CLICO’s Collapse: Poor Corporate Governance

Wayne Soverall¹

Abstract

The corporate collapse on January 30, 2009 of CLICO, the largest conglomerate in Trinidad and Tobago and the Caribbean, is the worst financial shock experienced by the region to date. Today, more than two years later, its devastating effects are still being felt as the government continues to struggle with the bailout to stabilize the financial system, mitigate contagion risk, and resolve the CLICO crisis. Even one year after the bailout, there was still no resolution of the crisis. In view of the intractable nature of the CLICO collapse, the People’s Partnership government that came to power on May 24, 2010 established a commission of enquiry to investigate the causes of CLICO’s collapse, the scope of the MOU, the cost of the bailout, and the failure to provide a bailout to the Hindu Credit Union (HCU) that collapsed in 2008. There are many questions that are still unanswered. What were the root causes of CLICO’s collapse? What corporate governance structures and practices precipitated the collapse? Did the bailout create moral hazard? Who or what was to blame for the collapse? What action has the government taken to date? What lessons have been learnt and, more importantly, how can this situation be prevented from being repeated in the future? This concept paper examines these questions, analyzes the evidence to find answers, and in the conclusion, suggests ways to improve corporate governance and the empowerment of regulators to provide competent regulatory oversight and enforcement.

Key words: financial collapse, bailout, corporate governance, moral hazard, political influence, risk management

Introduction

The devastating effects of the corporate collapse of Colonial Life Insurance Company (Trinidad) Limited (CLICO) on January 30, 2009 are still being felt today throughout the economies of Trinidad and Tobago and the wider Caribbean. Thus, after 15 years of positive economic growth, the Trinidad and Tobago economy declined in 2009 (-3.5%), as a result of the impact of the global crisis, and more particularly, the collapse of CLICO because of its sheer size, the scope of its operations, and the systemic risk posed to the financial system. At issue, however, was not only the containment of the risk exposure of the Trinidad and Tobago economy (10 percent of GDP), but also the spillover effects in the wider Caribbean (17 percent of GDP).² Perhaps, even more compelling was the immediate challenge of providing a policy mix to support economic recovery, while completing the resolution of CLICO’s financial crisis.³

The uncertainty regarding the restructuring of CLICO, the inordinate delay in finding a solution, and the management of government’s intervention and subsequent bailout, put the successor administration under tremendous pressure. Thus, the 2010/11 budget announced a restructuring plan at a cost of TT$11.9 billion or 8.6 percent of GDP that would pay 235, 000 investors in full up to a maximum of TT$75, 000 and the remaining amounts in the form of a 20 year bond at zero interest rate which amounts to a discount in net present value of about 40 percent.⁴ In addition, the budget also extended a bailout to the 160, 000 investors of the failed Hindu Credit Union (HCU) similar to what had been worked out for CLICO based on the principle of social equity.⁵ However, there was strong resistance by policyholders to the plan which was viewed as a dramatic change from the assurance given by the governor of the Central Bank in 2009 that all policyholders’ funds were guaranteed by the government. This created a legal challenge by policyholders to the bailout plan which subsequently sought to incorporate their concerns in a revised plan.

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² Author’s interview with Dr. Winston Dookeran, Minister of Finance, Government of the Republic of Trinidad and Tobago, March 5, 2011.
In view of these challenges, the government established a public commission of inquiry to find out who and what were responsible for the fiasco at CL Financial subsidiaries CLICO, CIB and BA as well as the 2008 collapse of the HCU.\(^6\) This is in addition to the results of previous forensic investigations that have been sent to the director of public prosecutions by the office of the attorney general.

Understanding what caused the CLICO collapse, therefore, is critical to preventing a similar episode in the future. This paper provides some background to the underlying causes, describes how it evolved, and examines several possible explanations including concepts related to the CLICO business model, corporate governance, government bailouts, moral hazard, the notion of too big to fail, risk management, and the influence of political considerations in policy-making that may have contributed to the crisis. The uncertainty about the causes of the collapse, the delayed process of granting payments to policyholders and investors, and the apparent lack of urgency in resolving the corporate collapse of CLICO demonstrates that undertaking a bailout involving the restructuring of such a large conglomerate while simultaneously transforming it into a viable institution and containing the fiscal costs, is a process for which government is ill-equipped.

**CLICO**

CLICO is the largest insurance company in the country and the region, the flagship of the parent company, CL Financial (CLF), which is the largest privately-owned conglomerate in the Commonwealth Caribbean with operations spanning its core business of insurance, but which also includes financial services, real estate development, manufacturing, agriculture and forestry, retail and distribution, energy, media and communications (see Figure 1).\(^7\) CLF operates in 32 countries through its associated and joint venture companies (see Table 1)\(^8\) and more than 65 subsidiaries spanning the Caribbean, Florida, Europe, the Middle East and Asia (see Table 2).\(^9\) It controls assets in excess of TT$100 billion; owns 55 percent majority ownership of Republic Bank, the country’s largest commercial bank; owns Methanol Holdings of Trinidad Ltd. which operates M5000, the world’s largest methanol plant at Point Lisas; controls BA which is one of the main insurance companies in the Eastern Caribbean; and the four largest financial institutions in CLF manage assets of over TT$38b, over 25 percent of the country’s GDP.\(^10\)

CLICO’s imposing presence in Trinidad and Tobago and across the region, coupled with its phenomenal business success made it the entrepreneurial flagship of the entire Caribbean. Thus, CBTT was “very conscious of the contagion risks that the financial collapse of an institution as vast as CLF could have on the entire financial system of Trinidad and Tobago and indeed, in the entire Caribbean region.”\(^11\) Thus GORTT and CBTT intervened because they were particularly concerned about the potential impact that CLICO’s collapse would have as a consequence of the wide scope of coverage and the sheer size of CLF.\(^12\) It fact, the MOU specifically indicates that “CLF has asked for the GORTT’s intervention in the rehabilitation of CIB, CLICO and BA in the interest of and for the protection of depositors, policy holders and creditors.”\(^13\)

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\(^6\) `Government probes CLICO, HCU,’ Trinidad Newsday, October 2, 2010: 5.


\(^9\) Ibid.

\(^10\) Ewart Williams, Governor, Central Bank of Trinidad and Tobago, Remarks at the CIB/CLICO Media Conference, January 30, 2009: 3.

\(^11\) Ibid: 3.

\(^12\) Karen Nunez-Tesheira, Minister of Finance, Government of the Republic of Trinidad and Tobago, Statement at the CIB/CLICO Media Conference, January 30, 2009: 4.

\(^13\) MOU between GORTT and CLF, op. cit: 1.
Figure 1: Organizational Structure of CLF

Table 1: Associates and Joint Venture Companies

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>COUNTRY OF INCORPORATION</th>
<th>PERCENTAGE OWNED (%)</th>
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</thead>
<tbody>
<tr>
<td>One Caribbean Media Limited</td>
<td>Trinidad and Tobago</td>
<td>33</td>
</tr>
<tr>
<td>Southern Chemicals Corporation</td>
<td>USA</td>
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<td>Cumberland Communications Limited</td>
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<td>Bram-Ber Holdings Limited</td>
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<td>Caribbean Nitrogen Company Limited</td>
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<td>Nitrogen (2000) Unlimited</td>
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<td>Securicor Trinidad Limited</td>
<td>Trinidad and Tobago</td>
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<td>Infolink Services Limited</td>
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<td>Laqtel Limited</td>
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<td>United Image Technologies Inc.</td>
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<td>Europa LLC</td>
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<tr>
<td>Fidelity International Development Inc.</td>
<td>USA</td>
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<tr>
<td>Eastern Caribbean Home Mortgage Bank</td>
<td>Each member state of the Eastern Caribbean Union</td>
<td>20</td>
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Table 2: Principal Subsidiaries

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<tr>
<th>COMPANY</th>
<th>% SHAREHOLDINGS 2007</th>
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<th>% SHAREHOLDINGS 2005</th>
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</tr>
<tr>
<td>Clico (Bahamas)</td>
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<td>Clico Mortgage &amp; Finance Company Limited</td>
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<td>Mariner’s Haven Limited</td>
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<td>Energy, Manufacturing, Agriculture and Forestry:</td>
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<td>Burn Stewart Distillers Limited</td>
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<td>Services:</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Clico Holdings (Barbados) Limited</td>
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<td>HealthNet Limited</td>
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<tr>
<td>Primera Oilfield Management Services Limited</td>
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<tr>
<td>CL Communications Limited</td>
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<td>97</td>
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<tr>
<td>Video Associates Limited</td>
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<tr>
<td>Telemedia Limited</td>
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Memorandum of Understanding

The terms and conditions of the Memorandum of Understanding (MOU) are central to an understanding of CLICO’s collapse. The corporate collapse of CLICO triggered the intervention of the Government of Trinidad and Tobago (GORTT) through the Central Bank of Trinidad and Tobago (CBTT) which signed a Memorandum of Understanding (MOU) because “the financial condition of CLICO, CLICO Investment Bank (CIB), and British American Insurance Company (Trinidad) Limited (BA), subsidiaries of the parent company, CL Financial threaten the interest of depositors, policy holders and creditors of these institutions and pose danger of disruption or damage to the financial system of Trinidad and Tobago.”

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14 Memorandum of Understanding (MOU) between the Government of the Republic of Trinidad and Tobago (GORTT) and CL Financial Limited (CLF) dated January 30, 2009.
The MOU was dated 30th January 2009 and made “between the Minister of Finance, acting for and on behalf of the Government of the Republic of Trinidad and Tobago (GORTT) and CL Financial (CLF) acting for itself and as agent for its affiliates to include Colonial Life Insurance Company (Trinidad) Limited (CLICO), CLICO Investment Bank (CIB) and British American Insurance Company (Trinidad) Limited (BA),”15 GORTT and CLF, therefore, agreed to enter into the MOU whereby steps were to be taken to correct the financial condition of CLICO, CIB and BA and to protect the interest of depositors, policy holders and creditors of these institutions.

To be more specific, CLF agreed to take steps to correct the financial condition of CLICO, CIB and BA by selling all of its shareholdings in Republic Bank Limited (RBL); selling all of its shareholdings in Methanol Holdings (Trinidad) Limited (MHTL); selling all of its shareholdings in Caribbean Money Market Brokers Limited (CMMB); and selling all or any of their other assets as may be required to achieve the said correction.16 In addition, the proceeds of the sale of assets will be applied to satisfy the statutory fund requirements for CLICO and BA under the Insurance Act 1980 and the balancing of the third-part assets and liabilities portfolio of CIB.17 Moreover, in the event that there is a shortfall after the application of the proceeds realized from the sale of the assets, CLF warrants an agreement to provide collateral which may include a secured charge on the fixed and floating assets of CLF, CLICO and BA sufficient to secure any financial assistance to be provided by GORTT in respect of that shortfall for the purpose of maintaining public confidence and stability in the financial system.

CLF agreed that “CLICO and BA will restructure its business and operations to conform to traditional life insurance business lines in a manner approved” by the CBTT, including “a reconstitution of the Board of Directors, Board Committees and senior management” whose selection shall be approved by GORTT.18 In view of GORTT’s significant financial exposure to CLICO, CIB and BA, it received a minority shareholding in CLICO and BA which CLF was responsible for listing on the Trinidad and Tobago Stock Exchange (TTSE) within a period of two years.

Precipitating Factors

There were several factors that precipitated the collapse of CLICO. First, the insurance legislation had remained fundamentally unchanged since its enactment over twenty-eight years ago and the CBTT had only incrementally updated the regulatory framework governing licensed and registered financial institutions to enhance its regulatory oversight.19 Second, the liquidity challenges experienced by CIB which was deemed to be the result of unusually high levels of withdrawal requests illustrated a serious mismatch between assets and liabilities.20 Third, CLICO was also experiencing liquidity problems because of the prevalence of inter-group transactions. Fourth, CLICO’s chairman formally raised the issue of possible financial assistance from the CBTT at a meeting on January 13, 2009. Fifth, the increase in withdrawals at CIB, and the near panic at CLICO were attributed to concerns about the impact of the sharp decline in methanol and real estate prices on CLF’s overall financial situation.

In addition, other factors identified as central to the financial difficulties experienced by CLICO included “excessive related-party transactions which carry significant contagion risks; an aggressive high interest rate resource mobilization strategy to finance equally high risk investments, much of which are illiquid assets (including real estate both in Trinidad and Tobago and abroad); and a very high leveraging of the Group’s assets, which constrains the potential amount of cash that could be raised from asset sales.”21 These deficiencies in the operations of CLICO highlighted the inadequacies in the legislative framework of CBTT which in 2009 still did not have the authority to conduct on-site supervision, share information with other regulators, or demand the required changes from CLICO even though since 2004, regulatory authority for insurance companies and pension funds had been transferred from the ministry of finance to CBTT.22

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16 Ibid: 1.  
17 Ibid: 2.  
19 Statement by Karen Nunez-Tesheira, Minister of Finance, op. cit: 1.  
20 Remarks by Ewart Williams, Governor, CBTT, op. cit: 2.  
21 Ibid: 2.  
22 Ibid: 3.  
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Moreover, the operational weaknesses pinpointed two underlying causes of CLICO’s collapse, namely, the need to change its current business model and adopt a more robust and less risky model, and to change its corporate governance structure.23

**Business Model**

The concept of the business model played a significant role in the collapse of CLICO. In this business model, CLICO was the primary source of deposits that were used to finance CLF’s expansion through investments and acquisitions held in the name of other entities in the group.24 Some of these enterprises were wholly owned and managed by CLF, others were simply investments in which CLF did not participate in management, and some were a mixture of both. In some cases CLF borrowed from financial institutions to invest, and in most cases, it used CLICO, CIB, BA, and CMMB as the conduit to purchase investments or borrowed from them to do so. In short, CLICO became the guarantor for many of CLF’s assets most of which were heavily pledged and, therefore, limited in terms of the potential proceeds from asset sales. As a consequence, both CLICO and CIB were viewed as isolated cases of an overly-aggressive and risky business model.25

The CLICO business model was viewed as a ponzi scheme or alternatively, as a pyramid scheme because it took large amounts of deposits on a short-term basis paying high interest rates and used them for long-term investments which resulted in significant cash flow problems that precipitated its ultimate collapse. 26 The CBTT on June 7, 2011 alleged that CLICO operated both an external ponzi scheme in which the insurance company took in new money from policyholders and mutual fund investors as well as an internal ponzi scheme in which money was diverted or misappropriated away from CLICO to fund CIB, CLF or other group entities with little or no prospect of return.27 The terms pyramid scheme and ponzi scheme are often used interchangeably to describe specific forms of investment fraud where sustainability depends on the influx of new investors to the scheme.28 However, there are some differences in the way that these two types of schemes operate. Pyramid schemes are a form of fraud where the expected benefit to members depends primarily on the number of individuals they recruit, which is not necessarily the case in a ponzi scheme.29 Thus, for example, each member may be required to recruit five others who each recruit five more, and so on to get the reward, creating a pyramid in which payments flow upward to earlier members – and not necessarily to a central pool of funds, as in a ponzi scheme.

**Corporate Governance**

The corporate governance structure of the conglomerate CLF has to be factored into the analysis of CLICO’s collapse because although the business model was high risk and dangerously flawed, the regulators were not blameless. The evidence indicated that the “soft touch approach to regulation” which was essentially based on moral suasion while aligned to the philosophy of the market mechanism had led to the excesses that caused the crisis.30 The corporate collapse of CLICO also highlighted the critical need for legislation and regulation to keep pace with the rapidly evolving operations of financial institutions. This is required to ensure that regional regulators have supervisory authority over the operations of the conglomerate or holding company structure which has become the preferred form of organization for large financial institutions such as CLICO. In addition to the regulatory gaps, the CLICO case illustrates that poor corporate governance, weak risk management practices, and inadequate management information systems were also major contributing factors that led to the collapse of CLICO.31

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23 Ibid: 5.
24 Ewart Williams, Governor, Central Bank of Trinidad and Tobago, Media Address on “Update On CIB/CLICO/CMMB”, February 13, 2009: 3.
30 Ewart Williams, Governor, Central Bank of Trinidad and Tobago, Opening Address on “The Future of the Financial Industry After the Crisis,” The Caribbean Centre for Money and Finance 14th Caribbean Business Executive Seminar, Port of Spain, April 30, 2010: 6.
Some of the deficiencies in the corporate governance structure of CLICO included too much control by the chairman who was also the chief executive officer, failure of the directors’ fiduciary duties, failure of the directors’ duty of care and skill, conflicts of interest, poor risk management, political influence, and weak supervision by CBTT. The Jamaican experience can possibly serve as a model in the post-CLICO restructuring process since there is currently no consensus on a corporate governance model for the Caribbean. Arising out of the failure of a number of indigenous banks and insurance companies in 1997, the Government of Jamaica (GOJ) has led the way in corporate governance practice. In 2001, it reformed and strengthened financial sector supervision by establishing the Financial Services Commission (FSC) as a new oversight body which supervises and regulates the securities industry, the insurance industry and the private pensions industry. In addition, there is the Private Sector Organization of Jamaica Corporate Governance Code which is similar to the United Kingdom Combined Code.

As a consequence of the government bailout of the financial sector which cost over 40 percent of GDP, the GOJ also established the Financial Sector Adjustment Company (FINSAC) to restructure and recapitalize financial institutions. It eventually took control of seven insurance companies, five commercial banks, three investment banks, and three building societies by purchasing ownership stakes of at least 25 percent in these institutions to obtain veto power over management decisions, and in some cases, it took over direct management. Subsidiaries of Trinidad and Tobago’s Guardian Holdings Limited also played a crucial role by acquiring four leading Jamaican insurance companies, namely, Crown Eagle Life, Dyoll Life, Horizon Life and Jamaica Mutual.

The corporate collapse of CLICO has been compared to similar collapses of unregulated investment schemes (UIS) that operated elsewhere in the region. For example, it was compared to the February 2009 failure of the Antiguan-based Stanford Financial Group (SFG) which included Stanford International Bank (SIB) and Stanford Capital Management (SCM). However, the SFG collapse pales in comparison to CLICO as a result of its size, scope and extensive risk exposure to a wider number of individuals and countries. The SFG was a privately-held group of companies specialized in wealth management, with assets under management in excess of US$50 billion. The founder and sole owner of the group was Robert Allen Stanford, a prominent U.S. financier, philanthropist, and sponsor of professional sports. The U.S. Securities Exchange Commission (SEC) alleged that SIB, through a network of Stanford Group Company (SGC) financial advisors, executed a massive ponzi scheme that sold approximately US$8 billion of certificates of deposit (CDs) to investors around the world with the promise of higher returns than available through traditional banks.

In addition, the SEC alleged that SFC sold more than US$1 billion of a propriatory mutual fund wrap program, using misleading information. As a result of these alleged misdeeds, the SEC froze all SFG assets on February 17, 2009 as charges of fraud were brought against financier Allan Stanford. The evidence illustrates that the Stanford case has had significant repercussions in several countries where the SFG had operations, including Antigua and Barbuda, Canada, Colombia, Ecuador, Peru, and Venezuela. Regulators in these countries had to take emergency actions. Meanwhile, as a consequence of the SFG debacle, financier Stanford was accused of fraud and illegal activities and imprisoned in Texas pending trial in January 2012. However, there are four important factors that make the CLICO case significantly different from the Jamaican and Stanford cases and, therefore, its resolution much more difficult – its enormous size, its regional scope, its occurrence in the midst of the worst international financial crisis for almost a century, and the heavy fiscal cost associated with public bailouts.

Contagion Effect

The corporate collapse of CLICO had a substantial contagion effect throughout the Caribbean because of the operations of its subsidiaries. As a consequence, governments across the region implemented policies of judicial management to stem the fallout and to minimize the contagion effect as outlined in the table below.

32 Goldson, Suzanne (2008) Commonwealth Caribbean Corporate Governance: A One Size fits all?, Faculty Workshop Series, Faculty of Law, University of the West Indies, Cave Hill Campus, Bridgetown: 2.
35 Ewart Williams, Governor, Central Bank of Trinidad and Tobago, Opening Remarks at the CCMF/CARICOM Secretariat and CARTAC Workshop On Regional Financial Stability, Port of Spain, March 3.
Bahamas  CLICO Bahamas placed under provisional liquidation in February 2009  
BA Bahamas placed under Judicial Management in September 2009
Barbados  CLICO placed under Judicial Management in October 2010  
BA placed under Judicial Management in December 2010
Belize  CLICO Belize placed under Judicial Management in March 2009
Caymans  CLICO Caymans closed in December 2009
ECCU  BA placed under Judicial Management in August 2009
St. Lucia  CLICO and BA deemed insolvent in March 2009
Suriname  CLICO Suriname sold in July 2009

Bailout

In order to minimize the contagion, the GORTT provided a bailout to CLICO. However, there are several conceptual issues related to the CLICO bailout that need to be carefully examined. In economics, a bailout is an act of loaning or giving capital to an entity (a company, a country, or an individual) that is in danger of failing, in an attempt to save it from bankruptcy, insolvency, or total liquidation and ruin; or to allow a failing entity to fail gracefully without spreading contagion. Thus, a financial institution bailout involves government intervention through a transaction targeted to a financial institution or group of financial institutions. However, in the absence of a bailout, the financial institution would either be forced to go through receivership or bankruptcy in the prescribed legal form, or have its role in financial intermediation disrupted.

The CLICO case demonstrates that government bailouts can be problematic, especially in the absence of a national crisis management plan which details how regulatory authorities should react in the event of a systemic financial crisis. Moreover, the development of such a plan raises a much more fundamental issue, namely, the vexing question of whether there should be institutions that are considered too big to fail. The immediate objective of the 2009 intervention and bailout was to prevent a systemic crisis, ensure that the public maintained confidence in the financial system, and avoid the implications of the negative fallout from the failure of CLICO and its deleterious consequences for the economy. The intervention gave the GORTT the opportunity to approve a new board of directors and, therefore, what it failed to do through regulation, it subsequently attempted to remedy through board membership. Moreover, since it was clear that the intervention would be costly, given the size of CLICO, it was agreed that the government would provide the bailout but the company and its managers would be made to pay whilst minimizing the effect on the country’s national debt and international ratings.

The government provided liquidity in the form of cash injections which amounted to TT$5.4 billion – TT$5 billion to CLICO, and TT$400 million to BA. The major issue, however, was how to resolve the intractable problem of the Executive Flexible Premium Annuities (EFPAs) of which more than TT$2 billion were either due for renewal or would be due for renewal and rollover within 36 months since people were fed up of promises to pay. The CLICO bailout of policyholders stood in stark contrast to the HCU situation where shareholders were not bailed out and, therefore, were concerned about losing all or part of their savings.

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37 http://www.aabusiness.com/2984614-1.html
38 McKinley, Vern and Gary Gegenheimer (2009) Bright Lines and Bailouts: To Bail or Not To Bail, That Is The Question, Policy Analysis, No. 637, April: 1.
41 Browne, op. cit
42 Ibid.
The previous administration argued that the fundamental difference between CLICO and HCU was that the justification for the CLICO bailout was the legal and moral obligation of the GORTT to act in the public interest to protect policyholders and depositors and not the companies or shareholders. In the case of the HCU, however, shareholders who sought higher returns could not expect taxpayers to bail them out for their poor judgment. In addition, the GORTT and CBTT proposed to bailout and take control of institutions which it regulated. Finally, CLICO was deemed too big and important for GORTT to let it fail in a disruptive manner that would negatively impact the economy, therefore, it had to intervene to restore confidence in the financial system and to minimize the contagion effect in the wider region. In comparison, the impact of the collapse of HCU was only limited to shareholders.

The rationale for the government’s intervention in CLICO was viewed with a tinge of suspicion, however, because it failed to offer a similar bailout to the HCU. In addition, there was speculation about the political motivation of the bailout. In the circumstances, the issue of political influence and political considerations cast a long shadow over the government’s bailout plans for CLICO because the evidence from the commission of enquiry indicated that the former chief financial officer of CLICO was involved in trying to negotiate a deal to secure funds to ease CLICO’s liquidity problems. Empirical evidence indicates that Trinidad and Tobago would have been severely exposed to a substantial financial shock following the corporate collapse of a large institution as CLICO without the bailout because its assets were equivalent to 25% of the country’s GDP. Thus, CLICO was deemed too big a risk to fail. In fact, GORTT was compelled to act because if it failed to act, it would have been held liable for reckless behaviour.

The incalculable social, psychological and political costs associated with the failure of large conglomerates such as CLICO in terms of poor corporate governance, market discipline, and their negative impacts on the economy far outweigh the economic cost of a bailout. Thus, without GORTT’s intervention, not only would there have been a significant contagion impact on the economy, but CLICO would have been vulnerable to liquidation and policyholders would have suffered significant losses. Moreover, as illustrated by the decision to bailout the HCU, social equity and political considerations cannot be minimized in the broad bailout strategy. In defense of the government’s bailout plan, the governor of the central bank stated that government had only been able to get depositors with investments under TT$75, 000 to accept its bailout plan of 2010/11 and, therefore, warned those policyholders with larger investments who were contemplating legal action that any legal action against the government or the bank would hurt the economy.

Given the fiscal pressures that the government faced, the best solution was to stagger the payment to policyholders. There was also a need to review the MOU that was signed in January 2009 because the entire process had not unfolded with the pace that was originally expected. In addition, it was discovered that the sale of CLICO’s assets required the consent of Duprey-appointed directors and the amount of assets that were considered to be available when the MOU was signed, might not be the reality now. The situation was further compounded by the fact that the value of CLICO’s shares in Republic Bank had declined while its shares in Methanol Holdings were tied up in covenants and other arrangements and, therefore, the immediate sales of these assets would have resulted in losses. One of the interesting points that can be made about the MOU is that the previous government appeared to have signed the agreement and then immediately ignored its terms. Back in January 2009, it was agreed that CLICO would sell its shares in Republic Bank, Methanol Holdings, and CMMB. However, only CMMB has been sold to date and, therefore, it appears that unless the government makes some urgent decisions to resolve the corporate collapse of CLICO, it may well be overtaken by the rapid pace of events as they unfold and, ultimately, entangle it in a whirlwind of political turbulence that can lead to its downfall.

Policy Implications

The collapse of CLICO underscored the need to strengthen the regulatory framework for the insurance industry in Trinidad and Tobago.

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44 Ibid.
45 Ibid.
46 Ibid.
To this end, new pieces of legislation were introduced after extensive consultation with industry personnel in an attempt to correct some of the glaring deficiencies that contributed to the crisis in January 2009. Thus amendments to the Insurance Act, No. 3, 2009 as well as the Central Bank (Amendment) Act No. 4, 2009 were implemented on February 6, 2009 in order to provide financial assistance to banking, financial and insurance companies with a view to preventing the collapse of any such institution. In addition, the Central Bank issued a circular on July 10, 2009 stating that quarterly returns, as required by Section 61A of the Insurance Act were updated to include a computation of the statutory fund requirements in order to monitor compliance in accordance with Section 37 (7) of the Act. Moreover, the Central Bank also issued circulars on July 2, 2010, January 13, 2011 and March 21, 2011 respectively that provided guidelines in relation to the information requirements to facilitate the product approval process, statutory fund requirements and, the approval and/or notification of new or amended insurance and banking products.

These policy changes are meant to strengthen the regulatory framework and to reinforce the Corporate Governance Guideline that was issued on May 8, 2006 which incorporates existing legislative and regulatory requirements, characteristics of the financial sector, and comments submitted by stakeholders within the industry and international best practices. However, although these amendments reflect a modern approach to the supervision of the insurance industry, including measuring company solvency against a risk-based capital formula and establishing more effective protection of policyholders, the new procedures must be constantly monitored and evaluated by supervisory personnel in order to achieve the desired results. Moreover, there are still several weaknesses in the regulatory framework, for example, the statutory fund requirements are a cause for concern because the investment limits of statutory funds have not been clearly defined in the new legislation.

Another area of weakness is the need for comprehensive supervision of local and regional institutions or conglomerates that are increasingly active internationally in order to minimize contagion risk. The present danger is masked by informal relationships and interlocking directorships that often blur the boundaries of due diligence and diminish the responsibility of fiduciary obligations and effective corporate governance practices. These deficiencies result in poor application and enforcement of corporate governance practices which undermine the goals of transparency and accountability. To this end, greater market discipline and supervision of the activities of large financial groups such as CLICO should be significantly improved by encouraging them to disclose much more than mere pro-forma information in their published financial reports. This is particularly critical to their credit and market risk management policies and practices since it speaks to their capability to manage exposures during the reporting period.

In view of present and future danger posed by perceived and real threats of regional contagion risk arising from problems within large financial groups like CLICO, there should be an identification system of early warning signals in a comprehensive risk management approach to supervision. This approach should include both qualitative and quantitative stress tests of the portfolios in question and counterparty risk management practices of these large financial institutions in order to identify the most likely sources of contagion. The results should be discussed with all relevant stakeholder institutions in an attempt to ensure that effective mitigation mechanisms are implemented, monitored and evaluated to ensure compliance.

**Policy Recommendations**

The corporate collapse of CLICO crisis had multiple reinforcing causes which combined to produce devastating economic and financial consequences for Trinidad and Tobago and the wider Caribbean. Informed by an analysis of these factors and structural flaws in the current financial system that contributed to CLICO’s collapse, this paper now proposes some useful policy recommendations that are designed to end this crisis. The author believes that if they are enacted and vigorously enforced, the policies could significantly reduce financial instability and minimize the repeat of similar problems in the future. First, the bailout clause is severely flawed and may not achieve its stated aim of stabilizing the financial institution in question and the wider financial sector. The bailout was implemented without insisting on proper safeguards over how the money would be spent, and more importantly, without even attempting to illustrate what would actually be done to prevent such a catastrophe from occurring again.

Second, regulation should focus on risk governance and management as much as risk measurement. The CLICO crisis revealed both gaps in regulation and unanticipated interconnections among different types of financial institutions in the CLF group of companies.
However, no regulator was charged with the responsibility for monitoring and evaluating the health of these institutions, markets, and interconnections between them across the entire breadth of the financial system, looking for gaps, detecting early signs of systemic threats and acting to mitigate them. Thus, despite the shift in the supervision of CLICO’s operations from the ministry of finance to the central bank, surveillance remained weak at best. The government has to implement tough measures with appropriate sanctions in order to overhaul the regulation of the financial services sector because the existing light regulation of the insurance industry, in particular, has severely compromised the integrity of the central bank.

Third, implement a regulatory financial precautionary principle with respect to new products and processes created by financial innovation. Regulators would then determine whether these innovations were likely to increase systemic fragility and associated risk. This is absolutely essential in an environment where financial innovation has facilitated the sidestepping of national regulation, increased informational asymmetries among market participants, and encouraged unethical and deceptive practices in the sale and promotion of financial products and services. For example, the central bank could not determine the legal status of the complex structured financial instrument referred to as an EFPA and therefore, consumer protection was neglected and placed at risk.

Fourth, contagion between certain financial market segments has become a primary concern because of the rapid transfer of risk from one institution and/or industry to another which poses new challenges for regulators. The CLICO crisis illustrates that there was no comprehensive risk management system in place to contain the rapid transfer of risks. The new capital adequacy framework, commonly referred to as Basel II is a recent initiative arising out of the global policy coordination process among central bankers and regulators that can perhaps be used to mitigate the downside of the crisis by identifying the most pressing regulatory policy issues within a globalized financial system. In addition, it should be noted that regulations approved in a crisis must be subsequently fine-tuned and renewed periodically because they often outlive their usefulness.

Fifth, shortcomings in financial regulation contributed significantly to the collapse of CLICO which triggered a contagion throughout the local and regional financial system. There were several regulatory practices that were not being enforced by the regulators. For example, the statutory requirement that CLICO was required to fulfill by law was just one instance of the failure of the institution to comply with its legal requirement and the failure of the regulator to impose any penalties for such negligence or reckless behaviour despite the central bank’s repeated use of moral suasion which itself proved to be totally ineffective. Sixth, the larger and more complex an institution, the higher the standards for capital, liquidity and leverage to which it should be held because the size and scope pose greater risk to the system and these risks should be internalized. Moreover, a more adequate capital structure should strengthen corporate governance and provide a greater buffer in the event that the institution faces difficulties. Thus, large financial institutions or conglomerates such as CLICO should maintain regulator-approved liquidation plans and, if their plans are consistently weak then they should be required to divest businesses until their failure poses significantly less risk of spillovers. No institutions, however, large or complex, should be allowed to become too big to fail. A policy of ‘no more too big to fail’ will minimize moral hazard and public costs. Any taxpayer costs of resolution should be recovered from the institution once conditions permit.

Seventh, implement lender-of-last-resort policy actions with commensurate penalties. There will always be the need for a lender of last resort bailouts, notwithstanding the implementation of appropriate policies. However, there should be a key distinction between the financial institution and the agents who made the decisions to take risks and benefitted from these decisions, i.e. executive management, agents and other highly rewarded operatives. These decision-makers must be made to pay significantly when their firms are bailed out. Based on the current example of the CLICO case, the perverse incentives manifested in the asymmetric reward structure are underwritten by the central bank and this creates significant moral hazard. Eighth, the excessive leverage and inadequate risk management policy of CLICO highlighted not only the structural flaws in its operations, but also poor governance structures and serious weaknesses in Trinidad and Tobago’s regulatory structure (Central Bank Act and Insurance Act). In addition, these weaknesses placed the entire financial system at risk and only improved regulation and sanctions will reduce both the frequency and severity of future crises. Ninth, the insurance industry and related financial services underscore the need for an aggressive system of financial regulation that will be effective based on relevant reforms that are tailored to current conditions and constantly monitored to ensure effectiveness.
Conclusion
This paper concludes with the caveat that these policy recommendations or any other regulations will not have the desired impact unless the political economy of regulation is dramatically changed. Adequate regulatory reforms will not take place until three fundamental changes occur. One, there must be a broad political mandate in support of serious financial regulatory reform. For too long, business has corrupted the political process and, by extension, compromised the implementation of public policy. Two, the lax attitude of regulators has to be dramatically changed so that public sector institutions can be empowered by law to control financial institutions and thus, force them to act in the public interest. Three, the regulatory gap that currently exists has to be closed by training public officials so that they are competent to deal with financial innovations and associated risk management principles that will induce a significant culture change.

On September 14, 2011 the GORTT announced its revised plan to pay policyholders. It also succeeded in passing the Central Bank Amendment Bill 2011 in order to prevent legal action against the Central Bank. The GORTT’s enhanced resolution consisted of offering electronic bonds to retire the remaining indebtedness of CLICO policyholders. The new deal would benefit 235,000 policyholders, 160,000 depositors, and 2,000 firms as government sought to close the CLICO chapter for now and thus, ensure that the CLICO debacle no longer dominates the budget agenda. The minister of finance alerted investors to expect a haircut of 20 percent on bonds that were less than ten years old but a full return on longer-term paper, while the more than 200,000 holders of traditional insurance policies will get all their money back. In this context, the average return would be approximately 92 cents on the dollar, a significant increase over the 67 cents on the dollar implied by the original plan and holders of traditional policies would end up receiving 100 cents on the dollar.

Other groups to get all their money back include mutual fund investors with less than TT$75,000, trade unions and credit unions through the TT$788m liquidity window managed by the CBTT. In addition, the holders of short-term investments and mutual funds in values in excess of TT$75,000 will receive, subject to the valuation of the National Enterprise Ltd. (NEL) shares and the mean curve in the financial sector, an average of close to 92 cents on the dollar and there is a possible upside if they hold on to the NEL shares. In order to demonstrate its support for the new deal, the banking sector fronted TT$300m to NEL as an overall contribution to financial stability. The chairman of the CLICO Policyholders Group (CPG), Peter Permell, said that the revised offer vindicated policyholders who had asked the minister of finance to amend the original plan that he had proposed in the 2010/11 budget last year. 48

In view of this final resolution, the minister of finance appealed to depositors and other stakeholders who still threaten to sue the GORTT and CBTT until they see the details of the plan. He asked them to consider the national interest as opposed to their individual interests and, thus, refrain from any legal action. Moreover, he noted that the resale of CLICO assets may not be in the national interest since the revised offer far exceeds any recovery that would be obtained from the liquidation of CLICO. In addition, investors may have to wait years before they can receive payments, and the estimated recovery may change significantly as values received from assets may be much lower in reality. Meanwhile, forensic investigations and reports commissioned by the CBTT have been forwarded to the director of public prosecutions for his determination as to whether there will be any prosecution of wrongdoers involved in the CLICO collapse. In addition, the Commission of Enquiry continues and, therefore, the true nature and scope of the corporate collapse of CLICO is yet to be unraveled.

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