VERBATIM NOTES

OF

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

HELD AT

THE JAMAICA PEGASUS HOTEL
81 KNUTSFORD BOULEVARD, KINGSTON 5
ON

TUESDAY, 10TH NOVEMBER, 2009

PRESENT WERE:

COMMISSIONER

The Hon. Mr. Justice Boyd Carey (Ret'd) MEMBERS

Mr. Charles Ross
Mr. Worrick Bogle

COUNSEL FOR THE COMMISSION

Hon. R.N.A. Henriques OJ, QC

SECRETARY TO THE COMMISSION

Mr. Fernando DePeralto

MARSHALLING THE EVIDENCE

Mr. Ransford Braham - Attorney-at-law

REPRESENTING THE BANK OF JAMAICA AND HON. OMAR DAVIES

Hon. Mr. Michael Hylton, Queen's Counsel
Mr. Robin Sykes - Attorney-at-law
Mr. Kevin Powell - Attorney-at-law
Miss Celeste McCalla - Attorney-at-law

REPRESENTING JAMAICA REDEVELOPMENT FOUNDATION Miss

Kaianne Lee - Attorney-at-law

REPRESENTING DEBTOR AND HIS COMPANIES

Mr. Gayle Nelson - Attorney-at-law

REPRESENTING DEBTOR

Mr. Raphael Codlin - Attorney-at-law
Miss Melissa Cunningham - Attorney-at-law

FINSAC ENQUIRY -- 10TH OF NOVEMBER, 2009

CHAIRMAN: Good morning ladies and gentlemen. This session of the enquiry is now open. Mr. Braham. May it please you Mr. Chairman and members. This morning we have with us the Acting Governor of the Bank of Jamaica who will be giving evidence into the Commission this morning but before I do that sir, may I tell you of the attorneys who are present. Representing the Bank of Jamaica and the Acting Governor is Mr. Michael Hylton, Queens Counsel. **With him is Mr. Robin Sykes, along with Miss Celeste McCalla and Mr. Kevin Powell. Then sir, we have Miss Kaianne Lee. Miss Kianne Lee represents FINSAC, sorry, Jamaica Redevelopment**. There is a slight difference between them, my apology, Jamaica Redevelopment Company. Also present is Mr. Gayle Nelson and with him I don't know as yet Mr. Leighton Miller who is supposed to be in attendance very shortly, they are representing

Mr. Bentley Rose, Benros Limited and

Micro Finance Corporation Limited. In addition sir, we have Mr. Raphel Codlin and with him is Miss Melissa Cunningham and they are representing Mr. Michael Levy. Those are the attorneys who are present today sir.

CHAIRMAN: Thank you.

MR. BRAHAM: That being out of the way, sir, I would ask that the Acting Governor be sworn.

COMMISSIONER: Before the Acting Governor is sworn we we should like to know about the Governor.

MR. HYLTON: Good morning, Mr. Chairman, members of Commission, can I address two issues, sir? In addition to Mrs. Anderson, Mrs. Myrtle Halsal who is the Deputy Governor of the Bank with responsibility for monetary policy will also be giving evidence to the Commission. As you know sir, you and your members know, that the Bank has two roles, and these two and I suppose appreciated. Very well. Can we make a start.

MR. HYLTON: We are ready to start.

MRS. ANDERSON SWORN

MR. HYLTON: It has been discussed between myself and Mr. Braham sir, that I would take the witness' evidence-in- chief.

COMMISSIONER: I have no problem with that. I think you should stand.

MR. HYLTON: May the witness sit though?

COMMISSIONER: Witness may sit.

MR. HYLTON: May I proceed?

COMMISSIONER: Indeed.

EXAMINATION-IN-CHIEF BY MRS. HYLTON

Q: Your name is Mrs. Audrey Anderson?

A: Yes, I am.

Q: Could you tell me your occupation,

Mr. Anderson?

A: I am a Central Banker by profession and I am currently the Acting Governor of the Central Bank.

Q: Of the Bank of Jamaica?

A: Yes.

Q: How long have you been with the bank?

A: I have been with the bank now over 30 years.

Q: During the 1990s, let us say in 1994, what was your position in the Bank?

A: At that point I was Senior Director in charge of the Financial Institutions Supervisory Division with responsibility broadly for supervision of the banking sector.

Q: And were your subsequently promoted?

A: I was, in 1996.

Q: To what position?

A: Deputy Governor.

Q: With what responsibility?

A: Responsibility for that area of the Bank's operations, Bank supervision.

Q: And you remained in that post for the remaining of the 1990s?

A: Yes, I did.
Q: Until?
A: Until 2005, I believe.
Q: And you were promoted?
A: Yes, to Senior Deputy Governor.
Q: And you have been Acting Governor for just over a week?
A: Just over a week.
Q: The Commissioner of Enquiry sent a number of questions to the Bank?
A: They did.
Q: You saw them?
A: Yes.
Q: Did the Bank prepare a response to those questions?
A: Yes, we in fact prepared a comprehensive or what we feel was a comprehensive response which was provided to the Commission.
Q: I won't actually take you through that comprehensive response but what I propose to do, subject to the Commission's guidance, is to take you through the questions asked and invite you to give your response orally to each

of the question.

COMMISSIONER: By all means.

Q: First question Mrs. Anderson is, does the Bank perform the function of a Central Bank insofar as monetary policy is concerned?

A: Yes, the Central Bank does perform that function.

Q: Could you describe that monetary policy function briefly?

A: It basically influences the volume and conditions of supply of money and I would think that the core mandate of the Bank is the control of inflation within the whole monetary policy aspect of its operations.

Q: This is not one of the specific questions asked by the Commission, but other than monetary policy, what else is the Bank's core function?

A: Its other core function would relate to financial stability while not specifically spoken to, in the Bank of

Jamaica Act but it does have as a specific responsibility the regulation and supervision of deposit taking entities which broadly speaking make up the banking system.

Q: In the performance of its function, is the Bank totally independent and if not from whom does it take direction?

A: No, the Bank is not totally independent in the true meaning of the word. The Bank has had significant independence in how it has been allowed to carry out its function but certainly in relation to monetary policy, it is still subject to the dictates of the Minister of Finance, certainly in terms of variation of liquidity requirements and specifically in relation to its function of supervising the banking sector, the Minister retains significant powers in relation to approval of licences, revocation of licences and so on.

Q: In relation to, say, approval and revocation of licence, what is the function of the Bank and what is the function of the Minister?

A: The function of the Bank...

COMMISSIONER: Are these provided by the Act?

Q: Yes, they are, Chair. Specifically, in the case of an application for licence, the Bank's responsibility is to assess the application on its technical merits, to assess the fitness and proprietary of the applicant and to make specific recommendations to the Minister as to whether such a licence should be issued. In the case of revocation, the Bank would similarly assess the conditions of the entity and in fact if a situation of revocation was about to occur, the Bank would have already been doing that on a continuing basis and providing reports and recommendations to the Minister on which he would make his final determination.

Q: And are any of the key posts in the Bank appointed by the Minister?

A: Yes, specifically the Governor and the

deputy governors are still subject to appointment by the Minister.
Q: And is there a general power given by the statute to the Minister to issue directions of a general nature?
A: Yes, there is such a power and there is also a power that the Minister retains in relation to foreign exchange activities, specifically, in terms of entities being able to operate in the foreign exchange market or to be exempted from certain conditions of the Bank of Jamaica Act in the acquisition of foreign assets.
Q: On this question of independence and direction, are you aware of any instance in which the Minister or the political directorate has sought to intervene in the Bank carrying out it core macro economic mandate?
A: I am not aware of any specific instance. In terms of the carrying out of the macro economic mandate the Bank, and very specifically the Governor, would certainly have to be in communication

with the Minister on a fairly regular basis in terms of specific actions that the Bank is going to take in that regard but I am not aware of specific instances where there has been control exercised over the Bank's determination as to what is appropriate in the circumstances.

Q: If I can turn next to the other core function, the regulatory, does the Bank regulate and supervise the banking sector, specifically retail, commercial banks, merchant banks and building societies?

A: Yes, it does.

Q: And that is pursuant to?

A: That is pursuant to the provisions in the Banking Act which govern commercial banks, the Financial Institutions Act, which govern what we refer to as merchant banks, the Building Societies Act and regulations issued for building societies under the Bank of Jamaica Act.

Q: All of which name the Bank as the...

A: Supervisor.

Q: And in carrying out that function, the regulatory function, does the Bank carry out inspection of those institutions?

A: Yes it does. On a normal basis each licensed entity would be subject to an annual on-site examination. If the condition of the entity warranted it, it could be subject to more regular examination and on an ongoing basis we receive what we refer to as prudential returns which provide financial information on the entities and these are monitored. So you have what we refer to as an on-site examination regime in addition to an off-site regime which monitors the financial indicators of the entities and the system.

Q: And that relates to all those groups, commercial banks, merchant banks?

A: Exactly.

Q: And that regime of on-site returns, was that in place a decade ago, two decades ago?

A: It was.

Q: The institutions are required to make reports, I think you just said, are these reports required on quarterly, half-yearly or annual basis?

A: There are some reports that are actually required on a monthly basis and the majority of the reports that we get are actually monthly returns but we do get quarterly and annually also.

Q: For example, which ones are monthly?

A: The balance sheets returns, the returns that detail non-performing loans, the liquidity position of the entities, those are the major ones. Profit and loss returns would come in on a quarterly and annual basis and of course we have a huge subset of returns which were referred to in the original submission.

Q: Referred to in more detail?

A: Absolutely.

Q: Let's turn now, Mrs. Anderson, to a question dealing with the Bank's lending function. Is the Bank a lender of last resort and if so, in performing that function, does it make a distinction between liquidity and solvency?

Q: It does, the Bank is lender of last resort and this function relates very specifically to commercial banks which are clearing banks, and by that I mean the banks operate in the clearing system, they are operators of current and chequeing accounts which have to be cleared through the Central Bank.

Q: Let me interrupt you for a second. Is the Bank's role as lender of last resort a statutory function, is it provided for in the statute?

A: It is provided for in the statute and as I said it relates in the main to commercial banks. And in terms of your query re the issue of liquidity or solvency, certainly the Bank's rules and policies allow for the extension of liquidity support usually through over-draft facilities to banks that have temporary liquidity issues, and the general rule of thumb is that liquidity would be provided on the basis that the bank is illiquid but not insolvent.

Q: You mentioned the clearing system, could you say a little more about how that works?

A: I mentioned that the commercial banks operate chequing or current accounts and all of these cheques when drawn by customers have to go through a clearing system and the cheques are settled by banks one against the other and in that regard the Central Bank operates basically as the clearing house for all of that, so each of the bank accounts would be debited or credited depending on the cheques that are drawn against the accounts of customers.

A: And this happens on a daily basis?

Q: In the detailed response, there is a sentence which says; **'The reality is** that the **decision to withhold liquidity report is essentially** a **decision to close an institution'.** Could you comment on that?

A: Yes. I had mentioned that normally the rule of thumb is that liquidity is provided in the case of liquidity stringency but not direct outright insolvency, however, there maybe cases where an entity that has significant liquidity problems might eventually go into insolvency, so the situation could occur that having already provided liquidity support, if the entity has not made necessary attempts to mitigate the situation, ameliorate their problems could go into insolvency. You would therefore have to take a decision at that point as to whether you would allow a continuation of liquidity support based on efforts being made by the shareholder, management or board of the entity to improve or ameliorate the problem situation in the bank. You are also then faced with the very rare situation that if liquidity is pulled at a particular point it could very well mean the death knell of the entity because at the point that the Central Bank is providing liquidity support, it would also signify that that entity was unable to raise liquidity in the general market. So essentially, once you determine that you have reached the point where no further liquidity is going to be provided, you are essentially making a decision that this entity can no longer be helped and therefore it may be through the door.

Q: And that decision to effectively close the bank would involve other considerations?

A: Absolutely and I would say that certainly in situations like that significant discussions would have to have already taken place with the Minister of Finance to whom the Bank ultimately reports because an occasion like that could certainly impact the stability of the banking system, and if the entities were large enough it could have contagion effect on other entities; if the confidence of the system is shaken it could also lead to runs on other entities, whether affiliated or not in the system. So it is a critical decision which cannot be taken lightly. Certainly as I said the issue of the systemic impact as well as the best interest of depositors and the whole stability of the payment system are issues that would have to be taken into account in making that final decision.

Q: As I understand your evidence, there would be situations where although an entity is technically insolvent, support continues?

A: It is possible.

Q: The Commissioner as you know is looking into difficulties in the Financial Sector in the 1990's. And the next question now takes us to that period and asks whether the Bank as regulator forsaw the -- the question reads, the pending collapse of the financial institutions or any of them in the 1990's?

A: And I would have to say yes, certainly based on the on going off-site examinations that we do as well as very specifically the on-site examinations of specific entities, the bank would have seen evidence of escalating weaknesses in the financial condition of various entities and would have assessed the threat that that would have posed to the overall stability of the system and these weaknesses were identified broadly throughout the 1990's.

Could you give me some examples of the weaknesses that you speak of.

A: Certainly, there were very specifically growing levels of non-performing loans, there was significant decline in the profitability of several banks, several showed precariously low capital bases and this would have been over a period. There was evidence of poor management practices in several of the licensees and in particular those that were eventually intervened. We saw numerous cases of imprudent accounting practices where accounting entries were used to essentially window dressed the conditions of the financial entities. There were in some cases the submission of inaccurate or misleading financial information relative to the true financial condition of the entities and we saw the increasing use of depositors' funds to resolve difficulties that were being experienced especially in the insurance sector and I would have to say that the problems that occurred in the insurance sector had a very direct and significant impact on the commercial banking system and on the course of events that occurred during the 1990s.

Q: The Bank was not and is not the regulator of the insurance industry?

A: No, it is not.

Q: Why did the problem in the insurance industry sector have that direct effect on the banking sector?

Q: Well, by the early 1990s we had seen a phenomenon of financial conglomerates growing very quickly and in a lot of cases these conglomerates were headed by insurance companies as the parent companies with banks, within those financial groups as subsidiaries to the insurance companies and to a large extent the practices which obtained in the insurance, in several of these insurance companies were what we regarded as imprudent. 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 liquidity 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.

Q: Could you give us some examples of the groups that had that relationship?

A: Off hand there was certainly the issue of the Crown Eagle Insurance Company which created major problems especially for Eagle Merchant Bank. Additionally you had Life of Jamaica and Mutual Life. Mutual Life at the time was the parent of NCB and it created enormous problems for NCB. In fact the insolvency of the Mutual Life later led to the insolvency of NCB, because there was a huge exposure to Mutual Life on the bank's books.

CONTINUED .....

MR. HYLTON: There was some degree of overlapping between that question and the one that follows but perhaps you can expand. But next question is:

As Regulator, can the Bank give any reason for the cause of the failure of some of these institutions resulting from the question of say, a meltdown in the 1990s?

MRS. ANDERSON: Yes, and I think there were a number of factors that were in play at the time. Some were macroeconomic in nature such as the acceleration of asset and consumer price inflation and in fact, we reached a period of height in inflation in the early 1990s following the liberalization of the foreign exchange market and certainly all of this had a massive impact on the entities operating in the market.

MR. HYLTON: When you say `height in inflation' would you like to give us a number?

MRS. ANDERSON: I think at one point the inflation reached over a and in fact, I think we had provided tables in the Report which showed a movement of inflation at approximately 20% and the next year it jumped to by the mid- of the following year it was over 100%.

MR. HYLTON: What year was that? Could you be precise?

MRS. ANDERSON: I think it was - it could have been 1992.

Q: Yes.

A: Between 1990 to 1991; 1992.

Q: And to put it in context you said, following the liberalization...

A: Following the liberalization.

Q: When was the liberalization?

A: The liberalization of the FX market was 1990.

Q: Well continue. You started with macro-economic factors and talked about height in inflation.

A: Right. And looking more from the regulatory perspective we had issues of an extremely outdated legislative framework governing the banking sector and to a lesser extent the insurance sector.
Suddenly the legislation covering deposit-taking entities lacked key regulatory powers and sanctions. And so, just to give an example, at that point if there was a problem in a deposit-taking entity the powers available at that point resided in the Minister because at that point the Central Bank had obviously no sanction powers in relation to the licensing which he supervised; the powers available to the Minister were at the two extremes. You either could appeal to the banks to improve their operations through more prudent behaviour by the use of moral suasion or you went to the

other extreme where the Minister had the power to revoke the licences. It was not a very effective way of managing a financial system because for less significant issues you certainly wouldn't want to use the final hammer of licence revocation so just the sketch, the legislative framework was extremely deficient. There was also over that period, leading up to that period there had been a phenomenal growth in the number of financial entities which in our view, in the Central Bank's view led to a situation of over competition where the system was actually overbalanced and it led to a severe strain on the managerial expertise in the banking system. You had a situation where numerous entities were scrambling for small parts of the banking pack so the most negative effects of over-competition were becoming obvious. This also created a severe strain on the regulatory resources of the Central Bank. There was also the issue of regulatory arbitrage because at the time there was weak regulation in other parts of the financial system. In some cases weak; in some cases non-existent. For instance, the Building Society sector and the IMP, Industrial and Provident Building Society really had no formal supervisory apparatus. There was no control from the standpoint of government appointing agencies to oversee their operations. In the case of the insurance entities there was the Office of the Superintendent of Insurance but that agency -- and it operated as a department of the Ministry of Finance but that agency lacked resources to deal with the issues that were arising which were significant.

Additionally...

Q: Before you leave that. Could you explain for the moment what you mean by Regulatory Arbitrage? A:

Okay, I am sorry. I forgot that I had mentioned it. Regulatory Arbitrage essentially means that entities would move some of the questionable activities of areas which were under significant scrutiny, the areas that were less rigorously scrutinised. So for instance, banking entities that the Central Bank had concerns with in terms of specific parts of their activities, on the basis that since the regulatory oversight in the insurance sector was less stringent a lot of those questionable activities were moved into the insurance entities within the financial groups that they operated in, and you will recall that I already referred to the emergence of massive financial conglomerates. The effect of that was that a lot of these questionable activities were r removed from the oversight of the Central Bank and while we did have concerns we had no legal reach to the insurance companies at that point.

Q: You mentioned Building Societies and Industrial Provident Groups, did any of these problem groups also have entities in those sectors?

A: There were some problem IMPs. To be honest Mike, at this point I am a little hazy on the actual composition of some of the groups. Building Societies - because at the time Building Societies were not subject to regulation, there was - let me say, there was at least one financial group that had a Building Society which was being used to deal with transactions which could not be scrutinised. That entity...

Q: Two of the first problem groups were Blaze and Century?

A: Exactly. Blaze certainly had a building society within that group.

Q: If you don't remember we can move on.

A: Right.

Q: We are going through the factors that there may have been the reasons for the failure of institutions, any others?

A: As a sketch, some of the broad system issues; but certainly there were specific characteristics within the individual entities the I will name a few. We s saw excessive risk capital and very poor management of corporate governance strategies.
We saw conglomerate structuring, which I had referred to before, done specifically to avoid scrutiny by the regulators.
We saw that very much in terms of Eagle Group where the actual ownership structure of the group was deliberately changed so that the Central Bank could only go so far and in fact, the ownership of the group was moved outside of the Jamaican jurisdiction. And I do believe that in the frill Report we have provided very detailed comment on that particular entity.
We saw reckless and also irresponsible banking practices. There were significant non-arms length transactions between connected parties. This was a problem because in a lot of instances these were facilities that were not only granted licences on questionable bases but the credit facilities were not

being repaid in relation to the original terms of the loans. There was significant misrepresentation of capital positions and this was a critical problem that the Central Bank faced because in assessing the need for additional capital we had situations where entities would purport to have capital
injection by various means which after digging into the entities -- going on cite and digging into the entities it was found that these were mere paid entities and did not reflect real injection of capital. And I will give an example.

There was what we call a `buddy loan' facility where one entity; the owner of one entity would purport to inject capital in another unconnected entity but when the examiners would go into the entities and check behind -- and in fact, at one point our examiners almost became forensic auditors and that is a tribute to their insistence in getting to the bottom of some of the transactions -- what we found was that loans were given between the entities. Say one Merchant Bank would lend a loan to another and the incoming funds would be booked as the capital coming in and it was a really circular transaction where the endpoint was that the loans would cancel each other, no real capital would be injected into the capital.

There are other instances where capital was purported to have been introduced by external parties and on checking it again, was found to be an accounting entry.

Q: External to the entity or external to the country?

A: External to the entity and also external to the country.

There was an instance involving the Century Financing entities which again -- it's fully detailed in the Report. And the problem that the Central Bank had was that even where it sought to get external auditors' confirmation that the capital injections, they were real, the auditors themselves were being flummoxed by the entities. We saw where one particular transaction where we were advised that capital had been injected and the auditors were - we asked to receive external confirmation that this was the case because by this time, we had realised that a lot of circular transactions were taking place. So this was one means of trying to ensure that the capital was real. Well, we did the auditors' confirmation - we got it fairly quickly. The BOJ examiners went into the entity, I think maybe a week or two after we had received the external auditors' confirmation and when they looked on the accounting entries they saw that the same funds that the auditors had confirmed as having been introduced as capital had come in and had been booked in the morning and the funds had been sent back out the very same afternoon. There was therefore a significant problem that we also had with the external auditors because we certainly felt that their auditing techniques were certainly not assisting in ensuring that the entities were operating on a sound and prudent basis. And in addition to that we identified significant conflicts of interest at least in one case and I think that is a matter of record in the case of Century where the auditor in fact was not only the appointed external auditor for the company but the auditor was also passing actual accounting entries for the bank and there was also a very clear conflict of interest situation because the auditor was in receipt; the auditor and his personal companies were in receipt of significant loans which were also not being serviced and which were severely non-performing at one point.

Q: Were all these problems discovered by the bank before the failure of these institutions or were they discovered subsequently?

A: Several of the problems were discovered before. More detailed information was garnered after the entities had been intervened at which point the temporary managers would have full access to the record but I should indicate that certainly all the problems that were identified by the Central Bank and its examiners prior to the problems actually causing, leading to the intervention, all of these were substantiated by the reports of the temporary managers and in other instances by the reports of the forensic auditors who were contracted by the government to look into specific conditions of these entities following on reports made by the Central Bank and following on recommendations made by the Central Bank.

Q: Were there any other difficulties, any other reasons for the failures?

A: I would say that there was an overall very poor compliance culture within the banking system. There were several breaches of Board undertakings; there were breaches of statutory direction planning; other statutory obligations and there were also delays in the closure of entities which resulted from all the events leading up -- and I should say that while the Central Bank made technical assessment as to the problems, the overall conditions, and made its recommendations as to action, decisions were at certain points taken to delay intervention action and to give the entities and their shareholders and management time to take corrective action and in a number of cases to introduce additional capital.

You will appreciate that when the Central Bank made recommendations for severe sanction or intervention by the Minister many of these recommendations when put to the entities by the Minister would have been severely resisted.

CHAIRMAN: Excuse me. There was a morale malaise in the banking culture, was there one?

A: There was a morale malaise.

CHAIRMAN: So what can we expect from rogues?

A: What can we expect from?

CHAIRMAN: Rogues.

A: Well, I did not use that word. But am...

CHAIRMAN: I am using it

A: I think the word is well used and I am - well, there was the issue where entities would -- to coin a term `loophole mine'. They would mine for loopholes in the law and they would use every loophole available not to do the right thing. And so, the problems instead of being addressed early did escalate in instances because the decisions were taken to allow entities additional time to meet the commitments that they undertook to meet. At times we were considering multiple proposals for capital injection, none of which materialised eventually. But all of these things caused time to run and with the situation not improving then the fundamental conditions of the entities were in fact, worsening.

MR. HYLTON: I think that may lead conveniently Mrs. Anderson, to the next question. The question was asked, did the bank foresee the failure of some of those institutions? And I take it from your answers so far that the answer is yes. If so, what actions were taken to avoid this?

A: Well, as I pointed out earlier the bank conducts ongoing examinations of these entities and we report on the condition of entities not only to entities themselves but the to Minister of Finance.

There were specific requirements of banks and their Boards and management to take corrective action and I have already detailed that in the majority of cases these requirements were not met. There were also specific recommendations made to the Minister for sanctions where this
was assessed as appropriate and specifically in relation to the issues that were identified as weaknesses or areas of concern.

The Bank also made very comprehensive recommendations for upgrading of legislative framework and some of this did take place in 1992 and more substantive amendments took place during 1996.

Q: You said the bank made some recommendations and there were some changes?

A: Yes.

Q: Were the changes based on recommendations?

A: Yes. Many of the changes to for instance, the legislative framework were in direct response to the Central Bank's recommendation.

Q: You said that you made recommendations in relation to sanctions to the Minister?

A: Yes.

Q: Did the Minister act on any of these recommendations?

A: In some instances, yes. And I would have to say in the final analysis all recommendations were in fact acted on because intervention action was in fact taken in relation to the specific entities. In several instances recommendations for issue of directions were taken on board. Issues of the assumption of temporary management of specific entities were in fact acted on and I think again...

Q: Would you like to give us some examples?

A: Yes.

Q: During the 1990s.

A: Okay. During the 1990s temporary management was taken of Tower Merchant and Trust Bank and that was 1993. Blaze Trust and Merchant Bank was intervened by a temporary management in 1994. Consolidating Holdings which was a Blaze affiliate was intervened by the same route in 1995. Blaze Building Society also in 1995. First Metropolitian Union Society, 1996. Century National, the bank and the Building Society were intervened in 1996.

And Workers Bank Corporate Merchant Bank and Capital Assurance Society, all of which formed part of Workers Group were intervened by the Minister in 1998.

Q: Under the powers in the new legislation?

A: Under the powers in the new legislation, by the new legislation.

Q: Were there any cases of intervention not by statutory power but by perhaps, agreement?

A: Amm...

Q: What happened for example, in the case of Eagle?

A: Eagle. Well, Eagle was not a straightforward case. Crown Eagle I think was taken over -- by the time of the Crown Eagle event three or four major insurance companies had already made specific approaches to the government for massive financial assistance and the Eagle issue was by way of take over and nominal sale I think, for adoption, if my memory serves me correctly. But you used the word `voluntary' and I am not sure that the word appropriately described the situation because by the time that happened nothing was voluntary. The commercial banks had run up significant overdraft at the Central Bank. Crown Eagle was in very dire straits and the merchant banks were in very significant problems.

Q: Well, I used `voluntary' meaning not a statutory intervention.

A: Yes.

Q: There were some of the entities which were failed which was subject to action to rehabilitate them, and perhaps we should go to the next question which asked what action if any, did the Bank take in relation to the failed insurance companies in order to rehabilitate them?

A: Well, one intervention took place and this took place in most instances via the assumption of temporary management. The role of the Bank sort of changed and certainly the Bank would not have played a role in the rehabilitation of the entities because the Bank was still supervisor of the entities so that would have been conflict of interest. That role was specifically the role of the temporary manager to assess the true condition and to take actions where necessary, to either rehabilitate or recommend a final closure of entities. So the role of the Bank at that point would have been very strictly interfacing with temporary managers to assess the loss and consider the best option for resolution,

but certainly not a role for resolution, rehabilitation of the entities. We would have also provided technical assessments and recommendations to the Minister of Finance based on the report of the temporary manager in relation to issues impacting on the viability of the business plans certainly that were being put forward and financial projections that were being put forward or on the matter of fitness and propriety of potential new owners that were being proposed for some of these entities. Now we would have had that continuing role to advise and recommend to the Minister. And of course, we would have continued to monitor the financial entities or the intervening entities because the temporary managers would have had responsibility for making reports on the financial conditions to the Century Bank.

MR. HYLTON: So the same role you would carry out in relation to other financial institutions?

A Yes.

Q Is it a fact that all the depositors in the failed institutions were repaid 100% of their deposits, and if so from what source were those?

A I think the very first case that comes to mind was Blaize entities and the final payout in that one was 90% of depositors' funds. So a depositor would have gotten back 90% of the funds he had in the entity, the depositors and creditors.

In terms of other interventions that followed that, depositors received 100% of their deposits either through a full payout or by the assumption of the deposit liabilities by a sound and ongoing institution.

Q In relation to the second part of the question, from what source were the funds provided?

A This was specifically through FINSAC, the resolution agency established by the government at the time to deal with the whole intervention or through government paper, government bonds as the asset to back the assumed liabilities that were taken on by some of the ongoing entities.
Q Okay. Do you recall whether the first two large groups based on Century were done through FINSAC?
A Blaize was done through another company which was the precursor to FINSAC.
Q FIS.
A That is FIS. Century would have been impacted by FINSAC.
Q And so that those entities would have dealt with the funding?
A Right.
Q Not the Bank?
A Not the Bank. No, once intervention happens any funding that would have been provided by the Central Bank would assist.
Q Did the Bank as lender of last resort

advance monies to any of the failed institutions, if so which ones and how much?

A Okay. Well, as I said in response to an earlier question, the Central Bank would have been providing liquidity support to several entities at point where they had liquidity strigencies. It is difficult to guage when a bank moves from a position of severe illiquidity to insolvency. But at the point of intervention such overdraft facilities would have ceased. So the actual amounts would have been frozen at the point of intervention and the Central Bank, in fact Mr. Eve subsequently received from the government, government paper to back the facilities that had been extended to these intervened entities.

Q Mr. Chairman, would you want us to give the actual down figure details?

COMMISSIONER: I think we need to get them on the record.

A Can I refer to the...

COMMISSIONER: Sure.

A At the point of intervention the overdrafts at the Bank of Jamaica in relation to Century National Bank was $4.349B. In terms of -- and that was on the 10th of July 1996.

MR. HYLTON: That is the intervention date?

A That is the intervention date. The intervention date for the Commercial Bank was the 14th of March 1997 and the figure outstanding at that point was $10.871B and all of these are Jamaican Dollars.

Workers Bank, the intervention date was the 23rd of February 1998 and the amount outstanding on overdraft was $4.434B. National Commercial Bank was intervened on the 30th of March 1998 and the outstanding overdraft balance at that point was $1.223B.

Q The question referred to failed instutions, you just listed banks?

A Yes.

Q What about licensees under the Financial

Institutions Act, the Merchant Banks?

A They were not in receipt of direct liquidity support from the Central Bank.

Q And building societies?

A Neither.

Q Did the Bank make any advances to any of the failed institutions which were insolvent at the time? Going back to our earlier question.

A Yes. And it is a fact that when the liquidity arrangements commenced the banks would not have been insolvent because the Central Bank would not have started to provide liquidity support where there was clear insolvency so the support started at the point where there were liquidity problems where the banks were required to take active measures to correct their situation. But as I also pointed out earlier there may have been situations where liquidity, where banks might have been assessed as being technically insolvent but at which point the Central Bank might have taken a decision to continue provision of liquidity on the basis of plans that had been proposed by the entities for capital injections to correct the situations.

Q Thank you.

Mr. Chairman, I propose to -- you would have noted that I have gone to question 13. I propose to move from here to question 17 because the other witness will address those questions in detail.

COMMISSIONER: Would this be a convenient time for the break? We will take a 15 minute break?

SHORT BREAK 11:15 a.m

ON RESUMPTION AT 11:30 a.m

MR. HYLTON: Mrs Anderson you are still under oath.

A Okay sir.

Q Mr. Chairman I will now turn to Question 17.

Mrs. Anderson, in your opinion given the large number of financial institutions that failed -- we spoke of this earlier. We return to the question which says, (the vast majority of banks and insurance companies by assets)does the financial sector collapse of the 1990's constitute a systemic crisis?

A We thought seriously about this question and I would have to say that systemic crisis is generally considered one in which the stability of the banking system and as a consequence the payment sytem and the real sector are threatened. The Bank of Jamaica has come to the view that while the financial system did undergo very severe stress some of the features that have manifested themself in other crises did not develop and so for example Jamaica did not experience significant capital flight as occurred in many of the jurisdictions across the world which supported financial problems in the 1990's. And in fact the phenomenon that we saw operating in our jurisdiction was rather one of a flight to quality, where depositors would move funds from entities that they determined were weak or in which they had concerns, to entities which were in their opinion strong. And so we saw some entities being the beneficiaries of huge inflows of deposit liabilities to the extent that despite their attempts to dissuade new deposits by lowering very significantly the rates of interest that they would attract at that point, because really you had no way to effectively invest these funds at the time. Nonetheless depositors felt safe in placing their funds there. So we had that situation where no significant capital flight was in fact flight to quality.

Q When you say a flight to quality from one institution to another?

A From one institution to another within Jamaica.

Q And could you give us a couple examples Mrs Anderson. You said that other countries had capital flight problems?

A Yes, well there were several countries in Latin America at the time and in fact there was also the Asian financial crisis where many of the Asian countries and I think Thailand is one that comes to mind, but certainly a range of countries.

COMMISSIONER: Anything failed from Japan?

A Not at that point sir, but Japan as you know did undergo significant banking system dislocation.

COMMISSIONER: It did?

A It did.

COMMISSIONER: And when you speaking figure you are certainly talking about a Government Savings Bank business?

A Yes.

MR. HYLTON: You mentioned the Jamaica payment bank system?

A Yes, also the Jamaican payment system did not suffer dislocation. Due I think in large part to the fact that the authorities had taken action to provide a 100% guarantee for deposit and there was also the decision taken by the authorities at the time not to act on the recommendations of some of the multilateral institutions. In fact there was a meeting where the World Bank and IDB had made a recommendation to the government to close the banking system for two weeks and it was the determination of both the Central Bank and the administration that to take that decision would have thrown the system in absolute turmoil and so we did not take that decision and I think the record speaks for itself because those countries especially in East Asia which acted on similar recommendation saw massive dislocation. And in fact I remember being advised that one country had -- there was civil unrest.

So based on those actions, really we had a fairly stable situation despite the significant distress that some entities were undergoing at the point. And of course the arrangements that were implemented for repayment of depositors on a seamless basis either through outright payout or through the transfer of deposit liabilities to stronger entities would allow for that ongoing stability in the overall system. The Jamaican resolution process as regards to the restructuring of the banking system and the insurance sectors and the safeguarding of the interests of depositors, policy holders and pensioners has been assessed by some outside observers and in fact this is a comment made in a joint -- in a specific World Bank country study. They made the point that the resolution in Jamaica was one of the costliest in terms of GDP worldwide. But its clean up was one of the quickest. And in fact the clean up that was done and the method of clean up did allow for the payment system to be basically unruffled and on that basis we came to the determination that it was not a systemic crisis.

MR. HYLTON: I am moving Mr. Chairman, to question 19 and I will return to 18 with the next witness.

Mrs. Anderson did the bank have any input in the amendment of the Bank of Jamaica Act in 1992, the Banking Act and the Financial Institution Act also in that area and their amendments in 1997 and if so what were the reasons for their amendment where the Bank is concerned?

A I would say the bank played the major role in pushing for and having effected the major amendments that took place in all of those statues between 1990 and 1997. I think I had referred earlier in my testimony that the Bank had made very significant recommendations for the upgrade and amendment of the banking statute and in our earlier documentation to the Cmmission we had provided a very comprehensive legislative report that outlines for the Commission of the actual state of banking laws prior to 1990 and the significant upgrades that took place throughout the 1990's and the reasons for the amendments, several of the reasons I would have already spoken to.

Just to be on record I can't recall whether this morning in speaking about the specific problems that were evident in the financial system, I can't recall whether I spoke very specifically about the problem of dominant shareholders that we face, as well as the severe concentration of lending to connected parties on a very imprudent basis. And these were some of the critical issues that we sought to address in the amendment to our banking legislation. So for instance, there were very significant controls finally effected in banking legislation to control the amount of credit that could be extended to connected persons, and by connected persons I refer here to shareholders, the directors, senior management personnel of licensee entities, their affiliated companies and a whole host of personal connections. Because we have found that entities were being misused by these connected parties to fund initiatives or private ventures on very unsafe terms; the creditors were certainly not being serviced; they benefited from preferential low terms

which were not extended to unconnected third parties.
There was also the issue of the dominant shareholder where a very dominant shareholder also controlled the chairmanship of the board and in some instances was also the CEO. And all of these issues went to the heart of the problems that we saw in our financial system during that time. So those were just merely some of the types of issues we tried to grapple with.
There were also significant amendments in relation to the fit and proper requirement. Much more stringent criteria was introduced on the basis of which persons seeking to become shareholders were directors and management would be assessed and this responsibility was seated in the Bank of Jamaica and continues to be so. Just some of the specific issues.
Q Just to mention another one, you had referred earlier to the difficulty in how accounts were kept and presented?

A Yes. We certainly recommended that and Parliament eventually did take on those recommendations that were provided in the draft, to ammend and give greater powers to the bank to call in auditors to be able to inquire as to how the audits were being undertaken. We were given powers to require special audit and to prescribe the areas that needed to be covered in that. Auditors were now also legally bound to report to the supervisory authorities within a specific time any significant issue that came to their attention during the course of audit and this would be whether it was a significant negative issue or not. So to a large extent we sought to ensure that auditors operated based on their poor mandate and to try to limit instances of conflicts of interest and to ensure that regulators were in fact getting accurate information.

Q Well lastly, anything in relation to capital requirement?

A There have been massive adjustments in terms of the legal requirements for capital and in fact we have operated now with a belt and braces approach where we have several capital ratios which must be adhered to. We have the normal leverage ratio act which originally in the now which prescribes a relationship between capital and deposit liabilities. We introduced the concept of capital base where the specific components of capital are prescribed by law so that not all elements that are regarded as normal equity would be included in capital base. So for instance paid up capital would be a part of capital base but not necessarily retained earnings. Retained earnings is the total of the profits after payment of taxes and the reason why we don't, we haven't allowed them to include it is because retained earnings can be paid out in dividends. So if a bank wishes to take account of any of its retained earnings in its capital base then it has to set aside that amount in a specific retained earnings reserve which may not be paid out as dividends and in fact cannot be touched except with the prior authorisation of the supervisory authorities. We additionally introduced what I referred to earlier as the belt and braces approach where we now require, where the law subsequently require entities to meet a primary ratio it is a 6% ratio and which measures the level of capital that is being held against all asset categories. And the significance of this is that in, certainly in another capital ratio the risk based capital ratio which is our jurisdiction 10%, as against the international benchmark of 8%. In that risk base capital ratio capital is assessed, the need for capital is asssessed in terms of the level of risk in the various asset categories. So for instance if a bank were to have its balance sheet totally in risk free cash which would be an impossible situation but for example, then the risk base capital ratio would in fact be zero because you are assessing that cash has no risk, but I am just going to the extreme.

Normally a bank's balance sheet is made up of items like loans and investments and that kind of thing, placement with other entities, and so all of those categories of assets are assigned a risk rating. Loans have a 100% risk rating and so capital would be assessed in relation to the risk rating. However the primary ratio which I referred to after is a ratio that requires that you keep 6% of capital in relation to your entire asset portfolio and this is in addition to the risk based capital and it is irrespective of this. So we have a number of capital ratios which build on each other and which have sought to ensure that our banking system currently operates on very sound capital bases. We have also recommended that

Parliament accepted the recommendation

finally to move the provision in requirement and the non-accrual period from 180 days to 90 days. So that non-performing loans would now be assessed on the basis of their performance at 90 days instead of 180 and at the point of 90 days provisioning would be automatically required in addition to the general provisioning that the bank is also required to make.

Q When you were answering an earlier question which related to reasons, difficulties that the banks or reasons for delays,you described the process of recommendation as Minister looking forward to decide on sanctions and so on, was there any change in that requirement?

A Yes, there has been significant change. In the later amendments in '96 or '97 the bank.

Q The later date.

A The Bank was -- got significant powers which had originally resided only with the Minister of Finance. In fact the

Bank was by then allowed by law to issue directions, cease and desist orders, was allowed to require boards, undertakings of boards of licensed entities and finally the power of, to take temporary management was moved from the minister to the Bank of Jamaica. The final powers of license issues and revocation however remained with the Minister of Finance.
Q As a matter of interest did the Bank make a recommendation in that regard?
A Well I will tell you that the Bank as a regulatorty authority adheres to the Basil core principles of some banking supervision. These are issued by the Basil Committee that operates out of the Bank for international settlements in Switzerland. And one of the core principles and I think it is core principle one, it requires that regulatory authorities be independent in the use of the regulatory, in relation to their regulatory functions.
Independent from the political

directorate and the basis of that requirement in that core principle is to ensure that decisions taken by the regulators are based solely on the technical assessments that the regulators make in relation to the entities that they supervise.

In the in the case of Jamaica when we were subject to a FSAC, that is a Financial Sector Assessment programme which is done by the IMF in conjunction with the World Bank, we were assessed as being none compliant in relation to that core principle because of course the Central Bank's regulatory function is not independent. We have operated on the basis however that this is a policy decision that would need to be taken by the administration as to ultimate independence of the Central Bank and its regulation functions. And to date such a decision -- well the situation remains as is. Let me say that.

The Commission's terms of reference

Mrs. Anderson, includes looking to the future and avoiding future problems. And the last question I would ask, as regulator supervisor of these financial institutions what can be done to avoid the occurrence of another meltdown particularly having regards to the prevailing global crisis?

A Well, I would say that over the years we have made a series of recommendations some of which have not yet been implemented in terms of legislative issues. While a lot have been taken on board there are still some outstanding but I will go through a list quickly of those issues that the Central Bank feels is significant in relation to this particular question. And I think I should also begin by saying that certainly it is recognized internationally that there is a specific role for regulators in terms of ensuring that prudent activity takes place in entities, but in the final analysis it is the responsibility of boards and management of the licensed entities to ensure that the operations are managed prudently, profitably and efficiently. Having said that I would also have to say that despite the current international crisis that has errupted mainly in the G20 countries. We have certainly felt the effects of this in Jamaica to the extent that it has impacted our economy. We have seen fallouts in various economic sectors and this has in turn impacted our financial system to the extent that borrowers' capacity to repay loans have now been negatively impacted and so we have seen an increase in the level of nonperforming loans in our banking system. And as I said this is directly correlated to the fact that significant industries have been negatively impacted by the fallout from the international crisis that errupted, mainly in North America and spread worldwide since last year. So we have seen an increase in nonperforming loans but nonetheless despite the fact of the very significant economic impact that we have seen, our financial sector has maintained very strong capital levels and very strong provisioning levels, and that is as a result of action that the Central Bank and the regulatory authorities have taken over the past several years to ensure that we operate on the basis of very strong and judicious regulatory policies as regards capital and provisioning. And I have mentioned before that our requirements as to what components would constitute capital base are extremely stringent and in fact I should say that they are much more stringent than even some of the G20 countries. I would also have to say that our measure of capital requirement in terms of our 10% risk rating assest is also much stronger than the several of the G20 countries. I would also have to say is that our additional 6% ratio is leading the world because it is only since the erruption of the international crisis that several much larger countries have determined that this is possibily a good additional bulwark to implement.

November 10th, 2009

11:30 a.m.

MRS. ANDERSON: We have also insisted on other very prudent policies which I think have served us very well and which again are being taken on by several other countries around the world and I would say here I would include in this the fact that we no longer allow what is regarded as loan capital or original statute had allowed a mechanism called special debentures which is essentially loan capital and we ensured that that was phased out and it's no longer allowed. Preference shares to qualify as capital have to be non-cumulative and non-redeemable and this is not a feature that exists everywhere in the world although it seems a most logical requirement to have in place and in addition preference shares despite having those characteristics are not eligible for tier one capital. Tier one is sort of a poor capital. I had mentioned the issue of retain earnings that for retain earnings to constitute capital base it has to be specifically segregated into a specific retain earning reserve which cannot be distributed to shareholders and unrealized revaluation dates are not eligible to be taken to profits and therefore can no longer be used to artificially inflate capital and Mr. Chairman, I will make this specific point because in the events that preceeded the financial system distress in the 1990's, we saw several instances and in particular several instances in one specific bank where almost on a monthly basis assets would have been revalued in the main real estate, would be revalued upwards because you will recall that at that period we were operating in a highly inflationary period and so real estate prices were skyrocketing and this particular bank would revalue its real estate assets and it would take these unrealized revaluation gains to a revaluation account and it would then put those into profits and take it eventually into capital and at the time that this was taking place we had no control in the law to stop it and I recall very clearly appearing before the joint select committee of parliament when the legislative amendments were being taken and making the point that this was a most imprudent way for the system to continue to operate, because if the gains had actually been realized, if real estate had in fact been sold, funds actually came in, real funds came in then -- this would be a source of moving into capital. But this was not what was happening and virtually by the stroke of a pen entities were being enabled to capitalize these unrealized gains and you know when the real estate bubble broke all of this would have been nowhere. So one of the very critical changes to our law was to stop that practice and it was on this specific recommendation of the Central Bank. I had earlier spoken of the much more prudent bonus provisioning that we were able to recommend and get Parliament to agree to, all of which have helped to ensure that our banking sector at this point is operating on the basis of strong capital and very prudent positioning and a look at some of the financial data that the Central Bank publishers on a quarterly basis which show that the capital ratios and provisioning levels in our system are pretty high. In fact, in some entities the provisioning exceeds a hundred percent of their non-performing notes and we are extremely stringent on ensuring that they adhere to these regulations. So at this point I would say that we are still operating despite the negative effects of the international crisis, we are still operating on the basis of very strong capital and provisioning levels. But we do assess and there are additional things that need to be done, additional e

regulatory measures that need to be taken and I will advise you someday.

MR. HYLTON: I think the Commission will be very interested in hearing you on that.

MRS. ANDERSON: Okay. We had spoken before about the independence of the supervisory authority and I had mentioned the Basel Committee. I won't go back into that. I would also say that it has been the experience of the Central Bank that in the majority of cases where we have suffered banking failure there have been clear instances of a serious culture, lack of culture of compliance and lack of prudence within the financial entity and in fact in some cases we have seen seen extreme recklessness. This coupled with a high appetite for risk and exacerbated by the various weaknesses in management and that I have outlined earlier have created problems for us before in addressing this difficulty and in addressing the conduct of management we have sought to emphasize the importance of good risk