

Answers to Questions - FINSAC Enquiry

1. 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 to sell the debts was 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 H. 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 comprehensive 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.