Regional Seminar on Non-bank financial Institutions Development in Africa – 9 December 2003

Welcoming Remarks by Mr. B.R. Gujadhur, Managing Director,

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Good Morning

I must begin by congratulating the World Bank and the Financial Services Commission of Mauritius for organizing this Regional Seminar to bring into focus the development of non-bank financial institutions in Africa.

It has helped to bring together a remarkable gathering of practitioners and eminent personalities who are considered as world authorities on the subject of non-bank financial intermediation. I have the pleasure therefore to welcome all of you in our midst today. I hope that the natural charm of Mauritius and its splendid weather will contribute to promote a fruitful exchange of views for the urgent and necessary further development of this area of activity in the Africa region.

Mauritius has a long history of financial intermediation. Its first bank was established in 1812. However, before that, during the French settlement, the island's internal trade was handicapped by periodic shortages of currency. To face these situations, the inhabitants had to devise an alternative medium of exchange, which included the use of playing cards as currency. Past experience of this nature has made of Mauritius a full fledged exchange economy with barely any informal sector. It may also interest you to know that Mauritius' strategic position in the maritime navigation routes of those days made it a favourite haunt for pirates who are reputed to have used our volcanic caves as old style vaults to lodge their high risk earnings from the high seas. This activity provoked the

British to such an extent that they fought a battle in 1810 to conquer the island for good and rid themselves of the pirates who attacked their ships plying between East and West across the Indian Ocean.

Mauritius today is far more sophisticated in terms of financial infrastructure. Banks are regulated by the Bank of Mauritius whereas NBFI's are regulated by the Financial Services Commission (FSC). Mauritius hosts 22 banks half of which specialize in the financing of international business. The NBFI's include a formal stock exchange, a score of insurance companies, several pension funds, house finance and leasing companies, non-bank deposit-taking entities, foreign exchange dealers, money-changers and thousands of global business companies engaging in global market financial business, ranging from acting as simple repositories of invested assets to active managers of international funds and trust business. Microfinance was recently started by the Development Bank as an explicit NBFI activity. However, a well designated legal and regulatory framework for this activity is yet to be introduced.

Much of the more recent NBFI development in Mauritius has come about as a result of tax and regulatory arbitrages. Corporate listing was induced by a tax incentive scheme whereby the listed company and its shareholders were lightly taxed compared to other corporates. Similarly, insurance, pensions and unit trusts have generally been marketed with reference to relative tax benefits. The leveling up of tax rates over time has raised questions among some stakeholders concerning the judiciousness of their past decision to form part of the NBFI accountability framework, once those incentives ceased to constitute a distinct advantage. The unfolding of the regulatory embrace of the Financial Services Commission on NBFI's has similarly started raising questions in parts of the NBFI sector as to whether they are not being made more accountable than it is justified by their sheer business pursuits.

Seen from another angle, Mauritius is equipped with a modern Real Time Gross Settlement (RTGS) system since 2000, which ensures that interbank transactions are cleared and settled within seconds, with instantaneous finality. The Central Depository System of the Stock Exchange is also based on an automated trading system, the full capacity of which remains to be utilized as the market gains in depth and liquidity. Advancing technology support, backed by a well defined system of bank rules and regulations, became the driving edge in favour of the banking sector, compared to NBFI's which have proved to be slower in terms of product development or targeting of cross-border opportunities. The more this gap is efficiently plugged, the sooner will the financial sector of Mauritius, including NBFI's, equip itself to better serve our regional economic hinterland. This Seminar would, I believe, enlighten us on how to improve regional financial integration and, hence, best serve the underlying economic interests.

It is estimated that over one third of Mauritius' total financial assets are managed by NBFI's. The bulk of financial assets are consequently held by the banking sector. This situation is in sharp contrast to what obtains in the developed financial markets where the banks' share has been dwindling as active NBFI's have taken over the business of diversifying the financial market. As stated, adoption of new technology and improvement of product quality have been moving faster in the banking sector than in the non-bank sector. So that a better balance is achieved in the relative weights of the bank and non-bank financial segments of the economy, more product development and use of technology would do justice to the NBFI sector. For the economy as a whole, a better balancing of the two segments of the financial market is expected to send the appropriate price signals and speed up macroeconomic adjustment. This development should usher the economy into a new phase of balanced growth and take greater care of market volatility.

As we all know, a financial system is judged by the speed with which funds are efficiently allocated by it to alternative uses. Thus, one would expect that a situation of easing of monetary policy would normally drive more funds into other financial asset markets, including equities. The successive reductions of the Lombard Rate by the Bank of Mauritius since after November 2002 has been reflected in sustained increase of the SEMDEX, the local stock market index. This shows that the money market and the equity market can develop clear communication channels when there is a realistic alignment of the interest rate structure with the internal rate of return of companies. Had our stock of tradeable alternative financial assets also been more substantial, the transmission of signals between the money market and other financial assets market would have been even more effective. Our experience shows that insufficient integration of the short and medium term funds markets and relatively low volumes of trades can inhibit their efficient coordination especially in a situation where price distortions prevail.

To bring the money market and the longer-term funds market to correspond more efficiently in terms of the transmission mechanism, we reckon that a wider array of financial instruments should be put in place for trading. In the present Mauritian context, sustained dealings in government and corporate bonds should move the market a stage further. For, as it is also known, a well functioning government and corporate bonds markets, combined with an active market for bills of exchange, is conducive to an efficient overall liquidity management in the economy. We will have to work harder to bring about the development of those debt instruments, creating a sustaining market for them and giving this market the necessary depth and liquidity. The start of primary dealing in Government securities since 2002 and the fillip this activity is expected to give to secondary market trading of Treasury Bills on the Stock Exchange, represent steps in this direction. While Government securities are available for trading, the corporate bond market still has to take shape significantly, doing away with the current pattern of financing capital investment needs using short term money market funds. There is good scope therefore for a more dynamic style of corporate treasury management in Mauritius. If so, that should spin off the required corporate debt market to enable us to strike a meaningful balance between bank and NBFI financing of economic activities.

Cross-border financial transactions are currently largely centred on specialized international banking and offshore corporate structures operating from Mauritius but these are mostly part of the system of international capital flows. They do not impinge directly on the domestic money supply. As there is no exchange control in Mauritius, regional cross-border financial transactions, under proper safeguards, should be able to extend the scope of the NBFI sector. This activity can take concrete shape when there is a good interplay of regional economic partnerships. Such partnerships are expected to generate continuing short and long term financing needs across regional economies, thus encouraging the flow of funds to competing uses in a wider market. We have for decades been working hard to bring about convergence of standards and norms at the level of regional economic blocs which should act as the trigger for this type of activity. Progress made so far paves the way for a wider competitive regional market for funds for soundly structured NBFI's to venture in.

The prospect for NBFI's to assume cross-border roles raises a number of questions. I believe that those issues will be addressed in the course of the Seminar. One cannot help mentioning, however, the importance of adequate capitalization, good risk management, competence, skills, proximity to one's market, competition and good governance in determining the success of NBFI's in the search for a wider market and the sharing of experience regarding the financing needs of what may be called an essentially local environment. Mauritius can look forward to play its role in this broader context once our NBFI's venture out into this bigger enterprise calling for regional alliances.

A vital role which NBFI's play in an economy is to act as a buffer, especially in moments of economic distress. The ongoing skilful manoevring of monetary policy in the US, coupled with a correct balancing of potential policy slippages by constant movements of prices on the bond and equity markets, has probably spared the US and, with it, the World economy, the pains of a pronounced economic downturn. The duty to foster NBFI development extends therefore beyond the immediate objective of creating jobs in specific sectors of the economy which are not readily served by the more formal segments of the financial sector. As the developed markets' experience in the current economic cycle demonstrates, an efficient NBFI sector also acts as a systemic risk mitigator and contributes to the overall goal of financial stability in the domestic economy and in the region.

In these introductory remarks, I have tried to paint a broad brush view of some of the current issues facing the development of the financial sector of Mauritius with the hope that it will give you an insight into the constraints we are confronted with in the context of a small island economy trying to forge better links with its regional neighbours while striving to give the internal market more substance.

May I now wish that your stay in Mauritius be a pleasant and instructive experience and thank you all for your kind attention.