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The regulation of Islamic banking in Mauritius

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Abstract

Purpose – The purpose of this paper is to analyse the main components of the regulatory framework for Islamic banking in Mauritius. This small island state of the Indian Ocean aspires to host Islamic banking products while diversifying the range of financial services offered within its hybrid jurisdiction despite having a minority Muslim population. The study also aims at drawing some comparisons with the well-established regulatory framework that applies to conventional banking.

Design/methodology/approach – In this qualitative analysis of the regulatory framework of Islamic banking in Mauritius, the doctrinal approach is adopted. This method relies principally on a scrutiny of the provisions of the law and delves into the primary and secondary sources of law guiding Islamic banking practices in the Mauritian jurisdiction.

Findings – The research study concludes that, with the view of encouraging investors into Islamic banking, policymakers took some regulatory initiatives but these remained timid. These initiatives relied too often on borrowing from the regulatory framework in place for conventional banking practices instead of regulating the area within its own precepts. Prospects for expanding Islamic banking exist but will require more audacious regulatory steps so as to secure the environment within which Islamic banking is to flourish. In the meantime, the industry is in a status quo position with no further legal action currently being envisaged to re-launch this area.

Originality/value – This research study is among the first generated specifically on the regulatory framework of Islamic banking in a small financial centre that operates mostly offshore financial activities. Previous research work either focused on the empirical analysis or on reviewing the challenges and the prospects but no study has provided an in-depth analysis of the regulatory provisions circumscribing Islamic banking. This lacuna is being filled up by this research paper which highlights the regulatory needs of Islamic banking and comments on the inclusion of and the need for specific rules related to Islamic finance instead of relying on the overlap with conventional banking laws.

Keywords Corporate governance, Regulatory framework, Islamic finance, Islamic banking, Compliance and standards, Transparency, Mauritian offshore financial centre, Banking regulations

Paper type Research paper

Introduction

Islamic finance has been churning into a non-negligible component of the global financial panorama and offers a significant platform to be exploited, especially for small financial centres, which experience an utmost need for diversification so as to offer a panoply of products to prospective customers. This multi-billion-dollar industry gets more relevant for

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small financial centres, which share proximity with countries having Muslim communities as it entails a guaranteed demand for Islamic finance products. Having contemplated the prospects that Islamic finance represents, the Mauritian International Financial Centre introduced legal provisions to cater for Islamic finance, with a special focus on Islamic banking, in 2007. Being one of the few countries in Africa operating in the area of Islamic finance, Mauritius serves as an illustration since it bears some pertinent characteristics that make it interesting and idiosyncratic to study, namely, it has a hybrid system of law; it operates as an international financial centre with a focus on offshore activities, and it introduced Islamic finance despite being a secular country having only a minority Muslim community.

With these reflections, it remains appealing to probe into the reasons that initiated the launch of Islamic banking in the Mauritian jurisdiction and most importantly, to explore how the domestic regulation caters for Islamic banking products. The existing limited literature provides background information on the introduction and evolution of Islamic products in Mauritius, but none probes into the legal framework that surrounds those products. This study, therefore, aims at pioneering in this area by analysing the key legal principles such as corporate governance, transparency and disclosure that are adhered to in the domestic laws of this small financial centre to regulate Islamic banking.

From a definitional approach, Islamic banking and finance, as launched in the 1970s in countries such as Egypt and Malaysia, refers to an economic system that operates within parameters and principles set out by the Sharīʿah (Islamic law) (Alexakis and Tsikouras, 2009; Hassan and Aliyu, 2018). Gelbard *et al.* (2014) reiterate that it outlaws the payment or acceptance of *ribā* (interest), as well as contracts involving excessive risks and speculative behaviours and it prohibits trade and other such activities, such as gambling and transactions related to pornography, alcohol and tobacco, that are contrary to its principles. It keeps at its core, therefore, the distinction between right and wrong and ensures that investments and earnings are all *ḥalāl* (permissible). As interest is not involved, banks earn profits and fees on the financing facilities extended to customers and the field remains mostly asset-based (Alexakis and Tsikouras, 2009).

At its beginning, Islamic banking and finance remained a financial system, which was typically serving the financial needs of the Muslim population in the Middle East and Southeast Asia with high concentration in Malaysia and the Gulf Cooperation Council countries. However, for the past decades, Islamic finance has witnessed an era of internationalisation and is gaining popularity in non-Islamic countries such as the UK, Australia and in African countries. Several institutions and jurisdictions are increasingly participating in Islamic financial markets and Sharīʿah-compliant cross-border flows of money are increasing, hence making the area interesting for research.

This research paper, using a doctrinal approach, aims at expounding on the various legislative provisions that apply to Islamic banking in Mauritius so as to determine whether the Mauritian financial centre is properly equipped with the relevant regulatory tools to handle this area of financial activities. The study further explores the cohabitation and overlap that occurs with conventional banking regulations.

The study starts by briefly reviewing the evolution and importance of Islamic financial products for a small financial centre of a non-Islamic state. Then, it provides an analysis of the legal framework available for hosting and sustaining Islamic banking products, with emphasis on principles of good governance, transparency and disclosure. Eventually, the challenges and prospects of Islamic banking in this particular regulatory context are considered. Additionally, the need to harmonise with international practices and standards is assessed as competition is lurking from the emerging African financial centres, without forgetting the Southeast Asian competitors such as Malaysia, which are already occupying a large share of the market.

Analysing the specificities of the Mauritian financial and regulatory context

The genesis of the Mauritian financial centre

Mauritius is a small island country of the Indian Ocean with a total population of some 1.2 million people and strong democratic values. For the past decades, it has been a rising star as an international financial centre, performing very well and proving itself as one of the leading economic success stories in Africa. Gifted with few natural resources, Mauritius has, during its little more than fifty years of independent existence, exploited different sectors for its survival and has geared mostly towards an outward-looking strategy to achieve success. Starting the early post-independence years as a mono-crop agricultural economy, the policymakers quickly understood the need to diversify the economy. This was realised by the introduction, firstly, in the 1980s, of the manufacturing component with the setting up of textile factories and export processing zones and secondly, in the 1990s, by the exploitation of the tertiary sector through labour-intensive industries such as tourism, information and communication technologies and financial services. All these sectors have highlighted the country's human capital capacity (Subramanian and Roy, 2001). The information and communication technology and financial services sectors brought a real impetus to Mauritius, especially when the island deeply needed to review its economic strategies. It was at that time experiencing the erosion of the various preferential access agreements it had previously negotiated with the European and American markets to its benefit. The success of Mauritius as a financial hub is undeniable, especially in the Indian Ocean and African regions. The island state is perceived as one of the most developed and one with the highest adult literacy rate of the Southern African region, both contributing to the economic success of the island.

In its early days, the financial sector initially rested on the banking sector, but later on it managed a diversification to the insurance and other non-banking financial sectors in the 1980s. This shift to other non-bank financial activities proved to be very beneficial to the financial sector and to the economy generally. Successful in developing a robust and diversified financial system, the policymakers aspired to maintain the competitive edge that Mauritius had acquired in other sectors that had been exploited on the island. To this end, the government ventured into the exploitation of offshore businesses and churned the early 1990s economy into an offshore banking and financial services centre, which was highly dependent on the global business sector ensuring offshore financial activities in a regulated and monitored framework. This orientation of the financial sector led to Mauritius qualifying as an international financial centre with several regulatory and policy efforts being implemented, as well as a broad treaty network of double taxation avoidance being developed to achieve excellence in the field.

The financial regulatory framework of Mauritius

The regulatory efforts were always a challenging aspect in Mauritius since the island has inherited legal features of its colonial history encompassing both English and French occupation. It, thus, has a hybrid legal system comprising components of the common law and civil law systems (Venchard, 1982; Domaingue, 2002; Gunputh, 2005). Areas such as family law, property, contract and tort law, commercial law and criminal law are mostly regulated by French-based laws contained in the Mauritian Civil Code, Commercial Code and Penal Code, respectively. Areas such as company law, evidence, constitutional and administrative law are based more on common law. The Constitution of Mauritius stands as the supreme law of the country and is complemented by primary legislation contained in Acts of Parliament and subsidiary legislation in the form of regulations or guidelines enacted by statutory bodies. Following the same hybrid trend, the financial sector is regulated by a multitude of laws, which are sometimes based on French law and sometimes on common law. A more recent trend is harmonisation with international standards, resulting from collaboration with international standard-setting organisations. One of the areas where this study aims to contribute is in understanding the legal coverage provided to Islamic finance in such a hybrid and evolving system.

To regulate and supervise financial services in Mauritius, a variant of the unified approach that suits small financial centres so well has been adopted (Group of Thirty, 2008). Prior to 2001, several specialist agencies monitored the different sectors of operations of the financial sector. Pursuant to the recommendations of the Steering Committee which studied avenues for a new regulatory framework for financial services in Mauritius in 2001, two poles of regulation and supervision were set up, namely the Bank of Mauritius (BoM) and the Financial Services Commission (FSC). Regulating the banking sector while also operating as the central bank of the island, the BoM was set up in 1966 while the FSC (Mauritius), which is the integrated regulatory authority for non-banking financial services, was created in 2001. The BoM is responsible for licensing, monitoring, supervising and even investigating banking institutions, as well as non-banking deposit-taking institutions. The FSC is mandated to license, monitor, supervise and investigate non-banking services including insurance, the securities market, pension funds and global business entities.

The inclusion of Islamic finance in Mauritius

The relevance of Islamic finance. In the midst of the evolution of the financial sector in Mauritius, one area that started to be exploited in view of strengthening the financial sector and diversifying the range of products available within the financial ecosystem was Islamic finance. The Mauritian policymakers assessed the opportunities available to develop Islamic financial products, either by exploiting and strengthening the commercial and diplomatic linkages with countries of the Middle East or by entering into African markets where Islamic products were being demanded. During the past years, a consolidation of the diplomatic relationship with Saudi Arabia led to the latter injecting money in infrastructural developments in Mauritius; such circumstances provide a win–win situation since Islamic finance strongly encourages real asset financing. Furthermore, the trade linkages with the Common Market for Eastern and Southern Africa and the Southern African Development Community countries were to be fully exploited so as to build the bridge with African – particularly sub-Saharan African – countries where the demand for Islamic finance exists.

From another perspective, the local Muslim community could have the opportunity of investing and using Islamic products, if they so wish. However, Abduh and Ramjaun (2015) pointed out that in such a multicultural and multi-religious state, the drivers for choosing Islamic banking are not the same as a typical Islamic state. Lallmahamood (2014) reflected that the Muslim minority, comprising 17% of the population, comes principally from India and have a less traditional and less conservative belief that has led them, since their arrival in the 19th century, to easily adapt to conventional banking practices. Mauritian society is well-known for the coexistence of different communities, ethnic groups and cultures in peace and harmony. All of these originated elsewhere, the islands having been uninhabited when Europeans first arrived there. In fact, a certain osmosis has occurred within the local community. Most of the locals consider themselves as Mauritians with conventional and atheist practices rather than conservative and religious practices. Consequently, Islamic banking and finance has not gained much popularity within the local Muslim community.

Other reasons, apart from the religious determinant, exist for the local population to patronize Islamic banking. Abduh and Ramjaun (2015) pointed out that an awareness needs to be created amongst locals that one does not need to be a Muslim to use and derive benefit from Islamic banking. Still, the authors demonstrated that Muslims have a higher tendency to adhere to Islamic finance as compared to non-Muslims. Furthermore, Ramdhony (2013) noted that even amongst the Muslim community there were some uncertainties and lack of knowledge on the precepts of Islamic finance. Opting for Islamic banking was eventually not really a question of religious beliefs but more a question of high returns. Bank customers remain mostly profit-driven and concerned about good standards of customer service (Lallmahamood, 2014; Abduh *et al.*, 2018). Thus, if proper information about the sound ethical principles contained in Islamic banking practices is disseminated to the public, even people of non-Muslim faith may find Islamic finance appealing.

The evolution of Islamic finance in Mauritius

The origin of Islamic finance in Mauritius can be traced back to 1998 when a cooperative entity, the "Al Barakah Multipurpose Cooperative Society Limited" was crafted as an Islamic cooperative credit union offering personalised *murābaḥah* (cost plus mark-up) schemes, hajj saving accounts and *istiṣnāʿ* (construction) financing. The entity was mostly involved in micro-financing transactions and operated under the Cooperatives Act 2005 (Gelbard *et al.*, 2014). In 1999, there was another initiative taken by the professionals and businessmen of Muslim faith to start an open-ended fund known as the "Authorized Long Term Ethical Equity Fund Ltd."

In June 2006, the government instituted a panel to probe into the options and prospects of launching Islamic financial products in Mauritius; one of the major recommendations of the Committee was to make amendments to the existing legal framework. More formally, the acceptance of Islamic finance came through the introduction of Islamic banking in a highly profitable banking environment in 2007. The Banking Act 2004 was amended to officially permit Islamic banking ventures and to remove restrictions existing on the purchase and sale of immovable property and other investments. As the policymakers realised that Islamic finance products tend to attract more tax than conventional banking products, amendments were brought to the existing legislations. The Registration Duty Act 1804 and the Stamp Duty Act 1990 were also amended so as to abolish the levy of multiple taxes on Islamic methods of financing land and property. The Income Tax Act 1995 was reviewed so as to link interest with effective return of Islamic financing arrangement and the Finance Act 2008 aligned the taxation laws applicable to conventional banking practices with Islamic banking practices. All these changes, therefore, waived the payment of double stamp duties and allowed smooth global investments, Sharīʿah-compliant funds and financial transactions (Joharris, 2012). In 2010, the Mauritius Revenue Authority also issued a Statement of Standard Practice (SP5/10) for aligning fiscal measures applied to *murābaḥah* transactions, which tended to attract the payment of value added tax (VAT). The Mauritius Revenue Authority clarified through this Statement that *murābaḥah* transactions should not be subject to VAT and the profit generated by the transactions should only be considered as finance charges.

The BoM provided more efforts to position the island as a Sharīʿah-compliant hub when it enacted a guideline dedicated solely to Islamic financial institutions in 2008 so as to supplement the existing regulatory framework. The "Guideline for Institutions Conducting Islamic Banking Business"' (thereafter referred to as "the Guideline") was reviewed in July 2018 and it is the principal piece of legislation incorporating regulatory provisions on Islamic banking in Mauritius. An ex-Governor of the central bank affirmed that Mauritius should seize the opportunities offered by its pluralism and develop a niche market in Islamic banking and endeavour to become a regional hub for Islamic finance (Bheenick, 2011).

Despite these regulatory commitments taken, the growth of Islamic finance remained sporadic and never really took off, with only two licensed banking institutions having as then accepted to launch Islamic services (Lallmahamood, 2014). In 2009, one of the licensed banks, HSBC Bank Mauritius launched Islamic banking products, thereby becoming the first conventional bank offering such services. However, those services were offered through a window service of the bank, with no full-fledged department dedicated for Islamic products, and these services were ceased in 2012. In another development in 2009, the licensing authority, BoM, approved the licence of the Century Banking Corporation, which became the island's first full-fledged Islamic bank and which is still operational as to date. Additionally, Indian companies have used the Mauritian platform to launch Sharīʿah equity funds for investment in equity-listed Indian companies that adhere to Sharīʿah principles. In 2008, the British American Investment Company Limited launched its *takāful* (Islamic insurance) services through an Islamic life insurance policy. During the years of operation of its Islamic window, HSBC launched "Amanah" Islamic insurance.

Recently, in April 2019, one of the most important banks of the island, the State Bank of Mauritius, having branches in Madagascar and Kenya, launched two Sharīʿah-compliant funds, namely, "the Islamic ASEAN Equity Fund" and "the Global Sukuk Fund" (State Bank of Mauritius, 2019). The Equity Fund offers investors options of capital growth over the medium to long term through Sharīʿah-compliant investments in the ASEAN (Association of Southeast Asian Nations) region while the Sukuk Fund tries to expand total revenue over the medium to long term by investing mainly in a diversified range of Sharīʿah-compliant fixed-income securities. The launching of these Islamic products confirms the bank's strategy to offer a more diversified variety of financial products to regional markets.

Islamic insurance is deemed to be regulated under the existing insurance laws contained in the Insurance Act 2005 and under Sections 1983-1 to Section 1983-52 of the Civil Code, as well as under the Captive Insurance Act 2015. The regulatory requirements applicable to the conventional insurance entities are, therefore, exported to *takāful* and *retakāful* (reinsurance) operations. Similarly, where the issuance of *ṣukūk* is concerned, it is expected that the provisions of the Securities Act 2005 (which fall under the jurisdiction of the FSC) will apply to Islamic investment products. However, instead, the Public Debt Management Act 2008 (which is under the BoM) was amended so that its Section 3(a) read: "The Minister may enter into such agreement, sell, purchase or otherwise acquire any immovable property or any right therein, lease movable or immovable property and generally engage in such transactions and perform such activities as may be reasonably necessary for the purpose of issuing Sovereign Sukuks in Mauritius". This amendment of the Public Debt Management Act restricted *ṣukūk* to represent only investment products issued by the central bank, while investment products of these types generally fall under the supervision of the FSC and not the BoM. Thus, while some initiatives cropped up to include Islamic investment in the Mauritian jurisdiction, similar to the rest, they remain either unknown or rarely used. Thus, as mentioned earlier, despite constant measures emerging since 2004 to introduce and encourage Islamic banking practices in the Mauritian regulation, it is observed that, in 2020, the development of Islamic banking has been hesitant with only a few timorous initiatives to launch Sharīʿah-compliant products that did not meet with much popularity on the market.

Furthermore, authors such as Uteem (2009), Lallmahamood (2014) and Rassool (2018) make mention of the setting up of quite a number of Sharīʿah-compliant global funds and the use of special purpose vehicles for hosting Islamic financial products. Nonetheless, no reliable statistics are available on this issue. Within the existing legislative framework, trusts set up under the Mauritian Trusts Act 2001 and following the English common law trust model can be used as a special purpose vehicle to host the issuance of *ṣukūk*. As explained by Uteem (2009), these legal entities not only offer the advantage of being Sharīʿah compliant; but also offer a bunch of other fiscal advantages that make them attractive to foreign investors. In this context, our focus remains on analysing only the legal framework for Islamic banking.

Analysis of the legal framework for Islamic banking

Since the early days of Islamic finance, it is understood that Islamic banking products were mostly favoured rather than Islamic insurance (*takāful*) and investment products (issuance of *ṣukūk*) but the trend is showing signs of change. Under the FSC, no regulation or guideline exists specifically for Islamic non-banking financial products. As mentioned above, it is only under the aegis of the BoM that "The Guideline" was mounted, and the provisions of the latter remain the focus of this article and will be further explored. The Guideline aimed at implementing a simple and standard regulatory framework, which would allow the expansion of Islamic banking and its integration with the conventional banking system in a seamless manner (Rassool, 2018).

The Guideline completes the existing strong regulatory structure applicable to financial institutions, which Islamic banking institutions (IBIs) are required to follow. For example, in connection with risk-weighted assets, Section 7 of the Guideline states that IBIs are guided by the "Guidance Notes on Risk Weighted Capital Adequacy Ratio" of the BoM. Thus, it is understood that no specific primary legislation was nor would be enacted to cater solely for Islamic banking. The regulatory framework for Islamic banking would evolve in a system, running parallel to conventional banking, where the common rules contained in the latter will apply to Islamic finance as long as they are compatible. Mauritius being a non-Islamic secular state where conventional banking has been adhered to for centuries, it would obviously have no rationale to implement solely Islamic banking laws. At the same time, however, it would need to ensure that a level playing field is initiated for traditional and Islamic banking practices. As such, it compares with other jurisdictions such as the UK, Singapore, Nigeria and South Africa where Islamic banking co-exists in an ecosystem of conventional banking.

Definition of Islamic banking in Mauritian law

The Banking Act 2004 was amended in 2007 to remove the regulatory hurdles that could hinder the smooth operation of Islamic banking businesses. Section 2 of the Banking Act acknowledges that a "bank" is a "company incorporated under the Companies Act or a branch of a company incorporated abroad, which is authorised by the central bank to carry on any or all of the following banking business: Islamic banking business and private banking business". It goes on to define "Islamic banking business" as "any financial business, the aims and operations of which are, in addition to the conventional good governance and risk management rules, in consonance with the ethos and value system of Islam". This generic definition is inspired from the definition of the English and Malaysian jurisdictions. Furthermore, it is clearly enunciated that the determined Islamic banking products will adhere to the existing common rules applied to governance, as well as risk management issues. Thus, no special privilege is given to Islamic banking practices, which will have to fit in the existing regulatory framework.

The licensing requirement

Apart from Section 2, Section 3(5) of the Banking Act draws some attention as it makes mention that the provisions of the latter will mandatorily apply to all banks licensed to carry out Islamic banking business. In these circumstances, the offering of Islamic banking again resembles that of other non-Islamic states where it is on offer, that is, through IBIs, which are defined in Section 1 and 2 of the "Guideline for Institutions Conducting Islamic Banking Business". These can take two forms. The first comprises existing licensed and well-established banks proposing Islamic banking through window operations whereby Islamic banking operates in parallel with conventional banking transactions. The second comprises institutions which may be accorded a licence to embark solely on Islamic banking business and no other activity. The key issue here is linked to the licence: whether the institution operates within a window or as a full-fledged body, and whether it is a local entity or foreign operator, it needs to seek prior authorisation from the BoM to operate on Mauritian territory. Otherwise, as per Section 97(1) of the Bank of Mauritius Act 2004, operating without the approval and licence of the BoM constitutes an offence that carries a penalty of a fine of not more than one million rupees and an imprisonment term of a maximum of five years. Thus, as a prudential measure, appropriate licensing requirements are essential for both conventional and Islamic banking institutions (Song and Oosthuizen, 2014).

Compliance with international standards

Besides the prevailing local laws, international standards have a notable influence on the progress of the local regulatory regime. In 2007, the BoM joined the Islamic Financial Services Board (IFSB) as an associate member and soon upgraded to become a full member, while the FSC opted for observer membership. After Singapore, Mauritius was the second non-Islamic country to join the IFSB. The existing framework is largely founded on the global prudential specifications promoted by the IFSB, which encourages and boosts the reliability and constancy of the Islamic financial services industry (Alexakis and Tsikouras, 2009). Adherence to international norms, practices and standards is fundamental if, at another stage, the authorities request disclosure and transparency as these international precepts mostly encourage transparent practices and stipulate the disclosure mechanisms to adopt.

It is worth mentioning here that when the IFSB coordinated the establishment of the International Islamic Liquidity Management Corporation in 2010, the BoM became one of the founder members, joining the latter in 2011. Locally, the BoM took initiatives to introduce an Islamic interbank money market to facilitate interbank dealings and liquidity management for IBIs.

Regarding the accounting standards and financial reporting requirements of IBIs, they are required to adhere to the set of rules published by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), which favours transparency, good governance and disclosure practices. Those standard-setters elaborate, appraise and adopt international standards after thorough reviews based on Sharīʿah law, and it remains fundamental to maintain membership so as to allow for harmonisation of domestic laws with international standards and recommendations.

An example of adherence to international standards is linked to the definition of zakat. Defined in the Guideline, zakat is founded on AAOIFI's lexis and stands for "a fixed annual obligation that is calculated by reference to net assets, together with cash holdings of the obligor". Furthermore, as per Section 31, the prudential requirements of the Guideline shall principally endorse the "Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision (BCBS)", and improve the international principles set by BCBS by accommodating the particularities of Islamic finance. Song and Oosthuizen (2014) mention that adherence to the "Capital-Assets-Management-Earnings-Liquidity-and Sensitivity (CAMELS)" rating framework can also be appropriate to the Islamic banking environment.

Compliance with Sharīʿah principles

Obviously, Islamic finance is made to happen in an environment where Islamic rules and principles are observed and the Mauritian context is no exception. AAOIFI recognises that a Sharīʿah advisory board (SAB) needs to be formed which shall be the main internal body entrusted with the responsibility of verifying and requesting for compliance with Sharīʿah principles. As per the Mauritian Guideline, IBIs shall conduct business, which is compliant with the ethos and philosophy of Islam. To monitor that the institution is Sharīʿah compliant and to complement its good governance practices, the institution itself will either establish an SAB comprising at least three members or appoint a Sharīʿah advisor.

Provision is made at Section 13 of the Guideline for introducing a common SAB as a provisional measure where IBIs may, with the authorisation of the BoM, institute a common SAB. However, some conditions must be satisfied, namely, the common SAB shall be started at the request of the IBIs that do not wish to have their own SAB or Sharīʿah advisor; the common SAB shall provide advice in Sharīʿah matters solely to the IBIs that do not have their own SAB or Sharīʿah advisor. While guaranteeing that every member of the common SAB conforms to a duty of confidentiality, sufficient measures shall be implemented to evaluate and handle any conflict of interest that may crop up from the measures taken to facilitate recourse to a common SAB. Nevertheless, the BoM can, at some point, re-examine the feasibility of maintaining such provisional measures, especially if a serious potential exists for future developments that could entail the visible expansion of Islamic banking in Mauritius. Till now, however, the Mauritius Bankers Association has never formally set up the common Sharīʿah board (Lallmahamood, 2014).

The Guideline, at Section 14, further explains the benchmarks for the selection of a member of the SAB or the Sharīʿah advisor, who can be a local or foreign intellectual. The chosen individual shall be of the highest integrity and ethical reliability and should have recognized experience or knowledge in the delivery of Sharīʿah decisions and issuing of scholarly opinions on matters of Islamic law. When a single Sharīʿah advisor is selected, the eligibility criteria, with regards to both qualification and competence, will be assessed through higher benchmarks. As per Section 15 of the Guideline, the aptitude of the selected Sharīʿah advisor will be evaluated through either his solid background of academic contributions to Sharīʿah research or his experience in Sharīʿah advisory practices which should extend to at least ten years. The BoM needs to validate the selection of the members of the SAB or the Sharīʿah advisor. In addition to the criteria specifically mentioned above, the members of the board or the advisor need to satisfy the Fit and Proper Test required at Part 3.2 of the "Guideline on Fit and Proper Person Criteria" of the BoM. Coupled with Section 46 of the Banking Act 2004, this test entails consideration of the person's diligence, business experience, probity, competence and integrity of the applicant. In addition, their previous conduct and activities in business must be reviewed, and they must have no previous conviction for any offence involving fraud or other dishonesty.

Additionally, the BoM can only validate and go by an already founded SAB or advisor if the latter has been ratified by another regulator abroad. The functions of the SAB or Sharīʿah advisor are expounded in the Guideline. Firstly, the advisor or the SAB will verify that the financial products offered by the IBI conform with Sharīʿah ethics and standards, and secondly, they will examine the internal practices before the promotion and endorsement of any new Islamic products launched by the IBI. The SAB or Sharīʿah advisor shall record the grounds for authentication of any financial product, and the internal control and audit of the institution, as well as the BoM, should be granted access to the relevant documents for supervisory appraisals.

For counselling purposes, the BoM will also appoint an honorary Sharīʿah advisor who will advise on broad regulatory issues and their compliance with Sharīʿah rulings and compliance. Yet, it is pointed out that at no point does the BoM embark on any *ex ante* analysis of the Islamic products marketed by the IBI to confirm the Sharīʿah compliance of these products. The regulator will presume that the products being introduced are Sharīʿah compliant and will only license the operators and not the products.

Thus, it is observed that the regulatory body, namely, the BoM, shifted the onus of monitoring and compliance to Islamic rules to the service providers themselves as if they are operating in a self-regulatory model. This has its advantages, as well as its risks. Further, the Islamic finance ecosystem will be called upon to mingle and co-exist with the conventional banking ecosystem. In this context, the Sharīʿah advisors should not only have in-depth knowledge of Sharīʿah rules but should also be familiar with conventional financial products and principles.

Governance of Islamic banking institutions

Corporate governance plays a crucial role in the administration of financial institutions. Srairi (2015) affirmed that adherence of Islamic banks to better compliance and governance structures will increase stakeholders' confidence, as well as prevent failures and instability. The Guideline provides some succinct remarks on the general governance approach to be adopted by IBIs. The IBI will institute a governance policy structure that will apply to its business administration and that will maximise value and benefit to all participants. Section 8 of the Guideline stipulates that the Islamic techniques of corporate governance embrace notions of transparency, accountability and fairness, which line up closely with international norms of good governance. The IBI is, thus, expected to implement a system of best practices that endorse these ethical ideals by applying a stable and reasonable stance for the benefit of its various stakeholders. Section 9 of the Guideline provides that the principal objective of the governance framework is to safeguard close observance of the guidelines and principles as favoured in the Sharīʿah. Observance of the Sharīʿah remains crucial in sustaining the reliability and authority of an IBI. As a result, the IBI is responsible for the introduction of a suitable system for the application and supervision of Sharīʿah compliance in all its business operations.

According to Section 10 of the Guideline, all IBIs should launch an operational framework with a board of directors. This board will set up and approve an operational and management mechanism by visibly describing policies of responsibility, as well as accountability. It will espouse an internal control system that observes the corporate aim of providing services that support the ethical ideals of Islamic finance. It will, moreover, examine the suitability of the established structure for accommodating market variations and regulatory requirements and recommend any necessary changes. It will also guarantee that the operational structure adopted is validated in a policy and procedures manual, which is disseminated at every operational level. It remains fundamental, therefore, for IBIs to follow these governance requirements as banks, in general, operate in a more opaque environment as compared to other financial institutions and they face a more stringent regulatory framework. In some cases, their government ownership makes them even more peculiar (Srairi, 2015).

Prudential issues

Transparency. Transparency in Islamic finance remains of fundamental relevance, particularly within the Islamic concept of risk-sharing, and is deemed to be a fundamental concept of Sharīʿah, which contains a decree prohibiting the concealment of evidence.

Information is expected to be shared as information asymmetry can lead to an absence of transparency, and this may allow a discriminating benefit in a transaction. Accordingly, an IBI needs to adopt meaningful, timely and accurate disclosure measures for the investment accounts held in its portfolio while duly upholding the quintessential protection of property and confidential information. Consequently, the IBI needs to apply disclosure guidelines that urge market participants to evaluate relevant and significant information that lets them scrutinise the functioning of their investments. It is believed that the disclosure of substantial information brings market rigour and discipline in terms of timely price modifications and offers incentives to the IBI to deter unwarranted risk-taking when carrying out its activities. The IBI is, thus, constantly encouraged to adhere to transparent financial and non-financial reporting standards that sustain the safety and stability of the Islamic financial system.

Back in the early 2000s, surveys undertaken by the IFSB revealed a lack of transparency and disclosure from Islamic finance institutions (Alexakis and Tsikouras, 2009). The more recent literature demonstrates that transparency practices strengthen consumer and investor confidence, and there is a direct correlation between an increase in transparency practices and adherence to corporate governance practices by Islamic institutions and the stability of those institutions (Sekreter, 2013; Lahrech *et al.*, 2014; Srairi, 2019). This allows for a more precise and significant risk management strategy. Lahrech *et al.* (2014) investigated the effect of transparency practices on the performance of banking institutions so as to review the transparency of Islamic banks with regard to profit-and-loss sharing with investment account holders. The author also appraised the impacts of Islamic banks' performance on management motivation to allocate profit and loss to investment account clients. The research demonstrated that encouraging compliance with transparency standards will preclude IBIs from blurring their profit distribution mechanisms and provide investment account holders with more appropriate opportunities in the administration of their invested capital.

Adhering to the recommendation contained in Pillar 3 of Basel II, as well as Part 1 of Basel III, whereby greater disclosure is encouraged so as to strengthen market discipline and promote good governance, the legal framework fully fosters the application of disclosure measures. An IBI needs to set up an operational disclosure process that ratifies and strengthens international benchmarks on the transparency of financial reporting by tackling features specific to Islamic finance.

Generally, Mauritius is known to conform with best practices in terms of good governance, transparency and ethics. Several enactments such as the Financial Reporting Act 2004, the Good Governance and Financial Integrity Act 2015, and the Code of Corporate Governance 2016 have been promulgated so as to inculcate good governance practices in local practices. Furthermore, provisions related to Islamic practices are specified in the Guideline, which provides for some further supervisory and prudential requirements including the disclosure of information, record keeping and transparency practices.

Section 20 of the Guideline requires the IBI to generate financial statements and formulate appropriate disclosure that mirrors quarterly and annual financial statements, which are to be drafted according to the BoM's "Guideline on Public Disclosure of Information". An IBI needs to establish an official disclosure strategy consistent with the aforementioned guideline, and the content, as well as the transparency measures observed in the financial reporting, shall be accordingly ascertained. The IBI can, additionally, examine the measures issued by AAOIFI and may assume those standards if their adoption does not lead to the IBI being in breach of the provisions of the Banking Act or any guideline issued thereunder. Adequate compliance disclosures should also be included in the additional notes to the financial report. The financial statements of the IBI should comprise precise and significant figures and data with a correct range of disaggregation, judicious forecasting and estimates in the Management Discussion and Analysis (MDA). These enhance the concept of "materiality" used to provide an exact and rational interpretation of the financial state of affairs of the IBI. As mentioned in Section 21 of the Guideline, the standardised layout as prescribed in the "Guideline on Public Disclosure of Information" warrants consistency in the declaration of information and simplifies the comparison of the performance of corporate organisations. The financial statements, therefore, reveal the distinctive events related to Islamic finance as classified by the recognised accounting doctrines, as well as the operational characteristics of IBIs, which will be revealed in the Notes to the Accounts of the financial statements.

Disclosure requirements

The Guideline, from Sections 23 to 26, imposes a set of disclosure requirements on IBIs to ensure closer monitoring of the institutions. An IBI is required to give an overall description of the method used for validating that its financial systems and mechanisms are all Sharīʿah-compliant. As a corporate enterprise, the institution shall reveal its commitment for the settlement of zakat. Furthermore, it has to unveil the zakat duties that it has to respect when enacting the authorisation provided by the shareholders or depositors. For a conventional IBI functioning with an Islamic component, zakat is fixed on the basis of the net assets held by this compartment only. The explanatory notes to the financial reports shall comprise the disclosures designed at supplying periodic materials that boost accountability and transparency in the administration of the investment accounts held in the institution's portfolio. Section 25 of the Guideline instructs that the IBI needs to provide a report on the following:

> [. . .] an evaluation of the operation of each main business segment, together with comparative data on financial results of the previous two years; a summary of the approach used for computing the distributable profit and the rates of return on deposits; any amount appropriated out of gross income in respect of Profit Equalisation Reserve (PER) or any mechanism used for alleviating fluctuations in rates of return that come from alterations recorded in income, provisioning and total deposit placements; reserves set aside as Investment Risk Reserve (IRR) as an allowance to sustain highly probable but unexpected losses that may happen (Bank of Mauritius, 2018, p. 5).

In situations of window operations by an IBI, definite instructions would be employed; namely, the IBI will have distinct books and records for all dealings undertaken through the window. With regard to the sources and uses of funds, the IBI necessitates a coordination of strong firewalls so as to substantiate that there is no risk of commingling of Islamic banking business with conventional business activities. The two portfolios need to be clearly segregated so as to uphold the trust of the customers, who would need a guarantee that the financial involvements of the window operations are Sharīʿah-compliant. Additionally, the board of directors need to verify that the deliberations on their risk management policies integrate the particularities of Islamic banking business and are properly displayed in the financial overview included in the management discussion analysis. All these measures help to safeguard confidence in and stability of the Islamic financial system.

Audit function and compliance

An IBI, as per Section 28 of the Guideline, must put into operation an internal audit mechanism involving an autonomous evaluation of the control techniques tackling the specific needs of Islamic finance. Thus, the IBI shall verify that the terms of reference of the internal audit encompass an assessment of the level of Sharīʿah compliance, and this is to be carried out in close association with the SAB or Sharīʿah advisors or reviewers designated by the IBI. The internal audit shall consist of experts with the relevant aptitudes that will allow them to steer Sharīʿah-compliance reviews.

In IBIs operating Islamic windows, the nature and scope of the internal audit include an analysis of the usefulness of the established firewalls and the maintenance of separated accounting records relating to the undertakings of the entity. When an operational shortage is identified, the Audit Committee needs to be informed about the shortage and the board of directors becomes responsible for overseeing that prompt remedial action is applied.

As per Section 30, the IBI selects its external auditors according to the guidelines of the BoM. During the appraisal of the accounting procedures applied by the IBI, the Internal Audit Committee will collaborate closely with the external auditors, whose overall audit functions need to be explicitly established. In conformity with the internationally recognised accounting standards relevant to Islamic financial services, the inspection of the external auditors shall incorporate the reviews of products to assess their compliance to Islamic norms even in an *ex post* situation. The Audit Committee contributes significantly in ensuring that relevant, adequate and credible information is relayed to the stakeholders in a timely manner (Srairi, 2015).

Risk management processes

An IBI normally adopts a cohesive and holistic methodology in managing the risks specific to the Islamic financial products offered. In accordance with the Sharīʿah principle prohibiting the taking of profits generated without assuming any risk, an IBI will put in place a comprehensive risk management policy. Consequently, the IBI will be required to identify and assume risk mitigation strategies suitable for each category of Islamic financial products present in its portfolio. The whole burden of implementing a comprehensive investment policy congruent with its business objectives, while duly contemplating the risk profile of its products and the interests of its customers, is placed on the IBI.

A sound and inclusive approach to the investment strategy needs to be adopted. It will involve the following, according to the regulation:

> [. . .] reviews of the viability of the projects and appropriate due diligence of investment partners, implementation of reliable valuation procedures applicable for Islamic financial instruments, observation of the alteration of risks intrinsic to each phase of investment maturations, the establishment of an effective management information system for reporting and monitoring of risk exposures, recurrent assessment of market risk exposures occurring from price variations of tradable assets owned and application of risk mitigation mechanisms that are allowed under the Shari'ah and that will decrease the effect of any capital deficiency on investment plans (Bank of Mauritius, 2018, p. 7).

IBIs will elaborate Sharīʿah-compliant measures of risk mitigation. Such mechanisms may comprise collaterals that are subject to regular estimation, insurance protection for the value of the assets and reimbursement of claims from a lessee subsequent to a shortfall that emerges because of the latter's negligence or breach of contract. A relevant strategy needs to be developed that will decipher allowances for doubtful debts, including counterparty exposures, and that will estimate losses in value of leased assets. As per the "Guideline on Credit Impairment Measurement and Income Recognition", the IBI will cater for losses relevant to each type of financial product and service withheld in its portfolio. Furthermore, a liquidity policy framework needs to be implemented that mainly makes allowance for the liquidity exposures innate in current account deposits. An operative structure of liquidity management will be endorsed such that cash flow projections include all obligations and funding constraints concerning the fiduciary duties towards its investment contracts.

The IBI, though aware of the limitations prevalent in the financial system, will typically use Sharīʿah-compliant funds so as to comply with its overall liquidity requirements.

Jurisdictional issues

When assessing the regulatory cadre of Islamic banking and finance, jurisdictional issues cannot be ignored. Lallmahamood (2014) mentioned the inherent legal risks surrounding Islamic finance. The onus to verify that products offered and marketed locally are genuinely Sharīʿah-compliant is placed on the IBIs themselves. Nonetheless, the law does not stipulate any offence nor any sanction to apply to situations where there are falsely marketed Sharīʿah products. Penalties can be imposed against an IBI if it has been infringing the banking laws and guidelines, but any misconduct beyond those rules might well go unsanctioned. In such a case, the resulting reputational risk would be the sole deterring factor. The regulator could apply pressure in that regard by issuing a public notice confirming such misrepresentations. Beyond that, licences could be revoked if the misrepresentations could negatively affect the good repute of the Mauritian financial centre or constitute serious breaches of the licence conditions or endanger the financial stability of the system.

With regard to the litigation authorities, there are no courts, tribunals or other bodies having an exclusive jurisdiction to hear Islamic finance disputes. If the IBIs are licensed to operate and are operating on Mauritian territory, a first recourse could be the statutory Enforcement Committee and Review Panel of the regulatory bodies. Then, the courts of law of Mauritius will be empowered to hear the trial. Apart from the local courts, the parties can have recourse to the Judicial Committee of the Privy Council in England, which is still regarded as the ultimate court of appeal for cases that went to the Supreme Court of Mauritius. However, in the case of a dispute where the parties have included an arbitration clause in their contractual terms, the Mauritian courts will sanction the arbitration clause adopted by the parties.

Conclusion

To satisfy clients' sophisticated demands, Islamic banking service providers will need to continuously innovate and look for new markets, especially in the African region. Opportunities offered by the African market have always been in the vision of the Mauritian authorities as Africa is largely Muslim-populated, but they also need to be cautious as several countries such as Egypt, Kenya, Senegal, Nigeria and South Africa (which pioneered the emergence of Islamic finance in the region) have ventured into Islamic finance too (Gelbard *et al.*, 2014). Some countries such as South Africa and Egypt have already demonstrated positive signs of growth and integration of Islamic finance in their local scenery. Other countries such as Ethiopia, Uganda, Malawi – and to a certain extent, Mauritius, where Islamic finance has lingered in a budding stage – need more efforts to develop this area. To achieve more success, they may need to cooperate more so as to adopt a more standardised approach towards Sharīʿah-compliant financial products while also strengthening their regulatory and legal framework.

In fact, Mauritius should have seized the opportunity of entering into African markets demanding Islamic finance before other competitors such as Kenya and Nigeria did so. Unfortunately, Mauritian banks, being already very profitable with conventional banking products and more interested in the emerging blockchain technology, have adopted a passive approach towards Islamic banking. They may be perilously ignoring that diversification and penetration into the neighbouring East African markets represent a high potential for local service providers. Their latency could be capitalised on by more alert emerging African financial markets, which would then benefit further from the amplified demand for Islamic financial products that is expected in the coming decades (Abdu Seid, 2016).

Islamic finance was initially introduced to broaden the array of services and to attract high net worth customers to invest in Mauritius as it seemed scrumptious to have a taste of the total assets held under Islamic finance. The policymakers aimed at propelling Mauritius to new heights; and with these ambitions, they implemented a regulatory framework for welcoming and hosting Islamic banking practices in the Mauritian jurisdiction. It is reckoned that there has never been any objection to allow Islamic finance to penetrate the local financial system. On the contrary, a level of care and precaution has been exercised in the monitoring of these services so that they do not commend lower, or even, higher regulatory controls. The regulatory institutions have tried their best to maintain a level of monitoring and freedom to IBIs, which is at the same level that is granted to conventional banking institutions. However, it is observed that the disclosure, corporate governance, risk management requirements relevant to the conventional banking practices are often exported to Islamic products without re-designing them to suit the exigencies of the latter. As explained by Song and Oosthuizen (2014), Islamic banking is distinct and separate from conventional banking and an enabling legal framework adapted to the needs of Islamic banking will certainly impact positively on the expansion and popularity of the latter. Therefore, the Mauritian jurisdiction could gain more from Islamic banking should it develop a framework specific to the latter instead of importing a combination of the important principles guiding conventional banking into the Islamic finance panorama.

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Further reading

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