

Questions to be forwarded to Dr. Omar Davies

1. What options were open to the Government to deal with the financial crisis in the mid 1990's?
2. Which option was selected and the reason therefore in preference to the other options?
3. What was the prime purpose for FINSAC and what was it intended to achieve?
4. How was FINSAC capitalized? From what source did the funds come?
5. Was there a loan to capitalize FINSAC?
6. Was the public debt increase consequent on the establishment of FINSAC and to what extent?
7. What was the reason for the high interest rates between 1995 to 2000?
Was there a time factor within which FINSAC was to liquidate the loan for its capitalization?
9. What was the reason for the public debt rising from 124% of GDP in 1997 to 144% of GDP at the end of 1999?
10. Insofar as Financial Institutions were concerned, was a distinction made between those that had liquidity problems and those that were insolvent?
11. Were the depositors of the failed institutions paid their capital and interest which was sourced from loans to FINSAC?
12. Having repaid the depositors, why were these Financial Institutions closed down?

13. What progress did FINSAC make between 1996 and 2001 to recover funds from the delinquent borrowers and reduce its loans?
14. What was the quantum of the delinquent loans of all the failed institutions at the time of FINSAC's incorporation?
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17. Were parameters given to FINSAC within which to negotiate with delinquent borrowers?
- IS. Why was it necessary to sell the debts and their securities to Jamaica Re-Development Foundation, Inc.?
 19. What powers did Jamaica Re-Development Foundation have to enforce the collection of bad debts from delinquent borrowers that FINSAC did not have?
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 21. What was the JRF exempted from consequent on the Order made under the Act? Is it interest rates or any other exemption?
 22. Were any of the exemption Orders to JRF made retrospectively?
 23. What was the total amount in monetary terms of the debts sold to JRF?
 24. What percentage of the total debt was the deposit made by JRF?
 25. Why were no conditions attached to the exemption Order to JRF?

26. In what way was it in the public interest to give JRF an exemption under the Act? (Section 14).
27. Were any guidelines given to JRF as to how assets of delinquent borrowers should be disposed of?
28. Was any consideration given to the fact that interest rates were reduced by commercial banks, and what was to be done for delinquent borrowers?
29. Was it expected that the rate of interest charged by JRF should also be reduced accordingly? If not, why not?
30. Was it intended that JRF should be at liberty to charge any rate of interest on delinquent debts, consequent on the exemption order?
31. Was any direction given to JRF as to the rate of interest chargeable consequent on the reduction of lending interest rates by commercial institutions?
32. What was the reason for packaging the bad debts and advertising for a debt collector to deal with same, when this was the purpose for which FINSAC was established and had been doing so for seven (7) years?
33. FINSAC has been in operation for a period of fourteen (14) years and dealing with the enforcement of delinquent loans. What then was the purpose of selling the delinquent loans and securities of a foreign corporation?
34. How were the loans to FINSAC to be repaid and in what time?
35. Has the loans to FINSAC been repaid to date? If so, what was the status of the loans as at 2005?
36. At any time were any directions given to the Central Bank concerning interest rates?

37. Were any directions given to the Central Bank concerning monetary policy, in particular, exchange rate, inflation and financial stability? And if so what were they?
38. Were any directions given to the Central Bank to make loans available to insolvent financial institutions?
39. In cases where FINSAC sold properties below market value, was the delinquent borrower credited with the market value or the value at which FINSAC sold the asset?
40. Was any external advice sought as to how to deal with the financial crisis in the mid 1990's? If so, from whom and what was the advice?
41. What was the prime purpose for the Financial Sector Legislation in 1997?
42. Was an international audit firm retained to do a forensic audit on the failed institutions? If so, what was the firm and what recommendations were made?
43. The BOJ Supervisory Department made reports clearly indicating the insolvency of certain financial institutions. Why was timely action not taken by the Minister of Finance, although he had legal authority? Why were these institutions allowed to have caused a major systemic problem in the finance system?
44. The November 1996 Report of the IMF, IADB and IBRD estimates the size of the insolvency of Jamaican financial institutions at 20% of GDP and advised immediate action to rectify the situation. The same report says that your administration decided that this was not "politically possible". Can you please explain what was meant by that statement? Do you think that the eventual cost of 40% of GDP was an acceptable trade off in this regard?

45. The IMF in its letter of November 27, 1996 stated that "it has been our experience that no resolution strategy can be successful in restoring a financial system to soundness in the absence of a sound macroeconomic framework that is consistent with achieving a sustainable and low rate of inflation as well as external viability. Jamaica's policy mix of fiscal laxity, monetary restraint, and exchange rate stability is, in our view, not consistent with achieving such macroeconomic objectives". Are you in agreement with this assessment? Was this advice acted upon?

JilichaeCOyCton c Associates*

attorneys-at-Law

B. St. Michael Hylton, O.J., Q.C.

Kevin O. Powell, BSc., LLb

November 19, 2009

Mr. Fernando DePeralto
Secretary to the Commission of Enquiry
The Jamaica Pegasus Hotel
81 Knutsford Boulevard
Kingston 5

Dear Mr. DePeralto:

Re: Commission of Enquiry re
Financial Institutions in Jamaica - Dr. Davies' response

Further to previous correspondence, I enclose Dr. Davies' responses to the questions asked by the Commission.


Please confirm when he will be expected to attend before the Commission. I

look forward to

hearing from you.

Yours faithfully,
MICHAEL LTON & ASSOCIATES.

PER:


B. ST. MICHAEL HYLTON

cc: Dr. Omar Davies

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Answers to Questions - FINSAC Enquiry

- I. Two main options were open to the Government.
 - (i) Appoint receivers for the failed institution(s) and allow them to dispose of assets and eventually pay depositors a percentage of their savings based on the ratio of the realized value of assets to liabilities; or
 - (ii) The intervention could take the form of the establishment of an institution such as FINSAC which would be the umbrella organization through which depositors, holders of insurance policies and contributors to pension funds were protected. The latter intervention obviously came with a clear appreciation that the GOJ would absorb the difference between the value of the assets of the institutions and their liabilities.

There are variations on each option but conceptually, those are the two main ones which were available.

2. The second option was selected. It should be recalled that at that point in time there was no deposit insurance and hence pursuing the first option would, most likely, not only lead to the loss of their life savings by a significant percentage of the population but also the collapse of the financial system. In such an event both domestic and foreign organizations would lose confidence in the system even with regard to those institutions which had not failed.

Given that trade-off, the decision was made to establish FINSAC,

3. The prime objective in establishing FINSAC was to allow for orderly intervention in the failed institutions to prevent a total loss of confidence in the financial system; to preserve the savings, insurance policies and pension funds of the public. Secondly, FINSAC was charged with "healing" the intervened institutions and preparing them for divestment.

Finally, FINSAC was assigned the responsibility to spearhead the revamping of the financial system within the context of a more rigorous legislative framework.

4. FINSAC was capitalized by a small grant from the Ministry of Finance. (Accountant General's Department). The authorised capital was 200 ordinary shares at \$1 each. Issued and fully paid up were 150 ordinary shares at \$1 each,
5. See answer to 4.
6. The public debt was increased over time because of the intervention of FINSAC in the various institutions. Specifically in the first instance "FINSAC Bonds" were issued guaranteed by the Ministry of Finance. The public debt was increased when these bonds were brought formally into the Ministry of Finance's stock of public debt. As regards the second part of the question "To what extent", it is estimated that the cost of the intervention was approximately 40% of GDP.
7. The interest rate policy between 1995 and 2000 was determined by the Bank of Jamaica consistent with its mandate to maintain stability in the financial system and in the foreign exchange market. Within the context of a coherent macroeconomic programme, the interest rate policy pursued was consistent with the fiscal profile, as reflected in the annual budget.
8. As was indicated in the response to questions 4 and 5, the amount used to capitalize FINSAC was miniscule.
9. I have not checked the validity of the figures presented, although I am aware of the increase in the debt. The major reasons for the increase in the public debt during the period would have been the formal assumption of responsibility by the Ministry of Finance of the FINSAC bonds which had been issued. This step was necessary in order to "heal" the repackaged failed institutions, prior to divesting them.

10. Yes, there was always a conceptual distinction made between institutions with liquidity problems and those which were insolvent. However, it was only after FINSAC, through forensic auditors, was able to closely examine the books of the problem institutions that the full picture emerged. .
11. In general the answer is yes. However, with regard to the depositors in the Blaise Financial Institution, they were paid 90% of their savings.
12. The decision was taken to close certain institutions as it would not be prudent to return them to the original investors, not only because of capital inadequacy, but also because of inappropriate management practices which were unearthed.
13. I am unable to provide a precise answer to this question but answers should be available from the records of FINSAC.
14. Same answer as 13.
15. Same answer as 13,
16. The basic guidelines provided to the Board and Management of FINSAC was that equity, transparency and courtesy would be maintained in carrying out its activities. For the record, it should also be noted that at all stages, the Administration sought to appoint to the FINSAC Board and that of the subsidiaries, persons of the highest integrity. In addition, all important actions taken were guided by the Solicitor General's Department, with the personal involvement of the then Solicitor General, himself, the late Dr. Kenneth Rattray and his deputy, Douglas Leys, the present Solicitor General.
17. Having established FINSAC and appointed a Board of highly reputable persons (first Board chaired by Dr Gladstone Bonnick) the only policy

guideline given to FINSAC related to the sale of family residences which had been used to collateralize business loans.

18. ~~The decision~~ taken for the following reasons:

- (a) to allow FINSAC to concentrate on other aspects of its mandate such as preparing the restructured entities (eg NCB and Union Bank) for sale;
- (b) to allow FINSAC to provide leadership for revamping the regulatory system governing the financial sector;
- (c) to allow the Administration to reach the objective of returning the financial sector to normality, within the context of a regulatory system which met international best practices, in as short a timespan as possible; and
- (d) FINSAC staff were coming increasingly under pressure from some debtors, seeking preferential treatment in the settlement of their obligations,

19. I do not believe there were any.

20. I do not recall, but such information would be in the files at the Ministry of Finance.

21. Same as answer to question 20.

22. Same as answer to question 20.

23. Same as answer to question 20.

24. Same as answer to question 20.

25. I do not recall. The files at the Ministry of Finance would contain all the relevant correspondence.
26. Same as the answer to question 25.
27. No, except for the request or a moratorium of a certain period to allow those clients who had reached an agreement with FINSAC but had not been able to complete arrangements for financing prior to the transfer.
28. After the sale of the bad debt portfolio, the Ministry of Finance had no direct influence over the actions of JRF. However, it was assumed that since JRF was a commercial operation, they would be sensitive to changes in the market.
29. See answer to question 28.
30. See answer to question 28.
31. Not by the Ministry of Finance. Please see answer to question 28.
32. Please see answer to question 18.
33. Please see answer to question 18. The fact that the firm purchasing the portfolio was a foreign one was irrelevant to the decision. Of note is the fact that a prominent local firm which had initially expressed interest in purchasing the bad debt portfolio, had made a proposal significantly below that from JRF.
34. Based on the proceeds realized from sale of assets, FINSAC has contributed to the repayment of some of the debt incurred through intervention in the failed institutions. However, by virtue of the rationale for its establishment, it was clear that FINSAC would never be able to repay all the loans which had been guaranteed by the Ministry of Finance,

As such, the remainder became part of the public debt and repayment the responsibility of the Ministry of Finance.

35. Please see answer to question 34. As regards part 2 of the question such information can be made available by the Debt Management Unit of the Ministry of Finance,
36. No directions were given by the Ministry of Finance to the Central Bank concerning interest rates.
37. No directions were given to the Central Bank. However, in terms of the development of policies related to exchange rate, inflation and financial stability, the Governor and senior members of the BOJ were involved in ongoing discussions with me, as Minister of Finance, the Financial Secretary and the Director General of the Planning Institute concerning overall macro-economic policy. Within that context, the macro-economic programme was developed for each fiscal year and for the medium term.
38. After the Administration took the decision to establish FINSAC, the Central Bank was the only institution capable of making funds available to facilitate the intervention. However, repayment of these resources became the responsibility of the Ministry of Finance.
39. I do not know that there were any such cases. I would add that in financial transactions of this type, the only valid "market value" of an asset is that which a buyer is willing to offer.
40. Yes. Advice was sought from the IMF, the World Bank and the IDB. The discussions took place in both Kingston and Washington and dragged on for several months. The summary of the advice which was eventually received was that intervention would be costly and would impact for an extended period on the fiscal accounts. Against that background the advice was to allow institutions to fail; their principals excluded from future participation in the financial sector and the depositors paid out of the

proceeds of the sale of the assets which existed. In order to effect this approach, there was the recommendation to close the whole financial system for a period of two weeks to implement all the required changes. This last recommendation reflected a total lack of appreciation of the implications of such an action and was rejected as impractical.

41. There were six (6) main objectives:
 - (i) to provide more effective powers for remedial action to be taken by the supervisory authorities in respect of distressed institutions;
 - (ii) to reduce the capacity for institutions to lend to, or invest in, related parties;
 - (iii) a more stringent computation of capital adequacy;
 - (iv) a more precise definition of nonperforming rules and provide increased power for the supervisory authorities to prescribe accounting rules;
 - (v) to provide the supervisory authorities with greater control over changes of ownership and
 - (vi) a stricter definition of a "fit and proper person", for managers, directors and owners.

42. Two international firms were retained to do forensic audit.
 - (i) Lindquist-Avey from Canada, and
 - (ii) Ernst and Young out of the UK.

A major recommendation made by both firms was that civil proceedings should be instituted against the principals of the failed institutions. This advice was followed with significant success. In certain instances they advised that criminal prosecutions should proceed but this has not met with the same success as in the civil suits.

43. The BOJ did make reports indicating insolvency, or expected insolvency of certain institutions. However, in virtually all instances the level of bad

loans was far greater than initial inspections indicated. It was agreed by Cabinet, the Ministry of Finance and the BOJ that attempts would be made to work with the principals to inject capital and sell assets, in order to address the deficiencies identified. However, after many attempts, it became apparent that the principals had no genuine commitment to carry out the undertakings given and the decision was taken to do a generic intervention, through FINSAC. (My address to Parliament on July 16, 1996 provides a compressive report on the experience with the Century Financial Entities. A copy is attached).

44. I do not recall the specific report to which reference is made. I recall discussions with the institutions and the representatives of the institutions were told that the closure of so many institutions would result in chaos. I do not recall the use of the term "politically possible". I do recall it being pointed out to the multilaterals the potential social consequences of some of their recommendations.

As regards the trade-off of the cost of the intervention, there can be no definitive response. Whilst the eventual cost was greater than expected, there is no way to assess the social chaos which would have resulted from taking some of the actions recommended by the multilaterals eg closure of the system for two weeks.

45. I am in agreement with Part 1 of the assessment and actions were taken to achieve the objectives listed. These actions produced reduced inflation, an increased primary surplus, and stability in the foreign exchange market. Within that context I would argue that the advice was acted upon. I do not agree with the observation in the second part of the paragraph, in particular the reference to fiscal laxity.

Michael T. Conroy Associates

Attorneys-at-Law

B. St. Michael Hylton, O.J., Q.C.

Kevin O. Powell, BSc., LLb

November 9, 2009

Mr. Fernando DePeralto
Secretary to the Commission of Enquiry
The Jamaica Pegasus Hotel
81 Knutsford Boulevard
Kingston 5

Dear Mr. DePeralto:

Re: Commission of Enquiry / Dr. Omar Davies _____

I acknowledge receipt of your letters dated November 5 with a schedule of public hearings of the Commission and dated November 6 with a list of questions for Dr. Davies. As you know, Dr. Davies is presently off the island. I sent the list of questions to him and he has pointed out that not only are the questions numerous, but many require careful thought and detailed responses. In the circumstances, he would not be able to complete and submit written responses in time to appear before the Commission next week. In addition, I have prior court fixtures on November 18 and 19.

Dr. Davies estimates that he should be able to complete the responses in time to appear before the Commission on November 24 and I would also be available that week. In the circumstances, I ask that the Commission consider scheduling his testimony for the week of November 24.

Yours faithfully,
MICHAEL HYLTON & ASSOCIATES

PER: B. ST. MICHAEL HYLTON

Cc: Dr. Omar Davies

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2. In a release dated August 26, 2009, the Commission indicated that before the commencement of public hearings it would "ascertain (in the interest of fairness) allegations made against persons or institutions" and then "refer allegations to respondents in order that they may respond appropriately." I understand that no such allegations have been referred to Dr. Davies. Please confirm whether I should therefore conclude that no allegations have been made against him.
3. It is also my understanding that the Commission will determine the procedure which will be followed at the hearings. Please let me know whether any decisions have been made in that regard and/or any directions issued. I would wish to know in particular, who will be allowed to cross-examine witnesses.

Given the suggestions and questions above and the importance of the issues which the Commission will no doubt expect Dr. Davies to address, I would invite the Commission to consider rescheduling the date for his appearance.

I look forward to hearing from you in relation to the above.
cc: Dr. Omar Davies

Yours faithfully,
MICHAEL HYLTON & ASSOCIATES

PER:

B. ST. MICHAEL HYLTON

COMMISSION OF ENQUIRY
INTO **THE COLLAPSE** OF FINANCIAL INSTITUTIONS IN JAMAICA
IN **THE 1990'S**

**THE JAMAICA PEGASUS HOTEL
81 KNUTSFORD BOULEVARD
KINGSTON 5**

November 6, 2009

Honourable Micheal Hylton, O.J., Q.C.
Micheal Hylton and Associates
11A Oxford Road
Kingston 5

Dear Mr. Hylton,

RE: Commission of Enquiry- Questions to be answered by Dr. Omar Davies

Attached for your attention is a list of questions for Dr. Omar Davies guidance.

The Commission is requesting that Dr Davies submits written responses to these questions prior to appearing at the public hearings.

Yours faithfully

Fernando DePeralto

Secretary to the Commission of Enquiry

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