

TECHNICAL COOPERATION PROFILE

JAMAICA

April 11, 1997

PROJECT NAME: INSTITUTIONAL SUPPORT OF FINSAC

PROJECT NUMBER: MIF TC 97-03259

PROJECT TEAM: Desmond Thomas (RE3/OD6), Sharon Miller (CJA), William Armstrong (project team leader-RE3/FI3).

EXECUTING AGENCY: Financial Sector Adjustment Company (FINSAC)

BENEFICIARY: FINSAC

FINANCING PLAN:

MIF:	US\$ 1,500,000
Local counterpart funding:	US\$ 650,000
Total:	US\$ 2,150,000

TENTATIVE DATES:

Loan Committee:	May 29, 1997
Donors Committee:	June 25, 1997

I. BACKGROUND

- 1.1 Jamaica is going through a period of considerable instability in the financial sector. Over the past two years, two financial groups have been closed by the government and more recently another group has been intervened. The main causes have been high real rates of interest that make it difficult for borrowers to repay; regulations that permit poorly regulated institutions to take deposits and make loans; and weak laws that make it difficult for the authorities to take prompt, corrective action.
- 1.2 Although the problems in Jamaica show many similarities to financial sector crises that have occurred in other countries, the situation in Jamaica has an important difference. Losses in life insurance companies feature prominently as an important cause of the overall crisis. The life insurance companies have been able to offer bank-deposit-like instruments and they have used these to finance large portfolios of long-term assets. With interest rates very high now, this mismatch has seriously affected the liquidity of these companies. In addition, insurance supervision is not strong, so these companies have not had the guidance from supervision that is important to protect the health of the subsector. The problems of the insurance companies have spilled

over to the banks, because many insurance companies own banks, or vice versa.

- 1.3 The GOJ is moving aggressively to solve these problems. In December, 1996 it established the Financial Sector Adjustment Company (FINSAC) to provide financial and technical support to selected banks and insurance companies; to recommend to the GOJ the reforms that are required to create a firm legislative, regulatory and supervisory base for the financial sector; and to help implement these reforms.
- 1.4 FINSAC may provide financial support through loans or by purchasing shares in the affected institutions. In exchange, the owners of the institution may be required to cede control to FINSAC or its agents, or if the entity is a going concern needing only temporary support, control of the entity may only be partially given over to FINSAC. FINSAC's functions will end when the financial sector returns to health, a process which is expected to take several years. Accordingly, it does not wish to build up a large permanent staff, and will conduct much of its work through agents and consultants.
- 1.5 FINSAC has gotten off to a fast start. It has already taken over one financial group, and is negotiating support measures for several others. To date it is responsible for financial support of approximately US\$300m. This is a large sum for a small economy, and for that reason the GOJ has asked the Bank to provide technical assistance to ensure that FINSAC is effective in carrying out its important role.

II. PROJECT OBJECTIVES AND DESCRIPTION

- 2.1 FINSAC is the focal point for solving the problems that Jamaica has in the financial sector. In this role, it will act as the executive arm of the Minister of Finance and Planning. It will coordinate its activities with those of other government agencies, especially the Bank of Jamaica and the Superintendent of Insurance. It will provide financial and managerial assistance to companies in the sector, both directly and as agent for assistance provided by the GOJ. FINSAC will also conduct studies of specific institutions and of the sector in general and it will assist individual institutions to work out their problems.
- 2.2 FINSAC has responsibilities in the following areas:
 - a. to resolve the liquidity and solvency problems of banking and insurance institutions,
 - b. to strengthen management in the sector,
 - c. to improve the efficiency of the sector in intermediating resources,
 - d. to improve company governance and minority shareholder rights,

- e. to minimize the public cost and the duration of the support operations,
- f. to strengthen bank and insurance company supervision,
- g. to help create a transparent framework of incentives, rights and obligations for depositors, policy-holders, pension-holders, management and owners.

The objectives of this project are to help FINSAC exercise these responsibilities.

2.3 In respect of these activities, the GOJ has requested the Bank to provide technical assistance to cover the following areas, and others that will be defined by mutual agreement during project execution. These estimates are preliminary and will be refined in the Donors Memorandum following an assessment by FINSAC of their needs:

- a. a diagnostic study of the financial sector with recommendations for amendments to selected laws and regulations designed to create a strong foundation for a healthy financial sector, (approximate amount-US\$100,000);
- b. development and execution of a plan of action to strengthen supervision of financial institutions. Activities in the plan of action may include the appointment of special advisors to FINSAC on banking, insurance or capital markets supervision, an analysis of the information systems in the superintendencies, and the appointment of interventors or temporary managers. (approximate amount-US\$750,000).
- c. the drafting of regulations for one or more superintendency of financial institutions, and the procurement of computer hardware and software for the insurance superintendency provided the latter did not exceed \$200,000. (approximate amount-US\$300,000)
- d. an analysis of the financial health of selected financial companies, plus training in the techniques of such analysis, (approximate amount-US\$80,000);
- e. development and execution of a plan of action to set up the FINSAC department that will be charged with the disposal of the loan and real estate assets that are taken on as a result of the interventions. This is expected to require one or two full time consultants for a period of a year or so, (approximate amount-US\$900,000).

2.4 The project is expected to be executed over a period of two years. Expected results are: a stronger legal and regulatory infrastructure, efficient and transparent interventions of banks and insurance companies, transfer of technology and ability to local staff of the regulatory agencies, and the efficient and

transparent disposal of the assets that FINSAC becomes responsible for as a result of the interventions.

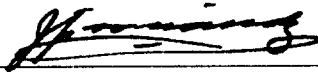
III. ISSUES

- 3.1 FINSAC requests that the project be approved in time for the consultants to be mobilized in early May. As the action plan below shows, this will not be possible given the distribution periods required for the Bank's various committees. Given the urgent need for the actions to be undertaken in this project, especially the diagnostic study (2.3a), and the absence of major issues, every effort should be made to process the documentation as quickly as possible.

IV. ACTION PLAN

CRG TC Profile	April 11, 1997
Programming Committee	May 14, 1997
CRG Donors' Memorandum	May 13, 1997
Loan Committee	May 29, 1997
Donors' Committee	June 25, 1997

Approved by:


RE3/DEP

Date:

5/13/97