FINANCIAL SECTOR ASSESSMENT MAURITIUS

AUGUST 2003

AFRICA REGION VICE PRESIDENCY
FINANCIAL SECTOR VICE PRESIDENCY

BASED ON THE JOINT IMF-WORLD BANK FINANCIAL SECTOR ASSESSMENT PROGRAM

I. INTRODUCTION

1. This Financial Sector Assessment (FSA) is based on the work of the joint IMF-World Bank missions[1] that visited Mauritius from October 21–31, 2002 and December 3–17, 2002 in the context of the Financial Sector Assessment Program (FSAP). The principal objectives of the missions were to identifiy the strengths, vulnerabilities and development needs in the financial sector, and to assist the Mauritian authorities in designing appropriate policy responses. The FSAP findings were discussed with the authorities at wrap-up meetings chaired by the Minister of Economic Development, Financial Services and Corporate Affairs and the Governor of the Bank of Mauritius at the conclusion of the second FSAP mission, and during the March, 2003, IMF Article IV mission in which the two FSAP team leaders participated. The authorities expressed broad agreement with the conclusions of the assessment, and have taken a number of measures to implement key recommendations. The final FSAP Report was delivered to the authorities in August, 2003.

2. This report summarizes the main findings and policy recommendations of the missions.

II. MACROECONOMIC CONTEXT AND BACKGROUND

3. **Mauritius has been remarkably successful in achieving rapid growth and substantial diversification of a formerly mono-agricultural economy.** Real output growth over the past two decades has averaged just below 6 percent per year, leading to an impressive rise in per capita income, a marked improvement in social indicators, and a narrowing in income disparities.

[1] The teams were led by Mr. Abdessatar Ouanes (IMF, Head), and Ms. Ann Rennie (World Bank, Deputy Head) and included: Messrs. Hemant Shah, Michael Andrews, Gamal El-Masry, Wim Fonteyne and Ms. Nancy Rawlings, and Ms. Delrene Alvis (Senior Administrative Assistant) [all IMF]; Mr. Dimitri Vittas, Mr. Alain Damais, Mr. Juan Costain, Mr. Peter Kyle, and Ms. Leora Klapper [all World Bank]; Mr. David Wilton (IFC); Mr. Thomáš Hládek (Czech National Bank), Mr. Kee Meng Lee (Monetary Authority of Singapore), and Ms. Diana Wong (Hong Kong Security Bureau, Government Secretariat).

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Mauritius has also succeeded in fostering a stable and democratic political system, underpinned by strong institutions and the rule of law. Sound economic management and a far-sighted development strategy have permitted the country to diversify its export and productive bases from a sugar-based economy into one based on four pillars of development: sugar, textiles, tourism, and financial services.

4. **Maintaining the past high rates of growth and employment will pose a major challenge.** The trade preferences on which two of the pillars of the economy are founded are being eroded[2], forcing the the sugar and textile industries to significantly improve their competitiveness or lose market share to larger, lower-cost producers. Both industries are restructuring and shedding labor. Since the early 1990s, unemployment (currently about 10%) has been rising despite continued robust growth, due primarily to labor market rigidities and a mismatch between the qualifications of the labor force and the skills demanded by the workplace. The erosion of preferential trade arrangements is likely to lead to a further rise in unemployment.

5. **The authorities have embarked on an ambitious program to transform the economy**. In partnership with the private sector, the government is taking decisive measures to build a knowledge economy based on higher value-added services, notably in information and communication technologies. They have also adopted programs to modernize and improve competiveness in the sugar and textile industries, and are investing heavily in education in order to realign the labor force with the requirements of the new engines of growth. The investments in education and infrastructure required to implement this reform agenda have contributed to high and unsustainable fiscal deficits (6 percent of GDP in 2002/03, and 5.5 percent forecast for the current fiscal year), and it is important that the authorities pursue their announced program to reduce the deficit to to 3 percent of GDP over the medium-term. Successfully re-engineering the economy while maintaining macroeconomic stability and social cohesion will represent a significant challenge, and there are down-side risks which could adversely impact the financial sector.

III. OVERALL ASSESSMENT

6. **Mauritius has a relatively large and well-developed domestic financial system and a growing offshore sector**. Mauritius belongs to a select group of developing countries where domestic bank assets represent approximately 100 percent of GDP, and contractual savings exceed 40 percent of GDP. The growing offshore financial sector is also large relative to GDP, but weakly integrated with the domestic economy. The basic financial sector infrastructure, such as payment, securities trading and settlement systems, is modern and efficient. Access to financial services is extremely high, with more than one bank account per capita and widespread

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[2] In the sugar industry, most Mauritian sugar is sold in the European Union (EU) market at the guaranteed European producer price, which is well above the world market price. This arrangement is currently under legal challenge at the WTO. The expiration of the Multifibre Arrangement at the end of 2004 will expose the export-oriented textile sector to stiff and uninhibited competition from low-cost producers such as China.

branch banking and ATMs. Unlike in most developing countries, new and small firms do not face major constraints in accessing financial services and credit.

7. **In order to move to the next stage in financial sector development, however, Mauritius needs to further diversify its financial sector**. While the financial sector is generally sound and profitable, the dominance of a few major players and the concentration of risks within a narrow banking sector pose certain systemic risks and inhibit competition and innovation.

8. **Overall, the Mauritian financial sector is currently in good health, and the short-term stability risks are modest**. The principal risks facing the domestic financial system are linked to the structure of the underlying economy. As wealth and economic activity are concentrated in a few sectors and in a number of large, diversified family-controlled conglomerates, credit concentration in the banking sector is high. A severe or prolonged downturn in economic activity in key sectors where bank exposure is significant could potentially threaten bank solvency, though stress tests indicate the system is resilient to all but very large shocks. A further risk arises from the short maturity profile of domestic public debt, which exposes the government to roll-over risk. Finally, there are some reputational risks associated with potential money laundering in the offshore sector, though recent measures to strengthen the AML regime should help to mitigate this vulnerability.

9. **The strategy for mitigating the potential risks facing the banking system in Mauritius requires a multifaceted approach.** This includes: (i) continuing the strengthening of banking supervision and encouraging banks to reinforce their internal controls; (ii) fostering the development of alternatives to bank lending to reduce portfolio concentrations and increase competition; (iii) encouraging sound international risk diversification; (iv) strengthening provisioning levels so as to enhance the resilience of the system to a downturn in economic activity; and (v) reducing the government's implicit contingent liability in the banking system.

10. **The assessment of standards and codes found a high level of compliance with internationally accepted norms and best practices**. The authorities have made substantial progress in this area and are upgrading key financial sector legislation and regulations. The ongoing implementation of the assessments' recommendations should help further strengthen the supervisory and regulatory framework and enhance the resilience of the financial system.

IV. MAIN FINDINGS

A. Banking Sector

11. **Mauritius' strong economic performance has spurred the development of a large, profitable and sound banking sector.** The domestic banking sector, which constitutes over two-thirds of the domestic financial system, has grown at an average 13 percent p.a. over the past five years. There are 10 banks, though the system is highly concentrated: the two large domestic banks, Mauritius Commercial Bank (MCB) and State Bank of Mauritius (SBM), control roughly 70 percent of system aggregates, and the two largest foreign banks, HSBC and Barclays, control a further 22 percent of the market. The system is generally well capitalized, highly profitable, and liquid. The average capital adequacy ratio of 13.1 percent comfortably exceeds the regulatory minimum of 10 percent. The return on assets has been consistently above

2 percent, and return on equity over 20 percent during the past five years. The average net interest margin of 3.5% appears reasonable given the sector's risk profile, and operating costs are relatively low. Finally, the system is rather liquid, with liquid assets covering 63 percent of short-term liabilities.

12. **Opportunities for portfolio diversification are constrained by the structure of the small island economy.** With sugar, tourism, and textiles accounting for some 40 percent of bank credit, the sectoral distribution of credit is probably as diversified as the economy allows. However, loan portfolios are also concentrated at the level of individual counterparties, and exposure to related parties is relatively high. Credit to the four largest borrowers in the economy exceeds the capital base of the system, and large exposures represented, as of September 2002, 225 percent of system capital. While portfolio concentrations are to some degree unavoidable, the recent tightening of BOM guidelines on large exposures and related-party lending represents a positive development. In comparison to countries in the African region and similar income levels, asset quality appears relatively sound, with a ratio of nonperforming loans (NPLs) to total advances averaging around 8 percent over the last five years. To guard against a deterioration in the quality of their portfolios, banks have been reducing their exposures to sectors where the risk is considered highest. Provisioning is relatively low (23 percent of gross NPLs), in part because banks historically have achieved significant recoveries from collateral. This level of coverage might, however, prove to be inadequate in the event of a sustained economic downturn, when the realizable value of collateral is likely to deteriorate.

13. **Stress tests indicate the system is resilient to most external shocks.** While credit risk is by far the most important risk facing the banking system, operational risk is also a concern, as highlighted by the detection of a substantial fraud at MCB in February, 2003. While the bank's strong underlying profitability enabled it to comfortably absorb the approximate US $30 million loss, the fact that the fraud went on undetected for several years points to a major failure of internal audit, control and governance systems. The banks face moderate and manageable liquidity and equity price risks, and negligible direct exchange and interest rate risks due to well-matched currency books and largely variable rates on loans and deposits.

14. **Faced with limited growth opportunities in the domestic market, the two dominant banks have expanded in the region.** While the regional market offers welcome opportunities for growth and diversification, it has also exposed the banks to riskier, less developed markets. Thus, expansion needs to be accompanied by enhanced risk management tools and effective information exchange between domestic and foreign regulators.

15. **Mauritius has no deposit insurance, but there is a general perception, based on past government behavior, that there is an implicit blanket guarantee for depositors**. In view of the large size of the deposit base (72 percent of GDP), this implicit contingent liability is quite high and may be unmanageable. MCB and SBM are widely considered "too big to fail" by depositors, and, in past cases of bank resolution involving smaller banks, depositors did not suffer losses. In at least one case, the BOM advanced funds to ensure all depositors were repaid. While it is to the credit of the BOM that insolvent banks have been addressed, in some instances, it might have been preferable for the authorities to ensure orderly exit rather than preserve weak banks, thus laying the foundation for future problems. The authorities are considering establishing formal limited deposit insurance. The introduction of such a scheme should be

contingent upon further strengthening of supervision, the adoption of a more forceful prompt corrective action plan by the BOM, and a withdrawal of the government from direct ownership in depository institutions. Should the policy decision be taken to introduce deposit insurance, it is important to ensure that the design incorporates best practices in order to obtain the expected benefits in dealing with problem banks, and to mitigate potential adverse effects.

B. Financial and Capital Markets

16. **The short-term money, foreign exchange, and treasury bill markets are relatively underdeveloped**. This makes it difficult for banks and other financial institutions to manage and allocate risks efficiently. It also impedes the development of more sophisticated financial instruments that would enable Mauritian companies to efficiently hedge risks. The authorities need to address a number of issues identified in the Treasury bill auction process and pursue efforts to stimulate more efficient money and foreign exchange markets.

17. **The longer-term government and corporate bond markets are also underdeveloped**. This is paradoxical given the strong and rising demand for longer-term assets from contractual savings institutions, the need for the GOM to extend the maturity profile of public debt, and the excessive risk concentration of the banking sector on a few large corporate borrowers. To encourage the development of these markets, the government needs to harmonize the tax treatment of interest income on financial instruments, eliminating the current disincentives to hold corporate securities, and to establish a yield curve through regular issuance of longer-term government bonds and a more active secondary market Strict enforcement of recent prudential requirements for banks regarding large exposures and related party lending should also help to foster the development of a corporate securities market.

18. **While the institutional, legal, and technical infrastructure of the stock exchange (SEM) is highly developed, the market is characterized by low volume, poor liquidity and lack of depth.** From 1997 to 2002, market capitalization declined from 43 percent to 19 percent of GDP; the average price–to–earnings ratio fell from approximately 14 to 6; and average turnover hovered around 5 percent, indicating that the market is small, even relative to the small economy.[3] Many of the challenges which face the market fall outside the scope of government policy, including the small scale of the domestic market, the need for local investors to diversify internationally, the recent global bear market, and the withdrawal of foreign portfolio investment from emerging markets. However, the GOM can take certain policy measures to promote a more active capital market. Investor confidence can be enhanced by improved standards of disclosure and corporate governance, and by more effective regulation and supervision of market participants, which is particularly critical in a market where there is considerable overlapping ownership among issuers, traders and investors. Measures to diversify the issuer base, including privatizations and greater regionalization, should also be pursued. Finally, the government should review the role of government-sponsored funds, which may create distortions in the pricing of securities.

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[3] Since the FSAP mission, the SEM, like many stock markets around the world, has experienced a strong bull market. In the 6 months to June, 2003, the major market index, the SEMDEX rose 22%, and market capitalization increased 17%.

C. Insurance

19. **The domestic insurance industry is well developed, and the large and medium sized companies are efficient and financially strong.** At 4.1 percent, insurance penetration (premia/GDP) is roughly on a par with Singapore, Chile and Cyprus. Life premia represented 61 percent of the total, providing further evidence of the development of sector. Life business has been favored by generous tax incentives and the high level of development of pensions and housing finance. The nonlife business is also generally sound, and does not suffer from high loss ratios or long delays in settlement. There are 22 insurance companies operating in Mauritius, but the market is highly concentrated, with the three largest groups controlling 76% of total insurance assets. Despite this high level of concentration, the industry appears competitive, efficient, and reasonably profitable. There are, however, a number of smaller companies which have weak financial ratios, and suffer long delays in settling claims, often forcing their customers to seek redress in court. Four of them have been intervened recently and remedial action has been taken. Further consolidation of the industry should be promoted to ensure sound competition and greater safety. This can be achieved by raising the level of the minimum capital and introducing risk-based capital requirements.

20. **Life insurance companies face considerable reinvestment risk arising from the duration mismatch of their assets and liabilities, and could suffer losses in the event of a large and persistent fall in interest rates.** This is due to the shortage of long-term assets in the local market and the prevalence of long duration liabilities on their books. While the risk of significant losses is mitigated by periodic review clauses in policies which offer guaranteed rates of return, and the relatively low rates of guaranteed return compared to current interest rates, caution is nevertheless advisable. With the contractual savings industry's strong and growing unsatisfied demand for long duration assets, it is in a position to stimulate the development of a long-term government and corporate bond market, as well as the equity and venture capital markets.

D. Pensions

21. **Mauritius has a well-balanced multi-pillar pension system, but the Basic Retirement Pension (BRP) scheme faces issues of affordability**. Due to a rapidly aging population the cost of an unchanged BRP is projected to double by 2020. The government is considering various options for containing the cost of this scheme. Increasing the entitlement age to 65 and applying an affluence test that would exclude high-income people would contain the projected cost to roughly its current level (3.2 percent of GDP) in 2020.

22. **The National Pension Fund has accumulated substantial resources (17 percent of GDP) and is well run by the standards of most developing countries.** It has high coverage, a low contribution rate, low operating costs and good investment returns, even by comparison to most private funds. The recent fraud involving large time deposits placed with the MCB underscores the need for stronger internal controls and for subjecting its operations to external audit by a reputable international auditing firm. The NPF invests heavily in government securities and needs to diversify its holdings and adopt more professional asset allocation and investment policies. It also requires considerable upgrading of its operations, creation of an independent

Board of Trustees, and appointment of full-time executive management. The NPF is currently based on an opaque point system, and consideration should be given to converting the NPF to a more transparent defined contribution scheme, complemented with the offer of real annuities based on life expectancy on retirement.

23. **The occupational pension funds appear to be generally sound, although the civil service pension scheme is unfunded**. Most occupational pension schemes appear to be well managed with diversified assets, good investment returns, and low operating costs. They generally follow sound accounting and actuarial practices, and are reasonably well funded. The civil service pension scheme operates on an unfunded basis and suffers from a growing deficit. The government faces a critical policy decision regarding the establishment of an appropriate basis and level of funding in order to protect benefits from future budgetary pressures. One reform option would be to create a defined-contribution scheme for new recruits, while continuing the defined-benefit scheme for existing civil servants. A White Paper on Pension Reform, due in early 2004, is being prepared for public consultation on the main policy options.

E. Other NBFI's

24. **The development of independent non-deposit-taking lenders could increase competition and lead to greater access to financing at lower rates**. Although both small and large firms seem able to access financing, rates remain relatively high and firms may have difficulties financing growth due to the widespread bank practice of taking floating liens that include all current and future business assets of the firm and personal assets of the owner. While leasing is already well-established in Mauritius, most companies are reliant on deposits for funding, and are therefore exposed to risks associated with maturity mismatches. Further development of non-deposit-taking NBFIs could be facilitated by the removal of tax policies that discourage the development of the corporate bond market.

25. **The establishment of a comprehensive credit information bureau would also promote greater diversity and competition in the financial sector.** The BOM has taken the positive initiative to propose the establishment of a credit information bureau. The current proposal to include initially only large bank loans will help reduce systemic risk; however, to foster competition and improve access to credit for smaller firms, the bureau should in time be made more comprehensive in scope. Amendments to the Banking Act and Bank of Mauritius Act that would allow the sharing of information are being considered. In accordance with best international practice, these amendments should allow for future relationships or joint-ventures with private credit bureaus, and should incorporate modern consumer protection provisions. Credit information would also be enhanced by standardizing and making electronically available financial information submitted to the Registrar of Companies.

F. Offshore Financial Sector (Global Business and Category 2 Financial Institutions)

26. **Mauritius' offshore financial center has grown rapidly since its inception in 1988, but remains small compared to the more established jurisdictions**. Global businesses are attracted to Mauritius by a very low tax environment supported by 26 double tax avoidance treaties; modern business-friendly legislation for global business; policies favoring open trade, capital flows and exchange convertibility; good telecommunications; relatively low wages; a

multilingual workforce; and location. As of June, 2002, the offshore sector included 14 banks, 11 captive and 4 non-captive insurers, 221 global funds and approximately 20,000 Global Business License (GBL) companies engaged in non-financial services or personal/family trusts. Global financial activities are large relative to both GDP and similar domestic activities. Category 2 bank assets amounted to 94 percent of GDP, marginally less than the assets of domestic banks; Category 2 insurance premia were 4.3 percent of GDP in 2001 and comparable to domestic premia; and the global mutual fund industry, with assets under management of $6.7 billion or about 1.5 times GDP, was significantly larger than the domestic fund industry. The licensing process for Category 2 banks and insurance companies appears to be effective, as license holders are generally subsidiaries or branches of well-established international financial institutions of high repute and standing, and both sub-sectors appear sound and profitable.

27. **Linkages between the offshore financial sector and the domestic economy have to date been limited.** While the industry confers important benefits in terms of global recognition, and development of world class financial, legal, accounting, and auditing skills, restrictions on dealings in local currency and the generally wholesale nature of the offshore financial business have implied a small impact of offshore activities on employment and economic activity. The sector does not therefore currently represent a systemic risk for the domestic economy, though it does pose reputational risks associated with money laundering or the financing of terrorism. The authorities are aware of these risks, and are taking steps to mitigate them[4]. The authorities have announced their intention to implement a phased integration of the onshore and offshore sectors, with the objective of eventually having a single financial center that caters to both domestic and global business.

28. **Changes in tax and regulatory regimes in other jurisdictions could materially affect the growth of the global business sector.** Such developments are possible in India and South Africa, the two most important markets for the Mauritian global business sector. There have been legal challenges in Indian courts essentially related to the argument that Mauritian tax vehicles may be abused by third country residents for tax-advantaged investments in India. While none have succeeded to date, a significant narrowing or cancellation of the treaty would affect Mauritius adversely[5]. Similarly, proposals by the South African authorities to tax world-wide income derived from South African sources or to further relax exchange controls would adversely affect South African business. Mauritius is guarding against these risks by seeking to enter into treaties that follow good practices in avoiding the encouragement of "tax shopping"; defending legal challenges effectively; and negotiating treaties and successfully attracting business with other countries.

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[4] The Global Business License 2 (GBL2) firms constitute the most significant source of potential AML/CFT risk to Mauritius. These companies have no physical presence in Mauritius, and are inherently difficult to supervise and monitor. Many were licensed at the time when Mauritius did not have strong customer identification requirements in place. Stricter licensing requirements are now in effect and monitored, and the FSC is vetting existing license holders.

[5] Mauritius has consistently been the greatest source of FDI into India, with some $7.5 billion in investment flowing from Mauritius to India between 1991 and 2003. These inflows have decreased sharply in 2003, which may be related to the ongoing legal challenges and uncertainties on future tax benefits.

G. Accounting, Auditing and Corporate Governance

29. **Recent high profile financial scandals have raised concerns about the quality of auditing and corporate governance.** The Companies Act 2001 has mandated the use of International Accounting Standards (IAS) and International Standards on Auditing (ISA) for all companies other than small private companies; however, there appears to be a gap between standards and practice. The World Bank has recently conducted an assessment of compliance with international auditing and accounting standards. The assessment focuses on the need to strengthen monitoring and enforcement arrangements through the creation of a financial reporting council, the establishment of a professional body for the audit profession, and enactment of a new law dealing with accounting, auditing and financial reporting. The authorities have announced their intention to introduce legislation in line with these recommendations in the near future.

30. **In line with international trends, the authorities are also taking steps to strengthen corporate governance.** The Companies Act 2001 and the listing rules of the stock exchange have enhanced shareholder protections, and the BOM has issued binding Guidelines on Corporate Governance for the banking sector which are in line with international best practice. The World Bank completed an assessment of corporate governance in 2002, and made detailed recommendations for improvements. In the wake of this assessment, a draft Code of Corporate Governance has been prepared and presented for public consultations. The draft code provides guidelines on Board and audit committee composition, and qualifications and roles of company directors, CEO's and corporate secretaries. It also provides strict guidelines governing conflicts of interest, which is a key concern in Mauritius given the concentration of corporate ownership. Once the code is finalized and adopted, listed companies should be required, at a minimum, to disclose their level of compliance. The GOM, as a shareholder in numerous companies, should set an example by strictly adhering to the code.

H. Financial Sector Regulation and Supervision

31. **The Government of Mauritius has undertaken a comprehensive program of legal and regulatory reform over the past three years with a view to developing Mauritius as a competitive international financial center of high standing.** This reform process was well underway, though incomplete, at the time of the FSAP missions.

32. **The government has adopted a prudent and phased approach to integrated regulation and supervision of the financial sector.** The Financial Services Commission (FSC) was established in December, 2001 as the unified regulator for the non-bank financial sector, while the BOM has maintained full responsibility for banking regulation and supervision. It was decided at the time of the creation of the FSC that a review would be conducted in three years to determine whether to merge the BOM and FSC into a single unified regulatory authority for the financial services sector in light of national and international developments. The FSC has taken over the regulatory and supervisory functions of the former Stock Exchange Commission (SEC), the Insurance Division of the Ministry of Economic Development, Financial Services and Corporate Affairs, and the Mauritius Offshore Business Activities Authority (MOBAA), and has also assumed responsibility for financial services that were previously either unregulated or only partially regulated. With technical assistance from the World Bank, the FSC is working to put in

place sound prudential and market conduct standards and policies, and has undertaken an ambitious staff recruitment and training program to enable it to effectively carry out its broad mandate.

33. **Banking supervision is of a good standard, reflecting significant progress made in building the capacity of the BOM in recent years**. However, there is scope to further strengthen the legal framework, develop needed regulations, and enhance implementation. Most legal deficiencies would be addressed if the current drafts of the new banking bill and Bank of Mauritius bill were enacted. Prudential guidelines are all of a commendable standard, and the BOM's capacity to enforce guidelines has substantially increased in recent years. However, there is a need for additional guidelines to address country and market risks and credit policy. Finally, banking supervision could benefit from further strengthening, notably in the areas of consolidated supervision, the supervision of operational risk, and problem bank resolution.[6]

34. **Regulation and supervision of the insurance sector have improved markedly since the creation of the FSC, but further strengthening is required.** The regulatory framework has many strong elements, including reliance on solvency monitoring, prudent asset diversification, and international accounting and actuarial standards. Gaps exist, however, in corporate governance, internal controls and risk management. Furthermore, solvency ratios are below international standards, and do not include risk-based capital requirements. These deficiencies have been addressed in the new draft insurance bills. Supervision needs to place greater emphasis on risk management and early warning systems. The FSC should also establish clear procedures for early and effective intervention.

35. **Enactment of a comprehensive law on occupational pensions would be desirable, and proactive supervision needs to be developed.** While the regulatory framework is extensive and contains many important provisions to enhance the security of retirement benefits, it is fragmented and has important gaps, such as the need for safe custody of assets and adequate asset diversification. The FSC is currently finalizing a draft pensions bill, and has commenced consultations with the industry. The complete absence of supervision represents a major shortcoming, which needs to be addressed to protect the pensions of participating workers. In strengthening regulation and supervision, however, care should be taken to avoid disrupting the good performance of the larger schemes.

36. **The regulation and supervision of the securities industry require considerable strengthening**. The FSC is currently preparing key legislation with respect to securities, collective investment schemes (CIS), and market intermediaries. Completion of this legislative agenda is critical to address existing deficiencies and gaps in the legal and regulatory framework. One of the most important gaps is the absence of legislation governing CIS, despite the existence of a sizeable domestic and offshore mutual fund industry. The FSC has imposed licensing and reporting requirements in the absence of legislation, but these requirements need to be backed by legislation which addresses important issues such as the segregation of funds, disclosure of investments, calculation of investor interest and net asset value, competency of managers and directors, and separation of functions within the CIS framework. It is also important that the

[6] The mission understands that the BOM has recently issued new guidelines for intervention in financial institutions.

FSC undertake a comprehensive on-site inspection program of all licensed entities in the securities industry, including SROs.

I. Insolvency and Creditor Rights

37. **Banks and financial institutions enjoy strong and enforceable creditor rights, but the legal framework governing corporate insolvency needs to be updated.** Nearly all corporate lending in Mauritius is done on a secured basis. Banks and financial institutions benefit from strong, preferential rights with respect to security and fixed and floating charges, but enforcement procedures are often slow and inefficient. The legal framework for corporate insolvency is outmoded, and is oriented almost exclusively towards liquidation. The authorities are working on a new law which will address weaknesses and incorporate recommendations of the assessment of insolvency and creditor rights systems that was recently conducted by the World Bank.

J. Payment Systems

38. **Mauritius has well-developed, modern, and secure payment systems**. Mauritius' Automated Clearing and Settlement System (MACSS) is a very modern, fully computerized, web-oriented, real-time-gross-settlement, large-value payment system. Checks are cleared through a manual, netting system, with three daily settlements through the MACSS. Card payments are technically well developed, with all ATMs, electronic funds transfers and point-of-sale transactions integrated in one network. Securities settlement is done on T+3 basis in a modern, fully computerized system. The assessment of payment systems conducted by the FSAP mission concluded that Mauritius fully complied with most of the Committee on Payment and Settlement Systems (CPSS) Core Principles.

K. Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT)

39. **The legal and institutional framework on anti-money laundering and combating the financing of terrorism (AML/CFT) in Mauritius is broadly in line with FATF 40 + 8 Recommendations.** The Mauritian authorities have demonstrated strong political will and commitment to meeting international standards, and have made significant progress in establishing a comprehensive AML/CFT regime in recent years. The Mauritian government passed the Economic Crime and Anti-Money Laundering Act (ECAML) in June 2000. Further efforts by the Mauritian government to improve the country's legal and institutional framework have resulted in the enactment of major legislation, including the Dangerous Drug Act 2000, the Financial Services Development Act 2001, the Prevention of Corruption Act 2002 , the Prevention of Terrorism Act 2002, and the Financial Intelligence and the Anti-Money Laundering Act 2002, which replaced the ECAML. The FIU was recently admitted to the Egmont Group. While certain deficiencies in the legal and regulatory framework were noted in the assessment conducted in December, 2002, the authorities have acted promptly and decisively to address them. Technical assistance has been provided, and amendments to existing legislation, as well as new regulations and guidelines have been promulgated to strengthen customer due diligence requirements, facilitate the exchange of information, and clear certain ambiguities in the legal framework. Further work is recommended to improve the coordination of law enforcement efforts, and to expand the scope and focus of AML/CFT reviews during on-site

inspections in line with the new Guidance Notes and Codes. In line with these recommendations, the BOM has recently issued new guidelines for supervisors, and the authorities have formed a task force to strengthen the coordination of law enforcement agencies.