To: Mr. Commissioner Worrick Bogle

Mr. Commissioner Charles Ross

Mr. Fernando DePeralto (Secretary)

From: Henderson Downer
Legal Counsel to the Commission

Bank of Jamaica's Response to Questions

1. Bank of Jamaica's role in monetary affairs shared with Ministry of Finance. When dealing with paragraph (viii) of the Terms of Reference wrongly numbered as (xiii) in Commissioner's Bogle proclamation, we will have to pick out those areas in the response where the Bank of Jamaica hints at its lack of autonomy to make our recommendations credible. The Bank ought to be independent, but accountable to Parliament for monetary policy. Pp 1-4 of Response.

2. Paragraph 5 pp 5-6. In view of annual quarterly, monthly and sometimes weekly returns, we will have to ascertain either from this Response or from the audits of the individual Banks etc as why did the meltdown occur despite those procedures. The answer on this Response is paragraph 9 pp 22-28.

3. Paragraph 7. This is very important especially in the light of Patrick Hylton's evidence, that it was he who detected the insolvency of Blaise and reported one matter to the Minister and BOJ. May we have Jamaica Assessment and Recommendation for Finance System, August 1996. Note, on page 10. Meetings 1994-1996, the then Governor Bussierre warned of impending crisis. We will have to determine in our report why action was not taken then which might have averted the crisis. It seems that the government had to await the Report of IMF, Inter American Bank and World Bank report, before acting as it could not tackle the problem without the massive finance assistance which was eventually secured from one of these International Institutions. 1994-1996- Governor warned the Banking sector of the impending crisis, presumably the warning was to the Minister of Finance.

4. Paragraph 8 The Bank in giving the causes for the meltdown hints a number of factors some of which were foreseen but its recommendation to

the MOF was not accepted. As to (a) the responsibility for legislative amendments was in the hands of the Ministry. As to (b) was the fact that the phenomenal growth of financial institutions put to the Financial Secretary. In any event there is a diplomatic note of the Ministry of Finance (MOF). See note 7 on page 11. As to (d) since the BOJ was aware of the questionable activities why those were questionable activities allowed to continue. The blame here is certainly to be attributed to the MOF. The real reasons are to be found at paragraph (iv) at note 32 on page 25. It seems that in every case the MOF used international auditors to second guess the initial findings of the BOJ reports. I hope I am not too optimistic, but I think all the answers we need are going to be found in the massive evidence and reports we have already collected. But time and patience will be required on our part to solve the problem. Paragraph (e) (iv) page 14 is crucial to grasp the slow response of the MOF. As for (f) page 14 non supervisory roles for BOJ with respect to Building Society. So Victoria Mutual could link up with Island Life to create Island Victoria Bank. Paragraph (g) page 44 shows that Insurance companies were hardly regulated. Remember Mr. Commissioner Bogle put this question to Jim Parkes and he got a courteous response but it made no sense to me. With respect to Appendix 5 of the Report, I earlier requested in paragraph 7 of this evaluation, I think the insurance company on page 15 (i) is Eagle. This report demolishes Mr. Chen Young's evidence and we should so find. The second case is certainly Mutual Life- demonstrates the irrelevance of the Rev. Jim Parkes evidence on behalf of Mutual Life.

5. The third case paragraph (iii) on page 16 is Life of Jamaica. Reasonable request- considered solvent. It was not a favourite as some contend, but it was solvent. Thereby a worthy entity.

6. As to (h) on page 16 and (a) on the same page, we need Second Interim Report note 13 page 16. This concerns Century.

7. Page 17. We need Ernest and Young report at note 14 for Workers Bank and its subsidiaries.

8. Page 19. We need to pay special attention to this reason as it was recognised internationally at paragraph 4.7 see note 20. World Bank Country Study to Sustained Growth in Jamaica Chapter 4. Nowhere did Mr. Chen-Young or the Rev. Jim Parkes allude to this fact in their evidence. Could we have the Temporary Managers Report at notes 22 and 23 at page 19?

9. (i) Page 22 The first paragraph on this page is of vital importance. It demonstrates that the BOJ carried out it's statutory regulatory functions and its findings were subsequently supported by the Temporary Managers and Forensic Auditors as well as by McKinsey and Co. The celebrated management consultants. We need to have a look at McKinsey's report dated 18 December 1998 note 28 page 22. One very important reason for us to look at the BOJ examinations into the failed institutions to ascertain the dates when these report were made. My point is that if BOJ is given statutory authority to supervise the Banking Systems then, when it reports it should be acted on by the MOF and this is a very important

recommendation that we will have to make pursuant to paragraph (viii) of our terms of reference. The first paragraph on page 22 states the BOJ position with clarity. It fixes the blame on the MOF. Should the power to impose sanctions be transferred to BOJ from MOF? I think so and we should so recommend. Paragraph 9 pp 22-28 sets out the Banks on other financial institutions given specific instruction and those taken over by the govt. We need the report on Legislative Development in Jamaica's Banking laws for Period 1999 to present page 27 which I suppose is in the boxes delivered, but which I have not yet examined. It will be interesting to evaluate the evidence and response of the Financial secretary and the Minister of Finance.

10. Please note that neither in paragraph 7 pp 7-10 or paragraph 9 pp 22-28 does the BOJ mention specifically, the high interest rate regime? We will have to include this in our report in this aspect as well as when we deal with borrowers failure to meet their obligations with the Banks which failed. For example the items (a) (b) (c) on page 8 are party attributed to

the high interest rate regime. On further readings this is specifically dealt with in paragraph 14 on page 32. The direct answer is stated at page 37. Even then it is sought to minimise the impact of high interest rates. The Bank's response while ultimately recognising that high interest rates was a crucial factor in determining the fate of the system, has ignored the disastrous effect on borrowers and without borrowers, there would be no need for financial institutions.

11. Poor provisioning for non performing loans is dealt with on pp 36 and 37. on pages 39-40 the results of the high interest rate policy on the meltdown is discussed and the BOJ relied on the paper by Stennett R Green P Foga C <u>Stabilization and Jamaica Commercial Banking Sector 91991-1997 Social and Economic Studies</u> Volt 48 Hos 1 and 2 (1999) We need to have look at these articles the BOJ's response mentions real interest rates. We will have to look at inflation rates over the period to get an estimate of the real interest rates. A very important fact emphasized was the lack of regulation of Insurance companies which was the responsibility of the MOF. Also the

consequences of instant liberalisation which resulted in increased money supply and the attempt to curb inflation is explained on pp 32-39.

12. The Banks answer to the collapse of the Construction and Real Estate sections is given pp. 43-44. It is given in economic jargon, but Mr. Rudd from JRF puts it in brutal terms. He said the borrowers should have walked away from the incomplete development projects. It is harsh judgement but it is probably sound advice. The brutal message is that having regard to the high interest rate policy, the collapse of certain business was foreseen. The issue was there an alternative policy? The liberalisation policy could have been more gradual. It seems to me that the Commissioners will have to so state in our report. The BOJ has refused to deal with this issue in its Response. Two examples of premature liberalisation were the 1947 convertible crisis of England and the instant liberalisation in Russia after the fall of The Soviet Union.

13. Paragraph 17 The government did not need to follow the IDB, The World Bank and the IMF to solve the crisis. So FINSAC paper was used with serious implications for the fiscal accounts by way of interest payments. The method of solving the problem was costly but the clean up was one of the quickest, see page 17 note 55. The cost was estimated at 40% of gross domestic product. The costs are part of our problem which we are still trying to solve. Paragraph 18 at pp 48-49 acknowledges that once there was Instant Liberalisation there was bound to be a high interest rate policy to protect the currency and to counter inflation.

14. Reforms Jamaica Deposit Insurance Cooperation, Financial Services Commission and Financial Regulatory Council p5 and adoption of Basel core principles. High interest rate policy again BOJ justifies this policy without considering whether a more gradual liberalisation was not open to the government.

15. Paragraph 20 page 50-60. is very important for our terms of reference to prevent a future meltdown as obtained in the nineties. But international and national economic circumstances change rapidly and BOJ and MOF must always be on the look out for necessary policy responses. How well were they prepared for the recession of 2007-2008 and the present Greek Crisis.

16. Note 66 on page 60. We need the Report which is presumed to be in our boxes.

17. This is a comprehensive document on contemporary economic history. Its major weakness is its failure to show whether an alternative to Instant Liberalisation Policy was not feasible. It seems to me that having regard to what happened they could have raised this issue in their answer to question 7 or 9. Further it seems even if the government was advised by IMF, World Bank and IDB to institute instant liberalisation they could have refused. The government did not follow the advice of those institutions and

paid the depositors, policy holders and pensioners in full. See paragraph 17 pages 46-47. Could we have at least one report from the Financial Stability Unit? There is such a unit in the Bank of England and its head was retired after he failed to discern the weakness of the Royal Bank of Scotland and Lloyds Bank after its merger with Halifax Building Society. The other weakness is the Bank did seem to connect the macro economic of Instant Liberalisation with the effect on business which had to try and survive in the high interest rate regime.