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"We have to think about how to grow the International Segment cake

Parik Tulsidas, Senior Executive – Treasury & Markets, AfrAsia Bank, says Mauritian banks, which for the most part, house significant amounts of foreign currency liquidity have to strike the right balance between deploying this liquidity into Africa or other emerging markets and their risk appetite

A recurring question but a topical issue in the local banking sector, how do you interpret the excess liquidity facing the industry?

Excess liquidity in the market has been prevalent for at least a decade now with the liquidity having slowly built up. It was indeed highlighted a number of times by international bodies that there was a clear disconnect between monetary policy and interest rates prevailing on the market.

This excess liquidity position has in turn contributed to interest rates decreasing over time in the local market. In fact, local interest rates and their trend is probably the best indicator as to how excess liquidity is evolving in the market.

In my view, the excess liquidity situation is a result of several combined factors such as tighter risk appetite from banks with reduced lending or reduced private sector expenditure. In fact, in recent years we have seen more and more corporates going for foreign currency funding due to the low interest rates environment internationally or funding projects via bond issuance, taking advantage of local interest rates having bottomed out.

Nevertheless, it has to be said that there has been significant efforts undertaken by the Central Bank over the years to normalize monetary policy through several mechanisms used to absorb the excess liquidity. Which is exactly why we have seen interest rates locally having gone up in the past year and they seem to have normalized at the current levels for the time being.

With IFRS 9 now being effective for reporting periods starting on or after 1st January 2018, what does this new impairment model imply for Banks in general?

Banking worldwide is a constantly changing business and more recently, the regulatory environment has evolved quite considerably. Having the best fit in terms of risk appetite, balancing risk and reward and sweating Capital usage are definitely the "talk of the town". Given the scarcity of Capital in the current environment, Return on Equity versus the Cost of Capital is increasingly being scrutinized by both analysts and shareholders.

IFRS9 brings about new challenges for all banks and we bankers will be forced to rethink the way we conduct our core activities.

In a nutshell IFRS9 replaces IAS39, and combines the principles of classification and measurement, impairment and hedge accounting phases of the International Accounting Standards Board (IASB). Importantly, it reciprocates to the various critiques that IAS39 is too complex, not consistent with the method entities manage their businesses and risks and defers the recognition of credit losses on loans and receivables.

Crucially for banks, in terms of provisioning the amendment pertains to the movement from an "Incurred Loss" model to a more forward-looking and prudent "Expected Credit Loss" (ECL) model. The ECL model will accelerate the recognition of losses by requiring provisions to cover for future expected losses.

The recognition of potential future losses will definitely impact the level of provisioning banks are going to take upfront and as a result our Capital Ratios. In all likelihood and what has already been witnessed around the world, banks will likely shore up their Capital Base to be able to absorb any IFRS9 impacts, and the Mauritian banking sector will be no different.

This paradigm shift will also bring about changes to how banks think about credit risk, hence probably would require a number of banks to rethink about their risk appetite. In fact, this is a process that has already started in a number of banks.

However, I would like to stress on the fact that Mauritius has a robust banking sector and IFRS9 certainly does not come as surprise to the industry. Extensive work has been carried out by banks over the past year or so, coupled with regular engagement with the Central Bank and other bodies to ensure IFRS9 readiness at all levels.

The local market being narrow, Mauritian banks have to look abroad to grow. We have witnessed that cross border investments often come with the potential of high returns but may also be risky. What are the main challenges of Segment B?

The reality of our banking sector is that business is heavily skewed towards Segment B instead of Segment A – in fact, the Segment B portion represents between 60-65% of the market. Segment B business in itself is for the most part driven by the offshore sector.

It is also fair to say that Mauritian banks have been extremely successful in catering for this segment and both have grown in tandem. A key benefit of running a significant Segment B business was the taxation benefit for banks on Segment B income. However, the recent Budget measure on taxation for banks will certainly change the banking landscape in terms of Segment A versus Segment B.

Indeed, there will be no differentiation between Segment A and Segment B in terms of taxation for banks and the abolition of this regime will be effective as from the year of assessment commencing 1st July 2020.

More so, with the imminent abolition of GBC 2 structures announced in the recent Budget speech, we are probably due to see a revamp in the offshore layout though the changes are yet to be assessed. Segment B therefore will be impacted as expected.

However, you hit the nail on the head when saying that the local market is narrow. I would argue that Segment B as it is right now is also narrow and highly competitive and the time is now right to look abroad for growth.

Africa could be the solution for banks to redefine their Segment B. Africa is at our doorstep and we need to be more relevant to our continent. Some banks are already accompanying large Mauritian corporates into Africa but this business is I would say "opportunistic" and doesn't boast volumes.

Mauritian banks, for the most part, house significant amounts of foreign currency liquidity so the key for banks is to strike the right balance between deploying this liquidity into Africa or other emerging markets and their risk appetite.

Banks also need to think about how to penetrate some of the African markets either via acquiring stakes in African banks or exploring key markets via the setup of Rep Offices. Some Mauritian banks have already embarked on this journey, although it is important for us to tread carefully.
In a nutshell, the real benefit for Mauritian banks in the long run is to think about how to grow the Segment B cake, or should I say, the International Segment cake.

What are the key trends observed in investors' appetites for Mauritius and Africa?

Having long been the tried and trusted investment route, I am of the opinion that Mauritius is now poised to be the financial gateway to the African continent, or should at least seriously position itself for same. And a large part of this success is the relatively speaking successful interplay between the government and private sector businesses.

There must be a continuous focus on developing this relationship further and be a model for countries in Africa as to how collaborative efforts between the public and private sector can generate thriving results, long-term growth and sustainability.

Mauritius must find new ways to attract FDI and deliver a viable platform for investment into the several markets within Africa. Part of the answer to this lies in developing niche offerings to international markets relevant to the region.

In Mauritius, we see refined investment taking place in infrastructure and property particularly the Smart City initiatives driven by both the government and private sector. The Smart Cities being developed across the island is aimed at boosting development and investments in the country, consolidating hence the Mauritian International Business and Financial Hub.

Internationally, we see continued investment into Africa and a good amount of activity in the Private Equity space across various sectors, especially infrastructure. One should not forget that with 200 million people aged between 15 and 24 (the youth bracket), Africa has the youngest population in the world. This will represent a huge opportunity in the future, hence why investment into Africa will be even more topical going forward.

Mauritius is now increasingly being used as the platform to facilitate these investments, so we are seeing numerous activities in this space. On the other hand, the commodity cycle seems to be turning and investment in mining and gas explorations is picking up particularly in countries like Mozambique.