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Dealing with Distressed Financial Cooperatives

A Caribbean Experience

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WORLD BANK GROUP

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Abbreviations

AGM	Annual General Meeting
BLA	Building and Loan Association
BAICO	British American Insurance Company
CARTAC	Caribbean Regional Technical Assistance Centre
CEO	Chief Executive Officer
CLICO	Colonial Life Insurance Company
ECCB	Eastern Caribbean Central Bank
ECD	Eastern Caribbean Dollar (USD/ECD = 2.7)
FSA	Financial Services Authority
GDP	Gross Domestic Product
LOLR	Lender of Last Resort
MoU	Memorandum of Understanding
NPLs	Non Performing Loans
NPV	Net Present Value
OECS	Organization of Eastern Caribbean States
PEARLS	Protection, Effective Financial Structure, Asset Quality, Rates of Return and Costs, Liquidity, Signs of Growth

UNITED STATES
Gulf of Mexico
Nassau
THE BAHAMAS
ATLANTIC OCEAN
Havana
CUBA
Turks and Caicos Islands (U.K.)
MEXICO
Cayman Islands (U.K.)
HAITI
DOMINICAN REPUBLIC
Port-au-Prince
Santo Domingo
British Virgin Islands (U.K.)
Anguilla (U.K.)
St.-Martin (Fr.)
St. Maarten (Neth.)
Puerto Rico (U.S.)
St.-Barthélemy (Fr.)
ANTIGUA & BARBUDA
JAMAICA
Kingston
Belmopan
BELIZE
U.S. Virgin Islands (U.S.)
Basseterre
St. John's
Saba (Neth.)
St. Eustatius (Neth.)
Montserrat (U.K.)
Guadeloupe (Fr.)
ST. KITTS AND NEVIS
GUATEMALA
HONDURAS
Guatemala
Roseau
DOMINICA
Martinique (Fr.)
Caribbean Sea
Tegucigalpa
San Salvador
ST. LUCIA
Castries
BARBADOS
Bridgetown
Kingstown
EL SALVADOR
NICARAGUA
Managua
Aruba (Neth.)
Curaçao (Neth.)
Bonaire (Neth.)
St. George's
GRENADA
Port of Spain
TRINIDAD & TOBAGO
Caracas
San José
COSTA RICA
Panama
PANAMA
PACIFIC OCEAN
R.B. de VENEZUELA
Georgetown
GUYANA
COLOMBIA
Bogotá
BRAZIL
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Summary

This working paper analyzes the restructuring of a distressed systemic financial cooperative in the Caribbean and draw lessons for supervisors or policy makers. It explains how the cooperative was intervened, restructured and revived in less than nine months. It analyses how a major contagion impact to the rest of the local financial system was averted with the supervisor building the necessary confidence from the members to recapitalize the cooperative. No public funding was disbursed. Success was never guaranteed during the intervention period and hinged on a comprehensive approach addressing liquidity, solvency and long-term viability issues.

This paper attempts to draw some lessons for policymakers and financial supervisors who may be confronted with a similar situation. The first part describes the distressed institution and the challenges it presented to its supervisor; the second part analyzes the key components and timeframe of the restructuring strategy; the third part draws tentative lessons for supervisors.

Introduction

On January 18th, 2013, depositors' queues formed outside the Building and Loan Association (BLA or "Association") in Kingston, Saint Vincent and the Grenadines, after a press article highlighted severe weaknesses in the Association. The BLA was insolvent and had little liquidity to meet depositors' demands. About 20 percent of the population held deposits the BLA, whose members' liabilities represented 12 percent of the country's Gross Domestic Product (GDP).

This working paper explains how this distressed systemic financial cooperative was intervened, restructured and revived in less than nine months.[1] It analyses how a major contagion impact to the rest of the local financial system was averted with the supervisor building the necessary confidence from the members to recapitalize the cooperative. No public funding was disbursed. Success was never guaranteed during the intervention period and hinged on a comprehensive approach addressing liquidity, solvency and long-term viability issues.

This paper attempts to draw some lessons for policymakers and financial supervisors who may be confronted with a similar situation. The first part describes the distressed institution and the challenges it presented to its supervisor; the second part analyzes the key components and timeframe of the restructuring strategy; the third part draws tentative lessons for supervisors.

1. Chronicle of a Distressed Institution

1.1 Financial Cooperatives in the English-Speaking Caribbean: High Penetration and Current Challenges

Financial cooperatives in the English-Speaking Caribbean have deep historic roots. Two forms of financial cooperatives are present: credit unions which provide consumer and mortgage loans to their members, and BLAs (also known as building societies), a type of credit unions specialized on mortgage lending. BLAs were introduced in the late 19th century (Trinidad and Tobago, Jamaica) and throughout the 20th century (Grenada, Saint Vincent, Dominica) to provide mortgage finance to the population in the middle to lower income brackets. Credit unions were introduced by missionaries from Canada, Ireland and the USA in the early 1940s. They took root in Jamaica from 1941, Trinidad and Tobago in the early forties and in Dominica from 1951. While commercial banks expanded to become dominant credit providers in the financial system, financial cooperatives continued to grow as a means of encouraging thrift for lower income earners and providing an easier access to credit for their membership, compared to the commercial banking sector.

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[1] This restructuring was implemented with technical assistance from the World Bank and funded by DFID. The authors wish to thank Jim Messec and Ruth Neyens who significantly contributed to the overall success of the restructuring strategy. In addition the authors are grateful to Nagavalli Annamalai, Juan Buchenau, Alfonso Garcia-Mora, Dave Grace, Edda Ros Karsldottir and Ruth Neyens for their helpful comments on the paper.

Table 1 Credit Unions in the English-Speaking Caribbean

	OECS countries	Barbados	Jamaica	Trinidad and Tobago
# Credit Unions	51	35	38	130
# Members	305,769	160,862	953,934	572,285
Members % of active population	77	70	48	54
Shares and deposits as % of GDP	13	17	4	5
Loans/shares deposit ratio (%)	90	88	89	69
Total CU assets, MUSD	840	842	720	1,692
CU assets as % of total sector	8	12	9	8
Number of building societies	4	0	3	1
Assets of building societies % GDP	12 (SVG)	NA	15	0.04

Source: Caribbean confederation of credit unions, December 2013 data, ECCB Monetary Statistics, IMF WEO, World Development Indicators and Central Banks. Data on building and loan associations come from national supervisors or the institutions. For OECS, building society assets/GDP is only available for Saint Vincent and the Grenadines (SVG).

Strong historical presence and focus on the low income households help explain the high penetration of financial cooperatives in the region. More than 40 percent of the active population is a member of a credit union. In the Organization of Eastern Caribbean States (OECS)[2] where the distressed cooperative was located, this percentage goes up to 75 percent. The number of institutions is significant with 35 credit unions in Barbados, 38 in Jamaica, 130 in Trinidad and Tobago and 51 in the OECS for a total population of only 600,000 people.

The fallout of the global credit crisis from 2008 resulted in multiple challenges for the locally-owned or so-called "indigenous" financial cooperatives. Decreases in tourism arrivals and foreign direct investment in Caribbean economies, as well as subdued growth recovery, resulted in higher unemployment and a fall in incomes, which in turn led to a deterioration of the asset quality as more members defaulted. It also uncovered structural problems. The challenges described below are drawn from cases in the OECS and documented by supervisors.[3]

- **Constraints to effectively compete in the financial services sector**: Financial Cooperatives have a menu of limited products and services. The primary products offered are savings, "share" deposits (deposits where share certificates are held) and time deposits with credit facilities dominated by consumer and mortgage related lending. However, the

[2] The OECS includes Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines and the British Virgin Islands. These countries, with the exception of the British Virgin Islands, share a single currency in a Monetary Union, the Eastern Caribbean Currency Union.

[3] CARTAC conference on "Creating Sustainable Credit Unions in the Caribbean: Crisis Management and Resolution Strategies" November 2013.

lack of convenient and modern payment products (debit, credit, internet and mobile banking) limits their relevance for some markets. Savings products are also being offered by larger commercial banks, often at highly competitive rates. The lack of scale of some financial cooperatives limits their access to the latest technology and talent.

- **Weak governance structure and lack of members' engagement:** The cooperative governance structure is drawn from its membership and is based primarily on volunteerism. The governing bodies comprise the Board of Directors and mandatory Supervisory and Credit Committees in accordance with the bylaws of the institution. Appointments to the governing bodies are made through an election process by members at the Annual General Meeting (AGM). Historically, this process has resulted in the election of key persons who fall short of the required standards of fitness and propriety. Only recently a new Cooperative Societies Legislation was introduced in the OECS to address this weakness, and includes provisions for fit and proper persons.

- **Limited capacity to mobilize capital from members**: Membership sharing by financial cooperatives (i.e. various cooperatives share the same members) is very common and a limiting factor to provide capital in case of systemic stress. Sources of recapitalization are invariably limited to the membership base of the institution if the institutions are to maintain a cooperative feature. In the event of systemic stress, the constraints are exacerbated on account of commonly held membership.

1.2 The Building and Loan Association in Saint Vincent and the Grenadines

The BLA is the oldest financial institution in Saint Vincent and the Grenadines. It was established in 1941 through its own specific act ("Building Societies Act"). Before it failed in early 2013, it was the largest non-bank deposit taker: saving deposits and redeemable shares[4] represented 12 percent of GDP and one-fifth of the population was a member. Saint Vincent and the Grenadines is a country of the OECS with 110,000 inhabitants and a GDP per capita of about USD6,600.

The founding act was still in force in 2013 and was severely outdated in its provisions for the operation, regulation and supervision of the BLA. It did not have any prudential standards, or provision for restructuring or resolution. The act was amended in 2009 to provide the Ministry of Finance with the authority to be provided with the financial returns and issue fines in case of non-compliance. In 2009, a Memorandum of Understanding (MoU) was entered into with the Ministry of Finance to address governance and asset quality problems. However the MoU was not followed through by either side. In addition, it became public knowledge that the BLA, like some other OECS financial cooperatives, had made bad investments into the failed insurers Colonial Life Insurance Company (CLICO) and British American Insurance Company (BAICO).

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[4] Redeemable shares were a type of savings product commercialized under the name of "shares" and structured as a program with monthly payments.

On January 18th, 2013, an article in the leading national newspaper triggered a deposit run on the BLA. The article questioned the safety and soundness of the Association, its future viability, the lack of compliance with minimum corporate governance standards, and the competence and integrity of senior management and Board of Directors. In a small country, the impact of this press report was extremely damaging and triggered a series of events beginning with a run on deposits. Considering the potential for adverse social, political and economic consequence should the Association collapse, the newly created supervisor (Financial Services Authority, FSA) took control of the BLA on February 1st. The Chief Executive Officer (CEO) and members of the Board were terminated.

Upon taking control, the supervisor found that the BLA exhibited all the characteristics of a "failed institution." It had no reliable financial statements, weak corporate governance, an unsustainable business model, high delinquency of loans, and it was unable to meet deposit withdrawal requests.

- **Lack of Financial Management:** The BLA had not produced any financial statements or bank account reconciliations for the past 13 months. Capital and earnings had not been reconciled for over a year. It had not had an external audit or held an AGM for the past two years. The audit commissioned by the supervisor as of the date of intervention for the previous 25 months showed significant losses and accumulated deficit which wiped out the capital (annex A).

- **Weak corporate governance structure:** A proxy voting system whereby individual members relinquished their voting rights to elect the Board was in force and did not appear to be well monitored. Hence the Board did not have incentives to take corrective actions.

- **Deficient Internal Controls:** The BLA did not have proper internal controls, policies or procedures, and various breaches of compliance with the institution's own rules were observed. For instance the rules requiring a 90 day notice for deposit withdrawals were being systematically waived by senior management.

- **Failed IT system conversion:** The BLA had changed its IT system 12 months before intervention, but the new system was not functional and resulted in parallel systems being run with neither having accurate or reliable financial data.

- **Unsustainable business model**: The rates paid on its special saving deposits were much higher than its competitors (about eight percent versus a regulatory savings deposit rate of three percent for commercial banks) and resulted in an unsustainable business model. Most of the loans were long-term fixed rate mortgages which could not be re-priced as per conventional practice.

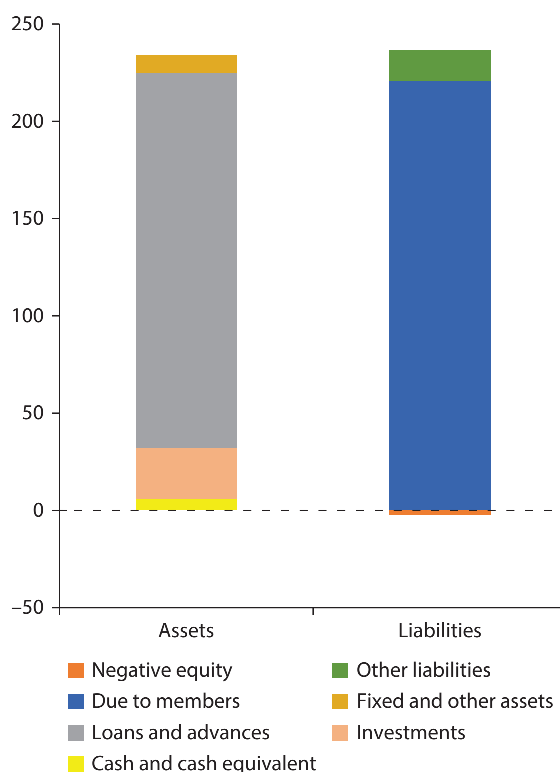
- **Tight liquidity**: At the time of intervention, the BLA liquidity available based on the holdings of cash was less than three percent of total deposits. The institution was faced with a high demand for funds' withdrawal of almost one-third of the total deposits. Despite its size, the BLA was not supervised by the regional central

bank (Eastern Caribbean Central Bank -ECCB), and there was no lender of last resort (LOLR) available either via the national government or the ECCB. Deposit insurance did not exist for BLA or any depository institution.[5]

- **High delinquency on loans**: There was a lack of effective follow up on delinquent balances, collections process and resolution of non-performing loans (NPLs). At January 31, 2013, the non-performing loans portfolio of approximately 490 loans totaled ECD80 million (USD30 million) representing 40 percent of the loan portfolio. Some of these were more than five years in arrears, and borrowers were not incentivized to remain current on their loans. The BLA was usually the last creditor to be paid in the country, even after utility bills, due to a weak enforcement of its own collection contractual rights. The lore in the Association was that they had never repossessed the collateral on any more than just a handful of homes in its 70 year history.

The figures below provide a simplified balance sheet of the BLA, as per the subsequent audit, as well as a breakdown of members' liabilities (deposits and shares). 73 percent of members' liabilities were held in "special deposits," a type of savings deposits carrying

Figure 1 Simplified Balance Sheet, January 2013
ECD million



[5] At the date of this paper, there is still no deposit insurance or lender of last resort facilities at the regional central bank or via national governments available to OECS financial cooperatives.

Figure 2 Breakdown of Deposits and Shares, % of Total

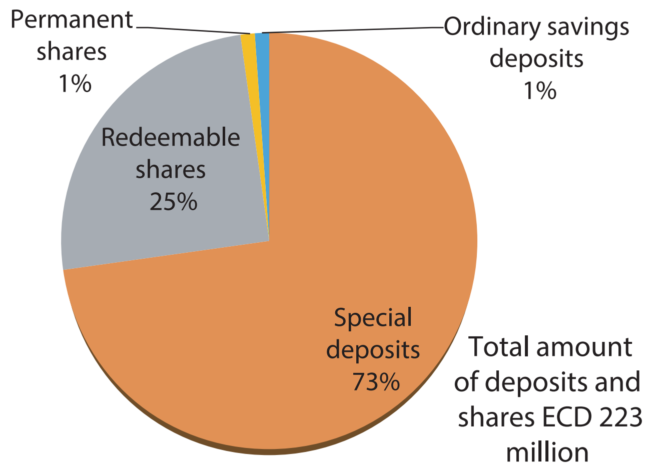
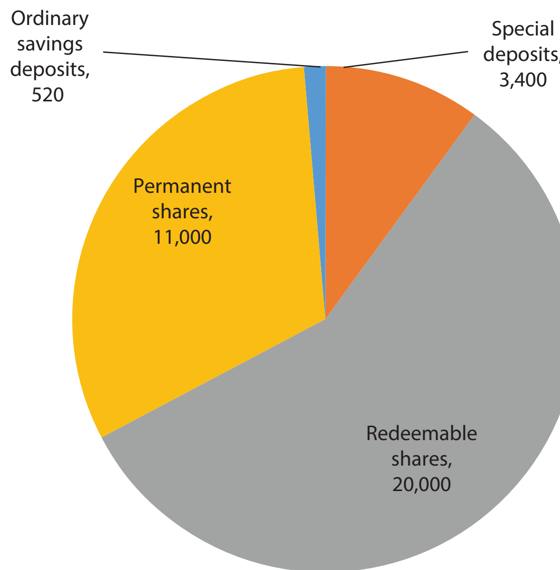


Figure 3 Number of Deposits and Redeemable Shares



Source: BLA Audit report 2014.

higher than market rates, and another 24 percent in redeemable shares. The audit showed that the BLA was insolvent and had negative equity of about 1.5 percent of total assets.

1.3 A Fledging Supervisor

Until the mid-2000s, the regulation and supervision of financial cooperatives fell under the responsibility of the Registrar of Cooperatives in each OECS country. As in other Caribbean countries, the role was focused on the registration and promotion of cooperatives but did not

have any prudential focus.[6] In 2005, the Eastern Caribbean Currency Union top authority, the Monetary Council, took the decision to establish single regulatory units in each country to supervise the non-banks and the offshore sector, and to strengthen the regulation with harmonized credit union legislation. However this legislation did not include the BLAs. In Saint Vincent, the act establishing the new single regulatory unit (FSA) was passed in 2011, and the harmonized Cooperative Societies Act in 2012. As a result, the FSA formally became the BLA's supervisor, but the provision of the Building Societies Act continued to apply.

The intervention of the BLA represented a defining moment for the newly created supervisor. The FSA formally came into existence in November 2012 with the establishment of its first Board of Directors. It was an unknown entity without a reputation, unlikely to inspire any confidence on the part of depositors. It was in administrative mode, trying to complete the merger of various supervisors for non-bank financial services (insurance, credit unions, BLA and offshore financial services) into one single integrated regulatory authority.

The task of the supervisor was made more complex as the situation of the BLA quickly became a "National Issue." It became intertwined in public political arguments, and a topic of debate in popular media, late night talk shows, radio and TV news. This situation required an immediate diversion of resources from the FSA to refocus the messaging on the on-going work to address the BLA situation, and to make swift decisions despite the lack of reliable financial information.

Practical and legal issues also constrained the FSA. It had no crisis containment strategy, crisis plan or manual for guidance. It had no history or experience in resolving a failed institution. The legal framework for the BLA did not have any provision for resolution; however this was mitigated by the broad powers available in the FSA Act for intervention and reorganization of regulated financial institutions. Under Section 8 of the new law, the FSA was empowered, inter alia, to reorganize, wind-up or seize management and control of a financial entity, or exercise such other powers as necessary to enable it to effectively discharge its functions under the Act.

2. The Restructuring Strategy and Turnaround Plan

Before taking control, the supervisor had a limited range of options available:

- Option 1—To issue further directives to current management to take immediate corrective actions
- Option 2—To take over management and control of the BLA in an open institution scenario
- Option 3—To close down and liquidate the institution

Option 1 had already shown limitations. With the non-implementation of the 2009 MoU, the FSA had no comfort that the BLA management would comply with new directives. Option 3

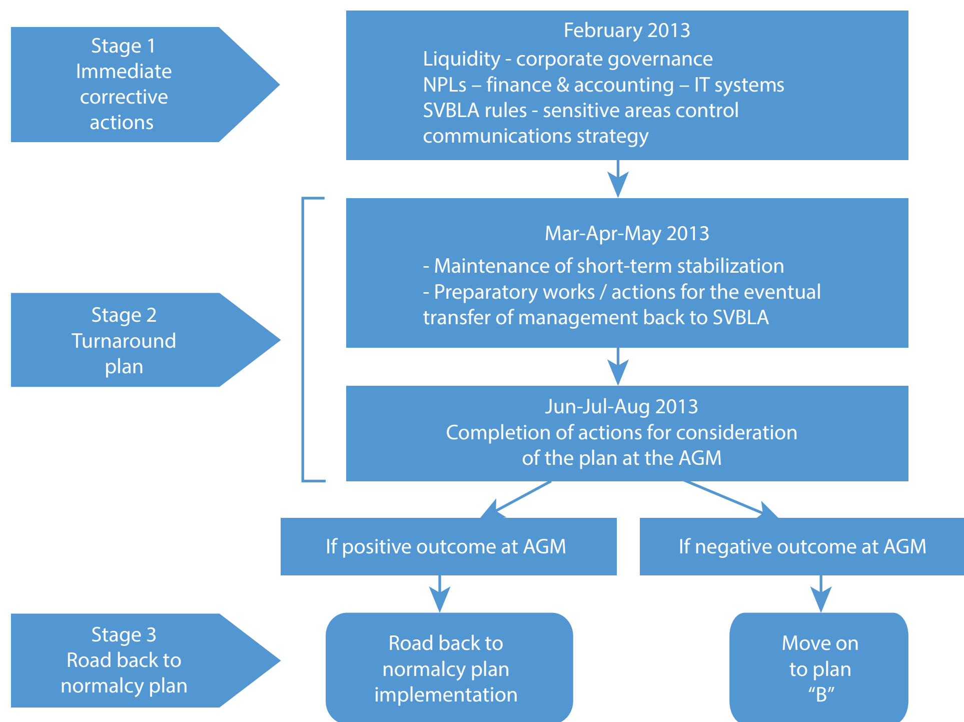
[6] See section 3 and annex D.

was considered as a worst case scenario in light of its impact on financial stability. Public confidence in the financial sector had already been dented by the failure of the two systemic insurance companies BAICO and CLICO in 2009. Based on a NPV estimate of recoveries in liquidation for various assets classes, the supervisor determined that members would be able to get up to 40 cents on the dollar of their deposits in liquidation.[7] Liquidation, however, would involve a lengthy judicial process as established by precedent and confirmed by local attorneys.

Thus, Option 2 was considered as the most appropriate by the FSA. The supervisor intervened with the following objective: “To stabilize the institution ensuring minimum operational levels of liquidity and solvency, correcting major deficiencies and transferring back to the members the control and management of the Institution.”

2.1 A Three-Pronged Approach

With support from international expertise, the supervisor elaborated a three stage plan to achieve the objective. This plan included immediate corrective actions, as well as short-term and medium term actions to implement the transfer of the BLA back to its members. The graph below illustrates the three different stages.



[7] To estimate recoveries, assets were broken down in four classes (investments, fixed assets, current loans and past due loans), and for each class a liquidation value was estimated by discounting the recovered cash flows minus collection expenses. The discount factor used was 10 percent and the average recovery time 5 years.

1. Immediate corrective actions (February 2013)

The immediate corrective actions were focused on governance, liquidity management in the context of the deposit run, IT system, and communication.

- **Establishing proper governance**: The Deputy Executive Director of the FSA was appointed as Acting CEO with three senior members of the FSA staff acting as the governing body (Executive Committee). Specific committees with FSA and BLA staff were established for Finance, Accounting/Administration, and Loan/NPLs Recoveries. A selection process of the new CEO was set in motion.

- **Liquidity management measures**: The Rules governing the redemption of shares and withdrawals of deposits were amended temporarily and extended again before the AGM in August. This resulted in deposits not being available for 16 months. For ordinary savings however, members could withdraw each month a small amount and for all others, exceptional "hardship" withdrawals were available and addressed on a one-to-one basis with the members (box 1). Limitations on lending were established depending on liquidity availability. In addition, a special Liquidity Task Force was established to monitor and deal with liquidity issues. Efforts were made to obtain contingency liquidity assistance facilities from the government and

Box 1 Liquidity Management Measures

The BLA had 98 percent of members' liabilities in special deposits and redeemable shares, and only two percent in ordinary savings deposits. For the latter (about 520 accounts), members could withdraw each month a small sum:

- For accounts with balances over ECD10,000 (USD3,700): A 30 days' notice established for the withdrawal of funds of up to a maximum of ECD2,500 (USD900). Each member had up to one notice per month.
- For account with a balance under ECD10,000: A withdrawal of funds up to a maximum of ECD2,500 per month was allowed.

For all other accounts (about 23,000 accounts), withdrawals were not available. The effectiveness and impact of these temporary measures was continuously monitored and reviewed. The FSA was concerned about the impact of these measures on the members and consequently established strict criteria to deal with extraordinary situations, most of these health-related, for all deposits and redeemable shares. The process worked well and it was appreciated by the members. For the first two months after intervention, the FSA developed a strategy to manage potential situations. All employees of the Association were informed of the new changes in liquidity rules. Department Heads were instructed to be present in the lobby to deal with any members that needed one on one attention. The acting CEO met with members when necessary, and the Police Commissioner provided two Policemen in uniform in the event they were needed.

other regional agencies. A liquidity facility of ECD15 million (USD5.6 million) was obtained from the ECCB by the Government of Saint Vincent as a contingency to support the BLA, but it was never used.

- **Dealing with NPLs:** The Recoveries Department in charge of recovering bad loans was reorganized and strengthened; past due loans were segmented by size and days past due and the borrowers were contacted; real estate collateral securing the largest and most delinquent loans to uncooperative borrowers were posted for sale. However, there was no law or clear commercial code which detailed the required steps, time-frames and process for final demand notification, auction sale and obtaining foreclosure judgment. In addition, the market for distressed assets was very thin (box 2).

Box 2 Successes and Challenges in Loan Collection

Loan collection was vital to provide liquidity to the BLA in the early stages of intervention. The strategy focused on:

- Get borrowers' attention: immediately after intervention, 22 properties were posted for sale in the newspaper. This was very effective to bring delinquent borrowers to negotiate. Advertised properties reached 140 at the end of intervention (about 30 percent of NPLs in number).
- Use the full collection toolbox: netting was systematically implemented and affected 10 percent of loans in number. A few loans were restructured when the borrowers could provide additional collateral. Foreclosure was pursued if the borrowers were not collaborating.
- Tap the diaspora: about 300,000 people of Vincentian descent are estimated to live abroad, a large number in North America. Many come back for Christmas and Carnival and the advertising of the properties was targeted during this period. About 5–10 sales transactions were facilitated by the diaspora.

Nonetheless, deficiencies in the legal framework constrained the effective collection of non-performing loans.

- Upset price: the power of sale was constrained by an upset price at 80 percent of the appraised valuation. In the OECS, there are no common standards for real estate appraisals and property appraisers are not regulated or supervised.[8] In many instances, the appraised valuation was much higher than the market would bear, and the BLA had to commission new property appraisals.
- Stamp duty applied on the sale of properties: once a transaction was approved by the buyer and the seller it had to be submitted to the tax authorities to determine the stamp duty. The tax authorities applied their own valuation which was in several cases much higher than the agreed price, and made the transaction uneconomical for the purchaser.

[8] The Eastern Caribbean Central Bank is working on establishing common standards for property appraisers.

- **Fixing the IT problems**: A team of IT experts was recruited to evaluate the systems. Work commenced to bring accounting records up to date and to test the integrity of data and IT systems.

- **Maintaining public confidence**: A communications strategy for relaying information to the public and members of the institution was developed.

- **Identifying legal liabilities**: A procedural and legal discrepancies log was instituted to record potential legal liabilities of former senior management and members of the Board of Directors of the Association.

2. Short term actions (March to May 2013)

The short-term actions had three objectives: to further stabilize the liquidity situation of the Association by preventing additional withdrawal notices; to consolidate efforts on the collection of NPLs; to start preparing for an eventual transfer of the BLA to its members. The work on NPLs recoveries became particularly intense in this phase as recoveries were the only source of liquidity for the Association.

- **Liquidity was constantly monitored and maintained by controlling cash flows**. In addition to the amended Rules which governed members' withdrawal of deposits, unfunded commitments on loans were limited to collections of NPLs. The securities and investments portfolio was gradually cashed in with proceeds credited to savings accounts to honor accrued interests. Administrative expenses were closely monitored and reduced to bare operating essentials.

- **The resolution of NPLs was significantly sped-up**: An active collection process was initiated through individual engagement with all delinquent borrowers. The largest and most delinquent properties were posted for sale when the borrowers could not get into a repayment plan. This was allowed by the power of sale included in the loan documentation.[9] NPLs resolution yielded considerable results with cash and non-cash collections of about ECD13 million in six months (16 percent of NPLs at intervention), however this was overshadowed by the migration of performing loans to non-performing loan status of approximately ECD9 million over the same period. As hurricane season was approaching, all real estate loans were reviewed to ensure that adequate insurance was in place. Where necessary, the BLA forced placed the insurance, the cost of which was then passed back to the borrower. In addition, updated appraisals were ordered so as to be able to develop appropriate workout plans as well as to substantiate the provisions for loan losses.

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[9] The power of sale is a non-judicial process allowing the lender to post the collateral to the loan for sale when the borrower is delinquent, so as to repay the mortgage debt.

- **Financial management issues were addressed:** The old IT system was rehabilitated so as to produce financial information for the audit. An initial strategy for internal reorganization was prepared. External auditors were retained to produce audited financial statements for 2011–13 up to the intervention date, and to conduct a forensic audit. They had to be contracted outside Saint Vincent to avoid conflicts of interest. Upon reception of the audit, the FSA prepared a recapitalization plan to be submitted to the AGM of members.

- **Prevention of contagion to other credit unions**: As the Association was by far the largest financial cooperative in the region, the supervisor was concerned about potential contagion to the rest of the credit union sector. The FSA conducted onsite examinations of all the credit unions in Saint Vincent to assess their financial situation. This exercise resulted in corrective actions plans being issued for four out of six credit unions, including measures to recapitalize the entities, and to address asset quality and governance issues.

3. Medium term actions (June to August 2013, and FSA-monitored thereafter)

The medium term actions were focused on setting the foundations for the longer-term sustainability of the BLA. While this phase culminated with the transfer of the BLA back to its members in August 2013, most measures were implemented in the subsequent months.

- **Annual General Meeting** (AGM): A tension-filled AGM was held in August 2013. Members were presented with the choice between recapitalization and bail-in or liquidation. The AGM endorsed the financial audit as of the time of intervention, the recapitalization plan based on the audited accounts, the new governance structure of the BLA and a reorientation of the business with new products and services. Attendance was about 300 members, which was considered a success compared to the attendance of previous AGMs (about 30-50 members). Please refer to annex A for key figures presented at the AGM.

- **New Governance structure**: A new Board of Directors was elected by the members during the AGM. Fit and proper criteria were elaborated by the FSA to ensure the technical quality and integrity of Board members. This was facilitated by an amendment to the Rules of the Association governing the nomination and election process for Board Members implemented by the FSA. The new process required, inter alia, an advance nomination of candidates, accompanied by submission to the FSA of a detailed resume supported by at least two members of the BLA in good standing. However the FSA retained enhanced monitoring over the BLA with veto power over significant decisions. A MoU between the Association and the FSA was entered into in December 2013 to formalize the targets for addressing the major deficiencies identified by the supervisor (see annex B).

- **New management**: A new CEO was appointed by the Board of Directors in September 2013. This was the result of an intense search led by the FSA in the previous months to find a suitable candidate with banking and turnaround expertise.

- **Recapitalization Plan**: During the AGM, the members approved the recapitalization plan for the Association, The plan targeted a 10 percent equity to total asset ratio consistent with PEARLS methodology and the Cooperative Societies Act, up from a negative equity position of 1.5 percent of assets. It consisted of an increase in the minimum share held by each member, the conversion of redeemable shares (similar to deposit products while giving full voting rights) into permanent shares, and the conversion of a small share of the deposits into permanent shares. Annex C describes the plan, which is summarized below.

	Percent of recapitalization	*Number of account affected*
Top up existing permanent shares	21	10,805
Conversion of redemable shares into permanent shares	54	ca. 20,000
Conversion of special deposits into permanent shares	24	ca. 3,400

Three important principles were applied to the recapitalization plan: a) it should be equitable and therefore the larger depositors should contribute proportionally more than the smaller ones; b) every member should contribute and c) it should be simple with a level of effort easy to understand by the members. A minimum amount of ECD 1,000 (USD370, up from ECD100 or USD37) was used as the "target" recapitalization amount per account held by each member. The formula for conversion for the class of special deposits ranged from 2.5 percent for the smallest balances to 10 percent for the largest. Overall, 6 percent of special deposits were converted into equity. All conversions were implemented at book value, and the principle one member-one vote was maintained. The largest depositors which had to convert a larger amount of their special deposits did not request more shares.

Several measures designed to ensure the long-term viability of the Association continued for months after the BLA was transferred back to its members. The AGM endorsed a broader turnaround plan which was then implemented by the new management. The most critical actions focused on:

- **The improvement of credit procedures**: A new credit manual was adopted; the delegation of loan authority was restricted to senior staff; credit administration procedures were strengthened; and credit staff trained to contain the origination of future NPLs.

- **Early stage recovery procedures**: Credit officers were required to regularly dedicate time to contact borrowers in arrears for less than 30 days in an effort to bring the loans current at the earliest possible time; loans over 30 days were transferred to the Recovery Unit and if they were able to agree to a restructuring with the borrower, the loan was returned to the lending unit for documentation and any further required follow-up. The outsourcing of 120 days + NPLs to Debt Recovery Agents was approved by the new Board of Directors.

- **Comprehensive review of the pricing policies**: All depository and lending products were reviewed, as well as the control of operational expenses, in order to achieve a break-even point as soon as possible.

- **Internal Reorganization.** The segregation of front and back office duties, the review of loan administration, the institutionalization of an Internal Audit function and the strengthening of the Finance and Accounting units were implemented.

2.2 Involving the Members and Restoring Public Confidence

The communications strategy became a critical aspect of the restructuring plan, especially in the light of the initial run on deposits and the political involvement. The FSA developed a communications plan for the general public as well as for the members.

1. Communication to the members

The communication to the members was based on an overarching message that if the Association was to be saved, it would be saved by the members. Bail out was not a feasible option and the co-operative structure of the BLA meant that the recapitalization effort would have to be made by the members themselves. Any external sources of capital, if they were available, would result in a change to the ownership structure of the BLA. The FSA organized town hall meetings to inform the members about the situation and the strategy. A first town hall meeting in March 2013 focused on the challenges to restructuring, the financial situation and the alternatives. The second town hall meeting in July 2013 aimed at preparing the ground for the AGM and assessing the potential level of support for the turnaround and recapitalization plan.

Individual engagement with members was an important tool. The change in the liquidity rules triggered an intense involvement with members, often on a one-to-one basis (see box 1 before). Notices were posted in the lobby of the BLA headquarters and on their website. The acting CEO and Department Heads were on hand to meet with members in person as required, stressing the temporality and necessity of the measures being undertaken.

2. Communications to the general public

An early decision was taken to inform the public that the FSA would be the only institution with the authority to speak on behalf of the BLA. During the first months of intervention, the FSA issued a pre-recorded televised broadcast and six press releases. Press releases were timed

Box 3 Key Messages from the FSA

Below are excerpts from FSA's press releases to illustrate some key messages and how they were conveyed.

- Neutrality of the FSA: "*The FSA is a governmental statutory agency, however, it is an independent agency governed by the Financial Services Authority Act 2011*."
- Clear objective: "*The objective of the FSA in assuming management and control of the Association is to safeguard the Association's financial stability and future sustainable growth*."
- Temporary measure: "*The FSA would like to emphasize that its management of the Association is not a permanent arrangement*." (…) "*It has to be pointed out that the FSA is exercising control and the management of the Association, but the Association's ownership remains, and will remain, with its members*."
- Cooperation from members: "*The Association would be considerably weakened if funds were hastily withdrawn. It is in everyone's interests to strengthen the Association and safeguard its future. In these circumstances, the Association needs the cooperation and support of all members, depositors and shareholders, and the FSA asks all parties to help us to help the Association*."

  "The FSA stressed that it is imperative that those members reflect and reverse their decisions to withdraw funds in reaction to the present situation. Bearing in mind the co-operative type structure of the Association, only such a collective approach would determine the survival and sustainability of the Association, and the return to normal business operations."

Source: Financial Services Authority of Saint Vincent and the Grenadines, Press Releases #1, 4, 5, 6, 7, 8, 2013

to address specific concerns in relation to the causes of the crisis and the planned strategy to address these issues. Messages were carefully worded to ensure that the information given was factual and constructive with a focus on encouraging calm, patience and confidence in the intervention process, highlighting the ultimate objective of recovery of this iconic, indigenous institution (see box 3 for an excerpt of FSA's key messages).

2.3 Considering Other Restructuring Alternatives

The success of the restructuring strategy was never guaranteed during the intervention. In addition, the strategy was regularly updated following interaction with members. Two alternatives were considered but did not materialize during intervention.

The first alternative was the sale of the good loan book and deposits of the BLA to another financial institution: given the amount of non-performing loans, it was unlikely that the deposit base could have been transferred without any loss for the depositors. In addition, early feedback from members showed a strong desire to maintain the cooperative feature of

the BLA. Thus this option was considered as a "plan B" in case members did not approve the recapitalization plan.

The second alternative was the consolidation of the BLA with a credit union. In the Eastern Caribbean region, merger of credit unions has been used as a way to resolve small and weak entities under the "moral suasion" of the supervisors, sometimes with a loss on the deposits of the weak credit union to balance the book. Consolidation of the BLA with another credit union in Saint Vincent was seriously considered, however it faced several issues: a) the sheer size of the BLA (12 percent of GDP) made a merger of equal proportions difficult; b) potential candidates would need to strengthen their solvency and governance prior to the merger; c) the level of effort required to implement a merger could not be mobilized during the short-time span of intervention.

Ultimately, the BLA had to be cleaned-up and restructured before any merger could be contemplated, otherwise the merger may have created a bigger and more problematic institution. Thus the FSA determined that consolidation should be left to the new management of the BLA, as a private sector led initiative. The large number of credit unions in the Eastern Caribbean, the strong competition from banks, and the membership-sharing make consolidation an inevitable issue for the long-term viability of the sector.

3. Lessons for Supervisors

Each intervention of a financial institution is different and what works in one country at one time may not work in another. This section highlights the relevance of general resolution principles in the BLA experience. Lessons are analyzed at three different levels: a) adequacy of the regulatory and supervisory framework; b) adequacy of the strategy and c) adequacy of the restructuring tools.

3.1 Effective Regulatory and Supervisory Frameworks for Financial Cooperatives

Prudential regulation and supervision of financial cooperatives in the English Speaking Caribbean has been a long process (annex D). In Jamaica and Trinidad and Tobago, the prudential supervision of credit unions has been in discussion for more than 10 years and is not yet effective. In Suriname, credit unions have been under the supervision of the Central Bank for the past seven years but supervisory actions have been scarce. In Guyana, credit unions are not subject to prudential supervision. In some countries however (e.g. Jamaica and Guyana), the building societies are supervised by the Central Bank. Explicit powers of the supervisor to supervise, take corrective actions and intervene financial cooperatives are the most critical pre-conditions for the successful restructuring of a troubled institution.

In Saint Vincent, the FSA Act provided very broad powers to act as deemed fit in dealing with a troubled supervised entity, thereby breaching the gaps in the Building Society Act. As per the Act, the FSA could "*seize the management and control of a financial entity or registered entity, appoint new manager or take other necessary action for the purpose of protecting the interests of customers of financial entities (…) as well as creditors and the public and ensuring that the financial entity remains financially sound*." This provision was

used to dismiss the Board of Directors of the BLA and secure management and control. The broad powers of the FSA are subject to an appellate process through a specific tribunal; however the commencement of an appeal does not operate as a stay or suspension of the FSA decision. The FSA sought legal advice prior to taking control of the BLA and dismissing the board.

Even when a framework for prudential supervision is in place, safety nets to help with the resolution and restructuring of financial cooperatives may be lacking. Credit unions in the Caribbean are not covered by explicit mandatory Deposit Insurance Schemes, although they are plans to do so in Barbados, Jamaica, Suriname and Trinidad and Tobago. The lack of deposit insurance in Saint Vincent meant that prospect of liquidation would have been a messy endeavor. It would have been subject to the local bankruptcy legislation, which does not acknowledge the priority of deposits within the priority of claims. Also resolution methods to sell assets and liabilities of the BLA were more complicated as there was no deposit priority threshold established in the law to help identify the deposits to transfer in priority.

The lack of LOLR facilities is another hindrance to effectively addressing troubled financial cooperatives. With the exception of Belize and Suriname, where financial cooperatives are currently supervised by the central bank, LOLR facilities for cooperatives are not available in the English-Speaking Caribbean. In Saint Vincent, the existence of a LOLR facility may have prevented the run, but would not have been an adequate response as the BLA was insolvent. The granting of a liquidity line after intervention did not have the desired results. When it became known that the government had received a liquidity line from the ECCB which could be used if needed by the BLA, the demand for withdrawals increased due to members' perceived availability of payout funds. This stresses the need for pre-established LOLR. Establishing the conditions and methods for LOLR facilities to financial cooperatives supervised by non-bank regulators will be critical to prevent future crises.

The BLA's experience also highlighted the importance of taking early enforcement action for supervisors when confronted with a problematic institution. Enforcement can be a challenge in countries with small and often intimately related populations. This illustrates the usefulness of a mandatory prompt corrective action framework. The 2009 MoU between the Ministry of Finance and the BLA was not enforced, and incentives to force corrective action were lacking. While the FSA Act does not have a mandatory prompt corrective action framework either, the intervention of the BLA, the systematic examination of credit unions and the subsequent issuance of corrective actions provided credibility to FSA's enforcement actions.

3.2 Temporary Intervention Focused on Long-Term Viability

Another key success factor was the consistency of the strategy: the intervention was temporary, and the BLA would be transferred back to its members as long as solvency and measures for the long-term viability of the BLA were in place. If not the institution would be liquidated.

1. Temporary measure

When it took control, the FSA emphasized that intervention was intended to be a temporary measure. The expected time frame for reaching an outcome was approximately six months. The FSA indicated that the members would decide on the fate of the Association, not the supervisor. This focused the attention of the members on the potential outcome as opposed to the intervention process itself.

The supervisory intervention of a financial institution is a last resort to restore viability. During the intervention the institution does not have transactional normalcy and the provision of products and services is adversely affected. For these reasons, the intervention must be limited in time and as short as possible, to ensure the achievement of key objectives that enable the rescue of the institution. At the moment of intervention, the regulator must have defined a strategy with clear objectives, and an action plan to achieve them.

The temporary nature of the intervention was crucial as it mobilized many of the FSA's human resources (including the Deputy Director who was acting CEO of the BLA) while urgent supervisory actions were also needed on the credit union sector. See annex E for a summary of the challenges posed by the intervention of the BLA from the FSA's point of view.

2. Holistic approach to ensure long-term viability of the institution

The turnaround strategy encompassed both short-term and long-term fixes. The short-term elements focused on the factors that brought the BLA down: the tight liquidity, the insolvency and the poor asset quality. As a result, the core elements of the strategy included an amendment of the rules governing deposits to manage liquidity, a recapitalization plan to increase solvency, and a significant strengthening of the recovery unit. However, stopping liquidity outflows and recapitalizing the BLA was not sufficient; the FSA had to ensure that the business model could be viable in the long-run once it was managed by its members. Various rounds of recapitalization were not an option considering the relative limited wealth of the BLA's members.

The long-term fixes focused on the sustainability of the business model. They included a business plan with a new pricing policy (the interest rate on special deposits was significantly lowered), the development of alternative products from mortgage lending (fixed term deposits, study and consumer loans)[10], and the internal reorganization of the institution. A new credit manual was issued to strengthen credit underwriting processes, and prevent the migration of performing loans to non-performing status. The BLA's liquidity situation was significantly improved with the mobilization of a large amount of cash to manage the progressive phasing-out of administrative measures on deposit withdrawals. This came from the sale of investments, loan collections and severe restrictions on cash expenses (interest on deposits were accrued instead of paid-in, and the BLA was not allowed to issue new loans). The charts below compare key indicators at intervention (25 months up to intervention),

[10] In addition the BLA offered money transfer services, death benefit plans, payment of utilities, and partnered with one insurer to sell its insurance products.

Figure 4 Performance Indicators
Percent

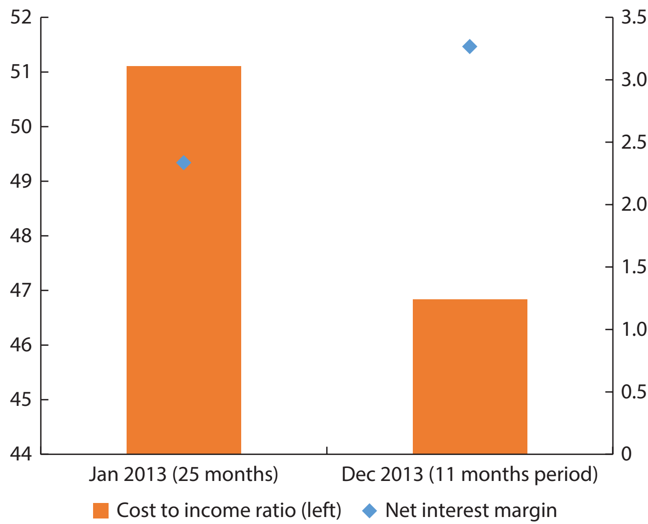
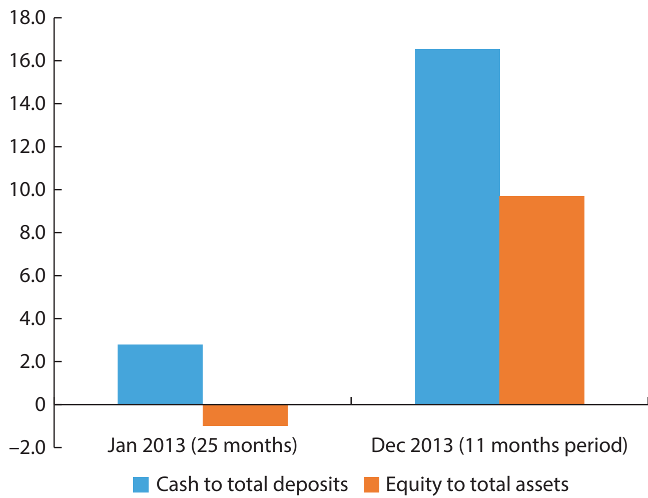


Figure 5 Liquidity and Solvency
Percent



Source: BLA Audit Report 2014. The net interest margin is annualized.

with the financial year following intervention (February-December 2013). The net interest margin and cost to income ratio markedly improved; solvency was restored to 10 percent equity to asset ratio, and the liquidity ratio increased from 2 to 14 percent.

The holistic approach also aimed at preventing a similar situation from occurring in other financial institutions at the time the BLA was being resolved. The onsite examination of all

the credit unions undertaken by the FSA enabled early correction of potential deficiencies and prevented contagion. The FSA paid special attention to the levels of interconnectedness of credit unions with the BLA, and issues where the BLA was particularly deficient: corporate governance (competence and integrity of the Board of Directors, conflicts of interest), quality of risk management and quality of assets. This helped strengthen the confidence of the public that the FSA was effectively in control.

3. Credibility and Communication of the Supervisor

The communication strategy was a core element of success. It was strengthened by the perceived credibility of the supervisor, which had to be built at the same time. The success of the communication strategy rested on three main pillars. The first one was the consistent message and unified voice of the supervisor. A consistent message was emphasized on the line that the BLA would be saved by its members or would not be saved; bailout was not an option. Only three FSA people were designated to communicate to the public: the Chairman of the Board, the Director and the Deputy Director. This prevented potential contradictions. Every public appearance was preceded by dry runs to align the messaging.

The second pillar was the transparency and visibility of the FSA: its management was widely available to attend individual queries from members and to meet one on one with large depositors. Its Board was present at each public appearance, the town halls meetings and the AGM.

The third pillar was the neutrality of the supervisor. The FSA reached out to political authorities to explain that their involvement was detrimental to finding an appropriate solution. It resisted attempts to be drawn into political debates. Such behavior reinforced the confidence of the members in the FSA as it appeared that the FSA would act in the public interest and would not be driven by partisan concerns.

3.3 Liquidity Management Measures and Bail-In

The turnaround of the BLA did not involve any public funding. The key short-term tools that allowed the BLA to be revived were the management of the liquidity situation and the improvement of the solvency via recapitalization and conversion of redeemable shares/deposits into equity. These tools are relevant to address the failure of financial cooperatives under specific circumstances.

1. Liquidity management measures

The 16-month restriction on the availability of deposits was made possible by the nature of the BLA's deposits which were effectively savings type products. Though not enforced before intervention, the rules of the BLA contemplated notice periods prior to withdrawals as historically deposits in building societies were designed as long-term saving instruments. This, together with FSA's communication and credibility, explains that when restrictions on withdrawals were implemented, they did not trigger a run to other financial institutions. Restrictions on demand deposits would be far more

disruptive to the economy and prone to triggering contagion. Allowing a small amount of the deposits to be withdrawn every month or for "hardship" cases, and keeping the initial rights intact (e.g. by accruing the interest) helped with the acceptability of the measure.

A key issue with liquidity management measures is how to lift them. The strategy pursued was a phasing in over time, and the build-up of significant cash buffers. Deposits became available for withdrawal in May and September 2014. As of end October 2014, about seven percent of total deposits had been withdrawn. While this amount may appear high in abstracto, it is reasonably contained in the BLA case considering that deposits were broadly unavailable for 16 months.

2. Recapitalization and bail-in

In the absence of specific legal provisions, the implementation of bail-in was purely voluntary. The approval of the scheme by simple majority as stipulated in the Rules of the Association meant that there were no holdouts. It worked due to psychological and technical reasons. On the psychological side, there was strong community support for the BLA which had financed the homes of generations of families in this small island community, and the prospect of getting up to 40 cents on the dollar over five years in liquidation was not appealing. On the technical side, the solvency gap was moderate, resulting in the need for a small conversion of deposits, and the BLA had a large number of "redeemable shares" that could be converted into permanent shares.

The insolvency situation of the BLA was moderate as negative equity was only 1.5 percent of total assets; therefore most of the additional funds were entitled to some upside as they were used for recapitalization. The BLA also had a large number of "redeemable shares" which were shares with deposit-like features (guaranteed interest, and permitted withdrawal subject to a notice period): these instruments were converted into permanent shares and such conversion represented more than half of the total recapitalization effort. The conversion of redeemable shares into permanent shares enabled the BLA to limit the scale of deposit conversion into equity (25 percent of the recapitalization effort).

The issues of adequate liquidity and equity valuation raised by the implementation of bail-in presented limited obstacles in the BLA case. The need for sufficient liquidity immediately after bail-in to inspire confidence was less critical as liquidity management measures were still in force. Regarding the valuation of equity to implement the conversion of liabilities, the BLA had a plain vanilla business model with simple assets valued at book value (loans, savings deposits in banks and a limited amount of bonds), and therefore the conversion was done at book value. The audit resulted in the write-down of 17 percent of the gross loan portfolio, which together with IFRS provisioning of NPLs, resulted in a negative equity position. The conversion of liabilities was based on the audit figures.

Voluntary bail-in would not have worked in case of hostile membership, or multiple troubled institutions (including some credit unions). This raises the question as to whether mandatory bail-in should be implemented in legislation for financial cooperatives. In the post global crisis literature, bail-in denotes a mandatory restructuring of liabilities under the

statutory power of the resolution authority. It has been used extensively in the European Union, but on banks, and mostly on junior and unsecured debt.[11]

The implementation of mandatory bail-in for financial cooperatives raises specific issues with regards to the applicability of the Key Attributes for effective resolution regimes and the "no creditor worse-off principle." Capital instruments in financial cooperatives give different rights than those in banks. Usually financial cooperatives are governed based on the principle of one member one vote so the number of shares held by one member does not affect his voting rights. In addition, financial cooperatives are not for profit institutions, so converting liabilities into permanent shares gives limited prospect of ultimately recovering the converted amount via dividend distributions. Finally, cooperatives shares are not easily traded. Therefore converting financial cooperatives' liabilities into shares using bail-in may result in the bailed-in creditors being in a worse position than they would have been in, had the institution entered insolvency. Thus it appears that the implementation of bail-in for financial cooperatives would require a demutualization and conversion into a bank.[12]

Overall, while not being a complex institution, the BLA was nonetheless systemic and a high risk for its supervisor. The approach followed by the supervisor highlights the relevance of international best practice for resolution of systemic institutions (box 4).

Box 4 BLA and the Key Attributes of Effective Resolution Regimes for Financial Institutions

The Key Attributes have been developed in response to the global financial crisis, and were endorsed by the G20 in November 2011 as the international standard for resolution regimes. While the Key Attributes are focused on financial institutions that are "systemically significant or critical in failure," and do not mention financial cooperatives, certain core elements resonate with the experience of the BLA. Selected principles are presented below.

- There should be a clear designated authority responsible for exercising the resolution powers over the scope of the resolution regime: The enactment of the FSA act a year before the run on the BLA was critical to provide the FSA with broad resolution powers over the BLA, and the entire non-bank sector.
- The resolution authority should have operational independence: Independence from political parties was particularly relevant to build the credibility of the FSA.

box continues next page

[11] For previous instances of bail-in see Spain on the subordinated creditors and preference shares of savings banks, Cyprus on deposits above EUR 100,000 of Laiki bank and Bank of Cyprus, and Portugal on the junior bondholders of Banco Espirito Santo. The case of the UK Co-operative Bank presents similarities with the BLA as it was a voluntary exchange offer and the bank was 100 percent owned by a mutual cooperative group, however the conversion was applied on preference shares and subordinated debt securities (not deposits).

[12] For a fuller discussion on the applicability of the bail-in tool to building societies, please see HM Treasury, Bail-in Powers Implementation, Consultation, March 2014.

Box 4 BLA and the Key Attributes of Effective Resolution Regimes for Financial Institutions *(continued)*

- Resolution authorities should have at their disposal a broad range of resolution powers such as remove and replace management, appoint an administrator, operate the firm, override rights of shareholders, carry out bail-in within resolution (…): All these powers were effectively used in the case of the BLA
- The resolution regime should make it possible to apply bail-in within resolution in conjunction with other resolution powers: bail-in was applied in conjunction with capital increase, the removal of management and appointment of new management, and a moratorium on payments.
- No creditor worse off principle: While depositors contributed differently to the recapitalization effort, no depositor resulted being worse-off than if the BLA had been placed into liquidation according to estimated potential recoveries in liquidation made by the FSA.
- Jurisdictions should have statutory or other policies in place so that authorities are not constrained to rely on public ownership or bail-out funds as a means of resolving firms: In the BLA case, the supervisor adopted a policy that the BLA would not be bailed out, as Government funding could not be mobilized, but also because of the willingness of members to keep the cooperative feature.

Source: FSB Key Attributes for Effective Resolution Regimes, 2011 and 2014.

Epilogue

"*In any moment of decision, the best thing you can do is the right thing. The worst thing you can do is nothing.*" T. Roosevelt.

Two years after intervention, the situation of the BLA has materially improved. A successful AGM was held in June 2014 in which the audited financial statements were presented to the membership. This showed a continued containment of expenses and a modest profit of ECD3 million (USD1 million), representing a significant turn-around and reversal of the previous years' trend of losses. The capital base of the institution was significantly strengthened, and the MoU targets are being followed through.

By the end of October 2014, the Association reported profits of ECD 3.7 million (USD1.4 million) with a continued shrinkage of the accumulated deficit. More recently, a new and updated IT system which carries full functionality for delinquency management was successfully installed. The Rules of the Association have been revised and will be presented to the general membership at a Special Meeting called for the first quarter of 2015.

Non-performing loans have decreased by 23 percent since intervention and there has been a gradual increase in new credit with a focus on shorter term, collateralized lending. Due to the fixed schedule of maturities established from the recapitalization plan it has become

easier to anticipate potential liability requirements. Liquidity is constantly monitored and remains stable above the 15 percent benchmark.

The run on the BLA presented its regulator with several decisions to take in a short time-frame, and for which it was unprepared. Perhaps the overarching lesson is the need for prompt and proactive action which could have averted the crisis. By the FSA's quick response, the insolvency was within the ability of the members to correct. If they had waited, even a few more weeks, the liquidity and insolvency situation might have been far different.

The approach adopted by the FSA offers a valuable blueprint for supervisors of financial cooperatives. While success was the result of a combination of actions, and a willingness of the members to keep the Association alive, a few best practices stand out: clear communication focused on key messages; individual engagement of the supervisor with stakeholders; sensible liquidity management measures; and an uncompromising strategy that the Association would only be saved by its members or would not be saved.

Annex A: BLA Key Audited Financials (Audit Report at Intervention, and for the 11 Months Following Intervention)

		11- mo. period ended Dec 31, 2013	Intervention 25-mo. period ended Jan 31,2013
Assets			
Cash and Cash equivalent	ECD	32.3m	6.1m
Investments	ECD	2.9m	15.3m
Term deposits	ECD	18.5m	10.6m
Loans and advances	ECD	166.8m	193.1m
Fixed and other assets	ECD	9.2m	8.9m
Total assets	ECD	229.7m	234.0m
Liabilities			
Due to members (deposits)	ECD	195.7m	166m
Redeemable shares	ECD	—	54.7m
Other liabilities	ECD	11.7m	15.7m
Total liabilities	ECD	207.4m	236.4m
Equity			
Permanent shares	ECD	24.6m	3.0m
Reserve accounts	ECD	5.4m	10.3m
Accumulated deficit	ECD	(7.7m)	(15.7m)
Total equity	ECD	22.3m	(2.4m)
Total equity and liabilities	ECD	229.7m	234.0m
Total profit (loss) for the period	ECD	3.06m	(11.3m)

Annex B: Critical Elements of the MoU between the BLA and the FSA Post-AGM

1. Governance

- Develop Terms of Reference for Board Committees and provide minutes of each Board Committee meeting to FSA.
- Notification of Board of Directors meetings and Board Agenda Item to report on ongoing Projects and the implementation of the restructuring plan. Minutes of Board of Directors meetings to be submitted to FSA.
- Meeting of Asset Liability Management Committee, Audit and Compliance and Membership Committees to review progress of the implementation of the Recapitalization Plan.

2. Risk management

- Implement measures to correct internal control deficiencies identified by the external auditors in their Management Letter.
- Review accounting systems and procedures to ensure regular monthly reconciliations and accuracy of reported figures.
- Institute internal audit and compliance function.
- Daily liquidity reports to be provided to the FSA; reporting framework for 3 months, 6 months and 1 year projected liquidity.
- Develop and adopt comprehensive Credit Policy and Procedure manuals.
- Design and implement Early Warning System to identify past due and problem loans. A system of classification of credit risk to be included.
- Submit to the FSA detailed proposal for outsourcing of loan collection activity.
- Training of Lending and Recovery Unit personnel in basic credit analysis and application of new credit policies and procedures.
- Reduction in delinquency ratio by at least 25 percent.

3. Integrity of systems and reporting

- Recruitment of a full time IT Manager.
- Conduct IT audit to ascertain suitability of system for future IT and operational needs.

- Development of comprehensive system of reporting to Board of Directors and FSA.
- Develop reporting system for corrective action plans, loan portfolio movement and non-performing loans performance reports.

4. Implementation of the restructuring plan and actions for future viability

- Execute the Recapitalization Plan.
- Review the Business Model and complete re-pricing, terms and conditions of current products and services.
- Implement a comprehensive review of the Rules governing the BLA.
- Review functional organizational structure to ensure adequate and appropriate staffing.
- Establish a fully staffed Recovery Unit.
- Formulate and adopt an investment policy.

Annex C: The Recapitalization Plan

Sources of recapitalization	Estimated capitalization amount	Impact on members (per segment)
1. Top-up of existing permanent shareholdings to reach the new minimum required of ECD 1,000 The new permanent shares could be paid in cash or with debit to shareholders' existing deposits.	**ECD 7.8 M** **(21% of total)**	10,805 accounts affected by an average amount of ECD 725 each
2. Partial conversion of matured redeemable shares Some redeemable shares had matured and had not been cashed in. An amount of ECD 1,000 was converted into Permanent Shares for each account. If the holding was less than this amount, the member was asked to make up the difference with cash or from its deposit. If the holding was greater than ECD 1,000, the excess was credited in a Deposit account.	**ECD 0.2 M** **(0.5% of total)**	171 accounts affected for a maximum amount of ECD 1,000 per account.
3. Partial conversion of active redeemable shares Shareholders of active Redeemable shares were asked to convert ECD 1,000 from their holding into Permanent Shares. If the holding was less than 1,000 the member was asked to make up the difference with cash or from its deposit. If the holding was greater than ECD 1,000, the excess was credited in a Deposit account.	**ECD 7 M** **(19% of total)**	About 7,000 accounts affected by the conversion.
4. Conversion of delinquent redeemable shares Some redeemable shares accounts were delinquent as payments had not been made for 6 months or more. ECD 1,000 from each of these accounts was converted into Permanent Shares.	**ECD 12.8 M** **(34% of total)**	12,800 accounts affected.
5. Regular savings deposit accounts No conversion was requested from these members, but in order to continue maintaining their membership and to hold their Savings Account they had to: a) buy the minimum of Permanent Shares, or b) pay the quarterly Membership fee.	**- 0 -**	520 accounts affected
6. Special deposit accounts—segment 1—balances >ECD 5,000 <ECD100,000 An amount equal to 2.5% of the Special Deposit account balance was converted into Permanent Shares.	**ECD 1.2 M** **(3% of total)**	About 3,000 accounts affected for an average amount of ECD 421 each.

Sources of recapitalization	Estimated capitalization amount	Impact on members (per segment)
7. Special deposit accounts—segment 2—balances >ECD 100,000 <ECD500,000 An amount equal to 5% of the Special Deposit account balance was converted into Permanent Shares.	**ECD 3 M** **(8% of total)**	About 300 accounts affected for an average amount of ECD 9,800 each.
8. Special deposit accounts—segment 3—balances >ECD 500,000 An amount equal to 10% of the Special Deposit account balance was converted into Permanent Shares.	**ECD 5.4** **(14.5% of total)**	About 62 accounts affected for an average amount of ECD 87,000 each.
Total estimated recapitalization amount	**ECD 37.5 M**	
Recapitalization: In all cases, the maximum impact per account of the recapitalization (i.e. share increase or conversion of redeemable shares into permanent) was ECD 1,000. *Conversion: The formulas were gradual to ensure an equitable level of effort. Conversion rates ranged from 2.5 to 10 percent. The average conversion amount was about 6 percent of total balances.*		

Note: interest on all products (i.e. Redeemable shares and Special Deposits) was always accrued, and when the conversion of these products into Fixed Term Time Deposits was done, interest was accrued and paid in accordance with the term of each Time Deposit.

NB: Amounts in the plan are indicative and not final. The plan underwent several updates as more reliable information became available.

Redeemable shares were a type of savings product commercialized under the name of "shares" and structured as a program with monthly payments.

Annex D: Regulation and Supervision of Financial Cooperatives in the English-Speaking Caribbean

Country	Status of prudential regulation and supervision	Deposit insurance
Barbados	Credit unions started to be regulated as financial institutions in 2011 when the Financial Services Commission (FSC) Act was passed (the FSC regulates and supervises all the non-bank financial institutions in Barbados).	A proposal for a deposit insurance fund for credit unions to be opened at the Barbados Deposit Insurance Corporation is under consideration
Belize	Since 2005, credit unions have been prudentially regulated and supervised by the Central Bank.	No deposit insurance for banks or credit unions
Jamaica	Law enabling the Bank of Jamaica to regulate the credit union sector has been in the pipeline since 1999 and has yet to be passed. Since credit unions are defined as "specific financial institutions" in the Bank of Jamaica Act, the Bank of Jamaica has collected since 2002 prudential information on the sector, and conducted periodic onsite examinations. Building Societies supervised by Bank of Jamaica	Stabilization Fund set up by the Credit Union League Plans to bring credit unions within the scope of the Deposit Insurance Corporation with the passing of the Credit Union Bill
Guyana	Credit unions are not regulated or supervised by a prudential supervisor. New Building Society supervised by the Bank of Guyana.	None for credit unions
OECS	As of 2014, all countries except Saint Lucia had passed the Harmonized Cooperative Society Act. All countries have established single regulatory units in charge of supervising non-banks. There are plans to create a single regional non-bank supervisor which would first start supervising insurance companies.	No explicit deposit insurance for financial institutions, including credit unions
Suriname	Credit unions are regulated and supervised by the Central Bank.	Credit Unions are not covered by Deposit Insurance although there are plans to do so
Trinidad and Tobago	Credit unions are supervised by the Commissioner for Co-operative Development in the Ministry of Labor but plans to put under supervision of the Central Bank Consultations on a Draft Credit Union Bill between 2006 and 2013. Credit Union Bill in Parliament as of December 2014	Voluntary Stabilization fund. Consultations on mandatory deposit insurance system managed by the Deposit Insurance Corporation launched in 2014

Source: Central Banks and credit unions supervisors.

Annex E: The Voice of the Supervisor

The Main Challenges Raised by the Intervention of the BLA

The risk of failure of a financial institution whether of systemic importance or otherwise is always a factor for contemplation of the supervisory authority in the design and implementation of its regulatory framework. In the majority of circumstances, the supervisory process and the regulatory tools available are sufficient to contain that risk in the event of its crystallization. Alternatively, an orderly exit from the market, with a mitigation of losses to the depositors and a reduction of potential contagion risk, may be possible with the use of safety nets, contingency and crisis management plans and robust legislation underlying the supervisory process.

The main challenges faced during the intervention of the BLA were a result of an absence of these fundamental elements and was further aggravated by the newness of the supervisory authority.

Crisis Preparedness: Having a crisis preparedness plan provides a roadmap of recommended actions to be undertaken pre- during and post crisis. While each situation would obviously require some level of customization in relation to the existing circumstances, such a roadmap would have been extremely valuable in focusing activity of the FSA particularly during the crisis itself.

Robust Legislative Framework: The absence of or the limitations of the supporting legislative framework and structures to facilitate the resolution and disposition of distressed assets was a hindrance in the speed and effectiveness of implementation of the bad asset recovery strategy. This was critical, as it was a key component to easing the liquidity crunch experienced by the BLA.

Safety Nets and Lender of Last Resort: The lack of lender of last resort or similar liquidity or joint guarantee scheme and safety nets like deposit insurance presented severe challenges in the circumstances. While the BLA was effectively turned around without the use of safety nets, it was more difficult to plan and manoeuvre during the crisis phase. While deposit insurance may be of limited value in the event of simultaneous institutional failure, in a one-off situation, it could be valuable in contributing to public confidence and stemming potential runs on the institution as occurred in this instance.

Credibility of the Supervisor: An effective supervisor usually cultivates the trust and confidence of the regulated sector through its interactions, transparency and credibility built over a period of time. The FSA did not enjoy this luxury being faced with the BLA crisis only three months after its establishment. It was therefore forced to demonstrate its commitment and capacity in full public view under challenging and often hostile circumstances.

Objectivity and Neutrality: Retaining focus on achieving the ultimate objective of a return to soundness and safety for the common good was a challenge. This was particularly so, due to the open door strategy used in the intervention process. This necessitated a simultaneous engagement of angry members, sometimes irresponsible media fuelled by sensationalism, public figures seeking to make as much political mileage out of the circumstances and disgruntled past officials of the BLA. All during an intense period of undertaking time sensitive corrective actions in critical areas of deficiency, which had resulted in the demise of the institution.

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