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IMPLEMENTATION COMPLETION REPORT
(FSLT-71500)

ON A

LOAN

IN THE AMOUNT OF US$ 75 MILLION

TO

JAMAICA

FOR A

SECOND BANK RESTRUCTURING AND DEBT MANAGEMENT PROGRAM
ADJUSTMENT LOAN

June 30, 2003

Caribbean Country Management Unit
Finance, Private Sector, and Infrastructure Department
Latin America and the Caribbean Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective June 26, 2003)

Currency Unit = JMD
1.00JMD = US$ 0.017009
US$ 1.00 USD = 58.7935 JMD

FISCAL YEAR
April 1 March 31

ABBREVIATIONS AND ACRONYMS

BOJ	Bank of Jamaica (Jamaica's Central Bank)
BRDP	Bank Restructuring and Debt Management Program
CAN	Country Assistance Note
CAS	Country Assistance Strategy
FINSAC	Financial Sector Adjustment Company Limited
FIS	Financial Institutions Services
FSC	Financial Services Commission
FY	Fiscal Year
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IFI	International Financial Institution
IMF	International Monetary Fund
LOJ	Life of Jamaica
LRS	Locally Registered Stock (Treasury bonds)
MOF	Ministry of Finance & Planning
MOU	Memorandum of Understanding
NCB	National Commercial Bank
NPLs	Non Performing Loans
RBTT	Royal Bank of Trinidad & Tobago
SMP	Staff Monitored Program

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JAMAICA
Implementation Completion Report
Second Bank Restructuring & Debt Management Program Adjustment Loan

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Project ID: P073756	*Project Name:* Second Bank Restructuring and Debt Management Program Adjustment Loan
Team Leader: Yira J. Mascaro	*TL Unit:* LCSFF
ICR Type: Core ICR	*Report Date: June 30, 2003*

1. Project Data

Name:	Second Bank Restructuring and Debt Management Program Adjustment Loan	*L/C/TF Number:*	FSLT-71500
Country/Department:	JAMAICA	*Region:*	Latin America and Caribbean Region

Sector/subsector: Banking (75%); Non-compulsory pensions, insurance and contractual savings (20%); Capital markets (5%)

Theme: State enterprise/bank restructuring and privatization (P); Regulation and competition policy (P); Legal institutions for a market economy (P); Debt management and fiscal substainability (P); Standards and financial reporting (S)

KEY DATES

			Original	*Revised/Actual*
PCD: 07/05/2000		*Effective:*	11/04/2002	
Appraisal: 02/05/2000		*MTR:*		
Approval: 10/24/2002		*Closing:*	12/31/2002	

Borrower/Implementing Agency: JAMAICA/MINISTRY OF FINANCE AND PLANNING

Other Partners:

STAFF	Current	At Appraisal
Vice President:	David de Ferranti	David De Ferranti
Country Director:	Caroline D. Anstey	Orsalia Kalantzopoulos
Sector Manager:	Fernando Montes-Negret	Fernando Montes - Negret
Team Leader at ICR:	Yira Mascaró , P.S. Srinivas	Yira Mascaró , P.S. Srinivas
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2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

Outcome: S

Sustainability: L

Institutional Development Impact: SU

Bank Performance: S

Borrower Performance: S

	QAG (if available)	ICR
Quality at Entry:		S
Project at Risk at Any Time:	No	

3. Assessment of Development Objective and Design, and of Quality at Entry

3.1 Original Objective:

The broad medium-term goals of the Government's Bank Restructuring and Debt Management Program (BRDP): The primary objectives of the Government's BRDP were to resolve the financial sector crisis and thereby contribute to placing the economy on a growth path, take steps to reduce the vulnerability of the financial system to future crises, and to restructure and manage the public debt arising from the financial crisis. Recognizing that macroeconomic stability was essential to the achievement of the above objectives, the Government articulated an overall macroeconomic framework aimed at placing the country's overall debt level as well as its dynamics on a sustainable path. The above objectives were to be achieved through: (a) Sale/restructuring/resolution of all intervened financial institutions in which the crisis management agency (FINSAC) had majority equity stakes; (b) Disposal of the entire portfolio of non-performing loans (NPLs) and other assets acquired in its intervention and rehabilitation stage; (c) Government take over of all outstanding FINSAC obligations and servicing these in cash; and (d) Strengthening the legal, regulatory, and supervisory framework for both banks and non-bank financial institutions. It was understood that these objectives would be achieved in a phased manner.

Objectives of the first phase of the BRDP supported by the Bank's first loan in November 2000: The overall objective of the first BRDP loan was to support the first phase of the Government's actions in achieving the above medium term objectives. The loan supported specific actions taken by the Government prior to Board presentation of the loan in the implementation of its BRDP. Specifically, the first loan supported (i) the sale of Union Bank (UB); (ii) significant progress in restructuring the other two remaining intervened institutions –National Commercial Bank (NCB) and Life of Jamaica (LOJ), the largest domestic commercial bank and the largest insurance company in Jamaica, respectively; (iii) the development of a strategy for disposing of its portfolio of NPLs as well as progress in disposal of FINSAC's portfolio of other assets; (iii) the Government's commitment to restructure FINSAC debt and service all remaining FINSAC obligations in cash beginning April 1, 2001; and (iv) progress in strengthening the legal, regulatory, and supervisory framework for both banks and non-bank financial institutions.

Objectives of the second phase of the BRDP supported by the Bank's second loan in October 2002: The overall objective of the second BRDP loan was to support Government actions aimed at largely completing the resolution of the financial sector crisis in Jamaica and thereby achieving the medium term objectives mentioned above. The second loan supported the following specific actions taken by the Government prior to Board presentation: (i) Sale of NCB and LOJ; (ii) Resolution of entire portfolio of NPLs through realization/sale; (iii) Sale of a significant portion of the portfolio of other assets; (iv) Winding down of FINSAC's operations; (v) Continued strengthening of the regulatory and supervisory framework for banks and non-bank financial institutions; (vi) Continued implementation of the Government's debt management strategy; and (vii) Strengthening the infrastructure of the Jamaican financial system by creating the legal framework to permit the operation of credit bureaus.

Overview:

Before proceeding further in the report, it is critical for readers to have a broad perspective of the overall situation in Jamaica as well as of the Bank's loans to the financial sector. The objective of this short section is to provide such an overview.

Jamaica's financial sector faced a systemic crisis in the mid/late 1990s in which much of the domestically owned financial sector became insolvent. In terms of fiscal cost of the crisis as a percentage of GDP – estimated at over 40 percent - it was one of the costliest financial sector crises in the world. In terms of the speed with which the crisis was resolved, it was one of the fastest. Within five years of the creation of the crisis resolution agency, the vast majority of assets acquired by the public sector through intervention had been sold, regulation and supervision strengthened, costs of crisis resolution explicitly taken on to the Government budget, and the financial sector completely restructured as well as placed on a path to enable it to support future economic growth.

The Bank provided two loans of US$75 million each to Jamaica in 2000 and 2002 to assist the Government in its actions aimed at resolving the crisis. It worked closely with the Fund, the Inter-American Development Bank

(IDB), and the Caribbean Development Bank (CDB) in designing its assistance. Overall, the design, preparation, implementation, supervision, and achievements of both Bank loans were satisfactory. The commitment of the Government to the program of crisis resolution was also satisfactory and commendable. It would be a fair assessment that viewed from the perspective of their impact on the financial sector as well as in terms of restructuring the debt arising from the crisis the loans were largely successful.

However, despite the fact that the financial sector itself has been cleaned up and institutional strengthening achieved to enable the sector to be far more robust in the future, it is extremely difficult, at this stage, to make a categorical determination regarding the sustainability of the achievements under the loans. In all its documents relating to the loans to the financial sector as well as several assessments of the Bank's first loan, and the CAS and its update, the Bank has repeatedly highlighted macroeconomic instability as the major risk that could adversely affect continued financial sector stability. In both loans, the Bank recognized these risks, as well as the fact that it was not realistically possible for the Bank's loans to address all risks and mitigate them completely. Despite the risks, the Bank believed it was worth supporting the Government's program, in order to play a constructive role in moving the process of resolution of the financial sector crisis towards completion and thereby attempt to achieve higher economic growth in Jamaica. The Bank was also of the view that not supporting Jamaica in its efforts at restructuring the financial sector might expose the country to even greater risks were macroeconomic instability to occur in the future. The Bank felt that a restructured financial sector largely in private hands, operating under a sound regulatory and supervisory framework, with liquid assets providing the sector the ability to contribute to economic growth would be better suited to dealing with evolving macroeconomic scenarios than a largely publicly owned financial sector operating under a weak regulatory and supervisory framework and with assets dominated by illiquid FINSAC bonds. The former is the scenario prevailing currently after the actions taken by the Government and supported by the Bank's two loans, and the latter was the scenario prevailing prior to the Bank's two loans. It was in this overall context that the Bank supported Jamaica.

Despite the Government's commitments to contain its overall public sector debt and fiscal achievements that are commendable, Jamaica's public sector debt/GDP ratio – after a period of relative stability - has recently begun to grow again. In addition, and partly as a result of the large debt burden, recent events indicate that, as of the date of this report, Jamaica is facing a period of increased macroeconomic stress. If the macroeconomic situation creates difficulties for the Government in servicing its large debt, the financial sector would be directly and rapidly adversely impacted. The key reason for this is that the continued strength of the financial sector depends critically on the assumption that the Government continues to satisfactorily service its large debt burden. The Government's financial sector restructuring program has been largely successful in placing the sector on a path to recovery. However, this was achieved by placing a large amount of Government debt in the sector, thereby raising its exposure to Government credit risk. Government bonds form about a third of commercial banks' and insurance firms' asset portfolios. As long as the Government continues to service its obligations, the financial sector is likely to remain relatively sound. However, if the Government has difficulty servicing its debt, the quality of bank assets will almost certainly rapidly erode, with concomitant adverse impact on banking system soundness. Clearly, the financial sector in Jamaica has become more resilient after Government actions that were supported by the Bank's loans. The key issue that remains unclear at this stage is whether the system is resilient enough to withstand the impact of any further fiscal pressures that may be faced by the Government.

Therefore, it is important to keep in mind that while the Bank's loans supported actions that were successful in restructuring the financial sector and managing the public debt arising from the crisis, adverse macroeconomic developments in the short/medium term driven in large part by an extremely high overall public debt burden, could undo many of these achievements.

Context:
In 2000, the Bank agreed to provide Jamaica with a series of two programmatic adjustment loans aimed at assisting the Government in the implementation of its BRDP. The overall objective of the two loans was to support, in a phased manner, the Government's BRDP aimed at completing the resolution of the financial crisis that started in the mid-1990s, strengthening the regulatory and supervisory framework of the financial sector to make it less vulnerable to future crises, and restructuring the public debt arising as a result of the crisis. The two-loan approach was chosen in order to create a flexible framework within which the Bank could assist Jamaica. In November 2000,

the Bank provided Jamaica with the first of the two programmatic adjustment loans with a clearly defined set of objectives that went part of the way towards achieving the overall objective of the BRDP. The current loan – approved in October 2002 **-** was the second in the series and was aimed at assisting the Government in its efforts at taking its BRDP to completion.

In the mid-1990s, Jamaica faced a systemic financial crisis with solvency and liquidity problems in virtually the entire domestically owned banking and insurance sectors. As described in the President's Reports of the two loans (Report Nos. P7397 JM and P7527 JM), the crisis was largely attributable to rapid financial sector liberalization that was not complemented by a sufficiently robust prudential and regulatory infrastructure and strong enforcement. This enabled risky investment and lending operations by a large number and variety of new financial institutions. In particular, insurance companies raised funds through deposit-like instruments disguised as insurance premiums, and invested the same in real estate, stocks, and securities. As the Government's macroeconomic policies aimed at containing high inflation led to high interest rates and the prevailing real-estate bubble burst, insurance companies faced liquidity problems and tapped mostly their related banks for funds. This transmitted liquidity problems to banks, triggering the crisis. Facing systemic insolvency, the Government placed a universal guarantee on deposits, provided liquidity to weak banks through extensive overdraft facilities from the central bank (Bank of Jamaica, or BOJ), and established a failure resolution agency –The Financial Sector Adjustment Company (FINSAC)— to intervene, rehabilitate, and divest troubled financial institutions. The Government also started a process of strengthening the regulatory and supervisory framework, aimed at reducing the vulnerability of the financial system to future crises.

Although the Government contained the crisis, the stabilization of the financial sector came at a substantial cost. Being cash constrained, FINSAC had issued non-tradable Government guaranteed bonds (on which interest was capitalized) to intervened financial institutions in exchange for non-performing assets or equity stakes. The ensuing rapid growth of FINSAC debt worsened as interest rates continued to rise, leading to a stock of debt of J$143 billion as of March 2001 (about 44 percent of GDP). This added to an already large pre-crisis public debt burden of about 100 percent of GDP, leading to an extremely high overall level of debt as well as to adverse debt dynamics.

The Government recognized the urgent need to resolve the crisis and contain the adverse debt dynamics in order to restart economic growth. Although costly and difficult to achieve, cash interest payments on FINSAC bonds became a central component of the Government's strategy to complete the resolution of the crisis. By restoring liquidity to the financial system and disposing of the Government's equity stakes in a large share of the system, a financial, as opposed to an accounting, resolution of the crisis was attempted. The Government approached the Bank, the IDB, and the CDB, for funds that would support this strategy. With the support of these International Financial Institutions' (IFI's) loans to retire a portion of FINSAC paper, the Government expected to improve the profile of its debt, by replacing high-cost short-term domestic debt with cheaper, longer-maturity, international (dollar-denominated) debt. The Government also requested IFI support in formulating a strategy for resolution of the crisis and strengthening the financial sector in order to reduce the vulnerability of the system to future crises. The overall strategy formulated by the Government with IFI support involved a phased approach to crisis resolution.

The Bank approved a US$75 million in November 2000 and disbursed it in full in December 2000 to support the first phase of the Government's program. The loan was part of a programmatic approach in which the Bank envisioned providing a second loan (to which this document pertains) of an equivalent amount to support the second phase of the Government's program. The IDB approved a two-tranche loan for US$150 million in September 2000 and disbursed the first tranche shortly thereafter. Faced with the external shocks of late 2001 – mainly the adverse impact of the events in the US of September 11, 2001, the IDB responded to the Government's request for funds by formally splitting the second tranche into two components of US$40 and $35 million each. The first component of the second tranche for US$40 million was disbursed in March 2002. In response to this emergency situation, the Bank provided Jamaica with emergency assistance (not related to actions in the financial sector) of US$ 75 million. The CDB approved a US$25 million loan, all of which has been disbursed. The CDB also approved an additional US$4 million for ongoing technical assistance.

The Government provided the macroeconomic underpinning for these loans through two Staff Monitored Programs (SMPs) with the IMF. The first SMP covered the two-year period April 2000 to March 2002, (IMF Document No. EBS/00/152) and the second SMP (Country Report No. 02/197) covered the period April 2002 to March 2003. In these SMPs, the Government committed itself to tight fiscal policies to generate large primary surpluses for the medium term that would enable it to service its debt. As of the date of the approval of the Bank's second loan, Fund staff had assessed Jamaica's performance under the SMP to be "broadly on track" and the Bank's CAS update had agreed with this assessment. However, both assessments had highlighted that the macroeconomic situation was still extremely fragile and subject to high risk.

Assessment**:** The overall two-loan programmatic structure of the Bank's loans in support of the Government's BRDP was appropriately designed with clear objectives suited for single tranche operations. Both loans supported up-front actions that were taken before presentation of the loans to the Bank's Board and both loans were disbursed fully upon effectiveness. An assessment of the first loan in greater detail is provided in the Implementation Completion Report (ICR) of the first loan (report No. 23336) distributed to the Board in December 2001. As far as the second loan is concerned, its objectives were fully consistent with the Government's policy agenda, as outlined in several budget presentations of the Government to the Jamaican Parliament during 2000-02 as well as laid out in the two SMPs of the Fund. In addition, the two BRDP loans were the central components of the Bank's Country Assistance Strategy (CAS, Report No. 21187, November 2000). An update of the CAS reinforced the importance of the second BRDP loan and was discussed by the Bank's Board together with the President's Report of the second loan in October 24, 2002. The objectives of the second loan were therefore fully aligned with those of the CAS as well as its update. As mentioned above, the Government's overall program was also supported by an IDB two-tranche loan for US$150 million approved on September 2000 and by a CDB US$25 million loan also approved in September 2000. As noted in earlier Bank documents, the total amount of US$ 150 million provided by the Bank under the two loans – was only a small part of the overall cost of the crisis. The Bank's two loans contributed to the restructuring of only about 5 percent of the overall debt incurred by the Government as a result of its interventions during the crisis. However, while the financial contribution of the loans – relative to the total cost of the crisis - was modest, the loans' impact lay in their support of significant structural reforms in the financial sector undertaken by the Government.

3.2 Revised Objective:

Loan objectives remained unchanged.

3.3 Original Components:

As discussed above, the second BRDP loan was designed as the second loan of a series of two single-tranche adjustment operations under a programmatic approach supporting the second phase of the Government's BRDP. The components included specific actions and commitments in the following areas:

Resolution of financial institutions: A key component of the Government's overall program was the sale/resolution of the three major intervened institutions. The first BRDP loan supported the sale of Union Bank as well as certain critical initial steps necessary in order to achieve the ultimate sale of NCB and LOJ. The second loan supported the sale of FINSAC's majority equity stakes in both these institutions. As of January 2002, FINSAC had no majority equity stakes in any financial institution in Jamaica. The responsibility of disposing of the Government's minority (and relatively small value) equity stakes in a few other financial institutions was handed over to Financial Institutions Services (FIS) – another public agency - upon the closure of FINSAC's operations.

Asset Disposal- Portfolio of Non-performing Loans: The first loan supported the formulation of a strategy for the full disposal of NPLs acquired by FINSAC. Under the second loan, FINSAC disposed of its entire portfolio of NPLs to a foreign bank.

Asset Disposal- Portfolio of Other Assets: A large part of intervened bank portfolios was concentrated in real estate – either as assets financed through loans or as collateral. FINSAC therefore became the owner of numerous real estate assets (such as hotels, commercial and residential real estate, furniture & equipment, artwork, and motor vehicles) and other non-core assets. The first loan supported FINSAC's efforts in continuing the disposal of these assets, under a plan acceptable to the Bank. Under the second loan, FINSAC disposed of about 98 percent of its total residential properties and 75 percent of total commercial properties as of the end-July 2002. It also sold J$3.9 billion in other assets (including motor vehicles, artwork, furniture and equipment etc.).

Winding Down of FINSAC: With the completion of FINSAC's responsibilities of intervening and rehabilitating crisis-hit institutions and subsequently, disposing of its majority equity stakes in intervened institutions, the Government closed FINSAC operations as of July 2002.

Strengthening the financial infrastructure in Jamaica: An important component of the infrastructure of a modern financial system is a centralized credit bureau through which relevant information of debtors would be available to financial institutions and other third parties, with adequate safeguards for protection of privacy. A centralized credit bureau does not yet exist in Jamaica. As part of the actions supported by the proposed second loan, the Government drafted a bill for the enactment of a Credit Reporting Act, which will provide the regulatory framework for the establishment of Credit Bureaus in Jamaica.

Strengthening of Regulation and Supervision of the Financial Sector: The Bank's first loan supported a concrete set of Government actions aimed at strengthening the regulatory, legal, and supervisory framework of the financial sector. Details of these actions are available in the two President's Reports of the loans as well as the ICR of the first loan. The second loan supported further actions in this area. Specifically: (i) relevant legislation was amended to strengthen specific weaknesses identified in BOJ's compliance with the Basle Core Principles (relating to consolidated supervision and remedial measures); (ii) amendments to various statutes were introduced to strengthen the independence of the BOJ; (iii) BOJ continued to undertake actions to clarify and increase transparency of its supervision of the banking sector; and (regarding supervision of non-banking sector) (iv) the new Insurance Act was enacted and the Financial Services Commission (FSC) --new regulatory agency for the non-banking sector-- established and is functioning; and (v) the FSC has undertaken steps to strengthen its institutional capacity, including putting in place a framework for risk based supervision and training its staff to conduct such supervision.

Implementation of the Government's Debt Management Strategy: The Bank's loans focused primarily on supporting Government actions to be taken for prudent management of the debt arising from the interventions in the financial sector and its management in a manner conducive to the development of the restructured financial sector. The Bank's loans did attempt to address the overall public sector debt (beyond the narrower issue of the debt arising from the financial crisis) and its management, although this was not the primary focus of the Bank's loans. The Government satisfactorily implemented its commitments – made under the first loan - to convert all outstanding FINSAC securities at intervened financial institutions into government debt and began servicing them in cash. As discussed in the ICR of the Bank's first loan in support of the BRDP, as well as the President's Report of the Bank's second loan, there were delays experienced in addressing FINSAC debt at the BOJ. This portion of the debt was restructured prior to the approval of the Bank's second loan although the agreement between the Government and the BOJ is that Government bonds that replaced FINSAC paper will continue to accrue interest until 2007/08. Although the Government did not meet its commitment – made in the first loan - of keeping the overall public debt (in Jamaican dollar terms) on a declining path from its level in 2000, deviations from this level were explained in the 2001 Article IV and revisions to the first SMP in mid-2001. The Government also committed to a revised macroeconomic scenario in the second SMP approved in 2002 in which it outlined measures to tackle the shocks experienced in 2001. Prior to the approval of the second loan, the Fund assessed the Governments macroeconomic performance – including its debt management – to be broadly on track and the Bank, in its CAS update agreed with this assessment. In its Letter of Sector Development Policy, the Government reaffirmed its commitment to manage its public debt in the short-, and medium-term and meet the structural benchmarks outlined in the SMP with the objective of placing Jamaica debt/GDP ratio on a sustainable path.

Assessment**:** The design of the second phase of the BRDP loan was sound and in line with achieving the overall objective of bringing the resolution of the financial sector crisis to completion. Under the loan, the Government essentially completed the sale of all major institutions in government hands as a result of interventions during the crisis, sold the entire portfolio of non-performing loans and other non-core assets, closed the operations of FINSAC, and took specific and relevant steps to further strengthen the institutional framework and thereby reduce the vulnerability of the system to future crises. Through the conversion of illiquid FINSAC paper at intervened financial institutions to tradeable government bonds, the Government explicitly recognized the fiscal cost of the crisis. Simultaneously, the banking system was provided with the necessary liquidity to enable it to resume lending that could contribute to increased economic growth. The loan also incorporated actions and commitments aimed at reversing the adverse debt dynamics facing Jamaica. The Government's satisfactory macroeconomic performance under two SMPs formed the basis of its commitment to fiscal policies that could reverse the adverse debt dynamics.

3.4 Revised Components:

The loan components remained unchanged.

3.5 Quality at Entry:

Quality at entry was Satisfactory. The loan's objectives were consistent with both the Government's medium-term goals and the Bank's CAS. The loan's objectives were also in line with the overall direction for the programmatic approach formulated in the first loan in support of the Government's BRDP. The design of the loan clearly incorporated lessons learned from the Bank's previous experience in Jamaica (and Mexico). Prior to the two Bank loans in support of the Government's BRDP, the Bank's experience with adjustment lending to Jamaica had been mixed. In some previous adjustment operations, not all the agreed upon actions had been satisfactorily implemented. The client's view was that the operations were over-designed and lacked flexibility while the Bank's view was that there was not enough ownership of agreed upon reforms by the Government. Both the Bank's loans in support of the BRDP incorporated these lessons. Reform actions that were supported by the loans were fully implemented by the Government prior to Board consideration of the loans. The timing of the loans and close coordination and policy dialogue with the Government ensured that the loans supported actions that had strong Government ownership and commitment. Similar to the first loan, the design of the second loan as a single tranche loan with up-front actions for effectiveness provided a flexible framework within which to address changing circumstances.

4. Achievement of Objective and Outputs

4.1 Outcome/achievement of objective:

As stated above, the overall objectives of the Government's BRDP were to resolve the financial sector crisis and thereby contribute to placing the economy on a growth path, take steps to reduce the vulnerability of the financial system to future crises, and to restructure and manage the public debt arising from the financial crisis. The Bank's loans were aimed at supporting this overall Government BRDP.

The implementation experience of the second BRDP loan has been Satisfactory as the loan supported specific actions – that are hard to reverse - taken prior to Board presentation aimed at addressing all of the above objectives. In terms of completing the resolution of the financial sector, the Government sold its majority stake in the two remaining large intervened financial institutions to foreign private investors. The Government currently has only minor (and low value) equity stakes left in the financial sector (which it is in the process of disposing of) and has no controlling stakes in any institution. In terms of reducing the vulnerability of the system to future crises, the Government has enacted new legislation, strengthened existing regulatory and supervisory agencies in the banking sector, established a new regulatory entity for the non-bank sector (FSC) and is in the process of strengthening this new agency. In terms of restructuring of the public debt arising from the crisis, the large stock of illiquid FINSAC debt was converted into tradeable Government bonds. There were no FINSAC bonds outstanding in Jamaica as of the date of approval of the Bank's second loan. The primary advantage of this action was to provide liquidity to the restructured financial sector to enable it to be in a position to resume lending and contribute to economic growth. In the process, this action also made the fiscal cost of the crisis explicit and thereby contributed to imposing the necessary discipline on the Government in servicing this debt. Therefore, viewed from the perspective of achieving the overall objectives of the BRDP, the loan was successful.

However, as mentioned above, the Government had also committed to a macroeconomic framework within which it was expected that the overall public debt of the Government would be placed on a sustainable path. Satisfactory implementation of this framework would have provided the necessary basis for sustainability of the achievements under the Bank's loans. Despite a period of relative stability of the debt/GDP ratio during 2000-02 –, in recent months since the approval of the second loan it has become apparent that the Government has not been able to reverse the increasing trend of the debt/GDP ratio, although its significant fiscal efforts have been commended by the Bank's CAS in 2000, the CAS update in 2002, as well as the two SMPs of the Fund. From a level of about 131.2 percent of GDP estimated at the time of approval of the first loan, and a level of about 130 percent of GDP estimated at the time of approval of second loan, the debt/GDP ratio has risen to about 150 percent of GDP currently – instead of declining as projected in SMPs as well as the Bank's CAS. As discussed in more detail in Section 6 below, it seems that it will be extremely difficult to ensure that the debt/GDP ratio does not rise further beyond this already high level, except in fairly narrow set of economic scenarios. Therefore, viewed from the perspective of its ability to positively impact the Government's overall debt situation and its management, the achievements of the second loan have been limited.

The evolution of the public debt remains the major risk faced by the Government's BRDP and the Bank's programmatic series of loans in support of the program. The greatest risk to financial sector stability that has been repeatedly highlighted in Bank documents as well as clearly understood by the Government is the Government's overall macroeconomic performance. In the process of restructuring the financial sector, the Government replaced non-performing loans at banks with Government bonds. About a third of all banking sector assets in Jamaica are Government bonds (and close to half for RBTT and NCB). As long as the Government continues to service these bonds in full, on time, and in cash, the financial sector can reasonably be expected to be stable and the achievements of the two BRDP loans sustained. If, however, Government macroeconomic performance deteriorates and it is unable to service its debt in the banking system, the quality of banking system assets can erode rapidly potentially leading to another systemic crisis. The cause of such a crisis, however, would be the Government macroeconomic performance and not the inherent structure, regulation, and supervision of the financial system – all of which have improved substantially due to Government actions that were supported by the Bank's two loans.

It is however important to note that despite the prevailing macroeconomic situation and despite the significant risks faced, the banking sector is far better placed now to handle any stresses and support private-sector led growth as compared to the situation that might have prevailed had the actions supported by the Bank's two loans not been taken by the Government. **Government debt as a percentage of total assets at NCB and RBTT (formerly Union Bank) has declined from 61 and 78 percent, respectively, in September 2000 --prior to the first BRDP loan, to 49 and 45 percent, respectively as of March 2003.** Also, the Government's actions since the crisis have placed the banking and insurance sectors almost entirely in private hands – with the largest financial institutions being foreign owned. The regulatory and supervisory structure has been significantly strengthened. Illiquid FINSAC debt in the intervened financial institutions has been replaced by tradeable Government bonds, thereby providing liquidity to the financial system to support economic growth through increased lending. As a result of these actions, the financial sector is now more robust and profitable than it was prior to these actions being taken by the Government. The banking system is in a much better position now to weather any shocks that may occur in the future. Large players in the financial system (mostly commercial banks) are now in a position to potentially be a part of a solution to any future macroeconomic problems as compared to them being part of the problem prior to the actions taken by the Government under its BRDP. **Therefore, while it is important to recognize that the macroeconomic situation does pose significant risks to the sustainability of the achievements in the financial sector, it is also important to recognize that the Government's actions supported by the Bank's loans have significantly strengthened the ability of the financial sector to withstand stresses.**

4.2 Outputs by components:

Following the structure of the second BRDP loan as a single-tranche adjustment lending operation, the actions were completed prior to Board presentation. As a condition of effectiveness, the Borrower took the key actions described in section 4.3. Evidence of the Borrower's compliance with all of the loan conditions is provided in

Annex 8 of this report.

Resolution of financial institutions:

National Commercial Bank- FINSAC sold its entire majority shareholding in NCB in January 2002 to a subsidiary of AIC Limited – the 11th largest mutual fund in Canada – for a total consideration of US$ 125 million (the net asset value of the bank as of September 2001). The BOJ reports that NCB is performing satisfactorily, with higher asset quality, increasing share of lending to total assets, lower share of Government securities to total assets, and higher profitability. As of December 2002, NCB has a market share of commercial bank assets of 38 percent, similar to its share in 2001.

Life of Jamaica- FINSAC sold its entire majority shareholding in Life of Jamaica in November 2001, to a subsidiary of Barbados Mutual Assurance Society for US$ 41 million. The FSC reports the LOJ is performing satisfactorily, reflecting the major restructuring process undertaken through its sale, as supported by preliminary on-site supervision results. LOJ is also in the process of merger with Island Life. As of December 2002, LOJ has a market share of total life insurance assets of 16 percent, similar to its share in 2002. Once the merger is completed, its market share could increase to 22 percent (including the current market share of Island Life).

Asset Disposal- Portfolio of Non-performing Loans:

FINSAC acquired a non-performing loan portfolio of J$74 billion (face value of J$33 billion along with accrued interest) from intervened financial institutions. FINSAC established a workout unit to manage this portfolio and attempt its recovery. By August 2001, this unit had recovered about J$5.7 billion. As part of the actions supported by the second loan, the balance of the portfolio was sold to a subsidiary of Beal Bank of Texas in January 2002. The Government received a down payment of US$23 million (about J$1.1 billion), and the sale is structured so that the government shares in the recoveries actually made by the purchaser are according to the following schedule: 15 percent of the first US$50 million recovered, 25 percent of the second, 35 percent of the third, 45 percent of the fourth, and 50 percent of the remainder. Based on cash flow projections for the next 3-4 years (following the sale) where the buyer expects to collect approximately US$215 million in gross proceeds, total estimated income for the Government is about US$90 million. This would result in a recovery rate of about 22 cents per dollar face value of NPLs. As of May 2003, FINSAC's total recoveries amounted to about US$27.3 million (about J$1.3 billion).

Asset Disposal- Portfolio of Other Assets:

Under the first loan, by August 2001, FINSAC had sold J$11 billion of other assets it had acquired. As part of the actions supported by the second loan, FINSAC made further progress in this area, with total sales of J$15 billion. It sold 98 percent of the portfolio of residential properties – realizing a total amount of J$0.5 billion. It disposed of J$10.6 billion of commercial properties (including freehold land, industrial assets, & hotels) accounting for about 75 percent of the total. Out of six hotels it had acquired, FINSAC sold four, entered into a lease agreement for another hotel with an option to buy (by end-2003), and put the remaining hotel under a long-term management contract with an international private hotel management firm. As of May 2003, the Government had also sold J$3.9 billion in other assets.

Winding down of FINSAC

With the completion of FINSAC’s responsibilities of intervening and rehabilitating crisis-hit institutions and subsequently, disposing of its majority equity stakes in intervened institutions, the Government closed FINSAC operations as of July 2002. The winding down of FINSAC had a significant positive signaling effect of indicating the end of a crisis and the beginning of a new era with stronger financial institutions. The management of the Government’s minority stakes in intervened institutions as well as the responsibility of completing the legal procedures required to formally close down institutions that have already ceased operations have been transferred to FIS. At the time of approval of the second loan, the Government had minority equity stakes in three institutions. The Government has since divested FINSAC’s minority equity stakes of 26 percent in Island Life, exchanged

US$8.25 million of preferred shares in Victoria Mutual Building Society (VMBS) for Government bonds, and is proceeding with the divestment of stakes of 26.5 percent in Dyoll Insurance Co. In addition, progress has been made in legally closing down the many subsidiaries of the financial institutions that FINSAC had acquired. Most of the remaining actions in this area are procedural and in some cases, the final resolution of some of the companies will be protracted, as there are legal and administrative issues surrounding them. The gross financial exposure of the Government on account of these remaining ownership stakes is small.

Strengthening of the Financial Infrastructure in Jamaica

An important component of the infrastructure of a modern financial system is a centralized credit bureau through which relevant information of debtors would be available to financial institutions and other third parties, with adequate safeguards for protection of privacy. Such a bureau permits financial institutions to better manage credit risk exposures to borrowers as well as permits the supervisor to better monitoring credit risk of supervised entities. A centralized credit bureau does not yet exist in Jamaica. The Government (as well as the banking sector participants) recognized the importance of such an entity for the future growth and development of the Jamaican financial market. As part of the actions supported by the second loan, the Government drafted a Credit Reporting Act for the creation of Credit Bureaus in Jamaica and submitted it for public consultation prior to its presentation to Parliament. This draft Credit Reporting Act provides for the licensing of credit bureaus by the Minister of Finance, with prior recommendation of the BOJ. It also spells out the conditions and limits for the disclosure of information, the form and content of consumer information, as well as the offenses and penalties for breaching of the law. Credit bureaus, managed by the private sector, are to be considered as credit institutions, thus subject to the scrutiny of the BOJ, the FSC, and the MOF; managers and directors should comply with fit and proper provisions. The Government expects to send this Act to Parliament during 2003.

Strengthening of Regulation and Supervision of the Financial Sector:

The Bank's first loan supported several actions of the Government in continuing to strengthen that regulatory and supervisory regime for the financial sector in Jamaica. Since the approval of the first loan, the BOJ continued to further strengthen its supervisory capabilities and bring them in line with international best practice. It is widely acknowledged by supervised institutions that the scrutiny performed by the BOJ has dramatically improved since the crisis.

In line with its commitments to the Bank under the first loan, the BOJ undertook an independent assessment of its compliance with the Basle Core Principles (BCP) in 2001. The IMF led the assessment team with participation from staff of the Financial Services Authority of the UK and the Bank of Sweden. The assessment concluded that the BOJ was fully compliant with 11 principles, largely compliant with 8, materially noncompliant with 5, and noncompliant with 1. Thus, even prior to the approval of the second loan, Jamaica showed a satisfactory level of compliance with the BCPs. Areas of weaknesses identified by the assessment related to independence of bank supervisors, consolidated supervision, remedial measures (as impacted by BOJ's limited autonomy to take action), and market and country risks. In relation to market and country risk, the IMF-led team also acknowledged that work which had already proceeded apace under the BOJ's action plan arising from its earlier self-assessment would result in material upgrading in this area in the short term. Based on this assessment, the BOJ updated its earlier action plan and implemented specific proposals to address areas of weakness. The main actions undertaken by the BOJ included the drafting of prudential regulations on country risk, market risk and consolidated supervision as well as obtaining IMF-sponsored technical assistance initiatives on market risk and consolidated supervision. The technical assistance received included training of supervisory staff in the areas of market risk and consolidated supervision. The BOJ also undertook other training initiatives in the area of market risk, which had involved training of several senior examiners by the Federal Reserve Board, and specific assignments of such senior officers at Federal Reserve Banks on Market Risk examinations.

As part of the actions supported by the Bank's second loan, relevant legislation was amended to enable BOJ's compliance with two of the five BCPs (relating to consolidated supervision and remedial measures) in which Jamaica had been found to be materially non-compliant.

- The BOJ was granted the necessary powers to carry out consolidated supervision over banks and building societies, including extended jurisdiction over non-banking institutions integrated in banking groups. In addition, MOUs were signed among the two main financial supervisory agencies (BOJ and FSC), the Jamaica Deposit Insurance Corporation, and the Ministry of Finance, which gave legal underpinning to the formation of a coordinating body, the Financial Regulatory Council (FRC), chaired by the Governor of the BOJ. This Council commenced meetings in December 2000 and has issued reports to the Finance Minister;

- The BOJ was granted the power to require the restructuring of a group of companies to ensure that financial and non-financial activities are segregated in different sub-groups within an economic group so as to reduce the possibility of contagion;

- The BOJ was granted the power to require the segregation of non-banking activities in banks by the transfer of those operations to a separate corporate entity;

- The BOJ was given the power to impose penalties in cases of specified technical breaches of the banking statutes and the schedule of fines and penalties was upgraded;

- Powers of temporary management of deposit taking financial institutions were transferred from the Minister of Finance and Planning to the BOJ;

- The categories of exemptions to bank secrecy laws were extended to permit disclosure of information where it is in the specific bank's interest that the information be disclosed (example for the purposes of the acquisition of the bank by outside parties);

- The Minister of Finance was granted power to issue regulations relating to external auditors; and

- Deposit-taking institutions were prohibited to manage funds on behalf of clients.

To achieve compliance with the issue of independence of the supervisor, amendments to various statutes were introduced in March 2002 transferring from the Minister to the BOJ the power of temporary management; the Minister retains powers of approval and revocation of licenses, final determination on persons debarred from bank management, vesting the shares of an intervened institution and other regulation making powers. Similar to the reform of the process for determining fit and proper criteria pursuant to the granting of new licenses, the Minister is now also required to obtain the prior positive recommendation of the BOJ when authorizing the change of control of a deposit-taking institution or a banking group.

To achieve compliance with the two other core principles (relating to investment criteria and market risks) with which the BOJ was also materially non-compliant and, more generally, to strengthen the overall regulatory framework, the BOJ proposed the introduction of further amendments to legislation including: (i) streamlining the provisions relating to the acquisition of interest in deposit-taking institutions and introducing new definitions of "control", "subsidiary", "parent company", and "capital base"; (ii) requiring institutions to notify the BOJ of any proposed acquisition of any other company and prior to undertaking of any new type of business, with the BOJ reserving the right to veto such acquisition or undertaking; (iii) requiring shareholders of institutions to advise of any transaction which will increase a shareholder's holdings by incrementals of 5 percent or more, or will increase the shareholder's holdings to 20 percent, 50 percent or 75 percent or more of voting power or issued shares; requiring institutions to advise the BOJ of any investment or credit facility in excess of 5 percent of the capital base; and (iv) introducing a new definition of capital.

Further subsidiary regulations have been drafted by the BOJ to develop and implement the new supervisory approach. Thus, new regulations are expected to be approved in the near future regarding capital adequacy, credit classification and provisioning, qualifications of external auditors, and supervision of credit unions:

- Credit and Provisioning Regulations are expected to provide guidelines for the classification of the loan portfolio and will establish minimum provisioning requirements. Jamaican banks are already complying with these rules.

- Capital Adequacy Regulations are expected to enhance capital standards in Jamaica by introducing Tier I and Tier II capital. Jamaican banks already comply with the new requirements.

- Qualification of Auditors. These regulations are expected to specify the standards for external auditors, in terms of independence, experience, and academic professional qualification, and are expected to require prior notification to the BOJ of proposed appointments.

- Credit Union Regulations. These regulations are expected to prescribe prudential criteria and minimum solvency standards for credit cooperatives, as well as other essential rules regarding capital adequacy, prohibitions on certain areas of business, credit and provisioning, submission of financial statements and returns, remedial actions, etc.

The BOJ continued to update the "ladder of enforcement" (*"Guide to Intervention of Supervised Financial Institutions"*) that clearly spells out to the industry the supervisory approach of the BOJ, aimed at (i) recognizing areas of concern at an early stage, (ii) enabling prompt action to effectively contain the problems, and (iii) taking the appropriate steps to sort out the problems and minimize any systemic effects. This guide anticipates the conduct—including sanctions—of every financial sector regulator (BOJ, FSC, and JDIC) at the occurrence of certain events, and includes provisions for all types of supervised financial institutions.

These amendments have corrected the shortcomings in the present legal framework that prevented Jamaica from fully complying with the BCPs. Hereafter, compliance with the principles would be accomplished through progressive implementation of the new laws, including new regulations and supervisory procedures, which the BOJ has started to implement. Although currently banks in Jamaica are not largely exposed to country and transfer risk (BCP 11), the BOJ has issued to the industry a guidance document on such risks that is now in force. The industry has effectively implemented this standard and this will make Jamaica compliant with this particular BCP.

Strengthening of BOJ's supervisory work. The BOJ has continued to intensify its effort in bolstering the framework and methodologies utilized in the conduct of supervisory activities. These undertakings include the further development of on- and off-site supervision methodologies to (i) include consolidated supervision, as well as the supervision of operational and market risks; (ii) be prepared for taking over the supervision of credit unions; (iii) enhance the reporting regime to ensure consistency with the recently adopted International Accounting Standards; (iv) enhance the IT base to integrate off-site supervision with financial forecasting and better anticipate—thus be prepare to deal with—systemic weakness. The BOJ has also expanded its menu of training programs—independently or in collaboration with other institutions, such as CEMLA, the Bank of England, and the Federal Reserve—which include seminars on financial markets, risk control, and market risk analysis. In addition, the BOJ has incorporated anti-money laundering and anti-terrorist finance in its regular on-site work and is expected to shortly amend the Anti-Money Laundering Guidelines for the Financial Sector to incorporate the new legal requirements. Also, the BOJ chairs a Financial Crimes Legislative Task Force, responsible for making proposals for the rapid amendments or enactment of new legislation.

As discussed above, a Financial Regulatory Council has been formed to improve the coordination among supervisors of different type financial institutions and it has been meeting regularly (six times in 2002). The FRC facilitates sharing of information and aids in the process of harmonization of important regulations (risk-based capital adequacy, reporting requirements, reserve requirements, crisis-intervention policies) to reduce the possibility of regulatory arbitrage. Amendments to relevant laws to permit information exchange between supervisors have been approved by the Parliament.

The BOJ is committed to continue to strengthen the regulatory and supervisory framework. Apart from the proposed regulations mentioned above, progress is being made in updating the current on-site examination policy and on-site manuals to streamline the existing examination procedures and promoting market discipline.

With all the changes in banking laws and regulations introduced since the crisis, there is an acute need for consolidation and harmonization of the various pieces of legislation governing the deposit-taking system, amendments, and regulations so as to remove material inconsistencies, which now exist. Such consolidation would provide a clearer and cleaner framework for future operations of the banking sector. BOJ has already developed guidelines on minimum policies and procedures that it expects licensed institutions to comply with. These have been formulated into regulations on "Standards of Best Practice".

Strengthening non-banking supervision. The second loan also supported several actions taken by the Government after the approval of the first loan to further strengthen the legal, regulatory, and supervisory framework for the non-bank financial institution sector.

The new Insurance Act was enacted. The insurance regulations and the actuarial regulations that followed the Insurance Act completed the legal framework for insurance supervision, which is entrusted to the FSC. The FSC has also issued several guidelines to the industry on corporate management, investment management, audit committee, related parties, reporting requirements, etc. The FSC is in the process of enhancing its internal capacity in terms of on and off-site supervision of insurance companies. The FSC is also implementing securities regulations in areas such as capital adequacy, custody of securities, payment and settlements system, and so on. Other regulations for the securities sector now under preparation include mutual funds and collective investment schemes, credit restrictions, and corporate governance. The FSC is also in the process of enhancing its supervisory capacity over all licensees under the "Examinations Project." The FSC is expected to be self-financed by end-2003. A Draft Pension Act –containing the legal framework for pension schemes— is expected to be shortly submitted by the Minister of Finance and Planning to Parliament.

Implementation of the Government's Debt Management Strategy

The Government has satisfactorily implemented its strategy to convert all outstanding FINSAC obligations with private financial institutions into Government paper and to service them in cash. (The Government also reached agreement with the BOJ regarding FINSAC debt held at the BOJ. Government bonds have replaced FINSAC paper, although interest on this debt is still being accrued. Restructuring of FINSAC debt at the BOJ was subject to some delays, as discussed in the ICR of the first loan as well as the President's Report of the second loan). This has been the cornerstone of Government efforts to revitalize the financial system and enable it to have the necessary liquidity to resume lending to the private sector. However, the overall level of Government debt has continued to climb substantially, despite significant fiscal efforts.

In August 2000, prior to the approval of the Bank's first loan, the ratio of debt/GDP was estimated at 131.2 percent of GDP. The first SMP projected that this would decline to about 115 percent of GDP by March 2001 (largely due to actions taken by the Government that were supported by the Bank's first loan), 107 percent by March 2002, and to about 95 percent by March 2005 under the base case scenario. Under the first loan, the Government committed to the Bank to ensure that overall public debt in Jamaican dollar terms would be no higher than it was in August 2000. Subsequently, due to a variety of reasons more fully explained in the reviews of the Fund's SMPs as well as the ICR for the first loan, this commitment of the Government was not implemented and the actual debt/GDP ratio as of March 31, 2001 was 137 percent of GDP. The first SMP – revised in mid-2001 – projected that from this level of 137 percent of GDP, the debt to GDP ratio would decline to about 127 percent of GDP by March 2002 – mainly due to the large primary surplus to be generated by the Government. As of March 2002, the actual debt/GDP ratio was about 130 percent. In its second SMP – approved in October 2002, the Fund's projections were that the debt/GDP ratio would decline to about 125 percent of GDP by March 2003. As mentioned above, the actual situation as of March 2003 is that the debt/GDP ratio is about 150 percent. While both Bank and Fund documents have repeatedly qualified the debt projections with substantial discussions on risks to the projections, it is clear that in the case of the evolution of the overall Government debt, many of these risks have been realized.

Since 1998/99, debt-financing activities of the Government have been guided by its medium-term *Debt Management Strategy*. The key objective of debt management has been modified to broaden the focus from minimizing borrowing costs to include risk management. The Government's recent debt management strategy – which is likely to remain in place for the coming fiscal year - has sought to maintain a prudent debt structure, further diversify the debt portfolio, increase reliance on market-determined instruments for domestic debt issuance, promote and build a liquid and efficient market for government securities, and increase the transparency and predictability of primary market debt issuance. To this end, the Government has been attempting to increase the share of loans at fixed rates and extend the maturity structure of its loans. During the 2002/03 fiscal year the Government continued to increase the fixed rate portion of the debt portfolio with about 48.4% of the outstanding domestic debt issued at fixed rates as of March 2003 compared to 43.2% as of March 2002. The Government has also attempted to further extend the maturity profile of the domestic debt to include securities with 20- to 30-year maturities. In order to mitigate the risk of currency depreciation that might concern domestic investors, the government has been increasingly offering US$-indexed local securities. Such securities currently form about 12 percent of total domestic debt. While such securities are more attractive to investors, it is clear that such securities expose the Government to greater risks in its overall debt management. The debt portfolio was further diversified in terms of the range of maturities, and the type and geographic distribution of investors. The Government continued to maintain a presence in the international capital markets.

The Government has re-emphasized in its publicly stated Debt Management Strategy that "despite the challenges, the Government has and will continue to service its debt obligations in accordance with Section 116 of the Constitution which stipulates that all loans (both external and domestic) represent a statutory charge on the revenues and assets of the country" ("Debt Management Strategy FY 2003/04", Paper of the Ministry of Finance No. 18/03).

4.3 Net Present Value/Economic rate of return:
Not applicable because this is an adjustment operation.

4.4 Financial rate of return:
Not applicable because this is an adjustment operation.

4.5 Institutional development impact:
The institutional development impact of the loan is high, particularly considering the far-reaching changes achieved in the regulatory and supervisory framework that resulted in a strengthened capability of the BOJ to regulate, supervise, and intervene supervised financial institutions, while the BOJ and the Government have taken steps to address weakness identified by the assessments of the Basle Core Principles. With the implementation of reform efforts, Jamaican financial sector regulation and supervision has moved more towards international best practice. In addition, the FSC started to function as the new integrated regulator and supervisor for non-bank institutions (insurance, securities, and pensions) and its operational capacity is being strengthened, as discussed above. The recently established Financial Regulatory Council together with the BOJ and the FSC are harmonizing regulation and supervision, as part of the Government's strategy to reduce future opportunities for regulatory arbitrage (which had contributed to the crisis). These institutional reforms, along with the sale of all intervened financial institutions have improved the environment for renewed bank lending through a more competitive, stronger, and liquid financial sector. Thus the financial sector is now in a position to support enhanced economic growth.

5. Major Factors Affecting Implementation and Outcome

5.1 Factors outside the control of government or implementing agency:
Coordination with other IFIs- Strong coordination efforts with the IMF and the IDB has been a hallmark of the Bank's overall program of assistance to Jamaica's financial sector. It has ensured a coherent approach to support the Government's efforts in achieving its BRDP goals. The Bank actively participated in the IMF Article IV and SMP assessment missions. Throughout the process of preparation and supervision of the two loans, the Bank was consistently more conservative in its assessment of the evolution of key macroeconomic variables. These views were incorporated into the Fund's SMPs and the Bank's CAS, along with assessments of monetary and fiscal policies required to achieve sustainability under more difficult scenarios. Unfortunately, and as discussed in greater

detail in Section 6 below, even these more conservative assumptions proved to be more optimistic than the actual macroeconomic situation faced by the Government ex-post. There was strong coordination with the IDB in the preparation of their parallel financial sector loan, and as a result, the process moved at a faster pace and the Government was able to gain access to a larger pool of funds to address its liquidity needs. The IDB loan approved in September 2000 had two tranches of US$75 million each, with the first tranche (comparable to the Bank's first loan) disbursed shortly thereafter. In response to the emergency situation faced by the Government after the events of September 11, 2001, the Bank provided Jamaica with emergency assistance (not related to actions in the financial sector) of US$ 75 million. The IDB, however, chose to change the original number of tranches of its financial sector operation from two to three. It disbursed a second tranche for US$40 million in March 2002 against compliance with roughly half the outstanding conditions, while the third tranche of US$35 million was disbursed in November, 2002**.** The CDB has approved a two-tranche loan for US$25 million in October 2000 and similarly split its second tranche into two components, both of which have been disbursed. The actions supported by the IDB and CDB loans were consistent with and complementary to those being supported by the Bank.

Macroeconomic shocks- As mentioned above, the main risk facing the program is the possibility of macroeconomic instability. Unforeseen circumstances such as September 11, 2001 events in the US, or even less costly events such as the violence in July 2001, or the passing of Hurricane Michelle through Jamaica are largely outside the Government's control but have had significant adverse macroeconomic impacts. Such events have added to the fiscal pressures faced by the Government. Indeed, as in any banking sector operation, there is the threat that global economic instability and/or recession in the US could have negative implications for the Government's overall BRDP. This is particularly true in Jamaica because of the need to maintain strict fiscal policy and the country's experience of low per capita GDP growth for much of the last 25 years. **The Government has been able to weather several risks of lesser magnitude with commendable discipline, with an overall primary surplus of 12 percent of GDP in FY2000/01, despite a shortfall in revenues.** The revised SMP targets took into account these shocks and entailed tighter measures to which the Government expressed its commitment. However, more recent macroeconomic developments indicate that the high level of debt and debt service significantly limits the degrees of freedom available to the Government to respond to external shocks while continuing to service its debt. A more detailed discussion of macroeconomic risks facing the program is provided in Section 6 below.

Adequacy of Bank resources in assisting in crisis resolution: The overall cost of the financial crisis in Jamaica was of the order of about US$ 3 billion. The Bank's two loans provided a total amount of US$ 150 million – about 5 percent of the cost of the crisis. The Bank's loans assisted the Government in restructuring some of its debt with financial institutions and assisted in replacing high cost domestic currency debt with relatively lower cost, long term, foreign currency debt. The Bank's own Quality Assurance Group (QAG) – in its assessment of the Bank's first loan in support of the BRDP **-** has questioned the adequacy of Bank support and pointed out that "…financing made available by the Bank was limited relative to the large need for funds by the country..", while expressing concern about the sustainability of the first loan. While this can be treated as a factor affecting the outcome of the Bank's loans, the decision to provide this extent of support was taken in light of Government requests, the Bank's assessment of the riskiness of the two operations, and the signaling effect that the loans, as well as Government actions supported by them, would have in bringing the financial sector back to health. It is also unclear how much larger support could have been provided by the Bank – especially in the absence of a Government request to the Fund for financial support.

Implications for Bank operations under an SMP vis-à-vis a disbursing Fund Program. The Bank had, very early on in its involvement with the Jamaican financial sector in 2000, suggested that the Government consider approaching the Fund for financial assistance. The Government repeatedly made it clear to the Bank that it would not do so since Jamaica was not faced with a balance of payments problem, which might require Fund assistance. Given the historical relationship between Jamaica and the Fund as well as within the context of an election year in Jamaica in 2002, political compulsions could also have been a driving force behind the Government's decision not to approach the Fund. The two loans of the Bank were therefore made under the aegis of two Fund SMPs in which the Government outlined its overall macroeconomic programs. These programs, while subject to risks clearly identified by the Bank and the Fund, were broadly considered acceptable by the Bank as a basis for Bank loans. One question that can be raised – especially if the financial sector faces difficulties due to the deteriorating macroeconomic situation – is whether the likelihood of the sustainability of the achievements under the Bank's loans would have been higher had the Government obtained access to a larger pool of funds by entering into a disbursing Fund program. Access to financial resources from the IMF could have had a larger impact in restructuring the Government's debt and thereby helped to potentially reduce the degree of fiscal stress currently faced by the Government.

5.2 Factors generally subject to government control:

Despite the likely risks to the financial sector in the future arising, the outstanding commitment of the Government in implementing its BRDP has been crucial for the success of the two Bank loans. The Government publicized the two SMPs that it had entered into with the Fund and stressed the Government's commitment to structural benchmarks that were also included in its macroeconomic program presented to Parliament during 2000-02. This provided a positive signal both to the domestic and foreign markets that the Government had decided to endure tight discipline to achieve the final resolution of the crisis, despite its large costs. In addition, **by divesting all major intervened financial institutions to foreign investors, the Government brought into the country fresh capital, technology, capacity, and increased competition that would help increase lending and thus enable the financial sector to contribute to greater economic growth.** The closure of FINSAC's operations also signaled to the market that a new era had begun in the financial sector – with the end of the financial crisis – and thereby contributed to improved market confidence. While there were some delays in some of the Government's commitments that formed part of the first loan, these were satisfactorily addressed prior to the approval of the second loan and there were no such delays in the second loan. All actions that were subject to Government control were satisfactorily completed prior to the Board consideration of the second BRDP loan.

5.3 Factors generally subject to implementing agency control:

FINSAC (under the supervision of the MOF, the main implementing agency), exhibited a large degree of cooperation and expertise both in the preparation of the loan as in undertaking its duties in the implementation of the program. FINSAC's management, in coordination with the Government, carefully designed its strategy to dispose of both intervened financial institutions as well as FINSAC's portfolio of NPLs and other assets.

5.4 Costs and financing:

Not applicable.

6. Sustainability

6.1 Rationale for sustainability rating:

The sustainability of the achievements under the loan is Likely, but subject to high risks.

The ICR for the Bank's first loan in support of the Government's BRDP rated as "Likely" the sustainability of the achievements based on the actions taken by the Government, its commitment to further the reform process, and the then prevailing macroeconomic scenario. The rating was qualified by noting that the program was exposed to significant risks – one of the major ones being the risk of macroeconomic volatility and fiscal stress. Rating the sustainability of the second loan, in the context of substantial achievements in financial sector reform but in a difficult macroeconomic and fiscal scenario is a more complex exercise.

Viewed purely from the perspective of reforms in the financial sector, improvements in the regulatory and supervisory environment, and steps taken toward creating an environment in which the financial sector is able to contribute to economic growth, the achievements under the loan have significantly increased the resilience of the financial system to endure shocks and are difficult to reverse. As discussed above, all major intervened financial institutions have been sold to foreign investors, the regulatory framework and on-the-ground supervision has been significantly strengthened – both in the banking and the non-banking sector – and financial institutions provided with liquidity through restructuring of public debt at the banks in order to enable them to undertake prudent lending to support economic growth. The Government's financial sector reform strategy provides a signal to the financial sector that a new framework is in place with stricter and better rules of the game, enforced in a timelier manner. These actions also lay the ground for a healthier financial system that exhibits enhanced competition with the entrance of international players.

However, underlying these achievements is substantial fragility engendered by the fact that a large fraction of financial institution asset portfolios still consist of Government bonds, albeit with a reduced share. As long as the Government continues to satisfactorily service its public debt – the achievements under the two BRDP loans are likely to be sustained. However, if the Government faces difficulty in servicing its debt the quality of financial institution asset portfolios will almost certainly rapidly erode, thereby weakening the financial sector. Macroeconomic and fiscal difficulties could therefore undermine the achievements under the loans and the sustainability of the reforms is therefore not necessarily assured.

The Government has not been able to contain its debt/GDP ratio within the parameters as laid out in the SMPs or in the Bank's CAS. It has also been unable to sustain the high primary surpluses that were necessary in order to ensure that this ratio was put on a declining path. The debt to GDP ratio which had remained relatively stable at about 130% during the two years 2000-02, has risen again since the last quarter of 2002 largely due to a rising fiscal deficit and depreciation of the exchange rate to reach about 150 percent of GDP by March 2003 (about 90 percent of GDP domestic, and about 60 percent of GDP external debt), one of the highest ratios in the world. Overall GDP growth – which has been very low or negative over much of the last twenty-five years – has recently shown signs of recovery but is hovering at a very low level of about 1% per year. All this has meant that short-term risks to the economy have risen substantially, access to external markets has deteriorated with recent downgrades by credit rating agencies, and the exchange rate has come under pressure in 2003.

Reaching fiscal and debt sustainability are critical to a return to sustained growth, but the Bank's recent Country Economic Memorandum has estimated that primary surpluses of more than 10 percent of GDP are needed just to sustain the current, high debt to GDP ratio of 150 percent. This is the case even under optimistic scenarios for growth and interest rates (for example, growth of 2 percent, and real interest of 9 percent). In this context, it is worth noting that the Government in June 2003 floated 2 and 5 year domestic bonds at about 34 percent (implying a real rate of about 25 percent). More politically sustainable levels of the debt-stabilizing primary surplus (6-7 percent of GDP) would demand a reduction in the debt by about 50 percentage points of GDP. It is clear that the Government faces a challenging time ahead as it tries to come up with options to improve the debt dynamics.

In this context, an appropriate rating for the sustainability of the achievements under the second loan would be "Uncertain". However, the Bank does not provide for such a category in its rating system, therefore, after extensive internal debate, a decision has been made to go with the latter rating for the following reasons, all of which have been discussed above. First, all actions agreed upon under the loan were satisfactorily implemented prior to Board consideration of the loan. Second, the loan supported Government actions that have already had significant achievements in restructuring and strengthening the financial sector. Third, historically, Jamaica has never defaulted on its debt thus far. As stated above, the Government maintains that it will continue to satisfactorily service all of its debt obligations. Despite the difficult macroeconomic situation faced by the Government, there is the possibility that the Government could succeed in averting a fiscal crisis. Fourth, the financial sector is far better placed to handle macroeconomic stresses and contribute to private sector - led growth as a result of Government actions supported by the Bank loans than it was prior to these actions. Therefore, if a restructuring of the debt were to become necessary, the banking system is now better placed to be a part of the solution and to constructively contribute to any orderly debt restructuring efforts. The actions taken by the Government, supported to the Bank's loans have therefore been successful in bringing the Jamaican financial system to this stage after the crisis in the mid-1990s. With this rationale, the sustainability of the achievements under the loan is rated "Likely". However, based on the discussion of the macroeconomic risks above, there is clear need to be aware that this rating should be accompanied by a strong qualification that the sustainability is subject to high risks. Future macroeconomic difficulties could endanger the achievements under the loan.

It is interesting to note that other than the risk of macroeconomic volatility, many of the other risks identified by the Bank during the preparation of the loans have not materialized. In large part, this has been due to the significant commitment of the Government to the reform process. There were risks that some of the larger financial institutions may not be disposed of in a timely manner or that the Government would continue to hold the portfolio of NPLs and other assets that it had acquired in the intervention process – risks which have been realized in other countries that faced financial crises. It is to the substantial credit of the Government that neither of these risks have materialized. There were also risks that the Government might not be able to continue the necessary institutional strengthening in order to satisfactorily implement some of the new legislation and regulations put in place. Once again, the Government showed a large degree of commitment to move the institutions responsible for the oversight of the financial sector towards international best practice. The risk of social disturbances – due to the tight fiscal measures in place – has not yet been realized and the Government seems committed to taking actions necessary to minimize this risk. Finally, the risk that FIS may not have as much commitment from the Government as did FINSAC has also not been realized. It is clear that these actions provide a degree of confidence regarding the commitment of the Government and its willingness to find alternatives to deal with risks as they arise.

6.2 Transition arrangement to regular operations:
Not applicable.

7. Bank and Borrower Performance

Bank

7.1 Lending:
Bank performance in the implementation of the second phase of the BRDP was Satisfactory. The Bank continued its close involvement and dialogue with the Government initiated during the preparation of the first loan. One of the most important aspects of Bank performance was the continuity that it maintained in the core team undertaking the lending operation. The Government appreciated the fact that the Bank had been highly responsive to its requests to put in place a highly capable team and maintain its continuity until the end of the two-loan process. The excellent professional rapport that had been developed by the Bank team during the processing of the first loan made things significantly easier by the time of the second loan. Both sides were well aware of each other as well as the situation and this made the client-Bank relationship that much smoother. The Bank team as well as the Government agreed upon a set of clearly identified actions to be taken before Board consideration of the second loan. Bank staff also played a key role in bringing to closure the issue of FINSAC debt at the Bank of Jamaica – an issue that had been outstanding despite Government commitments in the first loan. In this process, Bank staff played the role of an independent third party mediating in a difficult situation between the Central Bank and the Ministry of Finance.

7.2 Supervision:
Given the structure of the second loan as a single-tranche adjustment operation in which the agreed policy actions were implemented prior to Board presentation, there was limited scope for further supervision. However, the Bank has remained engaged with the authorities in following up implemented actions and ensuring effectiveness of commitments. The Bank continued to monitor progress in the financial sector through its work for the preparation of this ICR as well as during the preparation of the Country Economic Memorandum (Report No. 26088-JM). Given the recent macroeconomic volatility being faced in by Jamaica, the Government has also kept its dialog ongoing with the Bank and other IFIs through visits of senior officials including the Minister of Finance to Washington. The Bank's performance in the supervision process has been Satisfactory.

7.3 Overall Bank performance:
Overall Bank's performance has been Satisfactory

Borrower

7.4 Preparation:
Borrower performance in the identification and preparation of the project was Satisfactory. The Bank had extensive interaction with the main institutions involved (MOF, FINSAC, BOJ, FSC) throughout the process, which reflected the high degree of ownership of the program. The counterpart had selected an exceptionally qualified core team with MOF in the lead, which had developed and maintained a coordinated inter-institutional reform, bank

resolution and debt management program. The Government maintained an exceptional degree of stability in its high quality reform team throughout the two loans. Combined with an equal degree of stability of the Bank's own project team as well as the Government's appreciation of the quality of the Bank team, the environment for project design, preparation, and implementation was conducive to a successful outcome.

7.5 Government implementation performance:

The implementation performance of the borrower is Satisfactory. From the financial sector point of view, the Government took all the actions supported by this loan prior to Board presentation. After effectiveness of the loan, the Government has, thus far, not "back tracked" on any aspect of the reform of the financial sector. However, the major issue, as highlighted throughout the document, remains that of satisfactory debt management and macroeconomic performance.

7.6 Implementing Agency:

While FINSAC was the Implementing Agency (under the supervision of the MOF, the main implementing agency) as far as the financial sector restructuring was concerned, the Bank interacted extensively with the MOF and the BOJ on other aspects of the loan. The performance of all agencies was Satisfactory. Adequate access to officials, information, and data were provided at all the stages of the loan preparation.

7.7 Overall Borrower performance:

The overall borrower performance was Satisfactory.

8. Lessons Learned

The two loans of the Bank in support of the BRDP present an interesting, though complex, set of lessons. These loans were made in a context where all agreed upon actions were completed prior to Board consideration of the loan thereby achieving the objectives set out for the reform of the financial sector even prior to Board consideration. Subsequent Government actions have not, thus far, in any way "back tracked" on the core of the reforms. Yet, as stated above, the sustainability of the financial health of the privatized institutions (Banks and Insurance Companies) remains open to question – mainly due to macroeconomic uncertainties facing the country and their likely adverse impact on the financial sector. The lessons learned therefore, span the spectrum from the positive – where client commitment, choice of appropriate lending instrument, and close collaboration among the IFIs led to strong positive outcomes for the country – to the more circumspect and sobering that often Bank operations face country risks that are easier to identify than to mitigate within the context of sector adjustment loans and when some of these risks do materialize, they can have a substantial adverse impact even where the underlying reform effort is strong.

i) Importance of Client commitment to reform: The successful implementation of both phases of the Government's BRDP followed from a strong ownership of the program and commendable degree of commitment. Jamaica clearly spelled out the components of its financial sector strategy early on to its internal and external constituencies. It also published the two SMPs that it had entered into with the Fund. While there were some delays in the implementation of a few commitments during the first loan, these were sorted out to the satisfaction of the Bank prior to the Board consideration of the second loan. In the second loan, the Government ensured that there were no slippages on reform actions in the financial sector. As far as debt management issues were concerned, there were slippages from the agreements in the first loan. However, these were largely explained and satisfactorily incorporated into a new SMP with the Fund. The new SMP also endorsed the Government's proposed overall macroeconomic program – an integral component of which were efforts at prudent debt management going forward. The Government's cooperation with the Bank was excellent as the Government clearly saw – and repeatedly noted – the genuine commitment of the Bank team to work with the Government in identifying feasible policy options for dealing with the aftermath of the financial crisis. This joint effort led to a satisfactory implementation experience, despite the program being subject to major risks. This high level of commitment and ownership of the Government made it more feasible for the Bank to provide support, particularly since the cost of not supporting the Government's reform efforts was deemed unacceptably high.

ii) Importance of selecting an appropriate lending instrument: The experience of both loans clearly vindicated the choice of two single-tranche programmatic loans over a more traditional single-loan two-tranche approach. Single tranche loans provided greater flexibility to both the Government and the Bank in designing loans with achievable objectives taking into account ground realities as they developed. The design of the second loan assumed special significance in the face of large external shocks faced by the Government in the intervening period between the two loans – including the impact of the September 11, 2001 events in the US. It was only because the loans were designed as single tranche loans that the impact of such large external shocks could be incorporated satisfactorily into loan design with no adverse reputational impact for the Borrower or the Bank. The single-tranche approach also provided the Bank with leverage to work with the Government to arrive at satisfactory resolutions of some outstanding issues of the first loan. The choice of instrument also enabled lessons from past Bank experience with Jamaica as well as recent experience in other countries to be taken into account. Through this approach, the Bank reduced the risk of delay and failure in the achievement of the program's medium term aims by avoiding locking the client early on into an overly ambitious, politically sensitive, and risky agenda with excessive conditionality.

iii) Importance of close collaboration with other IFIs and with the country staff: A critical learning from both BRDP loans is the importance of close collaboration among IFIs – especially in the dysfunctional phasing of the reforms programs where risks were clearly high. The Bank gained from the sectoral perspectives of the IDB and the macro views of the IMF, while in turn both these institutions benefited from the Bank's strengths and knowledge in restructuring of banking sectors as well as its often more conservative views on evolution of key macroeconomic variables. Within the Bank, the sector unit (SMU) staff worked very closely with the country unit (CMU) staff and this collaboration was crucial for the success of the loan.

(iv) **Importance of designing adjustment programs with a clear identification of key risks.** Both Bank loans in support of the Government's BRDP clearly identified macroeconomic vulnerability as a key risk facing the sustainability of the reforms implemented under the loans. They also clearly identified that it was not possible for the programs to incorporate mitigation measures for all these risks into the loan design. The key lesson from this experience is that the argument for providing assistance to the reform process in a country needs to be predicated on a clear assessment of the substantial nature of the reforms and their likely impact while clearly recognizing the risks. The presence of risks is, by itself however, not an adequate argument against providing assistance. In many situations, macro risks cannot necessarily be mitigated within the context of a sector adjustment loan. There is a strong case for such operations in cases where the Government's agenda of reform is as substantial as was the case in Jamaica. The Bank and the Government need to continue to work together in order to ensure that macroeconomic volatility does not entirely undo the substantial achievements of the Government's BRDP.

(v) **Difficulty of choices facing the Bank in sector adjustment operations.** An important lesson from the two loans in support of the BRDP made by the Bank is that the Bank is often called upon to make difficult choices in some of its sector adjustment operations – which might, as stated in its assessment of the first loan by the QAG, involve taking "a high-risk/high reward strategy." **In the case of the two BRDP loans to Jamaica, it was clear from the beginning that macroeconomic risks facing the sustainability of the program were high.** These were repeatedly highlighted in Bank documents relating to the two loans. **However, it was also felt that the reputational costs of not assisting Jamaica – at a time when its Government was clearly committed to a program of significant financial sector reforms - were also high.** During the processing of the two loans, it was clear that resolving the financial sector crisis satisfactorily was a necessary, though not sufficient, condition to ensure resumption of economic growth in Jamaica. Resumption of economic growth was, in turn, a necessary condition for managing the large public sector debt in a sustainable manner. If the incipient resumption of economic growth continues, then the Government – along with its stringent fiscal stance - would be in a much better position to manage the transition to a lower level of overall public debt in relation to GDP. But it was clear that financial sector reforms could be potentially derailed by unexpected macroeconomic shocks as well as future Government policy that might relax the fiscal stance. At the time of approval of the second loan, some of the large macroeconomic shocks – especially the adverse impact of the events in the US of September 11, 2001 on the Jamaican economy – had already occurred. However, the Government had shown a commendable degree of fiscal restraint and provided confidence on its overall approach. This said, however, **events since effectiveness, as discussed above, raise concerns on the sustainability of the program.** Therefore Bank experience during these loans indicates the difficult choices facing the Bank. Ex-ante, it is often essential for the Bank to demonstrate its support to a strong reform program. However, **the strength of the reform program might not necessarily ensure its sustainability ex-post.**

9. Partner Comments

(a) Borrower/implementing agency:

BANK RESTRUCTURING AND DEBT MANAGEMENT PROGRAM ADJUSTMENT LOAN

IMPLEMENTATION COMPLETION REPORT

(Loan No. 7150-JM)

BACKGROUND

Following the financial sector crisis of the mid 1990s, the Government of Jamaica implemented measures to resolve the crisis and to contain the adverse debt dynamics resulting from its intervention in the financial sector. These initiatives included support from the World Bank, the IADB, and CDB. With the aid of the first World Bank loan, under the Bank Restructuring & Debt Management Programme (BRDP), the Government was able to successfully restructure all the intervened financial institutions and divest the majority of shares held by FINSAC. Also, the bulk of assets owned by FINSAC has been sold and the remaining residual assets are in the process of being disposed. Further, the Government was able to restructure and assume the FINSAC debt held by these institutions and the Bank of Jamaica.

The broad set of macroeconomic and financial sector reforms that have been implemented resulted in the considerable strengthening of the supervisory agencies of financial institutions. Consequently, the health of the financial sector has been restored and the vulnerability of the sector to future shocks has been significantly reduced.

PROGRAMME OBJECTIVES

Continuing on the first Bank Restructuring & Debt Management Programme (BRDP) loan, the second loan was used to support the second phase of the Government's BRDP. It focuses on completing the financial resolution of the crisis, through reform of the financial sector and management of the debt burden and involves the following:

- Sale of the entire equity in National Commercial Bank and Life of Jamaica to private investors;
- Sale of the non-performing loan portfolio of FINSAC to a private party;
- Disposal of a significant portion of the real estate asset portfolio owned by FINSAC;
- Restructuring and management of the public debt arising from the resolution of the financial crisis, servicing in cash all Government bonds that replaced FINSAC liabilities with the private sector;
- Ensuring that FINSAC did not incur additional liabilities as stipulated in the Staff Monitored Programme (SMP);
- Closure of operations of the crisis management agency, FINSAC;
- Taking the appropriate steps as set out the Memorandum of Understanding regarding the Bank of Jamaica Losses;
- Completing regulatory and supervisory reforms in the financial sector; and
- Maintaining a sound macroeconomic framework consistent with policy objectives and programmes outlined in the SMP.

BANK SUPPORT: A PROGRAMMATIC LENDING APPROACH

As characteristic of all World Bank projects in the 1990s, the project supported a centrally directed and demand driven approach.

Identification & Preparation: The IMF's SMP provided a solid macroeconomic foundation for the project and clear understanding of sub-components. The Government continued to consult with World Bank staff.

Appraisal: The Bank was involved in the appraisal process and suitable expertise was provided during consultations. The appraisal and project design were sound and the implementation plan was explicit and contained detailed performance indicators.
Supervision: The Bank's supervision was adequate. The team consulted and visited entities responsible for executing various aspects of the programme and received progress reports on programme.

ACHIEVEMENT OF PROGRAMME OBJECTIVES

- Divestment of institutions owned by FINSAC

  The Government made considerable progress with the divestment of FINSAC intervened financial institutions. In March 2002, FINSAC sold its entire shareholding of NCB to AIC Berkshire, a subsidiary of AIC Ltd. of Canada.

  The equity stakes in Life of Jamaica were sold to Barbados Mutual Assurance Society in December 2001.
- Sale of FINSAC's portfolio of real estate and Non-performing Loans

  FINSAC also disposed the non-performing loan portfolio. The loan portfolio was sold to Jamaica Redevelopment Foundation a subsidiary of Beal Bank of Texas in January 2002. In line with the agreement, the services of Denis Joslin Ja. Inc. commenced management of the portfolio as at February 1, 2002.

  With respect to the real estate portfolio, as at July 2002, over 40% of all commercial properties and 90% of the residential properties have been sold. Since its inception, the cumulative divestment of assets amounted to approximately $14.96B. Arrangements have been made to have the Financial Institutions Services resolve residual issues to deal with real estate portfolio and asset disposal.

- Closure of the crisis management entity, FINSAC

  As of June 30, 2002, FINSAC operations were officially closed. The company implemented a strategy in 2002 which saw the responsibility for the divestment of the remaining real estate portfolio and all other residual activities being handed over to Financial Institutions Services Limited, acting as its agent.

- Restructuring and management of the public debt arising from the resolution of the financial crisis, servicing in cash all Government bonds that replaced FINSAC liabilities with the private sector

  The Government assumed all FINSAC liabilities outstanding as a part of its domestic debt and continued to make cash payments as agreed on remaining FINSAC debt held by the private sector. An acceptable plan was also proposed to service the debt to the Bank of Jamaica.

- Maintaining a sound macroeconomic framework consistent with policy objectives and programmes outlined in the SMP

  The Government continued to comply with macroeconomic policy guidelines as set out in the SMP. The International Monetary Fund carried out reviews of the programmes.

- Completing regulatory and supervisory reforms in the financial sector

  In order to further reduce the vulnerability of the financial sector to the future crisis and to further strengthen the regulatory framework, the Government made additional efforts to consolidate the reforms in the financial sector. The reform initiatives included inter alia:

- Amendments to the Banking, Financial Institutions Acts to provide the Bank of Jamaica with the authority to intervene in deposit taking financial institutions, legal and administrative authority to assess penalties and to enhance it's regulatory authority over complex groups were enacted in March 2002;
- The enactment of the Insurance Act. This Act is in line with international best practices. Further, the Insurance Regulations were approved by the Minister of Finance and subsequently gazetted;
- The Regulatory Policy Council has been established, functioning and provides reports to the Minister;
- The Bank of Jamaica has updated its Supervisory Ladder of Enforcement;
- A Draft Bill to establish the legislative framework for credit bureau was prepared.;
- The Financial Services Commission was established and is operational. It has also issued regulations and

continued to strengthen its supervisory capacity through training.

<u>MAJOR FACTORS AFFECTING THE PROGRAMME</u>

Despite minor delays in the legislative procedure, there were no significant factors that adversely affected the second phase of the Bank Restructuring and Debt Management Programme.

<u>PROGRAMME SUSTAINABILITY</u>

Having successfully pursued the programme agreed with the Bank, the Government will take the necessary steps to ensure that medium term economic programme gets back on track. The Bank Restructuring and Debt Management Programme has helped to strengthen the overall environment of the financial sector. The Government hopes to use this as a catalyst to restart economic growth and development in Jamaica.

<u>BANK PERFORMANCE</u>

The Bank's performance was satisfactory in all phases of the project.

<u>BORROWER PERFORMANCE</u>

The Government of Jamaica performance was also satisfactory.

<u>ASSESSMENT OF OUTCOME</u>

The Government believes that the main objectives of the loans have been accomplished. The project has contributed to the strengthening of the legislative framework and resolution of the crisis with the management of FINSAC liabilities and the closure of FINSAC. The measures that have been implemented will help to restore the stability of the financial sector and the macroeconomic framework.

<u>KEY LESSONS LEARNED</u>

The experience has taught us that a programme that is well designed and managed with significant input from the borrower can be implemented satisfactorily.

(b) Cofinanciers:

Not applicable.

(c) Other partners (NGOs/private sector):

Not applicable.

10. Additional Information

None

Annex 1. Key Performance Indicators/Log Frame Matrix

Outcome / Impact Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
Not applicable because this is a single tranche adjustment operation in which all actions were completed prior to Board consideration.		

Output Indicators:

Indicator/Matrix	Projected in last PSR[1]	Actual/Latest Estimate
Not applicable because this is a single tranche adjustment operation in which all actions were completed prior to Board consideration.		

[1] End of project

Annex 2. Project Costs and Financing

Not applicable, because this is a single tranche adjustment operation in which all actions were completed prior to Board consideration.

Annex 3. Economic Costs and Benefits

Not Applicable because this is an adjustment operation

Annex 4. Bank Inputs

(a) Missions:

Stage of Project Cycle	No. of Persons and Specialty (e.g. 2 Economists, 1 FMS, etc.)		Performance Rating	
Month/Year	Count	Specialty	Implementation Progress	Development Objective
Identification/Preparation				
08/27/2001	*1*	Financial Economist		
	4	Sr. Financial Economist, Financial Economist, Financial Sector Specialist, Lead Counsel		
02/11/2002	*1*	Financial Economist		
Appraisal/Negotiation				
08/07/2002 - 08/12/2002	*1*	Financial Economist		
	1	Sr. Financial Economist		
	1	Legal Counsel		
Supervision				
05/30/2003 - 06/04/2003		Financial economist,		
		Financial Sector Specialist		
ICR				
05/30/2003 - 06/04/2003	*1*	Financial economist,		
	1	Financial Sector Specialist		

(b) Staff:

Stage of Project Cycle	Actual/Latest Estimate	
	No. Staff weeks	US$ ('000)
Identification/Preparation	21.24	28,871
Appraisal/Negotiation	38.32	115,603
Supervision		
ICR	3.13	10,323
Total	62.69	154,798

Annex 5. Ratings for Achievement of Objectives/Outputs of Components

(H=High, SU=Substantial, M=Modest, N=Negligible, NA=Not Applicable)

	Rating
☐ *Macro policies*	○ *H* ○ *SU* ● *M* ○ *N* ○ *NA*
☐ *Sector Policies*	○ *H* ● *SU* ○ *M* ○ *N* ○ *NA*
☐ *Physical*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Financial*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Institutional Development*	○ *H* ● *SU* ○ *M* ○ *N* ○ *NA*
☐ *Environmental*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
Social	
☐ *Poverty Reduction*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Gender*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Other (Please specify)*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Private sector development*	○ *H* ● *SU* ○ *M* ○ *N* ○ *NA*
☐ *Public sector management*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*
☐ *Other (Please specify)*	○ *H* ○ *SU* ○ *M* ○ *N* ● *NA*

Annex 6. Ratings of Bank and Borrower Performance

(HS=Highly Satisfactory, S=Satisfactory, U=Unsatisfactory, HU=Highly Unsatisfactory)

6.1 Bank performance	*Rating*
☐ *Lending*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Supervision*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Overall*	○ *HS* ● *S* ○ *U* ○ *HU*

6.2 Borrower performance	*Rating*
☐ *Preparation*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Government implementation performance*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Implementation agency performance*	○ *HS* ● *S* ○ *U* ○ *HU*
☐ *Overall*	○ *HS* ● *S* ○ *U* ○ *HU*

Annex 7. List of Supporting Documents

President's Report no. P7397 JM, November 2, 2000.
President's Report no. P7527 JM, September 17, 2002
Jamaica Country Assistance Strategy, Report no. 21187, November 2, 2000.
Jamaica: Staff Report for the 1999 Article IV Consultation, IMF Staff Country Report no. 00/08, January 27, 2000, www.imf.org.
Jamaica: 2001 Article IV Consultation and Review of Staff-Monitored Program, IMF Country Report no. 01/83, June 14, 2001, www.imf.org.
Jamaica – Letter of Intent – December 4, 2001 www.imf.org
Jamaica – Staff Monitored Program - Letter of Intent – Memorandum of Economic and Financial Policies, July 25, 2002, www.imf.org.
Jamaica: Staff report for 2002 Article IV consultation and new Staff Monitored Program, IMF Country Report no. 02/197, September 11, 2002 www.imf.org.
Jamaica: Country Assistance Note, Report no. 19356.
Jamaica: Implementation Completion Report for Bank Restructuring & Debt Management Program Adjustment Loan (FSLT-70360).
Jamaica: Country Economic Memorandum, Report no. 26088-JM. Jamaica-- The Road to Sustained Growth, June 2003.

Additional Annex 8. Matrix of Policy Actions

Issue	Objective	Actions taken by the Jamaican Government prior to Board presentation of BRDP II loan	Progress since effectiveness
Macro stability	Maintain sound economic policy framework	- Until the external shocks of September 11, 2001, the Government continued to maintain a sound macroeconomic framework consistent with policy objectives and programs outlined in the 2000 SMP and its revisions, 2000 CAS, and Letter of Sector Policy dated October 19th, 2000 which formed a part of first BRDP loan. Subsequent to the events of September 11, 2001, the Government entered into a revised SMP with the IMF – approved in July 2002. In its Letter of Sector Development Policy for the second loan, the Government committed to satisfactorily implementing its macroeconomic adjustment program as outlined in the revised SMP. The IMF, in its revised SMP, as well as the Bank, in its CAS update, complimented the Government on its continued tight fiscal stance despite significant pressures due to external shocks.	The Government has faced slippage in its macroeconomic targets, especially relating to fiscal deficits. As mentioned above, the debt/GDP ratio has also gone up significantly in the recent past, despite relative stability during 2000-02. .

Reduction of public sector debt	- The Government undertook periodic scheduled reviews of performance as agreed under the 2000 SMP and its revisions. The new SMP approved in July 2002, incorporated appropriate measures to address the large macroeconomic shocks that took place since the first SMP.	The Government undertook periodic reviews of the SMP during the period of preparation and implementation of the Bank's loans. It entered into a second SMP with the Fund covering the period 2002-03. Since the expiry of this SMP in April 2003, the Fund has indicated that it will not be supporting SMPs in future. The Bank is currently preparing a Country Economic Memorandum for Jamaica in which the overall macroeconomic situation is being assessed. As mentioned above, Jamaica is currently facing a period of increased overall macroeconomic stress.
	Largely due to external shocks and to the upward revision of the 2000/01 debt data, the reduction of public sector debt in Jamaican dollar terms was not consistent with the base case scenario of the 2000 SMP – a commitment that the Government had made in the first BRDP loan. The Government committed to a revised macroeconomic scenario reflected in the SMP approved in July 2002. This scenario anticipated that the stock of Government debt to GDP would remain flat at about 129 percent during 2001/02 to 2002/03 and show a decline thereafter due to primary surpluses proposed to be generated by the Government. The Government committed to meet the objective of reducing its public sector debt through further expenditure cuts, if necessary, in its Letter of Sector Development Policy for the Second Loan.	The objective of the Government to reduce its debt stock has not been achieved. Public sector debt has continued to rise significantly and is currently about 150 percent of GDP. Interest rates, after declining initially during the preparation and implementation of both Bank loans have risen again – largely due to the Government's efforts to defend a rapidly depreciating exchange rate. The combination of an increasing stock of debt and high interest rates have placed major strains on the Government's ability to satisfactorily service its debt. This problem has been reflected in the recent downgrades of the Jamaican sovereign credit rating by international rating agencies. This issue poses the single biggest risk to the continued sustainability of the achievements under the two Bank loans. A large of commercial bank asset portfolios are composed of Government debt. If the Government faces difficulties in servicing this debt in a timely manner, the quality of bank asset portfolios will almost certainly rapidly erode, creating problems for the liquidity and solvency of the sector.
	- Government explicitly assumed, as part of its domestic debt, all FINSAC liabilities outstanding as of March 31, 2001. As of the date of approval of the second loan, it had been making full interest payments in cash on all assumed liabilities to private financial institutions	There is no FINSAC debt outstanding in Jamaica. All such debt has been converted into Government bonds. As of the date of this ICR, the Government has continued to service all its obligations – including those to the financial sector – satisfactorily. However, as stated above, there are increasing fiscal pressures confronting the Government and it is unclear if these pressures will lead to difficulties for the Government in continuing to satisfactorily servicing its debt in future.

FINSAC	Reduce debt and pay interest in cash on remaining stock of debt.	- FINSAC did not incur additional liabilities over and beyond those identified in the 2000 SMP, as revised in December 2001.	FINSAC ceased operations in July 2002 – prior to the approval of the Bank's second loan. No additional FINSAC liabilities have been incurred. This objective has been satisfactorily met.
		- Government used all funds from the first loan (Loan No. 7036-JM) to reduce Government debt held by private financial institutions. It has committed to use funds from the proposed second loan for the same purpose.	The Government used all funds from the second loan to reduce Government debt held by the private financial institutions.
		- In addition to the restructuring of FINSAC's debt held by the BOJ (supported by the first loan), the Government has taken a broader approach to improve BOJ's profitability, as reflected in the MOU between the MOF and the BOJ regarding the resolution of BOJ losses, signed on September 9, 2002. The MOU provides that the Government: (i) has replaced J$ 8.3 billion in advances and other receivables from the Government (below market securities related to previous BOJ losses) with marketable securities, (ii) has committed to redeem J$2.2 billion in non-interest earning securities during FY 2002/03, and (iii) has committed to settle any losses sustained by the BOJ in subsequent periods through the issuance of Government securities. Interest accrued on the replacing securities will be capitalized with the issuance of Government securities until FY2007/08.	The Government has redeemed J$2.2 billion of non-interest bearing securities at the BOJ. The BOJ's fiscal year is January-December. The Government has provided the BOJ with bonds to make up BOJ's loss as of December 2002. The Government also issued fresh securities to the BOJ to cover interest costs on existing bonds with the BOJ.
		- FINSAC has provided all proceeds from recoveries of NPLs and non-core assets, net of operating expenses, to the Government. The Government has used these funds to service its bonds replacing FINSAC liabilities.	FINSAC ceased operations prior to the approval of the second BRDP loan. Its remaining responsibilities were handed over to FIS.

Restructure banking sector	Restructure/ sell intervened banks.	- Government has sold its entire equity in NCB to a private financial institution. This is the largest domestic bank with a market share of 37 percent of total commercial bank assets.	The Government held no majority stakes in any intervened financial institution prior to the approval of the BRDP II loan. Management and disposal of a few remaining minority stakes is managed by FIS. The Government has since divested FINSAC's minority equity stakes of 26 percent in Island Life, exchanged US$8.25 million of preferred shares in Victoria Mutual Building Society (VMBS) for Government bonds, and is proceeding with the divestment of stakes of 26.5 percent in Dyoll Insurance Co. In addition, progress has been made in legally closing down the many subsidiaries of the financial institutions that FINSAC had acquired. The BOJ reports that NCB is performing satisfactorily, with high asset quality, increasing share of lending to total assets, lower share of Government securities to total assets, and higher profitability. As of December 2002, NCB has a market share of commercial bank assets of 38 percent, similar to its share in 2001.
Sale of FINSAC non-core assets	Sale of non-core assets held by FINSAC.	- (i) Government has sold 75 percent of FIS's commercial real estate assets administered by FINSAC and 98 percent of FIS's residential real estate assets administered by FINSAC (acquired in the intervention process). (ii) Government has closed FINSAC operations as of June 30, 2002. It has transferred FINSAC's remaining asset administration and legal responsibilities to FIS and has provided the Bank with a satisfactory strategy for management, disposal, and winding down of these assets.	As of May 2003, the Government has also sold J$3.9 billion in real estate and other assets.
Divestment of FINSAC Non-performing loan portfolio	Divestment of NPLs by FINSAC.	- Government has sold to a private financial institution FINSAC's entire NPL portfolio, which was acquired in the intervention process.	As of May 2003, FINSAC's total monthly recoveries amounted to about US$27.3 million (about J$1.3 billion.
Insurance Companies – Life of Jamaica	Restructure/ sell intervened insurance companies.	- Government has sold its entire equity in LOJ to a private financial institution. LOJ is the largest insurance company in the system with about 30 percent of total insurance assets.	The FSC reports the LOJ is performing satisfactorily, reflecting the major restructuring process undertaken through its sale, as supported by preliminary on-site supervision results. LOJ is also in the process of merger with Island Life. As of December 2002, LOJ has a market share of total life insurance assets of 16 percent, similar to its share in 2002. Once the merger is completed, its market share could increase to 22 percent (including the current market share of Island Life).

Legal/ regulatory/ supervisory framework for the banking sector	Continue strengthening BOJ's supervisory and enforcement capabilities to ensure safe and sound banks in Jamaica. Ensure consolidated supervision and supervision of market risk.	- Legislation has been passed by the Government's legislature providing BOJ greater independence and broader intervention powers by: • Granting BOJ the powers of temporary management of deposit taking financial institutions. • Granting the BOJ the legal and administrative powers to impose penalties in cases of certain technical breaches of statute by financial institutions. • Upgrading the schedule of fines and penalties for non-compliance by financial institutions. • Transferring all the supervisory powers of the Minister of Finance and Planning to the BOJ, except the powers to grant and revoke bank licenses and the power to vest shares of institutions. • Granting BOJ (i) extended jurisdiction over non-banking financial institutions that are part of a banking group, and (ii) the power to require the restructuring of a financial group.	The Government has begun drafting an omnibus law that would take into all the changes to the existing legislation that have been in the past few years and help in harmonizing the legislative framework across the financial sector. The BOJ continues to operate satisfactorily in its supervisory role for the financial sector and is continuing its institutional strengthening activities.
		- The Financial Regulatory Council, consisting of representatives of the Bank of Jamaica, the FSC, the MOF and the Jamaica Deposit Insurance Corporation was formally established in and it is functioning satisfactorily, for purposes of coordinating the supervision of financial institutions. It has also provided reports to the Minister of Finance and Planning on technical guidance provided to the respective regulatory bodies.	The FRC has been meeting regularly (six times during 2002), thus facilitating coordination and information sharing among regulators as well as harmonization of prudential regulations to reduce the possibility of regulatory arbitrage.
		- The BOJ completed an independent assessment of BCP in 2001 finding most of the 25 principles fully or largely compliant. Subsequently, it has adopted a plan and begun undertaking specific training initiatives and capacity building measures thereunder in supervision and regulation of market risk exposure of supervised entities towards achieving full compliance with the BCP.	The BOJ has continued to carry out training, with the help of international regulatory bodies.
		- Legislation has been passed to include provisions dealing with consolidated supervision and market risk. Guidelines for risk management, inclusive of market risks, have been drafted by BOJ. Regulations to ensure capital adequacy (reflecting the amendments above) have been drafted, and they are being implemented by the market, and they will shortly be signed into law. Those Regulations will be subject to further amendment to take into consideration market risks not currently covered.	The BOJ has ensured that coming regulations (chiefly, capital adequacy and risk classification and provisioning) are being complied with in advance bay banks.
		- BOJ, by amendments thereto in 2001 and 2002, has updated its Supervisory Ladder of Enforcement".	The BOJ, along with the other financial sector supervisors continue to update the ladder of enforcement as warranted.
		- A Bill of law for the creation of credit bureaus has been drafted by the Government and submitted for public consultation prior to its presentation to Parliament.	The bill is expected to be enacted during 2003.

Legal/ regulatory/ supervisory framework for the non-bank sector	Strengthen regulation and supervision of non-bank financial institutions.	- FSC has been established and it is functioning satisfactorily. - The new Insurance Act has been enacted and it is in line with international best practices, as determined by the Bank.	The FSC continues to operate satisfactorily and is in the process of building up its institutional capacity. The staffing of the FSC is largely in place and training activities in relevant areas are being undertaken.
		- FSC has issued regulations governing FSC activities and has continued strengthening its supervisory capacity through training under a plan satisfactory to the Bank.	The FSC is in the process of enhancing its internal capacity in terms of on- and off-site supervision of insurance companies. The former includes training on risk examination procedures.
		- FSC has taken the following steps to strengthen supervision of non-bank financial institutions: • Hired consultants for the design of software for financial solvency analysis; • Designed two risk-based modules (one for general insurance supervision and the other for life insurance supervision) and began undertaking on-site supervision.	The FSC is also implementing Securities Regulations in areas such as capital adequacy, custody of securities, payment and settlements system, and so on. Other regulations for the securities sector now under preparation include mutual funds and collective investment schemes, credit restrictions, and corporate governance. The FSC is also in the process of enhancing its supervisory capacity over all licensees under the "Examinations Project." The FSC is expected to be self-financed by end-2003. A draft Pension Act, containing the legal framework for pension schemes, will be shortly submitted by the Minister to Congress.
		- Government has committed to take the following actions to further strengthen the insurance sector's regulatory framework: • Issue regulations to harmonize the rules regarding changes in control (acquisitions, transfer, and amalgamation) of insurance providers with the licensing requirements therefor. • Issue regulations to monitor market conduct principles and protection of policyholders' interests (fair treatment). • Introduce non-binding consultation with other boards or agencies and industry in the appointment of at least one member of FSC's Board. • Revise regulations to better define standards (i.e., international ratings) for selection of foreign re-insurers, including the creation of a registry of admitted re-insurers that comply with said standards. -FSC has provided the Bank with a satisfactory time-bound plan to complete training of its supervisory staff.	The FSC has issued several guidelines to the industry on corporate management, investment management, audit committee, related parties, reporting requirements, etc.