SUBMISSION TO THE FINSAC COMMISSION OF ENQUIRY

TO BE SUBMITTED MARCH 24, 2011, THE BEGINNING

In June 1991 we acquired all the assets of the Corporate Merchant Bank and then changed it's name to Horizon Merchant Bank.

We then proceeded to structure a Management Team of individuals with proven track records and the required expertise in the relevant areas of Financial Services,

I was appointed Chairman and at that time, having had over twenty-two (22) years of experience in the Financial Services Sector, eleven (11) years in the Building Society Movement, having served as Assistant General Manager of Jamaica National Building Society (JNBS) and eleven (11) years in Commercial Banking, having served as Managing Director of Jamaica Citizens Bank. Another Senior Member of the Management Team was an experienced Banker with over twenty (20) years experience and high levels of expertise in all the relevant areas.
A balanced Board of Directors was established with requisite skill sets.

The Bank experienced solid growth and attractive profitability and based on most of the key performance indicators, was always rated within the top five (5) of the market based on our recollection.

Based on the broader needs of our customer base and the structure of the financial services marketplace, it became necessary for us to broaden the range of services available to our customers. At the strategic level, we made the decision to become a "One-Stop Financial Centre".

Against this background, we took the necessary steps to expand the financial services network to include Horizon Building Society, Horizon Securities and Horizon Life. In each case, we recruited Senior Executives with the requisite skills expertise and experience to provide leadership for the respective units.

With full knowledge of international and local best practices, we developed the full range of operating policies and procedures to cover all aspects of their operations. Those policies and procedures were under constant review and were modified based on developments in the marketplace and changes to the regulatory environment.

CREDIT MANAGEMENT

The Credit Policies and Procedures were extensive and covered all aspects of the Loan process. The Credit Committee was chaired by a Non-Staff Director and operated in keeping with the approved Credit policies and procedures. The Committee met regularly, made decisions and reviewed reports in respect of Loan Approvals, Loan Re-financing, Loan Performance including payments and security documentation, Loan Loss provisions and Write Off of Debts. The Credit Committee minutes and relevant reports were presented at the monthly Board Meetings.

The Loan Approval process took into consideration the following factors - ability to pay, quality and type of collateral, assessment and grading of risk and the interest rate sensitivity analysis. All loans were the subject of a detailed credit proposal which formed the basis of the submission to the Credit Committee.

In respect of loan repayments, past due reports were reviewed by the Credit Committee on a monthly basis. This process guided the implementation of the various action plans. We had a fully staffed Credit Administration Department which was charged with the responsibility to ensure effective implementation of the decisions of the Credit Committee.

In respect of loan documentation, we had an experienced in-house Attorney-At-Law as a full time staff member who provided the leadership in this area.

ASSETS AND LIABILITY MANAGEMENT

The Assets and Liabilities Committee was the body that managed and focussed on Loan and Deposit Pricing, Interest Margins and Liquidity positions. This Committee met frequently and reported monthly to the Board of Directors meetings.

In the case of Asset and Liability Pricing, reports would be submitted to the Committee detailing Interest Rates present and forecasted, Liquidity position present and forecasted and most importantly Net Interest Margin (NIM) present and forecasted.

From the deliberations of this Committee, decisions would be made on availability of funds for lending and rates to be charged. The Committee also reviewed the existing portfolios of loans and decided when it was appropriate to adjust the interest rates being charged. A major objective of this Committee was to ensure that at all times we maintained a positive Net Interest Margin (NIM).

This Committee, as part of its mandate, reviewed all other earning assets to ensure appropriate portfolio mix, levels of liquidity and appropriate returns and risks.

Another function was to review funding, pricing and tenure with the overall objective of ensuring that our funding and liquidity requirements were met at minimal costs.

The entities operated with a clear vision to have a positive impact on the economic life of our country. **Growing** the loan side of business was a definitive strategy. **Recognizing** the structure of our entities we maintained a strong commitment to the preservation of high liquidity ratios.

OPERATING SYSTEMS

We started the operations with a high level commitment to the effective use of technology. We acquired the best affordable Computerised Management Information System which helped us to produce all financial information in respect of all borrowers and depositors on a timely and accurate basis. All these systems and records were transferred to Citizens Bank at the time of the merger. Further, we maintained an enviable record in the submission of all reports to the Regulators and to our Boards on a timely basis.

The entities were efficiently managed and we maintained a high level of integrity and probity in all our dealings. In approximately seven (7) years we had grown to become one of the most respected names in the Financial Services Sector. We enjoyed a high level of confidence in the marketplace and this was evidence through the strong growth in the level of funds deposited in our various institutions.

THE FIRST ROUND

We continued to operate soundly and profitable. However, in 1995 when the Bank of Jamaica (BOJ) made its first intervention in a major financial institution, signs of some changes in the environment were evident. Most of the indigenous financial institutions started experiencing increases in the levels of withdrawals of deposits which is referred to as a "Run on Deposits".

Because of our prudent approach to Liquidity Management, we were able to assist at least one unconnected Commercial Bank with some liquidity support during this period. The rumours continued as to which institution would be next. The environment became more and more sensitive and depositors more cautious.

On realizing the trend and in keeping with one of our operating tenets to be transparent at all times with the Bank of Jamaica (BOJ), we requested a meeting with the then Governor of the Bank of Jamaica. Along with two (2) other Senior

Executives from our institutions, we met with the Governor and his team. We presented the facts relating to the trend and discussed strategies for BOJ's support if this were to continue. The BOJ advised us not to panic and encouraged us to maintain even higher levels of liquidity.

After the BOJ meeting, we decided to be more aggressive in our deposit pricing to try and ensure higher levels of liquidity. At the same time, the Government had reversed their interest rate policy direction, increasing interest on BOJ's instruments to a high of above 50%. This sharp increase in our cost of funding made it necessary to increase the rates on our loans so as to maintain a positive Net Interest Margin. At this time, the break-even interest rate (that is, the effective rate) taking into consideration cash reserves, was in excess of 76%.

THE SECOND ROUND

As the rumours became stronger in late 1997 that further BOJ interventions were likely, our institutions started experiencing higher than normal levels of withdrawals.

Subsequently, BOJ intervened in the Workers Bank - our principal Bankers. Immediately this was announced, we started experiencing an unusually high demand for withdrawals.

We asked for a meeting with Senior Officers of the Bank of Jamaica to apprise them of the developments. It was clear from that meeting that Bank of Jamaica would not have been able to provide us with the appropriate assistance.

Recognizing the force of this development, we called an emergency meeting of the Board of Directors of Horizon and it was decided that we should approach the Financial Sector Adjustment Company Limited (FINSAC) for support. Based on our understanding of FINSAC's mandate, we were of the firm view that would have *met* all *the* requirements *for* FINSAC's support. *Against this* background, *we* approached FINSAC to purchase our real estate development loans as Developers were experiencing difficulties in the marketing of completed and uncompleted units. The purchase of those loans along with a few others would have provided *us with the* required liquidity *cushion we* needed. *We* further requested FINSAC to consider an infusion of equity into Horizon Financial Services Limited being a part of the restructuring programme we had proposed to the Bank of Jamaica.

FINSAC'S RESPONSE

After a review of our operations and various discussions, we made a further formal proposal in which we showed sustainable viability if certain selected loans were purchased in exchange for Government Bonds.

FINSAC's offer was a counter proposal to facilitate the merger of the relevant financial entities with Citizens Bank Group which by then was controlled by FINSAC. In respect of Horizon Life, the proposal was for Crown Eagle Life Insurance Company Limited to administer that portfolio.

The relevant heads of agreement was executed on March 5, 1998 and a news release issued setting out broad details of the arrangement. The detailed agreement was subsequently executed.

All the assets and liabilities for the financial entities, Horizon Merchant Bank, Horizon Building Society and Horizon Securities Limited were transferred to Citizens Bank along with all the records for the institutions including detailed loan records and documentations for all borrowers.

A BROAD LOOK AT THE ENVIRONMENT

The BOJ's intervention in 1995 was a "Game Changer". Most of the indigenous financial institutions experienced liquidity challenges to varying degrees. The institutions such as Horizon which had a commitment to contribute to economic growth and development through structured loan programmes had greater liquidity challenges. This was due mainly to the fact that the high interest costs adversely affected borrowers at all levels.

The deteriorating liquidity situation and persistent high interest rates among indigenous financial institutions was even more challenging for the newer financial institutions. As one of the newer financial entities having commenced operations in 1991, attracting a profitable base of mainly Blue Chip borrowers was not going to be achieved overnight. Further, with our clearly stated objective of growth through lending to the productive sector, the environment was even more challenging for our entities.

This timing coupled with the other realities of the marketplace, our loan portfolio grew with some good emerging borrowers. One of the outcome of the "Shake Out" of the 90's was the fact that some of the emerging businesses were among the early ones to default.

It was clear that the high interest rate regime placed excessive pressure on borrowers operating emerging businesses. This resulted in higher default rate on loans made by indigenous institutions and erosion of their capital due to new mandatory loan loss reserves introduced by the Regulators during the period.

Some of the unfriendly utterances of the period towards indigenous institutions resulted in a flight of deposits from indigenous institutions to foreign owned institutions which were perceived to have strong overseas parent company support. Those institutions were able to attract deposits at much lower rates of interest giving them a clear competitive advantage especially in the area of loan pricing.

During this period it was our considered **opinion** that the high interest rate **policy** was not sustainable. This **position** was influenced by the fact that we were of the view that the policy makers being fully aware of the longterm **implications** would not have maintained the high interest rate **policy** for any **prolonged** period.

In hindsight, if we honestly **believed** even for a brief moment that the **policy** makers knowing and understanding the implications for **collapse** of businesses and the disruption of lives, would have maintained the high interest rate **policy** for such a long period, we would not have pursued lending as the major strategy of our business model.

The interest rate sensitivity analysis was an integral part of our Credit Approval process. Based on our evaluation process, most of our borrowers upper threshold limit was a 50% borrowing rate. As part of our loan analysis, we subjected all our loans to a period of higher interest rates at varying rates up to 50% higher than the rates at which the loans were originally disbursed and for a limited period. Any loan that failed this test was not approved.

When it was evident that the interest rate policy direction would take borrowers above this threshold, we immediately took the decision to discontinue making commitments for new project loans. However, in respect of existing borrowers especially those in the construction sector, we made the decision in some cases to work with the borrowers to complete the projects and get them to market as quickly as possible.

The continuing high interest rate having forced us to exit the lending market for regular new loans, our strategic response was to focus on facilitating borrowers who could qualify for National Development Bank (NDB) and Agricultural Credit Bank (ACB) loans. It was strategies like those that contributed positively to our continued viability.

The construction and manufacturing sectors were two of the sectors most severely affected by the high interest rate policy and because our portfolio mix had a greater concentration in those sectors the effects were more devastating.

Another major "Game Changer" was the decision of the Bank of Jamaica (BOJ) to introduce New Capital Adequacy Standards during the period of continued high interest rates with all the related consequences. One of the major changes was the requirement for varying levels of capital support to be provided in respect of all non-performing loans regardless of the quality of collateral securing the loan, This immediately created some new challenges for all the indigenous institutions (especially the newer ones) supervised by the BOJ. The timing was unfortunate and one could conclude that all the implications were not carefully analysed.

The need for strengthening of the capital base became urgent, Against this background, we established a new company in 1997 known as Horizon Financial Services Limited which would have managed and operated all the financial entities. The private placement prospectus was developed and we were in discussions with prospective equity investors both locally and overseas. We wrote to the then Minister of Finance seeking approval to transfer the shares of the Merchant Bank to the new entity. We have no doubt that given reasonable time and the support to implement the plan, it would have been successful. The Horizon Financial Services Limited would have been listed on the Jamaican Stock Exchange.

Recognizing the continuing trend and concerned about the survival of the institutions, the shareholders of several Indigenous Financial Institutions developed a comprehensive plan to merge the various financial institutions into one major organization. It was a very attractive proposal, but needed to be facilitated at various levels. There were various levels of scepticism and the concept was never fully supported at some key levels. It should be noted that at the shareholders level, there were some unresolved issues. Although the market was not very receptive towards new equity investments at the time, mainly because of the attractive high interest rates, one could conclude that such a merged entity would have gained the attention and support of the market place.

In retrospect, one thing is clear there is no substitute for a strong capital base. Horizon, like most of the other indigenous institution active in the lending business had too low a capital for the risk of operating in the high interest rate environment. With higher capital ratios institutions such as Horizon would have been able to more comfortably ride through the vagaries of time.

GENERAL OBSERVATIONS

Good Loans became marginal, although most loans were repayable on demand, calling a loan would not have produced any real change as there were only a few willing and able buyers. in several cases, standby overdraft facilities were not renewed due to no fault of the borrowers, but due largely to the inability of the Bank to fund the continuing exposure, thus removing the liquidity support from some borrowers.

It was painful to journey with hard working, honest, creditable, trustworthy and up to then, successful entrepreneurs who lost the will to "fight". It will take generations for us to fully understand what the destruction in the 90's of several enterprises built by blood, sweat and tears of hardworking, honest, trustworthy and creditable Jamaicans have done to the psyche of our nation. Lives were destroyed-many lives. We are producing a new generation of professionals who are frighteningly risk averse. The period weakened our entrepreneural spirit, energy and passion.

It is well known that the view was expressed by the Regulators prior to the establishment of FI NSAC that there were too many financial institutions operating in Jamaica at the time. A view that no objective person would disagree with.

Against this background one is inclined to wonder if undue influence was exercised by the Regulatory Arm in the early period of the FINSAC interventions.

FINSAC was established as an organization to assist with restructuring and strengthening. The expectation was that the restructuring and strengthening of institutions, companies and individual facilities would have impacted positively on the overall economic environment. Regrettably, as the programme unfolded it became evident that the mandate was modified.

When the interest rates were raised to real levels to support the exchange rate and reduce the level of `overheating' in the economy, several persons including the presenter of this submission stated they understood the rationale for the policy shift. It was generally believed that this "shock treatment" would have been for a short period, maybe a few months--but lo and behold this was not to be, it went for years and years resulting in safe investment fixed deposits interest rate increasing in excess of 50% and BOJ's overdrafts to lending rate prime customers exceeding 120%.

No honest and objective person can argue against the view that the high interest rates were sustained for far too long a period. As a result many institutions, organizations, companies, individuals and lives were destroyed.
This Commission should aim to objectively answer these questions:

Why did good loans turn bad? Why did good investments fail? Recognizing that Sound Banks failed because of bad loans and failed investments.

FINSAC is now history, we need to focus on how we rebuild and rescue lives, rekindle the spirit of entrepreneurship that is so urgently needed to move this Country to another level. If this is achieved, we may live to experience our nation getting closer to the realization of the ultimate National Economic and Social Goal---a Better Quality Life For All.

Respectfully submitted:

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