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Jamaica: FINSAC Blanket Guarantee, 1997[1]

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Abstract

After a period of sustained distress in the early 1990s, Jamaican financial institutions faced significant liquidity issues by 1996, evidenced by runs on banks by depositors. The government responded by creating the Financial Sector Adjustment Company (FINSAC) on January 29, 1997, to rehabilitate weak financial institutions and administer a blanket guarantee on financial sector liabilities. The blanket guarantee covered all deposit-taking financial institutions, life insurance policy providers, and pension funds registered under the Banking Act, Financial Institutions Act, and Insurance Act. Within eligible institutions, the blanket guarantee covered depositors' funds in licensed deposit-taking institutions, pension funds managed by authorized institutions, and policyholders' funds in insurance companies. The government funded the blanket guarantee through domestic borrowing and FINSAC-issued notes that were fully guaranteed by the government. In total, the blanket guarantee covered JMD 262.1 billion (USD 7 billion) in liabilities. Observers credited the guarantee with restoring public confidence, although Jamaica's crisis was among the most expensive in recent history as a percentage of GDP. By mid 1998, FINSAC had spent JMD 73.5 billion (USD 1.9 billion) providing support to the financial sector, with JMD 68 billion going toward support for the banking sector, covering 1.5 million depositors. The Deposit Insurance Act of 1998 established a limited deposit insurance scheme to replace the blanket guarantee. This deposit insurance scheme came into effect on August 31, 1998, initially covering depositors in eligible institutions up to JMD 200,000 per account and gradually raising the limit to JMD 1.2 million as of 2020.

Keywords: blanket guarantee, FINSAC, Jamaica

[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering blanket guarantee programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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Overview

After a period of growth in the 1980s, the Jamaican economy experienced sustained distress beginning in the early 1990s (Chen-Young 1998). Amidst these economic difficulties, the government provided an ad hoc deposit guarantee and emergency liquidity to support two large deposit-taking institutions, Blaise Financial Entities in 1994 and Century National Bank in 1995. The terms of these individual guarantees were administered by an existing government body called Financial Institutions Services (FIS). In May 1996, CEOs of several life insurance companies approached the government for liquidity support. The government commissioned a working group to investigate problems within the financial sector in August 1996. The group discovered that several more commercial banks were contaminated alongside the life insurance companies (Bonnick 1998).

Large numbers of depositors withdrew their savings from weak local institutions and deposited them in branches of foreign banks. Amid continued runs and a growing liquidity crisis, the government adopted a comprehensive approach, announcing the creation of the Financial Sector Adjustment Company (FINSAC) on January 29, 1997. The FINSAC mandate was to address the problems of insolvency and lack of liquidity within the financial sector. The government merged the operations of the pre-existing FIS with FINSAC (FINSAC n.d.; Kirkpatrick and Tennant 2002; Ministry of Finance 1998).

Key Terms

Purpose: "To protect the investments of policyholders, depositors, and pensioners" while restoring liquidity and solvency to weak financial institutions (FINSAC n.d.)	
Launch Date(s)	Announcement: February 7, 1997
End Date(s)	August 31, 1998
Eligible Institutions	All deposit-taking financial institutions, life insurance policy providers, and pension funds
Eligible Liabilities	Deposits, pension funds, and insurance policies, were covered by the blanket guarantee
Fees	No fees associated with guarantee.
Coverage	JMD 261.7 billion
Outcomes	Direct payouts for depositors and policyholders in two banks and three insurance companies
Notable Features	The guarantee protected depositors, life insurance policyholders, and pensioners

On February 7, 1997, the Prime Minister announced a blanket guarantee in Parliament. The blanket guarantee covered depositors' funds in licensed deposit-taking institutions, pension funds managed by authorized institutions, and policyholders' funds in insurance companies (Bonnick 1998). FINSAC administered the blanket guarantee in addition to its liquidity support and bank restructuring responsibilities.

The blanket guarantee was funded entirely by the government. FINSAC received an initial JMD 6.3 billion (USD 177 million)[3] from the Ministry of Finance, with additional funding from domestic borrowing (FINSAC n.d.; Minister of Finance 1997a; World Bank 2004). Eventually, FINSAC funded its intervention through the issuance of FINSAC notes. FINSAC issued JMD 75 billion worth of paper to fund its interventions. These notes were fully guaranteed by the government. The blanket guarantee covered JMD 68.7 billion in deposits, JMD 19 billion in pension fund value, and JMD 174 billion in individual insurance policies. This totaled JMD 261.7 billion in covered liabilities (Chen-Young 1998; Kirkpatrick and Tennant 2002; Rattray 1999).

The exercise of the blanket guarantee occurred when FINSAC liquidated a failing financial institution, sold investments to recover capital support, and wound down its operations. FINSAC placed funds matching the eligible accounts in replacement accounts at stable institutions, ensuring that no depositors, policyholders, or pensioners incurred losses. FINSAC assigned the deposit liabilities of five small, failing merchant banks, placing them in stable institutions. The deposits in these five banks totaled JMD 300 million (FINSAC 1998a; 1998b; Ministry of Finance 1998). FINSAC also created a scheme for policyholders in three failing life insurance providers, which transferred lump-sum-type policies into the Bank of Nova Scotia (BNS). FINSAC estimated the cost of this scheme to be JMD 2.4 billion (FINSAC 1999).

Public financing measures meant that the crisis response was expensive for the Jamaican government (see Appendix). FINSAC intervened in more than 150 financial institutions and insurance companies, taking direct ownership stakes and making efforts to recapitalize, restructure, and merge as necessary. By mid 1998, FINSAC support had cost the government JMD 73.5 billion (USD 1.9 billion), JMD 68 billion of which represented support to the banking sector, covering 1.5 million depositors (Chen-Young 1998; World Bank 2004).

The government did not originally establish an end date for the blanket guarantee, though the Minister of Finance expected FINSAC operations to last five to seven years. The Deposit Insurance Act of 1998 established a voluntary deposit insurance scheme that initially protected depositors up to JMD 200,000 per account, eventually scaling up to JMD 1.2 million as of 2020. The new deposit insurance scheme came into effect on August 31, 1998, officially ending the blanket guarantee (Deposit Insurance Act 1998; IADI 2005; Minister of Finance 1997b).

Summary Evaluation

According to the International Monetary Fund (IMF), the public viewed Jamaica's blanket guarantee as credible, evidenced by the lack of further bank runs. However, the fiscal cost of Jamaica's banking crisis was among the most expensive in recent history (see Appendix). The resolution of the crisis was rapid, although growth never fully recovered, failing to return even to pre-crisis lows (IMF n.d.; World Bank 2004).

[3] In 1997, USD 1 was equal to JMD 35.40 (per FRED).

A former FINSAC chairman argued that issues of moral hazard arose with the extension of the blanket guarantee. He said that following the announcement of the explicit blanket guarantee, business managers may have converted liabilities into the categories guaranteed by the government. According to Kirkpatrick and Tennant of the World Bank, in the period prior to the explicit guarantee, the individual guarantees provided to Blaise Trust and Century National Bank resulted in the sense of an implicit guarantee of all deposits. Kirkpatrick and Tennant report that criticisms of the guarantee focused on its primarily benefiting a very wealthy minority of the population as well as fostering risk-taking and imprudence during a time of economic uncertainty (Bonnick 1998; Kirkpatrick and Tennant 2002).

Kirkpatrick and Tennant weigh Jamaica's crisis response against the counterfactual of a typical IMF response. Their results suggest that Jamaica's crisis response was superior to a hypothetical IMF-style response. The authors hypothesize that the initial step of an IMF-style response would have been the immediate suspension or closure of troubled institutions. They argue that such action without sufficient protection of depositors would have led to wholesale financial panic (Kirkpatrick and Tennant 2002).

<table>
<tr><th colspan="3">Context: Jamaica 1998–1999</th></tr>
<tr><td colspan="2" rowspan="2">GDP (SAAR, nominal GDP in LCU converted to USD)</td><td>$8.8 billion in 1998</td></tr>
<tr><td>$8.9 billion in 1999</td></tr>
<tr><td colspan="2" rowspan="2">GDP per capita (SAAR, nominal GDP in LCU converted to USD)</td><td>$3,368 in 1998</td></tr>
<tr><td>$3,376 in 1999</td></tr>
<tr><td rowspan="6">Sovereign credit rating (five-year senior debt)</td><td rowspan="3">1998</td><td>Moody’s: Baa3</td></tr>
<tr><td>S&P: Data not available</td></tr>
<tr><td>Fitch: Data not available</td></tr>
<tr><td rowspan="3">1999</td><td>Moody’s: Baa3</td></tr>
<tr><td>S&P: B+</td></tr>
<tr><td>Fitch: Data not available</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system</td><td>$3.0 billion in 1998</td></tr>
<tr><td>$3.2 billion in 1999</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system as a % of GDP</td><td>34.1% in 1998</td></tr>
<tr><td>36.3% in 1999</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system as a % of financial system</td><td>Data not available in 1998</td></tr>
<tr><td>Data not available in 1999</td></tr>
<tr><td colspan="2" rowspan="2">Five-bank concentration of banking system</td><td>Data not available in 1998</td></tr>
<tr><td>Data not available in 1999</td></tr>
<tr><td colspan="2" rowspan="2">Foreign involvement in banking system</td><td>Data not available in 1998</td></tr>
<tr><td>Data not available in 1999</td></tr>
<tr><td colspan="2" rowspan="2">Existence of deposit insurance</td><td>Yes in 1998</td></tr>
<tr><td>Yes in 1999</td></tr>
<tr><td colspan="3">Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.</td></tr>
</table>

Key Design Decisions

1. **Purpose: The government announced the blanket guarantee to protect policyholders, depositors, and pensioners, and to restore confidence in the financial sector.**

The Jamaican financial sector experienced sustained runs in late 1996, as large numbers of depositors withdrew their savings from local institutions and placed them in branches of foreign banks. After measures extended on an individual basis proved to be ineffective, the government took a more comprehensive approach. It established FINSAC to respond to solvency and liquidity throughout the Jamaican financial sector (Kirkpatrick and Tennant 2002; Minister of Finance 1997a; 1997b).

FINSAC developed several objectives to pursue that mandate. The first listed responsibility was "to protect the investments of policyholders, depositors, and pensioners" (FINSAC n.d.). As such, the government announced a blanket guarantee of depositors' funds, policyholders' funds, and pensioners' funds in deposit-taking financial institutions, life insurance policy providers, and pension funds registered under the Banking, Financial Institutions, and Insurance Acts on February 7, 1997 (Bonnick 1998; Chen-Young 1998; IMF n.d.).

On March 27, 1997, the Minister of Finance issued a statement reinforcing the importance of government support of life insurance companies, given the interlocking nature of the insurance sector and the banking sector (Minister of Finance 1997a).

2. **Part of a Package: The Prime Minister announced the blanket guarantee to Parliament following the creation of FINSAC to rehabilitate financial institutions.**

In early 1997, the government moved away from the individualized approach taken in the early 1990s in favor of a more comprehensive plan. The government announced FINSAC on January 29, 1997, to handle the rehabilitation of the financial sector[4]. On February 7, 1997, the Prime Minister announced the blanket guarantee, administered by FINSAC, to complement its other crisis response efforts (Bonnick 1998; FINSAC n.d.; Minister of Finance 1997a; Ministry of Finance 1998).

The government established FINSAC with a mandate to promote solvency and liquidity in the financial sector. FINSAC had three phases to support troubled financial institutions. It first sought to negotiate a rehabilitation plan with the leadership of the institution. FINSAC directly acquired or closed institutions for which rehabilitation was not feasible. In those cases, a second phase of FINSAC operations involved the attempted rehabilitation of institutions through asset management and portfolio restructuring, as well as leadership changes as necessary. The third and final phase involved the divestment of assets acquired by FINSAC, and the winding down of FINSAC operations. In this phase, FINSAC exercised the guarantee and transferred deposits or other insured liabilities to sound institutions (Bonnick 1998; FINSAC n.d.). This manifested in the assignment of deposit liabilities of five failing

[4] For a discussion focused specifically on FINSAC, see Runkel (2021).

merchant banks and the transfer of lump-sum type policies of three insurance companies (FINSAC 1998a; 1998b; 1999; Ministry of Finance 1998).

3. **Legal Authority: The Ministry of Finance created FINSAC as a limited liability company using the Companies Act.**

The Constitution of Jamaica gave the Prime Minister the power to appoint ministers who acted as the principal instruments of policy. The Ministry of Finance was responsible for Jamaican fiscal and economic policy as well as allocating public revenues. The Ministry of Finance created FINSAC as a limited liability company registered using the Companies Act (Constitution of Jamaica 2011; Ministry of Finance 1998; Ministry of Finance 2022).

4. **Administration: FINSAC administered the blanket guarantee in coordination with its other crisis response measures.**

FINSAC served as a vehicle for government support of the financial sector and the executive arm of the Ministry of Finance & Planning. FINSAC worked closely with various agencies (see Governance) (Minister of Finance 1997b).

5. **Governance: The Ministry of Finance appointed a board of directors to oversee FINSAC.**

The Minister of Finance appointed a 10-member board of directors tasked with guiding the operations of FINSAC, including the blanket guarantee. The appointed directors consisted of the financial secretary of the Ministry of Finance, central bank officials, former private bank executives, academics, and union leaders. As an organization, FINSAC served as the executive arm of the Ministry of Finance and Planning (Minister of Finance 1997a; 1997b; Ministry of Finance 1998).

FINSAC worked closely with the Bank of Jamaica, the Superintendent of Insurance, and the Securities Commission to streamline operations in the financial sector (Minister of Finance 1997a).

6. **Communication: The Prime Minister originally announced the blanket guarantee in Parliament, and the Minister of Finance made a statement to the media outlining the government's comprehensive response.**

The Minister of Finance announced FINSAC in a statement on January 29, 1997 (Ministry of Finance 1998, 1). The Prime Minister first announced the blanket guarantee to Parliament on February 7, 1997 (Bonnick 1998; Ministry of Finance 1998).

Spokesmen for the government said that the financial rehabilitation measures should not be seen as bailouts. The Minister of Finance made a statement to the media on March 14, 1997, to clarify the measures being taken to rehabilitate the financial sector (Dow Jones 1997; Minister of Finance 1997a). The Minister said, "Notwithstanding the situation, it is government's policy to do what is necessary to protect investments of our citizens," further stating that this was the reason the government created FINSAC (Minister of Finance 1997a).

FINSAC operations were regularly communicated to the public through annual reports (Rattray 1999).

7. Source(s) and Size of Funding: The government directly financed FINSAC operations, and FINSAC issued government-guaranteed FINSAC notes.

The government funded FINSAC's rehabilitation efforts, including the blanket guarantee. The Ministry of Finance provided FINSAC with JMD 6.3 billion of initial funding. The government borrowed domestically to fund necessary measures (Minister of Finance 1997a; 1997b).

Following the original government provision, FINSAC also raised funds by issuing FINSAC notes that were fully guaranteed by the government. Bonds could be issued quickly without approaching Parliament for approval to raise government debt ceilings (Bonnick 1998; Kirkpatrick and Tennant 2002). FINSAC issued JMD 75 billion worth of paper to fund its various intervention measures. The government officially took over the responsibility for bond payouts in 2001 (Chen-Young 1998; World Bank 2004).

8. Eligible Institutions: All deposit-taking institutions, life insurance policy providers, and pension funds were eligible for the blanket guarantee.

FINSAC extended the blanket guarantee to all institutions registered under the Banking, Financial Institution, and Insurance Acts (Chen-Young 1998, 1). These included deposit-taking institutions, life insurance policy providers, and pension funds (Chen-Young 1998; IMF n.d.).

9. Eligible Liabilities: The blanket guarantee covered deposits, pension funds, and insurance policies.

The blanket guarantee protected depositors' funds in licensed deposit-taking institutions, pension funds managed by authorized institutions, and policyholders' funds in insurance companies. The 1999 FINSAC Annual Report stated that the blanket guarantee protected JMD 68 billion in deposits, JMD 19 billion in pension fund value, and JMD 174 billion in individual insurance policies. This amounted to JMD 262.1 billion in protected liabilities (Bonnick 1998; Rattray 1999).

10. Fees: There were no fees associated with the blanket guarantee.

Jamaican authorities did not impose any fees in connection with the blanket guarantee.

11. Process for Exercising Guarantee: FINSAC placed matching funds in replacement accounts at stable institutions.

FINSAC exercised the blanket guarantee when it liquidated a failing financial institution and wound down its operations. For the eight instances in which FINSAC closed deeply troubled financial institutions, FINSAC took on the liabilities of that institution that were covered by the blanket guarantee. FINSAC exercised the guarantee by placing matching funds in replacement accounts at a stable institution. This ensured that depositors and pensioners had uninterrupted access to their funds (Bonnick 1998; Kirkpatrick and Tennant 2002).

12. Other Restrictions: FINSAC required the banks that it liquidated to obtain permission for various actions.

After taking over the deposit liabilities of two merchant banks, FINSAC required the two banks to receive FINSAC's permission before paying debts, purchasing or selling assets, paying shareholders or directors, or making any payments outside the normal course of business (FINSAC 1998a; 1998b).

13. Duration: The blanket guarantee ended with the introduction of a deposit insurance scheme administered by the Jamaica Deposit Insurance Corporation (JDIC).

The government did not originally set an end date for the blanket guarantee but intended for FINSAC to exist for five to seven years. On August 31, 1998, the Deposit Insurance Act created a limited deposit insurance scheme, replacing the blanket guarantee (Deposit Insurance Act 1998; FINSAC n.d.; IADI 2005).

The Deposit Insurance Act established the Jamaica Deposit Insurance Corporation (JDIC) and empowered it to administer the deposit insurance scheme. The JDIC called for every financial institution to apply for the insurance scheme and pay an initial premium. The deposit insurance scheme charged an annual fee calculated based on the characteristics of each individual institution. The scheme initially covered eligible depositors up to JMD 200,000 per account. The government gradually increased the insured amount; it was JMD 1.2 million as of 2020 (Deposit Insurance Act 1998; JDIC n.d.).

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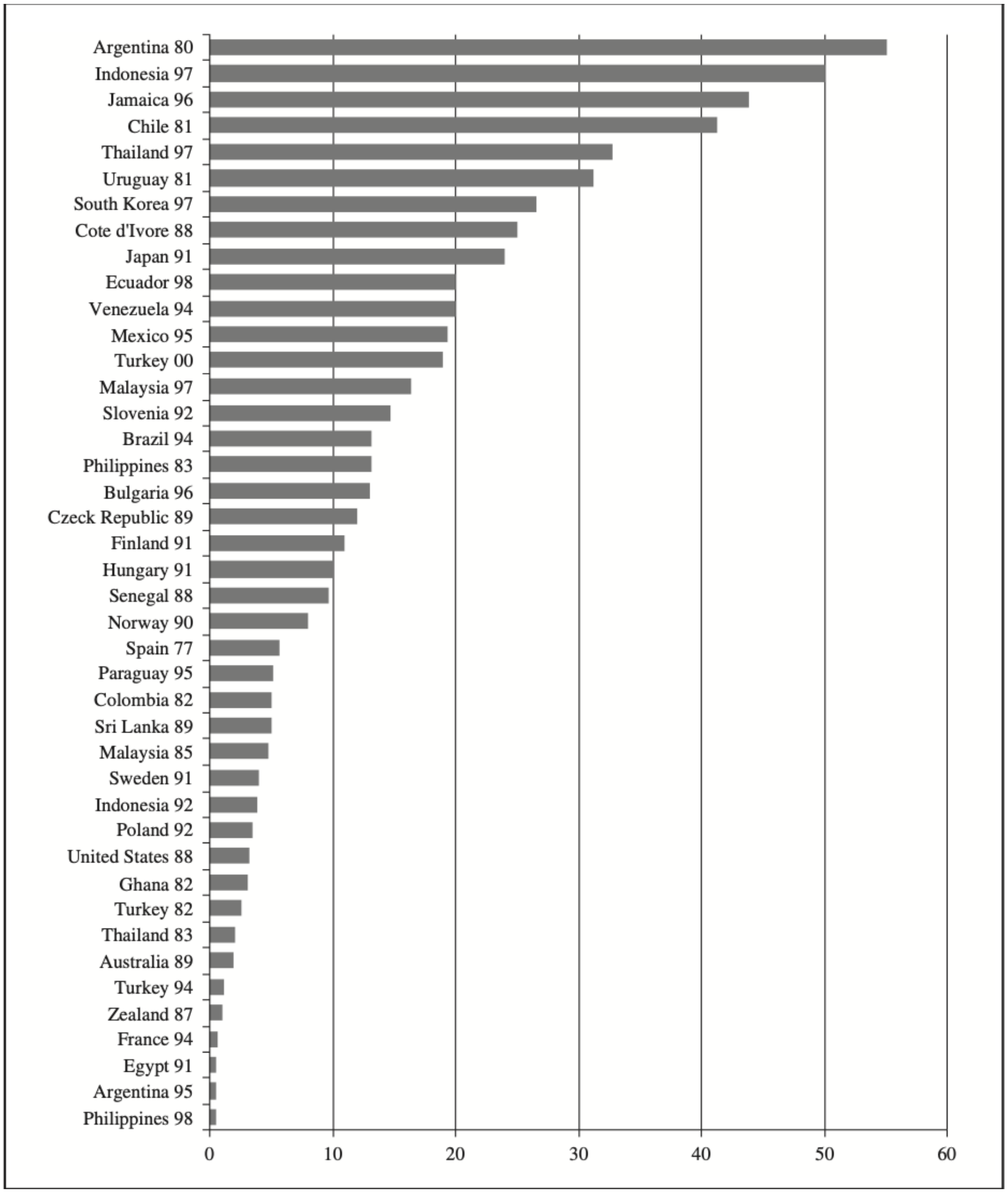
Appendix

Figure 1: Fiscal Costs of the 1997 Jamaican Banking Crisis Relative to Other Countries (as a % of GDP)



Source: World Bank 2004, 88.