ADDRESS BY MR YANDRADUTH GOOGOOLYE, FIRST DEPUTY GOVERNOR, BANK OF MAURITIUS AT THE AFRICAN TRAINING INSTITUTE, EBENE, MAURITIUS,

17 NOVEMBER 2017

Course on Core Elements of Banking Supervision

I wish to begin by thanking the ATI for organising this very informative course on the "Core Elements of Banking Supervision". This course is a must for any aspiring bank supervisor. However, allow me to humbly state that this course is but a stepping stone towards understanding banking regulation and supervision. To become an astute supervisor, one needs to effectively marry theoretical underpinnings with practical insights. In this respect, I will encourage you to constantly monitor even the minute anecdotal information that you come across during your day at work. And I am able to share these tips because I started my career at the Bank of Mauritius over three decades ago as a bank supervisor. And during my career, I have overseen not only the transformation of the banking sector in Mauritius and abroad, but also, the revolution behind banking supervision and regulation.

Finance and banking are necessary for growth and development. Besides contributing adequately to the economy's gross domestic product, the financial services sector intermediates between savers and borrowers, efficiently allocates financial resources, improves economic development, and creates employment opportunities. Thus, the promotion of a sound financial services sector is central to safeguard the economy's resilience. Trust and stability are other key elements that add towards the well-functioning of the financial system. In the absence of these elements, the economy's ability to mobilize savings for economic use would be jeopardised. Stability is key because it gives the assurance for participants to trade in financial markets and use the services of financial institutions.

Financial market infrastructure refers to the platforms that provide the services and facilities to support activities, such as exchanges, clearing houses, and payment and settlement systems. These platforms are crucial in the financial system as they are the nodes to mitigate systemic risks. The safe operation of these various platforms, even under extreme adverse conditions, is a prerequisite to ensure financial system stability. An efficiently working financial infrastructure would typically ease friction, diminish transaction costs, and take full advantage of financial intermediation.

The need for regulation and supervision of the financial system arises because financial intermediaries and markets are subject to asymmetric information. Thus, the major aim for financial regulation and supervision is to foster the effective functioning of the financial system in order to enhance the ability to absorb shocks and maintain financial stability. Financial instability arises as a result of shocks hitting the financial system, which impede with the payment system and, ultimately, affect the smooth running of business and trade. Regulators and supervisors across the globe are charged with managing the health of banks and other financial institutions and preserving the stability of the financial system for two basic reasons: consumer protection and maintain financial stability.

Accordingly, the ultimate objective of any regulator is to ensure that the banking sector attends to its traditional role of a shock absorber to the financial system. The banking sector has to work towards mitigating any risk between the financial sector and the real economy. Let me remind you that banks are also the channels through which the central bank transmits monetary policy to the economy. On this count, the central bank is definitely concerned with bank soundness for the effective transmission of monetary policy. In addition, thanks to its role as lender of last resort, the central bank is also compelled to have complete information on the financial soundness of any bank that might call for emergency liquidity assistance.

The route towards a framework for bank supervision and regulation can be traced back towards the end of 1974[1], when the then Committee of Banking Regulations and Supervisory Practices was established by the central bank Governors of the Group of Ten countries in the aftermath of serious disturbances in international currency and banking markets (notably the failure of Bankhaus Herstatt in West Germany). The Committee, headquartered at the Bank for International Settlements in Basel, was established to improve the quality of banking supervision worldwide, and to serve as a forum for regular cooperation between its member countries on banking supervisory matters. Starting with the Basel Concordat, first issued in 1975 and revised several times since, the Committee has established a series of international standards for bank regulation, most notably its landmark publications of the accords on capital adequacy which are commonly known as Basel I, Basel II and, most recently, Basel III. . It is surely not my intention to walk you through these various developments.

[1] Source: History of the Basel Committee, Bank for International Settlements.

In 1997, the Basel Committee issued the Basel Core Principles for Effective Banking Supervision, which have since been revised from time to time. These BCPs are the very gospel of effective banking supervision as they provide the lifelines for a sound banking sector. Bank supervisors naturally have to engage not only in off-site analysis of banks' performance but also in extensive on-site inspections to assess the soundness of banks

Now, allow me to share a few notes on the developments of supervision and regulation in Mauritius. This year marks the 50th anniversary of the Bank of Mauritius. The enactment of the Banking Act 1971 together with attributes in the Bank of Mauritius Act 1966 laid down the basic legal framework governing the operations of banks in the domestic financial system. The subsequent promulgation of the Banking Act 1988 set the basis for the development of a reputable offshore banking sector in Mauritius. In this context, emphasis was laid on the supervisory responsibilities vested upon the Bank, providing for mandatory trilateral meetings to be held with banks and their external auditors. After a few sporadic changes over the years, these two Acts were completely overhauled and replaced with two pieces of legislations in November 2004, namely the Bank of Mauritius Act 2004 and the Banking Act 2004. The independence of the Bank of Mauritius was reinforced, together with an added responsibility of ensuring the stability and soundness of the financial system of Mauritius. The Banking Act 2004 eliminated the separation between domestic and offshore banking activities and provided for a single banking licence to cover both activities. In 2016, the functions of the Bank were broadened with the added responsibility of regulating and supervising the locally incorporated, ultimate and immediate financial holding companies of banks and non-bank deposit taking institutions licensed by the Bank.

Alive to the fact that the Bank of Mauritius Act and the Banking Act still fall short of meeting the international standards for bank resolution and crisis management, the Bank sought assistance from the International Monetary Fund to strengthen the legal frameworks in these areas. In the same vein, the Bank opted for a review the Bank of Mauritius Act 2004 and the Banking Act 2004 in line with international best practices imposed not only by the Basel Committee of Banking Supervision (BCBS) but also the Financial Stability Board (FSB), the International Association of Deposit Insurers (IADI), the Organisation for Economic Co-operation and Development (OECD) and the Financial Action Task Force (FATF). Here, allow me to extend our deepest thanks to Mr Ravi Mohan, who was instrumental in this endeavour and supported us throughout. We also have a couple of bills in the pipeline, notably, the Deposit

Insurance Scheme Bill and the National Payment Systems Bill, both of which aim at strengthening the stability and soundness of the financial sector.

The Bank of Mauritius has already adopted the macro-prudential perspective in financial regulation to curb excessive risk on certain sectors. Guidelines have been issued for the implementation of macro-prudential policy measures such as caps on loan to value ratio, debt-to-income ratio, higher provisioning and capital requirements for certain sectors. The macro-prudential rules have been reviewed from time to time in the light of variations in the vulnerabilities of the system. One among the essential aspects of supervision that are crucial for macro-level monitoring is the efficient exchange of information between supervisors, both at home and abroad. Such an exchange provides an essential supervisory tool to support the supervision of banking groups. In this respect, the Bank has signed Memoranda of Understanding (MoUs) with several domestic and foreign regulatory authorities. The Banking Act 2004 allows the Bank to share information with any other central bank, under conditions of confidentiality. We are mindful, at the Bank, that exchange of information is crucial with regulators of countries where our banking groups hold a regional presence. The Bank has, in this context, held three Supervisory Colleges since 2013 with its host regulators.

In Mauritius, a Memorandum of Understanding (MoU) was drawn since December 2002 between the two supervisory authorities, namely the Bank of Mauritius and the Financial Services Commission, on information sharing. Over the years, the cooperation and coordination of these two institutions have been enhanced through the setup of a Joint Coordination Committee (JCC) and several working groups to coordinate supervisory work on common supervisory areas. The JCC typically meets every two months and reviews areas of interest. In addition, as the First Deputy Governor of the Bank, I have been appointed Vice-Chairman of the FSC since June 2017. This appointment makes the cooperation between the two institutions more efficient and focused.

As part of its reform strategy to reinforce the domestic banking sector, the Bank also initiated changes to the corporate structure adopted by the two largest banking groups in Mauritius. The separation of banking activities from non-banking activities limits the risk of contagion from non-banking business to the bank, and allows management to focus on their core business of banking. In line with Basel III requirements, these banks are made to hold higher capital requirements. Five domestic banks have been identified as being domestic systemically important banks, and since 1 January 2016, these banks have been required to

hold, in a phased manner over a four-year period, an additional capital requirement ranging from 1 to 2.5 per cent of their risk weighted assets depending on their systemic importance.

An area, where we, at the Bank, are very mindful is the improvement in AML/CFT processes. We have a zero tolerance approach for breach of AML /CFT rules and offending institutions are subject to fines. We have also instructed our banks to put in place a fully automated system for the detection of suspicious transactions and monitoring of the level of activity in customers' accounts.

The legal and regulatory landscape will, undoubtedly, undergo further changes driven primarily by innovative companies and applications – such as fintech companies and start-ups, distributed ledgers, blockchain and other crypto-currencies, which are transforming the financial services and banking sector landscape. The recently issued Basel Committee on Banking Supervision consultation document on the implications of fintech for the financial sector assesses how technology-driven innovation in financial services, or "fintech", may affect the banking industry and the activities of supervisors in the near to medium term and advocates 10 key recommendations for banks and bank supervisors to address the challenges of fintech. I will urge you to go through these documents and to keep abreast of such developments as they will be of key importance in the near future.

Ladies and gentlemen, regulation and supervision should not be limited to only banks and/or financial institutions. We often make this mistake of holding a narrow view on this subject matter. We have to see the bigger picture, instead. There is the need to focus on financial stability, which is encompassing and also address the regulation and supervision of financial market infrastructure. Going forward, the domain of bank supervision and regulation will keep its dynamism and a potential issue is the challenges for regulators which new technology is bringing to the banking industry. The emphasis on financial technology would entail identifying where risks lie. Putting forward a pro-active framework for regulation and supervision is high on the agenda. And this requires the collaboration and cooperation of stakeholders. We must not forget that gains achieved over years of development can be wiped out through lax financial regulatory standards.

Thank you.