I. INTRODUCTION

In recent years, banking crises in the international banking community, notably in Argentina, Chile and Venezuela have led policymakers and bankers to reexamine the efficiency of banking operations. Unlike some other countries, Jamaica has not experienced the level or severity of problems that result from unsound and inefficient banking practices. There is, however, evidence to support the observation that banks have been performing below optimal levels of efficiency.

The objective of this paper is to ascertain whether the level of efficiency which obtains in Jamaica's commercial banks is consistent with the operation of a sound banking system. The financial sector in Jamaica is dominated by commercial banks. In 1990, these institutions accounted for 57.8 per cent of total assets of selected finan-

Updated version (May 13, 1998) of the paper presented by N. Panton, Senior Economist of the Research Services Department of the Bank of Jamaica, at the XXXIII Meeting of Technicians of Central Banks of the American Continent, organized by CEMLA in Mexico City, Mexico, in November 1996. The views expressed are those of the author and not necessarily those of the Bank of Jamaica.

MONEY AFFAIRS, JAN-JUN 1998
cial institutions,¹ which increased to 83.6 per cent in 1995. Due to their dominant position in the financial sector, commercial banks mobilize a significant share of the sector’s savings, and are therefore highly accountable to their shareholders, clients and the nation. The paper will focus on the efficiency of commercial banks in delivering products and services at least cost, and on the overall proficiency of banks in carrying out their daily operations.

While there is no comprehensive definition of financial sector efficiency, economic literature on financial sector development identifies several criteria which may be used as measurements of such efficiency. This paper subscribes to the notion of operational or functional efficiency (Tobin, James, 1984) which looks at the overall performance of banks, chiefly by an examining risk management, allocation of resources and the administration of payments’ mechanisms. Functional/operational efficiency may be assessed by the soundness of the bank’s appraisal system. This can be measured by the level of arrears, the resource cost of specific operations, the quality and speed of delivery of services and the bureaucracy involved, particularly in routine financial transactions such as making deposits. The actual measurement of efficiency for the most part is done by the use of various operating performance ratios. These are compared to international benchmarks in order to ascertain the relative efficiency of commercial banks in Jamaica. The paper also attempts to assess efficiency from the perspective of the banks’ clients, as it is recognized that bankers’ idea of efficiency may not necessarily accord with that of their clients.

The paper is presented in four sections. Section II provides a background of the macroeconomic environment and financial sector development with specific reference to the commercial banks. Section III evaluates the performance of commercial banks with regard to their level of efficiency. Section IV (conclusion) will recommend some measures which commercial banks need to implement in order to bring about improved levels of efficiency.

II. BACKGROUND

1. The macroeconomic and financial environment

After more than a decade of structural adjustment, the Jamai-

¹ Selected financial institutions include commercial banks, merchant banks, trust companies, finance houses, building societies, insurance companies and credit unions.
can economy is now in an advanced stage of economic liberalization. The structural adjustment programme which began in the 1980s included elements of trade, public and financial sector reforms. The essential thrust of the programme was the reorientation of the economy toward private sector export-led growth and to enhance the flow of aggregate supply and net foreign exchange earnings. Since the late 1980s, the principal objective of macroeconomic policy has been the attainment of levels of inflation consistent with those of the country’s main trading partners. Other policy objectives have included the achievement of adequate foreign reserves and more manageable debt servicing, as well as the generation of surpluses in public sector financial operations.

Macroeconomic policy initiatives implemented over the period have met with mixed success. Real growth in the economy as seen in table 1, slowed from an average of 5 per cent in the 1986-90 period to less than 1 per cent during the period 1991-95. The annual inflation rate has declined, recording a rate of 25.6 per cent in 1995, after peaking at 80.2 per cent in 1991. The public

| TABLE 1. SELECTIVE MACROECONOMIC INDICATORS, 1990-95 |
|-----------------|-------|-------|-------|-------|-------|-------|
| Growth in GDP   | 5.5   | 0.7   | 1.4   | 1.4   | 0.8   | 0.5   |
| Inflation rate  | 9.8   | 80.2  | 40.2  | 30.1  | 26.8  | 25.6  |
| (point-to-point)|       |       |       |       |       |       |
| Overall public  | -4.3  | -0.4  | 2.2   | 1.7   | 4.7   | 3.0   |
| sector balances (\% GDP) |       |       |       |       |       |       |
| M2 growth rate  | 12.6  | 83.7  | 68.6  | 46.0  | 37.2  | 35.2  |
| M2/GDP          | 34.1  | 30.3  | 31.5  | 34.5  | 35.5  | 38.5  |
| Interest rates, 91 days |
| T'bills         | 27.0  | 35.1  | 25.8  | 38.4  | 27.0b | 19.4  |
| Savings ratea   | 18.0  | 18.0  | 21.5  | 20.0  | 20.0  | 19.5  |
| Avg. com. bank lendinga | 38.0  | 40.1  | 46.4  | 61.3  | 56.1  | 55.3  |
| Exchange rate e. o. p. | 8.1   | 21.5  | 22.2  | 32.5  | 33.2  | 39.6  |
| External debt service ratio | 30.4  | 30.6  | 42.2  | 36.0  | 27.9  | 24.0  |
| Change in NIR (US$ mn.) | 59.6  | -105.2| 337.2 | 113.4 | 337.5 | 65.3  |

SOURCE: Bank of Jamaica & Statistical Institute of Jamaica. a End of period. b 116 days.
sector has been achieving surpluses for the past three years. Following the liberalization of the foreign exchange market in 1990, there was rapid depreciation in the exchange rate from J$8.01 = US$1.00 to a relatively stable rate of J$39.6 = US$1.00 at end December 1995. Since April 1996, there has been a revaluation of the currency to an average weighted rate of J$37.8 = US$1.00 at the end of July. The Central Bank accumulated Net International Reserves (NIR) of US$421.3 million (equivalent to more than 17 weeks of non-bauxite imports) by the end of 1995, compared with negative reserves of US$314.2 million at the end of 1990. The country's debt service ratio (actual) at the end of 1995 was 20.1 per cent compared with 28.5 per cent at the end of 1990.

Trade reforms, mainly through the removal and/or reduction in tariffs, have underpinned the movement toward a more liberalized economy. In addition, the liberalization of the foreign exchange market and the subsequent removal of exchange controls in September 1991 resulted in a significant increase of foreign capital inflows into the country. This was aided by relatively large interest rates differentials on domestic money market instruments. The nominal rate on short-term treasury bills for the first six months of 1996 has been above 40 per cent, approximately 10 per cent in real terms.

Since 1985, financial reforms have been an integral part of the economic liberalization programme. Prior to 1985, the financial system was characterized by high levels of government regulation and bureaucratic controls on market entry. Other elements of financial repression such as low and sometimes negative real interest rates, credit ceilings and administered saving rates were identifiable features of the financial system during this period. Liberalization of the financial sector has involved a shift from allocating resources through directives toward greater reliance on market processes. In the post reform period, the financial sector emerged as one of the fastest growing sectors, recording a growth rate of 13.4 per cent during the 1990s. The sector has also made a significant contribution to GDP, and is, in fact, the second largest contributor with a share of 15.1 per cent in 1995. The process of financial reform has contributed to the emergence of a more competitive financial system, as over the last ten years, the sector has benefited from growth in the number and types of institutions, an expansion in the range of products offered to customers, new and improved credit and business facilities and the emergence of financial conglomerates. Numbering nine at the end of 1995, these financial conglomerates, of which commercial banks
are an integral part, have resulted in entities with a complex structures of inter-company share holdings, interlocking boards of directors, common management and extensive inter-company transactions. By the end of 1995, the financial sector comprised a Central Bank, eleven (11) commercial banks with one hundred and eighty-four branches, twenty-six (26) merchant banks, six (6) investment banks, four (4) finance houses, three (3) development banks, eleven (11) life and eighteen (18) general insurance companies, thirty-six (36) building societies and eighty-six (86) credit unions.

The legislation governing the regulation and supervision of the financial system has not kept pace with the growth and development of the sector, and as financial institutions have been operating under several different statutes (some of which are dated), the existing legislation is inadequate to appropriately deal with the operation of certain processes, products and relationships. This has led to recent changes in the legislation governing the operations of supervised deposit-taking financial intermediaries. The Banking Act (1961) and the Protection of Depositors Act (1966) were repealed and replaced by the Banking Act (1992) and the Financial Institutions Act (1992). During the latter part of 1995, two Task Forces were appointed to address legislative reforms and the introduction of a Deposit Insurance Scheme, with the latter slated to become operational during 1997. In addition, the human resource of the Bank Supervisory Division of the Bank of Jamaica has been increased and strengthened, through training, to meet the challenges of the emerging financial environment.

2. The performance of commercial banks, 1990-95

In Jamaica, as in most Caribbean nations, the financial system is dominated by commercial banks. This dominance by commercial banks is even more pervasive because of the banks' affiliation with other financial and non-financial institutions. Of the eleven commercial banks, three are wholly foreign owned, with another three having overseas affiliates. Three large banks dominate competition within the sector. Against the background of a high inflation environment, the deregulation of the financial system

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2 See Amendments to Financial Legislation, Appendix 4.
3 Since 1996, there has been an effective merger of two of the three largest commercial banks.
and increased competition from other financial institutions, commercial banks (especially the smaller indigenous banks) moved to enhance market share by rapidly increasing the riskiness of their portfolios. This was seen in the significant expansion in the balance sheets of commercial banks, as measured by the ratio of bank lending to GDP (constant prices). This ratio increased from 16 per cent in 1991 to 45 per cent in 1994. By 1995, with the shift in economic conditions (as was evidenced by the stability in the exchange rate and the reduction in the rate of growth of money supply and inflation rate), the increased risks undertaken by the banks were exposed, resulting in lower profitability for commercial banks. At the same time, loans collateralized by real estate were adversely affected, in that, the same conditions which reduced the borrowers' ability to pay, simultaneously reduced the value of the collateral.

At the end of 1995, assets of commercial banks totaled J$119,622.9 million (see table 2), with the three largest banks accounting for J$86,434.3 million or 72.3 per cent of total assets of commercial banks. Commercial bank assets represented 55 per cent of the total assets of the financial sector.

| TABLE 2. COMMERCIAL BANKS' ASSETS, J$MN (END OF PERIOD), 1990-95 |
|------------------|--|---|---|---|--|---|
| All banks        | 17,088.7 | 27,394.7 | 46,624.8 | 61,717.0 | 94,994.2 | 119,476.9 |
| 3 large banks    | 11,969.3 | 19,056.9 | 30,210.4 | 40,936 | 64,024.2 | 86,434.3 |
| Other banks      | 5,119.4 | 8,337.8 | 16,414.4 | 20,781 | 30,970 | 33,042.6 |
| Large banks % of all banks | 70.0 | 70.0 | 65.0 | 66.0 | 67.4 | 72.3 |

SOURCE: Bank of Jamaica.

The banking sector provides credit to fund working capital and the acquisition of fixed assets. Loans and advances outstanding from commercial banks increased from J$8.7 billion at the end of 1990 to J$44.2 billion at the end of 1995, an increase of 414 per cent. As a proportion of total credit outstanding, loans and advances to the productive sector stood at 48.3 per cent at the end of 1995 relative to 72.5 per cent in 1990. The liberalization of the foreign exchange market in 1991 made it possible for banks to grant foreign currency loans which were seen as a cheaper source of financing. Commercial banks have indicated that foreign currency loans have played a significant role in financing export ac-
tivities. At the end of 1995 outstanding foreign currency loan balances were US$363.80 million, a 17.4 per cent increase over the corresponding period of 1994.

Commercial banks attract the bulk of the private sector’s financial savings. The eleven commercial banks offer interest and non-interest bearing demand, savings and time deposits. There has been significant growth in commercial banks’ deposits over the period 1990 - 1995. On an annual basis, nominal growth in total deposits averaged more than 30 per cent. The highest concentration of commercial banks’ deposits is in savings deposits which attract low interest rates and accounted for approximately 50 per cent of total deposits in 1990 and 42 per cent in 1995.

| TABLE 3. COMMERCIAL BANKS’ LOANS & ADVANCES OUTSTANDING, J$MN (END OF PERIOD), 1990-95 |
|-----------------------------------------------|---------|---------|---------|---------|---------|---------|
| All banks                                     | 8,758.2 | 11,482.9| 13,651.8| 23,039.0| 31,259.8| 44,162.2|
| 3 large banks                                 | 6,733.3 | 8,671.0 | 9,429.7 | 16,209.3| 22,087.0| 31,778.7|
| Other banks                                   | 2,024.4 | 2,811.9 | 4,222.1 | 6,830.1 | 9,172.8 | 12,385.5|
| Large banks % of all banks                    | 77.0    | 75.5    | 69.0    | 70.3    | 70.6    | 72.0    |

Source: Bank of Jamaica.

As a result of the oligopolistic structure of commercial banking in Jamaica, more than 70 per cent of total deposits are concentrated in the three large banks. These banks are able to mobilize a larger proportion of deposits due to wide branch networks. In this context, deposit portfolios of the large banks are skewed toward savings and demand deposits. The smaller indigenous banks, in an effort to compete with the larger banks, are forced to operate more expensive term deposits with some banks offering NOW accounts (interest-bearing chequing accounts).

The minimum capital requirement of commercial banks is $80.0 million. The capital base may comprise paid-up capital, reserve fund, retained earnings, reserve and share premium less impairment by losses. The capital base of the banking system, J$4512.2 million in 1994, decreased by 12.4 per cent to J$3950.6 million in 1995. This compares with significant growth of 61 per cent in 1994. This growth occurred against the background of the
recently imposed Banking Act (1992) which requires that "a bank shall not incur deposit liabilities of an amount exceeding twenty-five times the amount of its capital base." In addition, several banks increased their capital base in 1994 to meet Basle Committee recommendations of 8.0 per cent of risk weighted assets. The increased capital was used primarily to facilitate capital expansion programmes, mainly in areas of computerization, product and technological innovations, as well as the establishment of new branches and affiliated institutions both locally and overseas. On the other hand, the decrease in the capital base in 1995 occurred against the background of declining profits and the operating losses of some commercial banks.

**TABLE 4. COMMERCIAL BANKS' DEPOSITS, J$MN (END OF PERIOD), 1990-1995**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>All banks</td>
<td>11,997.5</td>
<td>17,419.8</td>
<td>33,153.6</td>
<td>45,676.8</td>
<td>69,523.5</td>
<td>89,336.5</td>
</tr>
<tr>
<td>3 large banks</td>
<td>8,761.0</td>
<td>13,027.0</td>
<td>22,718.6</td>
<td>31,212.8</td>
<td>47,081.7</td>
<td>64,789.1</td>
</tr>
<tr>
<td>Other banks</td>
<td>3,236.5</td>
<td>4,392.8</td>
<td>10,435.0</td>
<td>14,464.0</td>
<td>22,441.8</td>
<td>24,547.4</td>
</tr>
<tr>
<td>Large banks % of all banks</td>
<td>73.0</td>
<td>74.8</td>
<td>68.5</td>
<td>68.3</td>
<td>67.7</td>
<td>72.5</td>
</tr>
</tbody>
</table>

SOURCE: Bank of Jamaica.

In recent times some commercial banks have experienced severe liquidity problems. Banking system liquidity is controlled by the use of Reverse Repurchase transactions and statutory reserve requirements. Commercial banks hold two types of deposits with the Bank of Jamaica - a current account and a statutory cash reserve account. The current account is held as an operating account to meet daily clearings, while the reserve account is held to fulfill statutory cash reserve requirements. The overall statutory reserve is 47 per cent, disaggregated into a cash reserve of 25 per cent and a liquid asset reserve of 22 per cent. A statutory cash reserve of 20 percent is required for foreign liabilities. At present, a penalty is charged on overdrafts or breaches of reserve requirements. The Central Bank investigates all circumstances in which a bank's current account remains in overdraft for more than three or four consecutive business days.

The graph depicting daily current account balances suggests that the incidence of commercial banks' overdrafts increased
FIGURE 1. CURRENT ACCOUNT BALANCES OF JAMAICAN COMMERCIAL BANKS (April 1990-May 1996)

since 1995. It is evident that the landscape of the commercial banking sector had been transformed, and was on the verge of even more far-reaching changes. One indication of this was seen in July 1996, when a medium-sized bank was deemed to be insolvent by the Central Bank.4

Another noticeable feature of commercial banks in the 1990s has been the growth in off-balance sheet activities. These are commitments made by the bank for clients that could potentially create loans if clients are unable to honour their obligations. These transactions represent a credit risk to the institution, and are thus added to risk weighted assets for calculating capital adequacy. Commercial paper is an off-balance sheet transaction that has grown significantly in recent years. By the end of June 1995, commercial paper guaranteed by commercial banks was approximately $5.4 billion, or 88 per cent of total paper guaranteed by financial institutions. In addition, over this period, the banks brokered commercial paper transactions amounting to $2.2 billion. Although the companies involved in commercial paper activities are usually blue chip companies, given the more competitive economic environment, even the most solid companies have been experiencing problems. The extent of banks' exposure in this market raises questions concerning the level of re-

4 This bank was placed under temporary management in July 1996.
sponsibility shown by banks in guaranteeing commercial paper of companies that may not be deemed blue chip. This suggests that banks may be exposing themselves to some avoidable risks.

The significant growth of the commercial banking sector in terms of assets and liabilities, and the diversification into non-core activities was assisted to a certain extent by the performance of the macro economy. Relaxation of controls under the financial liberalization programme of the 1980s and early 1990s created opportunities for commercial banks to diversify into other type of businesses. At the same time, high rates of domestic inflation encouraged inflationary profits. Subsequent macroeconomic stabilization efforts exposed the fragility of the financial sector and the banking sector, in particular - a situation which has become more visible since 1995. This was evidenced in the growth in non-performing loans and declines in profitability and capital adequacy requirements. In this regard, there is an urgent need to examine whether the efficiency level in Jamaica's commercial banks is consistent with that which is required for the operation of a sound banking system.

III. COMMERCIAL BANKING IN JAMAICA:
SOME ISSUES OF EFFICIENCY

1. Expansion of commercial banks' balance sheets

The annual rate of growth of commercial banks' assets over the period 1990-95 appears to pattern macroeconomic developments in the wider society. From an increase of 13 per cent in 1990, the growth rate peaked at 70 per cent in 1992 and fell to 26 per cent in 1995. The high growth rates of 60 per cent and 70 per cent in 1991 and 1992 respectively, coincided with periods of high annual inflation. A buoyant real estate market also created profitable opportunities for banks through lending and via direct acquisition of these assets. In addition, the liberalization of the foreign exchange market created income-earning opportunities from foreign currency trading and lending activities.

In light of the foregoing, it is questionable whether this increase in assets resulted from improvements in efficiency levels. This is borne out by the inability of the banks to maintain the growth momentum as inflation declined in the subsequent years. It is also important to note that while the three large banks
maintained a high asset concentration ratio of approximately 68.0 per cent over the period, there was no appreciable increase in the assets of the small banks. Efficiency, when measured by an increase in assets, is therefore significantly skewed in favour of the large banks with wide branch networks.

2. Performance of commercial banks' loan portfolios

An examination of commercial banks' loan portfolios reflects significant levels of inefficiency as measured by the extent of loan delinquency. Loans past due for six months or more is used as a benchmark to measure those loans that are at risk of default. This category of loans increased from $742.2 million in 1990 to $4.8 billion in 1995 (see figure 2), an increase of 546 percent. In addition, delinquent loans which were 8.2 per cent of total loans in 1990, increased to 10.4 percent of total loans in 1995.

The build up of non-performing loans is a major concern to policy makers, as generally, this is a sign not only of inefficient management of loan portfolios but also of financial distress.

The significant increase in the provision for doubtful debt by 612.4 percent from $238.9 million in 1990 to $1701.9 million in 1995 affected the profitability of commercial banks. Gross operating profits, net of provision, declined by 28 percent from $3.6 billion in 1994 to $2.8 billion in 1995, with four of the eleven commercial banks reporting losses for 1995. The declining trend in commercial banks' profitability has implications for the

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**FIGURE II. COMMERCIAL BANKS LOAN QUALITY, 1990-95**

[Diagram showing percentage of past due loans to total loans from 1990 to 1995]
sustainability of the banks' capital base. Marginal profits and losses erode the capital base and are signs of inefficiency in operations that, on occasions, might have resulted in liquidity problems of commercial banks.

A number of factors led to the growth in the banks' bad loan portfolios: poor loan administration, type of collateral used to secure loans and lending to related parties. Commercial banks, at least up to 1994, may have been lulled into a false sense of security because of high profits. In that scenario, appropriate attention was not given to the quality of the loan portfolio, in light of the fact that this should be the most important income-earning asset of the balance sheet. It was alleged that inexperienced loan officers failed, and in certain circumstances, did not possess the requisite skills to conduct appropriate risk assessment of loans. Occasionally, larger clients were not pressured to service their loans on a regular basis. This points to inherent deficiencies in the appraisal systems of the commercial banks.

An emerging trend also related to poor loan administration is the securing of loans with overvalued illiquid collateral, mainly real estate. During the high inflationary period of the 1990s, less emphasis was placed on clients' ability to repay loans through income streams, while more credence was given to the type and value of security used to secure loans. The decline in inflation rates in the latter part of the 1990s, specifically in 1995 and into 1996 has exposed the short sightedness of commercial banks' executives and the fragility of the banks' loan portfolios. Loans secured by real estate are especially vulnerable, because of the fall in real estate prices in 1996. In addition, attempts to realize this type of collateral could lead to a collapse of property values with adverse effect on the financial system and the economy.

Although the Banking Act (1992) specifically addressed lending to related parties, some commercial banks have violated this regulation. This has had an adverse impact on the quality of the loan portfolio of these institutions and contributed to the level of loan delinquency.

Commercial banks in Jamaica, in particular the smaller banks, seemed to have departed from the notion of the completed transaction, in which, loans are collected at periodic intervals or in a lump sum at maturity. A loan transaction is efficiently processed only after the loan has been collected without loss, and within the specified time of the agreement. An incomplete loan transaction is an inefficient transaction, as it results in loan losses, with the
potential for financial system distress. To return to the path of efficient loan administration banks need to practice the number one rule of survival, *do not make too many bad loans.* To ensure that this occurs, commercial banks in Jamaica, especially those with significant bad loan portfolios, need to conduct careful credit investigations of prospective borrowers, undertake prudent risk assessment of prospective loans, monitor the performance of existing borrowers, diversify loan portfolios and transact business within the ambit of a sound loan policy with adequate controls.

3. Composition of other assets

The mix of the commercial banks' asset portfolio also suggests a level of inefficiency. Following rapid depreciation of the domestic currency after exchange rate liberalization, commercial banks maintained long positions in foreign exchange holdings resulting in significant increases in foreign assets, from $5.0 billion at the end of 1991 to $19.3 billion at the end of 1995. Consequently, by April 1996, significant revaluation of the J$ vis-a-vis the US$ and other major currencies contributed to foreign exchange losses resulting from the exposure of foreign assets. Another area of inefficient asset management is the growth in the Other Investment category which comprises investments in non-financial entities, including real estate. As some of these holdings are publicly listed companies, and there has been a downturn in both the real estate and stock markets, the soundness of these investments is questionable, as liquidation of these holdings could result in banks becoming insolvent.

4. The adequacy of the capital base

In 1995 there was a significant decline of 12 percent in the capital base of commercial banks. This, coupled with the fact that the primary ratio (capital/total assets) of commercial banks deteriorated to 3.3 percent at the end of December 1995, indicated that capital coverage was below acceptable standards, as measured by the international benchmark of 6 per cent. In addition, given the level of off balance sheet transactions and the significant increase in the holdings of more risky assets, the balance sheets of commercial banks may be in danger of further deterioration. Commercial banks recorded an average capital to risk weighted assets of 6.0 percent for 1995 which
was below the Basle requirement of 8.0 per cent. The significant increase in past due loans showed clearly the inadequacy of the capital base. The ratio of past due loans to the capital base was 121.3 per cent in 1995, increasing from 53.3 per cent in 1994 (see figure 3).

5. The cost of mobilizing funds

The mobilization of funds is central to the financial intermediation role of commercial banks. As such, the resource cost of this operation is an indication of the level of efficiency attained by these institutions. However, considering that the mobilization of funds also directly affects the banks’ clients, it is important to extend the concept of efficiency to include a measurement of the cost borne by these individuals. The cost of mobilizing funds in the commercial banking system is an area that as a result of inefficiency has resulted in high costs to the public and to the banks. Two components impact on the cost of funds: the actual interest cost on the outstanding stock of deposits and the imposition of the cash reserve requirement (currently 25 per cent of commercial banks’ liabilities). As no interest is paid on the balances held in the Central Bank, the imposition of the statutory reserve requirement is effectively a tax on the banks. However, by maintaining a significant spread between deposit rates and loan rates, the cost of funds is passed on to clients. Average lending rate at the end of December 1995 was 55.3 per cent, while average sav-
ing rate was 19.5 per cent. These resulted in a crudely measured spread of 35.8 per cent, inclusive of the cost of the cash reserve ratio. According to E. A. Shaw (Bank of Jamaica, 1994), at the end of December 1995, to cover the cost of the reserve requirement (ignoring the cost of administration and profit margin), banks would need to charge a loan rate of 7 per cent above the average saving rate of 19.5 per cent, and 10 per cent above the average deposit rate (6 months and less than 12 twelve months) of 30 per cent.

Viewed from another perspective, the imposition of a cash reserve requirement on commercial banks could also result in relatively risky transactions being undertaken to avoid the tax. In recent years, banking groups have acquired high yielding non-core assets, such as hotels, agricultural land and real estate. While this cannot be attributed solely to the cash reserve ratio, it is sufficient to say that unremunerated reserve requirement distorts the earning structure of banks, as they seek to acquire high yielding assets. This contributes to undue asset concentration in some sectors and in particular clientele, thereby, weakening the asset portfolios of banks and creating liquidity problems in some banks.

While costs associated with the administration of passbook savings accounts are relatively high, interest rates allotted to passbook savers could be increased, provided banks are prepared to operate at a lower profit margin. The relatively low rates on passbook savings are not passed on to borrowers, as loan rates are not only high but have been very sticky downwards. Efficiency, measured in terms of least cost to banks’ clients, is not being achieved, given the opportunity cost of saving accounts and in some instances the usurious cost of bank loans.

6. Performance ratios as measurements of efficiency

The income and expense statements generated from the balance sheets of commercial banks indicate that profit levels have

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6 The impact of reserves requirements on banking spreads is calculated as \( s = rrDi/1-rr \). Where \( rr \) is the reserve requirement ratio and \( Di \) the deposit interest rate.
7 This section is largely informed by Reserve Requirements in Jamaica-Proposal to Reform, Marston David, IMF, 1996 (unpublished).
been declining over the last few years. In fact, four of the eleven commercial banks, reported losses for the financial year ended 1995. Over the last five years, non-interest income has become a major contributor to commercial banks’ profit. This income category has, for most years, grown faster than the interest income category. Fees have become an increasing source of revenue for banks, as competition, particularly from merchant banks and commercial paper activities, has forced banks to become less dependent on interest income.

Operating expenses which arise from costs incurred from employees’ remuneration, physical facilities, advertising fees, inter alia, are among the more controllable aspects of banking expenses and directly affect the efficiency of the bank. The strong growth in operating costs over the period 1990–95, peaked at a growth rate of 71.1 percent in 1992, and subsequently declined to 44 percent in 1995. The decline in gross operating profits of commercial banks which declined by 20 percent in 1995, was an indication of the emergence of difficulties in the banking sector.

Various operating performance ratios used as measurements of banking system efficiency suggest that, in certain areas, commercial banks in Jamaica are performing below optimum levels of efficiency, when benchmarked to international standards (see table 5). The two most important measures of bank profitability are return on assets and return on equity. Return on assets (ROA), which measures bank profits per dollar assets, is a comprehensive measure of overall bank performance from an accounting perspective. Worldwide, banks in a competitive environment that generate a minimum 1.0 per cent ROA are performing well. In keeping with the oligopolistic nature of the Jamaican banking system, commercial banks have enjoyed relatively high return on assets, from 4.5 per cent in 1991, peaking at 5.4 per cent in 1994, and declining to 3.3 per cent in 1995.

The same situation is evidenced in the return on equity (ROE) which measures accounting profitability from the perspective of the shareholders. A return of 20 percent (as measured by United States standards) can be obtained by a high performing bank. The shareholders of Jamaica’s eleven (11) commercial banks have been obtaining returns on equity well above generally accepted standards, averaging 61 percent over the period 1991-95.

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8 See appendix 2.
### TABLE 5. COMMERCIAL BANKS' SELECTED PERFORMANCE RATIOS (%), 1991-95

| Benchmarks³ |
|---------|------|------|------|------|------|----------------|
| Return on assets | 4.5  | 4.4  | 4.2  | 5.4  | 3.3  | 1.0 |
| Return on equity  | 61.3 | 58.0 | 62.0 | 68.3 | 54.5 | 20.0 |
| Net interest margin | 3.3  | 1.4  | 2.6  | 2.3  | 2.5  | 4.5 |
| Other operating income | 8.5  | 10.2 | 9.5  | 11.2 | 9.1  | -   |
| Operating expenses  | 7.3  | 7.2  | 7.8  | 8.1  | 8.3  | 3.6 |
| Employee remuneration | 3.1  | 2.9  | 3.4  | 3.5  | 3.6  | 1.6 |
| Rents, fixed assets  | 0.9  | 1.0  | 0.9  | 1.0  | 0.9  | 0.5 |
| Provision for losses | 0.3  | 0.3  | 0.3  | 0.5  | 0.4  | 0.7 |
| Pre-tax profit      | 3.9  | 3.8  | 3.7  | 4.5  | 2.5  | 0.7-2.4 |
| Operating exp: net int. inc | 2.2  | 5.2  | 3.0  | 3.5  | 3.3  | 0.99 |
| Operating exp: non int. inc | 0.9  | 0.7  | 0.8  | 0.7  | 0.9  | 2.0 |
| Operating exp: net inc. | 1.6  | 1.6  | 1.8  | 1.5  | 2.6  | 3.3 |


These relatively high ratios of ROA and ROE should not be seen as representative of high levels of efficiency by the banks, but should be viewed against the existing macroeconomic background. Banks were able to generate relatively high returns during periods of high inflation. This also coincided with the period of external sector liberalization in the 1990s which allowed banks to reap substantial returns from foreign currency transactions. In addition, lucrative investments in Government securities provided an easy source of returns for banks.

Another important ratio used as a measure of banking efficiency, is the net interest margin. This ratio identifies the core earning capacity of the bank, that is, interest differential income (interest income minus interest expense) as a percentage of average total assets. The ratio of net interest margin was 2.3 percent in 1994 and 2.5 percent in 1995. It is interesting to note that over the period 1991-95, the ratio was below the internationally ac-
cepted standard of 4.5 percent. This implies that commercial banks' main source of income is derived from non-interest earning activities. To ascertain the validity of this, there is a need to examine the ratio of other operating income to total income which provides an indication of commercial banks' dependence on non-traditional income sources. An increase in this ratio reflects a diversification into fee-based financial services. However, an increase may be viewed as negative if it is used as a means to earn speculative profits to make up for deficiencies in the banks' net interest income. Over the review period, the ratio of other operating income to total assets ranged from 8.5 percent in 1991, to 9.1 percent in 1995, peaking at 11.2 percent in 1994. A comparison of this ratio with the ratio of net interest margin indicates that the major proportion of income earned by commercial banks in Jamaica over the period came from non-interest income earning activities. It is arguable that this shift in income sources is consistent with trends that have emerged in other economies as banks experienced increased competition from near bank intermediaries. Nonetheless, the level of non-core activities undertaken by commercial banks in Jamaica has contributed to the liquidity problems experienced over the last two years.

The ability of commercial banks to intermediate at minimum cost is a crucial measure of efficiency. Standard ratios used to analyze intermediation costs include the ratio of operating expenses to average total assets and the ratio of pre-tax profits to average total assets (a cost to the public). The ratio of operating expenses to average total assets ranged from 7.3 per cent in 1991 to 8.3 per cent in 1995. Compared with international standards of approximately 3.6 per cent, this ratio is very high. The increasing trend in this ratio, ceteris paribus, indicates that the level of commercial banks' efficiency has been declining in Jamaica. A comparison of the ratio of total operating expenses in Trinidad and Tobago\(^6\) indicated that the ratios attained in that country were even higher than those of Jamaica. Data for the period 1991-93, revealed ratios of 8.8 per cent, 11.1 per cent and 10.7 per cent for the three years respectively. These compare with 7.3 per cent, 7.2 per cent and 7.8 per cent for the corresponding periods in Jamaica.

A closer examination of commercial banks' operating costs in Jamaica revealed that remuneration to employees and expendi-

\(^6\) *Quarterly Economic Bulletin*, vol. xix, n° 2, Central Bank of Trinidad and Tobago, 1993.
ture for rent and fixed assets accounted for the largest share of costs. The ratio of employee remuneration to average assets averaged 3.3 per cent over the period 1991-95. A comparison with the United States benchmark of 1.6 per cent suggests that employees in Jamaica’s commercial banking sector enjoy a relatively higher share of operating costs than counterparts in the United States. Following recent liquidity problems in the banking sector, a leading commercial bank announced the freezing of salaries of senior management.

Expenditure on rent and fixed assets as a proportion of average assets averaged 0.9 per cent over the five-year period. This was also higher than the United States benchmark of 0.5 per cent. The higher ratios in Jamaica, in the main, reflect the expansionary mode of commercial banks in the 1990s. Expansion was not confined to the increase in the number of branches but also to enhancement of existing technology (increasing and improving computer equipment, introduction of automated teller machines (ATM) and credit card facilities, additional security facilities, and the provision of television and video presentations for the entertainment of customers. The stated intention was to improve the efficiency of banking operations in terms of the quality and speed of delivery of services. This was achieved to a certain extent, in that, through ATMs, clients were able to access banking services at their convenience. In addition, the introduction of credit card facilities served to improve the process of transacting business. The increase in the branch network provided greater access to banking facilities, especially customer’s in rural communities. Therefore, although expenditure on rent and fixed assets was higher than in the United States, and no doubt a reduction in expenditure would reduce operating costs, there could also be corresponding improvements in efficiency levels. It may be argued that any improvement in efficiency levels is more of a perception, as televisions placed at strategic positions in banks and showing the latest movies or sporting events avert customers’ attention from the long wait required to complete transactions.

Loan loss provision and depreciation were not included in the overall operating costs as these were considered part of the operating risk of the banks. Nevertheless, over the period 1991 – 1995, provision for losses as percentage of average assets averaged 0.4 per cent, which is lower than the United States benchmark of 0.7 per cent. The relative stability in Jamaica’s banking sector up to 1994, allowed for moderate levels of provisions for bad debt, as the threat of widespread default was
not deemed imminent. However, with the increase in non-performing loans in 1995, the level of loan loss provision may be inadequate.

The ratio of pretax profits to average total assets, moved from 3.9 percent in 1991 to 4.5 percent in 1994 and subsequently declined to 2.5 percent in 1995. Pre-tax profit ratios, in developed and developing countries can range between 0.7 percent and 2.4 per cent. The relatively high ratios registered by local commercial banks confirm the existence of extremely high profit margins within the banking sector. It is arguable that profits are technically not a cost, but this may be interpreted as cost to borrowers. In addition, it may be argued that the significant levels of profits earned by the banks in the earlier years were attributable more to inflationary conditions and returns from investments in Government securities, than to improvements in efficiency.

The efficiency attained by commercial banks in their daily operations may also be measured by ratios of operating costs to the per dollar cost of generating income. These include the ratios of operating expense to net interest income, to non-interest income and to net income. The data indicates relatively high ratios of operating expense to net interest income in Jamaica over the five-year period. The ratio of 2.2 per cent in 1991, peaked at 5.2 per cent in 1992, subsequently declined to 3.3 per cent in 1995. These ratios are much higher than the United States benchmark of 0.99 per cent. Evidently, commercial banks in Jamaica, ceteris paribus, are not generating their interest income at the least possible cost. It is interesting to note that the ratio of operating costs to non-interest income which averaged 0.8 per cent over the period 1991 to 1995, is lower than the United States benchmark of 2.0 per cent. The implication of this is that local banks are more efficient in containing the cost of non-interest earning activities than in maintaining cost on core interest earning activities. This is validated by the fact that movements in the exchange rate over the period guaranteed a relatively profitable return on foreign currency transactions and that the core interest earning activities of commercial banks have been faced with competition from near bank intermediaries. However, the overall ratio of operating expenses to net income for banks in Jamaica was 2.6 per cent in 1995, and below the US standard of 3.3 per cent.

It is evident that cross-country comparison of banks' performance ratios is not ideal to measure levels of efficiency. This is due mainly to varying macroeconomic and financial policies, state of the economy, (i.e., inflation rate, stability of the currency, state of
the external accounts), number of banks and the degree of competition. The ratios obtained in Jamaica reflect the oligopolistic nature of commercial banking operations locally. The high concentration of assets in two of the larger banks restricts competition which has contributed to banks maintaining profit margins greater than internationally accepted standards.

7. Management efficiency

The quality of the management of commercial banks has been cause for concern. The rapid growth and development of new products and services offered by commercial banks have placed additional pressures on the management of these institutions, thereby creating the need for competent managers. The new cadre of financial managers may not have possessed the requisite skills and experience to facilitate the growth and development of the banks and the conglomerate in which the bank is a member. In addition, the stewardship of boards of directors of banks is also questionable, as evidenced in the degree of related party and insider lending, the poor management of the loan portfolios, and the level of foreign exchange risk exposure.

8. Innovations in Products and Services

Commercial banks in Jamaica, faced with more aggressive and competitive challenges from other financial entities, have been forced to modernize their facilities and create innovative products and services. This is done in an effort to attract new customers and to retain existing customers. Several banks in Jamaica are now offering the following products and services:

- Insurance-linked savings and deposits instruments.
- Interest earning chequing accounts.
- More personalized loan services.
- Credit card products.
- Customized products to meet the needs of corporate clients, for example, direct access to their accounts.
- ATMs (customers are given the opportunity to pay certain bills, transfer funds between accounts, deposit and withdraw funds).
- Most banks are part of conglomerates offering varied products
and services. The formation of one-stop banking has become a part of the financial landscape.

- Improved branch banking services as a result of updated communication infrastructure.

- Overseas branches and foreign investments in indigenous banks.

There is no doubt that there has been an improvement in efficiency levels as a result of the introduction of innovative products and services, as these impact on the banks’ ability to meet the requirements of a diverse clientele. Nevertheless, some innovations have resulted in a burden on the core operations of commercial banks. The most glaring has been the diversification into life and general insurance. In recent months, insurance companies, in particular life insurance, have been undergoing a process of restructuring. As a result, the commercial banks to which they are affiliated have, on occasions, provided liquidity support. On the other hand, decentralization of operations has resulted in banks becoming more flexible, more responsive to customers’ needs and more cost-effective as a result of shared facilities and personnel.

The assessment of efficiency levels in commercial banks has been, in the main, attributed to the overall sector, without due regard being given to foreign-owned banks relative to domestic banks or larger banks relative to smaller banks. Both qualitative and quantitative assessments suggest that foreign-owned banks achieved higher levels of efficiency as measured by the quality of their balance sheets and management practices. It is indeed true to say that foreign banks relative to domestic banks pursue more conservative banking practices and tend to pursue core banking business more vigorously. However, room exists for improvement in the efficiency levels of all banks as they have the possibility of exploiting economies of scale in their operations.

**IV. CONCLUSION AND RECOMMENDATIONS**

The commercial banking sector in Jamaica achieved an impressive level of performance over the period 1990 - 1994. However, the accomplishment was related to the benefits accrued from an inflationary environment rather than from the efficient operation of the banking sector. This has become more evident since 1995, with the adoption of a macroeconomic programme aimed at
achieving low and stable prices. In this scenario banks are no longer able to disguise inefficiency under the cloak of high inflation. Measuring banking operations utilizing internationally accepted operating performance ratios, the industry is performing below required standards. Consequently, there is an urgent need to foster adequate liquidity and stronger prudential management in the banking sector. This imperative should ensure that the level of efficiency in commercial banks is consistent with that which is required for the operation of a sound banking system.

In an effort to enhance internal efficiency and promote institutional viability, some commercial banks have started the process of restructuring. For example, there has been the effective merger of two of the country's largest commercial banks to achieve market efficiencies. With restructuring and consolidation the emerging institutions should achieve greater economies of scale in banking operations. To become more efficient, the banking community has also started the process of downsizing, (staff retrenchment, salary freezes and the rationalization of branch networks). Additionally, recent developments within the economy have resulted in several banks disposing of some areas of non-financial operations (e.g., real estate holdings), and returning to core banking activities.

To the extent that there has been a significant increase in non-performing loans, some banks have made infrastructural changes inclusive of managerial and systems changes to appropriately deal with problem loans. This in itself is positive, but places additional burden on the operating costs of the bank and reflects an inefficient use of resources which could have been avoided if proper risk assessment of loan portfolios had been undertaken prior to the granting of loans.

The Government and the supervisory arm of the Bank of Jamaica have also been integral in the promotion of increased efficiency in the commercial banking sector. In recognition of the liquidity constraints facing banks, the Bank of Jamaica has made more resources available to banks through the phasing out of the Special Deposit Requirement, introduced in August 1995. To assist those banks in which deposit liabilities have been growing out of line with capital, the Central Bank has been encouraging recapitalization. Significant improvement in capital levels is one of the preconditions for membership in the proposed Deposit Insurance Scheme. In addition, policy makers are committed to a reduction in statutory reserve requirements that would ultimately
lead to a reduction in banking spreads. To address the problem of inefficient management of commercial banks, the Bank of Jamaica has also been promoting owner, director and executive responsibility for prudential management. Concurrently, banks have been provided with “standards of best practice” along with a ladder of enforcement. In addition, financial legislation is being revised to provide the supervisory authority with greater scope of operation to secure the continued development of a sound and viable financial system.

To address the main operational/functional inefficiencies in the operations of commercial banks, corrective measures need to be targeted at specific areas inclusive of: asset quality, loan portfolio, related party and insider lending, capital adequacy, exchange risk exposure, liquidity and management practices. Given stable macroeconomic conditions, the following recommendations should address some of the inefficiencies in the banking sector.

- Greater efficiency in loan allocation and follow-up procedures. In some banks, in particular the small indigenous banks, there is a need for the implementation of a proper system of loan portfolio classification. This would involve loans being placed in specific categories, namely loans that are being serviced, those that are being serviced irregularly, loans that are at risk of default and those loans that are uncollectable. In so doing, banks would be able to assess and take corrective actions early, thereby preventing undue deterioration of the balance sheet.

- A reduction in the non-remunerated cash reserve ratio. The authorities are committed to this measure in the medium term. Given the oligopolistic nature of the banking sector, even with a reduction in the cash reserve ratio, it is questionable whether greater equity in the saving mobilization process could be effected by an increase in the interest rates which banks pay on savings deposit balances. Benefits should, however, accrue to the banks' customers if there is a level of competition in the banking sector which forces banks to operate at lower margins.

- Address the capital adequacy criterion.\textsuperscript{11} This is necessary as some banks are at risk of not having the required equity to protect depositors. In this regard, to improve efficiency in capital management banks need to meet Basle-type capital adequacy ar-

\textsuperscript{11} See amendments to Financial Legislation-appendix 4.
arrangements which presently stands at a minimum level of 8 per cent (capital to risk weighted assets). The Central Bank, aware of the particular circumstances of the Jamaican financial system (high degree of conglomeration within and outside the sector), is considering setting the minimum level between 10-12 per cent.

- Effective control of operating costs, while concurrently maximizing interest income. It should be recognized that non-interest income activities improve bank earnings. However, these functions require a higher level of technical knowledge to undertake investments, foreign exchange transactions, and to facilitate commercial paper transactions – therefore an increase operating expenses. To become more competitive and maintain quality service over the long-term, commercial banks must be low cost providers of services and yet be able to invest adequately in staff and equipment. To achieve this, the smaller banks in particular, may need to be more conservative in their operations. These banks should resist the temptation to increase income by making higher risk loans or by providing fee-based services that a reputable bank would avoid. Commercial banks therefore need to reassess the level of their off-balance sheet transactions and other high-income earning, but risky operations.

- Upgrade the technical and managerial expertise of bank executives. Boards of Directors also need to assume more direct responsibility for policy formulation, as it is the Board’s responsibility to promote “conservative banking” by ensuring that unscrupulous or inexperienced bankers do not put depositors’ funds at risk. There is room within individual banks for improved risk management, enhanced internal controls and increased training of operational personnel.

In the long-run sustainable improvement in efficiency in commercial banks in Jamaica will require an enhanced regulatory framework, restructuring of some banks, which includes the identification and removal of non-performing assets, the recapitalization of banks, and the return to core banking operation. To benefit from economies of scale in operations due consideration should also be given to shared services, if not mergers of smaller banks. These banks would therefore become more efficient and commercially viable entities and position themselves to compete in the global financial market.
Appendix 1

| Financial indicators | Rate of asset growth | 13.0 | 60.0 | 70.0 | 32.0 | 54.0 | 26.0 |
| | Rate of deposit growth | 19.0 | 47.0 | 88.0 | 38.0 | 50.0 | 30.0 |
| | Rate of loans growth | 21.0 | 32.0 | 19.0 | 68.0 | 36.0 | 42.0 |
| | Rate of primary capital growth | - | - | 118.0 | 49.0 | 60.0 | 3.0 |
| | Investments: total assets | - | - | 17.3 | 15.1 | 19.2 | 13.9 |
| | Fixed: total assets | - | - | 2.5 | 2.6 | 2.7 | 2.6 |
| | Loans: total assets | 51.3 | 42.3 | 29.3 | 38.3 | 32.9 | 36.9 |
| | Loans: deposits | 72.4 | 65.0 | 42.5 | 51.7 | 45.6 | 51.5 |

Asset quality

| Loan arrears (over 6 mths): total loans | 8.2 | 6.3 | 5.7 | 5.4 | 7.4 | 10.9 |
| Loan loss reserves: total loans | 2.7 | 2.5 | 3.2 | 2.4 | 3.3 | 3.9 |
| Loan loss reserves: arrears (over 6 mths) | - | - | 55.0 | 44.8 | 37.5 | 35.5 |

Capital adequacy

| Deposits: capital | 17.09:1 | 20.03:1 | 17.4:1 | 16.48:1 | 15.24:1 | 22.56:1 |
| Total shareholders equity: total assets | 5.6 | 5.7 | 6.2 | 6.4 | 6.9 | 5.6 |
| Primary capital: total assets | 3.8 | 3.1 | 4.0 | 4.5 | 4.7 | 3.3 |
| Primary capital: risk assets | 6.2 | 4.7 | 8.0 | 7.7 | - | - |

SOURCE: Bank of Jamaica; author's calculations.
TABLE A. 2. OPERATING INCOME AND EXPENDITURE OF COMMERCIAL BANKS (J$MN), 1991-95

<table>
<thead>
<tr>
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<tr>
<td>1. Interest on loans, adv.</td>
<td>2839.8</td>
<td>4882.6</td>
<td>6798.0</td>
<td>11005.9</td>
<td>12409.1</td>
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<td>2. Interest paid</td>
<td>2124.5</td>
<td>4387.2</td>
<td>5412.8</td>
<td>9194.7</td>
<td>9600.8</td>
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<td>Demand Deposits</td>
<td>127.3</td>
<td>336.5</td>
<td>370.7</td>
<td>642.1</td>
<td>1282.0</td>
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<td>Savings Deposits</td>
<td>1077.8</td>
<td>1771.7</td>
<td>2417.3</td>
<td>3051.5</td>
<td>4157.6</td>
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<tr>
<td>Time Deposits</td>
<td>919.5</td>
<td>2258.9</td>
<td>2624.8</td>
<td>5501.1</td>
<td>4161.3</td>
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<td>3. Interest margin (1-2)</td>
<td>715.3</td>
<td>515.4</td>
<td>1385.2</td>
<td>1811.2</td>
<td>2808.3</td>
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<tr>
<td>4. Other income</td>
<td>1815.6</td>
<td>3824.1</td>
<td>5051.7</td>
<td>8833.6</td>
<td>10023.1</td>
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<tr>
<td>Fee Income</td>
<td>202.3</td>
<td>352.8</td>
<td>523.7</td>
<td>867.6</td>
<td>1417.1</td>
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<td>Investments</td>
<td>356.5</td>
<td>1511.1</td>
<td>2358.6</td>
<td>5195.9</td>
<td>6184.9</td>
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<td>F. E. Trading</td>
<td>712.3</td>
<td>661.5</td>
<td>818548</td>
<td>925.8</td>
<td>1140.9</td>
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<tr>
<td>Other</td>
<td>544.5</td>
<td>1298.9</td>
<td>1350.9</td>
<td>1844.3</td>
<td>1280.2</td>
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<tr>
<td>5. Gross margin (3+4)</td>
<td>2580.9</td>
<td>4339.6</td>
<td>6436.9</td>
<td>10644.8</td>
<td>1283.1</td>
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<td>6. Operating costs</td>
<td>1563.0</td>
<td>2674.0</td>
<td>4169.9</td>
<td>6414.1</td>
<td>9230.3</td>
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<tr>
<td>Employee Remunera-</td>
<td>657.6</td>
<td>1097.2</td>
<td>1822.9</td>
<td>2738.2</td>
<td>3928.2</td>
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<tr>
<td>tion</td>
<td>190.5</td>
<td>357.809</td>
<td>407.4</td>
<td>782.2</td>
<td>1004.5</td>
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<td>Rents, Fixed Assets etc.</td>
<td>138.7</td>
<td>246.4</td>
<td>324.1</td>
<td>431.4</td>
<td>571.1</td>
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<td>Advertising, Fees etc.</td>
<td>186.2</td>
<td>289.1</td>
<td>488.6</td>
<td>665.4</td>
<td>1731.1</td>
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<td>Borrowing Costs</td>
<td>390.0</td>
<td>703.6</td>
<td>1036.8</td>
<td>1797.0</td>
<td>2000.4</td>
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<tr>
<td>Other</td>
<td>967.9</td>
<td>1665.5</td>
<td>2267.1</td>
<td>4230.7</td>
<td>5801.0</td>
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<tr>
<td>7. Net margin (5-6)</td>
<td>-131.0</td>
<td>-258.5</td>
<td>-312.9</td>
<td>-673.8</td>
<td>-760.8</td>
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<td>8. Other credits</td>
<td>-59.4</td>
<td>-127.2</td>
<td>-151.3</td>
<td>-261.4</td>
<td>-310.3</td>
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<td>Depreciation (-)</td>
<td>-74.1</td>
<td>-131.3</td>
<td>-161.6</td>
<td>-412.4</td>
<td>-450.6</td>
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<tr>
<td>Provision for losses (-)</td>
<td>836.9</td>
<td>1407.0</td>
<td>1954.2</td>
<td>3556.8</td>
<td>2840.1</td>
</tr>
</tbody>
</table>

**SOURCE:** Commercial Banks Quarterly Statements of Earnings and Expenditure. Bank of Jamaica.
Appendix 3

Calculation of ratios

1. Return on assets (ROA)  \[= \frac{\text{Net income after tax} \times 100}{\text{Average total assets}}\]

2. Return on equity (ROE)  \[= \frac{\text{Net income after tax} \times 100}{\text{Average total equity}}\]

3. Net interest margin  \[= \frac{\text{Interest income} - \text{interest expense} \times 100}{\text{Average total assets}}\]

4. Ratio other operating income  \[= \frac{\text{Other operating income} \times 100}{\text{Average total assets}}\]

5. Ratio employee remuneration  \[= \frac{\text{Employee remuneration} \times 100}{\text{Average total assets}}\]

6. Ratios of intermediation costs  \[= \frac{\text{Operating expenses} \times 100}{\text{Average total assets}}\]  
\[= \frac{\text{Pre-tax profits} \times 100}{\text{Average total assets}}\]

7. Provision for losses  \[= \frac{\text{Provision for losses}}{\text{Average total assets}}\]

Appendix 4

Legislative amendments 1997

During the last quarter of 1997, the following pieces of financial legislation were tabled and approved in the House of Representatives:

- The Banking (Amendment) Act 1997
- The Financial Institutions (Amendment) Act 1997
- The Building Societies (Amendment) Act 1997
- The Industrial and Provident Societies (Amendment) Act 1997

These amendments which were expedited ahead of a more comprehensive review of financial legislation, included the following significant changes:
Empowering the Minister of Finance to take control of the shares and subordinated debt of a licensee which has ceased to be viable so as to effect sale of the shares, assets or effect other types of resolutions for the purpose of restructuring the entity in the interest of depositors;

Empowering the supervisory authorities to take certain corrective measures such as to require a “Board Undertaking”, give “Directions” and issue “Cease and Desist Orders” (which previously could only be done by the Minister) in respect of financial institutions experiencing problems; and to require special audits of these institutions;

Tightening of credit limits for unsecured lending, and the total prohibition of unsecured credit to any connected person;

A reduction on the non-accrual period for interest on non-performing loans from six months to three months;

Amendment to the definition of capital base to allow for the imposition of minimum solvency standards and risk-based criteria.

Apart from the amendments to the principal Acts, certain regulations were also promulgated which specify the precise requirements and procedures in dealing with certain areas of institutional practice. Examples of these regulations include, Branches Regulations, which govern the opening and closure of branches, as well as regulations dealing with procedures for Mergers and Amalgamations. Additionally, at the end of 1997, the drafting of regulations dealing with the Qualification of Auditors, Risk Weighted Capital Adequacy and Credit Classification and Provisioning Requirements were at an advanced stage.

Other policy response since 1997

In response to the problems in the financial sector, the Government provided financial assistance to various institutions. This was done through the establishment of the Financial Sector Adjustment Company (FINSAC) in January 1997, with the objective of rehabilitating and restoring financial entities. During 1997, FINSAC successfully restructured and provided financial assistance to commercial banks and insurance companies plagued by liquidity problems.
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Rodrigo Gomez Award: 1999 call for papers

As a means of honoring the late Rodrigo Gomez, general director of Banco de Mexico, S. A., the governors of the Latin American central banks have established an annual award to encourage research projects of general interest to central banks.

The bases of the 1999 call for papers are as follows:

1. Papers dealing with topics of direct interest to Latin American central banks should be focused on any of the following themes:
   - Monetary policies and programming (experiences in Latin America).
   - The role of financial institutions in economic development.
   - Capital market analysis.
   - Balance of payments policy and international capital movements.
   - Financial cooperation among Latin American nations.
   - International monetary problems and their repercussions on Latin America.

2. Submitted papers should be original versions and may include university degree theses that have not been published commercially. The latter should be written in Spanish, French, English or Portuguese, and not exceed 30,000 words (approximately 100 pages, double space).

3. Competing authors should be citizens of the countries of central banks included in the meetings of governors of the central banks of Latin America¹ and Spain. Administrative personnel of the Centre for Latin American Monetary Studies (CEMLA) may not take part (general director and deputy general director).

¹ Argentina, Aruba, Barbados, Belize, Bolivia, Brazil, Cayman Islands, Colombia, Costa Rica, Cuba, Chile, Dominican Republic, Eastern Caribbean (Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vicent and the Grenadines), Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nederlandse Antillen, Nicaragua, Panama, Paraguay, Peru, Suriname, Trinidad and Tobago, Uruguay and Venezuela.
4. The jury shall be made up by the governors of the central banks forming part of the CEMLA Board of Governors or their representatives. The Centre for Latin American Monetary Studies, in its role as permanent Secretary of Governors meeting, shall act as consultant for the jury in whatever form deemed appropriate, and shall take charge of all competition administrative aspects.

5. There will be only one prize, consisting of ten thousand US dollars, which shall be awarded to the winning paper or papers, in accordance with criteria of the jury. In the event of a tie, the prize shall be divided in equal parts. The decision cannot be appealed, and the jury may declare the award vacant if it so chooses.

6. Seven copies of each study should be sent to CEMLA Administration (Durango n° 54, México, D. F., 06700) no later than January 15, 1999, and the jury’s decision will be forth-coming no later than 90 days from that date.

7. CEMLA shall omit the names of the authors when submitting the work to the jury, assigning a code that shall be the only means of identification available to the latter for the subsequent qualification of papers.

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