JAMAICA DEPOSIT INSURANCE CORPORATION/CARIBBEAN REGIONAL TECHNICAL ASSISTANCE CENTRE CONFERENCE

BANK INSOLVENCY IN THE CARIBBEAN: LAW & BEST PRACTICE (Detecting and Managing Banking Crises: Assessment of the Global Financial Crisis of 2007-2009)

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Address

Ladies and Gentlemen,

This conference is timely and I must thank the JDIC for organising it. In our globalised world, "no country is an island" and Caribbean economies are each particularly vulnerable to the developments, including financial institution failures, that occur elsewhere in the Caribbean and elsewhere in the world. I am sure that the conference will identify some of the big issues regarding financial institution insolvency and that it will float new and perhaps far-reaching ideas for improving the resilience of the financial industry in the broader Caribbean. The subject of bank insolvency is, to a regulator, perhaps somewhat similar to what the subject of pathology is to a family doctor. By examining in principle and in practical detail the nature and progression of the end of the life of an institution, the regulator is helped in her understanding of how to maintain a healthy institution.

Financial system crises are said to be similar to the human fingerprint in that each crisis is unique. Each crisis is unique in terms of its origins, the agents of transmission to other sectors of the economy, the points of impact and the timing and magnitude of the impact. As such there are no precise textbook solutions or readymade prescriptions to apply in a financial crisis. Despite the most robust of legal frameworks and the most comprehensive of crisis management arrangements, the formula for resolution to a certain extent will depend on the nascent circumstances and the peculiar features in each situation.

The recent global crisis reminded us that banks matter enormously to our economies. But it is well recognized that the purpose of financial sector regulation is not to prevent financial institution failures, desirable as that certainly is. The primary aim is better seen as providing the framework for the efficient functioning of financial markets with adequate banking services, the protection of depositors and of overall stability of the financial system. It is therefore of utmost importance that we continually seek to ensure that our oversight frameworks allow for the development of strong and resilient financial systems with necessary provisions for the orderly exit of intermediaries whenever this becomes necessary, with minimum disruption to depositors and the local economy.

In this regard, supervision in Jamaica has been substantially strengthened since the financial sector turmoil that the country experienced in the 1990s. The establishment of the Jamaica Deposit Insurance Corporation in 1998 and the creation of the Financial Services Commission in 2001 were just two of the more striking aspects of the effort to strengthen the regulatory and supervisory framework of the financial sector, and the process of strengthening continues. These past improvements stood Jamaica in good stead during the recent turbulence in global and regional financial systems as generally the banking sector fundamentals remained strong against the backdrop of the economic slowdown. Also, the financial system remained unaffected by the failure of a major regional conglomerate last year. It is still early days, but the system appears to have withstood the recently delivered shock arising from Jamaica's Voluntary Debt Exchange Offer, the JDX. This exchange, which received voluntary participation of almost 100%, involved a reduction of interest income from holdings of domestic government securities of close to 30% in addition to a lengthening of maturities by two years.

What is now necessary is for us to work to ensure that the regime for making our banks more robust against the threat of insolvency is as good as we can make it. Put another way, while these developments make for a more tightly regulated financial sector and place authorities in better stead to address weaknesses that may emerge, are the changes sufficient to deal with the potential impact on the Jamaican financial sector of a repeat of the recent global and regional economic crises and their spillover effects on the Jamaican economy? In at least one respect, we can say that the answer is "no".

A factor that was not a significant feature of the earlier turmoil in Jamaica was cross-border reach. The Caribbean Single Market and the prospect of the eventual Caribbean Single Economy involve the removal of certain legal, economic and trade barriers. In the past decade the Caribbean has seen a significant increase in regional expansion by companies operating in both the real sector and the financial sector. As such the potential for problems in one jurisdiction to impact developments in another regional market is now a critical concern.

Against this background, the central banks of CARICOM have initiated the development of a regional crisis management plan designed as a regional response to crisis situations of banking enterprises operating in more than one jurisdiction in the region. The plan is intended to address crises that involve illiquidity situations or the ensuing insolvency of at least one member of a banking group. It is also proposed that the plan will address principles underlying preparedness during normal times, systemic risk assessments, crisis identification, how and when to invoke procedures and the adoption of region-wide communication strategies. Adoption of the provisions of the plan is to be formalised by way of a memorandum of understanding amongst the participating central banks.

However, a number of challenges to making these arrangements a reality have been identified and remain unaddressed at this time. Here are some examples:

- How should the costs of any remedial action to stabilise the financial sectors in participating countries be shared in cases where there is or may be spillover contagion between jurisdictions?

- How shall we overcome the legislative and policy hindrances, such as exchange controls, that would restrict or inhibit the flow of funds to a distressed centre in the event of either a private sector crisis resolution or a collective public sector "bail-out"?

- How will we treat the variations in the different legislative and supervisory arrangements in place in member jurisdictions that may impact on the ability of jurisdictions to fully participate in the regional plan?

The implementation of a regional crisis management plan should make the banks in the region more capable of absorbing shocks and therefore enable an environment capable of delivering for the businesses and people of the Caribbean the sustained period of stability that is needed in order to foster innovation, creativity and growth in productivity. Resolving the issues that I have identified would therefore seem to be an urgent priority for regulators and policy makers across the region. I will end with a question that is pertinent to this audience that is drawn from the region: "Is it?"

Thank you.