

POLICY ADDRESS

FINANCIAL SECTOR REGULATION

Hon. NIGEL CLARKE, MP, DPHIL
Minister of Finance and the Public Service
January 23, 2023

I address you at a time of great concern in our society. The alleged fraud at Stocks and Securities Limited (“SSL”), which at this time, is estimated at over J\$2 billion represents one of the largest securities frauds in a security dealer since the Financial Services Commission came into existence nearly 30 years ago. It is an alarming amount that shocked the soul of Jamaica.

In addition, the anger and unease we all feel have been magnified by the long duration – 13 years - over which the fraud was allegedly perpetrated and the fact that the perpetrator or perpetrators seemed to have deliberately and heartlessly targeted elderly persons, as well as our much loved and respected National Icon, Ambassador Usain Bolt.

Furthermore, the coverage of this fraud in every major media outlet across the globe is a source of great embarrassment to Jamaicans here and in the diaspora.

I feel the full range of those emotions...anger, disgust and hurt. Like many Jamaicans I am pained by these events.

This is a body blow to Jamaica and has the unfortunate impact of tarnishing Jamaica’s global reputation. I am extremely saddened by this.

Over the past thirty years Jamaica has successively failed to successfully arrest and prosecute persons who were allegedly criminally responsible during the “FINSAC” era, neither those criminally responsible for “Cashplus”, “Olint”, “Worldwise” and other such schemes. Similarly, persons allegedly responsible for public sector frauds over much of the last thirty years have similarly escaped the punishment regularly meted out to others.

With that as our historical context, the SSL fraud has touched especially raw nerves:

- A nerve that represents the reservoir of distrust that has developed based on what many believe to be the historical Jamaican experience of one law for some and another law for others;
- A nerve that captures the wells of suspicion that white-collar crimes are processed and treated differently from other crimes;

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- A nerve that characterizes the deep pool of cynicism in our country where there is sometimes a belief that the real truth is artificially suppressed and nothing ever really changes.

These waters of distrust, suspicion and cynicism are existential threats to our society. It will take time to drain the system of these and we must begin now.

This time must be different.

Let me repeat what I have said and what the Most Honorable Prime Minister has said:

There will be full transparency in this matter. No stone will be left unturned.

The investigative authorities have full operational independence and will pursue the facts wherever they may lead. They will unearth exactly how funds were allegedly stolen, who benefited from such theft and who organized and collaborated in this. The probe will also seek to identify whether assets have been acquired with the proceeds of this fraud. If and when such assets are identified all legal steps will be taken to restrain these assets with the intention of full forfeiture. Having spoken with some of those leading the investigation I can say that they are resolute and determined to unravel its complexities and bring all responsible to justice.

In fact, based on the magnitude of this fraud and the lines of enquiry being pursued, the Financial Investigations Division and the Fraud Squad have already sought assistance from the Federal Bureau of Investigations (FBI) and other international partners.

1.0 THE FINANCIAL SECTOR IS STRONG

Ladies and Gentlemen, Jamaica's financial sector remains strong.

According to information provided by the FSC:

- There are 38 licensed security dealers operating in Jamaica.
- Security Dealers had assets under management that exceeded \$1.45 trillion as at September 30, 2022.
- The assets managed by SSL represented a little over 2% of the total assets under management by security dealers.

This does not minimize anyone's loss. As I said earlier, this fraud is one of the largest securities frauds in the last two decades. The market share information simply places SSL's demise into a national context.

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SSL was a relatively small securities dealer and its problems do not pose a systemic risk to the financial system. There is therefore no need for panic.

The financial sector is strong and well capitalized.

The financial sector is resilient.

The financial sector survived the Global Financial Crisis, two debt exchanges, the COVID-19 economic shock, the inflation crisis and it even managed to grow through all of it.

Not only is the financial sector strong, it is also resilient.

More specifically, the Securities Industry remains a strong and critical pillar upon which the Country, the Economy and our Investing Public depend upon. We as a country require a strong, stable and credible Securities Dealers Industry that is ready to operate not only on the regional level but internationally as well to move the country forward.

2.0 FSC REGULATORY HISTORY WITH RESPECT TO SSL

The Financial Services Commission has a Board of Commissioners appointed by the Minister and an Executive Director responsible for day-to-day affairs. It is operationally independent in supervisory and regulatory matters, which is the way it was set up and the way we want it to be. You do not want elected officials making prudential and regulatory decisions.

Let me also state categorically that, in approximately five (5) years of service as Minister of Finance and the Public Service, neither the FSC Board of Commissioners nor the FSC Executive Director nor any person from the FSC has ever raised Stocks and Securities with me in any way.

In fulfillment of our commitment to transparency in this matter and acting under Section 68 (1)A, sub-paragraph (c) of the Financial Services Commission Act, the FSC will release the regulatory chronology of SSL from 2010 to 2023 to the public.

We should not allow this account, however, to distract us from the fact that managers and directors of securities firms have a duty of care to their company and to their clients and this duty of care is independent of regulatory agencies. The managers and directors cannot be exonerated from that duty of care. They must account for their stewardship of SSL.

Furthermore, please recall that the FSC relies on the reports of external auditors and the reports of the management of licensees. For example, if the external

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audit records a balance as an asset on the balance sheet this generally means that the balance ought to be collectable.

The chronology shows that SSL was under regulatory scrutiny for much of the thirteen years between 2010 and 2023:

- SSL was under Directions¹ from the FSC for the period 2010 – 2013
- SSL was under amended Directions from 2013 – 2017
- SSL was again placed under Directions during the period 2019 – 2022 following the results of an on-site examination
- SSL was placed under Additional Directions in 2023

For ten of the past thirteen years, SSL has been under Directions from the FSC.

- Furthermore, the Board of Commissioners voted to Issue a Notice of Suspension, the most severe sanction, November 2016.
- All directors of SSL were required to provide the FSC with an undertaking of the SSL Board, signed by its directors, to implement specific actions as an alternative to license suspension. This is a legitimate enhanced supervisory technique provided for in law.
- SSL was put under enhanced supervision in June 2022

An objective review of the chronology of regulatory activity, over thirteen years, spanning three political administrations, four executive directors² (inclusive of an acting executive director) and at least five chairpersons³ shows a consistent approach of the FSC opting to work with a licensee towards rehabilitation rather than putting it out of business.

¹ In the context of financial sector regulation, “Directions” refers to specific instructions issued by the FSC to SSL. These instructions may relate to issues such as compliance with laws, regulations, or with risk management and operational procedures.

² Rohan Barnett (Executive Director), January 5, 2009 – March 30, 2012
Leon Anderson (Acting Executive Director) April 1, 2012 – March 10, 2013
Janice Holness (Executive Director) March 11, 2013 – June 2017
Everton McFarlane (Executive Director) August 1, 2017 – January 31, 2023

³ Emile George (deceased), 2010/11, 2011/12 (partially)
Colin Bullock (deceased), 2012/13, 2013/14, 2014/15, 2015/2016
Howard Mitchell, 2016/17
Jackie Stewart-Lechler July 2017 – September 2021
John Robinson September 2021 - 2023

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Over this time period as the FSC discovered breaches, it gave the entity Directions and followed up to ensure that those Directions were followed and implemented which, for the most part, they were.

This was not a JLP approach or a PNP approach. This was not Emile George's or Colin Bullock's or Howard Mitchell or Jackie Stewart Lechler or John Robinson's approach. The evidence suggests that this was consistent institutional approach throughout the 13 years of FSC's regulatory scrutiny.

For ALL of this 13 year period, according to the signed affidavit in the public domain, the fraud at SSL was occurring.

The fraud was occurring for under the JLP and under the PNP.

The fraud was occurring under the Collin Bullock's chaired FSC, Emile George's chaired FSC, Howard Mitchell chaired FSC, the Jackie Stewart chaired FSC and the John Robinson chaired FSC.

This is a serious issue – how did this fraud go undetected for 13 years, perhaps longer?

With external auditors, regulators, managers, bankers, and later internal auditors how did this fraud go undetected for 13 years?

I put it to you – that is the most important question. And it is a question this Government will ensure is answered.

Today, I will write to our international partners who have traditionally provided support to the Financial Investigations Division, and other law enforcement agencies, to specifically request the assistance of international forensic auditors to unravel this 13-year fraud so we can bring to justice all perpetrators and all co-conspirators.

IMF Agreement

This 13-year fraud has provided a window into how fragile financial sector confidence can be. While Jamaica has engaged in enhancing our financial sector regulatory environment, which is much stronger today, than a decade ago there is clearly more work to do.

In our December 2022 letter to the Managing Director the IMF, following the Staff-Level Agreement on the Precautionary and Liquidity Line and the Resilience and Sustainability Fund, we advised the Fund of reforms in the financial sector, that we have been pursuing, to strengthen stability, sustainability.

These include:

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- **A Special Resolution Regime law to strengthen the resolution of non-viable financial institutions while protecting financial stability and the public funds, in line with Fund staff recommendations. We have committed to a date of March 2024 to submit this law to parliament.**
- **A methodology via a BOJ consultation paper to identify systemically important (bank and non-bank) financial institutions and identify such institutions. We have committed to a date of September 2023 to submit this law to parliament.**
- **Establishing supervision by the Financial Services Commission of financial conglomerates without a deposit taking institution. We have committed to a date of September 2023 to submit this law to parliament.**

We have an ambition to be a vibrant, prosperous country with a strong financial sector. We have the largest and most dynamic stock market in the English speaking Caribbean. We have the largest and most dynamic bond market in the English speaking Caribbean. While we don't have an offshore financial sector like some Caribbean countries, we have the most developed capital markets in Central America and the Caribbean.

These are achievements we hope to build on. Strong capital markets can play a pivotal role in development. For our capital markets to achieve its potential confidence in its safety and soundness is vital. Furthermore, for our society to strengthen in peace, unity and cohesion fairness, equity and justice must be manifestly present everywhere, including in our capital markets.

We as a country operate in a complex interconnected global financial market, for us to attain and to maintain the position of a trusted counterpart to international business we must strengthen all of our abilities to identify, investigate and prosecute financial crimes, as such we will be working not just with the regulators but also with the Financial Investigations Division of law enforcement to ensure that the best human and technological resources are in place and are empowered to play their role in protecting not only our investing public but all investors

To take the Jamaican financial sector to the next level, the GOJ's reforms will include:

- **A review the penalty regimes in the Securities Act, the Banking Act, the Insurance Act and the Pensions Act. We will stiffen the penalties for white-collar crime in the financial sector. The discrepancy between white-collar crime and other forms of crime must be erased. If you rob depositors or defraud investors, you undermine the financial system and put our way of life at risk and, as such the Jamaican society wants you put away for a long, long time. 15 years perhaps.**

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- **The GOJ will require security dealers to publish their financial statements and material events at standards equivalent to public companies on the Jamaica Stock Exchange.**
- **The GOJ will tighten regulations around connected party transactions for security dealers.**
- **The GOJ will introduce a fixed penalty regime – where companies can be fined for AML/CFT and other breaches – if they don't pay they go to court. (What we have now authorities have to take companies through the court process for a penalties to be applied)**
- **The GOJ will tighten regulations around insider trading and ensure that the penalty and sanctions regime is severe and dissuasive.**
- **The GOJ will tighten regulations in such a manner that ensures that the penalty and sanctions regime against front running of clients in capital markets is severe and dissuasive.**

We will request technical assistance from our international partners in the design of these reforms and in advising us of additional reforms that may be necessary.

Non-Deposit Taking Financial Sector Regulation Reform

The institutional arrangements and approach of the FSC over these past 13 years, as highlighted by the case in question, cannot take us into the future.

Last week I had a discussion with the outgoing Executive Director that we needed to pursue a new direction at the FSC and I would need him to make way for that. Without hesitation he concurred and agreed to provide his resignation assuming we could mutually agree on the terms of his exit from his three-year contract that ordinarily would have expired in July 2023.

So as not to distract from the substance of today, tomorrow I plan to disclose the terms of his exit, which hew closely to what he is contractually entitled, given the circumstances of his exit.

As I announced last Thursday, Mr. Kerron Blair, Chief Prudential Officer of the Bank of Jamaica will succeed Mr. Everton McFarlane as Executive Director of the FSC.

Furthermore, there are four members of the current board of commissioners have volunteered to provide the vacancies that allowed me to make the following appointments to the board of the FSC which are effective today:

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Mr. Richard Byles, Governor of the Bank of Jamaica, will be Chairman of the Board of the FSC.

He will be joined on the Board of the FSC by:

Mr. Wayne Robinson, Senior Deputy Governor of the Bank of Jamaica

Mr. Jide Lewis, Deputy Governor of the BOJ in charge of Supervision

Mr. George Roper, Deputy Governor of the BOJ for Finance, Technology and Administration and a former Deputy Executive Director of the FSC

Another person to be named.

I do not believe in complete turnover of Boards as institutional memory is lost. Furthermore, that practice no longer accords with regulation.

As such the Board Commissioners who remain are:

Mr. Irwin Burton, former Deputy CEO of GraceKennedy

Mr. Dennis Brown, retired partner of PWC

Ms. Kenisha Davis, attorney-at-law

Mrs. Hilary Robertson, senior director at the BOJ on secondment to the Ministry of Finance

The immediate responsibilities of the new Board, in addition to what would customarily apply, are to:

- (i) oversee the current intervention in SSL;
- (ii) establish a mechanism to review FSCs approach to the SSL's case in order to identify gaps and constraints;
- (iii) assess the status of other licensees and whether there are concerns or potential concerns in respect of any other company in the securities industry;

Moving to a Twin Peak Model of Financial Sector Supervision

The institutional structure of regulation should reflect the structure of the industry that it is called upon to regulate.

With the intention of supporting the continued growth of the financial sector, while preserving the safety and soundness of the financial system, we need a regulatory structure that is appropriate for our circumstances and responsive to our needs.

In Jamaica, financial groups that include deposit-taking institutions account for close to 90% of financial system assets.

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That is, the Jamaican financial landscape is characterized by a number of financial conglomerates spanning banking, securities, insurance, and pensions that account for all but 10% of financial system assets.

Fragmented supervision can lead to regulatory gaps in a landscape such as ours where financial conglomerates dominate. In addition, there is often duplication of effort, duplicate oversight, and sometimes coordination challenges. The natural institutional silos that emerge detract from the nimbleness needed to comprehensively regulate financial groups.

The GOJ will pursue a unification of prudential supervision and regulation. The prudential supervision and regulation of deposit taking financial institutions, (commercial banks, building societies, merchant banks and credit unions) and non-bank financial institutions (securities dealers, insurance companies and pension funds) will be consolidated into one institution – the Bank of Jamaica (BOJ) - and a separate regulator for market conduct and consumer protection for the full spectrum of financial services will be established separately.

Market conduct and consumer protection regulation refers to the oversight of financial institutions to ensure that they are engaging in fair and ethical business practices and are treating customers fairly. This includes monitoring compliance with laws and regulations related to consumer protection, anti-money laundering, and anti-fraud measures. It also includes monitoring the sales and marketing practices of financial institutions to ensure that they are not engaging in deceptive or misleading conduct. The goal of market conduct regulation is to protect consumer and maintain the integrity of the financial marketplace.

Today Jamaica has a sector-by-sector based regulatory approach where the BOJ regulates deposit-taking institutions and the FSC regulates non-bank financial institutions.

Under the Twin Peaks regulatory model that we will be pursuing:

- (i) the prudential mandate of the FSC with respect to the non-deposit taking financial sector would be fully taken over by the BOJ and;
- (ii) the new FSC would become a highly visible market conduct and consumer protection supervision for all financial service providers (Deposit-taking institutions, Non-bank financial institutions, Cambios and remittance companies)

While some of the issues outlined in having sectoral regulators could be resolved by close coordination and cooperation of sectoral supervisors (such as Memorandum of Understanding (MoUs) and Statutory Committees such as the FRC), an integrated single prudential supervisor will be in a better position to address them. In particular, coordination and exchange of information will be smoother within one institution, as well as the effort to close any existing regulatory gaps within the regime.

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The implementation of a single prudential regulator (twin-peaks model) for Deposit-taking institutions and Non-bank financial institutions has several advantages:

- A single authority would provide economies of scale in supervision
- A single authority would allow for sharing of specialist knowledge across the supervisory spectrum
- It would help preserve scarce management resources
- A single authority would facilitate delivery of the much-needed system-wide oversight and effective supervision.
- It would help promote a consistent, harmonized framework of regulatory requirements, where applicable, and of supervisory methodology, reducing regulatory arbitrage and gaps.
- A single authority would generate cost savings relative to current arrangements, through the rationalization of management and support functions.

- More significantly, it would create options for more effective organization of resources, facilitating risk-based allocation of staff to emerging supervisory risks and different approaches to conglomerate supervision (these could include the creation of a single team for one or more groups, maximizing the synergies from the integrated model). Coordination of supervisory work would be greatly facilitated.

- It would create a richer, more dynamic scope for employees allowing for development and sharing of expertise while offering more challenging career paths for supervisory staff

Implementation of the Twin Peak Model of Financial Sector Supervision

The proposed integration of the prudential activities of the FSC into the BOJ involves 3 components – Interim Management, Legal and Governance Reform, Institutional Restructuring.

(i) Integrated Management

The regulatory responsibilities of the BOJ and FSC will continue to run in parallel initially, while the framework for a merger of the responsibilities (Legal and Governance Reform, Institutional Restructuring) are worked through. The composition of the new board and management are designed to facilitate the integration process.

We are about to access the PLL and RSF from the Fund. During the 18 month duration of these programmes, the BOJ and the FSC will continue to operate separately with integrated management.

(ii) Legal and Governance Reform

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Obtain technical assistance from multilateral partners and international consultants.

Determine and draft the required amendments to the relevant legislations, including the Financial Services Commission Act and Bank of Jamaica Act, among other legislation and the institutional governance reforms.

- (iii) Institutional Restructuring
Undertaking an organisational review of the FSC (and BOJ's FISD) to inform the new structure and staffing arrangements.

Market Conduct/Consumer Protection

The current work on the draft Bill for Financial Service Consumer Protection continues, incorporating the new direction with regard to consumer protection with the view that a reformed FSC could take on this role.

Timeline for Twin

We will need technical advice and time to consult with industry participants on the details. We expect to fully implement a unified financial sector regulator and a separate market conduct/consumer protection regulator for the financial sector in 18 – 24 months.

Capacity Building

Even with an upgrading of the regulatory structure to reflect the industry, Jamaica needs to continuously and sustainably strengthen and renew its regulatory and supervisory capacity.

BOJ currently has a range of international partnerships that provide training. This could be expanded and formalized. The economies of scale of a consolidated supervisor would allow the BOJ the opportunity to create its own staff training college, (not a physical college) for supervisory and prudential regulators.

CONCLUDING REMARKS