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"Lessons From Jamaica's Experience With Crisis Resolution"

Good afternoon ladies and gentlemen, colleagues!

I would first like to thank CARTAC for providing the opportunity for me to speak to the issue of Jamaica's experience with crisis resolution and the lessons we've learnt. Much has been written and theorized in various fora as to the genesis of

our financial system problems of the 1990s and certainly, the Caribbean and indeed the worldwide experience of the last two decades has shown that Jamaica has not been alone in having to deal with such turbulent events.

However, as no two crises are identical in terms of origin, evolution and eventual resolution, it would perhaps be pertinent that I start by providing a brief background on the context and extent of the financial system problems that occurred in Jamaica in the 1990s, before going on to highlight the resolution strategies that were engaged and the lessons learnt.

BACKGROUND

To establish the context, during the mid 1980s, our monetary policy consisted primarily of direct controls to dampen domestic demand and

maintain exchange rate stability. At the urgings of the multilaterals the government at the start of the 1990s embarked on a liberalization programme which saw deregulation of interest rates; removal of credit controls; and liberalization of the foreign exchange market.

These developments created opportunities for expansion in the scope of activities of financial businesses, and due to certain critical gaps in legislation at the time, also permitted a rapid growth in the actual number of deposit-taking financial institutions. To give an example, between 1980 and 1994 the number of deposit entities supervised by the Bank of Jamaica (i.e. commercial banks licensed under the Banking Act and merchants banks/trust companies licensed under the Financial Institutions Act) increased from 32 to 40. Even more telling

however, was the growth of financial entities that were not then subject to any officially structured oversight, principally building societies and deposit-taking entities registered under the Industrial and Provident Societies Act, which together numbered 47 by 1995. The intensification of competition across the system not only resulted in an anxiety for growth by these entities, but also placed a severe strain on available management expertise in the financial sector, both of which led to the emergence of highly imprudent and risky banking practices without appropriate risk management frameworks being in place.

The highly inflationary environment which emerged during the early 1990s (inflation actually peaked at over 100% in 1992) allowed for easier profit generation but critically, also

served to mask from public view, fundamental weaknesses in the sector, specifically inadequate capital and serious management and operational inefficiencies. This I believe, allowed bank management to deceive themselves that all was well, despite the increasing concerns being identified and made known by the Banking Supervisors.

The subsequent imposition of anti-inflationary policies began to expose the extreme fragility of the entire financial system. As inflation came off, profits became harder to realize as institutions were unable to pass along cost increases and inefficiencies automatically.

I will highlight some of the specific trends that were manifested in the sector that were of

concern to the Bank Supervisory Authorities during the period.

1. **Firstly, we experienced the phenomena of increasing conglomerization** – where a number of owners created complex corporate relationships comprising deposit taking intermediaries along with other financial and non-financial entities. In many instances these corporate structures were specifically designed to frustrate access by the Central Bank to full information on the entity, its parent and affiliates. Such conglomerate structures featured inter-company shareholdings, interlocking boards of directors, common management and extensive intra-group transactions. These structures enabled the exploitation of tax and regulatory differentials and often worked

to conceal relationships between entities and to facilitate financial transactions designed more for the benefit of majority shareholders than for the deposit taking institutions themselves. At the same time, such structures served to heighten contagion risk i.e. the risk of problems arising in one entity being quickly transmitted among related entities (especially from non-banking to banking entities.

2. **Also closely aligned to this issue was the regulatory arbitrage practices** designed to mask the true financial health of the supervised entity or to misleadingly reflect improved positions which, in fact, lacked substance. These involved, in some instances, transferring/moving criticized

loans and other highly suspect assets from supervised banking entities either to non-supervised affiliate entities to escape supervisory oversight, provisioning and liquidity requirements etc.; or to the insurance segment of the groups where regulation was far less stringent.

3. Increasing **use of depositors' funds to resolve difficulties that were being experienced by the affiliated financial companies in these conglomerates, and in particular difficulties in the affiliated insurance companies, where asset/liability mismatches were, by then, creating major liquidity and later solvency problems for these entities.** In one instance for example, depositors' funds solicited by a building society and reported

to the Bank Supervisor as being placed with its affiliate merchant bank, were found to have been instead routed directly to the insurance parent company to fund its highly imprudent and risky real estate activities. These types of practices **resulted in rapid contagion impact on the related deposit-taking licensees.**

4. **Poor credit administration practices** which were reflective of:
    - **Inadequate credit analysis and loan review procedures** – leading to **over lending** i.e. high loan-to-debt serviceability ratios with an undue reliance on collateral rather than income streams for repayment (often with unrealizable collateral values given the highly inflationary environment)

- **growing levels of non-performing loans** consequent on loose lending practices, (the ratio of non-performing loans to total loans in the sector rose from 5.4% in 1993 to approximately 25% at year end 1997 on the basis of loans reported over 6 months past due; and this notwithstanding under-reporting practices).
- Under-reporting/understatement of non performing loans inclusive of the use of **"ever-greening" techniques** (i.e. renegotiating and extending repayment terms of non-performing loans in order that they would always appear as current), with resultant under-provisioning and overstatement of profits, as well as artificially inflated assets and financial position.

5. A major problem turned out to be **non-arms length connected party lending and investment,** often well in excess of statutory limits and in several instances, non-performing and unsecured. This also included "**back-scratching" and "buddy loans**" arrangements, structured to facilitate concealment of imprudent self lending among related parties as well as fictitious lending (e.g. a loan extended to another licensee which in turn on-lends the funds to a related party of the original lender.)

6. Imprudent **use of accounting practices to "window dress" reported financial conditions** and the submission of inaccurate, and in some cases **misleading, financial information** relating to the entity's

true financial status/condition; Unrealized profits from asset revaluations sought to swell statutory capital and balance sheets with no real new value being created or realized.

7. **Lack of appropriate segregation of accounts of the licensed institutions and affiliated entities** (e.g. commingling of managed funds with deposit taking operations).

8. **Deteriorating capital levels** approaching insolvency (even in the face of attempts at artificial capital generation such as "circular capital injections", capitalization of unrealized revaluation surpluses; inter-group transfers and paper transactions representing no actual transfer of cash or

economic value; capitalization of non-accrual income on non-performing loans; failure to set aside appropriate provisions for loss thus overstating profits; payment of dividends and issuing bonus shares from unrealized “paper” gains.)

9. **A general culture of non-compliance** reflected in concerted efforts to avoid supervisory scrutiny of operations and an over-reliance on the form over the substance of transactions. This involved for example, legislative “loophole mining”, where there were conscious efforts and initiatives to take advantage of any perceived weaknesses or gaps in the law and where adherence was rather to the ”letter’ and not the “spirit” of the law. More

concerned too with an over-reliance on the form over the substance of transactions.

The background I have just outlined for you paints the picture of a potent mix of forces and factors. Taken together:

- market liberalization without the necessary prerequisite bolstering of financial legislation,
- the macro-economic developments,
- over competition,
- conglomerization (with heightened linkages and contagion impact), and
- imprudent bank management practices

as well as the very serious legislative inadequacies that existed at that time, in particular

- the lack of legal regulatory powers by the supervisory authorities to enable them to

effect timely corrective action, along with very active “loophole mining” by licensees

all combined to act as catalyst for the meltdown which followed and inevitably led to failure of a number of banking entities and financial groups.

As combustible as this situation was, the final trigger to the banking system distress proved to be the major contagion impact from entities outside of the purview of the Bank of Jamaica which in exploitation of regulatory arbitrage opportunities, engaged in risky and even reckless quasi-banking activities with disastrous consequences that spilled over to banking affiliates. In all, there were seventeen banking entities/groups that were intervened by the Authorities between 1994 and 1998.

SUPERVISORY RESPONSE

Before moving on to the governmental measures taken to resolve the difficulties, I will briefly outline the supervisory actions taken by the Bank of Jamaica during the period. These involved:

1. **Intensified monitoring** based on the findings from our annual on-site reviews and continuous off-site monitoring regime. Intensified monitoring involved:
   - Establishment of a "**Work-out Unit**" within the Financial Institutions Supervisory Division which was charged with undertaking closer monitoring and supervision of financial institutions determined to be in serious difficulty based on deteriorating financial indicators evidenced in prudential returns and, less

than satisfactory ratings coming out of the normal on-site examination process.

- Institutions being placed on **corrective action programmes** which, depending on evident weaknesses, required:
  - Injection of fresh capital to cover assessed deficiencies
  - Suspension of dividend payments
  - Suspension of increases in management remuneration
  - Development of credible business plans
  - Implementation of documented policies and systems of controls
  - Reductions in connected party exposures
  - Correction of all statutory breaches (e.g. credit, investments, fixed assets limits etc)
  - Full recognition of non-performing loans with the reversal of any non-accrual profits

from income and the establishment of appropriate provisioning.

- Implementation of **quarterly performance targets** under which the Supervisory Authority agreed with licensees the expectations for key operational indicators at specific quarterly intervals, which were then closely monitored.
- **Increased frequency of meetings with bank boards and senior management** - I should note here that the findings of all examinations and BOJ's required actions were forwarded to the Board and Management of institutions. Additionally the Minister of Finance, was provided with all examinations reports along with recommendations for intervention action which pursuant to the then existing laws, could only be taken by the Minister
- More **frequent and detailed information reporting** by licensees to the Central Bank

(inclusive of daily liquidity reporting in some instances)

- More frequent and **targeted on-site visits** which we termed as ‘limited scope’ examinations, but which would today be referred to as risk-focused examinations.

2. Pro-active efforts to improve corporate governance - In recognition of the critical role that Board and management must play in ensuring a strong and viable sector, the BOJ issued **Corporate Governance Standards of Best Practice** designed to engender prudent risk management practices and self-governance by establishing sound business, ethical and financial practices which institutions are expected to follow.

3. Development of the **"Ladder of Enforcement**" which is a schematic of the type of actions that would be taken by the Supervisory Authorities at the early warning stage of operational deficiencies to the final stage where insolvency is imminent. This document was provided to licensees as a stimulus to allow them to check themselves and not slip to the final stage, thereby necessitating intervention.

4. Bolstering the supervisory framework by making critical recommendations for **strengthening the financial legislation**. Despite the mix of measures adopted by the Bank of Jamaica, we were still constrained in our supervisory response due to the:
   - lack of statutory power for the supervisory authority to require specific ameliorative

actions with legal consequences on licensees for non compliance;

- lack of any intermediate powers to enforce corrective actions in instances of unsafe or unsound practices. Essentially, the only power available (which was also held by the Minister) was the ‘big stick’ of licence revocation, which would only be appropriate in extreme circumstances; and

- lack of legal powers to intervene in distressed entities before final insolvency reached.

As a result, there was an almost forced over-reliance on moral suasion by the supervisory authority which did not always engender positive responses from bank management.

[The new Banking Act and Financial Institutions Act that came into effect at the end of 1992 while providing some measure of strengthening of the regulatory environment,

did not go as far as recommended by BOJ. One case in point related to non-accrual requirements that were for the first time introduced in legislation but in relation to credit facilities past due for 6 months as against the more prudent 3 month time frame recommended by BOJ, in accordance with international standards. Another case related to the sanction powers introduced, which resided with the Minister rather than the Supervisory Authority, restricting BOJ's ability to act in instances of unsafe or unsound practices.]

5. BOJ undertook a **comprehensive assessment of the financial sector,** with some reference to insurance companies, when the negative indicators became

apparent. Some of the parameters examined were:

- Whether the problem was unique to one institution or was it more systemic;
- Whether the problem was one of liquidity or solvency or both.

The findings informed specific policy decisions and strategic action by the Authorities.

For example, the Minister had also acted on the Bank's earlier recommendations that other identified avenues for regulatory arbitrage be blocked - this included legislative amendments to prohibit deposit taking by Industrial & Provident societies except in very circumscribed situations which are subject to specific monitoring; that the issue of new licences to both deposit and non-deposit financial entities in sub-sectors evidencing

stress be suspended to minimize opportunities for worsening an already bad situation.

It was these assessments of systemic issues and implications for financial system soundness and stability, which were supported by independent reviews by the multi-laterals, that led the Government to initiate actions to preserve financial sector stability.

RESOLUTION

Recognizing the situation that faced the banking and insurance sectors, and the potential impact on financial system and macro economic stability, the Government moved to protect the savings of the country's depositors, life policyholders as well as its pensioners and workers whose pension funds were invested in and managed by insurance companies.

Government's approach to the problem rested on three pillars:

1. Firstly, the immediate strengthening of the regulatory framework by **fast tracking legislative amendments** to effectively grant more powers to the Central Bank and the Minister of Finance to enable earlier corrective action as well as to close regulatory loopholes and gaps. In 1994 and 1995 building societies and deposit-taking Industrial and Provident societies were designated "specified financial institutions" under the Bank of Jamaica Act giving the Central Bank supervisory oversight of those entities. Further amendments to legislation passed in 1997 included:
   - Empowering the Minister of Finance to take control of shares and assets of distressed

institutions for the purpose of restructuring the institution (vesting);

- Empowering the Supervisory Authorities to take certain corrective measures through "board undertakings", "directions" and "cease and desist orders", all of which previously could only be done by the Minister;
- Enhancement of then existing "fit and proper" criteria in relation to directors, managers and major shareholders of licensees;
- Provisions to allow for the imposition of a risk-based capital adequacy regime;
- Introduction of a more stringent time period for the definition of non-accrual loans (from six months to three months), with the added

rider that income previously taken to profits on such loans be reversed;

- Empowering the Supervisory Authority to require special audits and prescribe accounting standards where existing standards were considered deficient;
- Greater specification of the obligation of bank auditors in the presentation of findings and their reportage of problems to the Supervisor and respective bank Board of Directors;
- Granting power to the Supervisory Authorities to introduce licence conditionalities and restrictions at any time during the currency of a deposit taking licence;
- Tightening the credit exposure limits for third party as well as connected party customers;

- Granting of powers to the BOJ to allow for the examination of accounts of direct and indirect holding companies of supervised financial institutions

2. Secondly the **establishment of the Financial Sector Adjustment Company (FINSAC) i**n January 1997 to intervene troubled entities and rehabilitate and divest them to private hands as soon as was practicable. The modus operandi was that FINSAC intervened insolvent financial entities, carved out the non-performing assets; introduced new capital; rehabilitated and restructured problem entities which would continue in operation and be divested; and oversaw the liquidation of entities to be wound up. Using this intervention strategy FINSAC acquired equity and held board membership in six of the

seventeen intervened banking/deposit taking groups and five of the intervened life insurance companies. By 2002, these intervened banks and intervened insurance companies (some of which were merged) had all had been divested to private sector interests.

3. The third pillar, was undertaking **forensic audits** into institutions intervened by FINSAC to determine if fraudulent activities contributed to their demise, for appropriate action to be taken against principals as warranted.

The consolidation and rehabilitation efforts resulted in guiding those intervened entities, that continued in operation, back to profitability and in so doing, restored calm and public confidence in the financial system. The carve-out of

delinquent loans and the exit of certain non-performing entities resulted in a transformation of the aggregated balance sheet profile with improved income asset: expense liability ratios; significant improvement in asset quality (NPLs to total loans falling to below 3% by the early 2000s; and substantial strengthening of capital base well above the required minimum 6% leverage ratio.

I should perhaps indicate that while the financial system underwent severe distress during the 1990s, this was not considered by the Bank of Jamaica to be a systemic crisis as a number of features that have manifested themselves in other crises did not develop. For example Jamaica did not experience significant capital flight; (as has occurred in several other jurisdictions), but rather an internal 'flight to

quality'; and the Jamaican payment system did not suffer dislocation, due to arrangements for the repayment of depositors on a seamless basis invariably through the transfer of deposit liabilities to stronger entities.

On the matter of capital I will also indicate that with the experience of the 1990s firmly in our minds, the Bank of Jamaica has insisted on promulgating and adhering to prudent and conservative regulatory policies, such that very strong capital buffers have been built up over the years. Features of our capital framework include:

- relatively stronger capital requirements than required by Basel (required risk based capital ratio of 10% versus the 8% international norm);

- in addition to the risk based capital adequacy requirement, a "belt and braces" 6% primary ratio (which sets the floor for capital in relation to total assets, irrespective of inherent risk levels). In the wake of the current global crisis, I have noted that Basel is now recommending implementation of this requirement.
- a more stringent determination of eligible regulatory capital. For example:
  - retained earnings are not eligible for capital base unless specifically set aside to a non-distributable retained earnings reserve and have been attested to by external auditors as comprising realized earnings;
  - unrealized fixed assets revaluation gains are ineligible for inclusion in capital base; and

- "loan" capital is not permissible.

- prudent loan loss provisioning requirements as to specific as well as general provisions for potential losses that do not attach to specific assets, so as to ensure prudent buffers in times of balance sheet stress. This therefore results in stronger capital since these provisions accumulate over time and act as an additional capital buffer against losses

These measures have meant that despite the resulting fallout in our economy as a consequence of the current global financial crisis, the Jamaican banking sector even though showing an increasing level of non-performing loans has nonetheless continued to benefit from a strong capital and loan provisioning base, as borne out by continuing

stress tests. This is an area in which many industrialized countries have been found wanting. Hence, we note also that since the global meltdown several G20 jurisdictions are now reviewing their regulatory arrangements and have already determined on, or are considering, the re-introduction of several approaches similar to those taken by Jamaica, including a primary capital ratio to ensure their banks adhere to strong capital enhancement programmes.

LESSONS LEARNT

Looking at all we have experienced and the actions we have sought to take, what then are the lessons learnt from the Bank of Jamaica's experience with the financial sector distress in the 1990s?

1. Firstly, I think it is almost axiomatic and should go without saying that the achievement of **sound macroeconomic fundamentals and financial sector stability are inextricably linked** and therefore achieving financial sector stability in the absence of macroeconomic stability would be difficult, if not impossible.

2. Secondly, the **independence of supervisory authorities** is internationally acknowledged to be a key ingredient of effective banking supervision (Basel Core Principle 1). Independence on its own of course does not ensure that crises will be averted or that key decisions will be made on a timely basis. However, where the banking supervisor is vested with independent powers to act and

also possesses the specialized expertise and adequate resources, this does allow the Supervisor to intervene when problems are first discovered and to take appropriate and timely action based on technical assessments.

3. The third lesson for me is very closely aligned to the second and that is that there needs to be **full recognition by all stakeholders that not all entities can be saved** - and where the writing is on the wall that exit is the best strategy for the overall integrity of the system, then early intervention action, preferably before insolvency is reached, is a must! This not only reduces the eventual cost to the public purse, but also protects depositors and creditors who might further invest in a rapidly deteriorating entity. This would also help to

head off any future legal suits that seek to contend that the authorities failed to act with due care and alacrity. There must therefore be mechanisms for speedy and decisive corrective action and intervention as soon as it is recognized that an institution is in difficulty. In this regard, efficient channels of communication to the decision makers, as well as the political will to take appropriate action, are critical. And here I would say that communication is absolutely critical – a Supervisor must never be found in the position of not having communicated regularly on the problems of entities under their purview.

4. An over-banked system, where entities lack the necessary critical mass, leads inexorably to excessive and unhealthy competition, with

all the negatives that brings with it - intermediaries e.g. struggling for market share and therefore being particularly prone to taking excessive risks. We therefore need reasonably stringent but technically sound entry requirements that discourage and eliminate marginal players from the system.

5. There is **great risk in delayed action**. Problems do not improve through inaction but merely become more aggravated with the final costs having greater impact on the public purse. I often refer to what I've dubbed the "iceberg principle" which invariably manifests itself - problems are almost always much larger than they initially appear, again underlining the need and political will for speedy intervention once the problem has been assessed as reaching a stage of "no

return", to be able to fully come to grips and effectively manage the process while ensuring minimum systemic impact or disruption.

6. A precondition for such action however is the existence of **strong and unambiguous legislative provisions and tools** to be able to act quickly and decisively. This also helps to counter any specious legal action that could be threatened or initiated by owners or other stakeholders.

7. The need to have a cadre of experienced and well trained examiners. In the Jamaican case we certainly found that monies spent to train and properly equip supervisors and bank examiners in assessing and analyzing financial trends and bank conditions was money well spent, as in all cases, their initial

assessments were proven to be firmly and accurately based, supported eventually by conservators, forensic auditors and the IFIs. Additionally, the expertise born of experience, to assess and appropriately adapt international standards & principles (e.g. accounting, prudential, risk management) appropriate to the peculiarities of the jurisdiction is critically necessary. For example, the ability to determine what can and cannot work given the culture and the particular types of risks faced in one's own market cannot be overemphasized.

8. Effective data collection and early warning systems that provide basic indicators of incipient banking system problems are fundamental elements. This must be under-girded with technological resources to

maximize the effectiveness of harnessing data and facilitating rigorous "forward looking" analyses. We must be able to not only assess the current situation but also project the likely impacts of varying probable scenarios on the fortunes of supervised entities, so that regulators and the entities themselves can properly prepare to minimize or contain/manage the impact of potential and actual adverse events and maintaining system stability – hence the emergence of our significant stress testing capabilities in our Financial Stability Unit.

9. The need to ensure that there is an appropriately robust regulatory regime for every type of financial business to ensure that no entity escapes supervisory oversight or is given opportunities to engage in regulatory

arbitrage. Thus, every element I have highlighted as critical to the bank supervisor is similarly a fundamental requirement for the non-deposit taking system and its supervisors.

10. Experience has taught us the importance of consolidated oversight and supervision, with global standards applied according to a conglomerate's risks to ensure that group transactions and structures facilitate effective supervision. Such a regime must allow for unfettered supervisory access to financial information relating to the activities of other entities that are within the same group/conglomerate and which can impact on the financial conditions of the banking institution. This is especially crucial in an environment like ours where systemically important financial and mixed conglomerates

are a special feature, and where all entities in a group do not fall under the jurisdiction of the same regulatory body, and where the situation is further complicated by cross border factors. Certainly, this is also a lesson the world has had to relearn from the more recent global financial crisis.

11. Allied to this is the critical need for regulators to have the necessary legal authority to allow only those corporate and group structures which can be effectively regulated and over which they have effective regulatory reach.

12. Especially important in our situation is a mechanism for coordination between regulatory agencies. As governance of banks can be influenced by entities that are

themselves not subject to banking supervision, it is critical that arrangements are in place for the exchange of regulatory information and effective and prompt coordination of regulatory responses.

13. The need to be satisfied as supervisors, that a financial entity's owners, directors and senior managers are "fit and proper" individuals possessing sound judgment, integrity, competence and honesty and that they were not previously part of the decision making (for example through involvement in the board of directors or senior management) of a failed or intervened institution. While I'm sure this is something most persons would agree on it's not always the easiest rule to implement, especially where there are differing standards between in-country

regulators, as well as between home and host country regulators.

14. The need to promote the strongest possible corporate governance and risk management practices in financial institutions. Added to this is the need to be satisfied that proper management information systems and internal controls are in place to facilitate sound decisions by board and management.

15. A well developed crisis management plan that details the roles and responsibilities of stakeholders, the necessary resource requirements[1] and a specific and detailed

1. [1] Resources would include access to a pool of independent experts (for example experienced external auditors drawn from accredited auditing firms) who can be called upon to take charge of problem entities in a conservatorship or temporary management scenario. Basic issues such as total confidentiality of arrangements prior to taking of control, appropriate timing of the intervention with arrangements for all the critical operational areas to be taken over and manned from the outset, are preconditions for success. This would cover all branch locations, with particular emphasis on control of the bank's management information systems and securing records and physical structures.

communication policy to ensure that there is good flow of information between regulators and the public as to what is happening and why.

In Jamaica, our "Ladder of Enforcement and the FRC Memorandum of Understanding which I mentioned earlier, provides the protocol for interagency communications while the specific intervention Action Plan for the individual entities sets out the timing and responsibilities for communication with the general public.

16. Finally, we do need the depositing/investing public to be more financially aware so as to exercise informed judgment when selecting entities to be custodians of their savings and to ensure that market discipline actually

works. This requires not only deepening the awareness of the public with regards to the different types of financial instruments, products and services and the related risks involved, but also ensuring that there is appropriate disclosure by the entities as to their financial condition and operating results. In Jamaica, banks are legislatively required to publish in daily newspapers their annual audited financials and also display these throughout the year in each branch. Additionally, since the 1970s the Bank of Jamaica publishes in the daily newspaper on a quarterly basis, unaudited balance sheet of the licensed entities and during the 1990s this was further enhanced to include key system performance indicators.

SUBSEQUENT REGULATORY DEVELOPMENTS

I will now go into what I will term my "footnote" or in other words, regulatory developments subsequent to the 1990s.

In light of the constraining factors to supervisory action, the Bank of Jamaica continued to push for **further amendments to banking statutes**, important parts of which were passed into law during 2002. These amendments significantly, provided for the following:

- The transfer to the Bank of Jamaica, of the Minister's powers to assume temporary management of deposit-taking institutions where a licensee is, or appears, unlikely to meet its obligations;
- The granting to the Bank of Jamaica of power to require an institution to legally separate its

banking operations from investment activities undertaken on behalf of investor clients through transfer of the latter to a separate legal entity (this would preclude the earlier commingling funds that was observed in some institutions);

- The granting to the Bank of Jamaica of power to effectively carry out consolidated supervision of deposit-taking entities and other companies which are members of a group of which the deposit-taking licensee is a member. Under consolidated supervision, the existence of a mixed conglomerate is specifically prohibited, and where such groups do exist BOJ has the power to direct a restructuring in order to facilitate the establishment of a financial holding company comprising all the financial entities in that

group, to which the banking entity would report;

- The broadening of the types of cases in which a bank may disclose information concerning specific customer accounts (for example, where the information is being disclosed to an authorized officer, or is in connection with civil proceedings, or where the customer involved is an un-discharged bankrupt, or in the case of a company, is being wound up, or where the Minister in writing directs such disclosure).
- Segregation of commercial banking and investment management business. This aids transparency and ensures that banks remain true to their core competencies.

The Bank of Jamaica was also involved in other efforts aimed at strengthening regulatory and

supervisory framework of the financial sector, and which led to the:

1. **Establishment of the Jamaica Deposit Insurance Corporation during 1998** to provide depositors in the banking sector with protection from loss up to specified limits.

2. **Establishment of the Financial Services Commission** in August 2001which replaced the functions of the former Office of the Superintendent of Insurance and Unit Trusts, and the Securities Commission and integrated and strengthened regulation of the securities industry, the insurance industry and pensions industry.

3. **Establishment of The Financial Regulatory Council in 2000** to facilitate information sharing among regulatory bodies

and other key agencies (BOJ, Financial Services Commission, Jamaica Deposit Insurance Corporation, the Financial Secretary The Council was established pursuant to a Memorandum of Understanding and also has participation from the Solicitor General in an advisory role.

CLOSING

In closing, I would go back to a point I made earlier - that the objectives and functions of prudential regulation is not to prevent failure of individual institutions, nor to preclude every improper or ill advised practice. (Human nature being what it is, that would be an almost impossible task.) Rather it is, to the extent possible, to promote sound banking and risk

management practices within licensees such that their Boards and managements will prudently and profitably guide their operations. In the event of problem institutions, the role of the regulator is to seek timely resolution, which will at some point include orderly exits. I've learnt in my many years as a regulator that this is not a job for the faint of heart – it requires courage to stick to your guns to tell the unpleasant truth to critical stakeholders that sometimes a situation is untenable and must be exorcised.

Although the 1990s was an extremely painful and costly episode in the life of Jamaica, it provided an effective lesson to Jamaican policy makers and the public as to the importance of financial system stability and provided a catalyst for significant strengthening of regulation across

the entire financial landscape. However, I've also found that memories tend to be short.

POSTSCRIPT

As a postscript, allow me to observe that the importance of lessons learnt may sometimes fade. Our situation is complicated by the fact that we operate in an ever changing and dynamic world, where the future risks to banking and financial system intermediation are sometimes difficult to predict, nor are they always within our power to control. Even now our economy continues to feel the impact of the global meltdown which has unavoidably impacted our financial system. I therefore foresee that our job as regulator will always be fraught with challenges – to put in place the regulatory and supervisory prescriptions to enhance the strength and resilience of our

systems and that allow for healthy competition and innovation without increasing risks unduly - a daunting challenge by any standard! May we have strength for the challenge and clear memories to ensure we don't have to relive past history.

Thank you.