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Banking & Finance Insights

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Contents

Welcome to this new edition of Banking & Finance Insights!

In this edition, our article Locus will address two themes. Firstly, we will give you an overview of the Central Bank's guideline on the newly created issuer of commercial paper licence with a comparison with the Indian regime. Secondly, we will analyse the live subject of the LIBOR reform and its alternatives.

In the legal updates section, we will give you some insights on the proposed amendments to the Mauritius Commercial Code with the introduction of provisions relating to the "*fonds de commerce*" (commercial undertaking). We will also apprise you of the recent developments from the Loan Market Association.

We propose to continue our series on derivatives in "5 Things to know", this time touching on the 2002 ISDA Master Agreement.

The F.A.Q section will give you a high level overview of the salient features relevant to the financing of private equity funds in Mauritius.

Finally, Country Updates will focus on the recent initiatives taken by the Financial Services Commission which has been very active for the past months.

Wishing you an enjoyable reading.

LOCUS

PART 1: ISSUE OF COMMERCIAL PAPER, A NEW REGULATORY REGIME

The Central Bank of Mauritius (**"BOM"**) introduced in 2017 a licence for the issue of commercial papers (**"CPs"**). The aim of the BOM in doing so is two-fold: the licence should enable companies to diversify their source of funding. It is also intended to provide a steady supply of short term financial instruments for investors. Issuing CPs involves several steps, including obtaining a credit rating from an external credit assessment institution, the appointment of an issuing and paying agent and of a custodian. Once the credit rating is obtained and the appointments completed, the prospective issuer will apply to the BOM for an issuer of commercial paper licence.

Guidelines have been issued by the BOM on the 11 January 2018 but are yet to come into force (**"Guidelines"**).

In this article, we will outline the main features of this new regulated activity and will end with a short comparison with the recent evolution of the CPs legal regime in India.

Definition and key features of a Commercial Paper

Commercial papers are defined as unsecured, short-term money market instruments issued in the form of a promissory note with a maturity period not exceeding 364 days. The CPs can have a minimum size of issue of MUR 100 million. The CP can either be issued at a discounted price to its face value (as determined by the issuer based on relevant market factors), or at face value where the issuer receives the face value and accrued interest at maturity (as determined by the issuer based on relevant market factors). The CPs can be traded over the counter on the secondary market, be bought-back or transferred. There is no upper threshold to the size of the issue of the CPs, (except as determined by the board of directors of the issuer and as long as it is in line with the quantum indicated by an External Credit Assessment Institution (**"ECAI"**)). While the limit for the period of maturity of a CP is of 364 days, it can in no case exceed the validity period of the issuer's credit rating as assessed by the recognised ECAI and as set out in the licence issued by the Bank of Mauritius. The guideline provides for a list of information and disclosure that the CP offering document must contain, amongst which, (i) a short description of the issuer; (ii) a description of the CP, including form, tenor, mode of issue and credit rating; (iii) a copy of issuing and paying agent (**"IPA"**) certificate; (iv) a summary of audited financial statements for the last three years; (v) the end-use of funds; (vi) the tax treatment of payments under the CP; (vii) disclosure to the investors that the investment is subject to credit and other risks and that payment will be made only if the issuer has made the funds available to the IPA; (viii) investors must be informed that that in case of default, they will be treated equally and rank as unsecured creditors in terms of priority of claims as laid down in the Insolvency Act 2009; and (ix) information to investors that the CP will be held in dematerialised form through a custodian.

Participants

The issue of CPs involves several participants, the Guidelines set out their respective roles and the conditions applicable to them.

Eligible Issuer. Only highly rated companies regulated by the Mauritius Companies Act 2001 are entitled to issue CPs, to the exclusion of financial institutions and cash dealers. The BOM will deliver an 'issuer of commercial paper licence' if the company (i) has not earlier than 12 months prior to the proposed issue of the CP, a total net asset value exceeding MUR 300 million (ii) exists for at least 5 years, with positive net profits after tax over the last 3 years; (iii) its credit exposure or the credit exposure of its holding company has not been classified as impaired by a financial institution; (iv) it does not have a history of recurrent default/late payments reported by the Mauritius Credit Information Bureau; (v) it has an established working capital limit sanctioned by a bank; and (vi) it has an 'Investment Grade' credit rating from a recognised ECAI.

The issuer of commercial papers licence is valid for one year, but is subject to the issuance limit specified and the CP rating not declining.

Eligible Investors. A CP can be held by foreign and local corporates or individuals whether they are residents or non-residents in Mauritius.

Issuing and paying agent. An IPA is a financial institution appointed to act on behalf of the Eligible Issuer to facilitate transactions in CPs. The IPA will be responsible for (i) making the offer of the CP to Eligible Investors (ii) to effect principal and interest payments at the maturity of the CPs; (iii) verifying and holding certified copies of original documents provided by the issuer in its custody; (iv) verifying all information disclosed in the offer document before issuance; (v) arranging for the allocation of an International Securities Identifying Number (ISIN) to each CP issue; (vi) conducting KYC on the investor funds in compliance with the relevant legislation; (vii) conducting customer suitability assessments to ensure that individual investors understand the risks linked to investment in CPs, and that such investment matches their objectives and risk appetite. The IPA will be responsible for the periodical reporting to the BOM. In case of default of the issuer, the IPA will promptly notify the investors, ECAI and the BOM within a maximum of three working days of occurrence of such default.

External Credit Assessment Institution. To be able to issue CPs, the Eligible Issuer must be rated by an entity approved by the BOM. An ECAI is an entity that issues external credit assessments and is recognised by the BOM. The list of recognised ECAIs is provided in the Bank of Mauritius Guidelines on the Recognition and Use of External Credit Assessment Institutes as revised in October 2017. In a CP transaction an ECAI will be responsible, amongst other things, for gathering all the relevant information affecting and likely to affect the financial health of the Eligible Issuer in future prior to, during, and after the CP issue. The IPA must inform the BOM of the ratings of the CP and any subsequent change in the rating on the day of the change itself.

Custodian. CPs being issued in dematerialised form; a custodian will be appointed by the Eligible Issuer to hold the CPs on an account for the Eligible Investors. The custodian must be a financial institution.

The main objective of the regulatory framework for the issuance of CPs is to provide the opportunity for larger companies to diversify their source of funding. In a market where there is an excess of liquidity – like it is currently the case for Mauritius – it is questionable whether CPs are a cheaper source of funding than borrowing from banks. The structuring and administration of CPs may prove overly stringent in many ways due to the costs involved in the structuring and administration of CPs.

The net worth criteria for issuing companies with a total value exceeding MUR 300 million and the minimum size of issue of CPs of MUR 100 million excludes small and medium size companies from accessing the short term unsecured money markets. The issuer of CPs have to be structured as companies incorporated under the Mauritius Companies Act 2001, excluding other forms of legal structures such as *sociétés*, trusts or limited partnerships.

In parallel, the framework is very protective of the investors' rights with disclosure requirements in the offer documents as well as periodic reporting allowing the BOM to keep an eye on money deposited with companies outside the regulatory ambit of the Banking Act 2004.

By way of comparison, the two last pitfalls highlighted above, have been amongst the main subjects of the reform of the existing regulatory framework of issue of commercial papers further to the Reserve Bank Commercial Paper Directions of August 2017 (**"Directions"**) issued by the Reserve Bank of India (**"RBI"**). The Directions broadened the scope of eligible issuers of CPs to co-operative societies, unions, government entities, trusts and LLPs or any other body corporates having presence in India and having a net-worth of INR 100 crores or higher. The concept of special permission from the RBI for issuance of CPs by entities not otherwise covered under the Directions has also been introduced. These changes have been introduced to better address the economic realities and needs of the country.

The main focus of the Directions has been to enhance the disclosure norms in the offer document. By way of example, the exact end use of the money raised must be disclosed at the time of issue of the CPs. Additional disclosure on the outstanding CPs and other debt instruments of the issuer are now required. The offer document must further contain details of default of CPs or any other borrowings in the past three years. This major improvement in the Indian regulation of CPs will allow investors to take more informed decisions and increase the insights of the Reserve Bank of India into the affaires of the issuers.

PART 2: ALTERNATIVES TO LIBOR

Background. There have been numerous developments on the future of the London Interbank Offered Rate (**"LIBOR"**) in the past few months. LIBOR has been a mainstay of financial markets since the mid-1980s but remained unknown to the general public whose mortgages and credit card payments the benchmark was entrenched in. The relative anonymity of LIBOR changed during the past ten years when the LIBOR scandals brought the benchmark to the attention of the public. It ultimately led to the Government of the United Kingdom commissioning Martin Wheatley, the Chief Executive of the Financial Conduct Authority to conduct a review of the structure and governance of LIBOR. The Wheatley Review published its final report in September 2012 and formulated recommendations to reform the framework then in place for setting and governing LIBOR. The LIBOR scandals also triggered action on the part of the International Organisation of Securities Commissions (**"IOSCO"**). IOSCO published the Principles for Financial Benchmarks in July 2013 to address conflicts of interest in the benchmark setting process.

LIBOR has been regulated by the Financial Conduct Authority since April 2013 and its administration was taken over by ICE Benchmark Administrators (**"IBA"**) since February 2014. Since then, significant improvements have been made to the governance of LIBOR through the efforts of the Financial Conduct Authority, IBA and the panel banks that contribute to the benchmark.

Evolution of LIBOR. An important step in the evolution of LIBOR was taken by the IBA in April 2016 when it published the roadmap on LIBOR. The roadmap was the outcome of a consultation carried out by the IBA. The roadmap covered the submission criteria, the implementation of a transaction based approach and expert judgement determination. The roadmap introduced the following methodology for the submission of rates by panel banks:

- Level 1: transaction based submissions. Where a panel bank has sufficient eligible transactions, a volume weighted average price of eligible transactions is submitted to the IBA.
- Level 2: transaction derived. Where a panel bank does not have sufficient eligible transactions, it will make submissions based on transaction-derived data such as adjusted and historical transactions.
- Level 3: expert judgement. Where a panel bank does not have sufficient data for level 1 and level 2 submissions, it will submit the rate at which it could fund itself from the unsecured wholesale funding market.

The European Money Market Institute (**"EMMI"**) as administrators of the Euro Interbank Offered Rate (**"EURIBOR"**) is also looking at revising the methodology for the calculation of EURIBOR. It published a consultation paper on a hybrid methodology for EURIBOR in March 2018. The proposed methodology seeks to calculate EURIBOR based on euro money market transactions as required by Regulation (EU) N° 1011/2016[1]. It follows a tiered approach consisting of the following three levels:

- Level 1: Submission based solely on transactions in the underlying interest at the defined tenor from the prior TARGET day, using the formulaic approach provided by EMMI.
- Level 2: Submission based on transactions in the underlying interest across the money market maturity spectrum and from recent TARGET days, using a defined range of formulaic calculation techniques provided by EMMI.
- Level 3: Submission based on additional transactions in the underlying interest, excluded from Level 1 and Level 2 submissions, and/or other data from a range of markets closely related to the unsecured euro money market, using a combination of modelling techniques and/or the panel bank's judgment.

The EMMI will publish a summary of feedback in June 2018.

Issues with LIBOR. While a lot of work has been done to reform the method by which LIBOR and other interbank offered rates (**"IBORs"**) are calculated, the fact remains that there is a decline in the underlying wholesale unsecured money market used as a reference by panel banks in their submissions.

For instance, the median daily aggregate wholesale dollar market for three month funding is less than USD 1 billion per day. The three month period is the most heavily referenced LIBOR tenor. The median daily aggregate for six month funding stands at less than half that size. Transactions from the wholesale unsecured money markets used by panel banks in their LIBOR submissions are dwarfed by the value of contracts referencing LIBOR.

1. Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) N° 596/2014.

> ***"The absence of active underlying markets raises a serious question about the sustainability of the LIBOR benchmarks that are based upon these markets"***
>
> **Andrew Bailey, Chief Executive of the Financial Conduct Authority** [2]

Jerome H. Powell, a member of the Board of Governors of the US Federal Reserve said "in our view, it would not be feasible to produce a robust transaction-based rate constructed from the activity in the wholesale unsecured funding markets. A transaction-based rate from this market would be fairly easy to manipulate given such a thin level of activity, and the rate itself would likely be quite volatile".

The low level of activity in the wholesale unsecured funding markets has increased emphasis on the use of expert judgement by panel banks. Andrew Bailey, chief executive of the Financial Conduct Authority (the **"FCA"**), the authority responsible for the regulation of LIBOR, highlighted the reluctance of panel banks to keep on making submissions based on expert judgement. In a speech made in 2017, he said "'…panel banks feel understandable discomfort about providing submissions based on judgements with so little actual borrowing activity against which to validate those judgements."[3]

The Association of Corporate Treasurers and Loan Market Association produced a joint guide on LIBOR benchmark reform in March 2018 which provides some background to LIBOR reforms and covers the alternatives being proposed for the transition from IBORs to risk-free reference rates.

The guide refers to the speech made by Andrew Bailey in 2017 highlighting that panel banks support sustaining LIBOR until end-2021 but that a plan must be in place to transit to alternative reference rates. The guide also emphasised the need to move away from IBORs. In another speech made by Andrew Bailey on 1 March 2018, he said "…I would stress that I don't see a prospect of a reversal in the decline of the market activity that LIBOR seeks to measure, and the [Financial Conduct Authority] has not changed its position that it is not going to use powers of compulsion towards submitters beyond that point".

The guide lists several key issues in financial markets for the use of risk-free reference rates, including:

- No clear alternative to LIBOR has been identified for all financial products.
- Different rates and methodologies are being proposed in different jurisdictions.
- There is currently no term rate option available for risk-free reference rates as they are backward-looking, unlike LIBOR which is forward-looking.

The implications for syndicated loans are:

- LIBOR provides certainty of payment as the rate is set at the beginning of the interest period to determine the interest amount payable at the end of the period.
- Loan systems are not set up to process and calculate interest based on overnight rates.

LIBOR alternatives. The Federal Reserve Bank of New York, in cooperation with the US Office of Financial Research has begun to produce and publish three reference rates based on overnight repurchase agreement transactions secured by Treasury securities as from April 2018. The three reference rates published by the Federal Reserve Bank are based upon trade-level data.

The reference rates are the Tri-Party General Collateral Rate, the Broad General Collateral Rate and the Secured Overnight Financing Rate (**"SOFR"**).

The Tri-Party General Collateral Rate is a measure of rates on overnight, specific-counterparty tri-party repo transactions secured by Treasury securities and is calculated based on data collected from the Bank of New York Mellon.

The Broad General Collateral Rate is a measure of rates on overnight Treasury general collateral repo transactions, and is calculated based on the same tri-party repo transactions used for the Tri-Party General Collateral Rate plus general collateral finance repo transactions cleared through The Depository Trust & Clearing Corporation's General Collateral Finance Repo service.

SOFR is calculated based on the data used for the Broad General Collateral Rate plus transactions cleared through the Fixed Income Clearing Corporation's Delivery-versus-Payment repo service and is a broad measure of the cost of borrowing cash overnight collateralised by Treasury securities. Transactions to which the Federal Reserve Bank is a counterparty are excluded from all three rates.

SOFR was identified by the Alternative Reference Rates Committee in June 2017 as the recommended alternative to

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2. Speech by Andrew Bailey, Chief Executive of the Financial Conduct Authority, at the Association for Financial Markets in Europe, ICMA and ISDA breakfast meeting delivered on 1 March 2018. The speech is available on the website of the Financial Conduct Authority at https://www.fca.org.uk/news/speeches/recent-developments-financial-markets

3. Speech by Andrew Bailey, Chief Executive of the Financial Conduct Authority, at Bloomberg London delivered on 27 July 2017. The speech is available on the website of the FCA at https://www.fca.org.uk/news/speeches/the-future-of-libor

USD LIBOR for use in US dollar derivatives and other financial contracts. SOFR and the two other rates are published daily by the Federal Reserve Bank on its website at approximately 8:00 am Eastern Time based on the prior day's trading activity.

In relation to the sterling alternative to LIBOR, the Bank of England completed its reform of the Sterling Overnight Index Average (**"SONIA"**) on 23 April 2018. SONIA is a measure of the rate at which interest is paid on sterling short-term wholesale funds in circumstances where credit, liquidity and other risks are minimal.

The Bank of England became the administrator of SONIA in April 2016. Before completion of the reform in April, the rate was calculated and published on behalf of the Bank of England by the Wholesale Market Broker's Association. The Bank of England Working Group on Sterling Risk-Free Reference Rates (**"Working Group"**) approved SONIA as its preferred short-term interest rate benchmark. Following several rounds of consultation, the reforms result in:

- The Bank of England taking on the administration, including calculation and publication, of SONIA.
- The coverage of SONIA has been broadened to include overnight unsecured transactions negotiated bilaterally together with those arranged through brokers, including the Bank of England's Sterling Money Market daily data collection as data source.
- The average methodology for calculating SONIA has changed to a volume-weighted trimmed mean.
- SONIA is now published daily at 9 a.m. London time based on the previous day's trading activity.

Following the recommendation of SONIA as the preferred risk-free interest rate, the Working Group is working towards the adoption of SONIA as an alternative to sterling LIBOR. The Working Group's strategy is based on the following three strands:

- Adoption of SONIA for interest rate derivative products.
- Adoption of SONIA in derivative instruments other than interest rate derivatives.
- Conversion of existing LIBOR contracts to reference SONIA.

The Bank of England will publish an assessment of its compliance with IOSCO's Principles for Financial Benchmarks following implementation of the reforms.

LEGAL UPDATES

Loan Market Association ("LMA") launches green loan principles

The LMA has, together with the Asia Pacific Loan Market Association published the Green Loan Principles (**"GLP"**) on 21 March 2018. The GLP was developed with the support of the International Capital Market Association following the establishment of the Global Green Finance Council of which the LMA and the International Capital Market Association are founder members.

The GLP builds on the green bond principles developed by the International Capital Market Association and sets out a framework of recommendations which should be applied by market participants on a deal-by-deal basis.

In order for loans to qualify as green loans under the GLP, they must align with the following four core components:

- Use of proceeds.
- Process for project evaluation and selection.
- Management of proceeds.
- Reporting.

The GLP recognises several categories of eligibility for green projects. These are set out in appendix 1 to the GLP and seek to address key areas of environment concern. The list is based on the green bond principles of the International Capital Market Association and is not exhaustive. Categories of projects that can be eligible for green loans under the GLP include renewable energy, energy efficiency, natural resource and land use sustainable management, clean transportation, biodiversity conservation, pollution prevention and control, sustainable water and wastewater management, climate change adaptation, eco-efficient products and green buildings. The GLP also recommend that borrowers seek external review of formulation of green loan processes. This can be achieved through consultant review, verification of project standards with the borrower's own internal standards, certification following an assessment of the borrower's green loan standards with external green assessment standards or rating by qualified third parties.

Proposed amendment to Code de Commerce relating to business undertakings

The Code de Commerce (Amendment) Bill was submitted to the National Assembly on 10 April 2018 for its first reading. The bill seeks to amend the Code de Commerce to allow enterprises to use their business undertaking (*fonds de commerce*) to gain access to finance.

Pursuant to the bill, the following make up the business undertaking of an enterprise: goodwill, rights to leases, intellectual property, licences and other administrative authorisations, stock-in-trade, as well as other corporeal or incorporeal assets (other than rights to freehold land) used by that enterprise in its commercial activities.

The bill provides for, inter alia, the following:

- Transfer of the business undertaking.
- Encumbering the undertaking.
- Registration and inscription of transfer or charge instrument.

5 THINGS TO KNOW ON THE 2002 ISDA MASTER AGREEMENT

In this edition on our series on derivative transactions, we look at the 2002 ISDA master agreement. Together with the 1992 ISDA master agreement, the 2002 version forms the backbone of a large number of over-the-counter derivative transactions.

The 2002 master agreement provides the framework for two parties to enter into multiple derivative transactions. Each version of the master agreement consists of two parts. The first sets out the basic terms of the relationship and is found in the master agreement itself. The second part is set out in a schedule and complements, supplements or varies the basic terms set out in the master agreement. Standard terms included in the master agreement include representations, undertakings, events of default, termination events and netting provisions. The commercial terms of each trade are documented by a confirmation which should be read together with the master agreement and schedule.

The 1992 master agreement was revised in 2002 and the most significant change was the introduction of the close-out amount and changes to the force majeure provisions.

We have identified five things to bear in mind when looking at the 2002 ISDA master agreement.

1. Single agreement. Section 1(c) of the master agreement sets out that the master agreement, schedule and each confirmation form a single agreement. This section aims to protect the transactions under the master agreement from being cherry-picked by a liquidator.

The insolvency regime across many jurisdictions (including in Mauritius) generally allows a liquidator to disclaim onerous contracts which require the insolvent company to pay or perform obligations. However, where contracts are beneficial to the insolvent company, a liquidator can recognise such contracts and require that the counterparty pays or performs its obligations towards the insolvent company.

If the cherry-picking powers of the liquidator are applied to the transactions governed by the master agreement, the non-defaulting party could find itself being obligated to make payments to the insolvent company under transactions where it owes money. The non-defaulting party would then need to prove the amounts owed to it thus potentially leading to delay and reduced payments on the amounts payable by the insolvent company.

Section 1(c) of the master agreement aims to contractually protect the non-defaulting party so that a liquidator may only disclaim the entire master agreement rather than having the ability to disclaim each transaction under the master agreement.

2. Payment netting. Section 2(c) of the master agreement provides that payments due in the same currency on the same date can be netted during the term of the master agreement. Once a single amount is payable by each party, the obligation by each party to pay the other is satisfied and discharged if the party who owes the larger aggregate amount pays to the other party the excess of the larger aggregate amount over the smaller aggregate amount.

The section seeks to remove delivery risk and also has the potential to reduce the amount of withholding tax if such tax is imposed.

3. Events of default and termination events. The distinction between an event of default and a termination event under the master agreement is based on the element of fault. An event of default arises from the fault of the defaulting party. On the other hand, a termination event is caused by an event which is outside the control of the parties. Whether an event is classified as an event of default or a termination event would have an impact on the following:

- termination of the master agreement;
- which transactions can be terminated; and
- the way in which the amount due by one party to the other is calculated.

Examples of termination events include illegality, force majeure, or a tax becoming payable due to the action by a taxation authority or a change in law after the master agreement has been entered into. On the other hand, events of default under a master agreement include the failure to pay, breach of representations, insolvency, or merger without the surviving entity assuming all the obligations under the master agreement.

While the procedure to terminate affected transactions following a termination event differs depending on the particular event that has occurred, generally the termination procedure for a termination event encourages discussion between parties. It also requires the parties to actively find a remedy to that situation. This stands in contrast with the procedure to terminate following an event of default. The latter allows the non-defaulting party to terminate all transactions under the master agreement in a prompt manner.

4. Automatic early termination. If the parties have elected to apply automatic early termination, termination will occur without notice upon the occurrence of certain events. The occurrence of any of the following events in relation to a party to the master agreement will result in automatic early termination:

- dissolution;
- a compromise with creditors; or
- a resolution being passed for the winding-up or liquidation or becomes subject to the appointment of an administrator, liquidator or receiver or in respect of its assets.

The advantage of automatic early termination is that it terminates the transactions and applies the close-out netting provisions before the appointment of a liquidator.

This must be balanced with the shortcoming that the non-defaulting party may be unaware of the occurrence of automatic early termination and consequential close-out netting. Moreover, if an amount becomes payable by the non-defaulting party to the defaulting party, interest will accrue on that amount as from the date that automatic termination occurred.

5. Close out netting. The master agreement provides that a single net sum (the early termination amount) will be payable by one party to the other in respect of all terminated transactions. The 1992 and 2002 versions of the master agreement apply different methodologies to calculate the early termination amount.

ISDA has published the ISDA Close-out Amount Protocol to allow parties to amend the terms of their existing 1992 master agreement and adopt the methodology to calculate the close-out amount set out in the 2002 version.

Close-out netting under both 1992 and 2002 versions of the master agreement involves the early termination of the transactions, valuation of the terminated transactions and calculation of a single net sum payable by one party to the other.

Under the methodology adopted by the 2002 master agreement, the early termination amount is made up of the total cost of loss or gain that would be incurred by the parties in replacing each terminated transaction. The party making the determination has a duty to act in good faith and to use commercially reasonable procedures in order to produce a commercially reasonable result. The non-defaulting party may also set-off other amounts due to it by the defaulting party which arise under other agreements.

It becomes therefore of paramount importance that the close-out netting provision under the master agreement be enforceable in the jurisdiction of incorporation of the counterparty.

COUNTRY UPDATES

Financial Services Commission signs a memorandum of understanding with the Financial Conduct Authority of the United Kingdom

On 10th April 2018, the Financial Services Commission (the "**FSC**") and the Financial Conduct Authority entered into a memorandum of understanding to establish a framework for mutual collaboration relating to financial services, exchange of information and investigative assistance for the supervision and oversight of participants regulated by the authorities.

Financial Services Commission launches public consultation on insolvency sub-funds

The FSC has launched a public consultation on a new insurance resolution mechanism on 4th May 2018. The FSC also published a concept paper and the draft Insurance (Industry Compensation Fund) (Amendment) Regulations 2018 setting out the proposed resolution regime.

The concept paper provides for the extension of the insurance industry compensation fund to cover 2 separate sub-funds, the Insolvent Long Term Insurer sub-fund and the Insolvent General Insurer sub-fund. The concept paper proposes rules for the administration of the insolvency sub-funds, the mechanism for participation by insurers to the sub-funds and funding for the sub-funds.

The concept paper proposes that the insolvency sub-funds will be funded at the time an insurer is declared insolvent with the insurance industry compensation fund borrowing money either from commercial banks or from the Government of Mauritius to make payments. It is also proposed that a levy be established in the event that the sub-fund is unable to repay the financing through the recoveries from the insolvent insurer. The rate of levy will be determined by the managing committee referred to in the Insurance (Industry Compensation Fund) Regulations 2015.

Copies of the concept paper and the draft regulations are available on the website of the FSC at https://www.fscmauritius.org/media/4402/2018-04-18-concept-paper-v-4.pdf and https://www.fscmauritius.org/media/4403/2018-04-30-iicf-amendment-regulations.pdf respectively.

The consultation will close on 29th July 2018.

Financial Services Commission publishes circular letter on national code of corporate governance

The National Committee on Corporate Governance issued the second edition to the National Code of Corporate Governance (the **"Code"**) in December 2016 which will apply as from the reporting year ending 30 June 2018. On 28 February 2018, the FSC published a circular letter to inform its licensees of their obligations under the Code Compliance with the provisions of the Code will be mandatory for licensees of the FSC providing financial services. However, the following licensees of the FSC will be exempted from compliance with the Code:

- expert funds, professional collectively investment schemes or specialised collective investment schemes which are not reporting issuers;
- overseas family offices;
- private pension schemes
- insurance agents;
- holders of global headquarter administration licence or global treasury activities licence; or
- individuals who hold licences issued by the FSC.

Each licensee should disclose compliance with the principles set out in the Code on an apply or explain basis. A directors' statement of compliance in the prescribed form should be set out in the annual reports or audited financial statements of the licensees. Where a licensee does not comply with a principle of the Code, its explanation for non-compliance will be assessed by that licensee's auditors who will also be required to report on its assessment in the form and manner prescribed by the Code.

The FSC will monitor adherence to the principles set out in the Code and may use its statutory powers to direct compliance to the principles or impose sanctions in the event of non-compliance.

A copy of the circular letter is available on the website of the FSC at https://www.fscmauritius.org/media/4301/circular-letter-cl28022018.pdf.

Entry into force of protocols amending the double taxation avoidance agreements with Cyprus and Barbados

The Double Taxation Avoidance Agreement (Republic of Cyprus) Regulations 2018 and the Double Taxation Avoidance Agreement (Barbados) (Amendment) Regulations 2018 were published in March 2018 amending the double taxation avoidance agreements with Cyprus and Barbados respectively. The treaties with Cyprus and Barbados were amended to assist contracting states in the exchange of information. Once the amendments enter into force, a contracting state will use its information gathering measures to obtain information requested by the other contracting state even where it may not need such information for its own tax purposes.

Both sets of regulations amending the double taxation avoidance agreements will come into force once each contracting state notifies the other of the completion of the procedures required by its laws.

FREQUENTLY ASKED QUESTIONS

Financing private equity funds

Mauritius has positioned itself as a financial services centre offering a wide range of vehicles to structure investments in Mauritius or offshore, amongst which private equity funds. Whilst the objective of private equity funds is to pool money raised from investors in accordance with the fund documentation to invest in particular targets, fund managers are increasingly borrowing to finance investments.

What type of facility can be offered to private equity funds?

The most popular form of facility which private equity funds look for is an "equity bridge facility" also called "subscription or capital call facility". It is a short-term form of secured finance used to bridge the time between calls for contribution made to investors and the actual payment of the contribution by the investor. The fund will be able to use the money borrowed to make investments and to pay expenses in the ordinary course of its business and then repay this facility out of the capital contributions paid by the investors.

What are the key fund documents which lenders need to review?

Mauritius funds are typically structured as companies limited by shares or limited partnerships. Lenders should consequently carry out a detailed due diligence of the constitution and shareholders agreements, for companies, and limited partnership agreement in respect of limited partnerships. These documents will set out the objects of the funds, their powers, restrictions and more importantly the decision making process. Attention should also be given the side letters which may exist between investors and the fund, setting out specific conditions applicable to a particular investor.

What are the main obstacles which lenders may encounter in structuring a fund financing?

The fund documents may contain restrictions on the use of capital contributions to repay borrowings or to create security. In addition, investors' consent may be required for the disposal of the funds' assets or partnership interests which may be difficult to obtain especially when dealing with institutional investors.

OTHER RECENT PUBLICATIONS

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