Board of Executive Directors

For consideration

On or after 13 July 2016

PR-4405
28 June 2016
Original: English
Public
Simultaneous Disclosure

To:	The Executive Directors
From:	The Secretary
Subject:	Jamaica. Proposal for a loan for the "Financial System Reform Support Programme"

Basic Information:	Loan type ....Programmatic Policy-based Loan (PBP)
	Borrower .... Jamaica
	Amount .... up to US$100,000,000
	Source ....Ordinary Capital
Inquiries to:	Joan Prats (extension 3271) or Jaiwattie Anganu (telephone Country Office in Jamaica 876-764-0825)

Remarks:

This operation is the first loan in a programmatic series of two consecutive single-tranche operations, technically related to one another but independently financed as programmatic policy-based loans, in accordance with document CS-3633-1, "Policy-based Loans: Guidelines for Preparation and Implementation. New version".

As established in document GN-1838-1, "Criteria and norms for Board and Management relations", dated 1 July 1994, policy-lending operations are considered by the Board of Executive Directors by Standard Procedure.

Reference: GN-1838-1(7/94), DR-398-17(1/15), GN-2200-13(4/05), GN-2849(3/16), CS-3633-1(6/14), CS-4120(3/16)

PUBLIC
SIMULTANEOUS DISCLOSURE

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

JAMAICA

FINANCIAL SYSTEM REFORM SUPPORT PROGRAMME

(JA-L1058)

LOAN PROPOSAL

This document was prepared by the project team consisting of: Joan Prats (IFD/CMF), Team Leader; Jaiwattie Anganu (CMF/CJA), Alternate Team Leader; Agustina Calatayud, Gloria Lugo, Gabriela Andrade, Alejandro Tamola and Alison Arauz (IFD/CMF); Claudia Stevenson (IFD/CTI); Betina Hennig (LEG/SGO); Naveen Jainauth-Umrao (FMP/CGY); Juan Pedro Schmid and Brodrick Watson (CCB/CJA).

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2. Means of Verification Matrix
3. Results Matrix

OPTIONAL

1. Economic Analysis
2. Monitoring and Evaluation Plan
3. IMF Country Report No. 15/343. Jamaica
4. Bank of Jamaica. 2014 Annual Report
5. World Bank. Financial Sector Assessment. Jamaica. April 2015

ABBREVIATIONS	
AML	Anti-Money Laundering
ATM	Automated Teller Machine
BOJ	Bank of Jamaica
BSA	Banking Service Act
CRF	Corporate Results Framework
DBJ	Development Bank of Jamaica
DTI	Deposit-taking Institutions
EFF	Extended Fund Facility
EMD	Economic Management Division
EXIM Bank	National Export-Import Bank
FATF	Financial Action Task Force
FCMST	Financial Crisis Management Steering Committee
FSC	Financial Services Commission
FY	Fiscal Year
GDP	Gross Domestic Product
HHI	Herfindahl–Hirschman Index
IDB	Inter-American Development Bank
IGNITE	Innovation Grant New Ideas to Entrepreneurship
IMF	International Monetary Fund
JAMFA	Jamaica Micro Financing Association
JAMFIN	Jamaica Association for Micro Financing
JAMPRO	Jamaica Promotions Corporation
JBDC	Jamaica Business Development Corporation
JCEP	Jamaica Competitiveness Enhancement Programme
JSE	Jamaica Stock Exchange
LAC	Latin America and the Caribbean
MFIs	Microfinance Institutions
MIDA	Micro Investment Development Agency
MIIC	Ministry of Industry, Investment and Commerce
MOFP	Ministry of Finance and Planning
MSMEs	Micro, Small, and Medium Enterprises
NBFIs	Non-Bank Financial Institutions
NDTI	Non-deposit-taking Financial Institutions
NFIC	National Financial Inclusion Council
NFIS	National Financial Inclusion Strategy
NRA	National Risk Assessment
PBL	Policy Based Loan

ABBREVIATIONS	
PBP	Programmatic Policy-Based Loan
PCU	Programme Coordination Unit
POD	Proposal for Operation Development
PPP	Public Private Partnerships
SIPPA	Security Interests in Personal Property Act
SMEs	Small and Medium-Sized Enterprises
SSF	Self-Start Fund
TA	Technical Assistance
TC	Technical Cooperation
UIS	Update to the Institutional Strategy

PROJECT SUMMARY
JAMAICA
FINANCIAL SYSTEM REFORM SUPPORT PROGRAMME
(JA-L1058)

<table>
<tr><th colspan="5">Financial Terms and Conditions</th></tr>
<tr><td colspan="3" rowspan="2">Borrower: Jamaica</td><th colspan="2">Flexible Financing Facility[(a)]</th></tr>
<tr><td>Amortization Period:</td><td>20 years</td></tr>
<tr><td colspan="3" rowspan="2">Executing Agency: Ministry of Finance and Planning (MOFP)</td><td>Original WAL:</td><td>12.75 years</td></tr>
<tr><td>Disbursement Period:</td><td>1 year</td></tr>
<tr><th>Source</th><th>Amount (US$)</th><th>%</th><td>Grace Period:</td><td>5.5 years</td></tr>
<tr><td rowspan="2">IDB (OC):</td><td rowspan="2">100 million</td><td rowspan="2">100</td><td>Supervision and Inspection Fee:</td><td>[(b)]</td></tr>
<tr><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td rowspan="2">Total:</td><td rowspan="2">100 million</td><td rowspan="2">100</td><td>Credit Fee:</td><td>[(b)]</td></tr>
<tr><td>Currency of Approval:</td><td>United States dollars chargeable to the Ordinary Capital</td></tr>
</table>

Project at a Glance
Project Objective/Description: The objective of the programme is to enhance the contribution of the financial sector to economic growth by: (i) strengthening financial stability; (ii) enhancing the financial inclusion of firms and individuals; and (iii) improving the financial legal framework. This operation is the first of a programmatic policy based loan series, which will be made up of two contractually independent and technically linked loans, as per document CS-3633-1.
Special Contractual Clauses prior to the single loan disbursement: The disbursement of loan resources will be subject to compliance by the Borrower, to the Bank's satisfaction, of the policy conditions set forth in the Policy Matrix (Annex II) and in the Loan Contract. (¶3.2).
Exceptions to Bank Policies: None

Strategic Alignment			
Challenges[(c)]:	SI ☑	PI ☐	EI ☐
Cross-Cutting Themes[(d)]:	GD ☐	CC ☐	IC ☑

(a) Under the Flexible Financing Facility (FN-655-1), the Borrower has the option to request modifications to the amortization schedule as well as currency and interest rate conversions. In considering such requests, the Bank will take into account operational and risk management considerations.

(b) The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors during its review of the Bank's lending charges, in accordance with the relevant policies.

(c) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

(d) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, Problem Addressed, Justification

1.1 **Macroeconomic context.** In the last 30 years, Jamaica's real Gross Domestic Product (GDP) has increased at an average of 1% per annum due to natural disasters and financial shocks coupled with insufficient fiscal restraint, which resulted in persistent fiscal deficits financed through significant public sector borrowing. Since entering an International Monetary Fund (IMF) supported Extended Fund Facility (EFF)[1] in 2013, Jamaica's economic situation has been improving, with a projected increase in GDP of 1.4% for Fiscal Year (FY) 2015/16. The stabilization has been backed up by a series of policy reforms,[2] including enhancing competitiveness, fiscal modernization, public finance and the financial sector. Inflation has mostly been trending down. The current account deficit has reduced significantly from the 13.5% of GDP reported for FY 2010/11 to a deficit of 6.6% of GDP reported for FY 2014/15 and is expected to further improve to approximately 2.2% of GDP for FY 2015/16. Markets and credit rating agencies have endorsed the economic programme implemented in Jamaica (see IMF, 2015). Standard & Poor's and Moody's upgraded Jamaica's credit rating in May and June 2015, going from B- to B, and from Caa3 to Caa2, respectively. Jamaica issued a US$2 billion international bond on July 28th, 2015. The bond issuance was the largest in Jamaica's history. The fiscal targets in the first two years of the EFF were met with short-term measures, including a wage freeze and a substantial reduction in capital expenditures, which fell from 4.2% to 1.5% of GDP between 2011/2012 and 2014/15. Going forward, it is projected that a reduction in public sector wages and salaries from around 11% of GDP in FY 2012/13 (preceding the EFF) to 9% of GDP by FY 2016/17, will create space for more programme and capital expenditure. Similarly, a decline in interest payments from close to 10% of GDP in 2011/12 to 6.0% by FY 2019/20 will support debt reduction. Despite the implemented reforms, economic growth in Jamaica remains low. Fostering sustained economic growth is hence, a major priority for Jamaica in order to improve its developmental outcomes. In particular, further growth facilitating measures should complement the macroeconomic adjustment. Although important measures have been implemented already, severe obstacles still remain.

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[1] On May 1, 2013 a four-year EFF arrangement for Jamaica was approved to support a comprehensive economic reform agenda. The EFF arrangement amounted to SDR 615.38 million (about US$932.3 million at the time of approval), the equivalent of 225% of Jamaica's quota in the IMF. The financing arrangement formed a critical part of a total funding package of US$2 billion from Jamaica's multilateral partners including the World Bank and the Inter-American Development Bank, with each having preliminarily agreed to allocate US$510 million over the following four years. The main objective of the programme was to decrease public debt and thereby create a virtuous cycle of debt sustainability and higher economic growth. Regarding the financial sector, the IMF Structural Programme Conditionality contemplates the following areas of reforms: (i) the regulation of the repo industry; (ii) a new regulatory and supervisory framework for the banking industry; and (iii) giving the Bank of Jamaica the overall responsibility for financial stability. According to the "Tenth Review under the Arrangement under the EFF", carried out by the IMF in December 2015, programme performance was on track and structural reforms had progressed broadly on schedule.

[2] The Bank supported a number of these reforms through different programmes, including the Competitiveness Enhancement Programme II and III (1972/OC-JA, 2297/OC-JA and 3147/OC-JA, respectively), the Fiscal Consolidation Programme I and II (2359/OC-JA and 2502OC/JA), and the Fiscal Structural Programme for Economic Growth (3148OC-JA).

1.2 **Importance of the financial system for growth.** The financial system has a critical role in promoting economic growth.[3] An efficient financial system permits: (i) channeling resources to the most productive agents and projects in an economy; (ii) mitigating the impact of volatility and macroeconomic shocks; (iii) smoothing consumption of individuals and firms across time, thus overcoming liquidity restrictions; and (iv) transforming maturities by redirecting short-term savings to long-term investment.[4] In Jamaica, the limited development of the financial sector, together with the high level of sovereign debt issuance, has restricted the evolution of economic growth. Credit to the private sector as a percentage to GDP is a mere 30% in Jamaica, the lowest in comparator countries.[5] Likewise, more than 40% of Jamaican firms identify access to finance as a major constraint, compared to the average 31% in Latin America and the Caribbean (LAC) countries. In order to improve the contribution of the financial sector to long term growth and in agreement with the recommendations from International Organizations,[6] as well as the country's overall growth and competitiveness reform agenda, the authorities have embarked on an ambitious financial reform agenda, to address weaknesses in the following three main areas: (i) strengthening financial stability; (ii) improving financial inclusion; and (iii) improving the financial legal framework.

1.3 **Financial system and institutions in Jamaica.** The number of deposit-taking institutions (DTI) operating in Jamaica has remained relatively stable in recent times. DTI account for 49% of financial sector assets. As of 2014, DTI consist of seven commercial banks (70% of the total local portfolio of DTI), two merchant banks (3%), three building societies (20%), and 38 credit unions in operation (7%). The Bank of Jamaica (BOJ) regulates all DTI except credit unions, which are supervised by the Department of Co-operative and Friendly Societies under the Co-operative Societies Act. Non-Bank Financial Institutions (NBFIs) include non-bank security dealers (23% of financial assets), insurance companies (14%), and pensions funds (14%). These financial institutions are regulated by the Financial Services Commission (FSC). The two major types of non-deposit-taking financial institutions (NDTI), that provide financing to businesses in Jamaica, are the microfinance institutions (MFIs) and the Jamaica Stock Exchange (JSE). There are currently two associations representing MFIs, the Jamaica Micro Financing Association (JAMFA) and the Jamaica Association for Micro Financing (JAMFIN), which together have 16 member institutions. The JSE currently operates two markets, the main market and the junior market.[7] Regarding the public sector, the Government of Jamaica provides financial support to businesses and projects primarily through four entities: the

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3 Beck, T., Levine, R. and Loayza, N. (2000), "Finance and the sources of growth", Journal of Financial Economics 58 (12), 261-300.

4 Inter-American Development Bank (IDB), Sector Framework Document on Support to SMEs, and Financial Access/Supervision, GN-2768, 2014.

5 The countries being Trinidad, Caribbean Small States, Guyana, Namibia, Belize, Antigua, Bahamas, Upper Middle Income, Mauritius and Singapore. "Financing for Productive Development in Jamaica – David Tenant April 2015, page 29.

6 World Bank, Financial Sector Assessment, 2015. IMF, Ninth Review Under the Arrangement Under the Extended Fund Facility, 2015.

7 There are currently 43 listings on the JSE Main Market, with most of the listed companies being involved in either finance (9) or manufacturing (9). There are currently 25 listings on the JSE Junior Market, with most of the listed companies being involved in manufacturing (9 companies).

Development Bank of Jamaica (DBJ); the National Export-Import Bank (EXIM Bank); the Micro Investment Development Agency (MIDA); and the Self-Start Fund (SSF). Government support is generally directed to businesses involved in productive activities, businesses that have the potential to export, and Micro, Small, and Medium Enterprise (MSMEs).

1.4 **Financial stability and growth.** In order for the financial system to attain a level of development that maximizes its contribution to economic growth, regulation must attempt to ensure levels of stability that allow agents to make decisions in a predictable environment. At the same time, adequate regulation and supervision are key to further developing the financial system without compromising its stability. They make it possible to avert financial crises, the effects of which undermine confidence in the financial sector, thus limiting growth in savings and potential growth in intermediation, forcing participants to leave the capital markets, and curtailing the availability of medium and long-term financing. The importance of financial regulation and supervision is shared by analyses that evaluate the impact of structural reforms on growth; this highlights such regulation and supervision as one of the most important factors for growth.[8]

1.5 **Current situation in Jamaica.** The financial sector in Jamaica has been resilient with adequate profitability, capitalization, provisioning, and a relatively comfortable liquidity position, despite the short-term liquidity pressures. Despite the two debt restructurings, financial sector soundness indicators remain adequate, with DTI exceeding the 10% minimum capital adequacy ratio (at above 15% as of end-2013). Non-performing loans declined from 6.1% of total loans in 2012, to 4.9%, at the end of 2014. Banks are fairly profitable.[9] Nevertheless, according to recent analyses,[10] Jamaica needs to enact reforms in both the banking and capital markets sectors in order to reinforce the stability of its financial system. In particular, Jamaica needs to move the framework for banking entities closer to governing international standards in this area, namely the Basel Core Principles on effective banking supervision, and enhance systemic risk management, so that adequate policy and regulatory responses can be provided to ensure financial stability. This is especially important in the context of the significant exposure to the sovereign risk of the banking system[11] and the recent "de-risking" strategies of certain international banks. In line with this, it is crucial to upgrade and harmonize the regulatory framework of DTI, increase the supervisory autonomy and perimeter of regulatory authorities including consolidated supervision and agent banking, and enhance the prudential

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[8] Norris, D. et al., Reforms and Distance to Frontier, IMF Discussion Note, 2013.

[9] World Bank, Financial Sector Assessment, 2015.

[10] World Bank, Financial Sector Assessment, 2015. IMF, EFF, 2015.

[11] As of June 2015, government securities represented 25% of DTI assets (Banking Industry Country Risk Assessment: Jamaica. Standard and Poor's, 2015). This increases market vulnerability and requires improving the supervisory capacities of the regulatory framework. Furthermore, the latest debt exchange programme (National Debt Exchange -NDX) in 2013 weakened banks' profitability in the past few years and it may push banks to take on more aggressive competitive policies to maintain profitability. This overall situation calls for improving financial regulation in Jamaica.

regulation of the securities markets.[12] These are all lines of reform included in the IMF Structural Programme Conditionalities for Jamaica in the financial sector and this programme further develops them in order to guarantee its effective and sound implementation.

1.6 **Pending challenges.** Reforms should address important regulatory gaps in the financial sector through the following actions: (i) strengthening the autonomy and regulatory perimeter of the BOJ clarifying its mandate to guarantee financial stability; (ii) introducing clear and harmonized prudential and operational requirements for deposit taking institutions in order to avoid potential regulatory arbitrages; (iii) improving the prudential regulation framework for Credit Unions; (iv) improving prudential regulation of the securities, insurance and pension sectors; and (v) strengthening financial transparency and financial crisis management.

1.7 **Financial inclusion, growth, and reducing vulnerability.** The economic literature demonstrates that greater participation by the population in the financial system, through financial inclusion, stimulates growth and reduces poverty and inequality.[13] Essentially, increased financial inclusion allows a greater resource flow for individuals and enterprises, and a more efficient and secure management of those resources, which in turn makes it possible to better respond to adverse shocks, thus smoothing consumption, improving economic, education and health opportunities, and increasing investment. At the same time, the access and usage of electronic payments produces benefits in the form of lower transaction costs for individuals. These are reflected in lower physical and opportunity costs, generating savings that can reduce the depletion of assets. All of this has a positive impact in terms of reducing vulnerability, inequality, and poverty among the population.

1.8 **Current situation in Jamaica.** Financial development in Jamaica is lower compared to that of its regional peers. Despite total credit growth of 11% for the last five years,[14] domestic credit to the private sector remains limited at 30% of GDP, well below the level in Bahamas (77%) or Barbados (80%). There are two major dimensions in which financial development in Jamaica lags behind. First, the efficiency of financial institutions is very low. The lending rate spread in Jamaica (14%) more than doubles that in Barbados (6%), Trinidad and Tobago (6%) and other upper middle income countries (6%), whereas it is also almost five times that in the Bahamas (3%). This generates a measured net interest margin of about three times that of the Bahamas, the best performer in the group. The lack of efficiency is also seen in overhead costs which are almost eight times as high as those of Barbados. This situation is accompanied by a highly

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[12] The FSC has the regulatory and supervisory authority of the securities, private pension and insurance sectors. Especially important in the short term is to regulate the Repo activities of Securities Dealers (SD). Securities dealers (SD), with total assets of about 40% of GDP, finance long-term government bonds with short-term, deposit-like investments ("retail repos"). This model entails significant interest rate, liquidity, and concentration risks. These risks are not matched by either capital or liquidity buffers (IMF, Article IV, 2014). In order to mitigate these risks, it is crucial to introduce a sequence of reforms directed to prudential regulation and to provide better protection to investors.

[13] See: Karpowicz, I., Financial Inclusion, Growth and Inequality: A model application to Colombia, IMF Working Paper, 2014; Park, I. and Mercado, F., Financial Inclusion, Poverty, and Income Inequality in Asia, Asian Development Bank, Working Paper, 2015.

[14] World Bank, Financial Sector Assessment, 2015.

concentrated banking sector. The three largest commercial banks currently represent about 80% of total loans, the Herfindahl-Hirschman Index (HHI) is 0.43[15] (compared to the average 0.74 in LAC), and the Lerner index is 0.4[16] (compared to the 0.23 of LAC countries). High concentration in the banking sector creates potential barriers to entry, providing incumbent banks with enhanced market power due to the incurred sunk costs in obtaining knowledge on markets and customers and in creating the banking infrastructure. This situation may limit the incentives of potential banks to enter the banking system and, therefore, it may have a negative impact on product availability and prices, limiting the access to credit for individuals and small firms.[17,18] In this context, it is important to put in place policies to empower the consumer, in order to improve market functioning and efficiency. Secondly, Jamaica lags behind also in terms of access, usage and depth. Although in Jamaica 78% of adults report having a formal account, only 11% of adults have a loan from a formal financial institution. There is not a significant gender gap in either account access or credit; on the contrary, a larger proportion of women (11.3%) report having borrowed from financial institutions, than men (10.9%).[19]

1.9 The lack of access to credit is especially prevalent among low income individuals, MSMEs and the rural population. Only 26% of MSMEs report having a bank loan or line of credit, compared to the average 38% for LAC countries. In turn, although the agricultural sector's contribution to the economy represents approximately 6.5% of GDP and 17%of the labor force, lending to the sector represents only 4% of banks' total lending portfolio. In addition to the traditional agriculture specific risks (weather, diseases, and vulnerability to prices), lack of adequate land collateral in rural areas increases credit risks for banks. There are no specific instruments for agriculture finance and alternative credit products such as leasing and factoring are limited. At the same time, borrowing costs to Jamaican firms remain high at 18% (compared to the average of 6% of LAC-7)[20] and are twice as high for MSMEs.[21] The proportion of loans requiring collateral is as high as 97% of the loan value, compared to the average 72% for LAC countries. The lack of adequate collateral is a critical barrier to access credit, for both MSMEs and the rural population. The high interest rate and collateral requirements are due to the high credit risks, as a result of high informational

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[15] The HHI is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them. The index ranges from a high 1 to a low 0, with higher numbers implying low competition.

[16] The Lerner index is a measure of market power measured by the difference between price and marginal cost expressed as a percentage of price. The index ranges from a high of 1 to a low of 0, with higher numbers implying greater market power.

[17] After the 1996-1997 financial crisis, the financial system structure in Jamaica underwent major changes. The number of market participants fell drastically and foreign ownership of banks increased. Since then, the system has stabilized.

[18] For further discussion on financial sector concentration in Jamaica, please refer to World Bank, Financial Sector Assessment, 2015. For further discussion concentration in the banking sector financing obstacles and access to credit, see Beck, T., Maksimovic, V., and Demirguc-Kunt, A. (2003), "Bank competition, financing obstacles and access to credit", World Bank.

[19] See: Demirguc-Kunt, Asli, Leora Klapper, Dorothe Singer, and Peter Van Oudheusden. 2015. "The Global Findex Database 2014: Measuring Financial Inclusion around the World." Policy Research Working Paper 7255, World Bank, Washington, D.C.

[20] De la Torre, A., Ize, A., and Schmukler S. (2013), Financial Development in Latin America and the Caribbean. World Bank.

[21] Tennant, D., op. cit.

asymmetries and a low degree of competition in the financial sector.[22] In addition, penetration of traditional distribution channels (e.g. branches, automated teller machine-ATMs, etc.) is low, especially in rural areas. With 27 ATMs and six commercial bank branches per 100,000 adults in Jamaica, penetration is well behind countries like Bahamas, Belize, and Trinidad and Tobago.[23] The outreach of public policies remains limited. Despite an ambitious package of legislative reforms to improve banking regulation, financial infrastructure, or ease of doing business for MSMEs, public programmes to increase financing for MSMEs, or in rural areas, are scarce and lack sufficient coordination. Among the initiatives proposed by the Government of Jamaica is an existing partial credit guarantee scheme designed to mitigate lenders' credit risk, but it has to be re-capitalized as the initial allocation of funds has been depleted. Furthermore, improved financial consumer protection policies are needed to limit the vulnerability of consumers to abusive or unfair practices by financial institutions. The Banking Service Act (BSA) has made provisions for a mandatory code of conduct for DTIs, but a comprehensive framework on consumer protection and financial literacy is needed.

1.10 **Pending challenges.** In order to deal with the aforementioned challenges, it is key to develop an integrative policy framework to promote financial inclusion for individuals and MSMEs. A lack of a national strategy limits the capabilities of the authorities to develop a coherent and integrated action plan towards improving financial inclusion in Jamaica. Therefore, in order to foster financial inclusion, the country needs to: (i) develop a National Financial Inclusion Strategy to establish a coordinated medium-term policy action plan, including goals, timing and responsibilities; (ii) enhance the consumer protection regulation and supervision in order to increase competition and promote transparency, efficiency and accountability; and (iii) enhance access to financial services by those sectors particularly lagging behind (such as poor individuals, MSMEs and the rural and agricultural sector) by developing action plans targeted to address specific regulatory and institutional constraints and making the necessary adjustments to stimulate the use of available instruments such as the partial credit guarantee scheme.

1.11 **Financial legal framework.** The proper functioning of financial markets requires regulations capable of guaranteeing effective and efficient enforcement of financial contracts, in order to reduce borrowing costs or make collateralization-based financing feasible, so as to facilitate long-term finance. In contrast, inefficiencies in these areas raise financial costs and limit access to finance. There is ample empirical evidence showing that access to finance is directly related to improvements in the financial framework which, therefore, promote fuller exchange of information, better investor and creditor protection, and better contract enforcement guarantees and efficiency.[24]

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[22] The Herfindhal Index in Jamaica, a proxy for competition, stands at 0.43 in 2010, well below its regional peers and the LAC average (0.74). The informal economy in Jamaica, a proxy of informational asymmetries, is around 35-40%.

[23] World Bank, World Development Indicators, 2014.

[24] See for example Djankov, S., Hart, O., McLiesh, C. & Shleifer, A. (2008). 'Debt Enforcement around the World,' Journal of Political Economy 116(6), 1105 – 1149; La Porta, R., Lopez de Sinales, F., Shleifer, A. & Vishny, R. (1997). 'Legal Determinants of External Finance,' Journal of Finance52, 1131 – 1150.

1.12 **Current situation in Jamaica.** In Jamaica, access to finance is limited by an environment with weak credit rights, lengthy and costly dispute resolution mechanisms for property re-possession,[25] and information asymmetries. As a result, the value of collateral needed for a loan, as a percentage of the loan, is on average 204%, going as high as 240% for medium size loans.[26] Further actions are needed in order to deepen the implementation of a modern credit reporting system and collateral registry as well as broaden the range of assets that can be used as collateral to secure loans. Moreover, financing productive development requires sound regulatory frameworks and policy instruments in order to undertake productive investment projects with particular characteristics, such as those projects related to Public Private Partnerships (PPP) financing and innovation financing (e.g. financing for venture capital, angel investors or entrepreneurship). Jamaica has an incipient innovation financing programme and needs to upgrade its PPP policy, in order to streamline project design and execution and financially risky, innovative ventures.

1.13 **Pending challenges.** In order to enhance its financial legal framework, so as to increase access to finance, Jamaica needs to implement reforms in the following areas:[27] (i) contract enforcement mechanisms and creditors legal rights; and (ii) develop a framework and procedures for long-term financing.

1.14 **Bank experience and lessons learned**. The programme incorporates lessons learned by the Bank in designing policy-based loans for countries in the region in the area of financial systems, successfully combining reforms aimed at improving the regulation and supervision of the financial system to increase access to finance for firms and individuals. In addition, it incorporates lessons of other policy-based loans implemented in Jamaica, particularly the Competitiveness Enhancement Programme (JCEP) I, II and III (1972/OC-JA, 2297/OC-JA and 3147/OC-JA), the Fiscal Consolidation Programme I and II (2359/OC-JA and 2502/OC-JA), and the Fiscal Structural Programme for Economic Growth (3148/OC-JA). These lessons relate to the importance of: (i) adequate sequencing of reforms; (ii) interest of the country's authorities in promoting a reform agenda, and ownership of those reforms; (iii) support to the Government of Jamaica for informed decision-making for the reforms through technical assistance actions; and (iv) coordination with different multilateral and bilateral organizations. These lessons have been incorporated into programme design. The programme is also complementary to the reforms supported by previous operations. In the case of the JCEP series, in which several competitiveness and doing business issues were tackled and several concrete outcomes were achieved,[28] the present operation gives continuity by supporting the next generation of reforms in the areas of access to finance, promotion of private investment and reduction of the cost of doing business. A lessons-learned exercise shows that these types of reforms are complex, take a long time to be implemented, thus spanning more than one operation, and require substantial amounts of technical support to promote informed decision-making and raise the

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[25] In 2015, the country ranked 107/189 in the Enforcing Contracts indicator of the Doing Business.
[26] Ibidem.
[27] See for example Tennant, D., Access to Finance for Productive Development in Jamaica, March 2015; and Global Information Technology Report, 2015.
[28] Jamaica jumped 27 positions in the Doing Business Report in 2014.

awareness of decision-makers and stakeholders.[29] In addition, the programme is complemented by the reforms supported in the fiscal area, since a sound macroeconomic and fiscal policy, as the one promoted by the Fiscal Structural Programme, is required to provide stability to investors and private firms.

1.15 **Rationale of programme intervention.** Strengthening the contribution of the financial system to overall economic development is vital for reigniting growth in Jamaica and avoiding a potential reform fatigue in a country that has undertaken important fiscal, business and tax efforts during the last five years. Financial reforms are supportive of growth in two main aspects. First, financial regulation and supervision is the cornerstone of financial stability and, hence, the first step to avoid a costly crisis and to build investor and consumer confidence. In the case of Jamaica, it is especially important to consolidate financial regulation and supervision in order to promote a safer banking system, to avoid unlawful financial practices of the past that could destabilize the economy,[30] and to protect the banking system from recent "de-risking" policies implemented by international banks.[31] Second, financial policies and regulations are crucial to firms and individuals in order to develop their productive potential. In this latter respect, it is possible to distinguish two major lines of action: (i) policies focused on including firms and individuals in the financial system, lowering participation costs and improving intermediation efficiency in order to lower costs; and (ii) contractual arrangements directed at reducing the uncertainties and transaction costs inherent in financial contracts. These policies and institutions complement each other in building the framework upon which financial transactions take place. Hence, the overall logic of this programme combines both the stability and the growth enhancing role of the financial system in promoting a balanced development path.

1.16 **Strategic alignment.** The programme is aligned with the priorities set by the Government of Jamaica in its National Strategic Plan Vision 2030 and its Medium Term Socio-Economic Policy Framework 2015-2018, which highlights the need of strengthening both the legislative and regulatory framework for financial systems, and the financial inclusion strategy for greater participation of economic actors.[32] This operation will assist the government in strengthening the legislative, regulatory and supervisory framework of the financial sector, thereby contributing to the improvement of the business environment to promote financial deepening and inclusion of more economic participants in the economy. The programme is consistent with the Update to the Institutional Strategy (UIS) 2010-2020 (AB-3008) and is aligned with the development challenge of social

[29] Policy Reforms in Business Climate and Innovation in LAC: Lessons Learned from the IDB's Experience with Policy Based Loans (Draft). In the case of Jamaica, around US$1 million of Technical Assistance resources were used for reform design and implementation.

[30] In 2006, the country had to deal with a myriad of "Ponzi Schemes" in the financial sector. Unregulated investment schemes accounted for 12.5% to 25% of GDP and 50,000 households invested in these schemes. For more details on the crisis in Jamaica, see Carvajal, Anna et. al. Ponzi Schemes in the Caribbean. IMF Working Paper. April. 2009. WP/09/05.

[31] "De-risking" activities are undertaken by international financial institutions to mitigate risks related to underdeveloped and shallow financial systems. "De-risking" activities translate into closing important lines of businesses for local banks in developing countries, especially in small states, such as correspondent banking relationships and money transfers business.

[32] Medium Term Socio-Economic Policy Framework 2015-2018. Government of Jamaica

inclusion and equality, by proposing reforms and policy measures in the financial inclusion subsector. In addition, by supporting institutions and regulations that promote access to financial services, the programme is also aligned with the cross-cutting theme of institutional capacity and rule of law. Additionally, the programme is aligned with the Corporate Results Framework (CRF) 2016-2019 (GN-2727-4) since it will increase the number of micro/small/medium enterprises financed. This operation is aligned with the Country Strategy with Jamaica 2013-2014 (GN-2694-2)[33] and its priority area Financial Sector and Business Climate, specifically addressing the strategic objectives of increasing access to finance and reducing financial systems risks. In terms of the development of institutional and regulatory reforms to promote access to financing, the operation is consistent with the Support to SMEs and Financial Access/Supervision Sector Framework (GN-2768-3). The programme is also aligned with the Sector Strategy Institutions for Growth and Social Welfare (GN-2587-2), in that it proposes reforms to strengthen financial institutions in Jamaica.

1.17 **Policy reform coordination with other multilateral organizations.** Coordination with other multilateral organizations is vital in the case of Jamaica due to the strong efforts undertaken by other multilaterals and the Bank in accompanying both technically and financially the government's policy reforms in order to reignite economic growth. In particular, this programme builds upon the reform path embedded in the arrangement under the IMF-EFF. More specifically, the analysis and conditions established in this programme directed to strengthening the financial regulation and supervisory framework (Component II of this programme) contribute to the consolidation and sustainability of the structural benchmarks of the EFF. This programme contemplates actions included in the EFF, directed to improve supervision and regulation via the regulatory harmonization of DTI, enhancing the autonomy and overall responsibility for financial system stability of the BOJ, and gradually tighten prudential standards for the securities sector. Furthermore, the programme extends the structural benchmarks included in the EFF in order to deal with other key and complementary aspects of financial regulation and supervision such as conglomerate and credit union regulation and supervision, financial transparency and financial crisis management. At the same time, this programme introduces other vital components of financial development directed to improve financial inclusion and the legal framework of financial transactions (thus consistent with Components III and IV). Financial inclusion policy reforms are part of the diagnostic undertaken by the World Bank and IMF in the Jamaica Financial Sector Assessment 2015 and are currently supported by technical assistance provided by the World Bank.

1.18 **Technical assistance coordination with other multilaterals.** Coordination with other multilaterals is also important in order to optimize the use of scarce Technical Assistance (TA) resources. In the case of Jamaica, the IMF is providing TA in order to improve the financial crisis regulatory framework and has provided TA to enhance prudential regulation in the securities and the banking sectors (Component II of this programme). The World Bank is providing TA for

[33] A new Country Strategy with Jamaica (2016-2020) is under preparation. The transition period for the current Country Strategy ends November 1, 2016.

the National Financial Inclusion Strategy,[34] contemplated in Component II of this programme. This programme seeks to ensure implementation of such reforms and will be an added incentive to ensure same. The Bank is processing a Technical Cooperation (TC) proposal in order to improve supervision capacities of the FSC, as well as to support certain actions contemplated in Component III of this programme. The Bank will coordinate its (TC) actions with the other multilateral organizations and donors.

B. Objective, Components and Cost

1.19 **Programme objectives.** The objective of the programme is to enhance the contribution of the financial sector to economic growth by: (i) strengthening financial stability; (ii) enhancing financial inclusion of firms and individuals; and (iii) improving the financial legal framework.

1.20 This operation is the first of a programmatic policy based loan series, which will be made up of two contractually independent and technically linked loans, as per document CS-3633-1.

1.21 **Beneficiaries.** Programme reforms are crosscutting in nature, and are aimed at overcoming financial and regulatory hurdles that hinder the satisfactory operation of the financial system and the sector's contribution to growth. Given this objective, and the broad nature of the reforms, the programme is expected to benefit all stakeholders in the economy. In particular, by improving financial inclusion in Jamaica, it is expected that the reforms supported by the programme will benefit the individuals and the firms that are currently excluded or not sufficiently integrated into the financial system. Moreover, it is expected that the reforms aimed to improve the financial legal framework will enhance the provision of long-term financing for MSMEs and productive projects.

1.22 The proposed programme will be developed through the following components:

1.23 **Component I. Macroeconomic stability.** The objective of this component is to maintain a sustainable macroeconomic policy framework consistent with the objectives of the programme and the Policy Matrix (Annex II).

1.24 **Component II. Strengthening financial sector stability.** This component seeks to strengthen the areas for further work identified in international diagnostic assessments:

a. **Strengthening of the financial system regulation and supervision.** In order to enhance financial system regulation and supervision, the first operation includes: (i) enhancing the authority of the Bank of Jamaica by: (a) enhancing the governance and supervisory powers of the Supervisory Committee chaired by the BOJ; and (b) giving the BOJ the mandate and responsibility for financial stability surveillance in Jamaica; (ii) improving financial Deposit-Taking Institutions (DTI) regulation and supervision by: (a) harmonizing prudential standards across DTI sectors; (b) facilitating consolidated supervision of financial conglomerates; and

[34] The World Bank is supporting the drafting of the National Financial Inclusion Strategy on behalf of the Central Bank. This programme will be the impetus to complete same (which has seen delays in finalization) and also to implement the short to medium term recommendations entailed within.

(c) improving the sanctioning regime; (iii) developing the regulations of the Banking Services Act (BSA) including regulations on capital adequacy, licensing fees for DTI and application procedures to obtain a DTI license; (iv) proposing further amendments to the draft regulations for Credit Unions which are being developed in order to improve their supervisory and prudential regulation framework; and (v) developing the policy proposal to strengthen regulatory framework for the money lending institutions. The second operation will: (i) develop the regulations of the BSA, including: (a) consolidated supervision in order to adequately monitor and, as appropriate, apply prudential standards to all aspects of the business conducted by a banking group; (b) DTI Agent Banking; and (c) code of conduct on customer relations for DTI; (ii) approve the prudential regulatory and supervisory framework for Credit Unions following international best practices; and (iii) provide a clear and robust supervisory framework for the microfinance industry by developing a MicroCredit Act.

b. **Enhancing of the securities, pension and insurance regulation and supervision.** The first operation focuses on: (i) improving investor protection in the securities sector by enhancing the regulatory framework for the retail repo market through: (a) creating a new trust-based system to hold the underlying repo assets for the benefit of clients in the event of insolvency; and (b) defining the new transaction structure; (ii) improving protection for the private pension plan members by taking the necessary steps for the drafting of proposals for amendments to the pension funds legislation in order to: (a) regulate vesting and portability; (b) regulate solvency requirements; and (c) expand regulation of retirement schemes; and (iii) improving supervision of the insurance companies by amending the legislation to, inter alia, require the establishment of risk management techniques by insurers and protect policy holders by prioritizing their ranking during the winding-up of a company. The second operation will: (i) improve investor protection by strengthening prudential regulation of the securities sector following international best practice; (ii) improve protection for the private pension plan members by developing amendments to the pension funds legislation; and (iii) developing a report on the implementation of the Insurance Act amendments.

c. **Strengthening financial transparency.** The first operation will enhance financial transparency regulation and supervision in compliance with Financial Action Task Force (FATF) principles by: (i) submitting to Cabinet the National Risk Assessment (NRA) draft; and (ii) enhancing Anti-Money Laundering (AML) supervision by putting in place a dedicated AML Unit in the FSC with responsibility for conducting AML onsite inspections. In the second operation the programme will: (i) develop and implement the regulatory actions derived from the NRA in order to guarantee compliance with FATF principles and recommendations; and (ii) assess the performance of the measures undertaken to enhance AML supervision and suggest improvements if needed.

d. **Strengthening financial crisis management.** The conditions in the first operation will be: (i) establishing an integrated Financial Crisis Management Steering Committee (FCMSC) with participation by the major financial regulation authorities; and (ii) developing a concept note for a Financial

Crisis Management Framework for the Securities Sector. In the second operation it is expected that the country will develop a National Financial Crisis Management Framework following best practices, including: clarifying the process and the role of each financial sector regulatory agency and the Jamaica Deposit Insurance Corporation.

1.25 **Component III. Enhancing financial inclusion of firms and individuals.** This component introduces reforms in three important areas:

a. **Strengthening the institutional and policy framework for financial inclusion.** The first operation focuses on developing a draft National Financial Inclusion Strategy (NFIS) including the following areas: consumer protection and financial literacy; MSME Finance; Rural and Agricultural Finance and Retail Payment Systems. The second operation will focus on establishing the National Financial Inclusion Council (NFIC) as an overall policy coordinator with budgetary and monetary responsibilities. In addition, it will implement the NFIS.

b. **Enhancing consumer protection.** The first operation seeks to enhance consumer protection by establishing a consumer protection and financial literacy working group. The second operation will: (i) establish an action plan for the consumer protection and financial literacy working group; (ii) ensure that specific government agencies and supervisors have a clear mandate and resources for financial consumer protection by establishing the necessary regulations regarding information sharing and consumer rights; and (iii) develop a National Financial Literacy Strategy directed to improve financial education of low income and unbanked citizens.

c. **Improving MSMEs, rural, and agricultural access to finance.** In order to increase financing for such sectors, the first operation encompasses: (i) improving the functioning of the Credit Enhancement Fund managed by DBJ through: (a) broadening the eligible solvent financial institutions; (b) increasing the tenor and amount of the guarantee facility; and (c) incentivizing agricultural guarantees; (ii) increasing MSME supply-side data availability by drafting guidelines on MSME specific data reporting in order to enhance reporting to the BOJ and establish a data baseline for better MSME financial access monitoring activities; and (iii) improving coordination and efficiency within public agencies directed to provide financial and non-financial services to MSMEs by creating a Single Board for Self-Start, Micro Investment Development Agency (MIDA) and the Jamaican Business Development Corporation (JBDC). The second operation will seek to: (i) develop the microinsurance regulatory framework; (ii) develop a proposal on the leasing and factoring regulatory framework in order to increase value chain financing; (iii) implement routine data collection by the BOJ segregated by MSMEs; and (iv) implement the consolidation action plan for public sector entities providing financial and non-financial services to MSMEs.

1.26 **Component IV. Improving the financial legal framework.** This component focuses on two areas of reform:

a. **Strengthening long-term financing regulations and instruments.** The first operation encompasses: (i) drafting amendments to the PPP policy to develop a more flexible and agile PPP transaction framework, including: (a) avoiding unnecessary duplications; and (b) clarifying the role of the different agencies involved at different stages; and (ii) establishing alternative financing mechanisms to enhance long-term financing via venture capital (financing provided to emerging companies via equity), angel financing (financing provided by private investors to ideas and companies via equity) and Innovation Grant New Ideas to Entrepreneurship (IGNITE-grant financing for innovative ideas and business development services for entrepreneurs). The second operation will include: (i) approving the amendments to the PPP policy; (ii) developing a proposal on the organizations and instruments in order to increase the capacity of the DBJ to provide long-term financing; and (iii) concluding an evaluation of the venture capital, angel financing and IGNITE.

b. **Improving legal rights of creditors and contract enforcement.** The first operation will seek to: (i) improve usage of the Security Interests in Personal Property Act (SIPPA)[35] framework to enhance credit access by Small and Medium-Sized Enterprises (SMEs) by developing an action plan to increase the use of SIPPA collaterals, including methods to improve the secondary market and proposals to amend the regulatory guidelines; (ii) enhance creditor's legal rights by promoting the implementation of the Insolvency Act, including: (a) operationalization of the Office of Supervisor of Insolvency; and (b) training and awareness campaign initiated to sensitize the public on the new insolvency regime; and (iii) expedite conflict resolution for commercial disputes and reduce the backlog of commercial judicial cases by drafting amendments to the Resident Magistrates' Courts rule, including mandatory mediation for commercial claims over five hundred thousand Jamaican dollars where appropriate. In the second operation, the programme will improve usage of the SIPPA framework by: (a) updating BOJ guidelines to make specific reference to SIPPA; (b) developing and implementing a framework to support the SIPPA regimes; and (c) deploying additional public education and awareness on SIPPA. At the same time, the second operation will: (i) assess the impact of: (a) the operationalization the Office of Supervisor of Insolvency; and (b) the training and awareness campaign on the implementation of the Insolvency Act and identify areas of improvement if needed; and (ii) further expedite conflict resolution for commercial disputes by approving the amendment of the Resident Magistrates' Court rule, including mandatory mediation for commercial claims over five hundred thousand Jamaican dollars, where appropriate.

C. Key Results Indicators

1.27 The key indicator for measuring programme impact will be GDP growth, which is expected to exceed GDP growth under a non-reform scenario by 0.4 percentage

[35] Security Interests in Personal Property refers to the property interest created by operation of law over assets to secure the performance of an obligation. SIPPA will enhance credit access by SMEs as they will be able to use movable property as collateral to secure loans as opposed to land and buildings, while reducing the potential loss lenders may face from non-payment, as they will have assets they can seize to recover the value of the amount owing if the need arises.

points. Programme outcomes will be measured as follows: (i) the z-score index of insolvency risk as a measure of financial stability; (ii) the percentage of firms with a bank loan or line of credit; (iii) the percentage of adults with an account in a financial institution; (iv) the value of collateral needed for a loan (percentage of the loan amount); and (v) the interest rate spread. See the Results Matrix.

1.28 **Economic Analysis.** The economic analysis estimates the impact of the supported reforms on the medium-term growth rate and on quasi-fiscal savings. The calculations for the quantitative impact of the supported policies were approximated using a general equilibrium model of financial development proposed by Dabla-Norris et al. (2014) that specifically identifies three relevant financial elements (reach, depth, and efficiency). This model allows mapping most of the policies to specific parameters and therefore is considered an adequate approximation for the expected quantitative effects.[36] The main assumptions in the model are the following: (i) overlapping generations; (ii) heterogeneity among agents in wealth and talent; (iii) fixed cost to allow the possibility of receiving external financing; (iv) limited liability; (v) imperfect enforcement; (vi) costly state verification; (vii) exogenous failure rate in production; and (viii) production depending on standard inputs (capital and labor) and also on talent. The specifics of the model are described in more detail in the Economic Analysis, to which we refer the reader. Sensitivity tests of the baseline results were conducted for a broad range of parameters. A discount rate of 12% was applied to the resulting real net benefit flows, consistent with Bank recommendations. Use of the same general equilibrium model is proposed for the evaluation of programme impact as the existing calibration and the expected availability of data confirms the viability of this approach.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing Instruments

2.1 The current operation is the first of two consecutive operations that are linked on a technical level, but financed separately as Programmatic Policy-Based Loan (PBP) operations. The first operation is for a maximum amount of US$100 million, which is consistent with the country's external financing needs (US$900 million in FY 2015/16 excluding PetroCaribe buyback).[37] This operation would cover 11% of these needs. While the amount and the timing of the second operation will be decided in the corresponding programming exercise based on the country's financing needs, it is expected that the conditionalities identified for the second operation will be met during 2017. In accordance with the Policy-based Loans: Guidelines for Preparation and Implementation (CS-3633-1), a programmatic approach facilitates policy dialogue between the

[36] As it is also discussed in the corresponding annex, the consensus in the literature is that the supported policies contribute with each other in a positive way. Therefore, a less-than-perfect mapping from policies to parameters in the model would render an underestimation of the potential benefits and not an underestimation of the potential costs. In this sense, the quantitative results can be viewed as a conservative approximation for the net benefit of the programme.

[37] PetroCaribe buyback refers to the reduction of debt owed to state-owned Venezuelan oil company Petroleos de Venezuela SA (PDVSA) by Jamaica's PetroCaribe Development Fund (PDF). Under the July 2015 PetroCaribe buyback, debt value at US$3.25 billion of outstanding debt was bought back for US$1.5 billion.

country and the Bank, accords sufficient time for reforms to be implemented, and provides an opportunity for progress under the first operation to be evaluated and reforms adjusted based on the knowledge acquired. The second operation is expected to deepen the reforms initiated under the first.

B. Environmental and Social Safeguard Risks

2.2 In accordance with Directive B.13 of the Environment and Safeguards Compliance Policy (GN-2208-20) and Operational Policy (OP-703), no classification is required. The proposed reforms will not have any negative environmental or social impacts.

C. Other Key Issues and Risks

2.3 The main risks that were identified are the following: (i) deterioration in global economic conditions could reduce the impact and speed of the proposed reforms; and (ii) the proposed reforms will not show good results in the long run, if continuity is not provided through a following sequence of reforms that deepen progress in financial inclusion and financing of productive development. To mitigate this risk the authorities have carried out a process of socialization of the effects of the reforms, and the benefits to the beneficiary population. Another risk is the lack of coordination between public agencies responsible for the implementation of reforms, and economic and social agents. To mitigate this risk, the executing agency (the MOFP) will designate a Programme Coordination Unit (PCU) responsible for coordinating with the agencies involved in execution (BOJ, FSC, Ministry of Industry, Investment and Commerce MIIC and Jamaica Promotions Corporation JAMPRO). The reforms proposed by the programme have been designed in such a way that they provide benefits and great impact for the country and the team will be closely monitoring these reforms.

2.4 **Policy reform programme sustainability.** Several factors have been taken into account in order to maximize the sustainability of policy reforms. First, the conditions established in the policy matrix have been agreed upon by the major stakeholders, and are well advanced in terms of technical work and negotiation between the relevant parties. Second, there has been strong coordination between the government policy agenda and the programme policy matrix, in order to avoid dynamic inconsistencies and align incentives. Third, the TC provided by the Bank and other multilateral institutions will guarantee that the government will have the resources to implement the intended reforms. Fourth, the Bank will maintain a close policy dialogue with the authorities, in order to anticipate and overcome any potential bottleneck. In addition to this, the sustainability of the reforms after the programme is enhanced by the fact that the reforms are embedded in the priorities set by the Government of Jamaica in its National Strategic Plan Vision 2030 and are key subjects in the policy dialogue that the country has with multilateral organizations (IMF, World Bank, IDB), as well as the agreements taken under the EFF.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of Implementation Arrangements

3.1 The executing agency will be the MOFP, which will designate a PCU, responsible for coordinating the agencies involved in execution, as well as presenting work plans and semiannual progress reports on compliance with the Policy Matrix

(Annex II). The PCU will be the Economic Management Division (EMD) of the MOFP, in coordination with the relevant authorities at the BOJ, FSC, MIIC and JAMPRO. The PCU, together with these agencies, will carry out periodic monitoring of the reforms envisaged in the Policy Matrix, with a view to preparing a semiannual report on progress towards the fulfillment of the programme conditions and submission of this report to the Bank. The responsibilities of the PCU regarding monitoring the progress of projectimplementation,encompasses maintaining official communication with the Bank and submitting progress reports; coordinating with stakeholders to advance actions to achieve policy objectives; and collecting and providing data to the Bank for project monitoring. These responsibilities are detailed in paragraph 3.3.

3.2 **Special Contractual Clauses prior to the single loan disbursement. The disbursement of loan resources will be subject to compliance by the Borrower, to the Bank's satisfaction, of the policy conditions set forth in the Policy Matrix (Annex II) and in the loan contract.**

B. Summary of Arrangements for Monitoring Results

3.3 Programme implementation will be monitored by the MOFP's Economic Management Division, which will submit information periodically and monitor the means of verification for programme reforms. The Borrower and the Bank will hold semiannual meetings to review compliance with the conditions required for the second programme. As executing agency, the MOFP will designate a staff member whose responsibilities will include: (i) maintaining official communication with the Bank and submitting reports and evidence of compliance with conditions under the operation (as well as any other report that the Bank may require) in accordance with the agreed time frames and conditions; (ii) advancing actions to achieve the policy objectives set out in the programme (particularly those included as triggers for the second operation); and (iii) collecting, archiving, and submitting to the Bank all information, indicators, and parameters that will allow the Bank to monitor, measure, and evaluate programme results. Consistent with its role, the MOFP will coordinate the receipt of evidence regarding commitments made by the different government institutions. Central to the monitoring activities will be the scheme detailed in the Monitoring and Evaluation Plan, linking specific objectives to specific policies with clear and well-defined verification tools. With respect to the final programme evaluation of the two operations, the Bank will prepare a Project Completion Report (PCR) which will includean evaluation with two components. The first component relies on a general equilibrium model to estimate the impact of the policies on economic growth following implementation of the reforms. In the case of the second component, the same exercise described in the economic analysis will be conducted, but using effective values and defining a heuristic counterfactual (see the Monitoring and Evaluation Plan and the programme Economic Analysis).

IV. POLICY LETTER

4.1 The Policy Matrix for the proposed programme is aligned with the corresponding Policy Letter issued by Jamaica, dated May 31, 2016. The letter reaffirms the government's commitment to implementing the activities agreed with the Bank.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Development Challenges & Cross-cutting Themes	**-Social Inclusion and Equality -Institutional Capacity and the Rule of Law**		
Regional Context Indicators	**-Rule of law (average LAC percentile)**		
Country Development Results Indicators	**-Micro / small / medium enterprises financed (#)**		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2694-2**	**i) To improve access to finance and ii) To reduce financial system risks.**	
Country Program Results Matrix	**GN-2849**	**The operation is included in the 2016 Operational Program.**	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	**Evaluable**	**Weight**	**Maximum Score**
	8.0		**10**
3. Evidence-based Assessment & Solution	**9.6**	**33.33%**	**10**
3.1 Program Diagnosis	**3.0**		
3.2 Proposed Interventions or Solutions	**3.6**		
3.3 Results Matrix Quality	**3.0**		
4. Ex ante Economic Analysis	**7.0**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**2.5**		
4.2 Identified and Quantified Benefits	**2.0**		
4.3 Identified and Quantified Costs	**2.0**		
4.4 Reasonable Assumptions	**0.0**		
4.5 Sensitivity Analysis	**0.5**		
5. Monitoring and Evaluation	**7.5**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**1.3**		
5.2 Evaluation Plan	**6.2**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Medium**		
Identified risks have been rated for magnitude and likelihood	**Yes**		
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation	**Yes**		
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)			
Non-Fiduciary			
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The "Financial System Reform Support Program" (JA-L1058), in the amount USD 100 million, is the first of two programmatic loans. The objective of the program is to enhance the contribution of the financial sector to economic growth by: (i) strengthening financial stability; (ii) enhancing financial inclusion of firms and individuals; and (iii) improving the financial legal framework. The vertical logic of the program is consistent. The diagnosis identified challenges such as regulatory gaps in the financial sector, lack of a national strategy towards improving financial inclusion, and an environment with weak credit rights and costly dispute resolution mechanisms. The proposed outputs (some acts and regulations, and several communications) aim at tackling these challenges.

Both the economic analysis and the evaluation plan rest on a micro-founded general equilibrium model developed by the International Monetary Fund (IMF) to measure the effect of this type of program. The model was used recently in the design of similar programs (CO-L1144 and UR-L1108). The model allows simulating the evolution of relevant variables (like economic growth) affected by changes in the parameters of interest (for example, cost of participation in the financial system, efficiency of financial intermediation, etc.).

An advantage of the model is that much of the necessary data is available for Jamaica and the data is updated frequently enough to monitor the program. The main limitation of the economic analysis is that important details about the computations are not clearly explained, limiting the opportunities for learning and quality control. Further, important assumptions of the model, such as the magnitude of changes in parameters resulting from the reform, are not justified in a convincing manner. Consequently, the net present value obtained may not be realistic (though, the sensitivity analysis shows that the NPV remains positive for several scenarios). The main limitation of the evaluation plan is that it assumes that any changes observed over time in financial market characteristics (used to calibrate the main model parameters) are solely due to the project, whereas in reality many confounding factors may exist.

The project is aligned to the Bank's Country Strategy with Jamaica, for wich an extension period was approved.

POLICY MATRIX

POLICY OBJECTIVES	FIRST OPERATION	SECOND OPERATION
Component I. Macroeconomic stability		
Maintaining a macroeconomic environment consistent with the programme objectives and with the Policy Letter.	The macroeconomic environment of the borrower allows the achievement of the programme objectives and is consistent with the Policy Matrix.	The macroeconomic environment of the borrower allows the achievement of the programme objectives and is consistent with the Policy Matrix.
Component II. Strengthening financial sector stability		
II. a Strengthening of the financial system regulation and supervision.	Enhance the authority of the Bank of Jamaica (BOJ) by: (i) enhancing the governance and supervisory powers of the Supervisory Committee chaired by the BOJ; and (ii) giving BOJ the mandate and responsibility for financial stability surveillance in Jamaica.	Develop the regulations of the Banking Services Act (BSA) including: (i) consolidated Supervision, in order to adequately monitor and, as appropriate, apply prudential standards to all aspects of the business conducted by a banking group; (ii) DTI Agent Banking; and (iii) code of conduct on customer relations for DTI.
	Improve financial Deposit Taking Institutions (DTI) regulation and supervision by: (i) harmonizing prudential standards across DTI sectors; (ii) facilitating consolidated supervision of financial conglomerates; and (iii) improving the sanctioning regime.	Approve the prudential regulatory and supervisory framework for Credit Unions following international best practices.
	Develop the policy proposal to strengthen the regulatory framework for the money lending institutions	Provide for a clear and robust supervisory framework for the microfinance industry by developing a MicroCredit Act.
	Develop the regulations of the Banking Services Act (BSA) including regulations on capital adequacy, licensing fees for deposit-taking institutions and application procedures to obtain a DTI license.	
	Propose further amendments to the draft regulations for Credit Unions which are being developed in order to improve their supervisory	

POLICY OBJECTIVES	FIRST OPERATION	SECOND OPERATION
	and prudential regulation framework.	
II. b Enhancing the securities, pension and insurance regulation and supervision	Improve investor protection in the securities sector by enhancing the regulatory framework for the retail repo market through: (i) creating a new trust based system to hold the underlying repo assets for the benefit of clients in the event of insolvency; and (ii) defining the new transaction structure. Improve protection for the private pension plan members by taking the necessary steps for drafting of proposals for amendments to the pension funds legislation in order to: (i) regulate vesting and portability; (ii) regulate solvency requirements; and (iii) expand regulation of retirement schemes. Improve supervision of the insurance companies by amending the legislation to(Insurance Act), inter alia, require the establishment of risk management techniques by insurers and protect policy holders by prioritizing their ranking during the winding-up of a company.	Improve investor protection in the securities sector by strengthening prudential regulation of the securities sector following best practices. Improve protection for the private pension plan members by developing amendments to the pension funds legislation in order to: (i) regulate vesting and portability; (ii) regulate solvency requirements; and (iii) expand regulation of retirement schemes. Develop a report on the implementation of the Insurance Act amendments.
II. c Strengthening Financial Transparency	Improve financial transparency regulation and supervision in compliance with Financial Action Task Force (FATF) principles by: (i) submitting to Cabinet the National Risk Assessment (NRA) draft; and (ii) enhancing Anti-Money Laundering (AML) supervision by putting in place a dedicated AML Unit in the Financial Services Commission (FSC) with responsibility for conducting AML onsite inspections.	Develop and implement the regulatory actions derived from the NRA in order to guarantee compliance with the FATF principles and recommendations. Assess the performance of the measures undertaken to enhance AML supervision and suggest improvements if needed.
II. d Strengthening financial crisis management	Establish an integrated Financial Crisis Management Steering Committee (FCMSC) with participation by the major financial regulation authorities. Develop a concept note for a Financial Crisis Management Framework for the Securities Sector.	Develop a National Financial Crisis Management Framework following best practices, including: clarifying the process and the role of each financial sector regulatory agency and the Jamaica Deposit Insurance Corporation.

POLICY OBJECTIVES	FIRST OPERATION	SECOND OPERATION
Component III. Enhancing financial inclusion of firms and individuals		
III. a Strengthening the institutional and policy framework for financial inclusion	Develop a draft National Financial Inclusion Strategy (NFIS) including the following areas: consumer protection and financial literacy; MSME Finance; Rural and Agricultural Finance and Retail Payment Systems.	Establish the National Financial Inclusion Council (NFIC) as an overall policy coordinator with budgetary and monetary responsibilities. Implement the National Financial Inclusion Strategy (NFIS).
III. b Enhancing consumer protection	Establish a consumer protection and financial literacy working group in order to enhance financial consumer protection supervision, and financial education.	Establish an action plan for the consumer protection and financial literacy working group. Ensure that specific government agencies and supervisors have a clear mandate and resources for financial consumer protection by establishing the necessary regulations regarding information sharing and consumer rights. Develop a National Financial Literacy Strategy directed to improve financial education of low income and unbanked citizens.
III. c Improving MSMEs, Rural, and Agricultural Access to Finance.	Improve the functioning of the Credit Enhancement Fund managed by the Development Bank of Jamaica (DBJ) through: (i) broadening the eligible solvent financial institutions; (ii) increasing the tenor and the guarantee amount of the facility; and (iii) incentivizing agricultural guarantees. Increase MSME supply-side data availability by drafting guidelines on MSME specific data reporting in order to enhance reporting to the BOJ and establish a data baseline for better MSME financial access monitoring activities. Improve coordination and efficiency within public agencies directed to provide financial and non-financial services to MSMEs by Ministry of Industry, Investment and Commerce (MIIC) by creating a Single Board for Self-Start, Micro	Develop the micro insurance regulatory framework. Develop a proposal on the leasing and factoring regulatory framework in order to increase value chain financing. Increase MSME supply-side data availability by implementing routine data collection by the Central Bank, segregated by MSMEs, in order to enhance reporting from deposit institutions and establish a data base line for better MSME financial access monitoring activities. Implement the Consolidation Action Plan for public sector entities providing financial and non-financial services to MSMEs, with common governance structure and shared services.

POLICY OBJECTIVES	FIRST OPERATION	SECOND OPERATION
	Investment Development Agency (MIDA) and Jamaican Business Development Corporation (JBDC).	
Component IV. Improving the financial legal framework		
IV. a Strengthening long-term financing regulations and instruments.	Develop a more flexible and agile Public Private Partnership (PPP) transaction framework by drafting the amendment to the PPP policy, including: (i) avoiding unnecessary duplications; and (ii) clarifying the role of the different agencies involved at different stages. Establish alternative financing mechanisms to enhance long-term financing via: (i) venture Capital, (financing provided to emerging growth companies via equity); (ii) angel financing (private investors make equity investment in ideas and companies); and (iii) IGNITE- Innovation Grant- New Ideas to Entrepreneurship (grant financing for innovative ideas and business development services for entrepreneurs).	Develop a more flexible and agile PPP transaction framework by approving the amendment to the PPP policy, including: (i) avoiding unnecessary duplications; and (ii) clarifying the role of the different agencies involved at different stages. Developing a proposal on the organizations and instruments in order to increase the capacity of the DBJ to provide long-term financing. Conclude an evaluation of the venture capital, angel financing and IGNITE.
IV. b Improving legal rights of creditors and contract enforcement	Improve usage of Security Interests in Personal Property Act (SIPPA) framework to enhance credit access by SMEs by developing an action plan to increase the use of SIPPA collaterals, including methods to improve the secondary market and proposals to amend the regulatory guidelines. Enhance creditor's legal rights by strengthening the implementation of the Insolvency Act including: (i) operationalization of the Office of Supervisor of Insolvency; and (ii) training and awareness campaign initiated to sensitize the public on the new insolvency regime. Expedite conflict resolution for commercial disputes	Improve usage of SIPPA framework to enhance credit access by SMEs by implementing the action plan to increase the use of SIPPA collaterals, including: (i) updating BOJ guidelines to make specific reference to SIPPA; (ii) developing and implementing a framework to support the SIPPA regime, including valuations; and (iii) deploying additional public education and awareness on SIPPA. Assess the impact of: (i) the operationalization the Office of Supervisor of Insolvency; and (ii) the training and awareness campaign on the implementation of the Insolvency Act, and identify areas of improvement if needed. Expedite conflict resolution for commercial disputes

POLICY OBJECTIVES	FIRST OPERATION	SECOND OPERATION
	and reduce the backlog of commercial judicial cases by drafting amendments to the Resident Magistrates' Courts rule, including mandatory mediation for commercial claims over five hundred thousand Jamaican dollars, where appropriate.	and reduce the backlog of commercial judicial cases by approving the amendment of the Resident Magistrates' Courts rule, including mandatory mediation for commercial claims over five hundred thousand Jamaican dollars, where appropriate.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-__/16

Jamaica. Loan ____/OC-JA to Jamaica
Financial System Reform Support Programme

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with Jamaica, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a financial system reform support programme. Such financing will be for the amount of up to US$100,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___________)

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