Banking & Finance Insights

By BLC Robert

Contents

In this new edition we will take a look at the recent guidelines of Central Bank which provide for a detailed a framework for the newly created private banking licence.

In the legislative updates section, we will look closely at how Parliament has passed amendments to the existing legislation under the provisions of the Finance (Miscellaneous Provisions) Act 2017 to implement the various measures announced in the 2017-2018 Budget Speech. In our review, we propose to look closely at how Parliament has brought in a multitude of statutory amendments and we will provide you with an overview of the main legislative changes.

We propose to continue our series on derivatives in "5 Things to know", this time touching on the exchange-based derivatives market.

Finally, our F.A.Q section will give you a high level view of the salient features of Mauritian competition law.

Wishing you an enjoyable reading.

LOCUS

PRIVATE BANKING LICENCE

Last year a major amendment was brought to the Banking Act 2004 (the **Act**) to introduce a standalone licence for private banking business in Mauritius which was until then an activity authorised by virtue of holding a generic banking licence issued by the Central Bank. The amendment aims at providing precision through the introduction of a definition for "*private banking*", being "*the business of offering banking and financial services and products to high-net-worth customers including but not limited to an all-inclusive money-management relationship*".

Before the amendments, the realities of the market were such that many operators who had the ambition to operate as private banks had to apply for a full banking licence. This was often considered as being unnecessarily cumbersome by those operators which were looking forward to focussing on this market segment given the extremely onerous level of compliance and reporting that a full banking licence requires.

The Central Bank issued guidelines (in February 2017, which were subsequently revised in July 2017) setting out the regulatory and supervisory framework that would be applicable to banks licenced to conduct private banking business (exclusively or as part of their banking services), (the **Guidelines**).

The Guidelines covers various aspects such as (i) corporate governance and the role of directors (ii) risk management and monitoring of transactions (iii) policies and procedures through a "Know Your Customer" mechanism, (iv) anti-money laundering safety requirements (v) internal controls (vi) segregation of duties and (vii) compliance and audit. The key features of the Guidelines are as follows:

Key features

Supervision of controlling shareholding

The Guidelines empowers the Central Bank to supervise the shareholding of private banking institutions with the requirement that any person who holds or intends to hold a significant interest[1] in an such institution must seek the prior approval of the Central Bank to hold such an interest and undertake in writing to the Central Bank not to influence or impede the prudent management and functioning of the bank in accordance with sound banking practice.

Role of the board of directors

The board is accountable for its role in approving policies and procedures for the Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) programs. It is mainly responsible for approving policies, receiving regular reports of the effectiveness of the administration of the program and for obliging external auditors to report on the effectiveness of the program.

It is also important that for the board to ensure that there is a proper segregation of duties, suspicious transactions are properly identified and reported and compliance and audit programs are in place.

The Senior Management

In respect of AML/CFT compliance, the senior management is to be held accountable and responsible for the day to day management of the program and to ensure its effectiveness in mitigating money laundering and terrorist financing risks.
More specifically, senior management must ensure inter-alia, that the designated officer to monitor AML/CFT compliance is appropriately qualified for the execution of the program, that he is given adequate data management systems, that he provides objective opinions or advice and that his recommendations are acted upon in a timely manner.

Procedures must be put in place for reporting frauds to senior management. Complete, accurate and timely Management Information System reports must be prepared for review by authorised officers and line managers.

1. "significant interest" means owning, directly or indirectly, or otherwise having a beneficial interest amounting to, 10 per cent or more of the capital or of the voting rights of a financial institution or, directly or indirectly, exercising a significant influence over the management of the financial institution, as the central bank may determine.

Internal controls

The board and senior management must create a corporate culture based on sound risk management and appropriate control environment. Regular meetings must be held to oversee the operation as well as compliance with corporate policies and procedures. Those latter must be approved by the board with clear accountability established for risk management. Responsibilities must be well-defined and segregated, and relationship managers should not single handle customer instructions without the involvement of checks and controls units.

i) Staff must account for dealing policies and avoid violation of conduct and conflict of interest.

ii) The bank's Customer Due Diligence procedures must allow it to monitor transactions and to analyse each client. Audit trails of communications with clients should be maintained and customer relationships must be reviewed on a regular basis.

iii) As a general rule, private banking business should not allow for hold mail services to ensure transparency and full information of the customer.

iv) Rigid policies and procedures to flag suspicious cases and transactions must be emplaced and should ensure confidentiality of employees who raise concern, as well as disciplinary action for making false allegations for instances.

Dealings with customers

Banks carrying on private banking business have duties towards their clients, namely to protect their investments and act in their best interest. Accordingly, the banks are thus responsible to report to their clients on all their cash and investments made with related parties on a yearly basis or at such higher frequency as the client requests. Moreover, the banks are responsible to "know their clients" in order to be able to identify suspicious transactions.

"Know Your Customer"

Banks must adopt thorough "Know Your Customer" policies and procedures in order to comply with the AML and CFT programs respectively and must ensure that they obtain basic information on their customers (see below) that describe their source of wealth and line of business.

Banks must also be able to identify suspicious transactions, and have adequate policies and procedures that address money laundering-related issues amongst others.

Customer risk assessment

A risk profile of each customer must be established to monitor ongoing account activities. The banks must assess each risk separately and must base their assessment on the scope of its operations and on the complexity of its customer relationships.

When identifying risk characteristics of private banking customers, banks will take into account (inter-alia):

i) The source of the customer's wealth and the nature of his business activity;

ii) The size, purpose, type of account and services involved in the private banking relationship with the customer;

iii) The nature and duration of the bank's relationship with the customer;

Banks must ensure that they mitigate their risks to a minimum, therefore a rigorous assessment of risks a client may pose, is essential. Vulnerable customers such as the old-aged must be subject to more frequent checking of account activities to avoid risks of frauds.

Finally, the Banking Act specifically provides that a bank which has been granted a banking licence to carry on exclusively private banking business may be granted exemptions from certain provisions of the Banking Act and of the guidelines as the Central Bank may determine.

LEGISLATIVE UPDATES

Parliament has passed the Finance (Miscellaneous Provisions) Act 2017 to implement the various measures announces in the Budget Speech 2017-2018 through various amendments to pieces of legislation, including:

i) the Banking Act 2004;

ii) the Bank of Mauritius Act 2004;

iii) the Borrowers Protection Act 2007;

iv) Companies Act;

v) Financial Reporting Act;

vi) Insolvency Act;

vii) Mauritius Revenue Authority Act;

viii) Sale of Immovable Properties Act; and

ix) Securities Act.

The Banking Act 2004

***Introduction of a new licence of issuer of commercial papers* -** A new licence to be granted by the Central Bank to issuers of commercial papers has been introduced with a view of regulating a segment of the capital market. A commercial paper has been defined as an unsecured money market instrument in the form of a promissory note having a maturity of not more than one year issued by an eligible company. To be considered as an eligible company, the issuer will have to meet the following cumulative criteria:

a) The issuer should be a company incorporated or registered under the Companies Act;

b) The net asset value of the issuer company should have, at a point in time not earlier than 12 months prior the proposed issue of commercial papers, exceeded 300 million rupees and same should be certified by its auditors and reflected in its audited financial statements; and

c) The issuer should have a credit rating acceptable to the Central Bank.

The terms of this new licence and the prudential requirements which will be imposed on the eligible company will be determined by guidelines or directives of the Central Bank.

***Increase of the minimal capital requirement* -** The minimum capital of commercial banks licensed under the Banking Act has been increased from Rs 200 million to Rs 400 million.

Existing banks will have to comply with this requirement in phases with a first capital increase to Rs 300 million by the 30 June 2018, to reach the requisite Rs 400 million by the 30 June 2019.

Bank of Mauritius Act 2004

***Additional powers for the promotion of Islamic money market* -** The Bank of Mauritius Act 2004 has been amended to enlarge the powers of the Central Bank in the area of Islamic money market. The Central Bank is now empowered to also issue commercial papers as it may determine by way of rules or guidelines.

Companies Act 2001

***Disclosure of beneficial ownership and ultimate beneficial ownership* -** The general move for transparency in the holding of interest in Mauritian entities has been brought to another level with the requirement to now disclose the name of the beneficial owners or ultimate beneficial owners of shares issued by a company under the Companies Act.

The amendments introduce a definition of "beneficial owner and ultimate beneficial owner" meaning a person who holds by himself or his nominee, a share or an interest in a share which entitles him to exercise not less than 25% of the aggregate voting power exercisable at a meeting of shareholders.

However, this information will not be available for public inspection except (i) with the permission of the beneficial owner or ultimate beneficial owner, (ii) if required for the purpose of an investigation or enquiry or (iii) by judicial order.

Financial Reporting Act 2004

Dispensation from reporting on corporate governance - All public interest entities are required to adopt the National Code of Corporate Governance for Mauritius (**Code**). However as from now on, wholly owned subsidiaries are not required to report on corporate governance if their ultimate holding company is already complying with the Code. This dispensation does not apply to the wholly owned subsidiaries regulated by the Bank of Mauritius or the Financial Services Commission.

Insolvency Act 2009

Tax claims obtaining a preferred treatment in receiverships - The provisions relating to order of distribution of proceeds by a receiver have been revised to ensure an ultimate priority to income tax and value add tax claims over all other claims. With these amendments, the receivership order of priority is now aligned with that applicable in a liquidation.

Securities Act 2005

Dual listing and dispensation of a prospectus - Entities holding a global business licence category 1 which are also listed on a securities exchange in another jurisdiction are exempted from the requirement of a prospectus for an offer or issue of securities on the Stock Exchange of Mauritius.

The Securities (Preferential Offer Rules) 2017 have been amended accordingly and further provides that once listed, these entities will qualify as reporting issuers under section 86(1)(c) of the Securities Act and will still need to be registered as such with the Financial Services Commission and meet the reporting obligations under the Securities Act and any Regulation/FSC Rules including the Securities (Disclosure Obligations of Reporting Issuers) Rules 2007.

5 THINGS TO KNOW ON THE EXCHANGE-BASED DERIVATIVES MARKET

One of the primary risks facing a participant in the derivatives markets is the risk that its counterparty fails to perform its obligation, whether that is to make a payment or to make a delivery; this is known as counterparty or credit risk and arises both in exchanged-based or over-the-counter (**OTC**) markets. A key difference between the exchange-based and OTC markets is the mechanism by which credit risk is mitigated. In this edition of our series on derivative transactions, we examine the exchange-based derivatives market and how they are supported by the clearing and margining systems to mitigate credit risk.

1. ***Exchange members.*** All exchange-based trading is conducted between members of an exchange. The end-users will transact through a clearing member who will find a matching trade with another clearing member (who would place the matching trade with its own client). The clearing member itself is exposed to two sets of credit risks, the first is that the end-user might fail to fulfil the obligation it owes to the clearing member and the second risk is that the counterparty might fail to fulfil the obligation it owes to the clearing member. The clearing member is able to control the first risk by requesting initial and variation margin from the end-user whilst the second risk is addressed through the central counterparty.

2. ***Initial margin.*** Initial margin is collected from an end-user by a clearing member when a position is opened. Initial margin acts as security for the contracts that are booked by the end-user on the exchange. The amount of initial margin that is required for a position is calculated to protect against the maximum amount of loss arising from a position that can be expected to be made during one trading session and is calculated by the clearing house. The initial margin is then deposited by the clearing member into its account with the clearing house which will either hold the funds itself or with a custodian. The clearing member will usually grant a security interest to its client over the margin as security for the performance of its obligations.

3. ***Central counterparty.*** Once a transaction has been entered into between a buyer and a seller, details of that transaction are transmitted to the clearing house for registration. The initial transaction between the two clearing members are cancelled through the process of novation and replaced with two transactions, one between the seller and the clearing house and one between the buyer and the clearing house. The clearing house thus becomes the counterparty to each clearing member. Through the process of clearing, the credit risk that the exchange members would otherwise have to each other is eliminated and the clearing house assumes the risk of a default by one of its exchange members.

4. ***Variation margin.*** Each position that is open at the end of a trading session is marked-to-market by calculating the gain or loss made by that position during the trading session. Where an end-user's position has suffered losses exceeding the initial margin paid by it to the clearing house (through the clearing member), the clearing house will make a margin call requiring that the end-user to provide variation margin to make up the shortfall. Variation margin can also be requested intra-day to avoid accumulation of large exposures in fast-moving and volatile markets. Through the mechanism of initial and variation margin, the clearing house will maintain sufficient collateral to ensure that it will be able to pay profits to the clearing members whose clients are in-the-money even if it does not receive the corresponding payment from the losers.

5. ***Standardisation.*** Exchange-based derivatives are traded in standard form so that the maturity dates and the underlying forming the basis of the transaction are standard. Unlike OTC derivatives where the type of underlying which forms the basis of the transaction or other terms of the transaction can be tailor made to match an end-user's requirements, there are minimum variations permitted in exchange-based derivatives. Standardisation of the terms of the transactions allows these to be more liquid than OTC derivatives.

FREQUENTLY ASKED QUESTIONS

COMPETITION LAW IN MAURITIUS

In order to encourage sound competition by prohibiting business malpractices which reduce or eliminate competition to artificially manipulate the market, a Competition Commission (the **Commission**) was established under the Competition Act 2007 (the **Act**), to regulate and promote competition in Mauritius.

What is the scope of application of the Act?

The Act applies to every economic activity within, or having an effect within, Mauritius or a part of Mauritius. The Act covers any agreement whether legally enforceable or not, one which is implemented or intended to be implemented in Mauritius and also includes an oral agreement, a decision by association of enterprises, and any concerted practices.

What are the powers of the commission?

The Commission can compel disclosure of information by businesses. It may intervene and take corrective measures (through the issue of orders and directions, imposition of financial remedies and sanctions, enter into such contracts as may be necessary, concluding that a conduct constitutes an offence under the Act, working with foreign competition authorities and imposing charges and fees as required.)

What type of business practice can the commission investigate?

The main types of business practices which may be investigated by the Commission, with powers to take remedial action in the event of violation are (i) restrictive agreements (ii) abuse of monopoly situations, and mergers.

OTHER RECENT PUBLICATIONS

We have a number of recent publications available which provide a high level overview of a range of topics. Please visit **www.blc.mu/publications** for access to all our publications.

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