Developments in the Resolution Strategy for Colonial Life Insurance Company (Trinidad) Limited and Related Companies

Dr. Alvin Hilaire, Governor, Central Bank of Trinidad and Tobago

Launch of Monetary Policy Report, November 15, 2018

In January 2009, the Central Bank of Trinidad and Tobago received a request for extensive liquidity support from a major player in the domestic financial market. The CL Financial Group (CLF) at the time had either ownership or significant shareholdings in the country's largest bank and insurance company as well as a large non-bank financial institution and other smaller insurance companies, all of which were subject to the regulation of the Central Bank. In addition, the Group had very material investments in the energy and spirits sectors, among others. In total, the CL Financial Group then controlled over TT$100 billion of assets in more than 50 companies. The initial approach by the CLF Group was to warn the Central Bank of certain liquidity issues that had arisen at CLICO Investment Bank (CIB) and to request assistance in avoiding a run on that institution. As it turned out, the problems were much greater.

The systemic reach of the institutions in difficulty meant that financial stability in Trinidad and Tobago was at risk. It soon became clear that the difficulties were more fundamental and far reaching than liquidity issues that could be contained to CIB. Instead, this company was likely insolvent and furthermore, significant Statutory Fund deficits existed in both Colonial Life Insurance Company (Trinidad) Limited (CLICO) and British American Insurance Company (Trinidad) Limited (BAT). Moreover, the various entities within the CLF Group were highly exposed to each other through related party transactions. In the case of CLICO, the related party exposures were particularly egregious with CLICO having invested more than TT$4 billion with CIB, which was now at risk; indeed, almost 83% of CLICO's total assets were invested in related parties. Given CLF's imposing presence in the financial sector, any problems with the Group had implications for the wider economy of Trinidad and Tobago with possible contagion effects to neighboring Caribbean territories.

The extent of the support necessitated substantial fiscal outlay. In order to mitigate the potential systemic risk it was clear that substantial financial injections would be required. To give effect to this support, a Memorandum of Understanding (MOU) was agreed between the Ministry of Finance of Trinidad and Tobago and CLF to provide a framework for the Government's "bail out" arrangements aimed, among other things, at correcting the financial conditions of CLICO, BAT and CIB. Subsequent to the MOU, the Central Bank invoked its powers under Section 44D of the Central Bank Act to take control of CIB and shortly thereafter took control of CLICO and BAT after legislation was amended to provide the Bank with equivalent regulatory powers over insurance companies. Overall, the Government provided approximately TT$24 billion to the various entities covered by the Agreement, equivalent then to around 17% of the country's GDP. This was a substantial amount, made possible by the availability of fiscal space at the time. In comparison, the United States Government' s bailout of AIG during the 2008 financial crisis amounted to less than 1% of their GDP, while the infamous US savings and loan crisis of the eighties which saw the failure of almost 1,000 financial institutions cost about 3% of GDP. In emerging market and developing economies nonetheless, experience has shown that the direct fiscal costs can also be substantial, and accompanied by other costs related to the likely increase in the public debt and disruptions to the financial system as a whole that persist years after the initial fiscal outlay.

At the heart of the problems was a combination of poor governance, overreach and gaps in the legislative framework. The proximity in time of the global financial crisis of 2008 to the events at the CLF group might suggest that CLF, and in particular CLICO and BAT, were simply victims of global circumstances that caused distress across the financial markets of the world. However, such an assessment is at best only a small part of the story. In fact, the global financial crisis largely left insurance companies around the world unscathed—the notable failure in the industry was AIG due to the concentration of its subsidiary in credit default swaps. None of the local or regional insurance companies had any exposure to this type of risk. Instead, a foremost problem in the CLF entities involved poor corporate governance. For example, Boards met infrequently, had limited numbers of independent directors, while audit and investment committees did not function effectively. Moreover, an arms-length approach to inter-company transactions was not generally the norm. In this environment, there was investment overreach wherein depositors' and policyholders funds were invested in high risk, long term, illiquid assets without due regard to the imperative of asset-liability matching which is meant to be one of the core competencies of a well-managed insurance company. Worse, in many cases, due diligence on acquisitions was exceptionally weak and the prices paid represented questionable value for money. This whole approach was undoubtedly facilitated by a regulatory regime, especially for insurance companies, that was based on outdated legislation and which did not require that the level of capital held be commensurate with the risks being undertaken.

Over the decade since 2008, overlapping phases in the resolution strategy involved initial control; financial support; stabilizing the activities of the institutions to prevent further contagion; and recovery of the financial support. Having taken control of CIB, CLICO and BAT in early 2009, the first steps included assessing the true situation of the companies and implementing short term stabilization programs. In the case of CIB, it was determined that the only available option was to put the company into liquidation, and a winding up order was obtained in 2011 with the Deposit Insurance Corporation (DIC) appointed as liquidator. With respect to CLICO and BAT, the initial need was for liquidity and consequently, over the period from 2009 to early 2010, the Government injected a total of TT$5 billion into CLICO and TT$100 million into BAT . The injection in CLICO was used to buy 49% of the equity of the company at a cost of TT$7.25 million with the balance in the form of preference shares. Between 2011 and 2013 the Government also purchased the equivalent of TT$10.8 billion of short term investment products (STIPs) from CLICO investors and TT$0.75 billion from BAT investors in exchange for cash and bonds. In March 2015, a new phase to resolve CLICO and BAT was announced and encompassed: i) repayments by CLICO/BAT to those holders of STIPS who had not taken the Government's offer; ii) a plan to sell the traditional portfolios of BAT and CLICO to suitable purchasers at prices consistent with independent valuations; and iii) the monetization of assets or transfer of assets in kind to repay creditors, including the Government.

These phases were bolstered by efforts to strengthen the legislative and supervisory framework. Since the Central Bank became the regulator of the insurance industry in 2004, the Insurance Act 1980 and associated legislation have formed the basis for the Bank's regulatory powers for insurance companies. This Act was an amended version of the Insurance Act 1966 which was itself modelled in part on the Australian Commonwealth Act

[1]All figures in this presentation are approximate.
[2]Broadly speaking, there are two classes of policyholders in CLICO/BAT: a) the holders of traditional insurance policies (primarily life and term policies, deferred and immediate annuities, and group pension schemes); and b) investors in short-term investment products (STIPS) which do not generally have an insurance component but are interest-bearing instruments.

of 1945. It imposed minimal conditions on the capital required to run an insurance company, requiring only a flat amount of TT$3 million. The Act mandated that an insurance company maintain a Statutory Fund with assets equal to policy liabilities; however there was no requirement to include a buffer to offset any adverse movements in asset values or policy liabilities. In addition, the Act did not establish any standardized basis for the valuation of the actuarial liabilities, nor did it provide particularly effective means for the regulator to intervene. In short, the legislation was inadequate. After many years in development, a new Insurance Bill was assented to in Parliament in June 2018 and is carded to come into effect early in 2019. The new legislation will significantly update the conditions for running an insurance company—including more realistic capital positions, stronger governance and risk-based considerations—and fortify the regulatory powers of the Inspector of Financial Institutions on the insurance front.

The resolution plan is on track and the risks to financial stability in Trinidad and Tobago have been minimized. CLICO/BAT have already accomplished a number of key goals set out in the March 2015 resolution plan. All of the remaining holders of STIPs who have approached CLICO/BAT have been fully repaid. This means that the last material remaining block of policies consists of the traditional portfolios of BAT and CLICO. Traditional insurance policies are typically very stable and are not subject to the risks of runs or adverse policyholder behavior that can arise within banks or on more investment-related products. Given this fact and that CIB is in liquidation with few third party liabilities, the contagion risk of the entities to the Trinidad and Tobago financial system has been removed.

A substantial amount of the fiscal support to CLICO/BAT has been recovered. As of mid- November 2018, CLICO has returned almost TT$14 billion to the Government in cash and transfer of other assets. The majority of the repayment, about TT$8.3 billion, was in cash. The transfer of Republic Financial Holdings Limited (RFHL) and other shares received by CLICO from the liquidators of CIB in April 2018 formed the second largest block of the repayment. The balance has been effected by the transfer of a number of assets from CLICO to the Government in exchange for the reduction of debt owed by CLICO. Some of these assets, along with the RFHL shares, were used by the Government to create the National Investment Fund, which proved to be very successful on its recent bond issuance. In addition, as at the last audited financials, CLICO has returned to solvent status with an asset value which exceeds its liabilities even after allowing for the outstanding preference share liabilities that remain owing to the Government. As the situation has continued to improve during the current financial year, CLICO is expected to be in a position to repay all of the Government support that was provided. Ultimately, the remaining shareholder value of CLICO will be for the Government directly, since it owns 49% of CLICO, and for CL Financial (in liquidation) who will in turn be able to use the resources to settle the obligations of CLF to the Government and other creditors. BAT however has not been able to return to solvency and will not directly be able to repay the Government from its own resources; consequently any shortfall will need be treated with as part of the wider CLF obligations to the Government.

The sale of the traditional portfolio of CLICO is nearing completion. The traditional insurance portfolios of CLICO and BAT consist largely of universal life and term policies, deferred and immediate annuities and some group pension schemes. These portfolios continue to attract premiums and, as is the norm for this type of insurance, the policies will continue for many years into the future, requiring a sound, competent insurance company to deal with the ongoing administration of the policies and provide the necessary capital to ensure that claims will be paid in the future. As part of the resolution strategy CLICO/BAT, with Central Bank oversight, conducted a wide reaching, professionally managed and transparent process to identify a suitable company to acquire and manage the business. After the rigorous process that spanned several years, a preferred bidder was identified to purchase the portfolios of both CLICO and BAT. Sale and purchase agreements are expected to be signed shortly by CLICO, BAT and the party and the signatories will then work closely to get the necessary regulatory approvals in the shortest possible time in order to complete the transition.

This would pave the way for an exit by the Central Bank from control over CLICO and BAT once conditions are appropriate. The circumstances that emerged in 2008/09 warranted the Central Bank's control of the companies in the interest of policy holders and financial system stability. The Bank however does not perceive its role as running an insurance company or indeed any commercial enterprise. Now that a buyer has been identified for the traditional portfolio, following the signature of the sale and purchase agreements, the next steps will be for the Company involved to prepare 'schemes of transfer' to seek regulatory approval for the transfer of the policies from CLICO/BAT to the buyer. Upon satisfaction of all the requirements of the regulator/s for the approval of the schemes of transfer, steps would be taken to cancel the registration of CLICO and BAT and the Central Bank would be in a position to relinquish control.

The stronger legislative apparatus and integration of the lessons learnt would help to further reinforce supervision. With the implementation of the new Insurance Act, the local insurance industry will be subject for the first time to a modern risk-based approach to capital, actuarial valuation and other aspects of insurance supervision. The Central Bank has worked with the industry over many years on designing, agreeing and testing the implementation of this new Act and believes that the industry is ready and able to respond to the challenges of this new approach. The Bank also recognizes that it will need to "up its own game" to contribute meaningfully to the effective implementation of the new Act and is working assiduously to ensure that it will be in a position to do so via technical support, staff training, appropriate recruitment and strengthening interaction with other local and external regulators. An IMF/World Bank Financial Sector Assessment Program engagement, carded for the third quarter of 2019, would help to further advance our capacity in insurance supervision.