



**IN THE MATTER OF THE COMMISSION OF
ENQUIRY TO ENQUIRE AND REPORT ON
ALL THE CIRCUMSTANCES THAT LED TO
THE COLLAPSE OF SEVERAL FINANCIAL INSTITUTIONS
IN THE 1990'S**

**CLOSING SUBMISSIONS
ON BEHALF OF DR OMAR DAVIES**

Background:

1. On October 27, 2008 the Governor General of Jamaica issued a commission under the Commissions of Enquiry Act to enquire into and report on all the circumstances that led to the collapse of several financial institutions in the 1990's. The Commissioners appointed were authorized to:

Examine the circumstances that led to the collapse of several financial institutions in the 1990s with particular regard to:

- (a) the extent to which these circumstances were directly influenced by domestic or external factors;**
 - (b) Government's fiscal and monetary policies;**
 - (c) the management practices and role of Board of Directors of the failed institutions;**
 - (d) the performance of Government's regulatory functions.**
- ii. Consider what actions, if any, could have been taken to avoid this occurrence and to evaluate the appropriateness of the actions which were taken by the authorities in the context of Jamaica's economic circumstances and in comparison to intervention by the State in other countries which have had similar experiences;

- iii. Review the operations of FINSAC in relation to the delinquent borrowers and to determine whether debtors were treated fairly and equally;
- iv. Review the probity and propriety in FINSAC's management, sale and/or disposal of assets relating to delinquent borrowers;
- v. **Review the terms and conditions of the sale of non-performing loans** to the Jamaican Redevelopment Foundation;
- vi. Review the practices of the Jamaica Redevelopment **Foundation** in the treatment of delinquent borrowers and, in particular, the management, sale and/or disposal of their assets;
- vii. Assess the long term impact of the collapse of these institutions on the economy and on the businesses and individuals whose loans were involved as well as *the economic* and social impact of the actions taken by the Government with regard to the savers, depositors and investors of the failed institutions; and
- viii. Review the steps that have subsequently been taken and make recommendations as to what further steps should be taken to prevent a recurrence of such widespread collapse of financial **institutions** and **the** resulting **hardships**.

2. Dr. Omar Davies was the minister with responsibility for finance between 1993 and 2007, therefore including the late 1990's'. By letter dated July 13, 2009 the Secretary to the Commission wrote to Dr. Davies, sending him a copy of the terms of reference and

inviting his views and comments. The letter also invited him to appear before the Commission.

3. After an exchange of correspondence, the Commission sent a list with some specific questions², and Dr. Davies sent detailed written responses³. Dr. Davies then appeared before the Commission⁴, expanded on his written responses, and was cross examined by counsel representing various interested parties and by members of the public. He also answered questions from members of the Commission.
4. At the end of his cross examination, counsel for Dr Davies complained that he was at a disadvantage because he had been cross examined on issues that he had not had an opportunity to prepare for. The Commission assured Dr. Davies that he would be recalled. The then chairman said **"Well the position is this. We will give Dr Davies a rest. I can't pretend to know when he will resume but he certainly will get a nice long rest"**⁵. Dr Davies was never allowed to continue, and his counsel was notified in late October, 2011 that he would not be recalled.

Summary of Dr. Davies' Evidence:

5. During an exchange with the Commission at the hearing Dr. Davies candidly admitted that **"all of the various aspects of macroeconomic management would be [his] area of concern"** and he shared responsibility for the fiscal and monetary policies of the country⁶.

²Under cover of letter dated November 6, 2009

³Under cover of letter dated November 19, 2009

⁴On 4 days between November 24 and 26, 2009 and December 2, 2009 s

Page 80, transcript for Wednesday, December 2, 2009

⁵Transcript of Proceedings on November 24, 2009 at pages 6-7

Dr. Davies was therefore in a unique position to identify, assess and analyze the factors which would have contributed to the financial situation into which the Commission was inquiring.

6. Dr. Davies addressed the various issues in the course of his oral and written evidence. The issues can be summarized under the following four headings:

- a. Was the crisis in the financial sector caused by the Administration's interest rate policy?
- b. Were the owners/senior management of the affected financial institutions treated fairly?
- c. Was FINSAC operated in a professional and transparent manner in dealings with bad debtors?
- d. Was the sale of the portfolio of bad loans to JRF handled fairly and in a transparent manner?

Cause of the Crisis

7. The conventional wisdom is that the cause of the crisis in the financial sector was the government's "high interest rate policy". Dr. Davies' response to this charge is two-fold. First, similar financial crises have occurred worldwide and in many of those jurisdictions e.g. Scandinavia, Japan and the United States of America, they have occurred during periods characterized by extremely low interest rates. Objective analyses of the causes of such crises invariably point to bad operational practices in the

institutions and the failure of the regulatory system either to detect such practices, or to act quickly once they are detected. There are clear lessons for Jamaica.

8. Closer home, Trinidad and Tobago is still grappling with a resolution to the collapse of the CLICO group. The March 2011 IMF Country Report, on Trinidad and Tobago, analyses that collapse and makes reference to the 1990s crisis in Jamaica. In analysing the causes of our crisis, the IMF highlights the bad operational practices of the failed institutions. There is no mention made of high interest rates!
9. A second point is that although there was a period when interest rates were high, the use of this lever of macroeconomic policy cannot be taken out of context. Many persons who assert that high interest rates represented the fundamental cause of the crisis, fail to take into consideration the context in which this policy was pursued.
10. What is this context? It is a fact that the first half of the 1990s was characterized by high levels of inflation and instability in the foreign exchange market. As regards inflation, Jamaica experienced inflation of more than 100% in fiscal year 1993/94. For some years following the liberalization of the foreign exchange system, the market demonstrated extreme instability. The cry at that time, from both the general public and the business community, was for inflation to be controlled and stability to be imposed on the foreign exchange market.
11. With few policy tools available to the authorities, liquidity was tightened in order to make it more costly for currency speculators

to buy speculative holdings of US dollars, a practice which had been artificially driving up the exchange rate and, consequently the rate of inflation.

12. There is the legitimate question as to whether the policy ought to have been pursued as aggressively, and for as long, as it was. The reality is that during that period, attempts to move "gingerly" had borne very limited results. The twin challenges of rapid devaluation and high inflation had sowed the seeds of further deterioration in the economy, as well as possible social explosion.
13. It is submitted that this context for the decision to tighten liquidity cannot be ignored by the Commission. Dr. Davies accepted that the question of the pace and extent of increase in interest rates is one on which reasonable people may differ.

Treatment of Owners/Senior Management

14. It is clear from the evidence that several owners/senior managers egregiously mismanaged the funds of investors and savers. Nonetheless, some of them are seeking to portray themselves as victims of FINSAC.
15. Dr. Davies pointed out that Jamaica had a major problem related to the predominance of the position of "Executive Chairman" in several local institutions. This position provided the holder with excessive powers and inadequate checks and balances. As CEO, he determined what matters were brought to the board and, as Chairman, he had significant influence over the selection of other board members, as well as controlling the conduct of board meetings. As such, several Executive Chairmen were able to

manipulate the affairs of their companies, often leaving other board members "in the dark".

16. The treatment of these Executive Chairmen was not based on arbitrary assessments. The Government engaged international experts in forensic auditing, to examine the operations of the institutions which had been intervened. These included Lindquist Avey of Canada, Ernst & Young of the UK and PriceWaterhouseCoopers from Canada. Their reports were formally documented and were in evidence before the Commission.
17. Innumerable violations were identified, some of which, the Government was advised, would have led to criminal charges in jurisdictions with more rigorous financial legislation. Violations included the "ever greening" of loans and the making of excessive, under-collateralized loans to "connected parties". The term "ever greening" describes the practice whereby a bad loan is "sold" to another financial entity in the group at face value, thus removing it from the portfolio of the first financial entity. If this process is repeated, it becomes difficult, if not impossible, for the regulators, through one-off audits, to identify the deception.
18. The forensic audits identified evidence of several serious malpractices in these institutions [REDACTED]
[REDACTED]
[REDACTED] The situation was worse within the context of the group of institutions controlled by a set of "Executive Chairmen" who called themselves "The Owners Club". Loans to "connected parties" were often transferred between their institutions, in order to avoid detection by the regulators.

19. When this evidence was presented to the Cabinet of the day, it was decided that these owners could not be allowed to continue to operate within the financial sector. Simply put, these owners could not satisfy the "fit and proper" criteria. Dr. Davies gave evidence that it is a matter of record that at an emergency Cabinet Meeting held one Sunday at Vale Royal, former Bank of Jamaica Governor, Jacques Bussieres, advised Cabinet that it should act decisively against the principals of a set of local institutions. The Bank of Jamaica's analysis had identified many of the deficiencies and corrupt practices which were later confirmed by the forensic auditors.
20. The Commissioners are also invited to reflect on the fact that during the period of the crisis, the local subsidiaries of Bank of Nova Scotia, CIBC and Citibank were not affected. Neither were several local institutions, including Jamaica National Building Society and the credit unions. These institutions were operating in the same macroeconomic environment with the same "high interest rates" but they prospered. Why the difference?
21. It is submitted that the difference lay in the fact that these other institutions operated within much stricter regulatory guidelines. It was not possible for the CEOs of the latter group of institutions to take arbitrary decisions, to make questionable loans, to use short-term funding to acquire long-term illiquid assets, or to invest in sectors of the real economy in which they had no expertise.
22. Yet another corrupt practice came to the fore, following the completion of the forensic audits. It was revealed that many of the bad debtors were simultaneously clients of several institutions.

These clients used their contacts and connections to secure loans from several domestically-owned banks, with few of these loans ever serviced in line with the loan agreements.

23. There has since been independent confirmation of these matters. A number of owners and senior managers have been taken before the courts. As we indicate below, the courts (including the Privy Council) have considered and ruled on these issues, and have concluded in every instance that the owners/managers were guilty of the egregious breaches described above and others, and that they were not unfairly treated.
24. It is submitted that there is no evidence of any arbitrary or unfair treatment of owners or senior managers, and that the evidence is all to the contrary. We refer to two particular cases in relation to which there was substantial evidence before the Commission,

Dr. Paul Chen-Young and the Eagle Financial Entities ("the EFEs")

25. Dr. Chen-Young gave evidence to the Commission by video-link. It is submitted that Dr. Chen-Young's evidence was contradicted by the documents which were in evidence before the Commission and was also inherently inconsistent and not credible in several respects.
26. Both our Supreme Court and our Court of Appeal have considered Dr Chen Young's management of the EFEs and have held that there was evidence of serious breaches of fiduciary duty.

27. The Court of Appeal⁷ had to determine whether there was sufficient evidence that Dr. Chen-Young had breached his fiduciary duty to the EFEs to justify a freezing order against his assets. The Court of Appeal dismissed Dr. Chen-Young's appeals, finding that there was indeed sufficient evidence of breaches.⁸

28. The case went to trial, and in **Eagle Commercial Bank of Jamaica Limited and another v Paul Chen-Young and others**⁹ the Supreme Court held that Dr. Chen-Young was guilty of multiple breaches of the fiduciary duties he owed to the EFEs. The judge held¹⁰:

I believe that based upon the evidence which has been accepted by this court in relation to the several issues, there can be no doubt that [Dr Chen Young] has been guilty of a breach of his fiduciary duties at common law, and he is not protected by the Articles of Association purportedly put forward in his defence by his counsel.

29. Finally, in considering the propriety of Dr. Chen-Young's involvement in loans advanced by the Eagle Commercial Bank to a company in which he had an interest, the court found that: **In these circumstances, it would seem that the breach of duty owed on the part of the First Defendant, to those whom it was his duty to protect, does constitute "equitable fraud".**¹¹

30. During his cross-examination before the Commission, Dr. Chen-Young's memory failed at critical times, and at others he simply

⁷ Paul Chen-Young and others v Eagle Merchant Bank and others SCCA 23,25 and 46 of 2000 delivered July 23, 2002

At page 19

⁹ Claim No. CL 1998 E/095 delivered May 4, 2006 at page 56

At pages 58-59

ii At page 71

evaded the questions. The Commission is asked to bear in mind the witness' demeanor and to conclude that he was not a credible witness.

Donovan Crawford and the Century Financial Entities ("the CFEs")

31. Another Chief Executive Officer and majority shareholder of an intervened financial institution who gave evidence was Donovan Crawford, the former head of the CFEs. Like Dr Chen Young, he gave evidence by video-link. After filing a 12 page statement and giving extensive "evidence in chief" on June 7, 2011, Mr Crawford appeared again before the Commission on July 27, 2011, also by video-link, when he was to have been cross-examined. On that date, in defiance to the Commission's directions, Mr. Crawford refused to be cross-examined, purportedly acting on the advice of his attorney^{x2}.
32. Mr. Crawford's refusal to be cross-examined should be considered in light of evidence he gave during his earlier testimony before the Commission. In reference to one of the litigious matters connected with the Government's temporary management of the CFEs, Mr. Crawford said: **"All the counsel that I have been able to afford to hire, advised me against appearing in person in court. In retrospect, it is clear that my absence in court was interpreted as some form of tacit admission of guilt."** [REDACTED]
[REDACTED]
33. Mr. Crawford's reference to his absence from court was in relation to the case of Crawford and others v Financial Institutions

¹² Transcript of the proceedings on July 27, 2011 at pages 17-18

Services Ltd.¹³ In dismissing an appeal from Mr. Crawford against findings that he, among other things, breached his fiduciary duties to the Century Financial Entities, the Privy Council noted Mr. Crawford's refusal to give any evidence in support of his case. According to the Board: **"Despite the variety of serious allegations made in the pleadings against Mr. Crawford, and the matters deposed to by the investigating accountants as calling for explanation, neither Mr. Crawford nor any member of his family gave evidence...It is well settled that in civil proceedings the court may draw adverse inferences from a Defendant's decision not to give or call evidence as to matters within his knowledge or his employees."**

34. In his written submission to the Commission and in his oral testimony, Mr. Crawford made serious allegations against a number of persons, including Dr Davies. Counsel representing these persons were never allowed to challenge the allegations against them by cross-examining Mr. Crawford. It is submitted that the Commission should not take into account any of Mr. Crawford's evidence.
35. In a well known decision from the English Court of Appeal¹⁴ an issue arose as to whether a defendant was compelled to be crossexamined on his affidavit evidence. The case was concerned with an application for contempt of court which was quasi-criminal in nature and held that in those circumstances, where the liberty of the deponent was in issue, he could not be compelled to be crossexamined. However, in the course of the judgment, the court accepted that in ordinary civil proceedings, a different consideration would apply. According to Denning, MR:

is [2005] UKPC 40 delivered November 2, 2005

¹⁴ Comet Products UK Ltd v Hawkey Plastics Ltd. [1971] 1 All ER 1141

I think counsel for the plaintiffs was on much stronger ground when he said that here the defendant had filed an affidavit which had been put before the court and therefore he was liable to be cross-examined on it. He referred us to *Clarke v Law* and *Re Quartz Hill etc Co, ex parte Young*. Those cases seem to show that in ordinary civil proceedings in Chancery, if an affidavit is filed and used before the court, the defendant, when he is threatened with cross-examination, cannot get out of it by saying that he will withdraw his affidavit. If he has filed an affidavit, and, in addition, if he has gone on to use it in the court, then he is liable to be cross-examined on it if the court thinks it right so to order. I would not say that the mere filing is sufficient, but I do say that when it is not only filed but used, the defendant does expose himself to a liability to be cross-examined if the judge so rules.
(Our Emphasis)

36. Mr. Crawford has not only filed a statement with the Commission but he appeared and gave evidence based on that statement. The Commission directed that he be cross-examined and he instead refused to expose himself to that liability. In the circumstances, the only proper course open to the Commission is to disregard his evidence in its entirety. Such a course would be consistent with the powers given to a Supreme Court Judge under the Civil Procedure Rules¹⁵. In this regard the Commission is reminded of its powers under the Commissions of Enquiry Act which are similar to that of a Supreme Court Judge in the summoning and examination of witnesses¹⁶.

¹⁵ is Civil Procedure Rules 29.8 and 30.1(5) is Sections 9 and 10

37. Even aside from this procedural issue, it is clear that since counsel for affected parties were deprived of the opportunity to cross-examine him, it would not be appropriate for the Commission to rely on Mr. Crawford's evidence. In another decision from the English Court of Appeal¹⁷, Sachs, LJ, who delivered the leading judgment described the prevention of a party to cross-examine a witness as "...the **wrongful denial of the fundamental right to cross-examine an opponent's witness...It is more akin to misdirection, at any rate in cases when the appellant is entitled to the determination of a specific tribunal entrusted by the legislature with the relevant decision.**"¹⁸
38. Dr Davies has been deprived of his fundamental right to cross-examine Mr. Crawford and challenge the allegations against him. This is particularly unfair because when Dr Davies gave evidence he was completely unaware of the adverse allegations that were being made against him by Mr. Crawford. He has therefore been deprived of the opportunity to address Mr. Crawford's allegations.
39. In the circumstances the Commission is urged to reject in its entirety the evidence given by Mr. Crawford.
40. The Commission is also invited to note the many decisions of the courts. Mr. Crawford appealed all the way to the Privy Council twice, losing at every level¹⁹. In one of the cases decided by the Privy Council, after extensive argument was made on Mr. Crawford's behalf, the Court held that the decision to assume

¹⁷ Blaise v Blaise [1969] 2 All ER 1032

¹⁸ At page 1037

¹⁹ Century National Bank Limited and others v Davies and others (1998) 52 WIR 361 and Crawford and others v Financial Institutions Services Limited [2005] UKPC 40, 34 of 2004

temporary management of the CFEs was properly and lawfully undertaken²⁰,

41. In the other case that went to the Privy Council² x the central issue was whether Mr. Crawford had breached his fiduciary duties to the CFEs. In dismissing Mr. Crawford's appeal, the Privy Council expressly agreed with the Chief Justice (who presided over the trial) that one of Mr. Crawford's transactions was "steeped in fraud".
42. It is submitted that this Commission should not allow Mr. Crawford to attempt to re-litigate issues already determined by the Courts.

Objectives/Operations of FINSAC

43. It is important to note that FINSAC was established after it became apparent that the problems in the financial sector were widespread. It is inaccurate to speak of FINSAC having "clients" who they treated badly. All these "clients" of FINSAC and their loan agreements were inherited from the intervened financial institutions. Against that backdrop, FINSAC was established to protect:
 - a. the savers in the failed institutions;
 - b. pensioners and employees whose pension funds were mismanaged by the failed institutions, and
 - c. the holders of insurance policies issued by the failed institutions.

²⁰ Century National Bank Limited and others (fn 15)

²¹ Crawford and others (fn 15)

44. FINSAC was not established to protect the owners/managers of the failed institutions or the bad debtors. There has been an attempt to suggest bias and political interference in decision-making. Here again, it is submitted that there was no evidence before the Commission to support that suggestion. Dr. Davies gave evidence that many persons, including prominent political personalities approached him to intervene on their behalf. In every instance, he referred them to the FINSAC management.
45. It is submitted that the Commission should also note the persons who agreed to serve as board members of FINSAC and the related companies. The Chairmen of FINSAC were Dr Gladstone Bonnick, the late Dr the Hon Ken Rattray and the Hon Shirley Tyndall, all persons of eminent distinction and unquestioned integrity. In terms of the intervened entities, Mr Dennis Morrison, QC (now Justice of Appeal Morrison) was first Chairman of Union Bank and later of Life of Jamaica, and the Hon Oliver Clarke was Chairman of National Commercial Bank. It has not, and we submit cannot, be suggested that the political directorate could instruct such persons to act in a biased or improper way.
46. In terms of the approach to the intervention, consistent with his earlier written responses to the Commission²² Dr. Davies identified the two options that could have been pursued by the Government to deal with the financial crisis in the mid 1990s. One involved the appointment of receivers over individual financial institutions with a view to disposing of assets and paying depositors in line with the realized assets. The other broad option was to have a **"...generic intervention as was done with the establishment of FINSAC and therein**

²² Answers to Questions - FINSAC Enquiry submitted November 19, 2009 at paragraph 1

rather than on a case by case you would have an umbrella organization through which the depositors, the holders of the insurance policies and also pensioners whose funds had been compromised in this period, where they would be protected." ²³

47. It is instructive to note that the advice from the multilateral financial institutions was that the Government should accept the failures in the banking system as part of the operations of a market economy. On that basis, the Government was advised to appoint receivers for the intervened institutions who would then pay back to depositors and creditors a percentage of their investment/savings based on the value of the assets recovered. As is known, the Government did not follow this recommendation.
48. Dr Davies accepts that in a debate as to whether this the correct decision, there would be strong points on either side²⁴. He testified that he was part of the team which made the decision to intervene, protect the savers, pensioners and holders of insurance policies and that he still considers that the correct decision. However, he respects the views of those who felt that the institutions should have been allowed to fail and creditors paid back whatever fraction of their savings/investments was recoverable when assets were realized.
49. It cannot escape notice that all of the complaints being voiced at the Commission have come from the owners/managers and the bad debtors. A succinct summary of their position is that the government should have also protected them in the intervention. The cost of protecting the depositors, the members of failed

²³ Transcript of Proceedings on November 24, 2009 at pages 9-10

²⁴ Transcript of Proceedings on November 24, 2009 at pages 12-18

pension funds and the holders of insurance policies amounted to 40% of GDP. The Commissioners should consider what would have been the cost if bad debtors and the owners were also "bailed out". It is submitted that it would have been unjustified and irresponsible for the Government to do so.

50. Dr Davies testified that even while recognizing that bad debtors could not be "bailed out", the Government took specific steps to seek to alleviate their situation. A special committee, headed by the Hon Beverley Lopez, was established to review the cases of those companies, the operations of which could impact on economic output and employment. It should also be remembered that the Government took special action to address the situation where a bad debtor had put up his principal place of residence as collateral for loans taken out. Again a special window was provided to such bad debtors whereby, on concessionary terms, they could retrieve their homes from FINSAC.
51. A point seldom raised in the discussions on FINSAC relates to the "silent majority" - the hundreds of thousands of Jamaicans whose savings, pensions and life insurance policies were saved by the intervention of FINSAC. Also seldom mentioned are the thousands of former bad debtors, who reached compromise agreements with FINSAC, and moved on with their lives and businesses.
52. A final point to be made is that the multilaterals, in particular the World Bank and the IDB, although initially disagreeing with the approach taken by the Government, eventually commended the methodology employed, based on rigorous analyses of FINSAC's operations. This commendation was backed by the decision to loan the Government a sum of US 350 million to help in meeting

the cost of intervention. It is submitted that it is unlikely that such support would have been forthcoming if the multilaterals had questions about the transparency and efficiency of FINSAC's operations.

Sale of Bad Debt Portfolio

53. The decision to sell the bad loan portfolio has elicited a great deal of comment. One view is that the Government should have retained the portfolio and dealt with bad debtors on an individual basis. Dr Davies indicated that there are several reasons why that course was not pursued. The first is that FINSAC was established with explicit objectives: to intervene and take action to rehabilitate the failed institutions, and then move on. To retain the bad debt portfolio would require its continued existence over an extended period.
54. However, above and beyond that reason, he emphasized that during the period when FINSAC interfaced directly with the bad debtors, its staff members came under severe pressure from several individuals, seeking additional concessions, even after they had agreed to compromise arrangements. It became apparent that the pressure on employees would continue to mount, if the bad loan portfolio were retained by FINSAC.
55. A second question relates to why the bad debt portfolio was sold to a "foreign company". The evidence is that there was never a decision to sell to a "foreign company". Rather there was an attempt to elicit interest from reputable companies, local or foreign. A prominent local company showed preliminary interest but indicated that their analysis suggested a maximum offer of ten

cents in the dollar. The fact is that the offer from the principals of what became the Jamaica Redevelopment Foundation ("JRF") was the best received, as the Jamaican taxpayers would benefit not only from an initial cash payment, but also from an increasing percentage of further collections.

Conclusion

56. It is submitted that there are several policy lessons which the country should have learnt from the intervention and the events which followed.
57. The first is that there should never be any attempt to relax regulatory requirements to "accommodate" domestic financial institutions. We have learnt that "affirmative action" has no place in the regulation of financial entities.
58. A second lesson is that there is need for continuing review and tightening of the regulatory framework. The present regulations need to be strengthened such that the authorities can take swift pre-emptive action, even against unlicensed institutions. Our recent experience in dealing with the various Ponzi schemes demonstrated the extent to which the Bank of Jamaica and the Financial Services Commission were hampered in taking action. Even at this point in time, the regulatory authorities still cannot act unless it is established that the operators are engaged in activities reserved for licensed institutions.
59. In considering this matter, it must never be forgotten that hundreds of thousands of Jamaicans were saved from financial devastation by the decision to intervene in, and rehabilitate the

failed institutions. Difficult decisions were made in trying circumstances. The country's saving base was preserved and the experience prompted a thorough review of the financial regulatory framework. One result is that the country now boasts a robust and well-regulated financial sector. Proof of the effectiveness of the improved framework is the fact that the recent worldwide financial crisis had no negative impact on Jamaican institutions.

November 7, 2011

B. St. Michael Hylton, Q.C.

Kevin O. Powell



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THE 1990'S**

**CLOSING SUBMISSIONS
FOR AND ON BEHALF OF THE BANK OF JAMAICA
Background:**

1. On October 27, 2008 the Governor General of Jamaica issued a commission under the Commissions of Enquiry Act to enquire into and report on all the circumstances that led to the collapse of several financial institutions in the 1990's. The Commissioners appointed were authorized to, among other things,:

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- ii. To consider what actions, if any, could have been taken to avoid this occurrence and to evaluate the appropriateness of the actions which were taken by the authorities in the context of Jamaica's economic circumstances and in comparison to intervention by the State in other countries which have had similar experiences.

iv.

v.

vi.

vii. To assess the long term impact of the collapse of these institutions on the economy and on the businesses and individuals whose loans were involved as well as the economic and social impact of the actions taken by the Government with regard to the savers, depositors and investors of the failed institutions.

viii. To review the steps that have subsequently been taken and make recommendations as to what further steps should be taken to prevent a recurrence of such widespread collapse of financial institutions and the resulting hardships.

2. On May 28, 2009 the Secretary to the Commission wrote to the Bank of Jamaica ("the Bank") drawing the Bank's attention specifically to sections i, ii, vii and viii of the Commission's terms of reference. In that letter the Bank was also requested to provide certain specified information in relation to "Bank Supervision and Regulation" and "The Bank" ¹. The Secretary to the Commission subsequently wrote to the Bank requesting that it respond to a detailed list of questions² and also to provide other material³.

¹ Letter from Fernando DePeralto to the Governor, Bank of Jamaica dated May 28, 2009

² Letters from Fernando DePeralto to the Governor, Bank of Jamaica dated September 11, 2009 and October 26, 2009

³ Letter from Fernando DePeralto to Senior Deputy Governor, Bank of Jamaica dated October 26, 2009

3. On July 6, 2009 the Bank provided to the Secretary of the Commission the information requested on May 28, 2009⁴. On October 29, 2009 the Bank provided its responses to the questions posed to it by the Commission⁵.
4. The Bank also provided to the Commission its "Report on Legislative Developments in Jamaica's Banking Laws for the period 1990 to the Present" by letter dated 31 August 2009. This is addition to numerous reports and listings provided by the Bank to the Commission relating to the state and structure of the banking sector over the relevant period.
5. On September 9, 2009 the Secretary to the Commission invited the Bank to appear at the public hearings of the Commission. The Bank accepted the invitation. Over the course of the first 3 days⁶ on which the Commission received evidence, representatives of the Bank gave evidence and responded to the questions posed by the Commissioners and counsel representing other interested persons.
6. These submissions are in support of the *viva voce* evidence given by the Bank's representatives at the public hearings of the Commission and the written material previously submitted to the Bank by the Commission.

Letter from Mrs. Gayon Hosin, Deputy Governor to the Secretary of the Commission dated July 6, 2009 s
Bank of Jamaica's Responses to Questions dated October 29, 2009 (submitted to the Commission with a
folder containing appendices to the responses)

⁶ November 10, 11 and 12, 2009,

Introduction:

7. The Bank submits that it acted appropriately in the context of Jamaica's economic circumstances and against the background of the statutory powers and responsibilities which the Bank had at the relevant time.
8. The Bank had (and still has) two core functions. These two core functions related to the Bank's role in determining the monetary policy of the country and the Bank's supervisory role in relation to those financial institutions over which it had regulatory jurisdiction.
9. The supervisory function of the Bank was to ensure **"financial stability"** owing to its responsibility for the **"regulation and supervision of deposit taking entities which broadly speaking make up the banking system."** ⁷The monetary policy function was described as **"basically [influencing] the volume and conditions of supply...and the control of inflation within the whole monetary policy aspect of its operations."**⁸

The Bank's Supervisory/Regulatory Functions and the causes for the failure of some financial institutions in the 1990's:

10. The Bank's evidence relating to the supervisory function of its operations in the 1990s was primarily given by Mrs. Audrey Anderson, who during the 1990's, was the Senior Director in charge of the Financial Institutions Supervisory Division with responsibility broadly for supervision of the banking sector⁹. The Bank's supervision

⁷Transcript of proceedings on November 10, 2009 at page 8

⁸Transcript of proceedings on November 10, 2009 at page 7

⁹Mrs. Anderson was acting Governor of the Bank at the time she gave evidence

of financial institutions was governed by the provisions of the Bank of Jamaica Act, the Financial Institutions Act and the Building Societies Act along with the various regulations passed under those legislations.

11. The evidence was that the supervisory and regulatory function was mainly carried out by off-site evaluation of monthly and quarterly returns submitted to the Bank of Jamaica as well as by conducting periodic on-site inspections and examinations of the relevant financial institutions. The Bank also required the financial institutions to provide annual reports. The Bank increased the frequency of its inspections and examinations on an ongoing basis where it was felt that a particular financial institution warranted additional attention.
12. In the fulfillment of its supervisory role, the Bank noted in particular, increasing levels of non-performing loans and a decline in the profitability of some deposit-taking entities with several of them having low capital bases. There was also evidence of poor management practices and imprudent accounting practices. This included inadequate levels of provisioning against non-performing loans, capitalization of unearned and uncollectible income, which artificially inflated profit positions. The Bank also found that some of the financial institutions submitted inaccurate and misleading information.
13. The Bank noted that there was an increased use of volatile, short term depositors' funds to resolve liquidity difficulties encountered by some of the financial institutions, especially in the insurance sector. The Bank's evidence was that the vulnerabilities in the insurance sector, over which it had no supervisory or regulatory powers, contributed significantly to the financial failures in the 1990s.

14. In identifying the factors which contributed to the failure of some financial institutions during the relevant period the Bank referred to the outdated legislative framework governing the banking sector and the insurance sector¹⁰. The legislative framework at the time did not include any substantive provisions relating to prudential limits on key financial activities. In particular there was an absence of key regulatory powers and sanctions. For instance, prior to 1992, the Bank had no power to sanction any of the licensed financial institutions over which it exercised its supervisory function. The only available options were the two extremes of appealing to the financial institution through moral suasion or recommending that the Minister of Finance revoke its license.
15. In the early 1990s, there was an increased growth of financial conglomerates with insurance companies as the parent companies and banks as the subsidiaries in the financial group. Mrs. Anderson described it in this way: **"There were major mismatching of assets and liabilities, there was a practice where the insurance companies were funding their operations very significantly through very short term funding, not normal insurance company type funds. Funds were not coming in to a large extent through normal insurance contracts, but through instruments that the Central Bank regarded as more deposit-like in nature than insurance type and as the mismatch of funding sources took place, and the insurance companies came under very serious liquidity problems, these problems were pushed into the commercial bank by the insurance parent requiring significant funding from their commercial banking subsidiaries and in several of the large entities this created major problems for the affiliated bank, for the subsidiary bank."**

¹⁰ Bank of Jamaica's Responses to Questions dated October 29, 2009 at page 11

16. The Bank also drew attention to the increased growth in the number of financial entities. This growth in turn led to over-competition in the system, a severe strain on the managerial expertise in the banking system and the regulatory resources of the Bank.
17. The Bank identified as a factor what it described as "**regulatory arbitrage**" which "**essentially means that entities would move some of the questionable activities from areas which were under significant scrutiny [to] the areas which were less rigorously scrutinized.**" ¹²
18. Included among the factors which affected the sustainability of certain financial entities in the 1990s, the Bank drew the Commission's attention to the practices of certain specific entities¹³. These practices included excessive risk-taking; very poor management or corporate governance strategies; corporate structuring to avoid regulatory scrutiny; irresponsible banking practices; and significant non-arm's length transactions between connected persons.
19. Having identified these problems, the evidence supports the view that the Bank did all that it could have done in the circumstances. In the context of the lack of statutory regulatory sanctions that the Bank could apply, the Bank reported the condition of the troubled entities to the Minister of Finance. This was not contradicted by the Minister who during his evidence confirmed the Bank's actions ¹⁴. The Bank tried to impose specific recommendations on the troubled entities and their boards and management but in the majority of cases these recommendations were not followed. In the absence of statutory powers to independently impose sanctions for the refusal or failure to

¹² Transcript of proceedings on November 10, 2009 at page 26

¹³ The Bank also gave detailed specific examples of these practices in the Bank of Jamaica Responses to Questions dated October 29, 2009 at pages 15-22

¹⁴ Transcript of proceedings on November 24, 2009 at pages 83-85 and November 25, 2009 at pages 153-155

follow its recommendations, the Bank performed to the best of its functional capabilities.

20. The Bank also gave evidence of specific recommendations made to the Minister of Finance for sanctions where the Bank assessed this as the most appropriate. Included in these recommendations was the intervention and assumption of temporary management of some of the financial institutions.
21. The Bank having identified the weaknesses in the supervisory statutory framework also made comprehensive recommendations for the amendment and upgrade of the various legislation, which led to some amendments being enacted in 1992 and more substantive amendments in 1996. The legislative changes were, in large part, a direct response to the Bank's recommendations.

The Monetary Policy Employed during the period:

22. The liberalization of the exchange rate regime in 1991 in the absence of supporting foreign exchange reserves precipitated a sharp adjustment in the exchange rate and consequent increases in domestic prices. Inflation rose to unprecedented levels and the Bank was forced to employ a restrictive monetary policy stance.
23. The pursuit of tight monetary policy by the Bank in the post-liberalization period was manifested in increased interest rates to contract aggregate demand and to bring aggregate spending in line with supply conditions. The approach included greater reliance on market-based instruments to conduct monetary policy, This approach was successful in achieving substantial moderation in the growth in

domestic prices and the exchange rate. In particular, the 12-month point-to-point inflation rate declined to a range of between 25.4% and 25.6% during 1995 from a high of more than 100% during 1992.

24. In 1993, the BOJ continued to rely on open market operations coupled with a liquid assets ratio (LAR) of 50% in order to absorb excess liquidity in the system. The Bank's policy focus of containing inflation and bouts of significant exchange rate instability continued well into the second half of the 1990s with a strong degree of success. By 1998, inflation had been reduced to 7.9%¹⁵.
25. This corrective action, in particular, the deceleration of inflation, exposed the extent to which some financial institutions and borrowers had relied on the continuation of the escalation of asset and consumer prices to maintain their levels of expansion and expenditure. The BOJ's annual reports in the early 1990s under the signatures of various Governors ranging from the tenure of G.A. Brown to Jacques Bussieres (June 1993 - March 1996) consistently referred to the Bank's battle against high inflation, a challenge which emerged following the liberalization of the financial system in late 1990.
26. In addition to interest rates, the Bank also applied, at various times, other measures to curb money supply and maintain stability within the foreign exchange markets, taking into account market developments. These included:
 1. Re-introduction of the non-cash portion of the liquid asset requirements;

¹⁵ Transcript of Proceedings on November 10, 2009 at page 114

2. Increases in the penal rate imposed on commercial banks in respect of breaches of the cash reserve and liquid asset ratios;
 3. Controls on spreads that could be charged by authorized foreign exchange dealers;
 4. Establishment of a network of authorized foreign exchange dealers;
 5. Selective Special Deposits; and
27. It should be noted that these monetary measures had to be employed in the absence of other structural measures and conditions that would have allowed the authorities greater flexibility in dealing with the inflationary environment. One such condition would have been stronger Governmental surpluses which would have lessened demand on the market for funding and thereby affected the interest rates (and risk premium) which investors would have accepted. In addition, the Bank did not have at the time the strong level of net international reserves which would have allowed it to intervene into the foreign currency market, which would have also affected the level of interest rates that would have been accepted by investors.
28. Some witnesses ¹⁶ have pointed out that, whilst necessary, the imposition of tight monetary policy went on for too long a period. The Bank of Jamaica made the point that the effectiveness of monetary policy depended on changing persons' inflationary expectations, which required convincing persons that future conditions would stabilize and be characterized by low inflation. This then, over time, reduces expectations and eases demand with regards to interest rates and risk premiums¹⁷. It would manifest in investors accepting lower rates in

¹⁶For instance, Submission of Dr. Enoch Crafton Carlton Karl Blythe at page 5 and Transcript of Proceedings on January 21, 2010 at pages 93-94 (evidence of Oliver Jones). ¹⁷ Transcript of Proceedings on November 9, 2009 at page 114

the market. Thus there could have been no fixed time-frame for the reduction of rates. The termination of tight monetary policy before investor expectations are in fact changed could lead to inflationary behavior and would not have amounted to the successful implementation of monetary policy.

The Nature of the Financial Collapses:

29. The Bank also considered the issue of whether there was a systemic collapse of the Jamaican financial sector in the 1990s. It was the Bank's evidence that while the financial system underwent some stress, it did not amount to the crisis that was evident in other jurisdictions across the world. For instance, there was no instability in the Jamaican banking system resulting in threats to the payment system and the real sector.
30. The evidence indicated that there were some sound financial institutions which remained viable and untainted by the difficulties encountered by other financial entities ¹⁸. There was no evidence to suggest that all or the majority of the financial institutions failed during the 1990s.
31. The maintenance of stability was also in part due to the determination of the Bank and the administration at the time that it would not accept the recommendation from the World Bank and the International Development Bank to close the country's banking system for two weeks. The Bank's view was that taking such a decision would have resulted in turmoil and massive dislocation as

¹⁸ Examples of these were Pan Caribbean Merchant Bank Limited, Trafalgar Commercial Bank Limited, Victoria Mutual Building Society and Jamaica National Building Society.

occurred in certain countries in East Asia. The Bank was also concerned about the logistics required to properly execute a systemwide lock-down.

32. There was also an absence of capital flight. Instead, the sector experienced "*a flight to quality*" in that persons moved their money from institutions which they determined to be weak to institutions which were considered stronger. This contrasted with the capital flight problems experienced in other jurisdictions including Thailand and other Asian countries.
33. On November 11, 2009 the Commission posed further questions to the Bank. A document containing the written responses to these questions was provided to the Commission ¹⁹ and oral evidence in response to these questions was given by Mrs. Anderson and Mrs. Halsall. In its evidence the Bank identified the myriad of factors which militated against a decision to take a preemptive and wide scale intervention ²⁰. The Bank also gave evidence, consistent with the implicit suggestion from the Commission that the Bank's approach was to prioritize interventions²¹.
34. It was recognized in the Bank's evidence that it operated under strict confidentiality laws which did not allow it to publicly indicate whether a financial entity may be insolvent²². The Bank was therefore legally bound to not inform the public of any such findings but the decision by the Minister of Finance to protect all depositors in the intervention process was informed by this consideration²³.

¹⁹ Questions for Bank of Jamaica drafted 11 November 2009

²⁰ Transcript of proceedings on November 12, 2009 at pages 4-15 and pages 26-31

²¹ Transcript of proceedings on November 12, 2009 at pages 19-20

²² See The Bank of Jamaica Act, section 34D

²³ Transcript for November 12, 2009 at pp. 47-50

35. The Bank also provided the Commission with a written response offering a comparative analysis of the Caribbean experience with problems in the financial system with a focus on the steps taken to address the issues and an identification of the differences in approach between those other countries and the actions taken in Jamaica²⁴. The Bank compared the resolution strategies undertaken in the Dominican Republic and Trinidad and Tobago with the intervention undertaken in Jamaica.
36. The approach that was taken to resolve the crisis in Jamaica involved the restructuring of the banking system and the insurance sectors and the safeguarding of the interests of depositors and policy holders.

Allegations against the Bank:

37. The representatives of the Bank were cross-examined by counsel representing individuals and entities who claim to have been affected by the events of the 1990s²⁵ and the Bank was also the subject of certain adverse allegations by other persons who appeared before the Commission.
38. Questions were posed to the Bank on November 10 and 11, 2009 by counsel representing Mr. Bentley Rose, Benros Company Limited and Macro Finance Corporation Limited. The Bank provided its responses in writing to the Commission and the questions were also addressed on November 11, 2009 in the *viva voce* evidence of Mrs. Gayon Hosin, Deputy Governor of Financial Institutions, Supervisory Division.

²⁴ Bank of Jamaica's Response to Question posed at the sitting on Tuesday 10 November 2009 dated November 11, 2009

²⁵ Gayle Nelson representing Mr. Bentley Rose, Benros Ltd. and MicroFinance Corporation

39. The evidence in that regard centered primarily on Workers' Savings & Loans Bank and the Bank confirmed that this was a financial entity into which it recommended intervention. Both on cross-examination and in response to questions posed by the Commission, it was explained and clarified that the Bank did not advance funds to the banks in any way other than by facilitating overdrafts and this would have applied to the Workers Bank²⁶.
40. The Bank was challenged on recognition that the Workers Bank was in breach of the Banking Act it did not take steps to have it closed. The Bank's response was consistent with its previous evidence that its powers were limited to supervisory recommendations for sanction because it had no powers or authority to intervene in that institution by temporary management or to revoke its license or the license of any of the other troubled financial institutions. The Bank also gave evidence that it had no power to remove any officer of these institutions.
41. The Bank also went further to explain that a recommendation for closure would take into account a number of factors, including the seriousness of the breach of the governing statute and the repetitiveness of any breaches. The evidence was that the Bank did recommend intervention into the operations of the Workers Bank and that recommendation was followed. Under cross-examination Mrs. Hosin consistently maintained that the Bank did not hold (and still does not hold) funds to satisfy judgments against any of its supervised entities. No evidence was ever given to suggest otherwise.

²⁶ Transcript of proceedings on November 11, 2009 at pages 20-27

42. The Bank also gave evidence that it had no supervisory or regulatory jurisdiction over the Jamaican Redevelopment Foundation Inc. and was not a party to any decision to grant to this entity exemptions under the Money Lending Act.
43. The Commission also heard evidence from the majority shareholders and heads of two financial conglomerates in which there was intervention - Paul Chen-Young of the Eagle Financial Entities and Mr. Donovan Crawford of the Century Financial Entities. Both men gave evidence which included adverse allegations against the Bank.

Dr. Paul Chen-Young and the Eagle Financial Entities ("the EFEs")

44. Dr. Chen-Young gave his evidence by video-link on April 14, 2011 and made himself available for cross-examination by the Bank's counsel. It is submitted that Dr. Chen-Young's evidence was contradicted by the documents which were in evidence before the Commission and was also inherently inconsistent and not credible in several respects.
45. For instance, Dr. Chen-Young put forward figures and statistics that he was unable to defend when faced with contrary evidence. Examples were his assertions that there was no economic growth between 1990 and 1998²⁷ and as to the Treasury Bills' rates between 1991 and 1999²⁸. Also, when confronted with the empirical data identifying the financial institutions that had not been subject to intervention, Dr. Chen-Young resiled from his earlier evidence that **"by 1997...every major domestic owned financial entity effectively had collapsed."**²⁹

²⁷ Transcript of proceedings on April 14, 2011 at page 50

²⁸ Transcript of proceedings on April 14, 2011 at pages 53-54

²⁹ Transcript of proceedings on April 14, 2011 at pages 130-132

46. Under cross-examination Dr. Chen-Young agreed that the regulator, the Bank, should have the authority to identify and examine the ultimate shareholder behind any financial entity³⁰. This was in direct contradistinction with his refusal, during the relevant period when he was head of the EFEs, to comply with the Bank's request to identify their ultimate owner.
47. This was supported by the findings of the Court of Appeal which concluded that Dr. Chen-Young was not open with the Bank and failed to fully disclose to the Bank information about the ultimate control and ownership of the EFEs. Despite claiming that he had provided this information as requested of him from the Bank, in the decision from the Court of Appeal³¹ the Court referred to a letter from Dr. Chen-Young which completely contradicted his evidence before the Commission³².
48. Dr. Chen-Young was also unable to disagree with the Privy Council's finding that the Bank only acted in the public interest when it recommended intervention into Century National Bank³³. This was after he had earlier in his evidence criticized the Bank for "*persecuting*" Mr. Donovan Crawford and the Century Financial Entities.
49. As part of his evidence Dr. Chen-Young sought to suggest that the Bank was not proactive in its attempts to prevent the issues which arose in relation to some of the financial institutions in the 1990s³⁴.

³⁰- Transcript of proceedings on April 14, 2011 at page 85

³¹ Paul Chen-Young and others v Eagle Merchant Bank and others SCCA 23,25 and 46 of 2000 delivered July 23, 2002

³² Transcript of proceedings on April 14, 2011 at pages 121-122

³³ Transcript of proceedings on April 14, 2011 at pages 97-98

³⁴ Dr. Paul Chen-Young Submission to the Commission of Enquiry at pages 27-28

However, after the Bank's comprehensive evidence on the steps it had taken was drawn to his attention, Dr. Chen-Young acknowledged these steps including the specific requirements for board members to read the Bank's on-site reports and to fix timelines for ameliorative action.

50. During his cross-examination Dr. Chen-Young proved to be a difficult and at times combative witness who was sometimes unwilling to answer the questions asked of him and unable to recall those events which would put his testimony under scrutiny. The Commission is asked to bear in mind the witness' demeanor and overall attitude when he was being cross-examined which suggested that he did not give a full and complete picture of the events as described in his submission to the Commission.

Donovan Crawford and the Century Financial Entities ("the CFEs")

51. Another Chief Executive Officer and majority shareholder of an intervened financial institution who gave evidence was Donovan Crawford. Mr. Crawford was the head of the CFEs. He gave his evidence by video-link on June 7, 2011. He appeared again before the Commission on July 27, 2011, also by video-link, and was to have been cross-examined on that date. That date had been agreed after consultation with Mr. Crawford, his attorney and attorneys representing several persons against whom he had made adverse allegations. Instead, in defiance to the Commission's directions, Mr. Crawford refused to be cross-examined, purportedly acting on the advice of his attorney³⁵.

³⁵ Transcript of the proceedings on July 27, 2011 at pages 17-18

52. Mr. Crawford's refusal to be cross-examined should be considered in light of his evidence during his earlier testimony when in reference to one of the litigious matters connected with the temporary management of the CFEs, he said: **"All the counsel that I have been able to afford to hire, advised me against appearing in person in court. In retrospect, it is clear that my absence in court was interpreted as some form of tacit admission of guilt."** It is submitted that Mr. Crawford's refusal to be cross-examined was another orchestrated tactical ploy.
53. Mr. Crawford's reference to his absence from court was in relation to the case of **Crawford and others v Financial Institutions Services Ltd.**³⁶ In dismissing an appeal from Mr. Crawford against findings that he, among other things, breached his fiduciary duties in relation to the Century Financial Entities, the Privy Council noted Mr. Crawford's refusal to give any evidence in support of his case. According to the Board: **"Despite the variety of serious allegations made in the pleadings against Mr. Crawford, and the matters deposed to by the investigating accountants as calling for explanation, neither Mr. Crawford nor any member of his family gave evidence...It is well settled that in civil proceedings the court may draw adverse inferences from a Defendant's decision not to give or call evidence as to matters within his knowledge or his employees."**
54. In his written submission to the Commission and in his oral testimony, Mr. Crawford made serious allegations against a number of persons, including the Bank. These persons and the Bank were not allowed to challenge the allegations against them by cross-examining Mr. Crawford. It is not clear whether the Commission intends to consider the evidence given by Mr. Crawford in spite of his refusal to submit to cross-examination³⁷. It is submitted that the Commission

³⁶ [2005] UKPC 40 delivered November 2, 2005

³⁷ Letter from Secretary to the Commission to Brian Moodie copied to All Attorneys dated October 24, 2011

should not consider Mr. Crawford's evidence and should instead refuse to take into account any aspect of it,

55. In a well known decision from the English Court of Appeal³⁸ an issue arose as to whether a defendant was compelled to be cross-examined on his affidavit evidence. The case was concerned with an application for contempt of court which was quasi-criminal in nature and held that in those circumstances, where the liberty of the deponent was in issue, he could not be compelled to be cross-examined. However, in the course of the judgment, the court accepted that in ordinary civil proceedings, a different consideration would apply. According to Denning, MR:

I think counsel for the plaintiffs was on much stronger ground when he said that here the defendant had filed an affidavit which had been put before the court and therefore he was liable to be cross-examined on it. He referred us to *Clarke v Law and Re Quartz Hill etc Co, ex parte Young*. Those cases seem to show that in ordinary civil proceedings in Chancery, if an affidavit is filed and used before the court, the defendant, when he is threatened with cross-examination, cannot get out of it by saying that he will withdraw his affidavit. If he has filed an affidavit, and, in addition, if he has gone on to use it in the court, then he is liable to be cross-examined on it if the court thinks it right so to order. I would not say that the mere filing is sufficient, but I do say that when it is not only filed but used, the defendant does expose himself to a liability to be cross-examined if the judge so rules. (Our Emphasis)

56. Mr. Crawford has not only filed a statement with the Commission but he has come and given evidence based on that statement. The

³⁸as *Comet Products UK Ltd v Hawkex Plastics Ltd*, [1971] 1 All ER 1141

Commission directed that he should be cross-examined and he has instead refused to expose himself to that liability, In the circumstances, the only proper course open to the Commission is to disregard his evidence in its entirety. Such a course would be consistent with the powers given to a Supreme Court Judge under the Civil Procedure Rules³⁹. In this regard the Commission is reminded of its powers under the Commissions of Enquiry Act which are similar to that of a Supreme Court Judge in the summoning and examination of witnesses".

57. Even aside from this procedural issue, it is clear that having deprived the Bank of an opportunity to cross-examine him, it would not be appropriate for the Commission to take into account with any weight, Mr. Crawford's evidence. In another decision from the English Court of Appeal⁴¹, Sachs, LJ, who delivered the leading judgment described the prevention of a party to cross-examine a witness as "...the **wrongful denial of the fundamental right to cross-examine an opponent's witness...It is more akin to misdirection, at any rate in cases when the appellant is entitled to the determination of a specific tribunal entrusted by the legislature with the relevant decision.**"⁴²

58. The Bank has been deprived of its fundamental right to cross-examine Mr. Crawford and to directly challenge him in relation to the allegations he has made against the Bank. This is particularly unfair because the Bank had already given its evidence and it did so at a time when it was completely unaware of the adverse allegations that were being made against it by Mr. Crawford. The Bank has been deprived of the opportunity to address Mr. Crawford's allegations.

³⁹ Civil Procedure Rules 29.8 and 30.1(5)

⁴⁰ Sections 9 and 10

as *Blaise v Blaise* [1969] 2 All ER 1032

⁴² At page 1037

59. In the circumstances the Commission is urged to reject in its entirety the evidence given by Mr. Crawford as it relates to any adverse allegations against the Bank.
60. In any event, it is submitted in the alternative, that should the Commission decide to consider Mr. Crawford's evidence it should be attached very little, if any, weight as against the Bank as his evidence was either contradicted by material already before the Commission or was not credible.
61. In his written statement to the Commission, Mr. Crawford suggested that in relation to the CFEs, **"...credit facilities granted to the subsidiaries were legally and transparently done on the financial strength of the group as a whole, generally in keeping with custom and the then existing Banking Act, and reported in the normal manner to the Bank of Jamaica."**⁴³ This was strongly contradicted by the Bank's evidence. Connected party credits as it related to the CFEs was always a major issue and was identified as part of the irresponsible and reckless practices of the troubled financial institutions and the CFEs in particular⁴⁴.
62. The evidence presented to the Commission included an affidavit sworn by Mrs. Anderson in civil proceedings involving Mr. Crawford⁴⁵ ("Mrs. Anderson's Affidavit"). According to Mrs. Anderson's Affidavit:

The extent of the loans made by the CFEs to each other and to their parent company Holdings and its subsidiary Developments was of great concern. The total loan exposure of the CFEs to "connected persons" (as defined in the governing statutes) as at the 1995 examination was \$4.893 billion (or approximately 36% of the CFEs combined asset base). As of

⁴³ as Letter to the Commission from Donovan Crawford dated April 7, 2011 at page 2 ⁴⁴

Bank of Jamaica's Responses to Questions dated October 29, 2009 at pages 19-20

⁴⁵ Exhibit 12 to the Bank of Jamaica's Responses to Questions dated October 29, 2009

April 30, 1996, the exposure of the Bank alone to "connected persons" totaled \$1.850 billion, or 51.5% of the bank's total credits...⁴⁶

63. The evidence before the Commission also established that it was not true (as Mr. Crawford alleged) that Century National Bank ("CNB") acted in compliance with the Banking Act. Mrs. Anderson's Affidavit goes on to state:

By subsection 13(1)(d)(i) the Bank was prohibited from granting unsecured credit facilities to any director in excess of 1% of the Bank's capital base. CNB was in violation of this provision by virtue of a loan to one of its directors which as at May 24, 1995 amounted to \$11.118 million or 2.95% of the new capital base...

By sub-section 13(1)(f)(i) a Bank is prohibited from granting credit facilities to any one person if the credit facilities exceed in the aggregate 20% of the bank's capital base, and where any portion of such facilities is unsecured, that portion shall not exceed 10% of the bank's capital base. As at March 22, 1995 [Century National Bank] had ten separate violations of this provision on its books...⁴⁷

64. Similar observations were also made in the independent audit report conducted by Coopers & Lybrand⁴⁸.
65. There are several other instances of allegations made against the Bank by Mr. Crawford which have very little, if any, credibility when

⁴⁶ At paragraph 54

⁴⁷

At paragraph 74

⁴⁸ Review of the Operations and Affairs of Century National Bank Limited and Century National Merchant Bank Limited by Coopers & Lybrand, Exhibit 16 to the Bank of Jamaica's Responses to Questions dated October 29, 2009

examined against the contemporary documentary evidence before the Commission.

66. Mr. Crawford implied that the Bank requested a list of the twenty-five largest depositors in CNB and advised them to remove their deposits⁴⁹. The Bank's request for a list of the largest depositors of CNB was standard practice for institutions placed on a watch list to monitor their liquidity problems⁵⁰. The Bank also wishes to use these submissions to make it clear that it has never been its practice to contact any depositor of any financial institution it has regulated and in particular, it did not contact these depositors as suggested by Mr. Crawford.
67. Mr. Crawford also characterized the audits of the CFEs conducted by the Bank as being "*aggressive*" and "*destructive*". This allegation ignores the statutory obligation of the Bank to carry out inspections into the affairs or business of every licensee over which it has supervision⁵¹. The credible evidence from the Bank was that where an entity is on watch list, as the CFEs were, more targeted audits and on-site examinations would be required⁵². It is submitted that the evidence overwhelmingly supports a conclusion that the Bank was not improperly motivated to recommend the assumption of temporary management of the CFEs, as Mr. Crawford alleges.
68. Finally, Mr. Crawford described the temporary management of the CFEs as "**an unheralded armed assault and assumption of temporary**

⁴⁹ Letter to the Commission from Donovan Crawford dated April 7, 2011 at page 5

⁵⁰ Mrs. Anderson's Affidavit at paragraph 13 and Bank of Jamaica's Responses to Questions dated October 29, 2009 at pages 5-6

⁵¹ The Banking Act and the Financial Institutions Act, section 29

⁵² The Banking Act and the Financial Institutions Act, section 29 and the Bank of Jamaica's Responses to Questions dated October 29, 2009 at page 5

management"⁵³ alleging that it was done without any warning. He also strongly criticized the Bank's role in recommending temporary management. This is contradicted by the credible evidence given to the Commission by the Bank. Mrs. Anderson's Affidavit outlined the extensive negotiations which were undertaken between Mr. Crawford and the Century National Bank and the Bank and the Minister of Finance⁵⁴,

69. Included among the facts are the various proposals for remedial action which were to be undertaken by the CFEs and the undertaking which was signed by the Century National Bank directors, including Mr. Crawford in relation to these remedial actions. The evidence shows that none of the undertakings given were fulfilled and the remedial actions were never completed. It was also clear from the evidence that the Bank's recommendation for the CFEs to be placed under temporary management was only after a protracted period of discussions and negotiations with Mr. Crawford and the CFEs.

70. Mr. Crawford litigated these same issues all the way to the Privy Council, losing at every level. In ruling against Mr. Crawford and in particular on the issue concerning the assumption of temporary management of the CFEs without consultation, the Privy Council said: "...a **prior opportunity for the directors and other insiders in the bank to make representations that a temporary management is inappropriate is both impractical and contrary to the public interest. The argument based on procedural unfairness must be rejected.**"

71. In looking specifically on the Bank's role in recommending temporary management, the Board concluded:

^{ss} Letter to the Commission from Donovan Crawford dated April 7, 2011 at page 2 ^{sa}
Paragraphs 11-16, 21-28 and 35-39

In the appellants' written case it was argued that the validity of the recommendation made by the Bank of Jamaica to the Minister under section 25(1) was open to doubt because the Bank had a conflict of interest. Counsel for the appellants did not address their lordships orally on this argument. That is understandable since there is nothing whatsoever to suggest that the Bank of Jamaica failed to carry out its statutory functions properly. There was no conflict of interest; the Bank of Jamaica was and had to be guided only by the public interest. Their Lordships reject the written argument on this point as wholly unsustainable.

72 It is submitted that this Commission should take notice of the pronouncements of the highest court for this country and not allow Mr. Crawford to attempt to re-litigate issues already determined by the Courts.

73. In all the circumstances, the Bank submits that Mr. Crawford's evidence should be disregarded for his willful refusal to be crossexamined. Alternatively, his evidence against the Bank has been contradicted by other credible evidence before the Commission and was so inherently incredible that no weight should be given to it.

The Subsequent Steps to Prevent a Recurrence:

74. The Bank recommended legislative changes to address problems such as the adverse actions of dominant shareholders and the extension of credit to connected parties on an imprudent basis. A more stringent requirement for satisfying the "fit and proper" person requirement was also the subject of legislative recommendation. Additional legislative

powers were also recommended by the Bank to allow it to enforce sanctions against supervised entities and inspect and monitor the books of related non-deposit taking financial institutions. Parliament subsequently made the changes recommended by the Bank. The legal requirements for capital maintenance and capital ratios were also legislatively improved.

75. The result of the implementation of the amendments recommended by the Bank is that it now has the power to issue cease and desist orders and to require and enforce undertakings from the directors of financial institutions. In effect, certain powers which resided only with the Minister of Finance were given to the Bank to assist it to effectively regulate the financial entities under its supervision. Generally, the Bank now has wider powers under the law, including for instance, the power to assume temporary management of a troubled financial institution.
76. In addition to the significantly improved legislative framework, the Bank has increased regular meetings with the senior management and the boards of directors of financial entities. These meetings encourage the acceptance of the directors' roles in prudently running their entities. The Bank's evidence was that this was an approach that has gained great acceptance and was followed by several other jurisdictions only after the eruption of the financial crisis in 2008.⁵⁵
77. The Bank has ensured that members of the financial industry receive training including seminars by the Bank on the various regulatory requirements and any new developments in the area of supervision

and regulation. This includes, for instance, money-laundering and any new procedures or reporting formats required by the Bank.

78. There has been the establishment and strengthening of the regulatory agencies with the establishment of the Financial Services Commission to strengthen oversight of non-deposit taking institutions. There has also been the establishment of the Deposit Insurance Corporation which was established for the protection of the smaller depositors.
79. There is increased co-ordination between the regulatory agencies, in particular, the Bank and the Financial Services Commission. In 2001 a memorandum of understanding was entered into by the Bank, the Financial Services Commission, the Jamaica Deposit Insurance Corporation, and the Financial Secretary of the Ministry of Finance which resulted in the establishment of the Financial Regulatory Council. The Solicitor General also participates in these meetings in an advisory role.
80. The Financial Regulatory Council's primary function is to coordinate the regulatory policy for the entire financial system. This involves the sharing of information and represents a formal coordinated approach to dealing with all the various financial entities in the jurisdiction⁵⁶.
81. The Bank gave evidence that it recognized the growth in regional and international financial conglomerates and sought similar memoranda of understanding with all the Central Banks in the region and monetary authorities in the countries where locally based banks also have a presence. The Bank's approach was to have an ongoing attempt to coordinate with the different regional regulatory bodies in an attempt to arrive at a common consensus on the various

⁵⁶ Transcript of proceedings on November 10, 2009 at page 76

regulatory requirements. The Bank is also working on a regional crisis prevention plan as requested by CARICOM.

82. Finally, the Bank also gave evidence of certain statutory initiatives which it believes will assist it in the regulation of the financial industry. For instance, it recommended the passage of an omnibus legislation which would address any existing gaps within its current legislative framework ⁵⁷. For instance the Omnibus will seek to implement enhancements regarding consolidated and conglomerate supervision that will bring the regulation of the banking sector in line with the recently issued Revised Basel Core Principles (i.e. Basel II). The Basel Core Principles are the global standards for prudential regulation and supervision of banking systems.
83. This recommendation also involves the establishment of a comprehensive financial holding company framework. Revisions to the financial legislation will also see operational supervisory functions such as the granting and revocation of licenses being transferred from the Minister of Finance to the Supervisor of Banks. This revision, when implemented, would bring the Bank closer to compliance with Basel Core Principle 1 which focuses on the key importance of Supervisory Autonomy.
84. The Bank is developing the framework for assuming express institutional responsibility for the stability of Jamaica's financial system ⁵⁸. The Bank of Jamaica Act will therefore be amended to, among other things, grant the necessary powers to the Bank to obtain information from systemically important financial institutions and

⁵⁷ See pages 55-60 Bank of Jamaica's Responses to Questions dated October 29, 2009.

⁵⁸ See Bank of Jamaica Discussion Paper Institutional Arrangements for Safeguarding Financial Stability, September 16, 2011, available at http://www.boj.org.jm/uploads/pdf/revised_financial_stability_discussion_paper_2011_16_sep_2011.pdf

powers to impose measures on such institutions to mitigate and control systemic risks. In addition, the law will allow the Bank to provide liquidity to financial institutions on a more flexible basis in order to respond to systemic instability.

Dated the 7th day of November 2011

B. St. Ilichayev, Attorney, Q.C.

Kevin O. Powell

In consultation with:

Robin Sykes, Acting general Counsel, Bank of Jamaica

Celeste Williams, Legal Counsel, Bank of Jamaica

Melissa Weston, Assistant Legal Counsel, Bank of Jamaica

BANK OF JAMAICA

DISCUSSION PAPER

INSTITUTIONAL ARRANGEMENTS FOR SAFEGUARDING
FINANCIAL STABILITY

REVISED VERSION: 16 September 2011

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INTRODUCTION

1. In December 2010 Cabinet approved the decision for the institutional responsibility for stability of Jamaica's financial system to be assigned to the Bank of Jamaica (BOJ). This reform also comprises the set of legislative reforms that underpin the current 27-month Stand-By Arrangement with the International Monetary Fund (IMF).

2, This Paper outlines proposed amendments to the BOJ Act to vest the BOJ with overall responsibility for financial stability. Comments received from the Attorney General's Chambers, Ministry of Finance, the Financial Services Commission, the Jamaica Deposit Insurance Corporation, the Jamaica Securities Dealers Association as well as individual financial institutions have been incorporated in the amendments.

BACKGROUND

3. One of the important lessons emanating from the global financial crisis is that institutional responsibility for the stability of the financial system as a whole needs to be clearly defined, codified and assigned. Full responsibility for financial stability is unclear where there are multiple supervisory agencies, with none having the authority or mandate to oversee the links among different kinds of activities and to recognize and address systemic risks.

4. To address this deficiency, the route taken by most jurisdictions has been to locate this function within their central banks. Adding financial stability oversight to the role of central banks has been a logical choice in light of their existing supervisory role over banking institutions, in most cases, their core mandate to influence conditions in money and credit markets and their essential function as store of liquidity in the economy.

As part of the set of reforms that underpin the Stand-By Arrangement with the IMF, it has been determined that the BOJ should bear the institutional responsibility for financial stability in Jamaica.

5. The main requirement to effect this change is the definition of a set of amendments to the BOJ Act that would facilitate a more macro-prudential approach to oversight of the financial system as a whole. This would complement the BOJ's traditional direct prudential approach to supervision of the deposit-taking system and expand both the focus and scope of the consultative process currently conducted through the Financial Regulatory Council.

6. Many other jurisdictions around the globe are concurrently pursuing a similar process of financial architecture reform to formalize the financial stability role. Based on a survey of their experiences, Jamaica's own experience and regulatory architecture as well as other considerations, the following has been approved by Cabinet and endorsed by the IMF as the essential amendments to the 130J Act to meet the objective of assigning formal responsibility to the BOJ and ensuring its ability to discharge the function.

PROPOSED AMENDMENTS

Mandate the Financial Stability Objective of the BOJ

7. Without prejudice to its primary objective of price stability, amend the BOJ Act to include the specific objective of ensuring the stability of the financial system (that is, macro-prudential oversight of financial institutions in addition to the current mandate for the direct prudential supervision of individual institutions and sub-sectors within the deposit-taking system). For this purpose, financial institutions would include those institutions that currently fall under the regulatory oversight of the BOJ or Financial Services Commission (including deposit-taking institutions, securities dealers, insurance companies, cooperatives, collective investment schemes and pension funds). Provisions would also be necessary to allow for the BOJ to designate any other type of financial institution to be subject to this type of oversight.

8. Macro-prudential oversight involves the detection of risks to financial stability and taking effective measures to mitigate and control these risks. This oversight will be effected by the BOJ principally through the exchange of information amongst Financial Regulatory

Authorities as well as forward-looking assessments of vulnerabilities in the financial system and its macro-financial inter-linkages with the real economy and abroad. However, it will be critical that the BOJ is provided with powers to directly access critical information from systemically important financial institutions (SIFIs) or class thereof that may not be readily available from another regulatory agency.

9. Risks to financial stability include shocks that could disrupt the orderly functioning of the financial intermediation process, financial markets and payment and settlement infrastructures and could significantly impair the allocation of economic resources. The power to take effective measures to mitigate and control risks to financial stability will be provided to the BOJ.

Mandate the Establishment, Composition and Tasks of a Financial Stability Committee of the BOJ

10. Amend the 130J Act to establish a Financial Stability Committee (hereafter, the Committee) which will be responsible for coordinating the activities pursuant to the objective of financial system stability.

11. The tasks of the Committee should be set out in the BOJ Act and would include:

Macro-prudential analysis, i.e. producing forward-looking financial stability assessments in relation to developments in the financial system as well as international markets and the regular exchange of information between members of the Committee regarding monitoring risks to stability of the financial system and assessing the macro-financial inter-linkages with the real economy and abroad;

- ii. Oversight of the design and conduct of periodic stress test scenarios in regard to plausible systemic threats to the stability of the financial system;
- iii. Periodic consultation with representatives from financial sector stakeholders in order to seek their views and obtain their input in assisting the

Committee's understanding of developments that may impact on financial stability;

- iv. Determination of an institution's risk to financial stability;
- v. Determination of criteria for a SIFT designation;
- vi. Determination of parameters which trigger action in respect of a financial institution as required under the BOJ's financial stability mandate;
- vii. Co-ordination of crisis prevention, crisis management and crisis resolution mechanisms and procedures;
- viii. International cooperation in support of financial stability objectives;
- ix. Preparation and provision of periodic and exceptional reports to the Minister of Finance assessing the performance of the financial system; and
- x. Any other activity as determined by the Committee in support of its financial stability objective.

12. A determination by the Committee that a situation of risk to financial stability exists means that corrective measures can be invoked and that process cannot be suspended or reversed without a similar determination that the process should be suspended or reversed.

13. Where any action is being proposed by the BOJ to the Committee in respect of a financial institution under the supervision of another regulatory authority, the head of that regulatory authority shall be notified.

14. The composition of the Committee, which is expected to include non-BOJ staff, will be specified by regulations made under the BOJ Act.

15. The rules of procedure of the Committee with respect to the frequency and conduct of meetings, appointment of support staff, recording of proceedings, etc. shall be determined by the Committee.

16. The law should also contain appropriate provisions to ensure that all members of the Committee are subject to confidentiality requirements relating to the work of the Committee similar to those that bind supervisory staff of BOJ and should also be indemnified with respect to their activities as Committee members.

Discretionary Powers to Provide Liquidity

17. Expand the powers of the BOJ to allow expressly for the provision of emergency liquidity assistance to financial institutions in the event of a threat to systemic stability and in accordance with criteria of systemic importance, solvency and collateral sufficiency. Accordingly,

- i. The BOJ should have the power, in the event of or in the anticipation of severe or unusual disruption in the normal operation of a financial market or the financial system, to issue its own securities or buy and sell securities, obligations, bills of exchange or promissory notes to the extent determined necessary by the BOJ for the purpose of promoting system-wide stability;
- ii. The BOJ should have the power, in the event of or in anticipation of severe or unusual stress on a financial market or the financial system, to:
 - a. Make secured loans, guarantees or other credit facilities to financial institutions upon such terms and conditions as the BOJ sees fit and to the extent determined necessary by the BOJ for the purpose of promoting system-wide stability;
 - b. Enter into cross-border institutional arrangements to ensure co-ordination of actions that may be taken with regard to financial

institutions situated overseas that may be the parent, subsidiary or a branch of a Jamaican financial institution;

- c. To accept upon such terms and conditions as the BOJ sees fit, collateral denominated in a foreign currency or located in a foreign jurisdiction with regard to the provision of emergency liquidity assistance to Jamaican financial institutions.

Power to Initiate Inspection

18. The BOJ should have the power, in consultation with the relevant Regulatory Authority that has jurisdiction over any financial institution, to co-opt that Regulatory Authority to perform, for a specified purpose, an inspection of any financial institution under the jurisdiction of that supervisory body. Inspections in this regard would be undertaken if the BOJ determines that the institution's financial condition or conduct poses or could come to pose a significant risk to the stability of the financial system.

Power to Request Information Pertinent to Macro-Prudential Oversight

19. The BOJ should have the power, after consultation with the relevant Regulatory Authority or Government Agency, to require any Regulatory Authority or Government Agency to provide any information in the possession of or accessible to that Regulatory Authority or Government Agency, where such information is necessary in the discharge of its financial stability function. Special arrangements may need to be made with the Statistical Institute of Jamaica to facilitate the collection and organization of information over which it may have primary responsibility for compiling.

20. All financial institutions should be required to provide the BOJ (through the relevant Regulatory Authority or Government Agency) with macro-prudential and other statistical information not typically collected by such Regulatory Authority or Government Agency which are pertinent to the BOJ's financial stability function. Information required in this regard should be specified by the BOJ in consultation with the Committee. For example, depending on an institution's risk profile and systemic importance, the BOJ may require

detailed evidence of, and periodic results from, an appropriate internal stress-testing programme that covers all material risks. In addition, as a central tool for assessing the financial sector's resilience to potential adverse shocks, the BOJ may prescribe the incorporation of specific alternative macroeconomic scenarios across a set of institutions based on emerging risks. (A stress-testing programme refers to a set of forward-looking quantitative techniques or risk models employed to assess an institution's vulnerability to significant financial and economic shocks. Stress-testing should be actively integrated in an institution's overall risk management framework, subject to oversight by the Board of Directors, to ensure that appropriate policies and procedures are used to manage and mitigate the adverse effects of all material risk factors).

21. The BOJ should have the power to require legal entities who carry out international transactions to provide information which the BOJ determines relevant to establish Jamaica's international investment position (IIP), without these entities being entitled to invoke bank or other secrecy privileges. The TIP, which records the stock of external financial assets and liabilities of residents of an economy, is necessary to provide an accurate assessment of the country's vulnerability and exposure to external creditors.

Power to Issue Prescriptive Rules, Standards and Codes Pertinent to Macro-Prudential Oversight

22. The BOJ should have the power, in consultation with the Committee, to instruct the relevant Regulatory Authority to issue prescriptive rules, standards and codes (applicable to any financial institution or class thereof) pertinent to macro-prudential oversight and the maintenance of financial stability. Such rules, standards or codes would specifically address gaps and imbalances in the financial system that could threaten stability. The setting of rules, standards and codes by the BOJ may include, for example: countercyclical capital buffers and loan loss provisioning; liquidity requirements; time varying loan-to-value (LTV) or loan-to-income limits; collateral valuation rules; foreign currency mismatch limits; more stringent risk weightings; leverage ratio ceilings; corporate governance and risk management guidelines; and restrictions on activities of payment and settlement systems.

23. In advance of issuing rules, standards and codes by a Regulatory Authority under the financial stability mandate, the concerned institution or group of institutions should be given an opportunity to make representation to the Financial Stability Committee unless delay would intensify any threat to financial stability.

24. The BOJ may impose administrative penalties on any institution for any delay in complying with any directives, rules, standards and codes issued by the BOJ in respect of carrying out its financial stability function.

Mandate to Establish and Update Central Financial System Database

25. The BOJ should have the mandate to establish and update a central database containing micro-prudential and macro-prudential information to be available for the relevant Financial Regulatory Authorities represented on the Committee.

Public Accountability of the BOJ's Financial Stability Mandate

26. The BOJ should be required to publish a financial stability report within three months after the end of its financial year to support its accountability on matters relating to the stability of the financial system as a whole.

27. A reasonable timeframe will be allowed before a sensitive or confidential financial stability action by the BOJ may be announced or discussed in public.

28. The BOJ will be prohibited from disclosing any information obtained in carrying out its financial stability mandate except in aggregate form, such that the person or legal entity to which the information refers cannot be identified.

CALL FOR COMMENTS

29. The Bank of Jamaica calls for interested parties to comment on the discussion paper.

Comments should be received by December 2011.

Comments should be sent to:

Governor,

Bank of Jamaica

Nethersole Place

Fax:

Email: fnancialstabilitycommentsCa*boi.org.im.