

The Oral Evidence of Dr. Omar Davies

Before adducing sworn evidence The Commission submitted forty-five questions to the Minister. His sworn evidence was an expansion of the answers he gave. He was questioned by the Commissioners, counsel for those who complained to the Commissioners and by some of the complainants.

The Minister of Finance who held office from December 1993 – September 2007 commenced his sworn evidence on November 24, 2009 and its important to reiterate that his final written submission was delivered to the Secretary of the Commission on May 10, 2011. After stating his impressive academic qualifications and the responsibilities of the Ministry of Finance which includes the Bank of Jamaica, the Minister in his evidence responded to the issues put to him.

The Finsac Option.

The initial issue posed by the Commission was the options open to the government to deal with the financial crisis in the mid 90's. The Minister stated that there were no two main options and he stated it thus at page 9 of the transcript,

“Sir, there are a whole range but I had summarized and suggested two, and then you could have combinations or parts from each of those. One would be to treat each challenge, each crisis on a case by case basis and appoint receivers for the failed institutions and these receivers would then dispose of the assets of the institutions and pay depositors in line with the ratio of the amounts realized from the sale of the assets to the liabilities which by and large would be the deposits from the citizens.”

He continues thus at page 10 of the transcript,

“The other one was to have a generic intervention as was done with the establishment of FINSAC and therein rather than on a case by case you would have an umbrella organization through which the depositors, the holders of insurance policies and also pensioners whose funds had been compromised in this

period, where they would be protected. This latter intervention as opposed to the first, came with the clear understanding that the state, the Government, would absorb the difference or take responsibility for the difference between the value of the assets realized as opposed to the liabilities, so in the first, you would simply intervene and this has been done, whereby a receiver is appointed, he or she goes in, takes total command, sells the assets and then settles with the creditors who would be by and large the depositors as a percentage of the ratio of the value of the assets as opposed to the liabilities.”

The Minister explained the difficulties in choosing the appropriate option in these circumstances and he explained that on the logistical side intervention was akin to a military operation. Here is how he put it on page 17 of the transcript,

“...if you decide to intervene in a an institution, that exercise almost became a military operation in the sense that if an institution has a head office and 15 branches, intervention meant that first of all, you have to find personnel unconnected to the institution; you have to check whether auditors...”

There was consultation with the relevant international institutions and the evidence on this aspect ran as follows at page 18 of the transcript,

“Commissioner Ross, our assessment and analysis was aided by our consultation with the multi-laterals. We consulted with the IDB, the World Bank, the IMF, both here and in Washington and to summarise again, as I stated, their recommendation would be the first option. In a sense, they said the market must work in a sense that banks prosper and banks fail; the market should work.”

Policy decisions are difficult and the Government realised that any choice made would result in some disadvantages. Here are the reasons given for choosing the second option at page 21-22 of the transcript,

“Well, let me start with a response to a previous question from the Chairman in that not only is a Government concerned about the financial stability, but the social stability and the second option was chosen because if you recall at that stage there was no deposit insurance scheme and hence whatever range of options you selected, if you decided that you put receivers in etcetera, a significant percentage of the population, those banking institutions or with their pension funds being managed by the insurance companies, would have lost, if not all, but a significant percentage of their life savings or their pension benefits or the

insurance policies which they had. So at that level, there is both the impact on the financial system as well as social stability. And again, one could argue for ever as to be you certain that there would have been chaos, but we had enough signs even for small institutions, which would suggest that that wholesale closure or allowing to fail without protection would have resulted in social instability.”

The issue of social stability was foremost in the thinking of the government. It meant that depositors’, insurance policy holders and pension funds were given priority. Those who borrowed would be among the casualties with respect to their ventures. The Minister indicated his priority thus at page 24 of the transcript,

“Yes. I didn't know the first in terms of total erosion or almost total erosion of the savings of -- and I define savings broadly, not just actual deposits but also your insurance policies; your pension; whatever you had put away for your pension. So I am defining it in the case that Commissioner Ross seeks to get me it to be totally technically correct but I am defining savings in that broader sense.”

Demonstrating the broader sense, the Minister stated that he was operating in an area of uncertainty. He stated thus at pages 24-25 of the transcript,

“It was a gamble which the administration had felt it couldn't take in terms of social stability. We had evidence from other countries --countries from South America of what would happen when it seemed as if the financial sector system was going to collapse; that could happen. We were not prepared to take that chance. But the other point was that Jamaica, was then or even more so now fully integrated in the world financial system and with remittances; with transfers; with trade; we felt that a comprehensive intervention which indicated a path out of the problem would be one way of retaining credibility and confidence in the system.”

He then concluded on this aspect on the matter by stating at page 35 of the transcript,

“...I am suggesting that we are here today; that we have a financial system which is sound; that we have a deposit insurance scheme which would preclude a recurrence directly related to bad debts but I am suggesting that we took perfect decisions in this case.”

WHAT WAS THE PURPOSE OF FINSAC?

Here is how the Minister stated the origins and purpose of FINSAC at page 36 of the transcript,

“Once the policy decision was taken and the word FINSAC -- the name FINSAC was Gladstone Bonnicks' invention because we had been thinking of something which strange enough had the initials IRS and Gladstone, he felt that -- also, FINSAC was his creation but the important thing was the orderly intervention because you had this overriding body which would then be in charge of the intervention business. So people had a point of reference whether local or foreign, to preserve the stability of the system.”

That minister continued thus at pages 36-37 of the transcript,

“The second thing was that FINSAC was charged with healing the system; the intervention, repackaging of institutions; for example, a set of institutions were combined as Union Bank and then sold, which is now RBTT. And third, it was through technical assistance from the IDB in particular, it spearheaded the revamping of the financial legislation; the legislation governing the financial system and part of the problems arose from the laxity of the legislation in parts.”

The Minister explained that the problems of FINSAC were compounded by the enormity of the problems. The true state was only realised when the Bank of Jamaica and forensic auditors examined the books of the failed financial institutions. In one case the Auditor was a bad debtor of the Bank. Here is how he explained the appointment of forensic auditors after FINSAC was set up at page 42 of the transcript.

“We brought in two highly respected international institutions, one out of Canada, Lindquist Avey and one out of the UK. Ernst and Young to carry out different tasks.”

On the issue was the criminality of those responsible for the failed financial institutions the Minister gave a fuller explanation than he gave in his final written submission. Here is his explanation at page 43 of the transcript,

“Well, I would say detailed in terms of -these forensic auditors actually went into day by day operations and revealed to us some of the activities which were carried out. If I should indicate,

the principal -- we had Lindquist Avey, once they completed their major work, we had them on a retainer and they voluntarily gave it up because they felt that criminal charges should be laid and prosecuted almost immediately based on the work which they had done but there was, and I hazard to guess, there is still a deficiency in terms of our investigative capabilities in that area.”

In his final submission he explained the gap in our financial statutes. But the Larceny Act has provisions for false accounting and the common law has provision for conspiracy to defraud and conspiracy to evade the provisions of the Banking Act and the Bank of Jamaica act. It seems regrettable that the forensic auditors report was not forwarded to the Director of Public Prosecutions with respect to the practice of ‘ever greening’ as described by the Minister. This is how he explained ever greening on pages 80-81 of the transcript,

“This was even more so in the instances where you had the group of companies because what was done is what they call ever greening of loans. So Company X, the deposit taking institutions would make a loan. It's not performing and in anticipation of a BOJ inspection that loan would be sold to another entity which was not subject to the same inspection, so you have a clear up of loan in the books of the deposit taking institution, but within the overall group of companies that bad loan was there and continued not to perform and that knowledge both because of the restricted legislation as well as the fact, that is the fact that the interventions hadn't taken place that knowledge in many instances was not something available to us.”

The Minister gave a further explanation of the reason why criminal prosecutions were not instituted. Here it is at page 76 of the transcript,

“I am aware of instances where the forensic auditors have presented the case and for one reason or another there has not been a follow through. Let me deal with the other reason. In certain instances we have been advised by the lawyers we have case which we believe we will win, but in that process given the length of the time in the justice system all the issues; disposal of assets, et cetera, would be put on hold during that period and bearing in mind our objective of trying to clear our way through we have to sometimes make judgment calls in that regard and

there were negotiated settlements in that regard I am aware.”

The issue of why the Ministry failed to act earlier was important and the Minister gave an explanation which must be recorded. Here is how he described the attempts of working with bankers who called themselves the Owners Club at page 45 of the transcript,

“There is one institution, Century Financial, Mr. Crawford never kept a single commitment given to the Bank of Jamaica.”

He continues thus on pages 45-46 of the transcript,

“...and when we took the decision, this is the end, the group of local owners, called themselves The Owners Club - Mr. Fullerton from Caldon, Mr. Elon Beckford from Horizon, Mr. Lindsay from Workers - they came to us with a proposal to create a 'good bank, 'bad bank' and we thought they were going to introduce capital et cetera, we thought that they were close to a solution and then at the last minute Mr. Crawford said they were trying to steal his bank and the whole thing collapsed. Now, if you said to me, you should never have trusted them in the first instance, right, you are probably right and perhaps my successors elsewhere should take that lesson. Governor Boussaires told us, he said that he would be the best person to advise us because he had no emotional ties and he was able to see the problem for what it was, but if you ask me for an error it is that we trusted them.”

Was the public debt increased as a result of the financial meltdown and the operations of FINSAC.?

The Minister rejected the solution of printing money to solve the problem.

The passage on page 46 of the transcript explains it thus,

“...you could have inflated away the, you could have used the Central Bank to clear some of these obligations and give them useless paper over time but clearly that is only a superficial resolution which would seem to diminish but down the road you would pay the penalty.”

The he emphasised on the same page,

“Essentially what the Central Bank would do is make the advances unlike the situation whereby the Ministry of Finance assumed responsibility for the debt that would be dealt with differently.”

The Minister said FINSAC was successful. He put it thus on pages 51-52 of the transcript,

“In fact what has been achieved, what is left of FINSAC is like a rub, they have some real estate or some minor things but the five to seven years by and large, the five to seven years timetable was achieved, has been achieved. The institutions, NCB was healed and sold; Union Bank which was healed and sold, the Financial Legislation has taken place, has been put in place, the ‘Fit and Proper’ criteria have been strengthened, the Deposit Insurance Scheme has been established, the FSC has been established; by and large the objectives have been achieved.”

As to the method of financing the FINSAC operations, the Minister gave this answer at pages 56-57 of the transcript,

In two ways. One, the first way, the Ministry of Finance drawing on surpluses which it had in the Bank of Jamaica provided some funding in the first instance and I presume you are speaking about the period after FINSAC took firm control. And the second way it was financed is that it issued paper, FINSAC bonds which were pieces of paper guaranteed by the Ministry of Finance and then when it got into operation in dealing with some of debtors there were inflows from payments made consequent on settlement.

In continuing the matter in greater detail he said at pages 57-58 of the transcript,

“In the first instance we issued FINSAC bonds which were essentially pieces of paper, stamped, guaranteed by the Ministry of Finance, such that John Brown knew that this was as good as a Treasury Bill or a long term certificate. This meant that for a period the value of those bonds or the debts implied by those bonds were not part the official debt stock. However, once we reached the point of selling the institutions, the repackaged institutions, the purchasers demanded, and rightly so, that we move from FINSAC bonds to actual LRS, the government paper, and at that stage you get these spikes in terms of the increase in the debts. So the debt was there being accumulated via FINSAC bonds but you would only have it officially recorded by the Debt Management Unit and the Accountant General's Department when we substituted LRS's for FINSAC bonds.”

In the first instance on the direct issue as to the ratio of the debt to GDP as a result of the FINSAC operation the Minister gave as estimate of 40%.

The Minister's account of how interest rates were determined.

The issue of interest rates is of cardinal importance to the Enquiry. The Minister spoke thus at pages 60-61 of the transcript,

“Let me begin by indicating that although the Bank of Jamaica is not independent in the legal sense, the previous administration had taken the decision to allow the Central Bank almost total latitude in terms of the in determination of interest rate, so interest rate policy was determined by and large by the Central Bank, and I say by and large because interest rate policy fitted within the overall macro economic programme. Well, currently we are discussing this Letter of Intent to the IMF. That Letter of Intent will essentially contain a macro economic programme which will speak to fiscal deficit, revenues, the interest rate policy, et cetera, and the Central Bank's determination of interest rates was within such a context but that was the responsibility of the Central Bank.”

The Minister was questioned as to the reason for the high interest rate during the period 1995-2000. The explanation the Minister gave was as follows at pages 63-64 pf the transcript,

“Well, at that particular period, one, with the intervention ensuring stability within the domestic financial system was critical and stability in the domestic financial system is twinned to stability in the foreign exchange market. With a liberalized foreign exchange market, if there are questions about the domestic financial system or about the overall macro economic programme, the inevitable result with a liberalized foreign exchange system is capital flight and one of the critical positive results of the intervention was that there was no capital flight. You had movements from either weak or perceived to be week institutions to strong institution. The Bank of Nova Scotia was the major beneficiary of that, but during that period it was the determination that there was a need to establish an interest rate regime which would ensure stability in the foreign exchange market and in the domestic capital

market. These were some of the reasons.”

The Minister was questioned by your Commissioner Ross and he explained the position at pages 65-66 of the transcript,

“As you would be aware, although I know you from your various public utterances, you and I differ in terms of the importance of stability in the foreign exchange market, but that is a critical element to us in maintaining stability in the overall macro economy, stability in the foreign exchange market. But Commissioner, I invite you to examine the record of some of our institutions. Unfortunately, most of them foreign own and managed during the same period, in that they did not have the same level in terms of bad loans during that period and I think it is too simplistic a notion to have this cause and effect between the interest rate regime, because it is not a unique situation within the Jamaican context in terms of the interest rate regime and failure of businesses, et cetera. Clearly there must be an impact, but at the same time there are financial institutions which not only survived but remained stable and were not beneficiaries of the FINSAC intervention.”

The Minister pointed out that BNS, CIBC, CitiBank did not fail and he added at page 69 of the transcript,

“I would never ever suggest that high interest rates are good for business, but I am suggesting that the notion that high interest rate, that is the problem, is somewhat simplistic.”

The Minister was asked, by your Commissioner Bogle on the issue of that duration of the regime of high interest rates in relation to business and the Minister’s response was at pages 71-72 of the transcript,

“One of the worst things which can happen is when a Government puts out an offer with an interest rate which it believes is appropriate and supportive of industry or whatever –the Trinidadians have an expression, "you call a fete and no one comes." When you put out an instrument and nobody buys it, that sort of crisis -- so it's not that anybody wishes to have high interest rate just to be punitive, but in the mix of things there is also the issue of ensuring stability but also that the needs of Central Government to meet its obligation are met and these are some of the factors which go into the determination as to the interest rate policy.”

The Minister concluded that high interest rate was one of the factors that contributed to the financial meltdown but also noted at page 75 of the transcript bad management practices played a part. He stressed the issue

by citing the conduct of National Commercial Bank,

“...that institution became involved in planting oranges, planted papaya, a whole range of things and you really get into a culture where your farm manager is being paid by the bank manager and these diversions were critical factors and these I also term as bad banking practices and it is one of reasons in addressing the subsequent legislation we have spoken to the range of activities in which a deposit taking institution can become involved.”

On the issue whether the intervention of FINSAC could have been earlier.

Your commissioners were concerned that the delay in setting up of FINSAC might have resulted in the huge expenditure involved in settling the crisis. Here is how the delay was explained at pages 84-85 of the transcript,

“As regards the Bank of Jamaica Inspectorate, These are spot checks, they are not living in the institutions as you would know and one of the problems when they wished to prolong their stay in the institutions, the institutions complained. They could not be blamed in not knowing everything. A forensic auditor goes in with a specific mandate and that's what he is doing. The Bank of Jamaica's Inspectorate cannot operate in the same way.”

On this issue he continued thus at page 86-87 of the record,

“I gave an address to Parliament on July 16, 1996 concerning the Century financial entities and it detailed the rationale for what you call the delays. We were operating in good faith, we were seeking to avoid the situation of a collapse of institutions. If you say in retrospect you should have just hit them and move them out you are perhaps correct but I am not saying anything I haven't said thirteen years ago. I detailed all the interventions, all the meetings -- one of the problems we were running people ragged because we never summoned anybody to the Ministry of Finance in daylight for obvious reasons. We were meeting late at night et cetera, just seeking to intervene, but I have provided in that address to Parliament full details of the Century financial entities and we could do the same for several of the other entities.”

