VERBATIM NOTES

OF

COMMISSION OF ENQUIRY INTO CIRCUMSTANCES
THAT LED TO THE COLLAPSE OF THE FINANCIAL INSTITUTIONS
IN THE 1990s

HELD AT

THE JAMAICA PEGASUS HOTEL
81 KNUTSFORD BOULEVARD, KINGSTON 5

ON

TUESDAY MAY 10, 2011

PRESENT WERE:

COMMISSIONERS

Mr. Charles Ross
Mr, Warrick Bogle

COUNSEL FOR **THE COMMISSION**

Hon. Justice Henderson Downer (Retired)

SECRETARY TO **THE** COMMISSION

Mr. Fernando DePeralto

REPRESENTING JAMAICAN REDEVELOPMENT FOUNDATION

Mrs. Sandra Minott-Phillips - Attorney-at-Law
Mr. Gavin Goffe - Attorney-at-Law

REPRESENTING FINSAC LIMITED

Mr. Bryan Moodie - Attorney-at-Law
Ms. Danielle Chai - Attorney-at-Law

REPRESENTING MR **PATRICK HYLTON**

Mr. Dave Garcia - Attorney-at-Law

ATTORNEY **MARSHALLING EVIDENCE** FOR **THE COMMISSION**

Miss. Judith Clarke

GIVING EVIDENCE

Mr. Patrick Hylton

May 10, 2011

COMMENCEMENT: 9:35 a.m.

COMM BOGLE: Good morning ladies and gentlemen, this Enquiry is now in session and for the records may we have the names of the attorneys present.

MRS. PHILLIPS: Sandra Minott-Phillips, shortly to be joined by Gavin Goffe instructed by Myers, Fletchers and Gordon for Jamaican Redevelopment Foundation Inc.

MR. MOODIE: Brian Moodie and Miss Danielle Chai representing FINSAC instructed by Samuda and Johnson.

MR. GARCIA: Dave Garcia, representing Patrick Hylton.

MR. LEVY: Anthony Levy, representing John Desulme and Thermoplastics and with me is Miss Roach.

MS CLARKE: Judith Clarke, appearing on behalf of the Commission.

CHAIRMAN: Okay, thank you. Today we have Mr. Hylton with us who will be presenting his statement to this Commission. Could we have Mr. Hylton sworn in, please.

(Witness called & sworn at 9:30 a. m.)

COMM BOGLE: Thank you very much. Mr. Garcia?

MR. GARCIA: Thank you Commissioner. I am afraid I am having a little bit of a difficulty with the microphone, it is not staying in place.

EXAMINATION-IN-CHIEF BY MR. DAVE GARCIA

MR GARCIA: Thank you. Could you state your name please, sir.

MR HYLTON: Well, my name is Patrick Hylton.

Q: And what is your occupation?

A: I am a Banker by profession.

Q: And your address?

A: Well, for these purposes, 32 Trafalgar Road, Kingston 10.

Q: Mr. Hylton, have you given a statement in this matter?

A: Yes, I have.

Q: Could you take a look at this document, please.

(Document handed to witness)

A: Thank you.

Q: Could you turn to page 54. Do you see a signature on that document?

A: Yes,sir.

Q: Do you recognise that signature?
A: It is my signature.
Q: Do you recognise the document?
A: I recognise the document.
Q: And what is the document, sir?
A: The document is my statement, sir.
Q: Statement prepared by you on the 5th of May, 2011?
A: That is correct, sir.
Q: Thank you. Commissioners, how I propose to proceed is to ask Mr. Hylton -- the statement of course is quite lengthy and what I propose to do is to ask Mr. Hylton to speak to the statement. I believe copies have been made available to the Commission and I think he will be quite long in speaking to it and then I will ask him some questions after.

COMM BOGLE: Okay. As it is customary, I know it is long, but if he could sort of, in speaking to it, speak in chronological order so that we can sort of follow where he is in the statement.
MR GARCIA: Very well. I am sure Mr. Hylton has heard what you are asking of him, sir.

A: Sure.

Q: Yes?

A: Yes, sir.

COMM BOGLE: Go ahead, Mr. Hylton.

A: Sure. All right, just to start with the Background. Well, I will start then with the Employment History because I think Mr. Garcia has stated my name and so on before.

I started my banking career in 1981 when I was employed at the Bank of Nova Scotia in Clarendon in May Pen, I subsequently left the BNS maybe a year or so later to pursue a full time banking programme at the College of Arts Science and Technology which was administered by the Chartered Institute of Bankers in England. So I pursued that programme between 1983 and 1986 then I returned to the Bank of Nova Scotia as a management trainee in 1986 and I remained there. I was appointed to run the Junction sub-branch and I resigned from the Bank of Nova Scotia, I think it was in 1988 and went to Jamaica Citizens

Bank, where I started working as a Loans Officer at the King Street Branch. I worked at Jamaica Citizens Bank for five years, I think it was, five good years. I was promoted like seven times, I think, during the five years and then I think it was 1994, early '94 I was approached by some head hunters to
run -- at the time I think I was Manager of the King Street Branch, used to be Head Office of the Citizens Bank. I was approached to run the Blaise Trust and Merchant Bank I think in about March of '94. Initially I declined because I had heard some rumours that Blaise had some problems, but they were pretty insistent and I was given certain assurances regarding Blaise eventually that the authorities had gone in, that they had conducted an assessment, that they had determined the size of the problem that Blaise had, that a new majority investor was coming in and had just injected capital into the institution thereby recapitalising it and you know, it

seemed that apart from the usual things of working out you know, some collection issues and so on, the bank was on a sustainable path. And so in November of that year, I think it was around the 23rd of November I started working at Blaise Trust and Merchant Bank in the capacity of its Managing Director. Within a few days I discovered that Blaise was insolvent, that the capitalization that had been put in by the new investor was wholly insufficient to deal with the problems that the institutions had. And I discovered this in spite of the fact that there were several attempts to prevent me from finding this out in the sense that --- as it turned out subsequently they are really -- even though there was one entity named on the building, even though if you look in the directory you will find one entity, there were actually three entities operating within that same location. Blaise Building Society was one of them and another company by the name of, I think it was Consolidated Holdings, if my memory serves me well, which was an industrial and providence society.

So essentially what I discovered was that there was a co-mingling and intermingling of funds between the three institutions to the extent that it was difficult to discern and perhaps impossible to define exactly what assets and liabilities belonged to which institution and in any event the liabilities were substantially more than the assets of the institution.

So immediately upon my discovery I decided that not only should I leave but I had an obligation to report it to the authorities.

So I called my principals and I told them what I had found. Some were not particularly pleased in terms of their responses, but I told them that I was obliged to report it and I was going to report it. And so I reported it first to the Minister of Finance. It took me about two days to contact him. I reported it to him and then to the Governor of the Bank of Jamaica at the time, Mr. Bussieres. I told them that having discovered that I was going to leave, that's the Minister and Mr. Bussieres -- I think we had a breakfast meeting the Friday morning after which I had told them exactly what my findings were. They said that the previous owners were contesting my findings and they wanted auditors to come in and to do an audit and to verify what the true situation was and they were asking me to hold on during that interim while that audit was being conducted.

I told them I would and I stayed there, I can't remember, maybe another week or a few days, but the truth is that I was confident in what I had found in my findings. I was satisfied that the institution was insolvent and I really struggled with the concept of staying there running the institution in circumstances when I felt that, you know, each person coming in I had to be trying to find an excuse not to take their money, tried to dissuade them because I was concerned. And so I think it was like the 14th or the 15th of December I decided that I was going to leave anyway and so I resigned and left the same day. A few days later the institution was placed under temporary management and Gilmore Ogle of Deliotte and Touche was appointed as the Temporary Manager. Mr. Ogle contacted me and asked me if I would come back and assist them in unraveling the affairs of Blaise and giving some further insights into what they had found was the problem and so on. I told them since I was not employed I would be happy to do that at the time and so some time in the weeks subsequently I joined the temporary management team, this time working under the auspices of Deliotte and Touche reporting to Mr. Ogle in the capacity of Operational Assistant to the Temporary Manager which essentially meant that my responsibility was to manage the day-to-day affairs of the company in temporary management and to try and come up with some resolution pursuant to the mandate the Minister had given Mr. Ogle, Temporary Manager.

I worked on that along with Ogle and eventually came up with a scheme of arrangements which led to the creation of a special purpose vehicle known as FIS, Financial Institution Services Limited. And that was incorporated in 1995, I think it was October 19,1995, if my memory serves me well again, as the company which would have the role of taking over the assets and prescribed liabilities of the failed Blaise financial institutions. So what essentially we did was to combine the assets of Blaise Trust and Merchant Bank, Blaise Building Society, such as they were and Consolidated Holdings and then to take over prescribed liabilities of three entities and to administer them under the scheme. Under the terms of that scheme we paid the depositors over, I think it was, 18 months 90% of their principal balances at the time. And you know, we would have administered the assets, meaning we would have sought to recover where we thought there were prospects for recovery. There was significant litigation involved and we defended ourselves in litigation as well as pursued, initiated and pursued our own litigation in our effort to maximise as it was then described the returns or to minimise the impact or the rescue of Blaise depositors on the public's purse. Sometime during the administration of that effort, Century National Bank also ran into some difficulty and was placed under temporary management; Mr. Richard Downer of PriceWaterHouseCoopers was appointed as the Temporary Manager. And whilst I was working through the Blaise issues, the Minister asked me to liaise with Mr. Downer because they were thinking that the ultimate resolution to the Century National problem could be found within the FIS again in terms of a scheme of arrangements and the administration of their assets and so on. So I liaised with Mr. Downer and I started to get familiar with the operations at Century. During that time also I was informed by the Financial Secretary initially and subsequently by the Minister that there were signs that a number of financial entities and particularly some insurance companies and their banking subsidiaries were exhibiting signs of financial distress. It was described at the time as primarily a liquidity problem and that the government had formed a Task Force which was to enquire into and get some kind of understanding of the nature and extent of the problem and to subsequently make recommendations as to a resolution and they said since you have had all this experience working with Blaise and Century, it might be useful for you to join this Task Force.

So I joined the Task Force.

Well, the Task Force was the precursor of course, to FINSAC and at the time had working with the Task Force on a daily basis consultants from Ernst & Young in the UK as well as consultants from KPMG in the UK. The *Modus Operandi* of the Task Force was to solicit information from the entities which had approached the Government indicating that they had a problem and then to do an analysis and assessment of the information that they received so as to make a determination to the extent of the problem and so on. And I must tell you that I told them that I had a little bit of a difficulty with the approach in the sense that certainly, in my own experience I suppose they might find it a little different in the context of Blaise and Century what I had raised and so many times when institutions were distressed you would find that what you got from management and so on by the time you got in there it was significantly worse.

Anyway they felt that because the institutions themselves had made the approach and they felt that there was a danger of sort of having this wide scale situation of consultants and starting to descend on several institutions and to investigate them may have led to a crisis of confidence that this was the preferred approach, a confidential approach, an approach which was built on trust and the provision of information and so on.

So it proceeded on that basis and in January of 1997 based on the recommendations of the Task Force, FINSAC was formed as a special purpose vehicle to protect, as they say, resolve the problems in the financial sector, and an explicit mandate given by the government at the time, and I think it is appended to my statement, was to protect the depositors, policy holders and pension funds for pensioners.

MR. GARCIA: Would that be exhibit, the attachment marked Hylton 1?

A:: Yes sir, that's correct. An announcement was made in Parliament commencing...

COMM BOGLE: Would you want us to identify exactly which one it is Mister....

MR GARCIA: Pages from the Annual Report of FINSAC Limited 1998.

COMM BOGLE: Would that be a particular page so that we can follow?

MR GARCIA: Perhaps Mr. Hylton can indicate the page to which he is referring, but I wonder if at this time Commissioner, perhaps I could ask that it now be tendered as an exhibit.

COMM BOGLE: Oh, that is why I want to identify...

MR. GARCIA: You want to identify the particular page first?

COMM BOGLE: Since he is referring to the particular page...

A: You mean in my statement, sir?

COMM BOGLE: In your statement I think you referred to a particular page extract.

A: I need to find it because I really wasn't looking at the statement.

COMM BOGLE: Look at page 9 of the Annual Report and see if that is the page.

A: Yes, that's is correct. It is page 9 of the Annual Report.

MR. GARCIA: And it's page 8, paragraph 27 of the statement.

COMM BOGLE: All right, so you would like to put the Annual Report in total as Exhibit 1?

MR GARCIA: It's the pages that are copied and attached to the statement which are pages -- well, it's actually cover page 1 and pages 8 to 14.

COMM BOGLE: 1998.

MR. GARCIA: And it maybe useful sir, at some point, perhaps not now, for the entire Annual Report to be received by the Commissioners if they have not already been.

COMM BOGLE: Well, at the moment we are taking Exhibit 41 to be the extract from the Annual Report from 1998 which speaks to page 1 and pages 8 to 14.

MR GARCIA: Yes, thank you sir. The witness has used the marking Hylton 1, I don't know whether Commissioner, you wish to use that or something else.

COMM BOGLE: Yes, we can use Hylton 1 or H1 so that we can shorten it by H1 or PHI.
MR GARCIA: PH1?
COMM BOGLE: PHI.
MR GARCIA: Thank you, sir.
COMM BOGLE: Go ahead Mr. Hylton.
A: Mr. Chairman I think I am going to just follow the track of the statement to make it more beneficial because I was kind of talking from memory.
COMM BOGLE: You have been following some way along, which clearly shows that you prepared the document.
A: Yes, sir, I did. So in March of 1997 following this incorporation, FINSAC had its first major public intervention and this was in the Eagle Group, it was acquired for $1, the entire Group. And this was based on a negotiation which took place with the then principal of the Group into the wee hours of the morning, I should say. I made reference to the point, the $1 was notionally in the sense that we recognised that Eagle was massively insolvent and quite apart

from its insolvency, there were some complications in terms of the structure of some of its internal operations and more particularly, some of the contracts and engagements which it had such as the structure of the Eagle Premium Growth Fund and some issues regarding Ciboney, the whole Ciboney Group and some of those institutional arrangements. I said public intervention, because we also inherited some legacy agreements, that's FINSAC which the government had previously negotiated by way of liquidity support. I know at least, Jamaica Mutual Life and I think there was maybe another, or two others where the government had provided funding through the Ministry of Finance to these institutions and FINSAC was asked to assume these arrangements.

One of the things that highlighted the situation in Eagle too was that there was a massive run on the institution. I don't how many people but remember the long lines, I remember I was trying to go there trying to assure people that their deposits were safe, that they would be protected. It started having a wider impact in the sense that persons started questioning the entire financial system particularly the indigenous financial systems having regard to the fact that Blaise had closed, Century had closed and now Eagle was clearly in significant financial distress.

So that by the time the run itself had abated which was subsequent to the acquisition, the overdraft of Eagle Commercial Bank, if my memory serves me well, was well in excess of $10 billion. So the mention here that FINSAC's mandate is to protect the policy holders and pensioners was communicated to the world at large and this was done by way of a Ministry Paper which the Minister of Finance prepared and tabled in Parliament.

One of the points that I think needs to bear emphasis is that FINSAC was formed as a response to an existing crisis because I think very often I have seen where persons tend to refer to the crisis as FINSAC. At the time I had indicated to the then government that I thought it was something that needed to be clarified in communication because I thought it was dangerous and persons need to recognise that there was a pre-existing condition and that FINSAC was incorporated to address that condition. In other words, the institutions which FINSAC bought, intervened, took equity were insolvent, the majority of them or at least at best I should say exhibiting financial distress. The loans which FINSAC bought were already non-performing and/or substandard. FINSAC's role therefore was to try to find a way to resolve this whole conundrum using its very limited resources and one of the things which we said we needed to do in that context is to manage these resources as efficiently and effectively as possible to minimise the cost on the public purse.

So there was a series of subsequent interventions. They had Citizens Bank, Life of Jamaica, Jamaica Mutual Life, NCB, Victoria Mutual Building Society among several others. There were many, many of institutions that went bust. A number of merchant banks, some building societies that are not named here. A number of them were eventually rehabilitated, some were liquidated, some were merged and consolidated and some were rehabilitated in more or less their original context as going concerns.

The rehabilitations, the strategy used was typically at that time, and this is prior to my being appointed as Managing Director now, but I was involved because I had been -- even though I was at the FIS as the Managing Director, FINSAC had been formed and I was appointed a Director at FINSAC and in addition, given the rapid rate of growth of FINSAC'S involvement and the work it had to undertake, the Minister had asked me to assist Messrs Bonnick and Bolt as much as I could in working through the FINSAC issues. And logistically it was a little easy because FINSAC and FIS were across the road from each other. So whereas FIS is on the corner at 9 Trinidad Terrace, FINSAC was at 76 Knutsford Boulevard, you had to just cross the road and you were there. So it was easier, I just walked across and worked. Dr. Bonnick assigned me certain responsibilities, Mr. Ogle would have certain responsibilities and so on. Dr. Bonnick eventually indicated his desire to leave FINSAC in an executive role and he recommended that I be appointed as the new CEO and he said he made the recommendation at the time based on the fact that he felt, having regard to the kind of role I had played, the type of analysis and insight I had brought to the process, that I was the best person to run the institution at that time, his words, sir, he said it. By that time of course, FINSAC was the owner, conservator, shareholder in a large number of companies and consequently a large segment of the indigenous Financial Services Industry. In addition to this, FINSAC had, through this process, acquired significant real sector holdings across a diverse range of industries. FINSAC had by this time very significant interest and somewhere around this time in over two hundred companies, several of them large and important companies. And I have exhibited this particular document which was prepared later on but which was an attempt to capture the various entities in which FINSAC has had an interest.

MR GARCIA: That's the document Mr. Hylton, that's marked Hylton 2?

A: Yes, sir.

Q: And it bears a date?

A: Yes, the date it was prepared, January 14, 2002.

Q: I am going to ask Commissioners, that this be entered into the evidence as Exhibit PH2. It was too large to attach to the statement so I had sent copies to the Commission.

COMM BOGLE: Hylton PH2, yes, and it is FINSAC Limited Ownership and Involvement in a number of entities.

MR HYLTON: Yes. One point to note Chairman, is that the scale of involvement was driven by the fact that the intervening entities under their struggles acquired these businesses. In other words, these businesses reflected the entities of their involvement in real sector activities, notwithstanding the fact, that they were core financial institutions. And so it was impossible of course to proceed with the intervention without dealing with the situation because in many instances the actual distress or a significant part of the distress the institutions were experiencing was driven by their involvement in some of these, many of them loss-making, many of them inappropriately financed acquired. Many of them we could say had no expertise et cetera, so all those were the things that we saw.

In addition to this I was appointed to the Boards of a number of the entities: NCB, Crown Eagle and several many, many others, I don't recall many of them quite frankly. And although the truth is that given my workload it was very, very difficult to take on additional responsibilities within these entities, it was important in as much as it gave me an insight, perspective, into some of the challenges that they faced and how the implementation or the resolution was going in terms of outcome. I made some observations here about some of the characteristics of the intervened financial institutions, and I made them purely on observations of what we saw and so on. For example, we saw in many instances, there was the absence of a framework for the management and monitoring of critical risk areas such as liquidity risk and foreign exchange risk. Some institutions didn't have an

Asset and Liability Committee, they were not being actively managed. They were in many instances not monitoring or actively managing issues such as gapping, such as duration, such as industry concentration. Our view was that this framework was particularly important in what we described as the post-foreign exchange market liberalization environment where we had moved out of the whole regime of financial repression.

On the credit risk and operational risk side of their business, we also saw significant inadequacies in terms of the framework, insufficient and inappropriate governance frameworks. And the truth is that the absence of these frameworks, these risk management attributes contrasted somewhat significantly with what we saw in some other foreign owned institutions. Of course, they would have to be the benefit of their parents and so on who would have had these things as operating requirements and operating in liberated markets and so on. So we saw that. One other characteristic which we noted, and I put it here because of the view on it, Chairman, is that the majority of the intervened financial institutions were run by Executive Chairmen and my view, while this might not be a significant issue with non-financial companies, I think it is risky with financial institutions because financial institutions manage significant risk and it is good to have appropriate checks and balances all along the way. And a situation where someone, the Board to my mind, plays a very important role in that process of the checks and balances and managing risk and if the same person who will be running the institution and would be running the Board with an institution which is highly leveraged, then I think it creates an environment for significant risk taking, which facilitates risk taking.

And I make the point here as well, that

the dominant characteristics of these institutions, I think I mentioned it before but I think it bears repeating, they were experiencing severe financial distress, were badly in need of liquidity, restructuring and rationalisation. It was a massive undertaking Chairman, the scale and scope of which was unprecedented certainly at least in the Jamaican context and suspected in several others. I tell people that it was not unusual for us to be working at 2:00 a.m, sometimes we never went to bed because we just had to try and stay on top of the issues.

So you know, it was what was required. One point I had mentioned...

COMM BOGLE: Just a minute.

COMM ROSS: Mr. Hylton, I would just like to ask you a question. You mentioned the scale and scope of the problem and what needed to tackle issues and roles et cetera. Was there at any point in time considerations as to what were the factors outside of these institutions which placed all of them in these difficulties? Roughly to save time and was there any consideration at all given to addressing the problems from that point of view?

A: Clearly Mr. Chairman, and certainly more specifically Commissioner Ross, I think that the -- and I have said it, my view is that the problem was primarily a micro-economic problem, and I tell you the reason why I said that in a moment. Of course it would have been exacerbated by macro-economic instability which was present at the time. The truth is, I didn't concern myself too much with the historical context save and expect to the extent that it reflected lessons for us going forward, yes. And what I mean by that is that, my own philosophy is that we have to manage our institutions and our business according to the environment, yes. And in fact, just to give you by way of anecdotes, I am of the views for example, that you know, you are going to have a macro-economic instability from time to time in any country, in any economy, in any set of circumstances, what you have to do in those circumstances is manage the institution well. I give you an example more recently. We have the situation with the global financial crisis 2007/2008 and I can tell you that I don't think many persons outside of the financial system would appreciate to the extent the challenges that it would have imposed on local institutions particularly, local institutions which had access to, which had access to and which had arrangements with foreign institutions in terms of funding lines and credit lines and so on which were withdrawn with immediate effect. And I remember -- and I tell you this, this is a philosophy. BOJ at the time had announced that they were providing a special facility to assist companies who had liquidity problems meeting margin calls and so on. Well, I remember the then Governor calling me to tell me about it and I told him, I said former Governor, let me be honest with you, sir. You will never get a call from me about a liquidity problem because I as far as I am concerned if I see signs that a liquidity problem is coming then there are certain actions I am going to take. If I see signs of exchange rate instability, I am going for long, and we have been criticised for it but that's what we did. The point I am making is that we have to manage the business in the context of the set of circumstances. I have heard people, for example, say we will continue giving loans and you know, credits expanded during high interest regime because they thought this was going to be short lived. I can't run a business on the basis of my expectation of what somebody else is going to do. I have to run my business within the context of the present reality. And I told my people within my organisation very clearly, that anybody who was running a strategic business unit and who called to say they had a liquidity problem needed to recognise that that was a career-defining moment. Where we had lines we assumed it would be prudent

where we had maturities, we assumed they would be taken and yes, we had to give up on yields, we had to give up on profits but that was the prudent way to run the business.

So my philosophy and I said so -- I mean, I came under some pressure when we went long. I said to the Governor, Governor, with all due respect Governor--it was the former Governor and I said to him: Governor, when you raise interest rates on our interest rates I would never call you. Yes, I never will. So Governor, we are going to go long, we are not going to speculate in going long because as it turns, in a way we are already in trouble but we are going to measure what it is that we think is required to survive, to thrive in this environment and we are going to make the adjustment. So that's my philosophy and my approach to things and that's my thinking and that's the thinking that we brought to the problem.

COMM ROSS: Certainly a prudent approach from a banker, but I think there are people who had a responsibility for the overall system and that's why a consideration would come in play or ought to come into play, perhaps. (Laughter)

A: All right sir, so essentially the point is that it was a very challenging environment. We worked hard, we recognised that there was a log that needed to be accomplished and in paragraphs 46 and 47 I quote from the Annual Report, FINSAC 1999 Annual Report. And this was just about coinciding with the time that I had taken responsibility for the institution where our Chairman then, The Honourable Dr. Kenneth Rattray had said: "We *realised that the fire-fighting was finally over and what we needed to do now was to access the extent of damage* *in the sector and work out what new superstructures might be needed for rebuilding to proceed".* And in my own remarks I said we considered two questions: How could FINSAC as an institution maximise the value of government's investments in the intervention?

How could we ensure that the new financial sector we were planning to build would be sustainable?

So we prepared a request or proposals and we went to the market to seek consultancy help and after going through a fairly rigorous process we selected McKinsey and Company to work with us on the basis of what we described then as a strategy of total emersion. In other words, we said to McKinsey this is not just consulting, we want work done in terms of resolving some of these problems. So we formed cross functional teams with our consultants from McKinsey as well as our own staff and the first engagement was to do what we called a "diagnostic assessment" of the situation. In other words, to try and work out a framework for how we are going to proceed going forward in terms of executing our mandates. And I will tell you Mr. Chairman, the philosophy then as it is now, quite frankly as I said to people is that, in terms of coming to me and certainly coming to us in terms of an approach or a resolution the philosophy was very simply, "In God we trust and for everyone else we want the facts and the data". In other words, we are not interested in somebody just coming to tell me that I feel it was this way or in my view. The concept was show me why it needed to be this way. That was the approach, that was the philosophy.

So we went through this process very detailed, very engaged process and at the end of it which was, I think it was around September or October of 1998, we had a number of findings indicating the need for a massive undertaking of consolidating and rationalisation of our core financial sector holdings and this was clearly to reduce cost, to remove excess capacity and restore viability. The truth is that the substance of our findings is that there were too many institutions operating in the market and part of that may have led to many of them going off into other business ventures, many of them in competition with their own customers, yes. So we found that in any event government having intervened in the sector and having acquired a dominant position in many of these companies now needed to assess its position in terms of rationalising what it owned so as to reduce the number of head offices, so as to reduce staff in terms of operating cost, so as to reduce the kind of infrastructure, and so as to rationalise even things like information technology platforms and so on so as to have a better benefit from scale in terms of its utilisation.

We also found Chairman, that particularly with the insurance companies, particularly, there was an over investment in real estates yes, and I think a lot of it had been driven at the time by the fact that in an high inflation environment real estate relative values kept going up so it seemed as a good investment on the face of it and when the person went in there and the bust came then the whole thing started to unravel.

Our findings also indicated a need to separate from the financial institutions the non-core operations and housed them in a place where we could very quickly facilitate their eventual sale and divestment to appropriate non-financial sector parties who knew how to run these businesses and who could assist them in returning to viability and to make their contributions to economic development. We concluded that we needed to separate the non-performing loans from the work of the institutions that we had acquired and probably from the initial they had been left there for several reasons and will go into those a little later. But one of the key requirements of both the loans and the other real estate and various other assets was that they were key sources of liquidity required for FINSAC and for financing its operations. The fact of the matter is that the government was not in the position to give us cash to intervene so we intervened using FINSAC notes and I am sure Commissioner Ross would remember the famous FINSAC notes, and we had a provision, the notes paid interest with more notes for the simple reason that we just didn't have the cash to pay interest on those notes. So what we tried to do was to liquidate, to collect and to get liquidity so as to redeem those notes as quickly as we could or pay some interest in some circumstances. It was a very challenging situation in terms of liquidity management because the truth is that, those non-performing assets whether by way of real estates, by way of commercial business ventures, by way of loans representing the significant asset or financial institutions from which they would have expected cash flow to run their business and they were no longer generating cash. So FINSAC having taken them, having now taken ownership had to find a way to generate cash to meet their operating needs. Some of them ran cash deficits just on a normal operating basis. For example, I know that Union Bank, shortly after it was formed our analysis had indicated that -- I don't like to quote this number because it is off the top of my head, but I think there was cash deficit in the order of about three hundred and odd million dollars a month which was huge, it was significant in those times so we had to find a way to fund that to meet those needs.

We also recognised that there was a need for significant legislative and regulatory reform. And so, we developed a number of key considerations for that reform and a lot of focus was given on what we considered the weaker area at the time which was the insurance legislation and the structure of the Office of the Superintendent of Insurance and we did a lot of that work through IDB funded projects and attached, marked Hylton 3, pages 18-20 of the 2001 Annual Report summarising some of the recommendations and the status of them at that point in time.

MR. GARCIA: Commissioners, I am going to ask that that be entered as Exhibit PH 3, 2001 Annual Report, cover page and pages 18 to 20. I am sorry Commissioners, the statement says that at pages 18 to 20 are attached but my copy actually only has pages 18 and 19.

COMM BOGLE: Yes, I was looking for 20 as well.

MR. GARCIA: So I believe I will have to ask Mr. Hylton to supply page 20 afterwards.

COMM BOGLE: Okay.

A: I am on page 17, Mr. Chairman. So the findings essentially became our blueprint for work going forward, the focus being on effective execution of each defined work stream. FINSAC's organisation structure was reorganized and resourced to efficiently and effectively support the major work streams and a couple of the organisational charts showing the major and functional areas is marked Hylton 4 and accompanies this statement.

MR GARCIA: Again sir, I am going to ask that this be entered as exhibit PH 4 and that also wasn't actually attached to the statement but was provided separately to the Commission.

COMM BOGLE: PH 4.

MR GARCIA: Mr. DePeralto, I am wondering if the Secretariat could provide copies for counsel.

COMM BOGLE: The organisational chart?

MR GARCIA: I am being told that counsel don't have and I had provided copies to the Commission.

COMM BOGLE: It will be provided so I think we can move ahead in the meantime. Yes, go ahead.

All right. So the major functional areas are set out there Chairman: Banking intervention and rehabilitation, insurance intervention and rehabilitation, asset management, monitoring, divestment, financial administration and of course, this very important function was mentioned before, liquidity management which cut across everything, across all of those areas. We worked closely in collaboration with trying to resolve many of these problems, both internally and externally. And as I had mentioned before the rationale for the mergers and consolidations was essentially to create an efficient structure to cut cost and to create something which we believe was sustainable in the context of the circumstances. So we decided for example, to merge a number of entities to create Union Bank which is now RBTT Bank, Jamaica, and we decided that we were going to create at the time a new insurance company. Initially, we had named it independent Life but that approach changed in the middle of its implementation in that it evolved into the sale of the portfolios of the legacy institutions on a combined basis rather than the creation of a new institution and the sale of that institution. And the reason we were able to do that Chairman, is that, in the process of creating Independent Life we tried to do a market read, just as we were doing when we tried to create Union Bank to do a market read to say, could we avoid the whole process of risk and all of the heavy work, the heavy lifting involved with merging several banks and so on. We were taking a Y2K approach and get somebody else who is in the business to do it. We never found that option with Union Bank but got indications that there was interest in relation to the various insurance portfolios and so what we did was to go through a public process of sale of the portfolios working along with our consultants in terms of defining what was for sale so that we wouldn't allow people to split it up in terms of buying different pieces and so on and that process went through and as a consequence Guardian Life emerged as a preferred bidder and is now operating as an insurance company here in Jamaica having acquired those portfolios. And of course, we went through a very aggressive process of trying to dispose of the non-core assets particularly the larger ones such as the hotels, and I make mention of a few of them here. Boscobel, Terra Nova, Hedonism II, Grand Lido, Holiday Inn, Ciboney and some other assets. I mentioned here the Orange Farm which had been owned and now operated by Trade Winds. All of these various assets. We had media holdings, holdings in Shipping all over the place. I mean it was diversed.

Q: I mentioned the liquidity issue before and one of the things we did, we established a liquidity management function within FINSAC and we literally have to monitor liquidity of the institutions on a daily basis. In other words, we had to be watching what was the net liquid position on a daily basis so as to respond to their liquidity needs and of course, we worked very closely with personnel from the Ministry of Finance, in particular the Debt Management Unit, the Accountant General and the Bank of Jamaica and we were able to successfully manage this challenge throughout that whole process.

On page 20 one of the things that I have tried to do Chairman, if I could just digress just a little bit but I think it is important -- in my statement is to speak to issues I have heard raised before the Commission and I have done by this way of, whether it is media reports or transcripts and so on which I have read of the various proceedings. So you will see, for example, here on page 20 of 54, I will deal with the issue of the treatment of some institutions particularly NCB because I know that that was a topical issue, well, I heard it raised as a topical issue. The point I make here, it must be underscored that while there was some common issues, each institution presented its own challenges. Our analysis and those other experts we engaged, justified maintaining some institutions, some in a merged form such as Union Bank which was a composite of a number of smaller banks. Life of Jamaica and NCB, the analysis showed, should be maintained as going concerns. There were others that were small and in our view, incapable of sustainable rehabilitation and in any event there was no justification in the sense that government, now having taken control, had to rationalise its own holdings. So there was no point in just restoring the institution because it was a separate institution just for those purposes. So we did that. And in the case of NCB I make the point that the decision to maintain it as a going concern was informed by several factors among them, NCB's size and interconnectedness, very important. We felt it was important for example, that there being at least one other large institution in the commercial banking space apart from the other large one which at the time, and still is BNS. The other challenge, the liquidating and institutional side of NCB was so entrenched within our economy, was manning the fallout and numerous other entities, other sectors and large number of persons; this could become extremely difficult and undermine the stability which at the time, had been restored to the sector. But perhaps more importantly our analysis supported NCB having greater value as a going concern not only in relation to its intrinsic value but also in terms of its role as a facilitator of economic growth in the years ahead.

We also found that NCB was useful as a

vehicle for further sector consolidation. There were a number of small merchant banks et cetera, that we determined were no longer going concerns and we had two options. We could have transferred their portfolios to other non-FINSAC banks but we would have to pay them cash or LRS for them to have; we could have transferred them to Union Bank and Union Bank was already significantly challenged in the context of its merger and consolidation activities but the other option was to transfer the portfolios at NCB and funded the FINSAC Paper we had and that's what we did. I am just being forthright, that's what we did.

The truth is that, the non-FINSAC institutions would not have taken FINSAC Paper as compensation but NCB did and so we were able to -- and as I told you, we were supporting them in terms of their liquidity needs on an ongoing basis. So we were managing the situation.

I make the point that if you look at the treatment of the shareholders, there is, turning to that point, in NCB as against other intervened institutions, yes, its major shareholder Jamaica Mutual Life was completely taken out and quite frankly when he debated at the time, the reason why they were compensated for NCB shares was -- and this was before my time and I was there -- is because it was a mutual and we said there was no point in not compensating because it was going to increase the size of the intervention you have to make in there anyway. So you put it in one way, you put in another way, it being a mutual you are not getting anything because you can't take shares. At the end of the day what we did Chairman, was to essentially do a reorganization under which FINSAC ended up with 75% plus one share in NCB so the other shareholders were significantly diluted.

MR. GARCIA: Mr. Hylton, if I could interrupt you there to ask a question. Dr. Chen-Young in his submission has suggested that the shareholders in NCB and in LOJ I believe it is, lost nothing during the intervention and I wondered whether you agree with that statement in relation to NCB and also whether you could comment on it, your statement deals with NCB, but whether you could comment on that issue in relation to LOJ as well.

A: It is not true that they lost nothing because their relative share value would have been diminished but they didn't lose everything but it is not true that they lost nothing. And I tell you quite honestly, part of the consideration was that FINSAC had to proceed on the basis of intervention by negotiation. FINSAC had no legislative authority, FINSAC couldn't go and take people's shares, yes. And there were going reasons for the intervention by negotiation because the truth is, if you try to proceed otherwise -- it's very difficult to manage a situation when you are dealing with 30,000 shareholders in terms of getting the compliance and so on to get control over an institution, that you can do the rehabilitation work that you need to do. So what we effectively did was to dilute them significantly and put ourselves in that position. In any event, the philosophy and the thinking was that these minority shareholders never really ran the institutions and would not have contributed to its financial distress or demise.

So even though there may have been some moral hazard issues there admittedly, the fact is that it was constrained in the sense that they were significantly diluted. And so, we were effectively able to go about our work very quickly instead of having to deal with that.

COMM BOGLE: Mr. Hylton, you mentioned earlier that -- your analysis indicates that most of the problems of the institutions really result from management.

A: Yes.

COMM BOGLE: Now, how did this sit with NCB, NCB being one of the intervened institutions, but how was the management of NCB dealt with vis-a-vis the management of the other institutions?

A: Okay. I will deal with that. There were significant management changes in NCB as there were significant management changes in other institutions. In NCB I think we brought in about five senior managers, if I recall, most of them from the UK. We brought in Chris Lowe, who came in as CEO of the bank; we brought in somebody in charge of Credit and Risk, somebody in charge of MIS and I think there were a few others that were brought in. In the other institutions we brought in -- in some cases we -- quite frankly, my predecessor used to put it this way Chairman, and so I will borrow his expression, he used to say that "all the people are tainted, let us try and use those that are less tainted until we can replace them." Yes, so the truth is that even as we went on a search for management to come into the various institutions, we also had to be mindful of the fact that we needed somebody to be running them in the interim. And so what we tried to do was to put in an aggressive rehabilitation plan to work with our consultants to engage, to some extent -- because of some of them, their actions and so on would have been a consequence of them not having been operating in a liberated environment, in fairness to them, and so what we tried to do was to engage to some extent what we called capability building. In other words, putting in place institutional frameworks, management principles and policies which would enhance the operating frameworks and entities in which they were involved. So it was a combination of things.

COMM BOGLE: Would you say that NCB at the time had a lot of loans that were to government and government institutions?

A: I am not aware off the top of my head, just thinking. NCB may have had loans to Government institutions, I am not aware of any government loan that was a problem loan that had to be taken over, I can't recall it.

COMM BOGLE: Well, just a matter of whether or not it was there in terms of, I would doubt whether or not FINSAC would have taken Government entities' loans.

A: They may very well have had government loans, in fact I am pretty sure they would have had. I mean, almost every bank had government loans at the time. 1 am sure NCB would have had its fair share. Yes, that is very correct, Chairman.

COMM BOGLE: The loans to Mutual Life.

A: Mutual Life loans.

COMM BOGLE: How was it dealt with?

A: Those were non-performing and eventually were paid out through the assistance to Mutual Life by way of FINSAC Paper.

COMM BOGLE: So they were paid via the paper?

A: Yes, sir.

COMM BOGLE: Earlier as well you mentioned that, especially in terms of the smaller banks the decision was taken to merge them?

A: Right.
COMM BOGLE: Was any thought given to the big, large reduction in the number of banks in view of wiping out -- this was wiping out competition by and large, because you had now two large banks, BNS and NCB but there was not much competition anymore at the lower level. Was that taken into consideration?
A: Our view at the time Chairman, was that Union Bank was a sufficient size along with, I think it was CIBC, to provide useful competition.
COMM BOGLE: But as we see today even with the number of the banks there is not sufficient competition.
A: I tend to disagree with you because I think there is robust competition in the banking sector today.
COMM BOGLE: Close competition.
A: I feel it every day.
COMM BOGLE: There is no close competition.
A: They say he who feels it knows it.
COMM ROSS: Sorry, Mr. Hylton, could you just tell us a little bit more about these Finsac

notes. I think you mentioned earlier that there was a problem of insolvency in the -- there were a number of institutions as result of their non-performing loan portfolios. But as you mentioned FINSAC as an institution was really without any intrinsic assets of its own, yet it issued many billions of dollars of these FINSAC notes which were then accepted as assets on the balance sheets of these institutions. Wasn't this in essence a fiction? 1 mean, and was it accepted as such by the regulators and so on?

A: I think we had this discussion in another light, Commissioner Ross, but I will give you my perspective on it. A couple of things. The initial intervention in the financial sector during the earlier FINSAC period was by way of cash primarily, in fact, almost exclusively. If you will recall that the Minister of Finance at the time, went to Parliament, I think in early 1997 and as indicated, based on the information that had been received from the various institutions which said they were distressed and the extent of the assistance they required, the government had identified some funds through sterilisation of accounts at the BOJ to intervene and that should essentially fix the problem. The truth is that what transpired subsequently and Dr. Bonnick speaks to it eloquently, in his Chairman's remarks in the 1998 Annual Report when he said, "What was communicated to the Task Force as well as FINSAC in its early days as a liquidity problem, initial liquidity problem, turned out to be a much larger problem". So that in a sense, FINSAC's initial involvement was premised on a certain basis, on a certain size problem, it turned out that the problem was much larger than that, so that is the first point. So that, in that sense it was anticipated that the cash used would have been sufficient, the cash provided, as it turned out it was not.

Having said that, the problem existed. So then the -- they have a saying that "it is what it is", so we now had to deal with it. The problem now confronted us and we had to deal with it. And what informed the strategy was essentially -- because we looked at a number of things; could we use some of the reserves that were there? Could we use all kinds of different things? What would be the implications? And then when we examined it very carefully we said to ourselves that banks operate essentially on the basis of tractional reserves meaning that at any point in time all things being equal, the bank doesn't need to hold more than a certain percentage of its assets in a liquid form because it is only a limited number of persons are coming in at any point in time to take funds and at the same time others are depositing funds. And so we said that if we could find a way in which to deal with the solvency problem by virtue of replacing the assets with an instrument which bear the undertaking of the Government of Jamaica to pay in due course and then manage the liquidity needs on the basis as they arose, then we are in business. So that's essentially what we did. So I wouldn't describe it as a fiction because it was real because we have to limit.

COMM BOGLE: How were these bonds classified in the financial institutions that got them?

A: As bonds.

COMM BOGLE: Was it a long term asset, short term?

A: In some instances they were, depending on the tenure, because some of them actually were short term and so would have qualified as liquid assets.

COMM BOGLE: And so could those have been liquidated had the need arose?

A: What we did with those, what we tried to do was to put ourselves in a position to redeem those and then they became -- that's why I said liquidity was always the challenge. We had to be looking at it, measuring it and responding to it but we were able to manage it. The truth is we were able to do it and that's why I said to Commissioner Ross, it wasn't a fiction, it was real.

MR GARCIA: And can I ask Mr. Hylton, how did FINSAC put itself in a position to be able to pay on those bonds on maturity?

A: Through collection of loans, sale of assets, sale of real estates, sale of hotels, loans collection, all those various activities that FINSAC engaged in.

COMM ROSS: Maybe a bit unfair question but do you recall how much of the FINSAC bonds were eventually converted to longer term bonds?

A: You mean the amount at the time?

COMM ROSS: Or percentage value.

A: Oh no, all of was eventually converted. I don't remember what the amount was at that point in time, but all of it was eventually converted. Where am I?

MR GARCIA: I believe Mr. Hylton was about to start the section about divestment on page 22.

COMM BOGLE: At this time Mr. Hylton, I think you may well deserve a 10-minute break just

before you go on to the other section.
A: Thank you, Chairman.
COMM BOGLE: So you will have a ten-minute break at this time.

(BREAK 10:51).

ON RESUMPTION:

COMM. BOGLE: Ladies and gentlemen this Enquiry is now reconvened. Mr. Hylton just to remind you, you are still under oath. You may proceed.
MR. HYLTON: Thank you. I think I am at 67 Chairman. So that at the end of the period of intervention, FINSAC had this massive holding of assets apart from shares in numerous indigenous financial entities. These included as Z mentioned hotels, large and small commercial and residential estates, including real estate development, non-performing loans, companies engaged in several real sector activities spanning the gamut from farming through media to shipping and a number of entities to domiciled overseas to include the USA, UK, and the Caribbean.

In 68 I made the point that a lot has been made of the fact that none of the financial institutions were sold to local entities or operators. While this is true, because it is a fact, there was nothing in our approach, nothing in our philosophy, nothing which would have prevented or precluded local operators from acquiring any of these entities once they met the criteria. I personally met with several business persons to suggest to them that I thought that some of these local financial institutions represented a potentially good investment, but they were either unconvinced or did not have the resources as they responded to me. What we could not do Chairman, was to sell the institution to a local entrepreneur, simply because they were locally based and I make references here to the experience of Mexico as I read in a book which had divested primarily, having concerns about the degree of foreign ownership, and divested primarily to local persons and found themselves in a lot of crises before the end of decade, because the divestment process had not been sufficiently robust in the implementation of its criteria.

COMM. BOGLE: Without having seeing the criteria, could it have been that that criteria could involve certain items or requirements that made it very difficult for local entrepreneurs to actively participate?

MR. HYLTON: I didn't think so, Chairman. The criteria, if I may describe them, was of high level, to be fit and proper, in other words, capable of passing the fit and proper assessment of the regulators To have the capital required to make, and not only to make the acquisition, but to create some cushion so that the institution could be on sound capital base and sound footing and to have the expertise, whether it was expertise in themselves or in terms of hired expertise to run the business effectively. I don't think there is

anything - T I think there were local
persons who could have qualified but for one reason or not was not interested. I can't speak to people's financial resources definitively, so that aside, I don't think there was any bar to local participation. So that...

COMM. BOGLE: Just a minute.

COMM. ROSS: Wouldn't you say that the prevailing circumstances in Jamaica was very high cost of capital, wouldn't that have been an effective bar to local participation.

A: I would say it would have been a challenge, Commissioner Ross, I don't know person's personal financial situation, so they may very well have the resources, I don't know, in all honesty I don't. I certainly spoke to people who I felt may have had the resources but they declined.

COMM. BOGLE: You are saying from recall you could not point to one or two persons who had come forward but the main problem was a resource problem?

A: What I would say, Chairman, is that I myself -- there may have been one person I can recall who actually came forward and enquired, looked at it and said, you know what, I think I like my business better. They were in another industry as that, I think I like my industry better, they never say they did not do it because they couldn't afford to but they said they prefer their business, they are more comfortable in their original business. And there were others who said I don't think I can go up to that capital. There are others who said I am not convinced that this a good deal.

COMM. BOGLE: But following on from what Mr. Ross is saying, could it be that some of them really were fearful, seeing what was happening at the time and not only in the cost of capital now, but just the atmosphere that prevailed that they might have been just fearful of what might happen?

A: That is quite possible Chairman, quite possible. You know what they say about danger and opportunity. (laughter). Our process, and 1 will just talk a little bit about the process for divestment of institutions was generally to approach through our advisors, I am talking about the core, big large institutions now, institutions regionally and globally to receive competitive proposals. These proposals were then assessed by us and our advisors using professional valuations which we had obtained on the various institutions; this would inform the selling price and the selection of the bidders. We would have due diligence conducted on the bidders being considered for selection before a final decision was made. We used a number of firms for this purpose, we sometimes used a New York law firm with expertise in due diligence exercises, I believe the name was Paul Weise & Company, I think they are in Manhattan and the person, as I recall that we used on a couple of occasions, was a gentleman by the name of Chuck Coughe who was a partner or the equivalent of that firm.

We sometimes had due diligence arranged through the Embassy in Washington and if the exercise was being carried on a bank, then it was conducted primarily by the Bank of Jamaica. Sometimes we used a combination of different approaches. Ultimately in relation to the financial institutions, successful bidders had to satisfy the Regulator's fit and proper requirements for substantial ownership. I make the point here that all the institutions we sold went through the challenges of 2003, I think many people forget that one with the exchange rate instability. The global financial crisis of 2008 and the Jamaica Debt Exchange Programme of 2010 unscathed, and I am saying here, I am asserting that this is suggestive of the health of the institutions post intervention and post divestment.

COMM. BOGLE: Unscathed, but I think if one should analyze a number of statements, unscathed is probably a strong word, in other words, they were not intervened or they didn't fall but quite a lot of them shook a bit in terms of their portfolios.

A: You mean the divested institutions?

COMM. BOGLE: Yes.

A: I don't think any of them would have shaken any more than those that were not intervened.

COMM. BOGLE: I am talking generally now.

A: Generally. Chairman here is the challenge that I have. My perspective on this post FINSAC is primarily informed by my experience at the institution that I am and I can say for the records that we were unscathed.

COMM. BOGLE: Yes?

A: One fact, Chairman, that gets lost in the debate is that the majority of hotel properties, large and small, as well as numerous pieces of commercial and residential assets were sold to local operators. Yes? That is a fact. And so we saw there were individuals and institutions who had the confidence and the vision to come to FINSAC with their hard earned resources to purchase these assets and I mentioned a few of them here, I mentioned the Sandal Group, I mentioned Superclub and I mentioned the Hendrickson Group. I agree, the purchases may have represented good news for them, they were not cheap and they paid good money and it was money we needed to conduct our activities and so I think not only was the funding useful but it also helped to create a platform of confidence and a momentum for the divestment process because we saw where the sales started to accelerate once the initial acquisitions were made from those portfolios.

Non-performing loans. Mr. Chairman, I have spent a significant amount of time on non-performing loans and it is a very, at times, emotive issue and I know it has occupied a great deal of the agenda and is a part of the terms of reference of the Commission. There are some points which I tried to make so as to put it in context and to explain what was the philosophy, what was the thinking and what was the rationale for some of the approaches and so on in the hope that it will add value to your own deliberations as you consider these matters. I start off by making the point and a number of observations that it was the proliferation of these loans along with an over investment in real estate, under performing equities, et cetera, that characterized the asset side of the balance sheet of the failed or failing institutions. It is the cash flow from these assets that in normal circumstances would fund their continuing operations, which would include payments to the policy holders and to pensioners. The distressed status of these institutions reflected the fact that too many of these assets were either under or nonperforming, creating for the institutions a severe liquidity shortfall, consequential losses and ultimately their insolvency. FINSAC intervened in many of these institutions by issuing notes, as that was the only significant means of purchase or re-capitalization that we had. We also purchased in most instances these non-performing loans or under performing loans at face value as a purchase at market, as market to market would have automatically resulted in a return to insolvency of the intervened entities. So we did that in terms of FINSAC notes as I mentioned, we didn't have any other ways of purchasing them. FINSAC notes as I mentioned before, while addressing the solvency problem did not address the liquidity problem and so the only means of generating cash would be to realize on some of these assets including the loans so that some of these institutions could continue as a growing concern and we needed to move quickly in this asset realization process and disposition, recognizing the fact that the notes which FINSAC issued at the point of intervention were somewhere in the range of thirty percent, that was around the rate for T-bills so we had to -initially, and we couldn't have issued the notes at a lower rate because they would be discounted in value returning the institutions to insolvency again. Initially after FINSAC purchased the loans we left them with the institutions for work-out -- well, one good reason is that we didn't have an infrastructure anyway to work them out and you know a transfer would take time, but we found that collections through the intervened institutions really posed a challenge for a number of reasons. One, the truth is that it be became a distraction for their management's time which needed to be focused on the institution's own rehabilitation, because the need was urgent. It was clear that in some instances officers of the intervened institutions either were or felt compromised in treating with some of the loans because they had recommended or approved loans which in hindsight, and in some cases maybe prospectively they should have recognized, should never have been given in the first place. And of course one of the things that we found was that there was a significant amount of overlap with borrowers, interestingly and there was analysis that was done and I hope it can be found of a section of borrowers and the extent to which they were in almost all and in some instances, all of the intervened institutions as non-performing loans. So we found that consolidation of these borrowers under one entity would more easily facilitate a resolution of that type of problem rather than having four or five or six entities trying to come at it from different angles for their own piece of the business.

COMM. BOGLE: That analysis, you said that it should be somewhere around, would you have any idea where around it would be?

A: Yes, FINSAC.

COMM. BOGLE: All right, okay.

A: And so, some time around the end of 19 -- the end of 1998, into early 1999, FINSAC went about setting up a Non-Performing Unit structured and staffed to undertake these activities. We engaged initially in a process of trying to value each loan using a framework, as well as developing and implementing a loans policy and procedurals documents.

COMM. ROSS: I just want to take you back for a moment to the management of the bad debts within the banks themselves, within the institutions. Were any sort of guidelines given to them in terms of the latitude they would have in resolving or restructuring debt or debts?

A: There was.

COMM. ROSS: How was that process managed?

A: Let me tell you how it worked. I can't say what the latitude was, there was an arrangement where they could settle on a particular basis, whether it was writing off certain amount of interests, et cetera, et cetera, but what used to happen is that initially there were weekly meetings when they would come to a joint committee comprising representatives of both those institutions and FINSAC's and make proposals for the settlement or resolution of those debts, and they would be approved there. If it was above a certain size it would probably go to FINSAC Board before it was approved and sent back to them. So there was a continuous process. Initially myself and Dennis Boothe were the ones who attended those meetings but after my workload really escalated it would have been the people in the Non-performing Loan Unit or the Head of Asset Management Unit to whom they reported who would attend.

COMM. ROSS: Why weren't banks given more latitude in terms of resolving the issues?

A: For one thing they were not our loans and we wouldn't want to, in those circumstances, having regard to the history of how the loans had gotten there in the first place be leaving it up to the same banks to make all the final decisions on how they were resolved, so we thought the prudent thing for us to do was to at least have oversight of the process.

COMM. ROSS: Just seems to, given the scale and size of the problem, to have it concentrated, resolution concentrated within a small body, that in itself would have doomed the process to failure.

A: I don't think and I have heard Mr. Cobham suggest that it created a bit of challenge, I don't agree with his perspective on it. I understand that if you were an executive accustomed to making decisions at a certain level and suddenly find yourself constraint that it might be a peculiar feeling, but I am not aware of any opportunity that was lost as a result of not being responded to on a timely basis which would be the danger, the more inherent danger in a situation like that because they always knew that they could call, and as I said I used to get hundreds of calls per day.

I was called about loans at times too when they had urgent situations and we would respond.

COMM. ROSS: I mean I am not entirely convinced because one of the things we have seen here is that of course with interest rates very high, the longer it takes to resolve the situation, the bigger the problem becomes and that certainly seemed, it certainly, I think, would have helped every one if the issues could have resolved more quickly.

A: Commissioners let me try to persuade you with this approach. What has happened, these loans have become non-performing within Bank X. We have now purchased them from Bank X but we don't have an infrastructure to collect them, so we have said to Bank X, please collect on our behalf, some would involve compromises. The incentives of Bank X who is conducting that activities just to collect, Bank X is not as incented as we are to maximize value because as long as they collect they have less work to do, less headaches to undertake whereas on the other hand we are saying we want to collect quickly but we also want to collect as much as we can and so there is a natural tension that exists and it becomes a judgment which has to be applied in all the circumstances and the truth is that we had very strong incentives to want quick collection. I mentioned it before, the thirty percent plus the innate liquidity needs of the institutions, so we were very, very incepted to collect.

COMM. ROSS: I appreciate that but I certainly also appreciate the point that it would have helped if the banks were incentivized to collect?

A: My difficulty with that Commissioner Ross, I have a difficulty rewarding somebody for the problem they have created.

COMM. ROSS: I am not talking about reward, there may have been other ways of approaching the problems which might have created an incentive to the bank.

A: So we went about in 1981 setting up a Non-performing Loan Unit with structured staff to undertake these activities. I was mentioning we went about the process of valuing the loans particularly -- one of the things we found was that even though there were tens of thousands of loans there were, I don't like to use these numbers, I am not sure, but there were less than one thousand loans, let's me put it that way, there were less than a thousand loans that accounted for perhaps eighty percent of the portfolio being bad, so we really focused a lot of our attention in valuing those loans because at first we started trying to value everything and it was crazy trying to value these tens of thousands of loans so we said, let's create priority framework, focus on the larger loans and what we essentially did was to value each loan using a principle, an algorithm, which we got from McKinsey, which is referred to as the 4 C's framework which was used in a number of other countries and so forth with similar problems and that would have given us what we called the MER, minimum expected recovery and we set targets for the loans officers to try and work out. It was based on the net present value principle, so in other words, it was really about discounting, if you could, to collect because we needed the cash but we said to them of course if you go out there now and in your negotiations, your investigations, find that there is different information from what you have put in the framework then you come back for the approval, for the change. And of course we -- so we had a policy for loan valuation, we had a standard policy for the management of the loans and we also had a policy for loan approval in terms of who could approve what, who had write-off authority and so on, the hierarchy, going right up to the board and a summary of the policy is appended, as Hylton 5 coming from the 2000 Annual Report.

MR. GARCIA: I am going to also ask Commissioners that this be entered into evidence as pages 40 -43 and the cover page of 2000 Annual Report for FINSAC as exhibit, I think we are at PH5.

COMM. ROSS: Yes. PH5.

A: And so in spite of the fact that we have worked with McKinsey and so on on this, I had a very good relationship with CIBC in Canada and you might see them appearing a couple of times and I asked them, because Canada had a sort of secondary banking crisis at some stage, and I asked them if they could provide some expertise, to just come and review what we were doing and give us some feedback and a gentleman came down and spent some time here, I think it was gratis, reviewing our operations and making some recommendations, I don't remember his name, I think his surname was Reynolds, that is as much as I can recall about him and he made some recommendations which we implemented. In paragraph 83 I make the point that philosophy underpinning our collection efforts was a preference for consensual agreements with litigation and the realization of security being a last resort. If you examine our public statements, all the annual reports, this point is underscored. I am also suggesting that a detailed examination of all loans managed and worked within this Unit will confirm that this was by far the dominant approach.

Quite apart, Chairman, from a commonsense perspective, there was another powerful reason for seeking consensus and I stated here that it is also that we recognized from the outset that a bad debt did not automatically make the debtor a bad person. There may have been issues of bad judgment or bad timing or bad idea or rapidly changing circumstances which may have impacted persons or their businesses.

So, while there was no explicit undertaking to bail out borrowers, which I am going to speak to a little bit later which would have compounded the moral hazard problem associated with waiving repayment requirements and the cost of the financial sector intervention, and I will speak to moral hazard later as well, the reality of the circumstances conspired to effectively result in significant compromises to debtors at taxpayers' expense, because anything we did not recover represented a charge on the public purse, it's just as simple as that.

The truth is that there were hundreds of millions of dollars and possibly, quite possibly, because I don't have the aggregate total, of billions of dollars of write offs. In many instances where the circumstances dictated no other reasonable alternative, this would have included some level of principal on the loans.

Another fact, is that FINSAC approved significant write offs on hundreds, possibly thousands of debts on the principles and policy framework in the way it operated taking into account high rates of interest that had been applied to the facilities. This was only pragmatic if FINSAC was to be successful in quickly and successfully raising funds to support its activities. These principles were applied irrespective of colour, creed, race, religion or political persuasion. Those were irrelevant Chairman.

COMM. BOGLE: Go ahead.

A: Where it was necessary to resort to litigation, I make the point here that FINSAC's track records in pursuit and defence of such ligation initiated or brought against, it was exemplary. So far as I can recall while I was with FINSAC, we were wholly successful in the vast amount of cases and at least partially successful in the few cases, we did not entirely succeed. This was partly due to the fact that where we were aware that FINSAC's position could not be legally sustained we resolved the matter without need for it to be tried in the courts.

The FINSAC Oversight Committee also played an important role in seeking to find resolution strategies for non-performing loans of businesses that fell within the National Industrial Policy, especially those in the productive sector. There was also special consideration given to owner occupied residences.

My view, is that in order to make a determination as to whether or not FINSAC treated debtors fairly would require a careful and detailed analysis of the majority, if not all of the tens of thousands of loans that FINSAC purchased. This would include those loans that were reviewed by the

Oversight Committee as well as those that sought to take advantage of the special window of opportunity that was offered and publicized in the media in 2001.

The process of loan work-out by its nature involves intense negotiation and let me state here that even though I recognize the importance of every single loan, customer and their experience, I do not think that if we have twenty complaints or even fifty out of the tens of thousands of facilities handled, that such a set of circumstances can lead to any reasonable conclusion regarding whether FINSAC was generally fair to debtors and the extent to which the approach to treating all debtors was similar. In any financial institution, the experience is that persons with loans that are non-performing and are aggressively pursued are those with the most complaints. To my mind the only fair way to accomplish that is to have every single debtor's file open to the scrutiny of the Commission and perhaps the public. If this is done, then the original loan circumstances, the records of the negotiations which took place, the rationale for FINSAC's approach as well as the response of the debtors will be public knowledge so that an informed position can be adopted. There is also, in my view, another important reason for such an approach to be taken. The fact of the matter is that to the extent that these loans were purchased by the Government and funded with taxpayers' money, then every dollar of write-off reflects a benefit at taxpayers' expense. In those circumstances, just as with waivers and everything else, taxpayers should be informed of who the beneficiaries were and the magnitude of the benefits they received. That is why we considered it necessary for our approach to write-off to be well structured and carefully justified with that justification documented in all the circumstances.

In every case where a compromise settlement was reached there would be a memorandum or case summary outlining the details. Those memos and case summaries represent a good starting point.

To the extent that the facts demonstrate very significant discounts and write-offs approved or offered by FINSAC where appropriate and necessary, then I am making the point that impact of high interest rate on the borrowers' ability to pay is somewhat mitigated.

I made the point before and I make it again that FINSAC had a powerful incentive to discount rates apart from its own need for cash. The fact is that the rate of accrual on FINSAC notes and hence the need to redeem or reduce issuing them also served as a discount factor.

FINSAC had urgent cash needs to enable us to assist with the liquidity needs of the intervened institutions.

One of the issues I observed, Chairman, was several borrowers who would eventually come in and negotiate settlements which involved significant discounts on the sums outstanding, several would initiate payments as agreed and then default again seeking new and further compromises.

Even though this may have on occasion been as a result of deteriorating circumstances, our initial projections, it was also our experience and admitted by some borrowers that they were using this as a strategy to try and get a better deal. Moral hazard was alive and well within the non-performing loan portfolio.

One of the questions asked frequently, why did FINSAC continue to charge interest on loans that were already in default or non-performing and I set out the rationale for charging interest on those loans.

Firstly, it is important that persons who were holders of the debt acquired by FINSAC be incented to come in and negotiate their settlement quickly. Continued interest accrual would represent a powerful incentive in this regard. It is important to note that the fact that FINSAC accrued interest was no constraint on our ability to write back that interest as well as in some cases part of the principal in reaching settlement within our policy framework.

Two, the notes which FINSAC issued accrued interest at market rates. These notes were used to fund the acquisition of the loans at their full book value. It was therefore also important that FINSAC apply and collect interest on those loans when it was fair equitable to do so. The rates charged by FINSAC were also consistent with existing market rates and primarily at the lower end of those rates.

Three, to have stopped accruing interest would have had the potential to create perverse incentives in the banking industry. It would be seen as unfair on the face of it to the customers who continued to pay on performing loans in both the intervened and non-intervened banking sector. We need to always remember that even as FINSAC managed non-performing loans, it also had a significant interest in existing performing loans in the sixty plus percent of the banking sector it controlled.

Four, worse than that, it could create a powerful incentive for borrowers and these are performing borrowers I am talking, to default particularly in banks that were controlled by FINSAC so that their loans could be sold to FINSAC therefore, giving them a break on interest accrual but creating worsening problems in the financial sector. That happened in several other countries. In fact Mr. Chairman, I make a point here that I don't think that many people are aware of but which came to my attention at the time that between 1980 and the time of our financial sector crisis, over one hundred countries had the experience of financial sector distress.

Number five. There may have been instances where persons were delinquent in one institution but have significant resource in another institution or even invested in Government of Jamaica instruments earning high rates of interest whether in their own name or that of an entity they controlled. I don't know that it would be appropriate in those circumstances to just waive interest, or not charge interest.

Number six, our experience also supported that continued application of interest could be beneficial as we were on several occasions able to collect some of this interest and maybe not even some, all of it.

And number eight, if FINSAC did not charge a rate commensurate with the market rate on the loans it bought, a delinquent borrower could be incented to sell assets and instead of paying FINSAC invest in Government paper and earn those levels of interest from the same government that bought his debt with an instrument on which the government was accruing interest obligations.

Therefore, the continued accrual interest at market rate was appropriate in that it served as an incentive for borrowers to want to settle their loans and a disincentive for performing borrowers within FINSAC controlled institutions to default on their loans. I make the point in Paragraph 101 that we often discovered many of the borrowers who were more than six or more months in arrears with the banks from whom they had bought the loans and who had received no more than one single call, sometimes none or a single letter from the legacy bank. This is what they discovered at some of those weekly meetings when we asked what action was taken and sometimes the letter may have been sent the week before. Consequently, we did find instances where we were able to collect not only what was due to the legacy institution but also some of the interest we accrued thereby maximizing the returns to taxpayers. Some of these had not paid simply because no pressure was put on them to pay.

There were also loans which we

restructured with write-offs and moratoriums to which the application of interest was also appropriate given the circumstances and future prospects of the borrower.

104. Even after the application of the valuation framework for the loans which I mentioned earlier there was a hierarchical basis for further compromises, starting within the Non-Performing Loan Unit through the head of that unit and the Credit Committee all the way to the Board. The structure was in this regard similar to that of a bank, appropriately so as they were bank debts that FINSAC had purchased and had to have obligations to satisfy from the debt recovery.

In 105, I make the point that many of the debtors, and not only debtors, commentators failed to acknowledge that FINSAC had no mandate to rescue or bail out borrowers, it was never part of our mandate. In any event, and I made the point before, maybe several of the points I made, as a general rule this would be inappropriate and at worse perverse. While we emphasized with many of the borrowers, we also need to recognize that we had taken over private arrangements from the private sector which were imposing a cost on taxpayers while the same is true of depositors, it is the potential damage to economies caused by their non-rescue and loss of confidence which forces authorities the world over to rescue them. And it is to be noted at the time that the rescue of depositors in failed or failing financial institutions can create its own moral hazard problem within our society where people are unable to take responsibility and we saw some evidence of this. So I made the observation but also accepted and I am still of the view that repaying depositors as we saw in the United States, in England, right across Europe was a necessary evil is how I described it, to restore confidence and preserve our financial system.

In 106, I make another point on the issue which I say one important reason why depositors needed to be treated differently from delinquent borrowers, is that while delinquent borrowers are in breach of their contracts with the financial institution, depositors are not in breach. The relationship which exists is that depositors lend their moneys and deposits to banks who then invest it in assets such as loans, with the expectation that repayment of these loans will enable them to repay depositors. It is the borrower's failure to repay, among other reasons, which, put it another way Chairman, every compromise represents an increased charge on the public purse, there is that direct correlation.

COMM. BOGLE: You said it is the borrower's failure to repay, among other reasons, which puts depositors in jeopardy. Could it be a major part of the management of the institutions in the first instance?

A: Absolutely.

COMM. BOGLE: Because the management of the institutions in many respects may have given loans that were bad,

A: Absolutely, or may have done several other things which may have been bad.

COMM. BOGLE: And could it also be, among other reasons, that certain macro conditions that caused some of these borrowers to have fallen into situations where they could not pay, situations totally outside of their control?

A: Happens every day Chairman, maybe not on the same scale but it does happen. So Chairman in 107, I make the point that if we look at what would happen if the banks were allowed to fail, it is quite clear that a liquidator would be obliged to sell whatever assets he found, and go after debtors for the full amount owed in order to maximize the payout to depositors and other creditors. By the government intervening and protecting depositors, it was facilitating the continuation of these as going concerns and/or the sector as a whole. The government then had an opportunity to seek to minimize the impact to taxpayers who would have to make up the shortfall in asset realization.

The government in guaranteeing depositors repayment effectively subordinated themselves to the position of these depositors. Consequently, they were entitled to pursue recovery of the loans as this represented assets in which their funds were invested.

If we were to, and I make a general point, if we were to extend some general form of rescue to delinquent borrowers of failed financial institutions, then I would argue that equity would require that the same assistance should be offered to non-delinquent borrowers who were making sacrifices to meet their obligations, and there were many. In fact it could also be argued that the same offer should be made to all borrowers in all institutions in Jamaica who would have to pay facilities at high interest rates. I could then go on to argue the case for assistance for customers of these borrowers, some of whom might have paid higher prices for goods and services given the need for these businesses to attempt to remain viable. If I were to take this to its logical conclusion we could become a nation of bail outs which we simply could not afford.

I am saying notwithstanding all of this...

COMM. ROSS: I think you have to argue with your logic, all of this taking place in a wider context and it just seems to be that, not that this is your responsibility or would have been your responsibility as the head of FINSAC, but, it just seems to us that somewhere along the line that context needs to be addressed because your job would have been made easier and cost might have been different, if we had looked at that bigger picture and done something about that issue because as you know, it is a lot easier to restructure a debt if you are able to do so at a lower interest rate. If you try to restructure a debt at the same interest rate, you have a bit of a difficulty.

A: I defer to your opening, that one, sir, is above my paid skill. I can only speak to what was in my remit and ambit and within the scope of my responsibility, so that is what I am doing here. So I am saying Chairman notwithstanding all of this we recognized the need to try to reach consensual settlements with debtors as we felt this approach would yield better results as well as facilitate greater levels of normality within the real sector. We also, as I have said earlier that bad loans did not necessarily, and in many instances, did not equate to bad persons.
FIS as well as FINSAC at the same time through Recon Trust Limited and Refin Trust Limited had to be careful that it did not fall into the same or similar

difficulties as Fobopropa in Mexico which had to be disbanded as among other things, they had engaged in significant write-offs for persons who had non-performing loans only to see them shortly after engaging in lavish lifestyles which created a scandal.

There were good reasons for us to seek to reach reasonable compromises as that in our considered view represented the best way to maximize value from the portfolio.

It is far easier in many instances to realize greater value from a loan by having agreement rather than adversarially seeking to enforce security. Once such a restructured loan performs for a while it can be sold at par or perhaps even at premium. The enforcement of security on the other hand can be quite costly and can often be protracted. There are however times when realization of security is the best or only option.

It is important Chairman to recognize

that the loan portfolio was not comprised of a homogenous set of borrowers, whose failure was caused only or in some instances primarily by high interest rates. There were loans that went bad prior to the period of high interest rates and were being constantly restructured by the bank over several years. The portfolio also contained loans to borrowers who applied for and were granted new facilities at high rates during the high interest rate period. This would have been based on their representation that based on their income or in the case of businesses their cash flows and business models they could comfortably service these facilities and remain viable and profitable. There were also borrowers who took out their loans at lower rates and saw those rates increased on them. In some of those cases they tried to cope with the situation by paying down their facilities but some also borrowed more at the new higher rates for new ventures that at times were unsuccessful. I make the point here Chairman that in business sometimes it is not a bad thing to have a tension especially between people who have different responsibilities.

And I make the point that it is also important to recognize that there would very often be a natural tension between collectors and borrowers whose loans were bought under the aegis of FINSAC. While the officers of FINSAC and its subsidiaries would be focused on maximizing recovery based on what they believed the borrower could or should be able to repay, the borrower on the other hand was naturally seeking to minimize this amount seeing that it would have a negative impact on his or her circumstances. That's natural, that is human nature.

Our experience, which is not unique in the financial sector, regardless of whether there is a crisis, was that some borrowers would resort to all kinds of strategies to accomplish, and I don't necessarily blame them for some of the strategies, ranging from understating income to hiding or attempting to hide assets to seeking interventions through politicians and other persons of influence. FINSAC's approach, however, remained one which was guided by its mandate and its standard policies for non-performing loan work-outs. That way, the approach was always one we felt we could defend as being consistent and fair.

At the same time, as I mentioned repeatedly, we need to recognize that the cash flows from these loans were critical to our funding needs. Our institutions were severely challenged with liquidity pressures on a daily basis even with the benefit of the flows from our other non-performing assets. Quite frankly it's difficult to imagine how we could have sustained our activities without these non-performing loan flows. My own view is that even if it were desirable to bail out borrowers which I have already said I do not believe to be the case, the bottom line is that I do not believe we could have afforded that as well as the rescue of depositors, pensioners and policy holders. The size of the debt would have been increased significantly. I go on to make the point in 120, Chairman, that in any organization and moreso in one so complex as FINSAC where a lot of work is being carried out by several persons, you will find from time to time individuals who may be unduly hard or unreasonable in exercising judgment. This can happen in spite of any policy framework of the organization and its best intentions. And that is why there was a system of checks and balances and an institutional framework including hierarchy of referrals for persons who wanted their cases reviewed for whatever reason. Many borrowers utilized this framework when they were dissatisfied with the decisions at first communicated to them.

COMM. BOGLE: Just a question going back. You mentioned that when you purchased the debts from the financial institutions you purchased them at face value?

A: Yes.

COMM. BOGLE: Which by and large was more than the market value, were you not then putting the tax payers of the country at a disadvantage in that the taxpayers were now buying these debts at a value that was more than market value and isn't this therefore part of the reason why your strategy, in terms of collection, might have been a little more, should I say, a little harder than possibly if we had bought the debt at the value of the debt?

A: Let me respond to that by saying this Chairman. Any discount on the purchase of the debt would have resulted in an increase in the amount of assistance that was offered to the institutions. In the first instance, now having bought the debt even at a discount, the liquidity requirement for the rehabilitation, for the normal operation of the institution would not have diminished and the responsibility, in the absence of any mandate which is to rescue borrowers, would have to maximize on the loan so I don't think it would have changed the circumstances, because remember, one other point Chairman that even having bought them at face value the first thing we did was to do a valuation and say what is the likelihood, what is it that we can really expect to recover and then set that for the officers to go out there. We did a valuation, a market to market, not at the time of purchase but at the time of work-out.

COMM. BOGLE: You see at the time of purchase and this is where I am at, when the taxpayers purchase at a lesser value, then what we are doing, I agree with you, we are not bailing out the borrowers but bailing out the institutions which we will then sell and we do not have any -- I mean after we have sold the institutions, we have moved out these debts, we have bought them at less than market, and we have floated these institutions, these institutions can now go ahead and make profit which we still have no residual value in those profits or anything like that.

A: Remember Chairman, the institutions were told at the time that the value of the institution would have taken into account -- in other words, it's a chicken and egg situation, it is a switch, in other words, the same amount of assistance that would have had to go in anyway to restore the institution to viability and the value of the institution would have reflected the extent of the assistance that went in, whether it went in by way of capital or it went in by way of loan purchase.

COMM. BOGLE: I am just looking at it.

A: What I will concede, sir, is that to some extent shareholders would have been further diluted than the extent to which they were in those circumstances.

COMM. BOGLE: So the bailout was on that.

A: Yes. Remember I made the point when I said in relation to many of the institutions where there were like thousands of shareholders, the whole process of going through and getting to take out those shareholders, would have imposed some challenges and what we said we are going to take out the people who control the institutions, dilute them down and apply some dilution to those who were even not in control.

COMM. BOGLE: The other point is, which is connected, I am wondering in view of the fact that we have bought and cleaned up and valued these institutions and we are selling them, whether or not we should have looked at, and this is in hindsight, whether we should have looked at retaining a position in some of these institutions for future pay-offs to the tax payers.

A: And that was a model which we tried on a number of occasions but the truth is that you can't tell a guy on what basis he is going to make an offer or reasonable offer. For example, in the case of NCB, I use NCB, there was an insistence by the purchaser that they wanted seventy-five percent, there was an insistence.

COMM. BOGLE: All right.

A: Some people have government in their business, some don't.

COMM. BOGLE: That is true too, but government did not take in any of the financial institutions, did they?

A: No.

COMM. BOGLE: Are we to conclude that all of the purchasers insisted that government stay out?

A: Sure.

COMM, BOGLE: I am looking at it from the point of view that the taxpayers were at the disadvantage from the word go and whether or not we could have done a little more to sort of let that taxpayers gain something in the future.

A: Perhaps we could have tried harder, let me put it that way.

COMM. BOGLE: Okay fine.

A: Okay, I am at 121, where I make the point that the primary consideration in determining the extent or the amount of a compromise would be the prospect for recovery. This would be assessed taking into account the financial circumstances of the borrower, the quality of the security, if any, quality of the documentation for the loan, the way in which the loan was managed or administered and the time for recovery. We also need to remember that almost by definition, with the exception of a few performing loans from Blaise and Century, FINSAC loans would have been loans that had reached classification. That is according to the legal definition within a banking sector, they were non-performing loans which had reached the stage at which the institution should fully provide for the loan being a bad debt.
Typically in a normal bank this would

have been a result of the bank going after the security held to maximize on the recovery as other means of the recovery had exhausted and failed. Thus, even if the banks had not required intervention, they would have like FINSAC attempted to collect on these loans, if they were being operated normally, and I also make the point if they had been liquidated, I think I made that point before.

COMM. BOGLE: Would you say from files and other information that you had gotten that the institutions did a good job at trying to collect, not since FINSAC, prior to FINSAC?

A: I would say in many instances, the effort was not sufficient. It was clear.

COMM. BOGLE: Okay.

A: And Chairman, I do this without advice, but, I somehow got the feeling that part of the challenge that the banks had was that, conceiving, prior to FINSAC, that the loans were bad would have created immediate problems, you are with me? In other words, they were always trying to restructure, to try and extend and so on because just accepting that it was non-performing, immediately starts to create a solvency problem which became obvious.

COMM. BOGLE: By extension, you are therefore saying that in many instances -- well a reconstruction of the loans was acceptance that the loan was by and large in trouble and in many instances therefore, the reconstruction of the loan was really an exercise in futility.

A: Yes, sir, futility.

So I am saying that FINSAC's arduous task was to maximize on the recovery of these loans to minimize the cost of intervention and provide urgently needed liquidity for its own operations internally as well as those of the financial institutions it had intervened. The difficulties in such an undertaking by itself were compounded by weak economic conditions including soft markets, generally as well as poor documentation and records for many of the loans acquired from the legacy institutions.

Notwithstanding the challenges as I have outlined, FINSAC assisted many persons and businesses in sorting out their challenges and getting a new start. I make the point Chairman, I go all over the place and people come up to me, I don't know them, in many instances because I have never worked out loans, having regard to my role and responsibility, just to say thanks for giving them another chance, it happened to me as recently as Sunday of this week. I was in Loshuchen Supermarket when a gentleman came up to me and told me the same thing, I told him I didn't know he was a FINSAC debtor.

One key thing we must always remember Chairman is that FINSAC never originated a single one of these loans. They were acquired not because FINSAC wanted them, but because removing them from the intervened banks was a prerequisite to