banks to disclose information of a proprietary nature that will put them at an uncompetitive position vis-à-vis banks and non-bank competitors. Besides, they will be costly to implement.

It will be necessary to educate analysts and other market participants concerning the correct interpretation of Pillar 3 disclosures to avoid unexpected and uniformed market reactions to this information. Therefore, more consideration needs to be given to a high quality disclosure package that is acceptable to banks.

4.4 STATUS OF THE PROPOSED NEW ACCORD

The Basel Committee received more than 250 comments on its second set of consultative documents. It has communicated its intention to thoroughly review and consider all comments received. It has also highlighted several important decisions that it has taken with respect to the proposals: -

(i) It remains committed to the three pillars architecture of the New Accord and to the broad objective of improving risk sensitivity of the minimum capital requirements.

(ii) The average bank should retain an equivalent level of regulatory capital under the revised Standardised Approach. It is also of the view that incentives between the Standardised and IRB Approaches should exist

to encourage banks to adopt these more advanced approaches to credit risk.

(iii) The Committee has concluded that the target proportion of regulatory capital related to operational risk (i.e. 20 per cent) will be reduced as this was considered to be too high.

(iv) The Committee intends to devise appropriate treatment of credit exposures related to small and medium sized enterprises.

(v) Finally, in view of the high quality of the comments received, the Committee has decided to modify the timetable for completion and implementation of the New Accord. An additional round of consultation will be released in early 2002 and will be finalised during 2002. Accordingly, the Basel Committee envisions an implementation date of 2005 for the New Accord.

4.5 CONCLUSION

The 1988 Accord does not deal sufficiently with sophisticated internal measures of economic capital and does not fully accommodate common credit risk mitigation techniques, such as collateral and guarantees and credit derivatives. The flat 8 per cent capital charge for claims on the private sector does not sufficiently differentiate underlying risk. The New Accord is an attempt to improve the robustness of the banking system by placing more emphasis on banks' own internal control and management and sets incentives for further progress in the risk management process of banks.

The New Accord however, places significant burden on national supervisors due to its complexity. This may be a problem in case of resource constraints. The latter will have to exercise judgement in the areas of giving approval to use the more advanced approach under the IRB Approach and in the supervisory review process under the second pillar.

The timetable for the implementation of the New Accord is longer than originally envisioned, reflecting the complexity of the proposals and to allow for national rulemaking procedures and the adaptation of banks' internal systems, supervisory and regulatory reporting.

The Basel Committee may eventually develop a simplified Standardised Approach which could be adopted uniformly by all banks which are not internationally active. Further, as the transitional arrangements proposed in the New Accord may not be sufficient for these banks, the supervisors may be given discretion to decide on the true framework for implementing the Accord and applying it to the banks in their jurisdiction depending upon the scale and complexity of their operations.

5. DEPOSIT INSURANCE SCHEME

A deposit insurance system is designed to act as a safety net. It aims at minimizing or eliminating the risk of loss of depositors' funds with banks. By providing for the security of funds in the event of bank failure, a deposit insurance scheme contributes to the stability of the financial system. It also supports the smooth functioning of the payment system and the credit mechanisms and facilitates the exit of problem banks.

The operation of a deposit insurance scheme can enhance stability in a financial system by preventing bank runs even when concerns arise about the condition of a bank. In this connection, government and supervisory authorities of many countries have set up deposit insurance schemes. These schemes can either be implicit or explicit.

An effective deposit insurance system can promote public confidence and contribute to the stability of the financial system only if the conditions necessary for the system to be credible and sustainable are in place. Such conditions should include:

- a sound legal system,
- stable macroeconomic environment and consistent economic policies to maintain a sound banking system,
- effective regulation and supervision of the financial system,
- compliance by institutions with generally accepted accounting, auditing and regulatory standards, and
- effective disclosure requirements.

A clear and well-publicized framework, mandatory bank participation, limited coverage and the ability of the insurer to access necessary resources are features necessary for a deposit insurance system to be effective in inspiring public confidence. The roles and responsibilities of the deposit insurer as well as the regulatory and supervisory agencies should be well defined.

5.1 IMPLICIT DEPOSIT INSURANCE SCHEME

In the implicit deposit insurance system, deposit protection is provided by government. Such protection is completely discretionary as government has considerable degrees of freedom in deciding between providing no protection at all, providing limited protection or protecting depositors fully. The amount and form of protection is determined on an ad hoc basis. The decision making process is not guided by pre-existing rules and procedures. Such a scheme may take any of the following forms.

- Government may finance a deposit insurance scheme from the current budget or through the central bank. *However, it should be noted that Government is not obliged by law to offer protection to depositors in case of a bank failure*.

- When an insolvent bank is closed, the government can make direct payments to depositors or arrange for the failed bank's deposits to be assumed by another bank.

- The government may alternatively arrange and financially support the merger of a problem bank into another bank. This would prevent the failure of the bank, thereby protecting its depositors.

- Government may choose to rehabilitate a problem bank by injecting capital into the bank.

- Government may decide to acquire some or all of the failing bank's non-performing assets at book value, giving the bank a fresh start with a clean portfolio.

5.2 EXPLICIT DEPOSIT INSURANCE

An explicit deposit insurance system provides a guarantee to repay insured deposits together with accrued interests. In such a system, explicit rules clearly set boundaries on the protection that will be provided and thereby contribute to discipline during normal times. The statute normally specifies, inter alia, the types of financial institutions and deposits that are eligible for insurance, whether membership would be voluntary or compulsory, the maximum amount of deposit to be insured, the funding process of the system and the devices to be used by the insurer to resolve failing banks.

When a bank fails under a limited coverage system, the insurer is authorized to pay off insured depositors up to the agreed maximum amount, or arrange for all of the failed bank's insured deposits to be transferred to another bank.

Full coverage system insures all deposit accounts completely but such schemes are very rare in practice. Most countries which offer deposit insurance schemes place limits on their coverage.

5.3 REASONS FOR IMPLEMENTING DEPOSIT INSURANCE

5.3.1 ENHANCE STABILITY OF THE FINANCIAL SYSTEM

A deposit insurance system reduces significantly the risk of bank runs and help to maintain confidence in the financial system as insured depositors have less incentives to remove their funds unexpectedly from their banks. Public concern about the safety of their deposits can lead to bank runs and ultimately to contagion runs. Public confidence in the safety of deposits promotes the stability of individual banking institutions.

5.3.2 ENSURE AN ORDERLY PAYMENT SYSTEM

Depositors save and withdraw funds whenever in need. The use of current deposit accounts enables payment systems to evolve beyond a system of settlements by cash. Cheques, credit cards and electronic payments are mainly settled through current account balances. Consequently, for payment systems to function properly, depositors must feel that their money on deposit is as sound as currency.

5.3.3 ENHANCE COMPETITION BY MITIGATING COMPETITIVE BARRIERS

Deposit insurance schemes reduce the unfair competition that exists between large banks and small banks in terms of deposit mobilization. These schemes eliminate the depositors' concerns about bank failure and allow market forces to operate freely and achieve more efficiency.

5.3.4 PROTECT SMALL DEPOSITORS

Asymmetry of information between market participants and inability of depositors to analyze available information often help problem banks. These banks attract such depositors with high interest rates. A limited coverage deposit insurance system provides protection to the uninformed depositors in cases of problem banks' failure.

5.3.5 MINIMIZES TAX PAYERS' BURDEN

The cost of protecting depositors often falls on the government and eventually on taxpayers in the absence of deposit insurance. Government's financial obligation is reduced by partial coverage through deposit insurance. Under a well-devised deposit insurance system, banks may also cover all or a portion of costs associated with resolving failures.

5.4 RISK ASSOCIATED WITH THE IMPLEMENTATION OF A DEPOSIT INSURANCE SCHEME

Deposit insurance like any insurance scheme creates the incentive for **moral hazard**. By providing protection to market participants, the costs of pursuing riskier strategies are reduced and creates the motivation for excessive risk-taking activities. Hence, deposit insurance reduces the likelihood for insured depositors to exercise discipline in selecting and monitoring the financial health of their banks, encouraging banks to practise moral hazard.

Moral hazard may be controlled by good **corporate governance, market discipline** by uninsured depositors and other creditors, and **regulatory discipline** by supervisory authority and deposit insurers.

5.4.1 CORPORATE GOVERNANCE

Good governance acts as a safeguard against excessive risk-taking by banks as it ensures accountability between shareholders, board of directors and management while protecting depositors' interests and takes into account effects on other stakeholders. This can be brought by oversight by directors and senior management, adequate internal standards, controls and audits, management of risks and evaluation of performance.

5.4.2 MARKET DISCIPLINE

Deposit insurance enhances market discipline as it enables market participants to shift funds from less sound banks to more stable institutions and in this process, provides signals to uninsured depositors. Such practices are only possible when information on the condition and performance of banks is available. Hence, there must be strong accounting and disclosure regimes obliging banks to disclose information which depositors, investors, regulators and the market in general can use as a reliable

basis for assessing the activities of a bank. To enable interplay of market discipline, depositors who are capable of monitoring banks' performance may also be excluded from coverage.

5.4.3 REGULATORY DISCIPLINE

Regulatory discipline encompasses all actions to curtail moral hazard by all participants in bank safety nets, including supervisory authorities, deposit insurers and central banks. Supervisors and deposit insurers have access to comprehensive information on banking risks through on-site examinations and off-site monitoring, than is generally available to the market. They may also be successful in rehabilitating troubled banks or limit the cost of their failure before the problems become irreversible.

Regulatory discipline includes strict licensing procedures, authorizing bank powers, assessing fit and proper managers and directors, measures to control risks and provisions for adequate internal controls and external audits. These measures have a continuous check on moral hazard.

Various tools of regulatory discipline have a direct bearing on controlling moral hazard. For instance, obligatory capital requirement induces owners to have greater interest in the sound operation of the bank due to substantial equity at risk. Managers' and directors' incentives to control moral hazard can also be reinforced by legal sanctions against improper activities such as self-dealing, conflicts of interest, negligence and failure to take required actions.

5.5 THE NEED FOR MAURITIUS TO IMPLEMENT A DEPOSIT INSURANCE SCHEME

The international banking community recognises the importance of deposit insurance to promote financial stability. Regional groups such as ESAF and COMESA have proposed initiation of plans for the adoption of deposit insurance schemes which best suit the specific environment of individual countries. Mauritius forms part of these two regional groups.

ESAF members are awaiting the development of a harmonised standard in deposit insurance for the entire region based on the South African model. Bank supervisors in the COMESA region have proposed initiation of plans for the setting up of deposit insurance schemes that suit the specific conditions of individual countries.

With the growing concern for deposit insurance at both the regional and international level, and given that the local financial system is undergoing significant changes and is aspiring to become a modern financial centre in this part of the world, the implementation of a deposit protection scheme in Mauritius may come up for consideration in the near term. The presence of a deposit insurance system will complement the existing supervisory framework in promoting stability and soundness of the financial system.

6. REGIONAL CO-OPERATION

In keeping with its open policy with regard to regional and international initiatives, the Bank continued to actively support initiatives taken at the regional and international levels to strengthen and harmonise supervisory standards. In particular, it joined in the efforts of East and Southern Africa Banking Supervisors Group (ESAF) and the Basel Committee on Banking Supervision to promote effective supervision of banks.

6.1 THE EAST AND SOUTHERN AFRICA BANKING SUPERVISORS GROUP (ESAF)

ESAF is a group of 16 regional Central Bank supervisory authorities established in 1993. It aims to promote and enhance the quality, nature and ambit of banking supervision and to harmonise banking supervisory practices among its members in line with international standards. The Bank of Mauritius is a founder member of ESAF.

ESAF also has the responsibility to build up competent supervisors through the provision of training facilities and fostering high level exchanges with supervisors from other parts of the world. Accordingly, during the year under review, several high level workshops and seminars were organised to the benefit of regional supervisors by ESAF with the support, amongst others, of the Financial Stability Institute, the IMF and the World Bank, with the Managing Director of the Bank as ESAF's Chairman. This forum is employed as a peer pressure group with a view to raising regional regulatory and supervisory standards and bring together the regulators of the region in a common forum that meets regularly. Furthermore, ESAF continued to act as the direct link between the Basel Committee of Banking Supervisors and the regional supervisory authorities in a two-way exchange of views on matters of mutual interest.

6.2 PRINCIPAL ISSUES ON THE AGENDA OF ESAF

Though ESAF has not been long in existence, it has committed itself in a vast programme of activities which should constitute a strong base for consolidating prudential regulation in the region. The regular meetings which have been taking place within ESAF have built up an 'esprit de corps' among regional regulators and brought up a consistent agenda for reform. The major projects being currently pursued by ESAF are set out in the following paragraphs:

6.2.1 IMPLEMENTATION OF CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

ESAF members have endorsed the Core Principles for Effective Banking Supervision and have committed themselves to implement them within a reasonable time frame. Members carry out a regular self-assessment of compliance with the Core Principles Methodology published by Basel Committee twice each year. The self-assessment exercise enables the supervisory authorities to constantly enhance their adherence to the Core Principles and to establish a benchmark for their supervisory systems with the ultimate goal of enhancing the effectiveness of supervision.

6.2.2 HARMONISING OF PROVISIONING STANDARDS

Members of the ESAF countries embarked on another project with a view to harmonizing their loan-loss provisioning practices. A questionnaire has been completed by each member supervisory authority in this regard, describing the respective loan-loss provisioning regimes applicable to banks. The information is being consolidated with a view to set best practices harmonised standard for the region.

6.2.3 HARMONISATION OF ACCOUNTING AND AUDIT STANDARDS

The Executive Committee of ESAF decided to remain a member of the Steering Committee of the Eastern, Central and Southern African Federation of Accountants (ECSAFA) which has been commissioned to carry out a survey of Accounting Standards. ESAF is considering the development of common enhanced standards through this forum for the publication of financial statements by banks of the region, in keeping with international accounting standards and providing for the necessary disclosures.

6.2.4 BANKING SUPERVISION HARMONISATION PROJECT: BUSINESS PROCESS MODELS AND SUPPORTING INFORMATION

The objective of the project on harmonisation of business process models and supporting information systems is the provision of harmonised banking legislation, regulations, procedures and systems at a national and regional level within the ESAF region by endeavouring to:

- Identify weaknesses and shortcomings in the current legislation, regulations, procedures and systems in the region.
- Provide the necessary resources in order to design a generic architecture of banking supervision, both on-site and off-site.
- Investigate and identify cost-effective solutions to support the architecture.
- Ensure the implementation of quality systems.

The project, which was initiated in June 1997, reached an advanced stage when the business process models were developed and presented by SADC IT forum in November 2000. In February 2001, the banking supervisors of SADC met with the SADC Central Banks Information Technology Forum to discuss proposed information technology solutions that can assist bank supervisors in their harmonisation and other strategic objectives. The report prepared by the SADC IT Forum on the meeting was discussed by the ESAF Executive Committee in March 2001. It was decided to support the IT solutions to be developed by the SADC IT Forum using the business model developed by ESAF. The implementation of the project has been undertaken by Mozambique. Once implemented, other ESAF member countries may freely adopt the appropriate modules to their own regulatory framework, depending on their requirements and stage of development.

6.2.5 ON-SITE SURVEILLANCE MODEL

Members of the ESAF countries have also completed a questionnaire pertaining to on-site surveillance, with the objective of determining a minimum standard of on-site supervision. A document setting out the minimum standards for on-site bank examination was compiled and work is still continuing on this project.

6.2.6 LEGAL FRAMEWORK

ESAF recognises that the conduct of effective supervision should be based upon an appropriate legislative framework. To this end, the Executive Committee is encouraging member countries to direct their efforts towards establishing a harmonised and efficient legal framework for the licensing and regulation of banks.

6.2.7 EARLY WARNING SURVEILLANCE SYSTEMS

The Executive Committee of ESAF is also working towards the development of an early warning system (EWS) to be shared by all supervisors. Each supervisory authority has been requested to submit its own EWS to this end. The material obtained will be consolidated with a view to the development of a comprehensive EWS model.

6.2.8 REGIONAL INFORMATION SHARING

To promote sound banking systems, ESAF has directed its efforts to circulate prudential information pertaining to each member country to the entire membership. As such, the Executive Committee decided that each member should submit to the ESAF Secretariat, annual bank performance reports which include financial statements, capital adequacy for the banking sector, non-performing loans as a percentage of loans and advances, growth in assets, liquidity ratios, efficiency ratios and return on equity. Data received in this regard is consolidated for each member country and made available on the ESAF website (www.esaf.org). This regional exchange of information is to bring about greater transparency and to form the background for raising the level of regional supervision through regular prudential information exchange.

6.2.9 ESAF TRAINING PROGRAMMES

Since ESAF's inception, the formulation of training programmes has been one of the group's successes. Due to the high cost implications to attend training courses in Basel, Switzerland, members of the ESAF countries expressed their concern about the scarcity of resources in the region to undertake adequate capacity building. As part of the programme of the Financial Stability Institute (FSI) of the Bank for International Settlements to hold regional seminars and

workshops in various parts of the world to this end, ESAF has availed itself of these facilities to organize regular training sessions for regional supervisors. During the period 1 July 2000 to 30 June 2001, the FSI held two regional seminars - the first seminar and workshop being held in Mauritius on credit risk between 17 and 21 July 2000 while the second one, also on credit risk, was held in Cape Town, South Africa from 8 to 12 January 2001. More work needs to be done on this front in order to build up a strong body of supervisors.

6.2.10 DEPOSIT INSURANCE SCHEME IN THE REGION

Member countries of the ESAF are working currently on the development of a harmonised standard on deposit insurance schemes for the entire region. In this regard, South Africa plans to implement its proposed scheme. This scheme may be modelled upon as a common platform for setting up deposit insurance schemes at the regional level.

6.2.11 RESEARCH

ESAF considers that research is an essential component of banking supervision. In this regard, members have been encouraged to submit research topics in the field of supervision and to circulate among members documents on completed projects. Also, the Banking Supervision Department of South African Reserve Bank (SARB) completed a research project on microfinance, a subject in which there is considerable interest in the region. The report has been posted on the ESAF Website. Members have been invited to analyse and comment the report with the aim of developing a best practice guideline for a harmonised approach to microfinance in the region.

So far, the main concerns raised have been about the regulation of cross border/international micro-lenders and micro-lenders taking deposits.

6.2.12 ESAF WEBSITE

The ESAF website has been populated further. The Executive Committee of ESAF decided that all its members will publish their bank information on the website. In addition to information and documentation, the website can be used for interaction between the region's bank supervisors to discuss supervisory matters.

6.2.13 BANK GUIDELINES FOR THE REGION

Members of the ESAF have decided that efforts should be put together to issue guidelines on general supervisory issues. Work has already started on electronic-banking guidelines. Once agreement is reached on these guidelines, they will be issued to all the members of the ESAF countries for them to consider their adoption in their own jurisdiction.

N O T I C E

FOREIGN EXCHANGE DEALERS ACT 1995 -
SURRENDER OF AUTHORISATION BY MONEY-CHANGER

Novleen Enterprise Co Ltd of 49 Lees Street, Curepipe was granted an authorisation on 17 September 1998 to carry on the business of a money-changer at the Port Louis Waterfront, Port Louis, subject to the provisions of the Foreign Exchange Dealers Act 1995 and to the terms and conditions set out in the Foreign Exchange Dealers Regulations 1995.

In accordance with section 6(4) of the Foreign Exchange Dealers Act 1995, Novleen Enterprise Co Ltd has surrendered its abovementioned authorisation with effect from 1 June 2001.

The public is hereby informed that Novleen Enterprise Co Ltd has ceased to carry on the business of money-changer as from 1 June 2001.

19 June 2001 Bank of Mauritius

N O T I C E

FOREIGN EXCHANGE DEALERS ACT 1995 -
SURRENDER OF AUTHORISATION BY MONEY-CHANGER

MPC Holidays Ltd of Morcellement Boucan, Nalletamby Road, Phoenix, was granted an authorisation on 11 June 1998 to carry on the business of money-changer at MEDCOR Building, John Kennedy Street, Port Louis, subject to the provisions of the Foreign Exchange Dealers Act 1995 and to the terms and conditions set out in the Foreign Exchange Dealers Regulations 1995.

In accordance with section 6(4) of the Foreign Exchange Dealers Act 1995, MPC Holidays Ltd has surrendered its abovementioned authorisation with effect from 30 June 2001.

The public is hereby informed that MPC Holidays Ltd will cease to carry on the business of money-changer as from 30 June 2001.

19 June 2001 Bank of Mauritius

N O T I C E

FOREIGN EXCHANGE DEALERS ACT 1995 - CESSATION OF AUTHORISATION TO CARRY ON THE BUSINESS OF MONEY-CHANGER

San Vinson Co. Ltd of Quay Street, Port Louis, was granted an authorisation on 16 March 2000 to carry on the business of money-changer at Quay Street, Port Louis, under the provisions of the Foreign Exchange Dealers Act 1995 and the terms and conditions set out in the Foreign Exchange Dealers Regulations 1995.

The public is hereby informed that, in accordance with section 6(2)(c) of the Foreign Exchange Dealers Act 1995, San Vinson Co. Ltd has ceased to be authorised to carry on the business of money-changer as from 9 October 2001.

10 October 2001 Bank of Mauritius

PROTECTION AGAINST UNSOLICITED FINANCIAL PROPOSALS

Dear Sir

It has come to the knowledge of the Bank of Mauritius that some Mauritians are receiving unsolicited mails, enticing them to enter into financial transactions with persons claiming to be highly connected with foreign statesmen of ill-repute or well known foreign government undertakings.

In this connexion, those contacted are being requested by the mail senders to provide their full names, addresses, account details, and even credit/debit card information.

Other than being connected with money-laundering activities, such unsolicited offers for engaging into dubious transactions with unknown parties, may form part of well orchestrated plans to deprive account holders of their monies or to entangle them into swindling activities or even dangerous deals. Utmost caution should be exercised by members of the public before responding, if at all, to such unsolicited mails or communicating details of their accounts, card numbers and so forth.

It would be appreciated if you would arrange to place this information in a conspicuous place in your bank to enable the members of the public to take necessary precautions to protect themselves.

Yours faithfully

B. R. Gujadhur

LIST OF AUTHORISED BANKS, NON-BANK DEPOSIT-TAKING INSTITUTIONS, MONEY-CHANGERS AND FOREIGN EXCHANGE DEALERS

The following is an official list of domestic and offshore banks licensed to transact banking business or offshore banking, institutions other than banks which are authorised to transact deposit-taking business and authorised money-changers and foreign exchange dealers in Mauritius and Rodrigues as at **31 December 2001**.

DOMESTIC BANKS

1. Bank of Baroda
2. Banque Nationale de Paris Intercontinentale
3. Barclays Bank PLC
4. Habib Bank Limited
5. Indian Ocean International Bank Limited
6. South East Asian Bank Ltd
7. State Bank of Mauritius Ltd
8. The Delphis Bank Limited
9. The Hongkong and Shanghai Banking Corporation Limited
10. The Mauritius Commercial Bank Ltd

OFFSHORE BANKS

1. African Asian Bank Limited
2. Bank of Baroda
3. Banque Internationale des Mascareignes Ltée
4. Banque Nationale de Paris Intercontinentale
5. Barclays Bank PLC
6. Deutsche Bank (Mauritius) Limited
7. Investec Bank (Mauritius) Limited
8. P.T Bank Internasional Indonesia
9. SBI International (Mauritius) Ltd.
10. SBM Nedbank International Limited
11. Standard Bank (Mauritius) Offshore Banking Unit Limited
12. The Hongkong and Shanghai Banking Corporation Limited

NON-BANK FINANCIAL INSTITUTIONS AUTHORISED TO TRANSACT DEPOSIT-TAKING BUSINESS

1. ABC Finance & Leasing Ltd.
2. B.N.P.I Leasing Company Limited
3. Finlease Company Limited
4. General Leasing Co. Ltd.
5. Global Direct Leasing Ltd
6. Island Leasing Co. Ltd
7. Mauritius Housing Company Ltd
8. MUA Leasing Company Limited
9. SBM Lease Limited
10. SICOM Financial Services Ltd
11. The Mauritius Civil Service Mutual Aid Association Ltd
12. The Mauritius Leasing Company Limited

MONEY-CHANGERS (BUREAUX DE CHANGE)

1. Direct-Plus Ltd.

2. Shibani Finance Co. Ltd

FOREIGN EXCHANGE DEALERS

1. British American Mortgage Finance House Co. Ltd
2. Rogers Investment Finance Ltd
3. TC (Mauritius) Operations Co. Ltd