ABSTRACT

The past decade has been unprecedented in Jamaica's financial history in terms of banking system distress and bank failures: the financial sector, and the banking sector in particular, has experienced revolutionary changes as well as sporadic eruptions of distress and bank failures. While considerable improvements have been achieved in transforming bank regulations to secure an environment for safe and sound banking, there is still a need for a robust prudential system, with appropriate mechanisms, to enhance supervision and monitoring and to protect the banking system from the recurrence of similar crises.

This thesis aims to shed light on bank failures in Jamaica through an empirical investigation of the factors that influence the failure of individual banks. Specific attention is also devoted to identifying the factors that influence the bailout of problem banks. A three-pronged approach is applied to investigate bank failures in Jamaica: a comparison of regulation and supervision in international perspective through qualitative inquiry, the use of binary and multinomial logit models to construct 'early warning' systems to aid in bank failure prediction, and an analysis of two failed banks in Jamaica to investigate regulators' closure decisions for distressed banks. The results of this study are potentially far-reaching. Some of the factors identified as contributing to failure include inadequate regulation and weak supervision, regulatory forbearance, deterioration in the macroeconomic environment, rapid expansion in size and weakness in a range of bank-specific factors: capital, management, liquidity. The size results are particularly significant and points to implicit or explicit 'too big to fail' policies since larger banks, though they are more likely to fail, are more likely to be bailed out than to be closed. Options to improve the supervisory system in Jamaica include the employment of 'early warning' models such as those developed in this study, the strict application of risk-based deposit insurance, and the avoidance of regulatory forbearance and the reduction of politics on the decision-making processes through the use of rules-based schemes.