3

Exporting Financial Services

Mauritian international financial services industry: origins and evolution to 1992

The international financial services (IFS) industry in Mauritius was based conceptually on the export processing zone (EPZ), which was established in 1970 with tax concessions and exemptions, an export orientation and prohibitions on domestic market access. The creation of the country's offshore financial centre (OFC) some 20 years later applied the same basic idea to exporting international financial services (IFS). Although it actually materialised in 1992, studies on an OFC had been carried out by the Bank of Mauritius (BoM) at the request of the Prime Minister's Office a decade earlier. However, the idea was put on hold during the mid-1980s, a result of the debt crisis engulfing the developing world from 1982–1992 and the salutary experience of the Seychelles during the 1980s, when it became an offshore centre for unsavoury financial dealings. Mauritius's OFC came up again for public discussion in 1988/89, when the findings of a study commissioned from an international consulting firm became available and, concomitantly, the domestic financial sector was overhauled under an economic reform programme.

The first offshore banking and management company licence was granted in 1989, to Barclays Bank operating under a specially tailored tax regime. However, that experiment performed below expectations, triggering a review that led to the establishment of the Mauritius Offshore Business Activities Authority (MOBAA). The economic motives and objectives for establishing the OFC under the MOBAA were the same as for the EPZ: (i) economic diversification, (ii) inward transfer of know-how, (iii) expansion of services exports beyond tourism, (iv) high-value employment creation and (v) smoothing the path for the eventual integration of Mauritius into the global economy and financial system. In setting up the offshore regime, particular attention was paid to protecting the domestic economy, with a clear line being drawn between domestic and offshore activities (though such demarcation later proved to be partly illusory).

OFC operations were favoured with a flexible operational and legal environment. They had tax advantages, which the authorities were determined to prevent from spilling into the domestic economy in order to preserve the integrity of public finances and prevent them from deteriorating. Offshore finance was defined as: an activity carried out within Mauritius, but transacted with non-residents in non-Mauritian currency. In addition, an offshore entity registered in Mauritius could not 'deal or transact' with a Mauritian resident. In stipulating these conditions, the authorities were concerned about the possibilities of leakage and other risks under a

regime of exchange control. They created an elaborate regulatory edifice within the BoM to ensure that the line between domestic and offshore business was not crossed.

During the 1990s, offshore business 'management companies' were incorporated by the Registrar of Companies on the filing of the usual company registration documents. However, the MOBAA was their regulator and licensor, issuing certificates authorising offshore operations after scrutinising the qualifications of applicants. This two-step incorporation and authorisation process, which took some time, was a bureaucratic irritant that made Mauritius uncompetitive with other OFCs that were able to issue administrative approvals for entities to begin operating within 24 hours. The overlapping institutional and legal framework was nonetheless thought necessary to prevent abuses of the OFC by money launderers and arms dealers, to which the MOBAA statute made specific reference.

Since its inception in 1992, this bureaucratic approach to IFS industry licensing and regulation has been challenged by management companies. There has been ongoing tension between the regulator and industry to achieve a better balance between the need for sound supervision to ensure the integrity of the IFS industry and prevent the line between domestic and offshore operations from being crossed on the one hand, and the need for operational flexibility and user-friendliness on the other. That tension was heightened with the establishment of the Financial Services Commission (FSC) ten years later and the ensuing avalanche of additional regulatory demands, making the argument about more balanced and appropriate regulation as current and relevant as ever.

Creation of the OFC in Mauritius did not result in immediate demand for international financial services from around the world: Mauritian firms did not have any domestic experience or capability in offering IFS. The island opted to have its IFS industry develop indigenously and organically, rather than opening up to experienced exponents from abroad. However, in fairness, better-known foreign corporate/bank providers of IFS had already established themselves in European 'offshore' jurisdictions (viz. Switzerland, Luxembourg, Lichtenstein and Monaco) as well as in Bermuda and the Caribbean (Bahamas, Cayman Islands etc.) to service their EU/US clientele. In Asia, OFCs like Singapore and Hong Kong had emerged rapidly to service clients from Japan and the ASEAN. At the time, South Africa was still a closed economy under apartheid with sanctions imposed upon it. Established global providers of IFS were not interested in offering IFS out of Mauritius, therefore. There was no critical mass of clients from another part of the world that the Mauritians could tap.

Reciprocally, typical OECD clients for IFS would not come to Mauritius unless established firms were operating out of there. Extant offshore banks, even foreign bank branches, did not attract business except for intra-bank, cross-border transactions aimed at achieving tax efficiency. For a nascent OFC it was a catch-22 situation. In other jurisdictions, the local legal establishment had been at the forefront of offshore business development. Yet in Mauritius, legal practitioners kept aloof. They

had neither the experience nor the interest in offering IFS; their client base was primarily domestic. It was mainly local and foreign accounting firms, networked internationally, with access to global contacts and clients, who nurtured the incipient IFS industry at the outset. They were ready when Mauritius's OFC was suddenly catalysed by economic reforms in India in the early 1990s. These reforms brought to life the provisions of the double taxation agreement (DTA) between India and Mauritius, which was signed in 1982 and ratified in 1985.

When the DTA (treaty) was ratified, the beneficiaries were mainly Indian companies doing business in Mauritius, for example, New India Assurance, Life Insurance Corporation of India, Bank of Baroda and Air India, as well as Indian expatriates working in Mauritius. However, the treaty remained dormant until 1992–93 because: multinational corporations were sceptical about its efficacy; the lack of necessary infrastructure in India inhibited foreign multinationals from entering that market; and foreign investment in the Indian capital market had not been sanctioned before then.

Owing to the perceived anti-foreign investment stance of the Indian government at the time, foreign direct investors were reluctant to venture into India using Mauritius as a gateway. However, in 1993, the DTA came alive when India allowed foreign institutional investors to invest in the Indian secondary market. Conterminously, Mauritius was promoting use of its OFC with the MOBAA Act of 1992 and the International Companies Act of 1994. The benefits arising from the DTA with India – mainly exemption from capital gains tax on gains derived from stock market transactions – were beneficial to both signatories. Investment flows routed through Mauritius became a significant driver of foreign portfolio capital flows into India, while the Mauritian OFC gained new business and employment opportunities.[1]

Mauritian IFS industry in the 1990s

From 1992–98, Mauritius was among the fastest growing OFCs in the developing world. It built up a reputation as a treaty jurisdiction for channelling investments from institutional and high-net-worth (HNWI) clients in the US, EU and South Africa into the rapidly growing economies of India, China and the ASEAN. Tailored incentive regimes were created for attracting specialised offshore activities, such as ship registration, aircraft leasing and other similar industry specific, cross-border financial arrangements. Yet Mauritius was unsuccessful in attracting a share of these global activities away from established centres like Liberia (for ship registration). The most important attraction of Mauritius became its tax treaties with third countries. Administering (rather than actively managing) global investment funds that benefited from tax reductions/exemptions under treaty arrangements became the mainstay of the Mauritian IFS industry. Local expertise emerged for investment fund administration by management companies as a result of a requirement that funds in Mauritius had to have a local administrator and a cash custodian.

Such funds focused mainly on investment in listed and exchange-traded securities of neighbouring emerging markets and developed markets. However, offshore financial services offered by Mauritian management companies also involved direct investment through special purpose vehicles and joint ventures by Indian and ASEAN clients in China, South Africa and Indonesia. Apart from these corporate services, Mauritius attracted a small share of the market for private wealth management undertaken by portfolio managers on behalf of high-net-worth individuals (HNWIs), with the proceeds parked in Mauritius and administered by management companies.

In other Commonwealth OFCs, tax-exempt trusts were the favoured vehicles for managing private wealth. However, in Mauritius the trust industry did not take off because it had no history of trust-law application. For that reason, there was an absence of lawyers trained in trust law and local accounting firms had no experience in that area.

At the same time, there was no world-class global fund or asset manager located in Mauritius, with real-time access to global market information and with direct trading ability on the world's principal securities markets. Yet many HNWIs (including a substantial number of non-resident Indians – NRIs) and offshore commercial businesses (OCBs, now known as global business licence [holders] or GBLs) were content to hold portfolio investments in Indian and ASEAN equities and bonds held by passive investment companies that benefited from advantageous tax treatment. This explains the rapid growth of licensed offshore companies – from 2000 in 1992 when the industry was set up, to 8,000 in 1998. Of these, the overwhelming majority were tax exempt and not reliant on treaty provisions. At the time of writing, there were over 27,000 such global business licensees, although not all of them are completely tax exempt.

Though tax treaties were the foundations supporting the IFS industry in Mauritius, local management companies had to compete with other OFCs as well as financial centres in home jurisdictions for business generated by such treaties. That competition led them to expand their knowledge base by recruiting from abroad, sending their staff for training/secondment to foreign firms and investing in ongoing programmes of 'on-the-job' training and professional development for their human resources.

Meanwhile, better, more tax-efficient use of tax treaties was made in designing outward Mauritian foreign direct investment in Africa and the Indian Ocean, for instance, in Madagascar and Mozambique. Financial engineering and structuring by Mauritian management companies and banks has also become more sophisticated as IFS knowledge has spilled over into the local capital market. Local investment fund products have become more effective and asset management techniques have improved considerably. The rules of the Stock Exchange of Mauritius (SEM) have been revised to encourage offshore fund listing, with the SEM working toward adopting global best practices (e.g. those of the Dublin Stock Exchange) in its listing rules and protocols.

Offshore vs. domestic financial market demarcation

The demarcation between onshore and offshore jurisdictions was severely tested from 1998 onwards, as Mauritian companies and professionals began to demand tax benefits granted to non-residents. The IFS industry has been pressing the government to migrate from a dual (offshore-onshore) tax regime toward a single low-tax regime, and to relax supervisory rules to enable the industry to conquer new markets, sharpen its global profile and increase its global market share. The argument for a single tax regime has the added attraction of averting the opprobrium and over-intrusive attention from OECD members (on exchange of tax information and harmful tax practices) that a dual-tax regime inevitably attracts. Dual regimes often seem to home countries (especially in high-tax environments such as those of OECD countries) to be designed to exploit inter-jurisdictional tax arbitrage opportunities created artificially at their expense.

More relaxed regulation would theoretically attract a greater number of company incorporations, while rules requiring more substantive value-addition and employment in Mauritius, with closer regulatory oversight, were traditionally thought to be indispensable in strengthening the capability of domestic firms. However, such rules are now being looked at with disapproval under the WTO regime for global trade in financial services, as being unacceptably protectionist in nature. Such rules are also seen by potential foreign investors in the financial services industry as an antediluvian deterrent restricting operational choice and flexibility.

Types of offshore entities/licensees

There are now two types of company incorporation in the Mauritian offshore sector:

- Offshore companies with regular company law features, qualifying for tax-treaty access but being subject to domestic tax. Mauritian residents investing abroad are allowed to set up or to hold a shareholding interest in such companies; and
- International companies exempt from taxation, which are more flexible than mainstream companies.

Trust settlements are open to foreign nationals when they have no Mauritian resident beneficiaries and no assets in Mauritius. Partnerships are rarely used. Special legislation for protected cell companies was adopted in 1999 to house 'fund-of-funds' structures, multi-class funds and the captive insurance business. Mauritius has not attracted much offshore insurance or reinsurance business except for some from South Africa. To accommodate the needs of a wide variety of global clientele, tax rules once provided for myriad tax structuring possibilities. Between 1993 and 1998, for example, a voluntary option was available that allowed offshore companies to choose a rate of tax along a scale from 0 per cent to 35 per cent. At the time of writing, all global business company (GBC) licensees are subject to a low 15 per cent rate of domestic tax which, by taking advantage of double tax avoidance agreements, can be reduced to 3 per cent on corporate income in many cases.

One of the hallmarks of the Mauritian IFS industry was total protection of confidentiality, safeguarded by legislation that prevented information relating to offshore clients from being disclosed (except by court order on specified grounds of suspected money laundering and arms dealing). However, that legislation did not bar domestic regulators from conducting investigations and exchanging information with their foreign counterparts. Nor did it prevent foreign authorities from obtaining rogatory commissions or other forms of permission for disclosure of information on local management companies and offshore or international companies.

The Mauritian IFS industry is now well established, but the country has yet to attract well-known foreign firms in the global investment or advisory business. Nor has it attracted well-known international law firms with global corporate and HNWI advisory practices. This is because of a legal framework constraint: the Mauritius Law Practitioners Act does not yet permit international firms to enter, although a study was carried out in 2006 that recommended amending the Act to make such entry possible. (Despite the current situation, one law firm has been operating from Mauritius for the last 12 years providing services to its Swiss-based clients).

As a result, IFS space has been left uncontested to local management companies with comparatively limited global experience and few international connections, especially in terms of dealing with OECD clientele. This may be because of invisible barriers – for example, excessive red tape in the granting of operating licences and not granting resident visas to managers and staff of foreign firms quickly and easily. The general complaint of foreign IFS firms seeking to locate in Mauritius is that the jurisdiction is far more protectionist in practice than it is in theory, and much more so than its legislation suggests. For that reason, despite its rapid growth in 1992–98, the Mauritius IFS industry continues to suffer from geographic concentration risk in its dependency on clients from the US/EU investing in India, Indonesia, Greater China and Africa, and excessive functional risk in being dependent on a limited range of products and services.

Post-1998 developments affecting the Mauritian IFS industry and its regulation

Growth of the IFS industry in Mauritius stalled when the OECD released its report on *Harmful Tax Competition* in April 1998. That report passed part of the burden of solving a problem created by OECD countries themselves on to offshore financial centres. Since then, OFCs like Mauritius have been under constant pressure from the Financial Action Task Force (FATF), the OECD, IFIs and the G7's Financial Stability Forum (FSF) to improve the transparency and accountability of their operations. The accompanying threat of blacklisting and applying sanctions to jurisdictions deemed non-compliant with OECD demands has strained international relations. Institutions and countries with asymmetric power have attempted to exercise extraterritoriality on questionable grounds over many small jurisdictions without countervailing power.

Fear of being blacklisted, with an ensuing loss of credibility and reputation, prompted OFCs around the world into taking disproportionate measures. OECD countries seem concerned about the proliferation of smaller OFCs offering services based on confidentiality; this was perhaps in part because of the competition offered to their own IFS industries in centres such as London. OFCs have been automatically, and in most cases quite wrongly, equated with the facilitation of money laundering and providing a safe haven for illicit tax-evading capital flows. When the 1998 report was released, Luxembourg and Switzerland, two OECD members, objected to the bank secrecy and confidentiality provisions it contained. After all, their financial services industries had been based on providing those two rights. However, these countries were not included in the 'tax haven' list, although non-OECD jurisdictions were faced with that stigma.

Harmful tax competition

The OECD report was published with the aim of countering tax practices deemed harmful to the interests of high-tax OECD economies. It took a prejudiced view of tax competition and set out criteria for identifying tax havens, which included inter alia, a nil or nominal tax regime, legalisation of entities with no substantial business activity, lack of transparency and no or little provision for exchange of tax information.

In May 2000, the Mauritian government made a set of commitments to eliminate tax practices deemed harmful by the OECD Fiscal Committee. It committed to a programme of tax information exchange, transparency, the elimination of provisions aimed at attracting offshore businesses with no substantial domestic activities, and to phasing out any practice deemed harmful by end-2005. In parallel, changes were made to remove the ring fencing of the offshore sector. From 1998 onwards, offshore companies (deemed 'incentive companies') were taxed at a flat rate of 15 per cent, although that rate could be brought down to a maximum of 3 per cent under domestic foreign tax credit regulations. The final list of 'tax havens' published by OECD on 26 June 2000 contained 35 jurisdictions. Mauritius was removed from the list for having committed to eliminating harmful tax practices. OECD has since monitored Mauritius's compliance with commitments and has conducted surveys to check adherence with its principles of international taxation. Mauritius was later given 'participating partner' status at the Global Tax Forum.

The Financial Stability Forum (FSF) report on OFCs

The Report of the FSF Working Group on Offshore Centres (2000) contained a list of OFCs categorised in accordance with perceptions about their quality of regulation/supervision, degree of co-operation with other jurisdictions and compliance with international standards. Category I included jurisdictions perceived as having supervision of a high quality. Category II included OFCs with procedures for good supervision in place, but weak in implementation, while category III jurisdictions

were defined as having supervision of a low quality, with little or no attempt to meet international norms. The unjustifiable classification of Mauritius in the third category led to an official protest by the government. The FSF was criticised because it had not given Mauritius an opportunity to make any representations on the findings of its Working Group on OFCs. Nevertheless, desperate steps were taken to meet the highest international standards at considerable domestic financial and political cost. The Mauritius government made forceful attempts to remove the country from the third category, but without success; this was in spite of a favourable Financial Sector Assessment Programme (FSAP; see below) assessment on its banking and anti-money laundering regulation.

The FATF-NCCT list

To avoid being blacklisted by the FATF, Mauritius pushed through a series of measures, tightened disclosure requirements of offshore companies and reduced its protection of confidentiality. The February 2000 FATF report on Non-Cooperative Countries or Territories (NCCT) established procedures and criteria for identifying jurisdictions that failed to co-operate in implementing effective anti-money laundering (AML) regimes. To compel compliance, FATF compiled a list of non-co-operative countries or territories (the infamous NCCT list) that failed to meet its criteria for 'co-operation'. When Mauritius enacted its Economic Crime and Anti-Money Laundering Act of 2000 (ECAMLA), the FATF excluded Mauritius from the list. ECAMLA was the forerunner to the Financial Intelligence and Anti-Money Laundering Act (FIAMLA) of 2002, which consolidated existing legislation on AML measures, although certain concerns regarding the identity of directors and beneficial owners of offshore trusts were raised.

By 2002, reacting to pressure from international bodies, Mauritius compromised the legitimate long-term expectations of its IFS industry and offshore clientele by reversing earlier policies and curtailing tax privileges provided to offshore entities. It whittled down confidentiality protection, increased regulatory scrutiny and imposed substantially heightened, costly compliance requirements over the IFS and domestic financial services industries. Government policy was to: (i) avoid confrontation with IFIs, FATF and OECD on OFC issues; (ii) make externally mandated changes at almost any cost short of closing down the IFS industry; and (iii) implement international standards and core principles set out in the modules of the IMF/FSF Compendium, regardless of whether they were contextually appropriate to Mauritius. That policy begs the question as to whether government made the right trade-off in accommodating the extraordinary demands of OECD countries and international agencies, while risking the IFS industry's business competitiveness. The conclusions of another Commonwealth Secretariat study provide an answer to that question.[2]

Major regulatory developments occurred after the Report of the Steering Committee on Financial Services Sector Reform in Mauritius (February 2001). That report recommended: (i) regulatory and industry consolidation and integration of the

financial services sector; (ii) establishment of the Financial Services Commission (FSC) as a unified regulator for all non-bank financial institutions (NBFIs) and for licensing global business entities, formerly known as offshore entities; and (iii) adopting a functional, rather than product-based, approach to regulation. The FSC was supposed to be the first step towards creating a single regulator for all financial services and was intended to bring about eventual integration of offshore and domestic financial services.

Prior to the establishment of the FSC, the regulation/supervision of financial services and institutions was carried out by several different institutions. In addition to its responsibility for the conduct of monetary policy, the BoM was responsible for the supervision of banks. Insurance companies and brokers were regulated and supervised by the Controller of Insurance in the Ministry of Finance. The Stock Exchange Commission (SEC) regulated the securities market, while the offshore sector was regulated by the Mauritius Offshore Business Activities Authority (MOBAA). This fragmented approach resulted in some key financial service providers escaping regulatory oversight. Effectively unregulated entities included, inter alia, leasing companies, commercial credit institutions, pension funds, asset management companies and investment advisory services. Moreover, the legislative foundations for financial regulation and supervision were not updated regularly. In many areas, current law inhibited supervisory authorities from taking timely action to prevent financial entities from becoming illiquid, insolvent or engaging in malpractices.

The industry impression was that supervisory authorities were vulnerable to inappropriate political pressure exerted to prevent them from taking necessary actions, so protecting privileged private interests. Because regulation was product based and sector based, the patchwork institutional framework supporting it was ill equipped to deal with the rapid changes sweeping through the financial services industry worldwide. Growing linkages between banking, insurance and securities activities, coming together under the umbrella of large, complex financial holding companies on the one hand, and the proliferation of hybrid financial products and derivates on the other, posed a serious challenge to a fragmented group of regulators, especially against the backdrop of ongoing globalisation and the development of e-commerce.

Under those evolving circumstances it was found that segregation between domestic and offshore business activities was no longer tenable. The division created too much opportunity for arbitrage and led to external misperceptions about how the system operated in Mauritius. The OECD, FATF and IFIs continued to challenge these artificial divisions established to exploit tax arbitrage. More importantly, such segregation was a handicap in the future development of the financial services industry in Mauritius. Accordingly, the island's OFC was abolished in favour of a single low-tax regime and the International Companies Act was repealed. That was not a condemnation of the offshore regime, which had been successful until 1998. Instead it suggested the need for a different response to changing circumstances triggered by OECD's 1998 broadside and subsequent developments.

It was thought that a unified single regulator for financial services, applying the highest international standards, would alleviate external perceptions about regulatory gaps and shortcomings in Mauritius. A two-phase process for regulatory unification was envisaged. The first was the establishment of the FSC as a single regulator for all NBFIs. It subsumed SEC, MOBAA and the Insurance Division of the Ministry of Finance under a single umbrella. The creation of the FSC was also intended to facilitate smooth integration of the onshore and offshore regimes. MOBAA's promotional functions were devolved to a new Financial Services Promotion Agency. The second phase involved the FSC merging with the regulatory part of the BoM to form a single regulator for all financial services. With the FSC's establishment in 2001, the first phase was completed. However, the second phase appears to have been dropped from official consciousness.

Since 2001, there has been a continual stream of legislative changes governing financial services in Mauritius including the Companies Act of 2001, the Financial Services Development (FSD) Act of 2001 and the Trusts Act of 2001. The Insurance Act of 1987 and the Stock Exchange Act of 1988 were maintained until 2005 and administered by the FSC. This arrangement was kept in place until the enactment of further special legislation (in 2005, see below) to consolidate the regulatory framework and harmonise the regulatory approach.[3]

The Companies Act of 2001 eliminated ring fencing between the offshore and domestic sector by providing for incorporating domestic and offshore companies under a single piece of legislation, with the incorporation process being streamlined. It also repealed the International Companies Act of 1995, while the FSD Act repealed the Mauritius Offshore Business Activities Act of 1992, which had provided the legal regime for offshore companies. It introduced the term 'global business' and expunged the word 'offshore' from the statute books. The Trusts Act of 2001 repealed the Trust Act of 1989 and the Offshore Trust Act of 1992. It added to the *Code Civil Mauricien* in order to integrate the fiduciary concept into domestic law. Broadly speaking, the Trusts Act of 2001 extended features previously available to offshore trusts to all trusts created under the Act, with certain limitations on trusts set up by a Mauritian resident.

The distinction between domestic and offshore banks was removed under the Banking Act of 2004 and replaced by a two-tier licensing regime. Class A licences permitted banks only to conduct domestic banking and open branches in Mauritius. Class B licences permitted transacting with non-residents and dealing in foreign currencies.[4] This was the first step towards further integration to be achieved through a single licence for providing banking services to domestic clientele and to non-residents and global businesses. However, an accounting distinction was still maintained between these two activities for determining the tax to be levied on the net income generated by each.

The supervisory regime for global business has changed from 'registration' to 'licensing', with the name change supposedly heralding closer monitoring of permitted

activities in that area. There are now two types of global business company (GBC) licences, viz. GBC-1 and GBC-2. Both draw on the Companies Act of 2001. A GBC-1 licensee can undertake prescribed activities in Mauritius, but is also permitted to transact business with non-residents in foreign currencies and is subject to Mauritian corporation tax. As a resident, it can avail of double tax treaty provisions entered into by Mauritius with other countries. GBC-1 licensees are subject to annual reporting requirements under the FSD Act. A GBC-2 licence is issued to a private company that conducts approved global business only with non-residents and only in foreign currencies. As a GBC-2 licensee is non-resident and tax exempt, it cannot avail of the benefits of the double tax treaties and is not subject to annual financial reporting obligations.

The enactment of the FSD Act was the first stepping stone towards meeting international standards. It aimed at improved supervision of the sector as a whole and at providing a building block for eventually embracing other specialised pieces of legislation covering various financial services. In 2005, the new Insurance Act and the new Securities Act were passed to modernise the approach to regulation in both sectors respectively by adopting international standards. Both statutes provide for domestic and global business in their respective sectors under the same unified legislation. The FSD Act was later amended to provide for more comprehensive enforcement powers of the FSC, establish a right of appeal against its decisions and the imposition of penalties and to require greater transparency on the part of the regulator in explaining its decisions.

Financial Sector Assessment Programme

In 2002–2003, a joint IMF/World Bank mission under the Financial Sector Assessment Programme (FSAP) on the observance of standards and codes for the FATF 40 recommendations on money laundering and eight (now nine) special recommendations on terrorist financing, reported that Mauritius had made progress in implementing a comprehensive AML/countering the financing of terrorism (CFT) regime. The mission applauded the government's efforts to enhance the AML/CFT legal and enforcement framework by introducing new legislation, including: the Dangerous Drugs Act of 2000, the FSD Act of 2001, the Prevention of Corruption Act of 2002, the Prevention of Terrorism Act of 2002 and the Financial Intelligence and Anti-Money Laundering Act of 2002. It found that enactment of these laws represented key advances in bringing Mauritius toward full compliance with international standards, but identified areas where further effort needed to be made. These included:

- modifying confidentiality provisions that hampered information sharing on suspected money laundering cases between supervisory authorities and the Financial Intelligence Unit (FIU);

- expanding the scope and focus of AML/CFT reviews during onsite inspection of financial institutions in line with the guidelines issued by the supervisory authorities; and
- improved co-ordination of law enforcement efforts.

The mission also recommended that financial institutions should: strengthen internal AML and CFT programmes by developing adequate internal policy/procedure frameworks to reflect guidelines issued by regulators, increase compliance testing and ensure that front-line and compliance staff received adequate training. These recommendations were implemented immediately, with supervisory bodies over-emphasising AML/CFT in monitoring their licensed population.

Where does the Mauritian IFS industry go from here? The challenge of diversification, expansion and growth

As the previous sections establish, Mauritius has exported international financial services (IFS) since the early 1990s. The value of such exports has grown nearly fifteen-fold: from barely MRs60 million in 1994 to over MRs875 million in 2006. This growth has not been linear. IFS exports were set back in 2001–2004 when issues arose with the OECD on harmful tax practices. OECD countries and international financial institutions unilaterally blacklisted what were deemed to be 'tax havens'. Externally imposed requirements on IFS transparency – monitored by the IMF and World Bank on behalf of the Financial Action Task Force (FATF) and Financial Stability Forum (FSF) – were accepted without much protest by the Mauritian authorities.

Consequently, new restrictions came into force involving 'know-your-client' and due diligence requirements for IFS transactions. Anti-money laundering (AML) and countering the financing of terrorism (CFT) requirements were the stated raison d'être. Yet the real underlying concerns seemed to be tax leakage and the competition provided by Mauritius to financial centres in OECD countries. These developments had a deleterious impact on Mauritius's IFS exports for three years until 2004. The legitimacy of the post-2001 regulatory restrictions, and the manner in which they were imposed on the local financial services industry, have been evaluated in another study undertaken under the Commonwealth Secretariat aegis.[5]

At the same time, while Mauritius's IFS exports have grown over the years, they have not diversified vertically into different IFS domains (although there has been some geographic diversification). The bulk of IFS exports are still attributable (directly or indirectly) to low value-added, passive administration of foreign accounts established to benefit from double taxation treaties and agreements (DTT/DTAs) with a number of countries. Most such accounts are related to tax benefits conferred by the DTT with India.

Under its terms, Mauritius has become a favoured way station for flows of foreign portfolio investment (FPI) from institutional and high-net-worth individuals (HNWIs) in the US, EU, Australia and the UK into India. These flows, and the investments to which they relate, are booked, administered and audited in Mauritius. They involve mainly account-management services. However, they generate a significant volume of connected offshore banking transactions as well.

Although there was little concern about that DTT in the late 1980s and 1990s, FPI flows into India exploded in the early years of the new millennium and especially after 2004. Confronting such large, almost unmanageable, inflows of FPI in 2005–07, the Indian authorities felt that the tax benefits/concessions provided to foreign investors through Mauritius were too generous. They exacerbated growth in FPI of a volume that threatened to destabilise monetary policy and India's macro-economy. The government of India felt that the treaty favoured, if not encouraged, round-tripping of resident and non-resident Indian investment – veiled as investment from other countries – into India via Mauritius. Although evidence in support of that was tenuous, circumstantial and speculative, the issue remains contentious, as are other provisions of the DTT.

India is now trying to standardise its DTTs with all other countries and has renegotiated its treaty with Singapore. However, the clauses renegotiated in that DTT cannot come into effect until the treaty with Mauritius is brought into alignment. The Indian tax authorities believe that they need to prevent domestic tax revenues (from FPI transactions) from haemorrhaging as a result of offshore tax treatment conceived 20 years ago. This backdrop, and the serious intent with which the Indian authorities are pursuing renegotiations, make Mauritius's current IFS exports seem dangerously concentrated and overly dependent upon its DTT with India. To avoid the adverse consequences of over-concentration, Mauritius urgently needs to expand and diversity its range of IFS offered to global clientele.

International financial services diversification/expansion was the subject of a symposium organised by the Commonwealth Secretariat in partnership with the Mauritian Board of Investment (BoI) from 22 to 26 January 2008. That symposium provided an overview of rapidly evolving global markets for IFS exports, clarified the role that Mauritius might play and dealt with IFS domains in which globally competitive capabilities could be developed.

Individual symposium sessions focused on: (i) private banking and wealth management (PBWM); (ii) asset management; (iii) insurance and re-insurance; (iv) transfer pricing and tax management (TPTM) for transnational corporations; (v) risk management services accompanied by local exchange traded risk management derivatives contracts; and (vi) complex financial engineering services for regional and global corporations in areas such as mergers and acquisitions (with an Africa focus) and public-private partnerships for infrastructure financing (mainly in Africa). The conclusions reached at the symposium and the observations and recommendations flowing from them are elaborated upon in the remainder of this chapter.

Table 3.1: Crude illustrative dimensions of international financial services (US$ trillions)

Year	2005	2010	2015	2020
World output	44	63	88	122
Global IFS revenue	1.1	1.9	3.6	6.9
World equity market capital	39	61	85	115
Global bonds outstanding	40	65	93	120
Global assets under management	45	64	98	125
Private wealth under management	33.3	44.6	>70	>95
Global recorded mergers and acquisitions	0.812	0.915	1.3	>2

Source: Capgemini, Boston Merrill Lynch, Consulting, Financial Times, Wall Street Journal, Business Standard India

Private banking, wealth management and asset management

The sense emerging from the Commonwealth Secretariat–Mauritian Board of Investment symposium of January 2008 was that Mauritius needed to make a strategic shift from **passive, low value-added** account management to **proactive, substantive high value-added** international financial services on an accelerated basis. To do so, the government and the financial services industry needed to work jointly on a programme aimed at developing policies, alleviating systemic constraints of

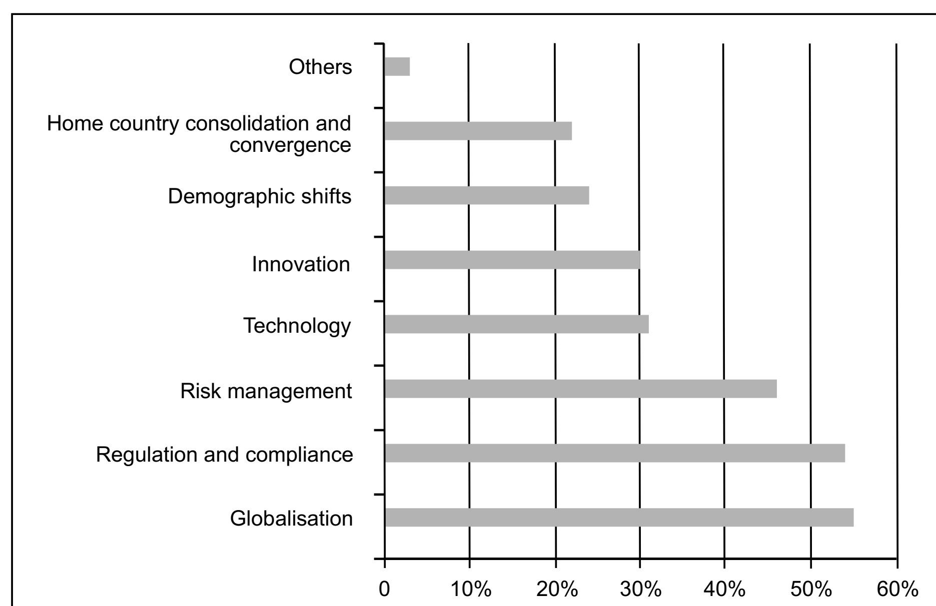


Figure 3.1 Catalysts estimated to have the highest impact on transformation of financial firms

manpower and infrastructure, and developing business plans, to exploit rapidly growing global opportunities for services exports in these domains.

In particular, Mauritius needed to develop **private banking, wealth management and asset management** capabilities as a matter of urgency. Its management companies are already serving an established base of HNWI clients in India and Asia. Mauritius is well located to provide private banking, wealth management (PBWM) services to emerging entrepreneurs from India, the rest of South Asia, South-East Asia (ASEAN) and China (whose HNWIs are also being served by Hong Kong and Singapore). HNWIs from the Arabian Gulf were more likely to be served by global banks operating from Abu Dhabi, Dubai, Bahrain, Kuwait, Muscat and Doha. However, unlike other centres, Mauritius could specialise in creating African investment portfolios for these clients, especially as Africa now provides the last emerging market frontier that has not yet matured.

The large and rapidly growing pool of HNWIs in Asia[6] would be easier for Mauritius to tap than HNWIs in OECD countries, which represent 'old wealth' serviced in other established IFCs. PBWM as a business relies on trust, strict observance of privacy, discretion, a firm's reputation for global investment knowledge, proficiency and probity. Firms with established global brands to whom clients feel they have recourse tend to dominate, while small domestic firms and banks unknown to HNWI clients offshore are unlikely to make significant inroads into developing such business without international partnerships.

The bulk of global PBWM business is concentrated in the 20 largest global financial firms.[7] Such firms/banks have to be attracted to Mauritius and offered assurance that it is a safe, attractive (in terms of tax, security, privacy and country/political risk) centre in which to locate (and from which to have actively managed) a part or the bulk of their wealth.

PBWM activity is consonant with Mauritius's efforts to market high-value properties developed under its specially legislated Integrated Resort Scheme (IRS) to a global

Table 3.2: Dimensions of private wealth management: number of HNWIs (net worth > US$1m) and their wealth

	1996	2000	2005	2010
Number of HNWIs global (millions)	4.5	7.2	8.7	10.5
Value of their wealth (US$ tr.)	16.6	27.0	33.3	44.6
Number of Asian HNWIs (millions)	0.9	1.5	2.4	5.0
Value of Asian HNWI wealth (US$ tr.)	2.8	4.2	7.6	14.2
Value of Indian HNWI wealth (US$ tr.)	<0.1	>0.1	0.3	1.1
Annual growth in global HNWIs			6.0%	5.7%
Annual growth in Asian HNWIs			6.4%	6.7%
Annual growth in Indian HNWIs			19.3%	12.5%

Source: Capgemini/Merrill Lynch World Wealth Reports for 2005–06.

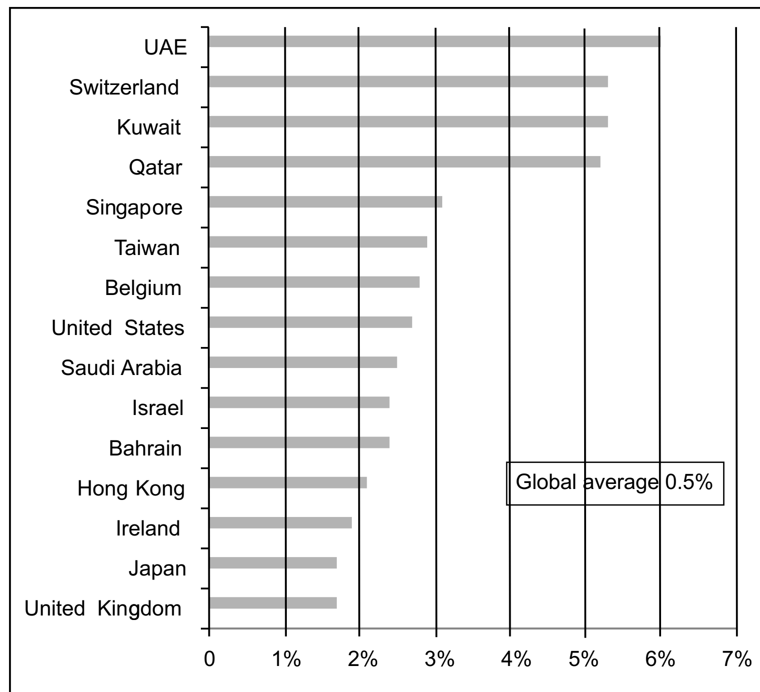


Figure 3.2 Millionaire households as percentage of total households

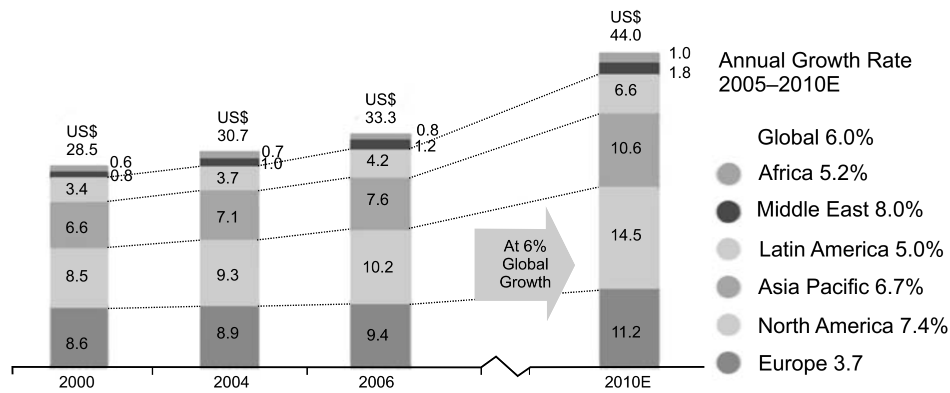


Figure 3.3 High Net Worth Individual wealth forecast by region, 2003–2010 (US$ trillions)
Source: Capgemini Lorenz curve analysis, 2006.

HNWI clientele. Such clients are likely to be more comfortable having investment portfolios managed where they are residing on a part- or full-time basis. That synergy needs to be exploited through joint marketing efforts by IRS developers with the local financial services industry to attract HNWIs into IRS investment **and simultaneously** into PBWM services.

Thus, a natural entrée would be for financial firms to work with IRS developers in offering financing and insurance packages (in foreign currencies with instruments allowing value fluctuations to be hedged) for the acquisition, maintenance and (possibly rental) of IRS properties and their contents. Marketing efforts for IRS properties, in conjunction with efforts to attract PBWM business, need to be refocused from targeting potential IRS buyers from the 'old' European Union, to targeting HNWIs from the 'new' EU, as well as the Gulf emirates, India, China and the ASEAN.

Partnerships with established IFCs specialising in PBWM

Some established IFCs that had specialised in providing PBWM services to a global clientele for decades (e.g. the Channel Islands, the Isle of Man and Ireland) are now running out of human resources, space and infrastructure. Their costs have escalated and they are becoming uncompetitive. As a result, opportunities are emerging for firms/banks located in Mauritius to 'partner' with PBWM firms in these jurisdictions. Appropriate partnership arrangements need to be devised that aim at relieving the constraints of the latter, while attracting a growing volume of PBWM business into Mauritius, along with the knowledge/expertise that exists in these IFCs.

PBWM services are usually provided successfully in financial centres that also have asset-management capabilities. Mauritius would be unable to offer PBWM credibly

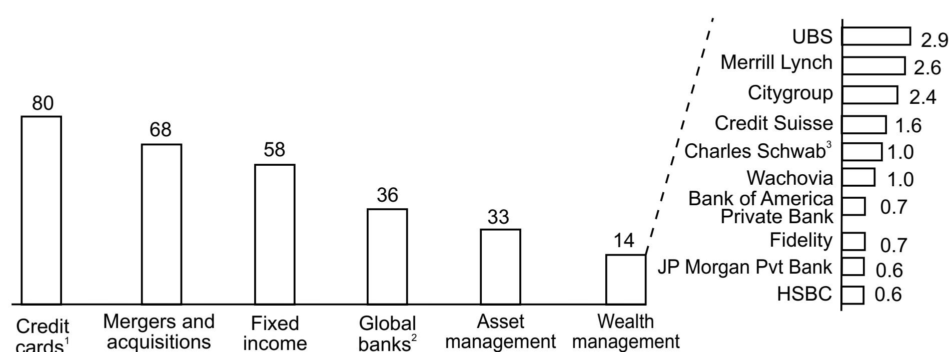


Figure 3.4 Global market share of top ten players, end 2004 (percentage)

[1] US market only

[2] top fifteen, based on market capitalisation

[3] includes US Trust

Source: Percy Mistry, Presentation at Symposium on the Export of Financial Services

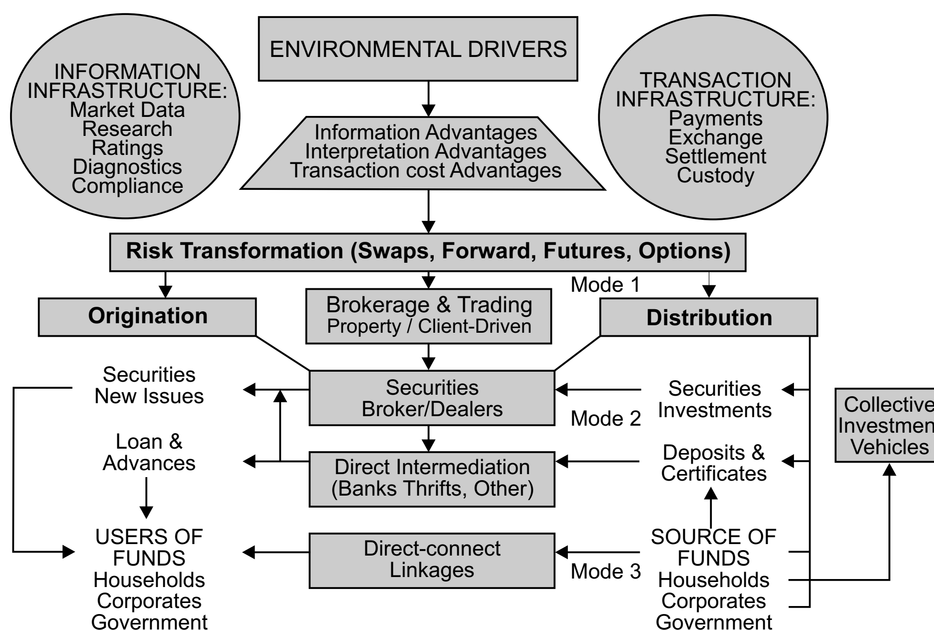


Figure 3.5 What drives asset management?

Source: Asset Management and Investor Protection: An International Analysis by Julian Franks, Colin Mayer and Luis Correia da Silva, New York: Oxford University Press, 2003. Presentation by Percy Mistry at Symposium on the Export of Financial Services.

without developing a local asset-management industry at the same time. Such an industry has to be capable of managing **global** assets in equities, fixed-income, derivatives, as well as in art, real estate, gold, commodities and so on. It is imperative for Mauritius to attract asset-management companies capable of handling global and African portfolios of HNWI clients. It is also necessary for the Government of Mauritius to consider repatriating the asset management of Mauritian public and private pension funds, so as to provide a boost to the local asset-management industry.

With full capital account convertibility, Mauritius offers an advantage to asset managers constrained in providing similar services from India. The Reserve Bank of India (RBI) recently liberalised capital outflow for investment abroad by **resident** Indians through established Indian and global asset management vehicles.[8] This relaxation provided an opportunity for Mauritius to attract global fund management business by having Indian asset managers operating from the island. Simply put, such firms need to be persuaded to use the same operating and account management platform created for directing foreign portfolio investment (FPI) flows into India via Mauritius, by facilitating a symmetric reversal of flows of outward FPI from India to the rest of the world.

A similar opportunity has emerged since April 2008, when the UK levied a tax on non-domiciles (unprecedented in two centuries) who have resided in Britain for more than seven years. There is expected to be an exodus from the UK of 'non-doms' betrayed by this retroactive punitive tax action. Mauritius could benefit by targeting PWBM and asset-management services to non-domiciles seeking to exit the UK, by emulating financial services providers (as well as lawyers and accountants with HNWI clientele) from the Channel Islands, as well as jurisdictions like Switzerland and the Netherlands.

For the foregoing reasons, PBWM and asset-management activities need a policy-cum-implementation push **jointly** from **government**, which needs to take policy measures to facilitate the rapid emergence of specialised firms, private banks and asset managers; and **private** foreign and domestic firms in the IFS industry to upgrade and transform presently limited capabilities. It requires a concerted industry effort to realise the potential that exists.

A promising start could be made if the fragmented sub-industry associations in the financial sector (i.e. for insurance, banking and management companies, not to mention brokerages) were to merge voluntarily into a single financial services industry association under unified leadership, while keeping their sub-industry focus intact under a single umbrella.

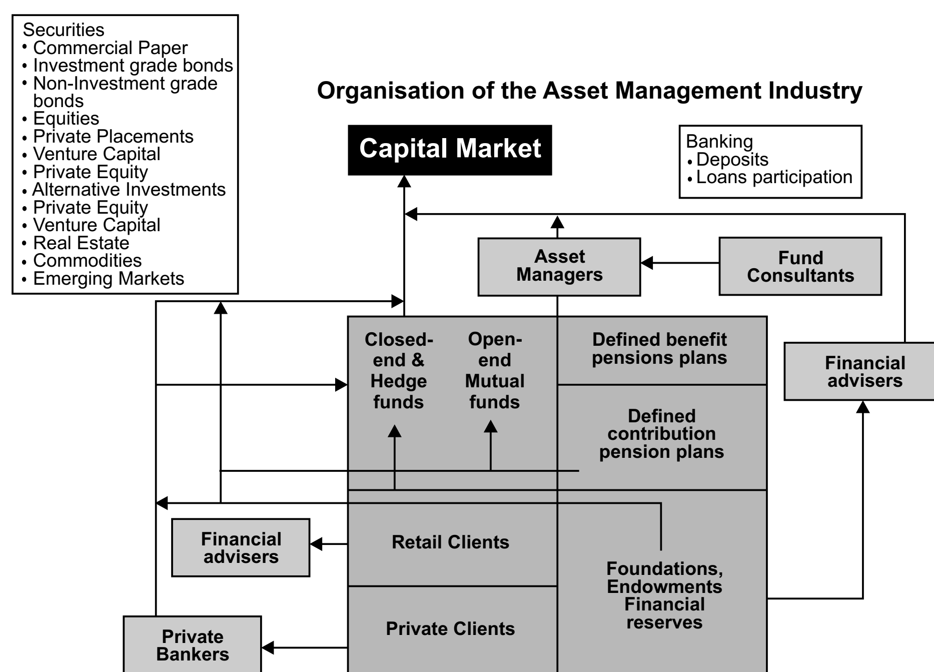


Figure 3.6 The asset management industry

Source: New York: Oxford University Press, 2003. Presentation by Percy Mistry at Symposium on the Export of Financial Services.

Insurance and re-insurance[9]

For insurance and re-insurance to become important areas for international financial services in Mauritius, established local companies would need to operate in the African and Indian Ocean regions more aggressively. Concomitantly, they would need to de-concentrate their over-exposure to domestic risk and domestic investments.

It is unlikely that global insurance companies would use Mauritius as a regional insurance centre for Africa or for asset-liability management. They are more likely to gravitate to South Africa for that purpose. Nonetheless, there is scope for Mauritius to emulate the success of Bermuda and some Caribbean islands as a regional or global **re-insurance** centre. That would, however, imply providing specifically tailored tax advantages for this industry, which might cause problems with other African countries and possibly even with some OECD jurisdictions.

As two-way trade between India-Africa and China-Africa grows, it is bound to create more insurance opportunities (for goods and the vessels they are being carried in) to be captured by insurance companies based in Mauritius (whether locally, regionally or globally owned) for tax as well as operational reasons. New products (such as catastrophic risk, cyclone risk and weather insurance) also offer opportunities for IFS growth by insurance companies based in Mauritius, working in tandem with international counterparts to undertake the associated actuarial risk analysis and to offer insurance products tailored to African markets and for exploiting insurance opportunities created by rapidly growing Afro-Asian economic interaction.

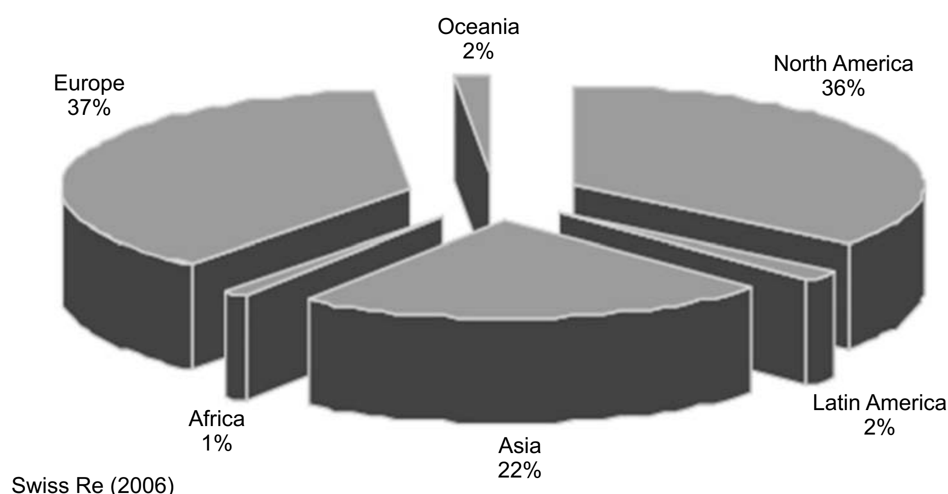
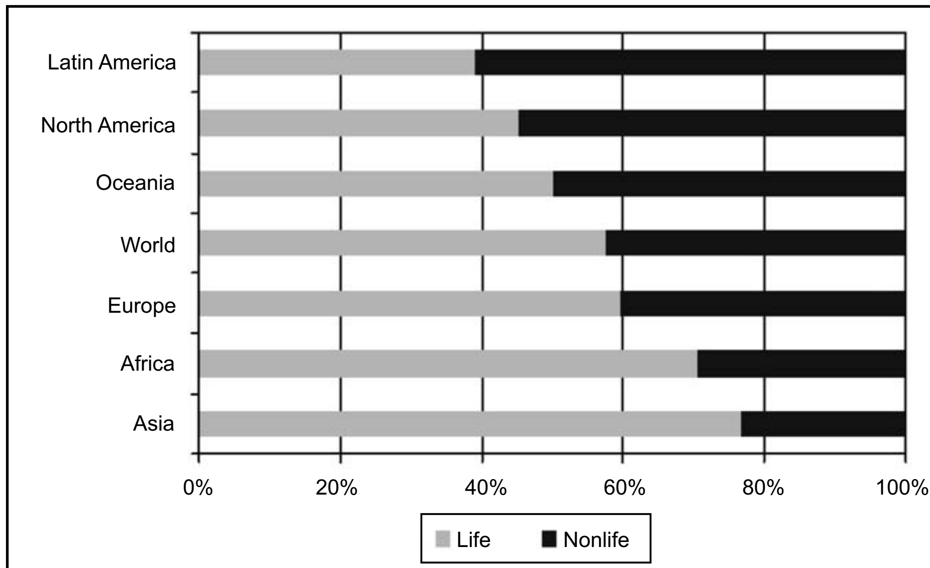


Figure 3.7 Distribution of insurance premiums

Source: Presentation by Mr Anthony Pedersen at the Symposium on the Export of Financial Services



Swiss Re (2006)

Figure 3.8 Share of insurance premiums
Source: Presentation by Mr Anthony Pedersen at the Symposium on the Export of Financial Services

Transfer pricing and global tax management

Discussions at the Commonwealth Secretariat–Mauritian Board of Investment symposium of January 2008 also established that there was unexploited potential in Mauritius for offering a range of transfer pricing and tax management (TPTM) services to a larger universe of transnational corporations (TNCs) than is presently imagined by local management companies, given the flexibility and amenability of global business licence (issued by the Financial Services Commission of Mauritius) tax treatment. What seemed to be lacking was sufficient domestic knowledge and experience in TPTM for the global market.

To develop such expertise quickly, Mauritius needs to make itself more attractive for the world's major tax and accounting firms to relocate TPTM business from other centres. While Mauritius has over 33 double taxation treaties/agreements negotiated on a bilateral basis, it remains too dependent on routing FPI investments to India. For TPTM business to grow, tax-related IFS must be provided over a wider canvas. Local management companies, as well as tax accountants and tax lawyers, need to develop skills in offering TPTM services as a specific area of IFS business opportunity.

By the same token, a larger number of TNCs (in manufacturing, financial services, transport services and other areas) need to operate out of Mauritius to avail of TPTM

benefits and services, so lowering their global tax liabilities. The objective of attracting such TNCs into Mauritius, in turn, would be easier to achieve if Mauritius could be developed into a more attractive location for the regional headquarters of TNCs involved in growing Asia-Africa trade, or even as the administrative or treasury headquarters of emerging TNCs from Asian-source countries, particularly India and China, which have the largest future need for African resources, commodities and markets.

To prevent tax leakage from their own jurisdictions, large countries are refining and tightening their approaches and laws to deal with TPTM. They require more 'substance' to be demonstrated in offshore locations of TNCs where TPTM services are being availed of. These requirements do not pose insuperable obstacles to the potential growth of TPTM-international financial services from Mauritius. With the growing importance of TNCs from Asia in world trade, and particularly trade/investment interaction between India/China and Africa, Mauritius is well positioned to develop this business successfully. To do so, it needs to ensure that the tax treatment of global business licence (holders – GBLs) remains favourable and competitive by global standards, taking into account changes occurring elsewhere.

Given the highly specific, tailor-made nature of TPTM services offered to individual client firms (as well as to HNWIs) it is difficult to advocate generic solutions and prescriptions. Different management companies need to devise specific strategies (including strategies for acquiring the necessary skill sets) for developing such business, beginning with their extant client base in particular geographies. However, the Government of Mauritius and the Financial Services Commission need to be made aware on a real-time basis of TPTM issues and opportunities, to ensure that continual changes in tax and regulatory policy/practice do not compromise the steady development of this line of business.

Risk management and capital market activity

In contemplating the provision of risk-management services[10] from Mauritius, it is important to distinguish between: (i) specialised **financial** risk management – i.e. a narrow concept employing financial, traded derivatives to manage specific types of country, political, credit, currency, interest rate and equity price risk; and (ii) a wider notion of risk management, which embraces virtually every corporate asset and activity. The Mauritian IFS industry should focus on the narrow concept for IFS. However, such services are unlikely to develop apace if the Stock Exchange of Mauritius (SEM) and local firms are confined and geared exclusively to meeting the needs of a small and inherently unviable (from a volume and transaction-cost viewpoint) domestic capital market.

In view of the state of development of Mauritius's capital and derivatives markets, local participants believe that risk management employing derivatives is likely to be a distant development in the context of the island. Yet foreign interlocutors think

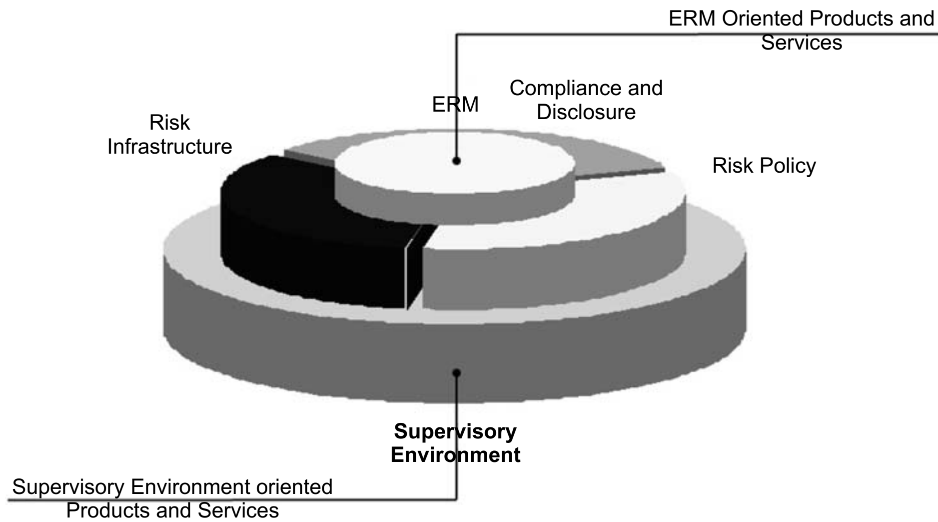


Figure 3.9 Risk management industry
Source: Presentation by Dr Manoj Vaish at the Symposium on the Export of Financial Services

the opposite. They believe that, despite the existing limitations of the SEM, Mauritius already offers a valuable incubation site for innovating specific risk management (derivative) contracts relating to Indian currency and securities markets (in which Mauritius plays an important pass-through role). Over time, such products and services could be extended to African markets as well.

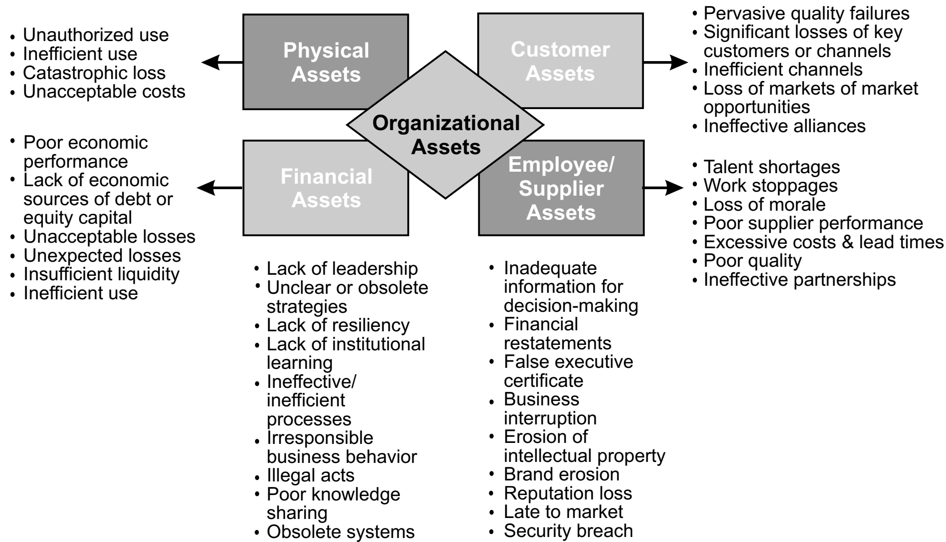


Figure 3.10 Risks associated with the sources of value

Resident and foreign investors in Indian securities presently confront restricted possibilities for portfolio risk management. Remaining restrictions on Indian rupee convertibility and the absence of standard derivative instruments traded in India hinder them in managing currency, interest rate, duration and country risk, as well as hedging against market movements in either direction. The development of such possibilities in India is likely to be much slower than growth in demand. The same is true of China.

Yet there are no similar restrictions on innovating and trading such instruments in Mauritius in real time. There is a large latent market for such services, which is being imperfectly catered to in Singapore and Dubai. However, to successfully develop and trade appropriately structured derivative contracts in Mauritius for Indian currency and securities markets, and to make them available to a global investor base, the SEM needs to be linked (through ownership) to Indian exchanges (particularly the National Stock Exchange of India – the NSE). Moreover, constructive and co-operative regulatory arrangements with Indian regulatory authorities need to be devised to ensure that the services offered in Mauritius do not circumvent key (and justifiable) Indian restrictions. Investment banks in India need to offer such services to their extensive client base from Mauritius, thus requiring them to establish a presence on the island for providing India-related risk-management services, as well as other investment banking and corporate finance services.

It should be a priority for Mauritius to attract such business as quickly as possible. The window that is now open will probably close within the next four to five years (i.e. by 2012 or 2013), when full Indian rupee convertibility becomes inevitable, and as non-equity derivative markets in India develop more rapidly with the extant regulatory chokehold over them being gradually relaxed. Mauritius needs to establish a first-mover advantage in key risk-management contracts before then. Such an advantage would enable it to retain a large share of the business so created, as the example of Singapore with Nikkei Index (spot and derivatives) trading amply demonstrates.

Developing the ability to provide such specialised international financial services will provide Mauritius with the knowledge and skill sets necessary to give it an added advantage in developing suitable financial derivative (risk-hedging) contracts for African securities markets (and commodities) as well, at a later stage. Over time, Mauritius might be able to develop the ability to offer and trade more sophisticated derivative contracts: for example, for country and political risk in Africa (if such a contract were available today, it would be heavily traded) and for weather risk, as well as for cyclone and catastrophic risk.

The role of the Stock Exchange of Mauritius (SEM)

In addition to risk management, formal and informal discussions at the symposium suggested that the Stock Exchange of Mauritius has a wider regional (and global) role to play than its current offering of capital market related IFS. The SEM is, after

Johannesburg, the most technically proficient and capable securities exchange in Africa. It operates in a jurisdiction with sound regulation, in conformity with international standards and with an established reputation for transparency and probity. It has established **commercial** viability servicing its limited domestic market. However, the SEM is too small an operation to be **economically** viable in global terms, unless its scope expands. Remaining confined to the domestic market, or to the limited eastern African regional market in the near future, will provide the SEM with little room for growth and diversification.

The trend worldwide is for bourses to ally themselves through cross-ownership holdings in two or three emerging **global** securities markets networks. That trend will encourage **globally seamless** trading in all 'national' securities in a phased manner over the next decade. The most liquid and heavily traded securities (equities, bonds and associated derivative contracts) will be cross-listed on multiple exchanges (some already are) and traded on a 24 hours a day, 365 days a year basis around the world as the future unfolds. Once that is done, the next tier of securities will be similarly globalised in a linked single market space.

Given the gradual emergence of such a world, the SEM has three strategic options: (i) remain independent with its present shareholding and attempt to grow using its own resources outside the domestic market to exploit opportunities wherever they present themselves; (ii) enter into an alliance with a premier exchange in Africa – most probably the Johannesburg Stock Exchange (JSE) – to form the foundations of a strong **regional or continental** African exchange; or (iii) enter into a similar alliance with an established Indian exchange – with the NSE probably offering the best partnership potential.

Conceptually, it might be thought that the same arrangement might apply with China. However, that is unlikely for a number of reasons. **First**, in comparison with India, the Chinese capital market (indeed its whole financial system) is relatively undeveloped in operational and regulatory terms. **Second**, China is too remote compared to the proximity of India, despite its obvious interest in Africa. **Third**, the benefits to the SEM from an alliance with Shanghai are much less obvious than a similar alliance with the JSE (option ii) or the NSE (option iii), while the complications involved are greater.

The first of the SEM's strategic options would stretch its resources and cap its future prospects. It could not compete effectively with the JSE as a credible exchange either for the regional Community of Eastern and Southern Africa (COMESA) or continental Africa. The domestic market is too small (in comparison with other African markets) to provide the SEM with significant leverage capacity. The second option would embed the SEM firmly in Africa. Over time, it might create opportunities for the SEM to 'bring Africa to the global capital market'.

The third option would permit the SEM to develop regional capabilities by leveraging and enhancing its resource base (in terms of financial, human and technical

resources). At the same time, it would allow the SEM to: (i) develop India-related risk management business in the near future; and (ii) link small African capital markets (in COMESA) with the larger, more rapidly growing Indian capital market. The latter option would permit Mauritian and growing African firms to access the Indian (and through it the global) capital market for funding. It would enable a greater number of firms (from Africa and India) to be cross-listed with their shares being traded in Mauritius for global buyers.

The Mauritian authorities and the SEM need to work together in formulating and co-ordinating a clear business strategy for securing its future. That needs to be done in a manner that enhances Mauritius's opportunities for expanding/diversifying its IFS exports. All three options outlined above need careful consideration. A clear business strategy needs to be decided upon and pursued. That should be done not on the basis of a 'beauty contest' to see which partner would offer the most for the SEM's shareholders and stakeholders. Instead, it should be done recognising that only one of these three options is optimal. Once that option is decided, the SEM should pursue the alliance most favourable to its prospects, for growth and diversification in the short and long term, on the basis of a specifically **targeted merger**. It should not open itself to being acquired through 'competitive bidding', which may not turn out in its own interests. That process is not appropriate under the circumstances.

If the right decision about the Stock Exchange of Mauritius is made, capital market and securities trading activity may provide a new area for the country to exploit, providing international financial services to a far greater degree than has presently entered the consciousness of either its capital market players or its authorities.

Complex financial engineering: mergers and acquisitions and public-private partnerships[11]

There has to be some immediate doubt about Mauritius's ability to evolve into a centre for IFS involving complex financial engineering, such as: (i) mergers and acquisitions (M&A) activity, which is staple of most investment banks around the world; and (ii) the growing global (and regional) interest in putting together more public-private partnerships (PPPs), especially for financing infrastructure. Mauritius does not lack the basic ingredients needed for such activities to be undertaken: i.e. a combination of financial-engineering skills, along with specialised skills in corporate legal work, familiarity with cross-border tax issues, complex corporate accounting skills and so on, and (for PPP activity) skills in large project construction, public-service delivery on a cost-recovery basis and project/service monitoring.

However, what Mauritius does lack is a universe of institutions (investment banks) with sufficient experience and credibility in these areas; a sufficiently large universe of private firms that engender M&A activity on a significant scale; and the necessary

experience (and skills) in government and the private sector with successful public-private partnerships operating on the ground in Mauritius.

As far as M&A activity is concerned, Mauritius can only develop the capacity for providing IFS if Mauritian firms (i.e. banks, investment banks and corporate finance boutiques) are operating credibly across Africa. Alternatively, it requires capable investment banks operating in Africa to locate in and operate from Mauritius. Most investment banks with such capabilities are based either in South Africa or in North African countries (Morocco and Egypt). It would be difficult to attract these institutions to Mauritius unless there was a particularly strong reason. A possible reason might be the prospect of accessing a wider universe of potential suitors (or acquirers) for African enterprises through M&A deals than they might from their extant operating bases. Such acquirers could be from Gulf oil-surplus countries with a strategic investment interest in Africa (although Egypt and Morocco would have an advantage over Mauritius in this instance) or from India, ASEAN countries or China.

However, Mauritius would need to demonstrate the capacity for clearly superior access to Asian and other sources of funds and acquisition interest in Africa. Conversely, to make Africa-related M&A activity sustainable over the long term, investment banks operating from Mauritius would need to make strategic investments in developing a credible knowledge base and operating capacity across the continent. These considerations suggest that the development of M&A activity as a source of IFS exports might pose greater difficulties and take more time than other areas of IFS activity.

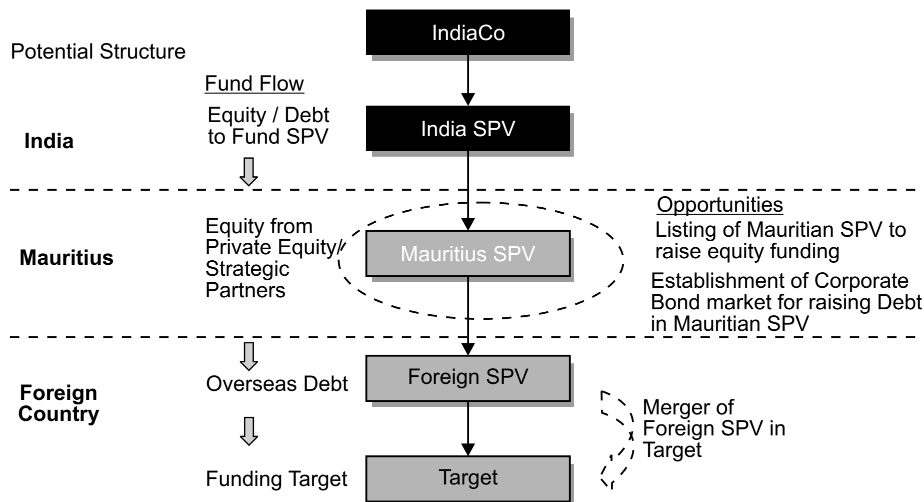


Figure 3.11 International Acquisition Structure

Source: Presentation by Mr Nimesh Kampani at the Symposium on the Export of Financial Services

Moreover, the African corporate landscape is inhabited largely by state-owned enterprises (SOEs) that are not subject to normal market-driven takeovers and acquisitions. SOE-dominated corporate environments are infertile for M&A activity (which flourishes mainly in a private sector dominated economy) to take off and be sustained. Large-scale privatisation of SOEs across Africa is a necessary pre-requisite for future market-driven M&A activity to be sustained in that region. One approach to kick-starting such a process on the continent would be for Mauritius to trigger exemplary privatisations of its own (e.g. of Air Mauritius, Mauritius Telecom, the State Bank of Mauritius) to attract global investment banking interest in Mauritius and get the ball rolling.

As far as PPP activity is concerned, the obvious drawbacks notwithstanding, the pipeline of infrastructure projects for Africa amounts to $300–400 billion over the next 10 years.[12] The infrastructure pipeline for India is about $500 billion for the period 2007–2012.[13] In both cases it is estimated that between half and two-thirds of these projects would be PPPs.[14] In Africa and India the 'demand' side of the equation for PPP skills and services far exceeds known sources of supply. As a result, the rate of implementation of PPP infrastructure financing has been slower than anticipated. Such services are intrinsically of a very high value-added genre. They are of a kind that Mauritius is suited to providing, if it can put the right ingredients (i.e. human resources, financial capital and knowledge/experience/expertise) together and use a recipe that works.

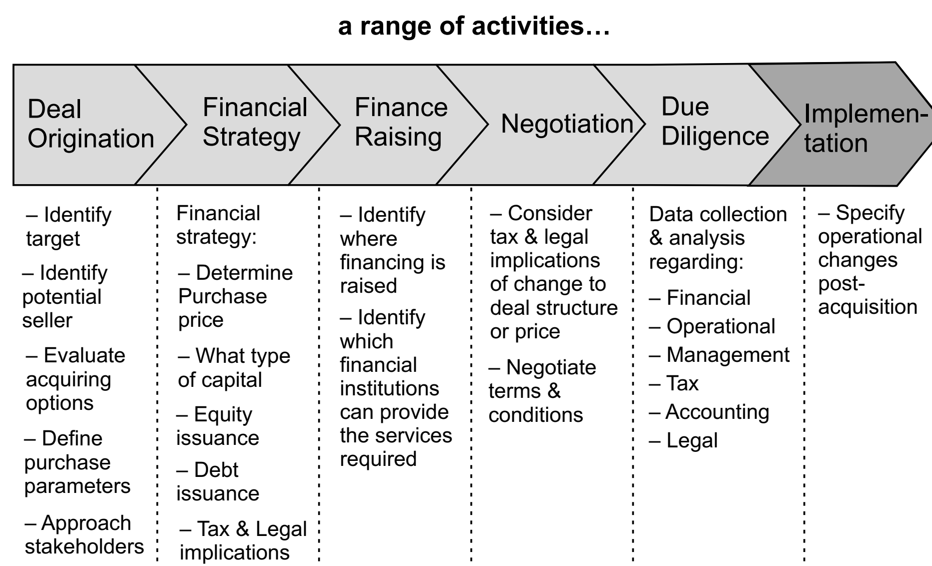


Figure 3.12 Mergers and acquisitions transaction flow

Source: Presentation by Mr Raymond Bourdeaux at the Symposium on the Export of Financial Services

	Global	Regional	Local
Tax Advisors	✓✓✓ ☺	✓ ☺☺☺	✓✓✓ ☺☺☺
Management Consultants	✓✓✓ –	✓✓ ☺☺	– ☺
Industry Experts	✓✓✓ –	✓ ☺☺	– ☺
Lawyers	✓✓✓ ☺	✓ ☺☺☺	✓✓ ☺☺☺
Accountants	✓✓✓ –	✓ ☺☺	✓✓ ☺
Investment Bankers / Financiers	✓✓✓ ☺	✓✓ ☺☺☺	– ☺

Figure 3.13 Essential Services Matrix

Note: ☺ refer to expertise required for medium-sized deals (*Scale:* ☺ ☺ ☺ (critical for success), ☺ ☺ (good to have, but not critical), ☺ (good to have)
✓ refer to expertise required for large deals (*Scale:* ✓✓✓ (critical for success), ✓✓ (good to have, but not critical), ✓ (good to have)

Source: Presentation by Mr Raymond Bourdeaux at the Symposium on the Export of Financial Services

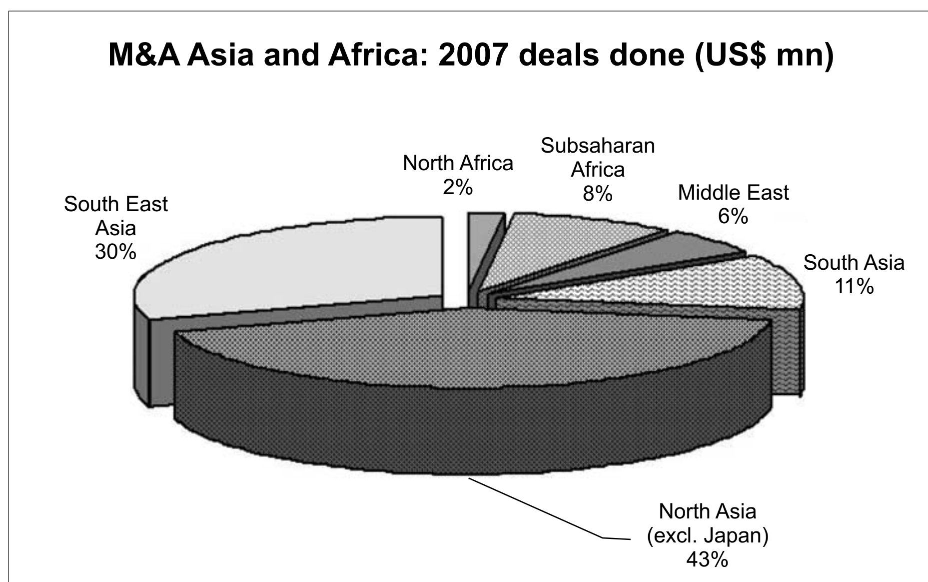


Figure 3.14 2007 Asia and Africa transaction value

Source: Presentation by Mr Raymond Bourdeaux at the Symposium on the Export of Financial Services

To do that, the Government of Mauritius and key players in the private sector need to exert joint efforts to acquire the requisite knowledge–skill mix quickly from abroad. The most advanced institutions with PPP skills and experience are based in the UK and continental Europe. The World Bank has also acquired a large database about what works and what doesn't.[15]

Tapping into these reservoirs of knowledge, the Government of Mauritius and the local financial services industry need to develop jointly a strategy to ensure that Mauritius acquires the image and credibility it needs as a purveyor of sophisticated PPP services. The potential pay-off of making Mauritius a centre of excellence for this particular high value-added service is extremely high. Both the public and private sectors need to make the upfront investment required to capitalise on the opportunities that are available.

Table 3.3 Examples of PPP projects in the SADC region funded by the European Investment Bank

Country	Project Name	Sector	Nature of PPP
Madagascar	Réseau nord des Chemins de Fer (Madarail)	Transport	Concession
Madagascar	JIRAMA	Water and electricity	Management contract at utility level (more than five active EIB projects in the water and electricity sector)
Mauritius	Harel Belle-vue Bagasse Energy	Energy	IPP concession
Mozambique	Maputo Water Supply	Water	Lease
South Africa	N3 Toll	Transport	Concession
South Africa	N4 Platinum Toll Highway	Transport	Concession
South Africa/ Mozambique	Mozambique-South Africa Natural Gas	Energy	Special purpose entity with public equity contribution

Source: David White, Regional representation for Southern Africa and Indian Ocean, European Investment Bank

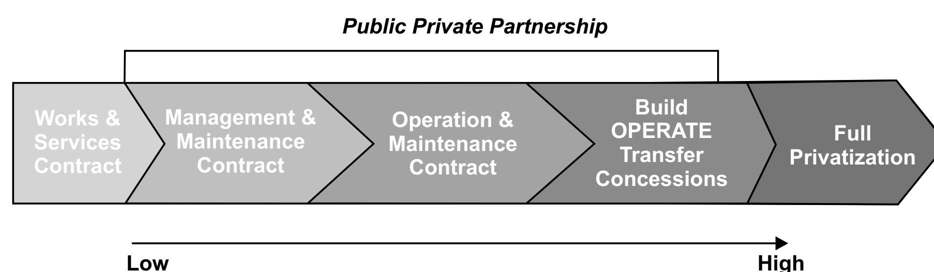


Figure 3.15 PPPs: A spectrum of options

Source: Presentation by Mr Raymond Bourdeaux at the Symposium on the Export of Financial Services

	Global	Regional	Local
Financial advisors	√√√	√√	√
Lawyers	√√√	√√	√√√ –
Technical advisors	√√√	√√	–
Lenders	√√√	√√	√
Tax and Accounting advisors	√√√	√	√√
Financial investors	√√√	√√	√

Figure 3.16 Expertise required
Source: Presentation by Mr Raymond Bourdeaux at the Symposium on the Export of Financial Services

Issues arising from the Symposium on the Export of Financial Services

Themes that arose when contemplating the evolution of the IFS industry in Mauritius – especially with respect to the constraints to capturing growing global IFS opportunities – are outlined below.

First, there is a counterproductive propensity for generating new laws, rules and regulations governing financial sector activity, as if that has become an objective in its own right. The financial services industry believes it is suffering from acute regulatory overload. At the time of the symposium, the industry felt that a pause was needed to digest regulations issued in the preceding two years. The implication is that there should be a moratorium on new regulatory initiatives, until the IFS industry has developed the absorptive capacity to cope with those already in place.

Second, there are concerns about the implicit conflict of interest between the roles of the FSC as a principal regulator as well as the prime promoter/marketer of IFS from Mauritius. Most private-sector players felt that playing both roles assertively compromised the external image of the FSC as an impartial, dispassionate, arms-length regulator; this is especially the case when it is seen by foreign governments and firms to be aggressively lobbying for business as well.

There are also concerns that governments of the day do not display sufficient political maturity when deciding on chief executive officers, senior executives and staff of regulatory, and other quasi-governmental, agencies (quangos). These agencies are supposedly independent, but are subordinated to ministries for budgetary convenience. Most providers of IFS believe that the Government of Mauritius displays a disconcerting tendency to change top regulators after each election, subordinating economic regulation to shifting political fortunes and convenience. Worse, quangos

have been shunted around between ministries to suit temporal political convenience or display prime ministerial displeasure with a particular minister. That practice conveys a poor impression to global interlocutors (and clients of the financial services industry) about whether the Government of Mauritius understands what good governance is, especially in terms of the independence, impartiality and probity of key regulatory agencies.

Ongoing concerns about an absolute shortage of qualified staff for the financial services industry remain. However, the industry had taken some self-help measures to remedy the situation in the months leading up to the symposium. Financial firms and associations were working with the universities and the Empowerment Programme[16] to upgrade the quality of the graduate intake at the industry's own expense, by providing remedial and inductive pre-training courses for school and university leavers, as well as on-the-job vocational training. This action is still not sufficient to remedy the problem.

The IFS industry in Mauritius was also concerned about the declining quality and dysfunctionality of output from the education system. School leavers and university graduates lack the basic attitudes, as well as literacy, numeracy and interpersonal skills, needed to make them employable in a rapidly changing labour market. It was felt that Government of Mauritius needed to review this situation (along with education policy, curricula etc.) urgently and to take swift remedial measures. The declining quality of human resources is incompatible with labour market needs, and this cannot continue without severe consequences for the future competitiveness of Mauritius.

Another area of concern was the extent to which the Mauritian financial services industry would need to depend on foreign staff and investment to develop the capabilities it needed to avail of global IFS export opportunities. Given the lacunae that exist in the domestic IFS knowledge and skills base, a larger foreign presence is a *sine qua non* for the expansion and diversification of IFS exports from the island. However, there is disquiet about the delicate balance between domestic and foreign firms being disturbed – for instance, by an overwhelming dominance by foreign companies, or by the possible disappearance of local IFS firms. While, in economic efficiency terms, the distinction between local and foreign players in IFS should not matter, the fact remains that as a socio-cultural-political issue it does. For that reason, the foreign-domestic firm balance in the financial services industry needs to be watched carefully and dealt with sensitively to avoid an anti-foreign backlash.

Finally, the financial services industry expressed concern about its ability to expand and diversify IFS exports when handicapped by poor physical and electronic connectivity with the rest of the world. It was emphasised that it is difficult for Mauritian financial firms to present themselves credibly to Asian or European firms as experts on Africa, when flight connections to African capitals other than Pretoria have to be made via Europe or the Middle East. Similarly, Mauritius Telecommunications Ltd. (MTL) made strong representations at the Financial Services Symposium (FSS),

and at the ICT-BPO Symposium as well, to the effect that it had reduced bulk-connectivity costs dramatically. Yet electronic connectivity costs are still too high by international standards, although MTL compares itself with African standards. Moreover, the critical issue of back-up redundancy is yet to be properly addressed, resulting in the financial services industry (and the ICT-BPO industries as well) being disadvantaged, if not compromised, in their efforts to compete effectively in global markets.

A post-script acknowledging the events of September 2008

Much has happened in the world of global finance since January 2008 when the Symposium on Financial Services was held and the contents of this chapter were written. The global crisis that broke in August 2007 entered a new and dangerous phase, resulting in the swift obliteration of many institutions and the demise of the independent investment banking model on which the bulge bracket investment banks – like Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers and Bear Stearns – were based. Only the first two of these are left standing, and they too have become deposit-taking banks. Two of these names have been absorbed into larger universal banks, while Lehman Brothers no longer exists.

The crisis is still unfolding and will take a greater toll on the global financial landscape. In the US, financial assets are being consolidated around three major universal banking groups and in the UK in five similar groups. Bank consolidation will probably gather force in most countries, resulting in fewer, larger institutions that could develop oligopolistic characteristics and tendencies if left undisturbed when things return to normal.

Despite the tectonic changes that have occurred abruptly in a very short time span, all of what has been said in this chapter about the export opportunities for Mauritius in higher value-added financial services and new markets remains valid. It may well be that, with confidence having been severely shaken in the banking systems of the US and Western Europe, but less so (if at all) in the economies of Asia, Africa and the Middle East, the locus of global financial services provision will shift gradually, but inexorably, from western financial centres to centres that are more proximate to emerging countries. These centres could then create new wealth more rapidly in the coming decades than the established ones.

The current situation may provide Mauritius with even greater opportunities for exporting a wide array of financial services than presently envisaged, providing it positions itself, and opens itself up quickly enough, to capitalise on these trends. To do so successfully, it will need to make the necessary changes at the **macro** (economy-wide governance), **meso** (in the financial services industry) and **micro** (in the structure and competitiveness of its financial firms and the human capital deployed in the industry) levels. Nowhere is that likely to be more true than in the areas of private banking, wealth management and asset management.

Notes

1. The authors are grateful to the CEO of the Mauritian Bankers Association (MBA) and the CEO of Multiconsult for clarifying issues regarded the DTA with India, and explaining how the situation evolved between its signing/ratification in 1985 and its coming alive in the early 1990s with the launch of Indian reforms.
2. J Sharman and P Mistry (2008). See http://publications.thecommonwealth.org/considering-the-consequences-556-p.aspx [accessed 14 November 2008].
3. The new Securities and Insurance Acts were enacted in 2005. New legislation covering pension funds as well as trust and corporate service providers was in the pipeline at the time of writing.
4. The Class A and Class B terminology was subsequently replaced by the Finance Act 2002, becoming Category 1 and Category 2 banking licences, without any fundamental change in the regime.
5. J Sharman and P Mistry (2008).
6. See tables entitled: Number of millionaires (source: BCG Global Wealth 2006, Mr Sanjeev Bhasin); Estimated growth of HNWI wealth (source: Mr Percy S Mistry taken from Cap Gemini and Merrill Lynch annual reports for 2005 and 2006); and HNWI population growth, 2005–2006 (source: Mr Sanjeev Bhasin). All tables presented at Symposium on the Export of Financial Services.
7. See table: Main players – fragmented market, presented by Mr Percy S Mistry at the Symposium on the Export of Financial Services.
8. Resident Indians are now permitted to invest US$200,000 annually per capita abroad in financial securities or real estate. That is equivalent to about US$1 million per family. There are estimated to be over three million families in India that can afford such an outflow representing a major market for PBWM services from Mauritius.
9. See also presentation by Mr Anthony Pedersen at the Symposium on the Export of Financial Services, especially diagrams: Distribution of insurance premiums and Share of insurance premiums.
10. See diagram presented by Dr Manoj Vaish at the Symposium on the Export of Financial Services, entitled: Risk Management Industry.
11. See also presentation by Mr Raymond Bordeaux at the Symposium on the Export of Financial Services, especially diagrams: The global M&A market; M&A transaction flow; Essential services matrix; 2007 Asia and Africa transaction value; PPPs: spectrum of options; Expertise required; and PPI projects in developing countries by region, 1990–2006.
12. See various World Bank and AfDB reports on infrastructure in Africa as reported in: the FT Special Report on African Infrastructure, 16 November 2006; World Bank Africa Action Plan (available: http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/0,,contentMDK:20641976~menuPK:258658~pagePK:146736~piPK:146830~theSitePK:258644,00.html [accessed 5 January 2009]); Infrastructure Consortium for Africa, Annual Report, 2006, etc.
13. See the 11th Five Year Plan prepared by the Planning Commission, Government of India, for the period 2007–2012.

14. See diagram: Observed PPP trends worldwide, 1990–2005, presented by Mr Percy S Mistry at the Symposium on the Export of Financial Services.
15. The World Bank PPI Project Database is accessible through www.worldbank.org [accessed 14 November 2008]
16. The Empowerment Programme was set up by the Government of Mauritius in late 2006. It aims to 'empower' young Mauritians, as well as employees displaced by structural change in industries such as textiles, to upgrade and change their skill sets through public grant support for specialised vocational training. The programme works with firms, trade unions and industry associations to adapt the skill sets of Mauritian labour with the changing needs of the Mauritian labour market. See: http://pmo.gov.mu/portal/site/Mainhomepage/menuitem [accessed 5 January 2008].