

RECENT FINANCIAL FAILURES IN THE CARIBBEAN - WHAT WERE THE CAUSES AND WHAT LESSONS CAN BE LEARNT?

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The 1980s witnessed the collapse of the investment firm DREXELL BURNHAM LAMBERT and the imprisonment of Michael Milken and Ivan Boeskey for insider trading. This was an era of leveraged buyouts financed by junk bonds, which demonstrated the greed and arrogance of wall-street personnel. The 1990s saw the dot com boom and bust. The stock market fell after 911 and then recovered before the decline occasioned by the 2008 financial meltdown. However, before the 2008 crisis we witnessed the collapse of MCIWORLD.COM and ENRON the imprisonment of Bernie Ebbers and some of the Enron executives for fraud. Ebbers is serving 25 years.

These international events were caused by a number of factors, such as, the greed and arrogance of wall-street actors; the greed and ignorance on the part of some investors and in some cases, an absence of effective regulation and the political belief in the virtues of the market to be self-regulating. ALAN GREENSPAN now admits that he made an error in assuming that the market would effectively regulate itself to prevent excesses.

The Caribbean over a similar period of time has witnessed financial crises. In Barbados the year 1986 saw the collapse of Trade Confirmers, a finance company offering interest rates on deposits that were in excess of what the other regulated entities were offering. The depositors lost their money. However, prior to that event, Barbadian depositors had lost money when two icons on the Barbadian business landscape the COTTON FACTORY and THE BARBADOS FOUNDRY collapsed. Here again there was no bailout of depositors. Trade Confirmers though a deposit taking institution was not regulated by the Central Bank and this brought about a change of legislation subsequent to the event to regulate these Finance Companies. However, there are still companies in Barbados accepting deposits from the public which are not licensed as banks or other deposit taking institutions. This has come to my knowledge recently.

The year 1995 saw a crisis in the financial sector of Jamaica. Dr. Gladstone Bonnick, a former Deputy Governor Bank of Jamaica and Executive Chairman of The Financial Sector Adjustment Company (FINSAC), which was formed by the Government of Jamaica to bail out the failed institutions and pay back depositors, gave some reasons for this meltdown.

The crisis in Jamaica resulted in 6 of the 9 commercial banks which accounted for 60% of the deposits, five life insurance companies which accounted for 90% of the premium income, one third of all merchant banks and several building societies being deemed insolvent and closed. These were all locally owned. This state of affairs resulted in the

Bank of Jamaica pumping J\$18 billion of special support to the local commercial banks and affiliated insurance companies to meet demands from depositors for withdrawal.

What were the causes of this situation? According to Dr. Bonnicks there were many:

The 1980s in Jamaica witnessed the emergence of conglomerates, encompassing insurance, banking, investment management etc. This corporate development was designed to take advantage of opportunities for minimizing taxation and regulation and supervision. This meant that resources could be shifted within the group from regulated to non-regulated entities, and in this way get around the restrictions placed on the regulated entities;

Insurance regulation was not up to the required standard. There was a knowledge and manpower gap. In addition to the regulatory issue insurance companies experienced liquidity problems and several commercial banks had been contaminated because of their inclusion in corporate groups which included insurance companies. Examples were Eagle Merchant Bank, NCB and Workers Savings & Loan Bank.

To quote Dr. Bonnicks " Insurance companies suffered from poor portfolio management, a mismatch of assets and liabilities, reflected in too much investment in real estate especially overbuilding of head offices and too high operational cost due to excessive commissions to agents and small size resulting in high overheads,"

In addition, there was weak corporate governance, which would have resulted in a situation like the following - 60% of the loans of failed institution Workers Savings and Loan Bank were to the owners and 10% to staff.

We move forward to 2002 and a Jamaican national by the name of Carlos Hill returns to Jamaica from the USA after spending 10 years in prison for mail fraud and operating a Ponzi scheme. He establishes an alternative investment scheme called Cash Plus Inc., which promises Jamaicans higher returns on their deposits than they are currently receiving from the commercial banks. Persons were promised returns as high as 10% per month according to a report in the Gleaner newspaper. In 2010 the Financial Services Commission (FSC) of Jamaica moved in on Cash Plus and the Court closed the operations. Some estimates of the fraud run as high as US\$ 7 billion and Jamaicans stand to lose millions of dollars. Carlos Hill, his brother and the Chief Financial Officer are on bail awaiting trial for fraud and operating a Ponzi scheme.

In March 2006 in Jamaica the FSC issued a cease and desist order to Olint Corporation owned and operated by David Smith and incorporated in Panama to do FOREX trading. The essence of the FSC's order was that Olint was offering

investment advice to the public and was not licensed to do such. Olint countered that it was an investment club and hence was not offering services to the public, but only to club members. The court of appeal in December 2007 confirmed the decision of the judge in issuing the order and David Smith moved his operation to Nevis and then Turks & Caicos Islands where he became a close friend of the Chief Minister, Mr. Misick who has been accused of embezzlement of his country's funds. However before Olint moved to Turks & Caicos, many Jamaicans at home and in Florida had invested in the Scheme which sent statements to members indicating that their investment had been earning as much as 10% a month in the FOREX market. In 2010 David Smith was sentenced to 6 years in prison in the Turks & Caicos having pled guilty to operating a Ponzi scheme. The liquidator found that when he had sent statements to members indicating that their investment had increased in value, no money had been invested. The US authorities requested the extradition of David Smith, since he sold investments to persons in Florida. He has recently pled guilty in the USA to 23 charges of fraud and money laundering and is in jail awaiting sentencing. The liquidator for OLint estimates that some \$US 200 million is owed to investors and that it is unlikely it will be recovered.

I now move to Trinidad. In August 1998, a report prepared in the Office of the Supervisor of Insurance of Trinidad & Tobago indicated that a review of the files of Colonial Life Insurance Company Limited (CLICO) of Trinidad & Tobago, over a 5 year period ended 1996, indicated that the Company had since 1992 found it difficult to satisfy its Statutory Fund Requirement. Nevertheless, the Company had declared and paid dividends in 1993, 1994 and 1995 and had proposed the payment of dividends in 1996, in violation of the Insurance Act.

Furthermore, the report goes on to say that a review of the Annual Returns showed that the insolvency position of the Company had gotten progressively worse as a result of the investment strategy of the Company. The company's investment portfolio had significant concentrations of risk both with respect to asset class as well as the inappropriate proportion of its funds invested in its parent company C.L. Financial, and other subsidiaries.

The report concluded as follows:

CLICO is experiencing liquidity problems in pursuing its investment strategy. This has necessitated large increases in borrowing not characteristic of core insurance business. The Company's equity represents only about 4% of its assets; hence there is no buffer for financial distress caused by a liquidity squeeze.

Incurring debt to acquire equity is relatively risky for a company with the capital structure of CLICO. Such behavior places policyholder funds at a level of risk inconsistent with the philosophy of the Second Schedule and the Admissible Assets Regulations of the Insurance Act. Added to this is the concentration of group (CL Financial) assets in the Statutory Fund, which makes the Fund highly sensitive to the performance of connected companies. The report noted that one loan to the parent represented almost 35% of its fund requirement

This report also indicated that the consulting actuary had in 1992 advised the Supervisor of Insurance to intervene in the affairs of the company. The SOI however did not favour intervention at that time and suggested that the company be given time to correct the situation. On January 1, 1994, the SOI noted that the company was technically insolvent by TT\$313 million on the basis of the 1992 accounts. In 1997 the SOI noted in a report that the company was technically insolvent by \$412M based on the 1995 accounts and that outstanding loans to the parent were \$350 million. The 1996 returns revealed that the loan to the parent company had increased 63% to \$571 million and that the Statutory Fund had a deficit of \$580 million. It was also revealed that CLICO Life's bank loans and overdraft had increased by 56%.

The consulting actuary in commenting on this state of affairs again recommended intervention into the affairs of the company. The review of the 1997 returns by the SOI found that its bank loans had increased by 230% to \$427 million and the company was technically insolvent by \$1.16 billion.

The office of SOI felt that because of the large investment by CLICO Life in its parent, the office should look into the operations of CL Financial so as to assess its future profitability and liquidity prospects.

The question to be asked therefore is, why despite the concerns of persons in the Office of the Supervisor of Insurance, no action was taken?

The political influence of large corporations:

The Trinidad Express Newspaper reported that CL Financial and subsidiaries provided \$TT 20 million for the PNM campaign in 2007 and also that Mr. Duprey Executive Chairman of CL Financial provided gifts and scholarships to the Panday family while he was Prime Minister.

Therefore in January 2009 when the Governor of the Central Bank of Trinidad & Tobago announced that the Central Bank was taking over the operations of that Company pursuant to an MOU between the Government and CL Financial, it was merely the culmination of years of bad management at that entity.

The economic recession was not responsible for the problems at CLICO; it was bad management and an inadequate or indecisive regulatory environment. **CLICO was a time bomb waiting to explode and explode it did.**

In Guyana, the consequences of the collapse of the Trinidad parent on CLICO Guyana are an estimated US\$ 30 million hit for the Guyana National Insurance Scheme, which represents an estimated 20 to 25% of the net reserves of the entity. In addition the Guyana Government has agreed to pay all persons who had invested money up to US\$ 20,000.00 per person.

In Barbados the collapse of the parent and the consequential contagion, has had a serious impact on the Barbados operations. Despite the assurances from the Executive Chairman of CLICO Holdings (Barbados Ltd), that there was no connection between the two companies, the Barbados operations of CLICO Life, mirrored the operations of the Trinidad entity, after all that is where the mind and management was. Failure to meet Statutory Fund obligations; a high level of related party transactions; failure to submit statutory returns; the selling of products not approved by the regulator, e.g., the attempt to sell Executive Flexible Premium Annuities (EFPAs) to credit unions and other institutions, and an aggressive investment policy with a concentration in real estate and other risky investments not proper for insurance companies.

CLICO Life Barbados has a statutory fund deficit and the estimated liabilities for EFPAs was Bds\$500 million as at December 31, 2009. In addition, there is an estimated asset liability deficit in excess of Bds\$200 million which has to be met. These figures are unaudited. However, it is noteworthy that even though the Statutory Fund was in deficit, there is no mention of this in any of the audited statements.

The estimated deficit of BAICO Barbados is some Bds\$48.1 million as at September 2010, according to the Judicial Manager. This is a consequence of the company carrying its investment portfolio of real estate assets at values in excess of what is realizable as assessed by an independent valuer.

BAICO in the OECS has an estimated deficit of US\$388 million. The Bahamas parent was responsible for the operations in the OECS.

What Lessons can we learn?

We have not learnt much from the mistakes of each other. The crisis in Jamaica was similar to what occurred in T&T and in Barbados. Companies were operating in an environment which allowed them to place policyholders and depositors funds at risk.

Regulators must therefore be given the tools to do their jobs and must be allowed to function by the political directorate. In Jamaica in the case of Olint the regulator tried to do his job by trying to stop this entity from operating, but the delays in the court system allowed the business to continue operating and taking money from persons for some-time, while an appeal was being heard.

There is a need for better public education about investing, so as to allow the public to make informed decisions. Many persons were duped by these get rich quick and high interest rate schemes. Of course one cannot protect people against their greed and in some instances stupidity.

Special attention has to be paid to the regulation of Conglomerates which own regulated entities. In Jamaica in the 1990s and in the case of CL Financial, there were numerous related party transactions and the shifting of assets from regulated to unregulated entities to get around restrictions on the investment of funds. Conglomerates which own regulated entities should be made to submit consolidated accounts to the regulator and where there are private companies publish consolidated statements in the press.

In addition, regulators must publish all decisions made about regulated entities. In Barbados the prohibition on CLICO Life from writing new business in August 2009 was not published in the press and so the Company was able to continue writing new business as attested to by the Chairman of Clico Holdings. Some Board members have even claimed that they were not aware that a prohibition had been made against the company until it was announced by the Minister of Finance during the estimates debate 2010. The law must be changed to allow for publication of such.

Corporate directors must not allow themselves to be mere appendages of the CEO, but must realize the seriousness of their role. The position of CEO and Chairman should also be split.

The Auditors must do their jobs and this is where our profession must share blame. CLICO Trinidad and the Barbados Life Company had not met their obligations under the STAT FUND, but there was no mention of this in the audited statements.

We need also to rethink the way political parties are financed. In Jamaica, the Gleaner newspaper of April 19, 2011, stated that the political parties who received money from Olint should repay it to the depositors who have lost their money in the entity. The editorial stated only the politicians would have benefitted. The same can be said about the political parties in Barbados, Trinidad and the OECS who received donations from CLICO and its subsidiaries. This practice can constitute a dangerous assault on democracy in small societies. Maybe the time is

ripe for the states in these small countries to provide financing to the political parties and ban other contributions.

The consequences to taxpayers of ineffective regulation can be very serious. In T&T the Government has so far injected \$TT 7 billion in CL Financial and the hole has not yet been plugged. In Jamaica there has been no bailout of depositors in Olint or CASH PLUS but in 1995 the BOJ injected J\$18 billion into the banking system. In Barbados there is a BDS\$48 million deficit for BAICO and an estimated \$240 million for CLICO LIFE if there is a bailout.

Finally citizens must demand that where corporate executives are by their fraudulent actions responsible for the demise of corporations, then the full weight of the law is brought to bear on such persons. Madoff is in jail, Stanford is in jail, David Smith is in jail, but no one in the Eastern Caribbean has been brought before the courts for the pain and suffering caused by the collapse of CL. Financial and BAICO. We have the ridiculous situation of the Executive Chairman of CLICO International Life Barbados bringing an action against the Company for non-payment of bonus payments, while policy-holders cannot receive what is due to them.