ANNUAL REPORT
on Banking Supervision 2008

BANK OF MAURITIUS

Annual Report on Banking Supervision 2008

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1 OVERVIEW

INTRODUCTION

The US sub-prime mortgage crisis intensified and culminated in the failure of Lehman Brothers in September 2008 that triggered a global economic crisis. Indeed, the failure of Lehman Brothers posed risks that were significantly underestimated by authorities and, combined with the unexpected collapse of AIG, led to conditions of extraordinary turbulence in global financial markets that rapidly spilled over to the real economy. The crisis spread with such rapidity that Government authorities across the world were forced to take drastic measures to restore confidence in the markets. The financial market turbulence has revealed a number of shortcomings in the regulatory and supervisory framework that require urgent corrective actions on the part of regulators and supervisors as well as the financial industry at large. Internationally coordinated efforts are required to prevent the banking system and the financial system from collapsing. The scope and duration of the crisis are not known at this stage and authorities have taken urgent measures to protect the real economy from the impact of the crisis.

A number of bodies, including the Financial Stability Forum, the Basel Committee on Banking Supervision (BCBS) and the European Community have produced reports and recommended a series of measures aimed at restoring confidence, strengthening financial sector supervision and regulation. At its meeting in London in April 2009, the G20 acknowledged that one of the preconditions for sustainable globalisation and rising prosperity for all was an open world economy based on market principles, effective regulation, and strong global institutions. To this end, it took a series of measures, and also pledged to reform international financial institutions, promote global trade and ensure sustainable recovery. Leaders of the G20 countries agreed on a global plan for recovery on an unprecedented scale. A major decision was the trebling of resources available to the IMF to $750 billion, a new SDR allocation of $250 billion, at least $100 billion of additional lending by the Multilateral Development Banks, $250 billion of support for trade finance, and the use of additional resources from agreed IMF gold sales for concessional finance for the poorest countries.

There was also agreement on the proposed establishment of a new Financial Stability Board (FSB) with a broader mandate, as a successor to the Financial Stability Forum (FSF), which will include all G20 countries, FSF members, Spain, and the European Commission. The FSB would collaborate with the IMF to provide early warning of macroeconomic and financial risks and the actions needed to address them. It was also decided to bring all systemically important financial institutions, including hedge funds, instruments and markets within the ambit of regulations, and to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice. Further, it was decided to take action against non-cooperative jurisdictions, including tax havens, and to call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards.

A new approach to regulation and supervision

In Mauritius, banking regulation and supervision has been reinforced in recent years, which has helped the banking system to remain resilient to external shocks. The Bank does not foresee any adverse impact of the ongoing events on the banking system in the country. However, continued vigilance is maintained and guidance provided to address emerging risk areas and more advanced risk assessment methods, including stress testing, developed to increase the Bank's capacity to address vulnerabilities at both micro and macro level.

The banking system in Mauritius is quite robust and has been relatively insulated from the global financial turbulence. The Bank has, nevertheless, been vigilant and paying due attention to the lessons that have emerged from the global financial crisis. The Bank has been constantly reviewing and refining its regulatory and supervisory policies to ensure that the banking system is strong enough to weather such situations. The new approach of the Bank towards regulation and supervision aims at adding a macro or systemic perspective to the traditional micro view of regulation and supervision, taking into account the developments in financial markets locally and abroad. The financial crisis has also highlighted the need for regulators and supervisors to focus on the big picture and the longer time horizon. The Bank continues to monitor the banking sector and financial markets closely, and makes amendments to guidelines governing the operations of banks in line with updated international best practices. A detailed description of changes to guidelines brought by the Bank is given in Chapter 2.

The Mauritian banking sector

Banking legislation which underwent a major overhaul in 2004 provides for the consolidation of the banking sector. The uniform regime has brought about significant changes in the way banks conduct their business. Banks are less dependent on the domestic market and have turned to foreign sources for their income. Now that the banking sector is more open to the global financial system, the risks of external shocks have also increased.

In spite of this, the Mauritian banking sector has so far been pretty much insulated from the financial market turbulence. The ability of the banking sector to withstand shocks is an important prerequisite for any economy in managing the spillovers from a slowing global economy and volatile financial markets. The fundamentals of our banking system are strong: banks are well capitalised and profitable; the risk management standards are high; asset quality is good. Our banks' balance sheets are not weighed down by toxic assets that were at the root of the international financial crisis. They rely more on deposit funding rather than on external funding and as such are relatively unaffected by the global credit crunch. There are no direct threats of any adverse fall-out of the on-going global financial market crisis on the banking system in Mauritius. Nevertheless, the slowdown in international demand will inevitably spill over to the real economy and will eventually put pressure on banks' asset quality and profitability. The Bank remains vigilant and monitors very closely these developments.

A major development in capital market in Mauritius that will benefit the banking sector has been the setting up of a Commodity Exchange in Mauritius. The new Exchange, known as Global Board of Trade Ltd (GBOT) was licensed by the Financial Services Commission (FSC) on 20 February 2008. GBOT is planning to launch the Commodity Exchange as the first phase of a broader Multi Asset Class Exchange. It is envisaged that trading will initially be carried out in precious metals, base metals, energy, green contracts and agricultural commodities.

At the end of 2008, there were 18 banks, 13 non-bank deposit taking institutions, 5 foreign exchange dealers and 7 money-changers in operation in Mauritius. During the year, the Bank granted its approval-in-principle for the opening of two Islamic banks, which have not yet started operations.

Nedbank International Limited, which was authorised by the Bank on 17 August 1999 to carry on class B banking business in Mauritius under the provisions of section 3 of the Banking Act 1988, applied for permission from the Bank for the surrender of its banking licence under the provisions of section 11(7) of the Banking Act 2004 with effect from close of business on 28 February 2007. On 26 February 2008, the Bank, under section 11(7) of the Banking Act 2004, accepted the surrender of its banking licence for cancellation.

In April 2008, the British American Investment Group, a Mauritian conglomerate with a well-established presence in many segments of the economy and having an international presence as well, took over South East Asian Bank Ltd which was hitherto owned by the CIMB Group, Malaysia. The name of the bank was subsequently changed to Bramer Banking Corporation Ltd.

Following the take-over of First City Bank by CIEL Investment Ltd (50%) and I&M Bank Limited (50%) in 2008, the bank underwent a major re-branding exercise and changed its name to Bank One Ltd in August 2008.

In October 2008, Indian Ocean International Bank Limited merged with SBI International (Mauritius) Ltd. Following the merger, Indian Ocean International Bank Limited surrendered its banking licence to the Bank in accordance with section 11(7) of the Banking Act 2004. The merged banks now operate under the name of SBI (Mauritius) Ltd.

With effect from 1 October 2008, Cim Leasing Ltd, a non-bank deposit taking company licensed by the Bank, amalgamated with Cim Finance Ltd and the amalgamated entity operates under the name of Cim Finance Ltd.

2 Domestic Developments in Banking regulation and supervision

Under the Financial Sector Assessment Programme (FSAP) of 2007, the Bank was assessed non-compliant in a number of Basel Core Principles (BCP). The Bank sought and obtained technical assistance from the IMF to enhance its regulatory and supervisory framework. The Advisor deputed by the IMF has made a number of recommendations, some of which have already been implemented and are highlighted below.

Two important initiatives have been the revision of guidelines to give banks greater operational autonomy and the rationalisation of procedures with respect to queries and requests from financial institutions. All guidelines are now drafted in a more legally rigorous style to enhance enforceability. The guidelines are generally more principles-based, the key principles that are necessary to ensure that business of banks is conducted in a sensible and prudent manner are set out. However, where the Bank deems it necessary, detailed checklists of requirements are set out. A more detailed account of the changes brought to the guidelines is given under the caption 'Guidelines'.

Section 62 of the Banking Act 2004 has been amended and financial institutions are now free to determine their working hours and the days they wish to operate, subject to observance of the core hours of business as decided by the Bank. Accordingly, the Bank has advised financial institutions that the core hours of business would be from 0930 hours to 1500 hours Monday to Friday, and financial institutions should remain open for a minimum of 32 hours per week. This is in line with government's policy of transforming Mauritius into a 24/7 economy.

Another change in policy has been with respect to advertisements. Under the Banking Act 2004, no advertisement respecting deposits shall be made on behalf of a financial institution unless a copy of such advertisement has been submitted to the Bank not less than 7 days before the intended date of publication or other dissemination. Where in the opinion of the Bank an advertisement is misleading, the Bank may direct the financial institution or other person responsible for the dissemination of such advertisement to withdraw or modify it. The responsibility now devolves entirely on financial institutions to ensure that any advertisement published or disseminated by them is couched in such a manner that it is not to be misleading and it also stands the test of being fair, objective and conforming to the highest ethical standards. The Bank has also laid down some broad principles which financial institutions are required to follow while framing advertisements. It is pertinent to mention here that it is a requirement to disclose information regarding the Annual Effective Rate (AER) or the Annual Percentage Rate (APR) equivalent in cases where the advertisement and public notice refer to specific interest rates. In calculating the AER (applicable on deposit accounts) or APR (applicable to loans/credit products), the interest paid on the deposit account or yield on the loan/credit products shall be computed after taking into account, the rate of interest applicable and the period of the deposit or loan. The objective of this initiative is to help the public in making financial decisions based on information that can be compared across banks.

Access to information on bank fees and charges

The Bank has created a window on its website with links to banks' websites that allow easy access by consumers to information on banks' principal interest rates and fees and charges in a standard format and facilitate comparison of the fees, charges and commissions among banks. This initiative of the Bank aims at promoting greater accessibility and transparency with regard to bank charges. Incidentally, the 'Banking the Poor'[1] publication of the World Bank that was launched at the Bank in November 2008 revealed that Mauritius has the highest density of accounts in Africa, with 2,011 accounts per thousand adults. In comparison, Singapore, the richest country in the sample, has 2,058 accounts per thousand adults. Among the countries covered in the survey, according to this indicator of banking access, Mauritius ranks third behind Malaysia and Singapore.

Risk assessment tools

With a view to attaining its objective of consolidating and enhancing the supervision of financial institutions, the Bank sees a need for the use of risk assessment tools that would improve the ability of supervisors to make better judgements on the health of financial institutions falling under its regulatory purview and to also identify any threats to financial stability. The CAMELs rating framework is presently under review and work relating to the development of other supervisory tools will soon be initiated. The risk assessment tools will eventually constitute an essential component of the supervisory review process under the Basel II framework. The Bank also expects banks to carry out stress testing as part of their risk management programme. To this end, general principles on the type of stress testing that would need to be carried out have been laid out in guidelines wherever warranted. Those initiatives emanate from the recommendations of the FSAP of 2007.

Mauritius Credit Information Bureau

The Mauritius Credit Information Bureau (MCIB) has been instrumental in improving asset quality of banks by providing information on the credit history of potential borrowers. Banks are thus able to better assess the creditworthiness of borrowers. The thresholds in place for reporting credit information to the MCIB did not allow banks to have a complete picture of the borrowers. With effect from 1 March 2008, the Bank has removed the thresholds in place for the reporting of credit information. The Bank intends very shortly to extend the coverage of the MCIB to other institutions such as the leasing companies, insurance companies and public utility companies. The Banking Act has also been amended to license the credit information bureau and recognise external credit assessment institutions.

Implementation of Basel II

Since the adoption of the original Basel Accord in 1993, the Bank has continuously endeavoured to strengthen its regulatory and supervisory framework with a view to aligning it with international best practices. At the time the BCBS released its first reform proposals of Basel I, the Bank's prudential supervision was at a reasonably good standard but the Bank considered the Basel II framework to be the next step towards the reinforcement of its bank supervision regime. By adopting Basel II, the Bank wants to attain the following objectives:

- better align regulatory capital with the risk profile of banks;
- align the current prudential standards with international guidelines; and
- make use of the available national discretions to better reflect the specificities of the local industry.

The Bank's approach to the implementation of Basel II was a consultative one with the setting up of a Committee for the Implementation of Basel II in Mauritius and eight Working Groups. Taking into account the level of development and degree of sophistication of our banking industry, the Bank, after a survey conducted to assess the industry's readiness to move to

[1] *'Banking the Poor' explores associations between countries' banking policies and practices and their levels of financial access, measured in terms of bank accounts per thousand adults.*

Basel II, judged it more appropriate and sensible to adopt the standardised approaches as a first step. The comments received from banks were supportive of that position and the Bank has been able to reflect much of the response in the proposal papers. During 2007/2008, the Bank finalised the guidelines relating to the Pillar 1 minimum capital requirements and Pillar 3 disclosure requirements. The prudential standards for the Pillar 2 are in progress.

Areas of national discretions

As permitted under Basel II, the Bank has exercised a number of discretions so as to adapt the standards to the conditions prevailing in the Mauritian banking sector. For example, the Bank has applied limits to exposures secured by residential mortgages that attract a lower risk weight under Basel II (35 per cent) compared to Basel I (50 per cent), and a conservative loan-to-valuation (LTV) ratio to reflect the rising importance of the housing sector, especially the mortgages under the Integrated Resort Scheme. The recent subprime mortgage crisis in the US has underscored the importance of aligning more closely capital to risk and of monitoring LTVs in time of falling house prices or stress in the market. The Bank takes comfort in the prudent approach it has adopted in respect of this type of exposure. The views of the industry are taken into consideration in reaching decisions, and the Bank keeps all its Basel II discretions under review.

Impact of adopting the standardised approaches

The banks have expended significant resources for the upgrading of their IT systems, internal and external training and education. On the other hand, the Bank has devoted resources to develop the supervisory infrastructure and technical capacity required for the implementation of Basel II. The benefits associated with the effort and resources deployed can already be seen in improved risk management in banks. As of now, banks are well into the process of moving towards full implementation of the standardised approaches of the framework.

Under Basel II, there are a greater number of deductions, of which a larger proportion need to be made from Tier 1 capital, for example investments in subsidiaries and commercial entities are now deducted from Tier 1 capital, and revaluation reserves, a component of Tier 2 capital, are subject to a discount of 55 per cent. Those changes in the components of eligible capital drive a decrease in minimum required capital – Tier 1 and total capital. The positive contribution that operational risk capital charge would normally make to the increase in minimum capital requirements has not been conspicuous in view of the fact that banks already maintain capital for operational risk since April 2005. With respect to market risk, there is no capital charge presently imposed on banks on account of the fact that trading activities of banks are not considered to be significant.

The residential mortgage portfolio (claims secured by residential property) and the regulatory retail portfolio, which attract risk-weights of 35 per cent and 75 per cent respectively, contribute to a lower capital charge for banks. Banks with an asset structure more oriented towards retail activities will benefit from the more favourable risk weighting. With respect to corporate entities, the risk weights are determined by the ratings of external credit assessment institutions. Corporate entities with ratings in the upper end of the spectrum would benefit from better risk weights. In Mauritius, most corporates are unrated and the Bank has used its discretion and allowed banks to continue to be assigned 100 per cent risk weight as under Basel I. This option must however be applied consistently across the corporate portfolio.

For the quarter ended 31 March 2008, total capital base in the banking system under the Basel II framework fell by Rs1.2 billion compared to the Basel I framework, while total risk weighted assets rose slightly by Rs0.4 billion. The combined effect of these changes was a marginal decline in the Capital Adequacy Ratio (CAR) of the banking system from 15.1 per cent to 14.7 per cent. For the quarters ended 30 June 2008 and 30

September 2008, the CAR of the banking system fell by 0.3 per cent to 14.9 per cent and 0.7 per cent to 14.0 per cent, respectively. The analysis indicates that the new method of computation of the CAR did not impact significantly on the CAR of the banking system, which remained well above the minimum requirement. However, at the level of individual banks, the ratio fell below the statutory minimum of 10 per cent in the case of two banks, requiring injection of fresh capital.

The way forward

The impact of the Pillar 1 requirements (standardised approaches) has been assessed over four quarters under the parallel run exercise. The preliminary results indicate that the new method of computation of the CAR has not significantly impacted on the capital of banks. The Bank has thus decided to do away with the parallel run exercise in the one-year time frame. The draft guideline on supervisory review process (Pillar 2), which has already been issued for consultation to the industry, will soon be finalised and will become effective in 2009. The Pillar 3 of the Basel II framework – market discipline – has been incorporated in the *Guideline on Public Disclosure of Information* and comes into effect on 31 December 2008. All three pillars of the Basel II framework (standardised approaches) would thus be implemented in 2009 as planned. The Bank keeps in mind that the adoption of advanced approaches of the Basel II framework would translate in a better measurement of risk for the banking industry and is set to give the incentives to banks to move to those approaches at the appropriate time.

Developments in Islamic Banking

Following the issue by the Bank of the Draft Guideline for Institutions Conducting Islamic Banking Business to the industry for consultation in February 2008, a wide range of queries and views were submitted by a number of institutions respecting the modus operandi and the supervisory framework within which banks were to be permitted to conduct Islamic banking business in Mauritius. A broad based and multidisciplinary Sub Committee on Islamic Banking was subsequently set up under the chairmanship of the Bank in order to deliberate on the issues raised by the stakeholders and review other details pertaining to the implementation of Islamic banking. The consultation exercise gave rise to modifications that were incorporated in the draft version of the document, and the Guideline for Institutions Conducting Islamic Banking Business was finalised and came into effect on 27 June 2008.

On a parallel basis, the Bank undertook initiatives towards ensuring that a level playing field is maintained between banking products offered by conventional institutions and the relevant Islamic financial products intended to be offered or availed of. Following a submission made in this regard to the Ministry of Finance and Economic Empowerment, amendments have been brought in the Finance (Miscellaneous Provisions) Act 2008 that obviate the levy of multiple payment of duties which would otherwise have become payable under the Islamic mode of financing land and property. Concurrently, the Income Tax Act was amended such that the effective return of an Islamic financing arrangement is duly captioned for references made to interest payable, paid, derived, received or incurred in relation to any loan, deposit or mortgage. Provision has also been made in the Finance Act 2008 to allow non-bank deposit taking institutions licensed under the Banking Act 2004 to engage in the business of accepting Islamic deposits, subject to these institutions having obtained the appropriate licence from the Bank.

The Bank has now embarked on a major project for the development of an Islamic money market and liquidity management framework. In terms of its statutory obligation for ensuring the stability and soundness of the financial system in Mauritius, preliminary work is being carried out at the Bank for the implementation of a systemic liquidity infrastructure that will have a direct impact on market liquidity and will facilitate the liquidity management of Islamic banking institutions.

Signature of a Protocole D'Accord and Launching of a Joint Bank of Mauritius/Financial Services Commission Coordination Committee

The Bank of Mauritius and the Financial Services Commission signed a Protocole D'Accord which expands on the scope of the Memorandum of Understanding (MOU) signed between the two regulatory and supervisory bodies in December 2002. The Protocole D'Accord makes further provision for the parties to agree on the extent of their responsibilities and harmonization of their procedures with respect to financial institutions which are regulated by both institutions. The Protocole D'Accord sets out a framework of co-operation between the Bank of Mauritius and the Financial Services Commission in their common pursuit to maintain a safe, efficient and stable financial system in Mauritius. Both supervisory bodies work in close collaboration to ensure the setting up of appropriate arrangements to respond to threats to financial stability, to coordinate information sharing and avoid duplication.

The Committee met on several occasions in the year 2008 and had set up two Working Groups, namely on Licensing and Regulatory Requirements and on Supervision. The Working Group on Licensing and Regulatory Requirements has completed a comparative study of the guidelines issued by both regulators concerning prevention of money laundering and its recommendations have been considered by both regulators with a view to harmonising the customer due diligence requirements. The Working Group on Supervision has also finalised proposals towards initiating joint/consolidated supervision.

Licensing of additional money-changers

During the last few years, the foreign exchange market has undergone changes, particularly with regard to the volume of foreign exchange traded. The Bank considered that there was a need to review its stand with respect to the number of existing money-changers in operation. Accordingly, the Bank decided to license additional money-changers with a view to providing a more appropriate intermediating infrastructure for the cash segment of the market that would translate in more competitive rates for consumers. The Bank also reviewed the basic terms and conditions governing the operations of money-changers, and has introduced a minimum holding in treasury bills. Money-changers should also move to an automated environment for on-line transmission of data to the Bank as and when required. The licensing fee structure was also revised. Under the Banking (Processing and Licence Fees) Regulations 2007, there was a fixed fee of Rs300,000 and Rs100,000 for foreign exchange dealers and money-changers, respectively. It was subsequently replaced by the Banking (Processing and Licence Fees) (Amendment) Regulations 2008, which stipulates that a foreign exchange dealer has to pay a fixed fee of Rs300,000 in respect of the principal place of business and a fixed fee of Rs100,000 in respect of every other place of business, and a money-changer has to pay a fixed fee of Rs100,000 in respect of the principal place of business and a fixed fee of Rs50,000 in respect of every other place of business. As at 31 December 2008, 5 money changers out of the 14 newly licensed ones had started operations. One new foreign exchange dealer was licensed on 3 November 2008 and permitted to commence operations as from the same date.

Guidelines

Guideline on Credit Concentration Risk

The Bank reviewed the *Guideline on Credit Concentration Risk* which was issued in the year 2000. The revision took into account best central banking principles, the recommendations of the FSAP and the specificities of the local industry. The main changes are summarised below.

- The term 'related parties' as used in the Banking Act 2004 has a different connotation than the one used in the earlier guideline. In line with the Banking Act 2004 the term used in the revised guideline is 'a customer and a group of closely related customers'.

- The system of approvals by the Bank on a case by case basis has been dispensed with and the limits moderated so as not to stymie a bank's ability to lend to a reasonable extent.
- The principle adopted in the revised guideline is that the impact on the viability of a financial institution operating in Mauritius, as a consequence of a credit risk taken by it crystallising, varies depending on the structure of the entity concerned. The exemptions granted from credit concentration limits reflect the fact that the impact would be of an ascending degree on the branch of a bank headquartered outside Mauritius, a subsidiary of a branch headquartered outside Mauritius and a locally incorporated bank. The exemptions are in line with section 29(4) of the Banking Act 2004 which empowers the Bank to grant exemptions only for exposures in currencies other than Mauritian rupee.
- Banks and non-bank deposit taking institutions have been given a transition period of two years to comply with the regulatory credit concentration limits set out in the revised guideline.
- The Basel II Pillar 2 specifications have also been taken into consideration. Banks will be required to conduct stress tests on the impact of the large exposures turning delinquent.

Guideline on Related Party Transactions

Exposures to counterparties related to a financial institution such as directors, senior officers, shareholders, and their families may pose additional risks to a financial institution in view of the fact that such exposures to related companies and individuals may not be carried out at arm's length basis.

In order to be in line with best international practices and to take into consideration the recommendations made by the FSAP, the Bank undertook the revision of the *Guideline on Related Party Transactions*. The substantive changes brought to the guideline are summarised below.

- Due care has been taken to ensure that the guideline embodies the essential criteria of the Basel Core Principles relating to exposures to related parties.
- The system of approvals by the Bank in excess of the regulatory limits has been dispensed with. The guideline realigns the definition of 'related party' with the Banking Act 2004.
- For the calculation of the regulatory limits applicable to related party transactions, related parties are classified into three categories, which take on board all the parties defined under related party in the interpretation section of the Banking Act 2004.

Category 1 – The Core Related Parties

Category 2 – The Tangential Related Parties

Category 3 – The Peripheral Related Parties

- The responsibilities of the board of directors have been enhanced and the scope of the mandate of the Conduct Review Committee enlarged.
- The regulatory limits have been increased so as not to reduce the ability of the financial institutions to lend to a reasonable extent to related parties.
- Banks and non-bank deposit taking institutions have been given a transition period of two years to comply with the limits prescribed in the revised guideline.
- Any derogation from the regulatory limits would be considered by the Bank on the condition that the additional exposure is deducted from the financial institution's Tier 1 capital.

Guideline on Liquidity Risk Management

The Bank's current prudential framework for liquidity risk management in banks, set out in *Guideline on Liquidity*, was introduced in 2000.

In the light of financial market developments and changing banks' liquidity management practices over the past decade, the Bank has initiated the review of the prudential framework to ensure that it provides banks with a sound, robust and relevant basis for assessing and monitoring liquidity risk, consistent with international best practices. The liquidity policy review has come at a time when the global financial markets are being subjected to a liquidity crisis unprecedented in scale and scope. The revised prudential standard takes into account the updated global principles for sound liquidity risk management and supervision developed by the BCBS as well as the lessons being learned from the global financial market turmoil. It provides for reporting of gap analysis and requires banks to perform scenario analysis and stress tests on their liquidity positions. The draft guideline has been issued to the industry for consultation.

Guideline on Measurement and Management of Market Risk

A Proposal Paper on market risk (including interest rate risk in the banking book) was issued to banks in January 2007. As a corollary to the paper, banks have been submitting pilot returns since September 2007. After reviewing these returns, a guideline for banks on market risks and interest rate risk in the banking book has been issued to banks. It is noted that due to the insignificant trading activities of banks the Bank has not imposed a capital charge in respect of market risk other than foreign exchange risk; rather capital add-ons may be required under Pillar 2 on an individual basis.

With the preparation of the above guidelines and the review of others as mentioned above, all significant risk areas will be addressed. Nevertheless, the Bank will continue to review its guidelines/issue new guidelines to address emerging risks in the banking system, taking into consideration international best practices.

Regulations made by the Minister

In October 2008, the Minister of Finance and Economic Empowerment made two regulations stipulating the compoundable offences under the Banking Act 2004 and the Bank of Mauritius Act 2004. The Bank can now impose fines on institutions for specified offences, but only with the consent of the Director of Public Prosecutions and of the institution concerned. The institution might normally be expected to consent only if it assesses that it would lose a court case on the issue.

Box 2.1

Instituting a Dual Banking System: A Comparison Between Conventional Banking and the Islamic Mode of Financing

Within the scope of amendments brought to banking legislation and formulating the relevant supervisory framework over the past two years, the Mauritian financial sector is presently poised to accommodate the provision of Islamic banking business by banks either through window operations or as fully-fledged Islamic institutions. Up to the present, conventional commercial banking has lived a tradition of nearly 150 years, with the total asset base of banks growing constantly to reach MUR730 billion as at 30 June 2008, and several major international institutions blazon the Mauritian financial landscape by having a significant presence on the domestic front as well as with regard to cross border dealings. The strategic measures adopted by the authorities may therefore lead to an unfolding of Islamic financial services that shall add to the range of products offered to customers but may also claim to provide an alternative mode of parallel banking that reflects an inherent set of specificities derived from Shari'ah principles.

The foundation of conventional banking rests on a relationship whereby the banker and the customer is either the debtor or creditor of a financial transaction. It is essentially the interest spread between the deposit and the lending rate that comprises the prime source of profit for the financial institution. Additionally, the involvement of a physical asset such as land and property or a tangible good occurs mainly in the form of guarantee or security upon which a charge is taken in favour of the bank. Default on the part of the borrower of funds may degenerate into seizure and disposal of the collateral with a view to recouping any loss that might have been incurred by the bank for this particular transaction.

On a comparative note, a pertinent means of distinguishing conventional banking from Islamic financing is perhaps to highlight the prohibitions in traditional financial dealings prescribed under the rulings of the Shari'ah. Primarily, the Shari'ah admonishes of the *riba* which represents the interest factor or usury existent in either deposit taking or lending activities. Concurrently, transactions should be void of any element of *gharar*, defined as contractual ambiguity or uncertainty, and *maisir* that is interpreted as gambling. Financial intermediation is moreover called to subscribe to a total exclusion of *haram* industries such as those related to pork products and alcoholic beverages.

The basis for eliminating the element of interest is the fact that in Islam, money is not considered as a commodity for which a price has to be paid for its use. Rather, it is perceived intrinsically as a medium of exchange and a store of value. Islamic banking business is required to be channelled into real economic activity and, genuine trade and business related transactions. For this purpose, the underlying asset forms the basis for intermediation of funds and the financing of an undertaking. On a similar note, deposit taking features a guaranteed custodian relationship as the bank acts as a guardian of the depositors' funds. Alternatively, depositors may request the bank to undertake investment activities on their behalf.

Generally, the rapid pace of financial evolution requires that the regulatory framework applicable to financial institutions is constantly brought to adopt new rules and prudential norms with a view to countering the upheavals that chronically shake the financial world, as shown by recent events. However, it is acknowledged that whether it is the conventional or Islamic mode of financial intermediation, the onus of supervisory purview remains the relentless pursuit of soundness of banking institutions via constant mitigation of risks, and fostering stability of the financial system.

3 Developments Relating to Banking Legislation

THE FINANCE (MISCELLANEOUS PROVISIONS) ACT 2008

The Finance (Miscellaneous Provisions) Act 2008, which was passed on 18 July 2008, brought amendments to, inter alia, the Bank of Mauritius Act 2004, the Banking Act 2004, the Companies Act 2001, the Financial Reporting Act 2004 and the Income Tax Act. The major changes are provided hereunder.

A. The Bank of Mauritius Act 2004

Section 26(4) (a) has been amended such that the confidentiality requirements of section 26 shall not preclude the exchange or disclosure of information, under conditions of confidentiality, between the Bank and any public sector agency or law enforcement agency, where the Bank is satisfied that the public sector agency or law enforcement agency has the capacity to protect the confidentiality of the information imparted.

A new subsection (1A) has been inserted to section 51 to require timely submission by financial institutions of any information requested by the Bank under section 51(1).

In section 52, concerning the establishment of a Credit Information Bureau, subsections (1) and (2) have been replaced and subsections (2A) and 2(B) have been added, as follows.

(1) Notwithstanding section 51A(4) or any other enactment, the Bank may, for the purpose of ensuring the operation of a sound credit information system in Mauritius, establish a Credit Information Bureau and require, on such terms and conditions as it may deem fit, any institution offering credit including leasing facilities and hire purchase and utility companies, to furnish at such time and in such manner such credit information as it may require for the purpose of-

(a) maintaining a data base on recipients of credit facilities and guarantors;

(b) collecting, consolidating and collating trade, credit and financial information on recipients of credit facilites, whether fund-based or non-fund-based;

(c) storing the information so collected;

(d) disclosing, or allowing access, to such institutions as it may approve, the information so collected, subject to such conditions as it may impose.

(2) Subject to subsection (2A), the credit information so collected shall be used for the purpose of meeting the objectives of the Credit Information Bureau and shall be kept confidential between the Bank and participating institutions.

(2A) The Bank may impart to such bodies and on such terms and conditions as it may deem fit, information so obtained for credit rating purposes.

(2B) Any duty of confidentiality which may have been imposed on any participating institution under any enactment shall not apply where the information is required for transmission to and meeting the purposes of the Credit Information Bureau.

Concerning record keeping, section 66 has been amended and now requires every record of the Bank to be kept for a period of 7 years after completion of the transaction to which it relates, or the date of the record, as the case may be, instead of 10 year previously.

B. The Banking Act 2004

In section 2, the definitions of "banking business", "deposit taking business" and "foreign exchange dealer" have been amended as follows:

Paragraph (ii) in the definition "banking business" has been repealed and replaced by the following paragraph-

(ii) the use of such deposits or funds, either in whole or in part, for-

  (a) loans, advances or investments, on the own account and at the risk of the person carrying on such business;

  (b) the business of acquiring, under an agreement with a person, an asset from a supplier with the purpose of letting out the assets to the person subject to payment of instalments together with an option to retain ownership of the asset at the end of the contractual period.

Deposit taking business has been redefined as the business of accepting-

(a) deposits of money for the purpose of –

  (i) financing the specific activities of the non-bank deposit taking institution receiving such deposits or such other activities as may be approved by the central bank; and

  (ii) investment in Government Securities, Bank of Mauritius Bills issued under the Bank of Mauritius Act 2004 or such other investment as may be approved by the central bank; or

(b) Islamic deposits for the purposes of financing the activities of the non-bank deposit taking institution receiving such deposits or such other activities as may be approved by the central bank, the aims and operations of which are, in addition to the conventional good governance and risk management rules, in consonance with the ethos and value system of Islam.

Money or value transfer services have been included in the definition of 'foreign exchange dealer'.

The following definitions have been inserted in section 2:

"collective investment scheme" has the same meaning as in the Securities Act 2005.

"credit information bureau" means any person licensed by the central bank to carry on the business of collecting, consolidating and collating trade, credit and financial information whether fund based or non-fund based on recipients of credit facilities and guarantors for sale to creditors.

"external credit assessment institution" means an institution recognized by the central bank under section 14C for the purposes of carrying on the business of assigning credit ratings on debt instruments and on issuers of debt instruments.

"Government securities" has the same meaning as in the Public Debt Management Act 2008.

"Money or value transfer service" means a financial service that accepts cash, cheques, other monetary instruments or other stores of value in one location and pays a corresponding sum in cash or other form to a beneficiary in another location, by means of a communication, message, transfer or through a clearing network to which the money or value transfer service belongs, and where the transaction performed by such service can involve one or more intermediaries and third party final payment.

In section 3(3), the words "other than banking business" have been added after the words "also engaged in any of the financial services". The section now reads as follows.

> "Where a bank is also engaged in any of the financial services other than banking business regulated by the Financial Services Act 2007, the bank shall not carry on business by virtue of its banking licence unless it is also licensed under that Act in respect of those financial services".

The under mentioned subsection (6) has been added to section 3.

(6) (a) No non-bank deposit taking institution licensed under this Act shall engage in the business of accepting Islamic deposits without an appropriate licence to that effect issued by the central bank.

(b) Any non-bank deposit taking institution licensed to accept Islamic deposits shall be governed by this Act.

In section 5, the following subsections have been inserted after subsection (8).

(8A) An applicant shall notify the central bank of any material change which may have occurred, before or after the issue of a licence, in the information provided in the application.

(8B) An application shall include an authority from the applicant authorizing any regulatory body, law enforcement body or financial institution, in Mauritius or in a foreign country, to release to the central bank, for use in relation to the application and the enforcement of this Act, any information about the applicant, and any of its directors, shareholders, beneficial owners, chief executive officer, managers or officers as may be applicable.

(8C) Where the applicant is not an individual, such an authority shall be given by each of the directors of the applicant or by 2 directors duly authorized by a resolution of the board of directors.

The following sections have been inserted after section 14.

14A. Licensing of credit information bureau or recognition of external credit assessment institution

No person, other than a company, shall engage in the business of credit information bureau or a recognized external credit assessment institution without an appropriate licence or recognition, granted by the central bank, as the case may be.

14B. Granting of licence to credit information bureau

(1) Any company wishing to carry on the business of a credit information bureau shall apply to the central bank for a credit information bureau licence.

(2) An application under subsection (1) shall be made in such manner and in such form as the central bank may determine and shall be accompanied by –

(a) such information or document as may be required by the central bank for the purposes of determining the application; and

(b) payment of such appropriate non-refundable processing fee as may be prescribed by the central bank.

(3) The central bank shall, within 30 days of the receipt of an application, or the supply of any additional information or document, determine whether to grant or refuse the application and inform the applicant within 7 days of its decision.

(4) Where the central bank decides to grant a licence under this section, it shall, on payment of such licence fee as may be prescribed, issue the licence on such terms and conditions as it may consider appropriate.

14C. Recognition of external credit assessment institution

(1) Subject to subsection (2), any institution desirous of being recognized by the central bank as an external credit assessment institution shall submit an application for recognition to the central bank in such medium and in such form as the central bank may determine and shall be accompanied by such information or document as may be required for the purposes of determining the application.

(2) On the coming into operation of this section, any institution whose ratings have been authorized by the central bank to be used by banks for capital adequacy purposes shall be deemed to have been recognized by the central bank under this section.

(3) The central bank may issue guidelines governing external credit assessment institutions including their recognition, suspension or revocation of their recognition by the central bank and their use by financial institutions.

In section 18, subsections (3) and (4) have been replaced by the following subsections.

(3) Subject to subsection (4), no financial institution incorporated in Mauritius shall have a board of directors consisting of fewer than-

(a) 5 natural persons; and

(b) 40 per cent independent directors.

(4) The central bank may-

(a) having regard to the scope of the activities undertaken by a financial institution, require that its board of directors be composed of such higher number of persons or, where the financial institution is a subsidiary or an associate of a foreign banking group of companies, of 40 per cent non-executive directors instead of 40 per cent independent directors, as the central bank may direct; and

(b) in the case of a cash dealer, require that its board of directors be composed of such lower number of persons as the central bank may direct.

In connection with limitation on investments and non-banking operations, the under mentioned main changes have been brought to section 30.

Subsection (1)(b) comprise a new subparagraph (v) which reads "a shareholding by a bank licensed to conduct Islamic banking business or that unit of a bank carrying on Islamic banking business through a window for the purposes of enabling the bank or that unit to carry on Islamic banking business".

Subsection (3) has been replaced by the following subsection.

(3) (a) A bank engaging in factoring, promoting, operating or managing a collective investment scheme or securities brokerage operations shall do so only through a subsidiary of the bank and in such a case, section 3(3) shall apply to a subsidiary as it applies to a bank.

(b) subject to section 3(3), a bank may engage in the sale of insurance policies or distribution of collective investment schemes or such other products as may be approved by the central bank.

A new subsection (3A) does not allow a bank to engage in the business of providing operating leases. In this regard, section 102(a) has also been amended so that where a bank has, at the commencement of the Finance (Miscellaneous Provisions) Act 2008, been engaging in the business of providing operating leases, it shall cease such operations within a period of 12 months from that date.

Subsection (5) has been changed and a new subsection 5(A) has also been included, as follows.

(5) Subject to subsection (5A), a financial institution shall not purchase or otherwise acquire any immovable property or any right therein except as may be reasonably necessary for the purpose of conducting its operations or engaging in financial leasing of immovable property, including provision for foreseeable expansion, or for providing housing or other amenities for its staff.

(5A) Subsection (5) shall not apply to a bank licensed to conduct Islamic banking business or to that unit of a bank carrying on Islamic banking business through a window which purchases or otherwise acquires immovable property for the purpose of enabling that bank or that unit to carry on Islamic banking business.

With respect to record keeping, in section 33, paragraph (c) of subsection (2) has been replaced by the following subsection.

(c) account files of every customer, business correspondences exchanged with every customer and records showing, for every customer, at least on a daily basis, particulars of its transactions with or for the account of that customer, and the balance owing to or by that customer.

Concerning record keeping, subsection 33(3)(b) has also been amended to require a financial institution to keep every record for a period of 7 years after completion of the transaction to which it relates, instead of 10 year previously.

Regarding disclosure of information, subsection (6) of section 37 has been replaced by the following subsection.

(6) Where a financial institution extends credit to a person, it shall-

(a) disclose to him-

(i) the interest charged and the manner in which it is to be calculated;

(ii) any applicable fee or other charge and the manner in which it is to be calculated;

(iii) every term or condition applicable to the credit, clearly identifying the obligations of the borrower; and

(b) send or make available to him and the guarantor, if any, a statement of account in written or electronic form, showing payments effected on the credit facility, interest charged and any applicable fee or other charge.

In section 57, which deals with a bank's obligations towards its customers, subsection (4) has been replaced by the following subsection.

(4) Where the cheque is not returned to the customer, the bank retaining the cheque shall keep it in its physical form or in a legible copy by use of microfilm, magnetic tape, optical disk, or any other form of mechanical or electronic data storage and retrieval mechanism as the central bank may approve, for a period of at least 7 years as from the date of the cheque is drawn.

Section 62 had been replaced as follows.

62. Hours of business

(1) Subject to this part, the central bank shall-

(a) determine the daily minimum working hours of a financial institution; and

(b) inform every financial institution of the hours during which the central bank shall give facilities to it for the purposes of clearing and settlement of payments under the Mauritius Automated Clearing and Settlement System (MACSS) set up by the central bank.

(2) Subject to this Part, every financial institution shall inform the central bank of-

(a) the hours during which it shall remain open for the transaction of business with the public; and

(b) in the case of a bank, the hours during which it shall give facilities to its customers to effect electronic transactions on their accounts for same day value.

(3) Where a financial institution proposes to review its hours of business on any day, it shall-

(a) forthwith inform the central bank; and

(b) give notice to the public at least 24 hours before the day on which the revised business hours are proposed to be observed.

In section 63 (Bank holidays), subsection 2 has been replaced by the under mentioned subsection.

(2) Where a financial institution proposes to transact business with the public on a bank holiday or a public holiday, it shall-

(a) forthwith inform the central bank; and

(b) give notice to the public at least 24 hours before the day on which it proposes to transact business.

In section 64, a new paragraph (m) has been added to subsection (3) so that the duty of confidentiality imposed under that section shall not apply where in respect of credit information, the information is required for transmission to the guarantor of a credit facility contracted by the customer.

Section 102(b) has been amended so that, for any unapproved significant interest held by a person in a financial institution, the central bank may order the financial institution to take such measures as may be necessary for the person to comply with section 19(b)(i) within such time as the central bank may determine not being later than 30 September 2008.

C. The Income Tax Act

One of the major amendments brought about by the Finance (Miscellaneous Provisions) Act 2008 to the Income Tax Act is the addition of section 151A concerning Islamic financing arrangement. The section is reproduced below.

151A. Islamic financing arrangement

(1) The provisions of sections 7,10,19,58, 84,111A,111B,111C,111K and 123 of this Act shall apply in relation to any Islamic financing arrangement as if a reference in any of those provisions to interest payable, paid, derived, received or incurred in relation to any loan, deposit or mortgage were a reference to the effective return of the Islamic financing arrangement.

(2) For the purposes of this section-

(a) "Islamic financing arrangement" means a financing arrangement between-

(i) a bank and any other person, in so far as the arrangement is related to its Islamic banking business; or

(ii) a non-bank deposit taking institution and any other person with respect to the acceptance of Islamic deposit and the financing of the activities of the non-bank deposit taking institution or such other activities as may be approved by the central bank, the aims and operations of which are, in addition to the conventional good governance and risk management rules, in consonance with the ethos and value system of Islam;

(b) "bank", "Islamic banking business", "non-bank deposit taking institution" and "Islamic deposit" have the same meaning as in the Banking Act 2004.

(c) "effective return" means the return in lieu of interest that is payable, paid, derived, received or incurred under an Islamic financing arrangement.

D. The Public Debt Management Act 2008

The Public Debt Management Act 2008 was passed on 6 May 2008 to amend, consolidate and modernise the laws relating to public loans, Treasury bills, bonds and similar instruments and Government guarantees for a better management of public sector debt and for related matters.

Section 4 of the Act specifies that in accordance with section 58 of the Bank of Mauritius Act 2004, the Bank of Mauritius may grant, in a fiscal year, advances to cover negative net cash flows of the Government.

For the purposes of section 5 (Issue of Government securities) of the Act, the Bank of Mauritius shall, on behalf of the Ministry, establish and maintain a computerised system for issuing, maintaining, servicing and redeeming the uncertified securities which means securities issued as bookkeeping entries pursuant to a book-entry system established by the Ministry.

The Act has amended section 58 of the Bank of Mauritius Act 2004 as follows:

(a) in subsection (1), by deleting the words "in respect of temporary deficiencies of Government's recurrent revenue" and replacing them by the words "to cover negative net cash flows of the Government";

(b) in subsection (2), by deleting the words "25 per cent of the Government's recurrent revenue" and replacing them by the words "10 per cent of the Government's revenue excluding grants and receipts of a capital nature";

(c) by repealing subsection (3) and replacing it by the following subsection-

(3) Any advances under subsection (1) shall be repaid as soon as possible and shall, in any event, be repayable not later than 4 months from the time the advances are granted.

4 International Developments

The financial crisis, which severely tested financial markets, financial institutions and supervisors in the more advanced economies, prompted international institutions such as the FSF and the BCBS and other bodies to probe into the root causes of the crisis. They made a number of recommendations, including putting in place a comprehensive strategy in order to reduce the likelihood of such a costly event happening again and to promote international financial stability.

Financial Stability Forum

The FSF investigated into the financial crisis and came up with a report in April 2008 which emanate from an intensive collaborative effort of the main international bodies and national authorities in key financial centres. The report advocates 67 recommendations on how to enhance market and institutional resilience. The list of recommendations is at the heart of international response to the financial crisis and the FSF is currently engaged in monitoring the implementation of the recommendations. The report highlights five priority areas of action:

- strengthened prudential oversight of capital, liquidity and risk management;
- enhancing transparency and valuation;
- changes in the role and uses of credit ratings;
- strengthening the authorities' responsiveness to risks; and
- robust arrangements for dealing with stress in the financial system.

Basel Committee on Banking Supervision

The BCBS also announced a series of steps to make the banking system more resilient in support of the recommendations made by the FSF earlier in the month. Chairman Nout Wellink commented that: "The key building blocks to core bank resiliency are strong capital cushions, robust liquidity buffers, strong risk management and supervision, and better market discipline through transparency."

The BCBS has already delivered on some of its promises; in September 2008 it released updated *Principles for Sound Liquidity Risk Management*, which incorporates lessons drawn from the financial market turmoil. "The principles are based on the fundamental premise that a bank's liquidity risk framework should ensure it maintains sufficient liquidity to withstand a range of stress events, including those that affect secured and unsecured funding" noted Nigel Jenkinson, co-chairman of the Basel Committee's Working Group on Liquidity and Executive Director of the Bank of England. The principles also strengthen expectations about the role of supervisors, including the need to intervene in a timely manner to address deficiencies and the importance of communication with other supervisors and public authorities, both within and across national borders.

Committee of European Securities Regulators

In May 2008, the Committee of European Securities Regulators (CESR) proposed the establishment of a Standard Setting and Monitoring Body (SSMB) at International Organisation of Securities Commission (IOSCO) in which credit rating agencies are to set up standards together with regulators.

Additionally IOSCO and the Securities Commission (SEC)s set out fundamental changes to their requirements on credit rating agencies to address the quality of ratings, to expand the information they provide, as well as proposals concerning how ratings are used in regulatory guidelines.

5 A Review of the Performance of Banks

5.1 INTRODUCTION

As on 30 June 2008, the banking sector comprised 19 banks licensed to carry on banking business in Mauritius, of which 7 were local banks, 7 were subsidiaries of foreign banks and 5 were branches of international banks. A list of these banks is provided in Appendix H.

A licence was granted to AfrAsia Bank Limited on 2 October 2007 and it started operations on 29 October 2007. During the year, the First City Bank Ltd was acquired by a consortium of investors comprising the CIEL Group and Investments and Mortgages Bank Ltd, a group from Kenya. The name of the bank was subsequently changed to Bank One Limited as from 8 August 2008.

The banking sector was dominated by five banks with 69.8 per cent of the banking sector's assets at the end of June 2008 compared to 69.1 per cent a year earlier.

The continuous expansion in the domestic banking environment coupled with improved access to markets over the years resulted in the overall on-balance sheet assets expanding by 16.9 per cent over the year 2007-08.

5.2 PERFORMANCE OF BANKS

5.2.1 CAPITAL ADEQUACY

Capital adequacy ratio is the measure of the adequacy of a bank's capital resources in relation to its risk-weighted assets and banks in Mauritius are required to maintain, at all times, a minimum capital adequacy ratio of 10 per cent. It is based on a concept of weighing the on and off-balance sheet exposures according to their perceived level of risks and ultimately measuring the capital base against total risk-weighted assets.

At end-June 2008, banks maintained their capital adequacy ratio in the range of 10.2 per cent to 99.6 per cent.

Chart 1 shows the average risk-weighted capital adequacy ratio maintained by banks on a quarterly basis from end-June 2006 to end-June 2008. The overall risk-weighted capital adequacy ratio of banks increased from 14.4 per cent at end-June 2007 to 15.2 per cent at end-June 2008.

This increase was the result of a higher growth rate of 16.4 per cent in the aggregate capital base as opposed to an increase of only 10.4 per cent registered in the total risk-weighted assets.

5.2.1.1 Capital Base

Table 1 shows the risk-weighted capital adequacy ratio maintained by banks on a quarterly basis from end-June 2007 to end-June 2008.

Banks' aggregate gross capital increased by Rs7,389 million or 18.3 per cent from Rs40,472 million at end-June 2007 to Rs47,861 million at end-June 2008. During the year under review, tier 1 capital grew by Rs7,603 million from Rs32,617 million to Rs40,220 million and represented 84.0 per cent of gross capital at end-June 2008 against 80.6 per cent at end-June 2007.

On the other hand, tier 2 capital, which represented 16.0 per cent of gross capital at end-June 2008, contracted by 2.7 per cent from Rs7,855 million to Rs7,641 million due to a reduction in subordinated debts qualifying as tier 2 capital. Expressed as a percentage of tier 1 capital, tier 2 capital represented 19.0 per cent compared to 24.1 per cent a year earlier.

Chart 1 : Capital Adequacy Ratio against Regulatory Requirement

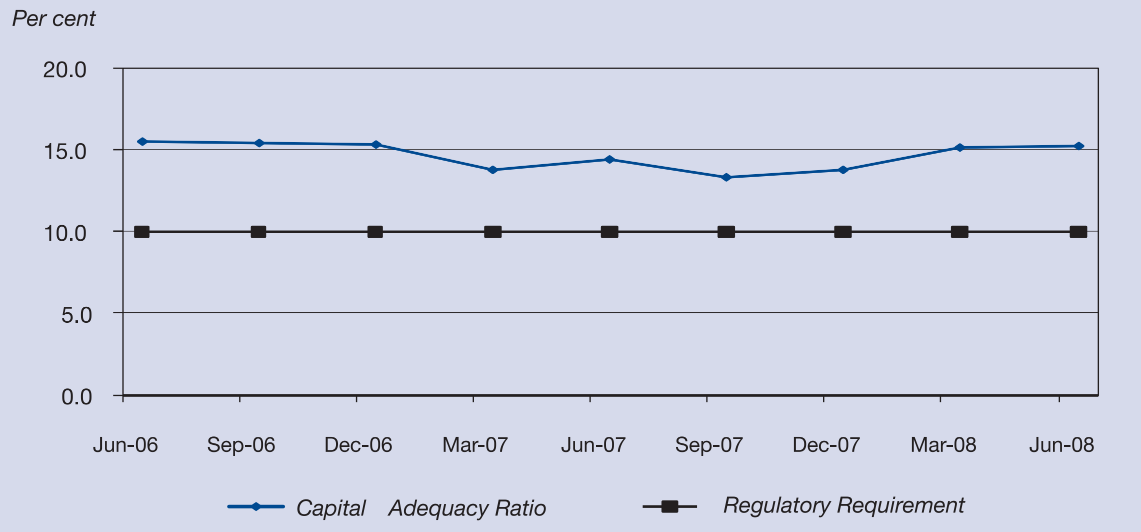
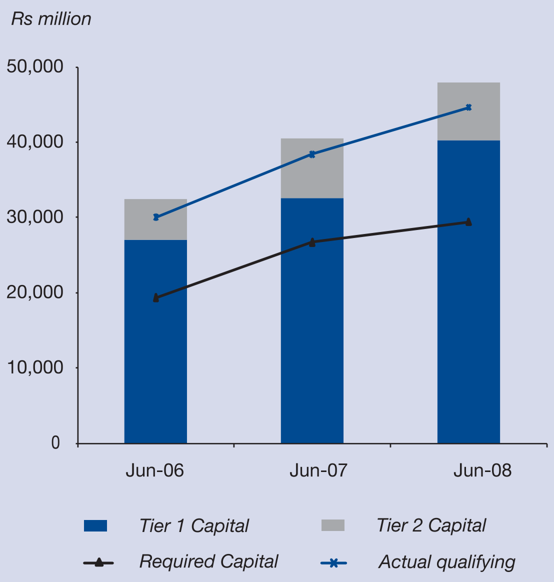


Table 1: Risk-Weighted Capital Adequacy Ratio

	(Rs million)				
As at end of period	**Jun-07**	**Sep-07**	**Dec-07**	**Mar-08**	**Jun-08**
Tier 1 capital	32,617	32,719	33,184	39,352	40,220
Tier 2 capital	7,855	7,716	7,397	7,133	7,641
Total Gross Capital	**40,472**	**40,435**	**40,581**	**46,485**	**47,861**
Deductions	2,117	2,242	2,283	3,118	3,218
Total Net Capital (A)	**38,355**	**38,193**	**38,298**	**43,367**	**44,643**
Total Risk-Weighted Assets (B)	**266,722**	**286,510**	**277,272**	**287,513**	**294,345**
Risk-weighted on-balance sheet assets	*227,151*	*244,598*	*235,572*	*244,450*	*249,604*
Risk-weighted off-balance sheet assets	*18,787*	*20,565*	*20,329*	*20,936*	*20,274*
Foreign exchange rate and interest rate related contracts	*726*	*856*	*656*	*502*	*503*
Foreign exchange exposure	*918*	*805*	*1,402*	*842*	*891*
Risk-weighted assets for operational risk	*19,140*	*19,686*	*19,313*	*20,783*	*23,073*
Capital Adequacy Ratio (A/B)	**14.4%**	**13.3%**	**13.8%**	**15.1%**	**15.2%**

Chart 2 illustrates the split between tier 1 and tier 2 capital as on 30 June 2006, 30 June 2007 and 30 June 2008. As may be seen therefrom, the increasing trend in the buffer of capital (the difference between the minimum required capital and the actual capital) was maintained. This buffer provides the banking system with the resilience required to deal with crisis situations and indicates the strong risk management practices of the banks in the country.

Chart 2: Minimum Required Capital v/s Actual Capital



5.2.1.2 Risk Profile of On and Off-Balance Sheet Assets

Total on-balance sheet assets of banks increased from Rs466,177 million at the end of June 2007 to Rs542,603 million at the end of June 2008, representing a growth of 16.4 per cent while the corresponding total risk-weighted assets of banks grew by 9.9 per cent from Rs227,151 million to Rs249,604 million. This indicates a prudent approach adopted by banks as reflected in a higher proportion of assets being in the zero and 20 per cent risk buckets than in the 100 per cent risk bucket.

Table 2 shows the comparative movements in the riskiness of banks' total on-balance sheet assets at end-June 2007 and end-June 2008. It may be observed that there has been a shift in the risk profile of assets maintained by banks from 100 per cent risk-weight to those weighted in the zero and 20 per cent band. The proportion of assets in the 100 per cent risk-weight went down from 39.2 per cent to 36.1 per cent while assets held in 20 per cent and zero per cent risk-weights increased from 39.0 per cent to 41.0 per cent and from 18.2 per cent to 19.3 per cent, respectively.

Table 2 : Comparative Change in the Riskiness of Banks' Portfolios of On-Balance Sheet Assets

	On-balance sheet assets (Rs million)	Percentage to total on-balance sheet assets	On-balance sheet assets (Rs million)	Percentage to total on-balance sheet assets
Risk Weights (%)	**June 2007**		**June 2008**	
0	84,899	18.2	104,912	19.3
10	852	0.2	787	0.1
20	181,698	39.0	222,550	41.0
50	16,004	3.4	18,678	3.5
100	182,724	39.2	195,676	36.1
	466,177	**100.0**	**542,603**	**100.0**

Table 3 sets out a comparison of the total on and off-balance sheet assets of banks with their corresponding risk-weighted values and their average combined risk weighting over the period ended June 2006 to June 2008.

lower capital adequacy ratio were that deferred tax assets, are being deducted from the capital base under the Guideline on Eligible Capital and certain assets are assigned a higher risk weight under Basel II than under Basel I.

Table 3: Total On and-Off Balance Sheet Assets of Banks, Equivalent Risk-Weighted Assets, Average Combined Risk Weighting and Capital Adequacy Ratio

		June 2006	June 2007	June 2008
A	Total On and Off-Balance Sheet Assets *(Rs million)*	384,622	572,245	646,647
B	Total Risk-Weighted Assets *(Rs million)*	193,789	266,722	294,345
C	Average Combined Risk Weighting (B/A) *(Per cent)*	50.4	46.6	45.5
D	Capital Adequacy Ratio *(Per cent)*	15.5	14.4	15.2

As may be observed from Table 3, total on and off-balance sheet assets of banks grew from Rs572,245 million at end-June 2007 to Rs646,647 million at end-June 2008, or by 13.0 per cent. Total risk-weighted assets of banks also rose from Rs266,722 million at end-June 2007 to Rs294,345 million at end-June 2008 or by 10.4 per cent, indicating that the growth in assets held by banks had been deployed in lower risk assets. Similarly, the combined risk weighting declined from 46.6 per cent at end-June 2007 to 45.5 per cent at end-June 2008.

5.2.1.3 Basel II

As already pointed out in chapter 2 of the report, as from the quarter ended 31 March 2008, banks are required to report their capital adequacy ratio as calculated under Basel II.

On a parallel basis alongside Basel I, a comparative exercise was carried out and it was found that certain banks which were in compliance under Basel I, were not under Basel II.

It was found that two banks which were in compliance with capital adequacy ratio under Basel I maintained a ratio of less than 10 per cent under Basel II. The main causes for a

It was also found that, under Basel II, local banks were operating with a higher capital adequacy ratio while in the case of foreign banks, the capital adequacy ratio was lower under the new framework.

5.2.2 ASSET QUALITY

Asset quality is a critical factor in the assessment of the soundness of a bank and in determining its overall condition. It impacts on many facets of the operations of a bank. A high asset quality generally reflects in the liquidity, profitability and the overall strength of a bank.

As at the end of the financial year under review, on-balance sheet assets of banks stood at Rs729,282 million at end-June 2008, as against Rs623,899 million at end-June 2007, registering a growth of 16.9 per cent. The drivers of this positive performance are related mainly to buoyant market activity and financial product diversification by banks.

Unlike the year ended June 2007 where only one bank recorded a decrease in its total assets, it is noted that during the current year, four banks experienced a fall in their total assets.

The remaining banks recorded increases ranging from 6.5 per cent to 113.8 per cent in their total assets. The contraction in total assets recorded by the four banks varied between 11.0 per cent and 29.6 per cent mainly due to reductions in their cross-border activities (segment B).

Off-balance sheet assets which comprise, *inter alia*, acceptances, guarantees and documentary credits, amounted to Rs53,908 million and represented 7.4 per cent of total assets of banks at end-June 2008 as compared to Rs44,498 million, or 7.1 per cent of total assets at end-June 2007.

5.2.2.1 Advances

Total advances including debentures increased by Rs64,739 million, or 21.0 per cent, from Rs307,745 million as at end-June 2007 to Rs372,484 million as at end-June 2008, compared to a rise of 35.8 per cent in the preceding fiscal year. Total advances as at end-June 2008 represented 69.4 per cent and 51.1 per cent of total deposits and total assets, respectively. The corresponding ratios as at end-June 2007 were 70.7 per cent and 49.3 per cent, respectively.

Loans and other financing in foreign currencies outside Mauritius stood at Rs185,336 million and represented the highest component of total advances extended by banks at end-June 2008, or 49.8 per cent of total advances. Loans and overdrafts in Mauritian rupees amounted to Rs118,839 million, or 31.9 per cent of total advances while loans and other financing in foreign currencies in Mauritius amounted to Rs36,304 million or 9.7 per cent of total advances.

5.2.2.2 Concentration of risks

Credit risk concentration is a major risk in a bank since lending constitutes the primary activity of banks. It refers to the risk of loss attributed to the magnitude of a bank's credit financing to a single entity and its related parties, industry sectors, and entities dependent on single commodities. The Guideline on Credit Concentration Limits requires banks to establish a policy on credit concentration, setting out the principles and objectives governing the extent to which they are willing to accept credit concentration risk as well as prudential guidelines and internal limits for granting credit to similar or single risk entities. Moreover, the guideline sets regulatory limits with respect to credit to individuals or groups of customers that are classified as single risk entities as the failure of one entity is likely to impact on the viability of the other related entities.

During the year under review, banks have been complying with the requirements of the Guideline on Credit Concentration Limits. In accordance with section 29(4) of the Banking Act 2004, the Bank may exempt from credit concentration limits, as it deems fit, that part of a bank's banking business or investment banking business that is conducted in currencies other than Mauritian currency. Banks are required to report all exposures to any one customer or group of customers for amounts aggregating to 15 per cent or more of their capital base on a regular basis. Such exposure, generally referred to as large exposures, should not in aggregate exceed 600 per cent of the capital base of a bank except in cases where the approval of the central bank is obtained.

At end-June 2008, total large exposures for the banking sector amounted to Rs190,525 million, down from Rs195,350 million at end-June 2007 and represented 44.7 per cent of the overall on and off-balance sheet commitments compared to 55.5 per cent a year earlier.

5.2.2.3 Sectorwise Distribution of Credit to the Private Sector in Mauritius

Banks are also exposed to sectoral credit concentration which shows exposures of banks to specific sectors of the economy. Chart 3 shows the sectorwise distribution of credit to major sectors within the private sector for the quarters ended June 2007 to June 2008. The 'construction' sector accounted for the highest share or 17.9 per cent of total credit to the private sector at end-June 2008 followed by 'tourism' sector with 14.4 per cent. The comparative figures at end-June 2007 were 16.2 per cent and 12.6 per cent respectively.

5.2.2.4 Non-performing Advances and Provisioning

Total non-performing advances (impaired credits) of banks rose by Rs1,447 million, or 20.0 per cent, from Rs7,220 million at end-June 2007 to Rs8,667 million at end-June 2008. The ratio of non-performing advances to total advances, however, remained at 2.4 per cent. The increase in the impaired accounts was mainly attributed to facilities extended outside Mauritius which rose drastically from Rs316 million to Rs1,269 million.

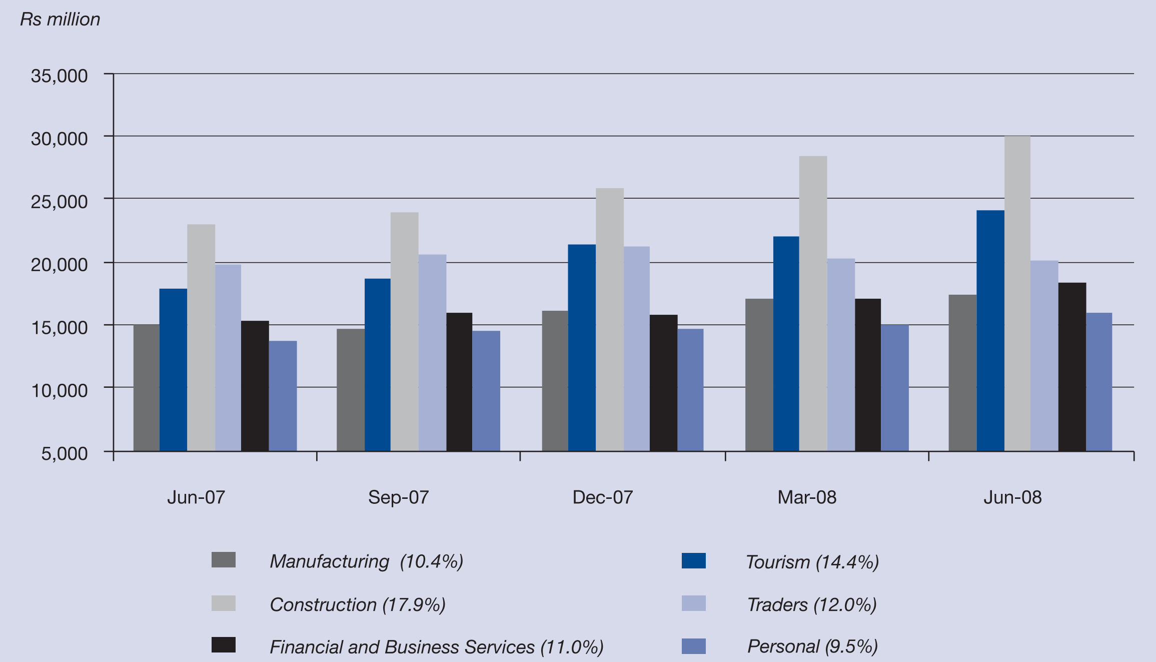
Specific provisions for loan losses made by banks increased by Rs941 million or 24.2 per cent from Rs3,886 million at end-June 2007 to Rs4,826 million at end-June 2008. Consequently, the ratio of specific provisions to non-performing advances increased from 53.8 per cent at end-June 2007 to 55.7 per cent at end-June 2008. Specific provisions made on the impaired accounts on the facilities extended outside Mauritius also rose drastically from Rs5 million to Rs829 million. Likewise, provisions on portfolio assessed advances grew from Rs1,008 million at end-June 2007 to Rs1,224 million at end-June 2008. Also, banks have set up a General Banking Reserve which is a general provision made by way of appropriation of profits.

5.2.3 PROFITABILITY

The consolidated profitability figures are based on the audited results of banks operating during 2007-08 covering financial years ended 31 December 2007, 31 March 2008 and 30 June 2008. Banks realised an overall pre-tax profit of Rs12,640 million in 2007-08 compared to Rs10,398 million in 2006-07.

Table 4 shows the consolidated profit and loss account of the banking sector for the past three years.

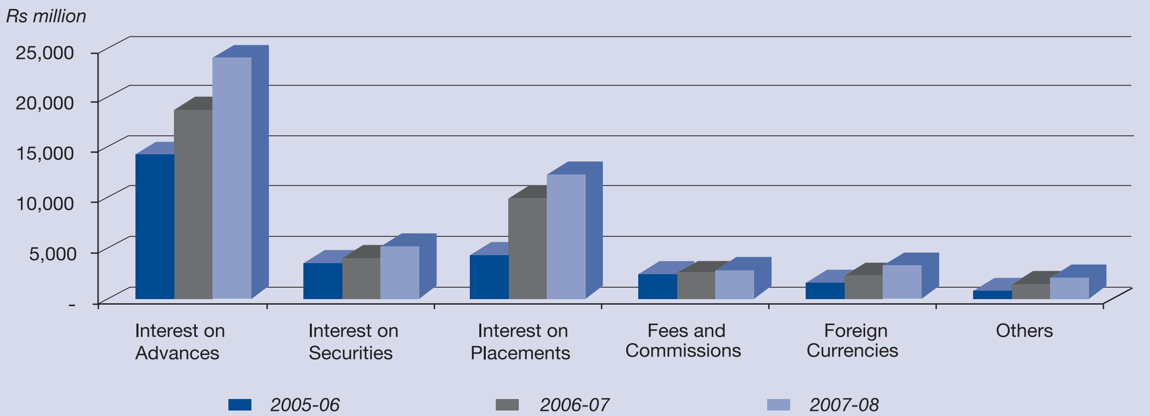
Chart 3: Sectorwise Distribution of Credit to Private Sector



Figures in brackets are percentages of total credit to private sector as at 30 June 2008.

Table 4: Consolidated Profit and Loss Account			
	2005-06	2006-07	2007-08
		Rs million	
Interest Income	**22,820**	**33,244**	**41,874**
Interest Income from Advances	*14,391*	*18,796*	*23,797*
Interest on Securities	*3,585*	*4,028*	*5,254*
Interest on Placements and Loans to banks	*4,346*	*9,938*	*12,383*
Others	*498*	*482*	*440*
Interest Expense	**13,420**	**21,824**	**28,176**
Interest Expense on Deposits	*9,799*	*15,756*	*20,343*
Interest on Borrowings from banks	*2,652*	*5,084*	*7,008*
Others	*969*	*984*	*825*
Net Interest Income	**9,400**	**11,420**	**13,698**
Non-interest Income	**4,311**	**5,749**	**7,826**
Fee Income and Commission	*2,348*	*2,524*	*2,778*
Profit arising from dealing in foreign currencies	*1,608*	*2,267*	*3,320*
Others	*355*	*958*	*1,728*
Operating Income	**13,711**	**17,169**	**21,524**
Staff & Operating Costs	**5,359**	**6,043**	**7,752**
Staff Costs	*2,494*	*2,790*	*3,617*
Other Operating Expenses	*2,865*	*3,253*	*4,135*
Operating Profit before provisions & taxes	**8,352**	**11,126**	**13,772**
Provision and adjustments to income for credit losses	*639*	*708*	*1,132*
Operating Profit after provisions and taxes	**7,713**	**10,418**	**12,640**
Share of profits in subsidiaries and associates	*0*	*0*	*0*
Exceptional Items	*28*	*(20)*	*0*
Profit before tax	**7,741**	**10,398**	**12,640**
Provision for income taxes/ (credit)	*875*	*1,150*	*1,289*
Profit after tax	**6,866**	**9,248**	**11,351**

Chart 4: Components of Income



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

5.2.3.1 Income

Chart 4 gives a comparison of the main components of income for the periods 2005-06, 2006-07 and 2007-08. Total income of banks increased by Rs10,707 million or 27.5 per cent from Rs38,993 million in 2006-07 to Rs49,700 million in 2007-08. Interest income from advances, securities and placements continued to be the main sources of income for banks, accounting for an average of 83.3 per cent of their total income through the years 2005-06 to 2007-08.

During 2007-08 interest income recorded a growth of 26.0 per cent compared to 45.7 per cent in 2006-07 as shown in Table 5. Non-interest income grew by Rs2,077 million or 36.1 per cent in 2007-08 compared to a growth rate of 33.4 per cent in 2006-07.

Table 5: Growth in Interest Income and Non-Interest Income

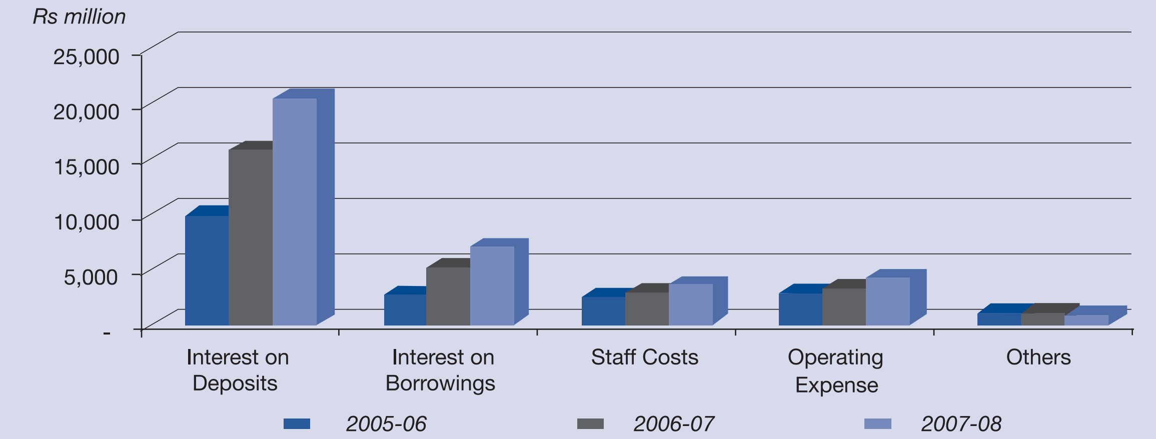
	2005-06	2006-07	2007-08
Growth in Interest Income *(per cent)*	28.6	45.7	26.0
Growth in Non-Interest Income *(per cent)*	13.6	33.4	36.1

Total interest income rose from Rs33,244 million in 2006-07 to Rs41,874 million in 2007-08. Interest earned from loans and advances increased by Rs5,001 million to reach Rs23,797 million in 2007-08, representing 56.8 per cent of total interest income compared to 56.5 per cent in 2006-07. Likewise, interest earned on securities increased by Rs1,226 million, reaching Rs5,254 million in 2007-08 as compared to Rs4,028 million in 2006-07. As may be observed from Table 6, interest income from placements and loans to banks recorded a growth of 24.6 per cent or Rs2,445 million to reach Rs12,383 million in 2007-08.

Table 6: Growth in Interest on Advances, Interest on Securities, Placements and Other Interest Income

	2006-07	2007-08
Growth in Interest on Advances *(per cent)*	30.6	26.6
Growth in Interest on Securities *(per cent)*	12.4	30.4
Growth in interest income from Placements and Loans to banks *(per cent)*	128.7	24.6

Chart 5: Components of Expenses



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

5.2.3.2 Interest Expense

Chart 5 gives a comparison of the main components of expenses for the periods 2005-06, 2006-07 and 2007-08. Total interest expense, comprising mainly of interest paid on deposits and borrowings from other banks and financial institutions, stood at Rs28,176 million during 2007-08, rising by Rs6,352 million or 29.1 per cent over the previous period. The increase of Rs4,587 million in interest paid on deposits or a growth of 29.1 per cent in 2007-08 was mainly due to a substantial rise in deposits mobilised by banks. The cost of borrowings from other banks and financial institutions, constituting 24.9 per cent of total interest expense of banks posted a significant increase of Rs1,924 million or 37.8 per cent during 2007-08.

As may be observed from Table 7, interest earned on Rs100 of advances went up by Rs0.16 while cost per Rs100 of deposits rose by Rs0.46. Consequently, the interest spread dropped from Rs4.22 to Rs3.92.

Table 7: Interest Spread

	2005-06	2006-07	2007-08
Interest Earned on Rs100 of Advances	7.69	8.31	8.47
Cost per Rs100 of Deposits	3.73	4.09	4.55
Interest Spread	3.96	4.22	3.92

5.2.3.3 Net Interest Income

Net interest income increased by Rs2,278 million or 19.9 per cent to reach Rs13,698 million in 2007-08 from Rs11,420 million in 2006-07. Chart 6 shows the trend in net interest income for banks from 2003-04 through to 2007-08.

Chart 7 shows the evolution of net interest income, other income, operating income and operating profit during the periods 2003-04 through to 2007-08.

Chart 6: Trend in Net Interest Income

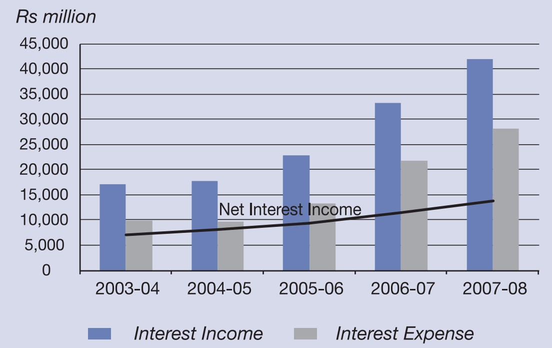
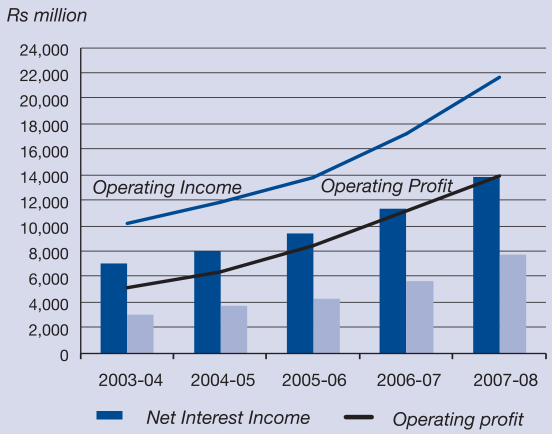


Chart 7: Net Interest Income, Other Income, Operating Income and Operating Profit



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

5.2.3.4 Non-Interest Income

Non-core activities of banks continued to be an important source of revenue. Income arising from fees and commissions, and profit from dealing in foreign currencies contributed to 83.3 per cent and 77.9 per cent of total non-interest related revenue in 2006-07 and 2007-08, respectively. Fee-related income and profit arising from dealing in foreign currencies grew by 10.1 per cent and 46.4 per cent or by Rs254 million and Rs1,053 million, respectively, in the same period.

5.2.3.5 Non-Interest Expenses

Non-interest expenses consisting of staff costs and other operating expenses increased by 28.3 per cent to Rs7,752 million in 2007-08 as compared to an increase of 12.8 per cent recorded in 2006-07.

While employment in the banking sector increased by 15.8 per cent, staff costs rose by 29.6 per cent. Other operating expenses increased by 27.1 per cent to reach Rs4,135 million in 2007-08.

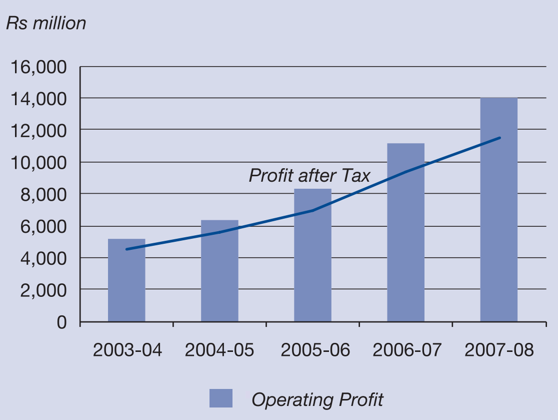
The ratio of non-interest expenses to gross operating income (before charge for bad and doubtful debts) increased from 35.2 per cent in 2006-07 to 36.0 per cent in 2007-08.

5.2.3.6 Operating Profit

During 2007-08, banks realised operating profit of Rs13,772 million before providing for bad and doubtful debts, that is an increase of Rs2,646 million or 23.8 per cent as compared to an increase of Rs2,774 million or 32.2 per cent recorded during 2006-07.

Profit before tax achieved by banks in 2007-08 reached Rs12,640 million, 21.6 per cent higher than the pre-tax profit of Rs10,398 million realised in 2006-07. Chart 8 depicts the evolution of banks' profit for the years 2003-04 to 2007-08.

Chart 8: Operating Profit and Profit after Tax



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

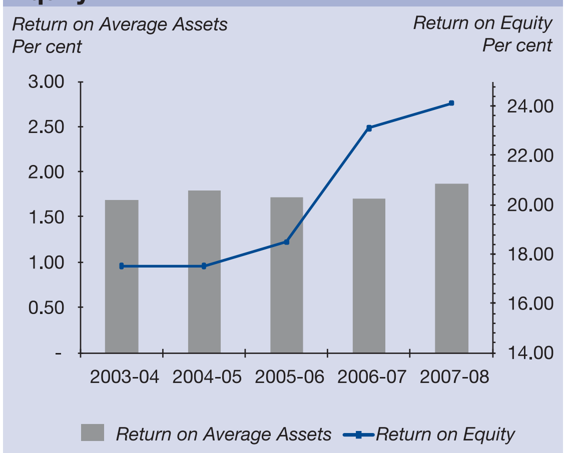
5.2.3.7 Return on Average Assets and Equity

The return on average assets and return on equity are key performance indicators which reflect the efficiency of banks in deploying their resources adequately and effectively.

The pre-tax return on average assets increased from 1.71 per cent to 1.88 per cent in 2007-08. The pre-tax return on average assets of individual banks ranged from negative 2.70 per cent to positive 3.57 per cent in 2007-08. With the exception of two banks, all banks recorded a positive return on average assets in 2007-08. Six banks achieved a pre-tax return on average assets of over 2.0 per cent. The negative return on average assets realized by the two banks was mainly attributable to high operating expense when compared to operating income.

The post-tax return on equity went up from 22.8 per cent in 2006-07 to reach 24.1 per cent in 2007-08. For individual banks, the post-tax return on equity ranged from negative 42.35 per cent to positive 46.58 per cent in 2007-08 with two banks achieving a return on equity of over 40 per cent during the same year.

Chart 9: Return on Average Assets and Equity



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

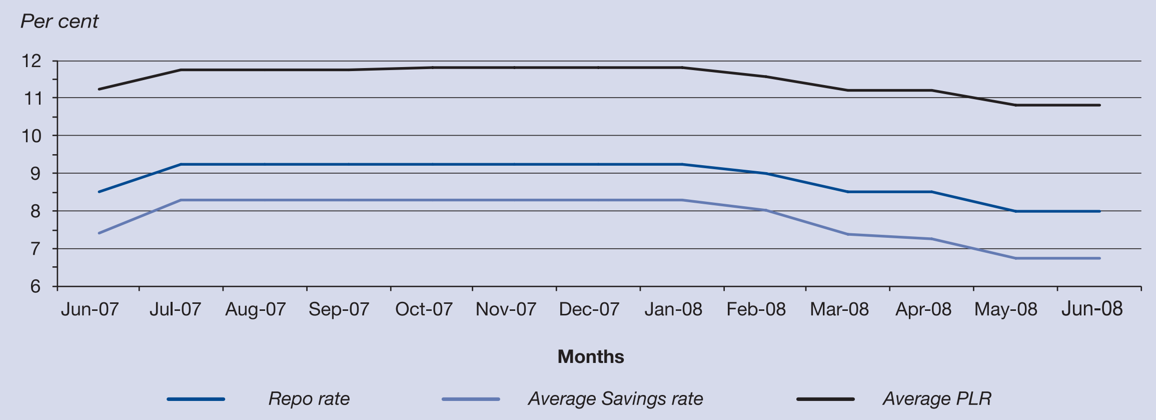
Chart 9 shows the return on average assets and equity over the period 2003-04 to 2007-08.

5.2.4 LIQUID ASSETS

Investments in Treasury Bills, other Government Securities and Bank of Mauritius Bills, which represent the most easily convertible non-cash liquid assets, increased by Rs15,757 million or 34.3 per cent from Rs45,986 million as at end-June 2007 to Rs61,743 million as at end-June 2008. The share of these investments in banks' total assets increased from 7.4 per cent as at end-June 2007 to 8.5 per cent as at end-June 2008.

The overall weighted average yield on Treasury Bills and Bank of Mauritius Bills went down from 11.04 per cent in June 2007 to 7.37 per cent in June 2008.

Chart 10: Movement of Interest Rates



5.2.5 INTEREST RATES

The Bank of Mauritius uses the Repo Rate as the key policy rate to signal changes in its monetary policy stance. During the year, the Key Repo Rate changed three times, going down from 9.25 per cent in July 2007 to 8.0 per cent in May 2008. As may be seen from Chart 10, the banking sector reacted positively by adjusting their key lending rate as well as their savings deposits rate.

5.2.6 DEPOSITS

Deposits continued to be the principal source of funding and constituted the largest share of total liabilities. The share of deposits in total assets increased from 69.7 per cent at end-June 2007 to 73.6 per cent at end-June 2008. During the year under review, total deposits grew by 23.4 per cent to reach Rs537,077 million from Rs435,154 million at end-June 2007. Foreign currency deposits to total deposits accounted for 67.4 per cent of total deposits at end-June 2008 compared to 65.9 per cent at end-June 2007. At end-June 2008, 56.9 per cent of total deposits were in time deposits, 26.2 per cent in demand deposits and 16.9 per cent in savings deposits compared to 57.0 per cent, 24.2 per cent and 18.8 per cent, respectively at end-June 2007.

5.2.7 ADVANCES /DEPOSITS RATIO

The advances/deposits ratio went down from 70.0 per cent at end-June 2007 to 66.3 per cent at end-June 2008. This ratio indicates the extent to which funds mobilised by way of deposits have been utilised to finance lending activities of banks.

5.2.8 ELECTRONIC BANKING

The number of banks providing electronic banking services was eleven as at 30 June 2008. Electronic banking is becoming increasingly popular as transactions can be carried out faster, and in a safe and secure manner. The number of transactions increased from 3,004,774 at end-June 2007 to 3,354,029 at end-June 2008.

Banks are continually investing in the setting up of new Automated Teller Machines (ATMs) at various locations to provide easy and convenient access to customers. The number of ATMs, in operation in Mauritius and Rodrigues increased from 334 during the year ended 30 June 2007 to 382 at end-June 2008. The total number of cards in circulation increased from 1,031,836 at end-June 2007 to 1,096,368 at end-June 2008, mainly as a result of an increase in the number of debit cards during the year.

The total value of transactions involving the use of credit and debit cards at ATMs and Merchant Points of Sale increased from Rs4,975 million as at June 2007 to Rs6,204 million as at June 2008. Advances due on credit cards amounted to Rs1,413 million as at June 2008, representing an average amount of Rs7,843 per card compared to Rs7,520 per card at end-June 2007.

Chart 11: Average Advances per Credit Card in the Banking Sector

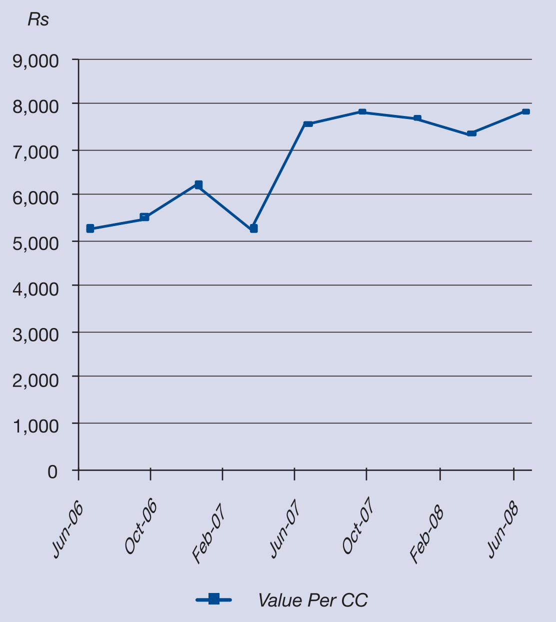


Chart 11 shows the average advances extended per credit card during the period June 2006 and June 2008. The average advance per card rose from Rs5,274 at end-June 2006 to Rs7,843 at end-June 2008.

Table 8 provides a summary of the evolution of electronic banking transactions for the quarters ended June 2007 through to June 2008.

Internet Banking is becoming increasingly popular due to its cost effectiveness and convenience. Many customers are having recourse to this service to carry out their banking transactions. As a result the number of internet banking customers has increased significantly from 46,407 at end-June 2007 to 52,735 at end-June 2008 with the total value of internet banking transactions amounting to Rs20,927 million at end- June 2008. On the other hand, the number of customers availing of phone banking facilities has increased from 41,834 at end-June 2007 to 43,211 at end-June 2008 with a total number of 749 transactions amounting to Rs31.5 million during June 2008.

Table 8: Electronic Banking Transactions from June 2007 to June 2008

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08
Number of ATMs in operation at end of month	334	344	368	374	382
Number of transactions during the month	3,004,774	3,310,451	4,496,145	3,592,922	3,554,029
Value of Transactions* *(Rs million)*	4,975	5,655	9,464	6,795	6,204
Number of Credit Cards in circulation at end of month	160,637	161,839	168,574	174,343	180,185
Number of Debit Cards and Other	871,199	892,794	915,444	941,102	916,183
Number of Total Cards	1,031,836	1,054,633	1,084,018	1,115,445	1,096,368
Outstanding Advances on Credit Cards at end of month *(Rs million)*	1,208	1,264	1,298	1,280	1,413

** Involving the use of Credit Cards at ATMs and Merchant Points of Sale*

6 A Review of Performance of Non-Bank Deposit Taking Institutions

6.1 INTRODUCTION

On 30 June 2008, there were thirteen non-bank deposit taking institutions (NBDTIs) in operation in Mauritius. A list of these NBDTIs is provided in Appendix H. Out of the thirteen NBDTIs, ten were involved in leasing activities, two in lending business and one in both leasing and lending operations. Eight NBDTIs engaged in leasing business were subsidiaries/related companies of banking institutions and insurance companies.

Following the promulgation of section 12(5) of the Banking Act 2004 on 1 June 2007, NBDTIs are subject to the same prudential regulations as banks. As such, they are required, *inter alia*, to maintain a stated capital of not less than Rs200 million by virtue of section 20(1) of the Banking Act 2004. As at the end of 2008, only one NBDTI was yet to meet this requirement.

6.2 PERFORMANCE OF NBDTIs

6.2.1 BALANCE SHEET STRUCTURE

During the year 2007-08, the assets (net of provisions) of NBDTIs recorded 14.1 per cent growth from Rs31,335 million at end-June 2007 to Rs35,752 million at end-June 2008. Most NBDTIs were able to maintain their position in the industry. At end-June 2008, two NBDTIs registered a drop in their total assets, one by 0.3 per cent and the other by 0.8 per cent. Total assets of the remaining NBDTIs registered increases in the range of 8.7 per cent to 33.5 per cent.

Charts 12a and 12b provide a comparative illustration of the composition of assets and liabilities of NBDTIs at end-June 2007 and end-June 2008. Loans were provided by only three of the NBDTIs and continued to dominate the composition of total assets with a share of 46 per cent at end-June 2007 and 43 per cent at end-June 2008. Leasing activities which constituted the second most important component of total assets, accounted for 32 per cent at end-June 2008 and were offered by eleven NBDTIs.

6.2.2 DEPOSITS

Deposits continued to be the main source of funding and represented the most important component of total liabilities. As at end-June 2008, deposits mobilised by NBDTIs constituted 67.0 per cent of total assets compared to 63.0 per cent at end-June 2007. During the year under review, deposits grew by 23.0 per cent to Rs23,968 million from Rs19,480 million at end-June 2007. At end-June 2008, only one institution recorded a contraction of 8.4 per cent in its deposit base. The deposits mobilised by the remaining NBDTIs recorded growth in the range of 2.1 per cent to 64.8 per cent.

6.2.3 ADVANCES/DEPOSITS RATIO

The advances/deposits ratio measures the extent to which funds mobilised by way of deposits have been utilised to finance lending and leasing activities of NBDTIs. The advances/deposits ratio is still on the high side for NBDTIs though it fell from 127.0 per cent at end-June 2007 to 110.5 per cent at end-June 2008, implying that the institutions are deploying in leasing and loan assets funds over and above those raised through deposits.

Chart 12a: Balance Sheet Structure - 2007

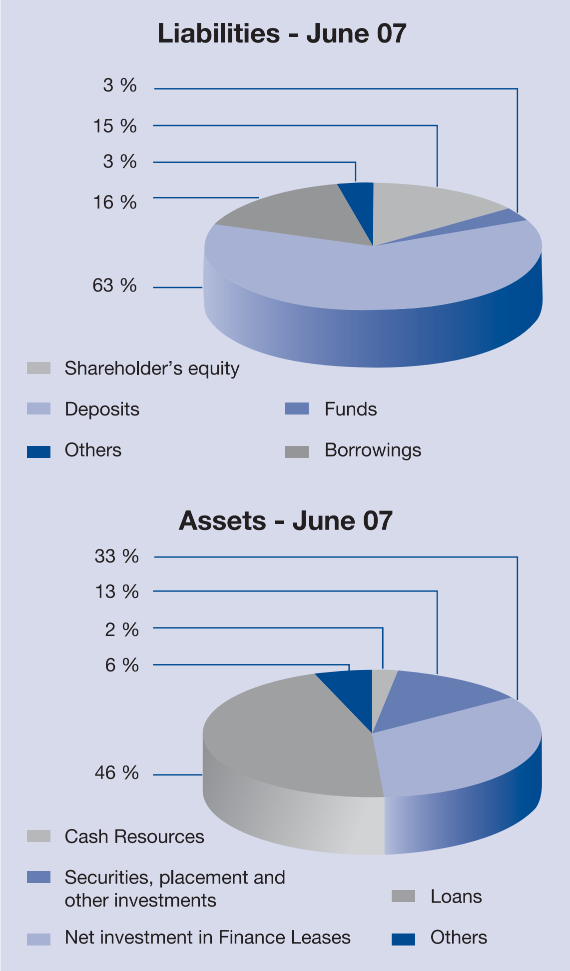
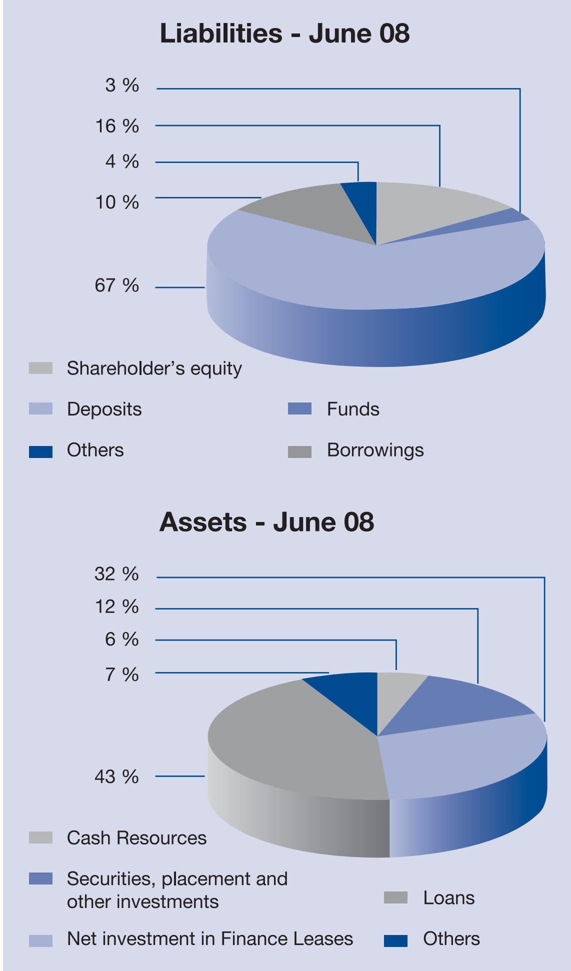


Chart 12b: Balance Sheet Structure - 2008



6.2.4 NET OWNED FUNDS

Prior to the promulgation of section 12(5) of the Banking Act 2004 on 1 June 2007, NBDTIs had to maintain net owned funds of not less than twenty five million rupees as per the terms and conditions for authorisation to carry on deposit-taking business. For this purpose, "net owned funds" meant the aggregate of paid-up capital and free reserves of the NBDTIs reduced by the amount of accumulated balance of loss, deferred revenue expenditure and other intangible assets as disclosed in their latest audited balance sheet. During the year under review, one NBDTI failed to maintain net owned funds of twenty five million rupees and appropriate action was taken by the Bank to bring the institution in compliance with the terms and conditions.

The terms and conditions for NBDTIs also required that the total amount of deposits accepted by them, together with their borrowings repayable beyond three months, including by way of bonds or debentures but excluding deposits and borrowings from, or guaranteed by, the Government of Mauritius, should not, at any time, exceed ten times their net owned funds. NBDTIs have to submit returns on a weekly basis to the Bank to demonstrate their observance of this requirement. During the year under review, NBDTIs were generally found to adhere to this stipulation.

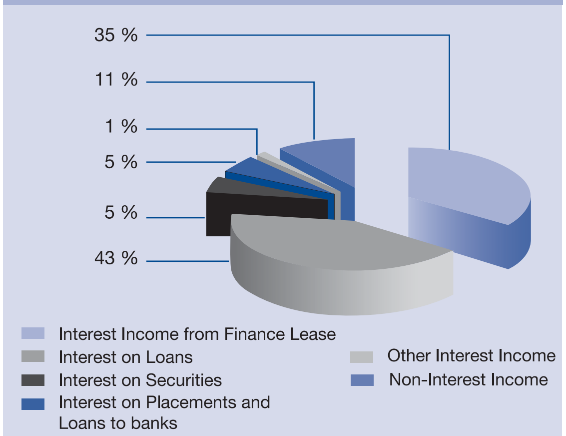
6.2.5 PROFITABILITY

The overall profitability of NBDTIs' operations improved during the period under review. Table 9 summarises the performance over the past two financial years.

The consolidated profitability figures are based on the audited results of NBDTIs as of 30 September, 31 December and 30 June. NBDTIs realised an overall pre-tax profit of Rs648 million in 2007-08 compared to Rs631 million in 2006-07.

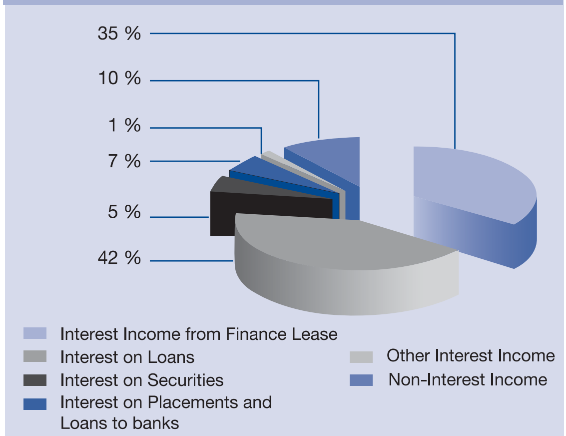
Charts 13a, 13b, 14a and 14b show the main components of income and expenses for 2006-07 and 2007-08.

Chart 13a: Components of Income 2006-07



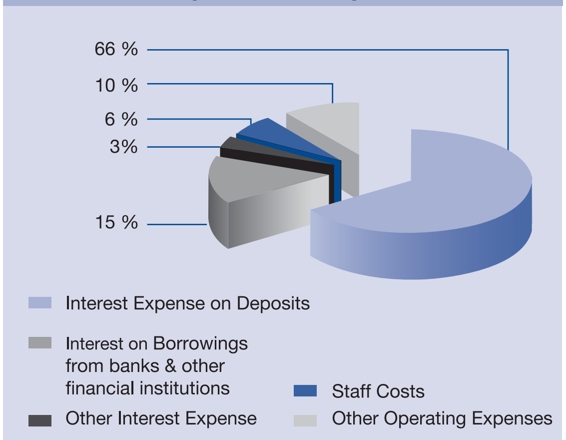
Based on combined audited data for financial years ended 30 June, 30 September and 31 December.

Chart 13b: Components of Income 2007-08



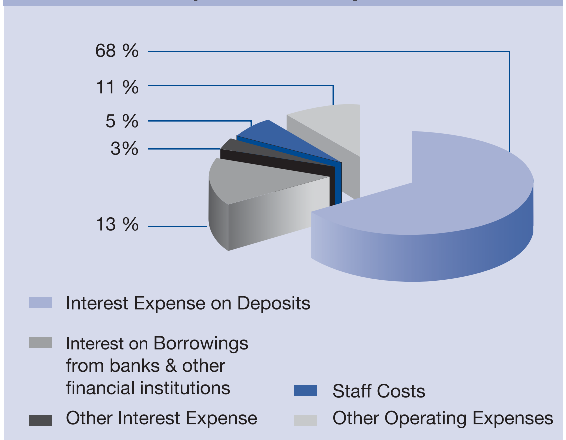
Based on combined audited data for financial years ended 30 June, 30 September and 31 December.

Chart 14a: Components of Expenses 2006-07



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

Chart 14b: Components of Expenses 2007-08



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

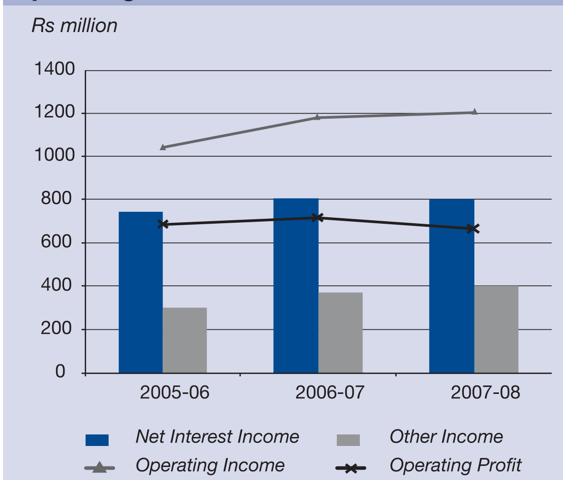
6.2.5.1 Income

During the year 2007-08, NBDTIs recorded 2.7 per cent growth in profits which is mainly attributed to higher returns achieved on their lending and leasing activities. Total income of NBDTIs registered a growth of 14.5 per cent, up from Rs3,527 million in 2006-07 to Rs4,039 million in 2007-08. Interest on loans and finance leases went up by Rs204 million and Rs176 million, respectively, and represented 77.0 per cent of total income in 2007-08. Non-interest income grew by 8.6 per cent in 2007-08 and constituted 10.0 per cent of total income for the period under review. The remaining income was derived from interest on securities and placements with banks.

Table 9: Consolidated Profit and Loss Account of NBDTIs	2006-07	2007-08
	Rs million	
Total Interest Income	**3,155**	**3,635**
Interest Income from Finance Leases	*1,225*	*1,401*
Interest on Loans	*1,504*	*1,708*
Interest on Securities	*222*	*209*
Interest on Placements and Loans to banks	*153*	*291*
Others	*51*	*26*
Total Interest Expense	**2,349**	**2,835**
Interest Expense on Deposits	*1,846*	*2,303*
Borrowings from banks & other financial institutions	*416*	*428*
Others	*87*	*104*
Net Interest Income	**806**	**800**
Add: Non-interest Income	*372*	*404*
Operating Income	**1,178**	**1,204**
Less: Staff Costs	*173*	*176*
Other Operating Expenses	*287*	*361*
Operating Profit	**718**	**667**
Other non-operating Profit / (Loss)	*(10)*	*63*
Profit before Bad and Doubtful Debts and Taxation	**708**	**730**
Less: Charge for Bad and Doubtful Debts	*77*	*82*
Profit before Tax	**631**	**648**

Chart 15 shows the evolution of net interest income, other income, operating income and operating profit over the years 2005-06 to 2007-08.

Chart 15: Evolution of Net-Interest Income, Other Income, Operating Income and Operating Profit



6.2.5.2 Net Interest Income

Chart 16 shows that the net interest income for NBDTIs has not grown substantially from the years 2005-06 to 2007-08. Total interest income went up by Rs480 million from Rs3,155 million in 2006-07 to Rs3,635 million in 2007-08 while total interest expense recorded a growth of Rs486 million or 20.7 per cent. Interest income on finance leases and loans grew by 14.4 per cent and 13.6 per cent respectively. Interest earned on securities decreased by Rs13 million from Rs222 million in 2006-07 to Rs209 million in 2007-08. Interest earned on placements and loans to banks recorded 90.2 per cent growth from Rs153 million to Rs291 million.

Total interest expense which is made up mainly of interest paid on deposits and borrowings from banks and other financial institutions, stood at Rs2,835 million in 2007-08 compared with Rs2,349 million in 2006-07.

Interest expense on deposits which constituted 81.2 per cent of total interest expense at end-June 2008, increased by 24.8 per cent from Rs1,846 million in 2006-07 to Rs2,303 million in 2007-08. The cost of borrowings from banks and other financial institutions posted an increase of Rs12 million during 2007-08. Net interest income decreased by Rs6 million or 0.7 per cent from Rs806 million in 2006-07 to Rs800 million in 2007-08.

Chart 16: Components of Net Interest Income

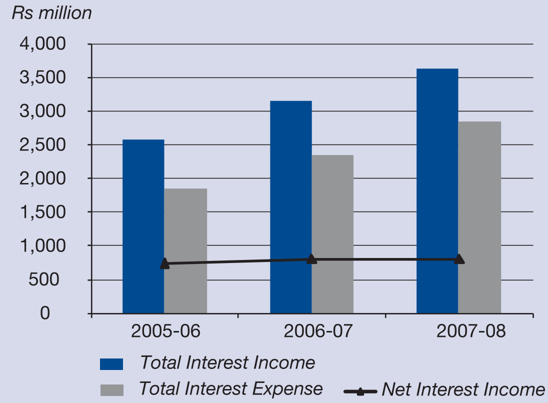


Table 10 shows the interest spread with respect to the activities of NBDTIs. Interest earned on Rs100 of advances/leases and interest paid on Rs100 of deposits increased by Rs0.76 and Rs0.89, respectively. As a result, the interest spread contracted from Rs1.47 to Rs1.34 during the year under review.

Table 10: Interest Spread

	2006-07	2007-08
Interest earned on Rs100 of advances/ leases	11.30	12.06
Cost per Rs100 of deposits	9.83	10.72
Interest Spread	1.47	1.34

6.2.5.3 Non-Interest Income

Non-interest income posted an increase of 8.6 per cent to reach Rs404 million in 2007-08. Fee income and commissions which represented 31.0 per cent of total non-interest income at end-June 2008, decreased by 1.6 per cent from Rs127 million in 2006-07 to Rs125 million in 2007-08. Operating lease rentals, which constituted 53.0 per cent of total non-interest income at end-June 2008, rose by 122.9 per cent to Rs214 million.

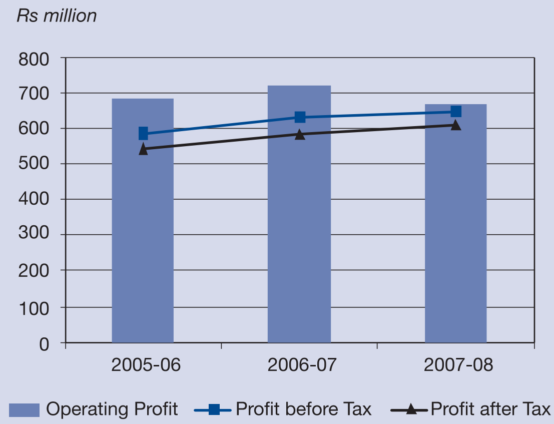
6.2.5.4 Non-Interest Expenses

Non-interest expenses consisting of staff costs and other operating expenses increased by 16.7 per cent to Rs537 million in 2007-08. Staff costs which represented 32.8 per cent of total non-interest expenses at end-June 2008, went up by 1.7 per cent from Rs173 million in 2006-07 to Rs176 million in 2007-08. The ratio of staff costs to operating income went down from 14.7 per cent in 2006-07 to 14.6 per cent in 2007-08. Other operating expenses which constituted 67.2 per cent of total non-interest expenses increased by 25.8 per cent to reach Rs361 million in 2007-08 compared with Rs287 million in 2006-07.

6.2.5.5 Operating Profit

NBDTIs posted an operating profit (before bad and doubtful debts and taxation) to the tune of Rs667 million during the year under review, representing a decrease of Rs51 million or 7.1 per cent compared to 2006-07. The profit before tax went up by 2.7 per cent to reach Rs648 million in 2007-08. The charge for bad and doubtful debts increased from Rs77 million in 2006-07 to reach Rs82 million in 2007-08. Chart 17 shows a comparison of profits for NBDTIs over the years 2005-06 to 2007-08.

Chart 17: Operating Profit, Profit before and after Tax



6.2.5.6 Return on Average Assets and Equity

The pre-tax return on average assets of individual NBDTIs ranged between negative 1.4 per cent to positive 3.4 per cent in 2007-08. It should be noted that one of the NBDTIs posted a negative return on average assets in 2007-08.

The post-tax return on equity worsened from 12.4 per cent in 2006-07 to 10.9 per cent in 2007-08. The post-tax return on equity for individual NBDTIs varied form negative 3.7 per cent to positive 18.7 per cent in 2007-08.

Chart 18: Return on Average Assets and Equity

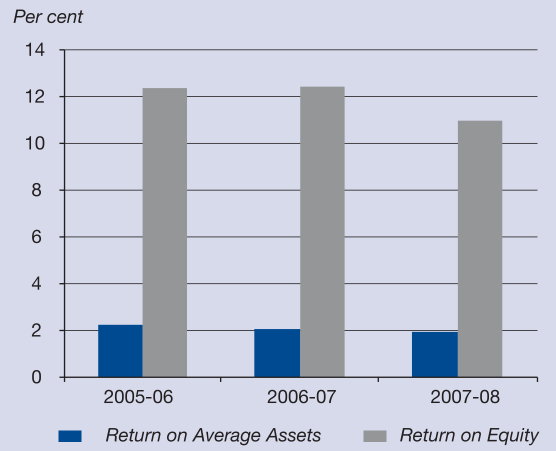


Chart 18 shows the return on average assets and equity over the years 2005-06 to 2007-08.

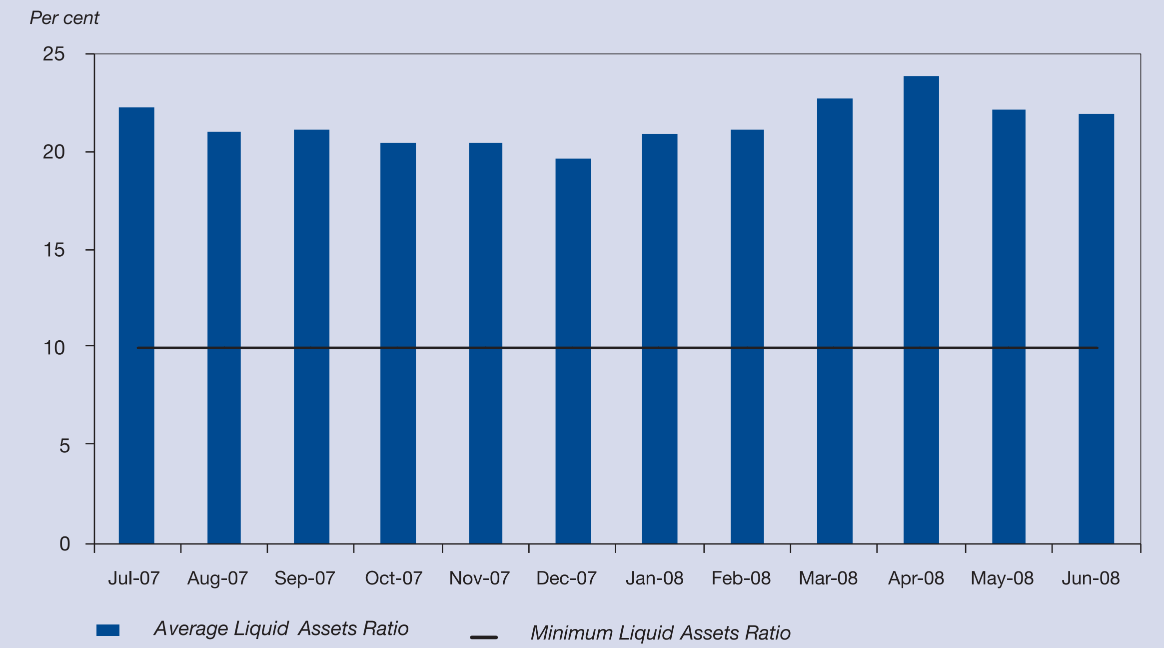
6.2.6 LIQUIDITY

Liquidity risk is defined as the risk arising from the inability to honour cash flow commitments as they fall due. Under the terms and conditions for authorisation to carry on deposit-taking business, NBDTIs are required to maintain liquid assets ratio of not less than ten per cent of their total deposit liabilities with maturity of not less than three months.

Liquid assets of NBDTIs comprise cash in hand, deposits held with Bank of Mauritius and authorised banks and non-cash liquid assets such as investment in Treasury Bills and Government Securities. As at 30 June 2008, liquid assets held by NBDTIs amounted to Rs6,014 million and were much higher than the required 10 per cent of the deposit liabilities of Rs23,968 million.

Chart 19 sets out the fluctuations in the weekly liquid assets ratio maintained by NBDTIs. The ratio ranged from 19.6 per cent to 23.8 per cent during the period July 2007 to June 2008.

Chart 19: Average Liquid Asset Ratio



APPENDICES

Appendix A List of Guidelines / Guidance Notes

1. Guidance Notes on Risk Weighted Capital Adequacy Ratio
2. Guideline on General Principles for Maintenance of Accounting and other Records and Internal Control Systems
3. Guideline for the Calculation and Reporting of Foreign Exchange Exposures of banks, Foreign Exchange Dealers and Money changers
4. Guideline on Credit Concentration Limits
5. Guideline on Liquidity
6. Guideline on Internet Banking
7. Guideline on Corporate Governance
8. Guideline on Related Party Transactions
9. Guideline on Public Disclosure of Information
10. Guideline on Transactions or Conditions Respecting Well being of a Financial Institution Reportable by the External Auditor to the Bank of Mauritius
11. Guideline on Credit Risk Management
12. Guidance Notes on Anti-Money Laundering and Combating the Financing of Terrorism
13. Guideline on Fit and Proper Person Criteria
14. Guideline on Credit Impairment Measurement and Income Recognition
15. Guideline on Outsourcing by Financial Institutions
16. Guideline on Operational Risk Management and Capital Adequacy Determination
17. Guideline on Control of Advertisement
18. Guideline for Institutions Conducting Islamic Banking Business
19. Guideline on Standardised Approach to Credit Risk
20. Guideline on Scope of Application of Basel II
21. Guideline on The Recognition and Use of the External Credit Assessment Institutions
22. Guideline on Eligible Capital

Appendix B Financial Soundness Indicators[1] for the Banking Sector[2], 2001-2008

(In per cent, unless otherwise indicated)

	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Capital Adequacy								
Regulatory capital to risk-weighted assets ratio[3]	13.0	12.3	14.2	15.0	15.4	15.8	13.3	15.3
Regulatory Tier I capital to risk-weighted assets ratio[4]	12.7	13.0	13.7	13.7	13.5	13.7	11.5	13.7
Total (regulatory) capital to total assets ratio	8.4	7.2	8.0	7.8	7.8	7.3	6.0	7.3
Asset Composition and Quality								
Share of loans per risk weight (RW) category								
RW=0 per cent	*6.8*	*9.5*	*5.2*	*6.4*	*16.6*	*12.8*	*9.1*	*9.0*
RW=10 per cent							*0.3*	*0.2*
RW=20 per cent	*0.4*	*0.4*	*4.8*	*6.7*	*0.2*	*1.3*	*3.9*	*3.3*
RW=50 per cent	*8.9*	*7.0*	*7.9*	*9.6*	*6.5*	*6.0*	*5.7*	*5.2*
RW=100 per cent	*83.8*	*83.2*	*82.1*	*77.3*	*76.7*	*79.8*	*81.1*	*82.3*
Total exposures to Total assets	59.2	51.6	47.8	45.9	53.6	40.1	44.8	54.9
Sectoral distribution of loans to total loans[5]								
Agriculture	*8.3*	*9.7*	*9.1*	*7.5*	*5.7*	*5.7*	*6.0*	*6.1*
of which: sugar	*7.0*	*8.6*	*8.0*	*6.4*	*5.6*	*5.0*	*4.8*	*5.0*
Manufacturing	*18.2*	*16.1*	*14.8*	*13.6*	*12.0*	*11.2*	*10.2*	*9.4*
of which: export enterprise certificate holders	*10.8*	*9.4*	*7.5*	*6.1*	*5.4*	*4.8*	*4.7*	*4.0*
Traders	*14.1*	*14.1*	*14.9*	*14.5*	*13.9*	*14.9*	*13.5*	*11.7*
Personal and Professional	*9.5*	*9.2*	*9.8*	*10.0*	*9.4*	*9.5*	*9.7*	*8.6*
Construction	*14.2*	*13.9*	*14.2*	*16.2*	*15.2*	*15.4*	*16.4*	*18.7*
of which: housing	*11.0*	*10.5*	*9.0*	*10.8*	*10.7*	*12.0*	*10.9*	*12.4*
Tourism /hotels[6]	*14.1*	*15.0*	*15.9*	*15.4*	*13.2*	*13.2*	*13.6*	*15.4*
Other	*21.6*	*21.3*	*21.2*	*22.8*	*30.7*	*30.1*	*30.6*	*45.6*
FX loans to total loans	13.1	10.3	10.9	12.2	51.1	50.7	56.3	65.5
NPLs to gross loans[7]	8.0	8.3	9.6	8.1	4.0	3.0	2.5	2.0
NPLs net of provisions to capital	37.8	34.0	28.1	22.4	11.4	7.0	9.1	8.2
Large exposures to capital[8]	270.1	263.7	220.9	200.0	250.3	380.0	493.2	394.2

	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Earnings and Profitability								
Return on assets	2.3	2.0	2.1	2.1	1.9	1.7	1.9	1.7
Return on equity	20.6	18.1	19.2	19.2	21.1	22.4	26.4	24.3
Interest margin to gross income	30.1	32.6	32.1	34.7	36.3	31.2	27.6	29.7
Noninterest expenses to gross income	20.8	23.1	23.9	27.7	20.1	16.4	15.0	17.2
Expenses to revenues ratio	10.3	10.5	10.6	10.2	8.1	7.7	6.8	8.5
Average Earnings per employee (in Rs'000)	1,670	1,819	2,212	2,433	2,904	2,817	3,402	3,747
Liquidity								
Liquid assets to total assets ratio[9]	29.2	32.7	36.6	37.9	44.1	52.8	47.7	27.7
Liquid assets to total short-term liabilities ratio[9]	60.2	65.3	71.0	71.7	88.6	118.8	104.2	31.9
Funding volatility ratio	21.1	16.4	13.9	14.0	-20.1	-51.6	-33.7	-9.3
Demand deposits to total liabilities ratio	10.9	10.3	10.3	10.7	15.9	15.4	18.4	19.4
FX deposits to total deposits ratio	12.1	11.7	11.0	13.8	57.3	68.0	67.6	66.0
Sensitivity to Market Risk								
Net open positions in FX to capital	3.2	7.5	20.8	1.9	4.2	6.4	3.2	3.8

Notes:

[1] The ratios were computed using the standard definition provided in the IMF's Financial Soundness Indicators Manual. The ratios may be different from those used in other parts of the report.

[2] Banking sector refers to former Category 1 banks up to December 2004 and to all banks as from Dec 2005.

[3] Regulatory capital refers to Total of Tier 1 capital and Tier 2 capital less investments in subsidiaries and associates.

[4] Tier 1 capital does not reflect deductions for investments in subsidiaries and associated companies.

[5] The definition used for sectoral classification was amended in 2001. The ratios were adjusted where possible to reflect the amendments.

[6] Up to 2000 the definition was limited to exposure towards hotels and hotel management certificate companies. As from 2000, the definition encompasses all exposures towards the tourism industry.

[7] Gross loans exclude accrued interest.

[8] Prior to June 2006, figures refer to Category 1 banks only.

[9] The ratio has been revised according to manual as from 2008.

Appendix C

List of Memoranda of Understanding entered between the Bank of Mauritius and other authorities on the Exchange of Supervisory Information

	Name of Authorities	Effective Date
Local		
-	Financial Services Commission	05 December 2002
Foreign		
-	Jersey Financial Services Commission	15 January 1999
-	Commission Bancaire Française	02 November 1999
-	State Bank of Pakistan	26 January 2004
-	Banco de Moçambique	15 March 2004
-	The Bank Supervision Department of the South African Reserve Bank	25 January 2005
-	Central Bank of Seychelles	02 May 2006
-	Hong Kong Monetary Authority	18 June 2008

Appendix D List of Charts

Appendix E List of Tables

Appendix F Glossary of Abbreviations

Abbreviation	Details
AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AIG	Accord Implementation Group
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ASRF	Asymptotic Single Risk Factor
ATM	Automated Teller Machine
Bank	Bank of Mauritius
BCBS	Basel Committee on Banking Supervision
CAR	Capital Adequacy Ratio
ECAIs	External Credit Assessment Institutions
FATF	Financial Action Task Force
FSAP	Financial Sector Assessment Programme
FSF	Financial Stability Forum
FSRB	Financial Action Task Force Style Regional Body
HLIs	Highly Leveraged Institutions
IFPs	Islamic Financial Products
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
MENAFATF	Middle East and North Africa Financial Action Task Force
NBDTIs	Non-Bank Deposit Taking Institutions
OFC	Offshore Financial Centres
WGL	Working Group on Liquidity

Appendix G List of Box

Appendix H List of banks, non-bank deposit-taking institutions, money-changers and foreign exchange dealers licensed by the Bank of Mauritius

The following is an official list of banks holding a Banking Licence, institutions other than banks which are licensed to transact deposit-taking business and cash dealers licensed to transact the business of money-changer or foreign exchange dealer in Mauritius and Rodrigues as at 30 June 2008.

Banks Licensed to carry Banking Business

1. AfrAsia Bank Limited
2. Bank of Baroda
3. Banque des Mascareignes Ltée
4. Barclays Bank PLC
5. Deutsche Bank (Mauritius) Limited
6. First City Bank Ltd
7. Habib Bank Limited
8. HSBC Bank (Mauritius) Limited
9. Indian Ocean International Bank Limited
10. Investec Bank (Mauritius) Limited
11. Mauritius Post and Cooperative Bank Ltd
12. P.T Bank Internasional Indonesia
13. SBI International (Mauritius) Ltd
14. South East Asian Bank Ltd
15. Standard Bank (Mauritius) Limited
16. Standard Chartered Bank (Mauritius) Limited
17. State Bank of Mauritius Ltd
18. The Hongkong and Shanghai Banking Corporation Limited
19. The Mauritius Commercial Bank Ltd.

Non-Bank Deposit-Taking Institutions

1. ABC Finance & Leasing Ltd.
2. Barclays Leasing Company Limited
3. Capital Leasing Ltd
4. Finlease Company Limited
5. CIM Leasing Ltd
6. Global Direct Leasing Ltd
7. La Prudence Leasing Finance Co. Ltd
8. Mauritius Housing Company Ltd
9. Mauritian Eagle Leasing Company Limited
10. SBM Lease Limited
11. SICOM Financial Services Ltd
12. The Mauritius Civil Service Mutual Aid Association Ltd
13. The Mauritius Leasing Company Limited

Money-Changers (Bureaux de Change)

1. Change Express Ltd
2. Max & Deep Co. Ltd
3. Gowtam Jootun Lotus Ltd[1]

Foreign Exchange Dealers

1. British American Exchange Co. Ltd
2. Cim Forex Ltd
3. Thomas Cook (Mauritius) Operations Company Limited
4. Shibani Finance Co. Ltd

[1] *The Bank has suspended the Licence granted to Gowtam Jootun Lotus Ltd to carry on the business of money-changer with effect from 26 January 2006.*

BANK OF MAURITIUS

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