Address by Mr Rundheersing Bheenick, Governor, Bank of Mauritius, at the signature ceremony of the Memorandum of Understanding between the Bank of Mauritius and the Competition Commission of Mauritius, Thursday 26 August 2010

Welcoming Remarks

Let me begin by welcoming all of you to the Bank. I extend a special warm welcome to the distinguished Acting Chairman and Executive Director of the Competition Commission of Mauritius, the Chief Executive of the Mauritius Bankers Association and the President of the Association of Leasing Companies. This is the very first signature ceremony that we are having this year and the last of a series of Memorandum of Understanding (MoU) that we signed. In fact in 2009, we signed MoU's with Central Statistics Office, the Financial Intelligence Unit and the Mauritius Revenue Authority. These added to the MoU that we had signed in 2002 with our sister regulator, the Financial Services Commission, which was revived in 2007 with the setting up of a Joint Coordination Committee between Bank of Mauritius and Financial Services Commission.

The special nature of banks

In the field of competition policy, banks are special. In many European countries the authority that had the responsibility of promoting competition was very often the supervisory authority itself. In the US, the Fed was vested with competition competencies for the banks it was supervising. This situation evolved in July 2010 with the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Act provides for the setting up of a new consumer financial protection agency to be known as the Bureau of Consumer Financial Protection. In Italy and the Netherlands central banks are entrusted with wide-ranging tasks in the area of competition policy. In the EU where there was a strong competition authority, ever since 1958, its extensive powers were not usually applied to banks. It is only in the 1980's that the European Court of Justice established that banking activity should not be excluded from the application of the Articles of the Treaty concerning competition policy.

Why was it like this? It was widely believed that a competitive system was not really congenial to banking – it was something to be feared as a potential source of serious disruption. Competition means selection – authorities must be ready to let the weakest banks leave the market.

The late 1980's saw a complete change of attitude following the liberalization of banking systems. The internationalisation of banking introduced an additional stimulus to competition – enlarging the set of competitors, introducing competition in rules, prudential systems and supervisory structures.

Competition is not the only mode in which the banking industry currently works; it works also in a cooperative mode. In the banking industry there are certain services that call for cooperation e.g. payment services, and clearing and settlement systems. The internationalisation of banking also generates a need for enhanced cooperation in the policy and supervisory functions. On the other hand, the light-touch regulation and market-friendly legislation favoured by many developed countries are conducive to self-regulation which is perceived as a cooperative exercise. Sadly, such cooperation may sometimes degenerate into collusion. This mix of cooperation and competition has been called co-opetition. Banking is the area *par excellence* where we have co-opetition.

In the global financial crisis, we witnessed how excessive competition among banks resulted in excessive risk-taking, threatened the solvency of particular institutions and spread rapidly with the risk of collapse of the global financial system. Added to this is the increased importance of networks and network externalities in the financial services industries which result in a complex financial system where no one knows where the risks really lie. We also saw the use of statutory powers by states to rescue failing banks which constitute a form of state aid which may distort competition – policy of "too big to fail". Deposit insurance reduces the likelihood of a general loss of confidence in the banking sector. But it does not enhance the incentives for banks to behave in a prudent manner.

We thus have a competitive banking system which develops with elements that are quite opposite to the nature of competition. A competition policy for the banking industry may therefore face certain limitations especially in such a small economy like ours.

Role of the Bank of Mauritius in promoting competition

There are indubitable benefits in competition: driving down costs and prices, stimulating innovation, achieving improvements in productivity and increasing choice – all these ultimately benefit the consumer. The welfare of the consumer is at the heart of every competition decision.

Central banks have a primary role as guardians of macro-economic stability. One of the objectives of the Bank of Mauritius is to promote a balanced and orderly economic development. We have competition powers embedded in our law, albeit in a very general manner, for example those addressing market power, mergers, ensuring that financial institutions under its purview do not engage in anti-competitive market practices detrimental to consumers of financial services. Competition policy is thus a core element in economic policy, playing a key role in promoting a strong competitive economy leading to economic growth and prosperity for our citizens.

If we look at the Herfindhal Hirshman Index (HHI) of the banking sector – the HHI is an indication of the degree of competition in the banking sector – we find that we have a hefty concentration in the banking sector: The two largest banks make up for over 50 percent of the market and if we take the four largest banks, it comes to around 80 per cent of the market. Banking system concentration is often negatively associated with competitiveness. But paradoxically, some studies show that a high market share results in a stable banking system. Should we therefore not promote competition but concentration?? Our banking sector shows significant resilience and stability. There is a choice to be made. Do we want more stability or do we want more competition that may destabilize the sector?

How do we achieve a balance between these seeming extremes? We have to balance competing claims of competition on the one hand and concentration on the other. Our wards have the same problems: we want them to compete but at the same time we want them to cooperate among themselves. The Bank of Mauritius is here to supervise this element of cooperation.

The Bank in consultation with the Mauritius Bankers Association has tried to bring as much competition as possible in the banking sector, while not endangering our banks to avoid liquidity and solvency risk. We want to make it as transparent and as competitive as possible by giving access through the Bank's website to fees, commission and charges of banks so that consumers can make more informed decisions in their choice of financial products. At the same time, the best way to enhance competition is to bring in new players. We strongly believe that being open to new entry is the most important competitive pressure. Banking is an area where there are barriers to entry. The Bank adopted a flexible approach towards licensing. There are no entry restrictions *per se* in our licensing policies but our licensing requirements are stringent with a propensity to accept strong overseas banking groups of good repute. Over the last three years, we have licensed more moneychangers, more banks including one Islamic bank.

We have recently taken certain measures to combat anti-competitive behavior in the money and foreign exchange market. We introduced short-term foreign currency swaps when in our monitoring of the foreign exchange market we had observed that exporters were holding back their export proceeds. The Bank is now considering introducing foreign exchange futures to complement the swaps. We initiated a forensic investigation to probe into suspected anti-competitive behavior by some market players and decided to supply the largest buyer of foreign exchange, the State Trading Corporation, directly with its requirements of foreign currency, pending normalization of market functioning. If we look at the chart on the evolution of the US dollar and the euro against the rupee, the movements clearly show that during the month of May the US dollar was trading around highs of Rs34 and the euro at around Rs42, but soon after the initiation of the investigation, both resumed their normal trend.

Today the foreign exchange market is functioning better and exchange rate movements are demonstrating less volatility, and this in spite of open criticism in some quarters on the appropriateness of our exchange rate regime. We intend to post on a daily basis a central rate around which the Bank is prepared to conduct sale and purchase operations for large volume transactions. We did not turn a deaf ear to the plight of operators in the export-oriented and tourism sectors. We have worked in concert with Government and private stakeholders to come up with targeted measures to give support to economic operators.

Importance of consultation and information-sharing

Competition Authorities have decision-making power over policies outside their main sphere of expertise. We, regulators have specialist expertise, knowledge and resources that should be tapped. Hence, the importance of mutual consultation and information-sharing between the Competition Commission and Bank of Mauritius – to help us avoid inconsistent decisions, ensure complementarity in policies and smooth out potential sources of conflict.

We welcome the Competition Commission. It has its job cut out for it. It will strive to get us to recognize areas where we could do with some more competition. I think that for a young institution which has been in business for a year, you have done quite a lot. If you continue on this trajectory, I think we will be able to see a more competitive Mauritius emerging within a very short time. I wish you all the best and look forward to work with you, hence the need for the MoU we are signing today. We do not want to have competition with you in the area of banking. We want to share our responsibility together with you, to cooperate with you, so long as you understand the special nature of banking. Banking is a sector that needs to be approached in a very prudential manner because of the risk that failure in the banking sector can bring down the rest of the economy if handled wrongly.