STATEMENT ON FINSAC

Introduction

In this statement I will address four major issues which effectively summarize the questions about the financial crisis of the mid 90s and the government's response through the creation of FINSAC. These four issues are –

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

Cause of the Crisis

The "sound bite" phrasing is that the cause of the crisis was the government's "high interest rate policy". The 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 US, they have occurred during periods characterised by 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 the Jamaican case.

Closer home, Trinidad and Tobago is still grappling with a resolution to the collapse of the CLICO group. The IMF Country Report (March 2011) for Trinidad and Tobago analyses that collapse and references the crisis in Jamaica in the 1990s. In analysing the causes of our crisis, the IMF highlights the bad operational practices of the failed institutions. **There is no mention of high interest rates**!

A second point is that although there was a period where 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, either deliberately or unwittingly, the context in which these rates were applied.

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 in excess of 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.

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 inflation.

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 an impending social explosion.

In the present discussion, this background to the decision to tighten liquidity has been conveniently forgotten. Nevertheless, 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

It is a travesty that several owners/senior managers who egregiously mismanaged the funds of investors/savers are seeking to portray themselves as victims of FINSAC.

Jamaica had a major problem related to the predominance of the position of "Executive Chairman" in several local institutions. This position provides the holder with excessive powers and inadequate checks and balances. As CEO, he determines what matters are brought to the board and, as Chairman, he has significant influence over the selection of other board members as well as controlling the conduct of board meetings. As such, the Executive Chairmen were able to manipulate the affairs of their companies, often leaving other board members "in the dark".

The treatment of these Executive Chairmen was not based on arbitrary assessments. The GOJ 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 are available to the Commission and the Government. If pursuit of the facts is really an objective, these reports should be released to the public.

Innumerable violations were identified, some of which, we were 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 corrupt practice whereby a bad loan in a group company is sold to another at face value, thus removing it from the portfolio of the first company. If this process is repeated, it becomes almost impossible for the regulators, through one-off audits, to spot the deception.

The corruption and malpractices discovered in these institutions bordered on the incredible. In the case of the Century Financial Group, headed by Mr. Don Crawford, it was found that the External Auditor was himself a bad debtor. 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.

When these discoveries were made, it became very clear that these owners could not be allowed to continue to operate within the financial sector. Put bluntly, they could not pass the "fit and proper" criteria.

It is a matter of record that at an emergency Cabinet Meeting held one Sunday night at Vale Royal, former BOJ Governor, Jacques Bussieres, advised Cabinet that it should act decisively against a set of local institutions. The BOJ's analysis had identified many of the deficiencies and corrupt practices which were later confirmed by the forensic auditors.

A factor hindering the search for the truth about the financial sector crisis is that many, who worked within these organizations and are fully aware of the malpractices, have chosen to remain silent. A specific example illustrates this point. I recall a visit paid to me by the Executive Chairman of a leading insurance company, accompanied by his two deputies. He came to make one final plea for government support for his organization, whilst retaining him in his position. After the meeting ended and the Chairman had departed, my secretary informed me that the two deputies wished to see me again. They pleaded with me to reject their Chairman's request as they felt that, under his stewardship, the organization was doomed to fail. I have deliberately refrained from giving names, but if necessary, I will.

A point must be made which many seek to ignore. This is the fact that during the period of the crisis, the local subsidiaries of BNS, CIBC and Citibank were not affected. Neither were Jamaica National 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?

The difference lay in the fact that these other institutions operated within much stricter guidelines. It was not possible for the CEO to take arbitrary decisions to make questionable loans, or 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.

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.

Objectives/Operations of FINSAC

It is important to indicate 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 were inherited from failed institutions, with existing contracts made with those institutions. Against that backdrop, FINSAC was established to protect the thousands of (i) savers in the failed institutions; (ii) pensioners and employees whose pension funds were mismanaged by the failed institutions, and (iii) the insurance policies issued by the failed institutions. FINSAC was not established to protect the owners/managers of the failed institutions or their bad debtors.

In speaking about the operations of FINSAC, there has been an attempt to suggest bias and political interference in decision-making. As the Minister responsible for the institution, I challenge anyone to provide any evidence to that effect. It is a fact that many persons, including prominent political personalities approached me to intervene on their behalf. There are some who presently serve in the Cabinet. In every instance, I would simply refer them to the FINSAC management.

It is also important for us to jog our memories about the calibre of persons who served as board members of FINSAC and the related companies. Consider the Chairmen of FINSAC: Dr Gladstone Bonnick, the late Dr the Hon Ken Rattray and the Hon Shirley Tyndall, all persons of eminent distinction. 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 NCB. Can anyone seriously consider a situation of the political directorate instructing such persons to act in a biased, or improper, way?

In terms of the approach to the intervention, it is instructive to note that the advice from the multilateral financial institutions was that we should accept the failures in the banking system as part of the operations of a market economy. On that basis, it was suggested that receivers should be placed in the institutions who would then pay back to depositors and creditors a percentage of their investment/savings based on the eventual value of the assets recovered. As is known, the GOJ rejected this advice.

Was this the correct decision? It is obvious that such an issue would have strong points on either side. I supported the decision made then to intervene and rehabilitate the failed institutions. However, I respect 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.

I still maintain the position that intervention and rehabilitation was the correct path. Following on the heels of liberalization of the exchange system, it was not felt at that time that we could risk the possible social chaos when citizens realized that their legitimate savings and investments had simply "evaporated". It was difficult to estimate the size of the problem and hence the eventual cost of intervention, partly due to the off-balance sheet hiding of liabilitiess and other accounting irregularities.

It cannot escape notice that all of the complaints being voiced at the Commission of Enquiry come from the owners/managers and the bad debtors. They are simply arguing that the government should have also protected them in the intervention. The cost of protecting savers/pension funds/holders of insurance policies amounted to 40% of GDP. Consider what would have been the cost if bad debtors and the owners were also "bailed out". It would have been unjustified and irresponsible for the government to do so.

Even whilst 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 which could impact on economic output and employment. Whilst

the committee met for a period, it was hampered by the fact that most bad debtors simply wanted their debts to be written off and their assets to be returned to them.

It should also be remembered that the government took special action to address the situation where bad debtors had put up their homes 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.

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 never mentioned are the thousands of former bad debtors, who came to mutually-accepted compromise agreements with FINSAC, which they honoured and moved on with their lives. Included in that group is the present Chairman of government tourism entity, who had his hotel returned to him so that he could earn his way to recovery.

A final point to be made is that the multilaterals, although initially disagreeing with the approach taken, eventually commended the methodology employed, based on rigorous analyses of FINSAC's operations. This commendation was backed by the decision to loan the GOJ a sum of (US)$350 million to help in meeting the cost of intervention. Is it likely that such support would have been forthcoming for an institution with questionable practices?

Sale of Portfolio

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. 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 imply its continued existence over an extended period.

However, above and beyond that reason, over the period during which FINSAC sought to deal with bad debtors, it became apparent that the pressures on employees would continue to mount. It was felt that if the bad debts were sold to a private company there would be greater willingness on the part of the bad debtors to come to a formal agreement.

A second question relates to why the bad debt portfolio was sold to a "foreign company". 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 JRF was the best we received, as the Jamaican taxpayers would benefit not only from an initial cash payment but also an increasing percentage of further collections.

Conclusion

There are several lessons which have been learnt from the intervention and the events which followed. While not representing an exhaustive list, the following are ones which should be highlighted.

The first is that there should never be any attempt to relax regulatory requirements to "accommodate" domestic entrepreneurs in the financial sector. We have learnt that "affirmative action" has no place in the regulation of financial entities.

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 with the Ponzi schemes was that the authorities were hampered as they could not act unless it could be established that the operators were engaged in activities, reserved for licensed institutions. It is a travesty that nothing has so far been done about this.

In considering this matter, it must never be forgotten that hundreds of thousand 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.

It is a shame that this important episode in our post-Independence history is being subjected to a flawed process for vulgar political objectives, rather than balanced fact-finding and analysis.

Omar Davies

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