CHAPTER 12

The Insurance Sector and the Collapse of CL Financial

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The Eastern Caribbean Economic and Monetary Union (OECS/ECCU) has a relatively large insurance sector.[1] Several regional firms based in Trinidad and Tobago and in Barbados have significant market shares. At the end of 2010, 161 insurance licenses (companies and agents) were in place in the region, resulting in 61 insurers of which 39 are general insurers, 9 life, and 1 composite, as well as others (Table 12.1).[2]

The January 2009 collapse of Trinidad and Tobago–based CL Financial Limited (CLF) and related companies caused a major financial shock throughout the Caribbean, but hit the OECS/ECCU region hardest. The collapse has had spillover effects throughout the entire Caribbean (the 15 Caribbean Community states) except in Jamaica and Haiti, leading to costly government interventions, with the highest gross exposure at 15 percent of 2009 GDP in the OECS/ECCU region. CLF's insurance subsidiaries, the Colonial Life Insurance Company (CLICO), CLICO International Life (CIL), the British American Insurance Company (BAICO), and related companies took in funds through deposit-like investment products,[3] as well as through traditional insurance and pension products, and channeled these funds to overleveraged sister companies and real estate developments that lost value sharply during the global economic and financial crisis. The collapse has placed at risk the assets of a wide range of policyholders, including individuals, corporate and public pension schemes, and financial institutions.

The OECS/ECCU region was hit hardest by the collapses of BAICO and CLICO for a variety of reasons.

- The region had the largest exposure as a share of GDP, reflecting in part the small size of its members' economies and the limited domestic investment alternatives (Table 12.2).
- It was exposed to both CLICO, through its arm in Barbados (CIL), and BAICO, a shell company based in The Bahamas, which operated exclusively in the OECS/ECCU and invested primarily in Florida real estate.
- Almost all of the assets were held abroad, beyond the reach of local authorities, except in Saint Lucia, where some assets were held locally.
- A broad range of governments, corporations, financial institutions (particularly credit unions and banks), public and private pension funds, and individuals were exposed.

As a result, OECS/ECCU governments faced the greatest challenges in addressing the collapse, despite having limited fiscal space to respond.

This chapter provides background to the developments that led to the crisis, describes how the crisis evolved, and assesses the business practices and regulatory and supervisory weaknesses that permitted the collapse. It also describes policy responses to date to address the crisis and to prevent

[1] Axco reports as of 2009 indicate penetration levels higher than 10 percent for each country, but these figures reflected the operations of CLICO, CIL, and BAICO in those markets (www.axcoinfo.com).
[2] A single company may hold multiple licenses for different lines of business.
[3] These were known as executive flexible premium annuities.

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TABLE 12.1

OECS/ECCU: Insurance Sector, End-2010

Indicator	ECCU	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines
					Number of companies				
Total licenses	**161**	**20**	**24**	**21**	**23**	**7**	**16**	**27**	**23**
By type									
Life	**24**	3	3	2	4	-	2	5	5
General	**91**	10	15	13	13	4	8	16	12
Reinsurance	**7**	2	1	1	1	-	-	1	1
Composite	**39**	5	5	5	5	3	6	5	5
Total number of companies	**61**	**20**	**24**	**21**	**23**	**7**	**16**	**27**	**23**
By type									
Life	**9**	3	3	2	4	-	2	5	5
General	**39**	10	15	13	13	4	8	16	12
Reinsurance	**3**	2	1	1	1	-	-	1	1
Composite	**10**	5	5	5	5	3	6	5	5
By origin									
Foreign	**31**	14	15	18	16	5	12	20	18
Domestic	**30**	6	9	3	7	2	4	7	5
Memorandum									
(*Millions of EC$*)									
Annual gross premiums written	**849**	41	177	49	98	13	97	216	158
Nominal GDP	**14,286**	739	3,115	1,274	2,116	156	1,818	3,247	1,822

Sources: Country authorities; and IMF staff estimates.

TABLE 12.2

Estimated Exposure to CLICO and BAICO
(*Millions of EC$*)

Exposed Sector	ECCU	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	Saint Lucia	St. Vincent and the Grenadines
Total	2110.6	89.2	504.4	194.9	404.3	87.9	256.8	188.3	384.8
Commercial banks	126.7	45.7	0	37.4	7.2	25.7	5.3	0	5.4
Credit unions	83.8	0	8.8	27.9	9.4	6.6	6.4	0	24.7
CLICO[1]	989.4	18.4	216.0	119.7	158.8	47.5	105.7	149.3	174.0
Commercial banks	83.2	17.0	0	37.4	0	21.9	1.5	0	5.4
Credit unions	27.5	0	1.9	14.7	2.6	0	0	0	8.3
BAICO[2]	1051.3	48.7	288.4	73.8	245.2	23.6	129.0	38.5	204.0
Commercial banks	17.6	6.6	0	0	7.2	3.8	0	0	0
Credit unions	47.8	0	6.9	11.8	6.5	0.6	6.4	0	15.6
Other[3]	70.0	22.1	0	1.4	0.3	16.8	22.1	0.5	6.8
Commercial banks	25.9	22.1	0	0	0	0	3.8	0	0
Credit unions	8.5	0	0	1.4	0.3	6.0	0	0	0.8
					(In percent of 2009 GDP)				
Total	14.8	11.2	15.4	15.0	19.3	54.0	13.8	6.3	21.2
CLICO[1]	6.9	2.3	6.6	9.2	7.6	29.2	5.7	5.0	9.6
BAICO[2]	7.4	6.1	8.8	5.7	11.7	14.5	6.9	1.3	11.2
Other[3]	0.5	2.8	0	0.1	0	10.3	1.2	0	0.4

Source: Country authorities.

[1] As of end-2008, except for Dominica, which is as of March 2010.

[2] As of end-June 2009, according to the November 2009 judicial managers' report.

[3] Includes CLICO Investment Bank, Caribbean Money Market Brokers, and the CL Financial Group.

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a recurrence, and presents key policy lessons about putting in place sturdy regulatory and supervisory frameworks. Appendix 12A describes insurance sector crises and their resolution in Jamaica, the Republic of Korea, and Canada.

HISTORY OF CL FINANCIAL

CLF grew out of the Colonial Life Insurance Company (CLICO) founded in 1937 in Trinidad and Tobago. CLF was created in 1993 as a holding company as the company's operations expanded beyond insurance into other sectors, including energy, financial services, real estate, and the beverages industry. According to the company's 2007 annual report, the last one published, the consolidated assets of CLF were about US$16 billion—equal to some 30 percent of the Caribbean region's GDP.[4] The conglomerate had operations in at least 28 countries through at least 52 subsidiaries and associates in a complex structure (see Figure 12.1). The conglomerate's enormous size made it difficult to supervise and may have contributed to policyholders' sense of security.

Precursors to the Collapse

As CLF expanded into other sectors, a critical source of financing for its expansion, particularly after 2004, was the offer of deposit-like annuity products through its insurance subsidiaries. The products offered returns that were substantially higher than bank interest rates, but the products were not subject to stricter banking regulation and supervision needed for deposit-taking institutions. As described below, the rapid growth in illiquid assets concentrated in such sectors as real estate and energy and financed by comparatively liquid liabilities, and the connected exposures, set the stage for the collapse.

CLF's assets grew by 32 percent during 2005–07 (see Table 12.3). As of end-2007, about 25 percent of total assets were illiquid assets in the form of properties, including investment properties, plant and equipment, and land for development. Among these assets were real estate investments in Florida and petrochemical plants. During 2005–07, property holdings increased by 78 percent.

A significant portion of CLF's liabilities comprised insurance contracts, borrowing, and deposits (Table 12.3). Of particular concern were the deposit-like products called Flexible Premium Annuities and Executive Flexible Premium Annuities. These products were sold for a fixed term of three to five years, paid interest of 8–9 percent (and up to 11 percent for large local currency deposits), with a penalty for early surrender before the instrument matured. By contrast, the ordinary bank savings deposit rate in 2008 in the OECS/ECCU was about 3 percent (Figure 12.2).

CLF sold these annuities, as well as traditional insurance products, throughout the Caribbean through its network of insurance subsidiaries and branches in 22 countries. CLICO affiliates were located in The Bahamas, Barbados, the Cayman Islands, Guyana, Panama, and Suriname. CLICO Barbados and another subsidiary, BAICO Bahamas, operated in all of the members of the OECS/ECCU. CLICO Bahamas operated subsidiaries in Belize and in Turks and Caicos Islands.

Insurance Regulatory Framework

A critical factor in the collapse of CL Financial was the weakness in the regulatory and supervisory framework. Insurance supervision in the OECS/ECCU is under the jurisdiction of national supervisory authorities, and at the time of CLICO's collapse was cursory for the most part, and statutory fund requirements were not adequately enforced, except in Saint Lucia. The 2004 ECCU Financial System Stability Assessment (FSSA; IMF, 2004) had already found that insurance

[4] The conglomerate is privately owned, and more recent financial data, either at a consolidated or subsidiary level, has not been readily available to the public. The Caribbean region in this statement covers all IMF members excluding the Dominican Republic and Haiti.

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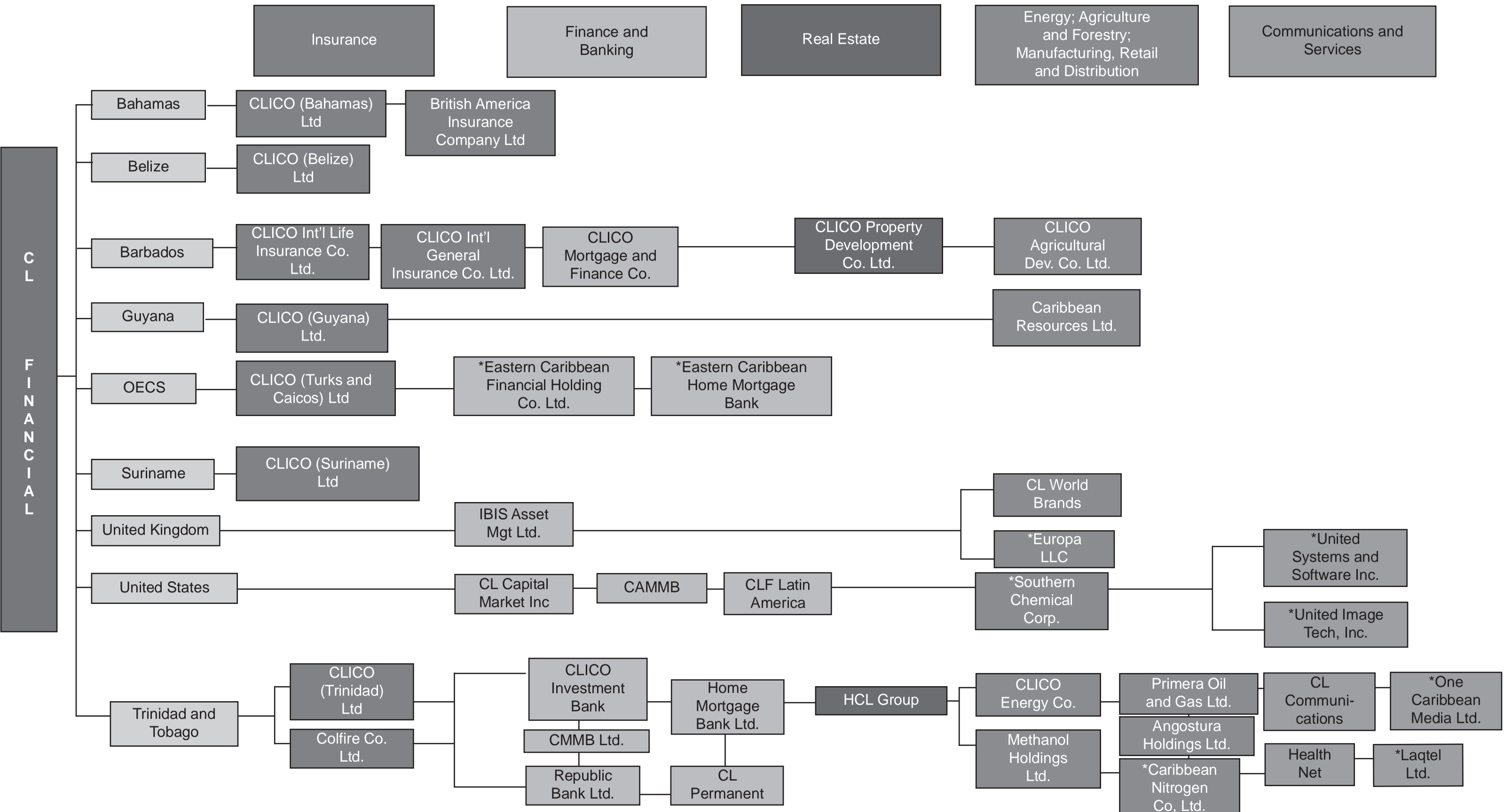

Figure 12.1 CL Financial Organizational Structure, 2007

Source: CL Financial Annual Report 2007 and http://www.clfinancial.com.
Note: * represents associates and joint venture companies.

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TABLE 12.3

Consolidated Balance Sheet of CL Financial

	2005	2006	2007
	(Billions of U.S. dollars)		
Assets	12.1	14.1	16.0
Properties	2.2	2.8	3.9
Loans and advances	2.8	3.2	3.5
Financial assets	3.5	3.7	3.3
Cash	1.1	1.5	1.9
Other	2.4	2.9	3.3
Liabilities	10.9	12.9	14.6
Insurance contracts	1.8	2.2	2.9
Borrowings	1.1	1.3	2.4
Deposits	4.0	4.5	4.7
Other current liabilities	3.1	3.4	3.3
Other	1.0	1.4	1.3
Equity	1.1	1.2	1.3
	(Percentage of total assets)		
Assets	100.0	100.0	100.0
Properties	18.0	20.1	24.8
Loans and advances	23.3	22.5	21.9
Financial assets	29.4	26.0	20.8
Cash	9.1	10.9	11.6
Other	20.2	20.6	21.0
Liabilities	90.5	91.3	91.6
Insurance contracts	15.2	15.6	17.9
Borrowings	8.8	9.5	14.7
Deposits	32.9	31.8	29.7
Other current liabilities	25.4	24.1	21.0
Other	8.1	10.3	8.3
Equity	9.5	8.7	8.4
Memorandum			
Exchange rate (TT$ per US$)	6.3	6.3	6.3

Source: Annual reports of CL Financial Group; and the Central Bank of Trinidad and Tobago.
Note: TT$ = Trinidad and Tobago dollar.

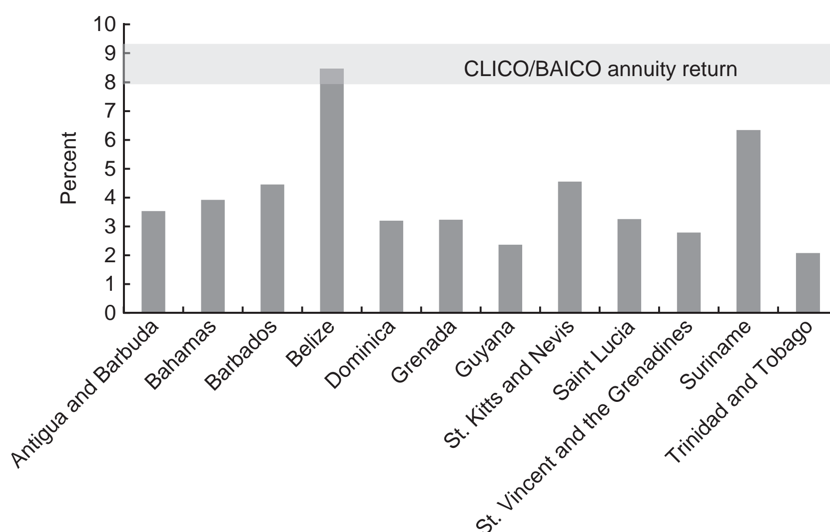

Figure 12.2 Deposit Interest Rates in Selected Countries, 2008

Source: IMF staff estimates.

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regulation was weak, and although a common insurance law had been drafted under the leadership of the Eastern Caribbean Central Bank (ECCB), it had not been enacted by the respective governments. In addition, solvency requirements, powers for inspection and intervention, controls on corporate governance, and internal controls were largely absent from the draft law. Insurance supervision was chronically under-resourced, particularly given the large number of insurance companies, and could not deliver adequate supervision against international benchmarks.

OECS/ECCU members, therefore, depended implicitly on home country supervision, which was weak. BAICO operated as a shell company in The Bahamas and was effectively managed from Trinidad. The insurance sector in Trinidad and Tobago is governed by the Insurance Act of 1966, and the Central Bank of Trinidad and Tobago (CBTT), which took over supervision in 2004, issued guidelines on matters including corporate governance, prudent lending, and claims handling to address shortcomings in the act. Enforcement, however, was constrained by legal challenges to these guidelines and the act. As the 2006 FSSA of Trinidad and Tobago highlighted, the overall legal, regulatory, and supervisory structure for the insurance sector in Trinidad and Tobago was riddled with critical gaps (IMF, 2006). Despite considerable strengthening of financial supervision, the framework was not fully aligned with the evolution of the financial system. Financial sector legislation did not endow regulators with sufficient formal powers to oversee cross-market and cross-border activities or matters such as prudential and market-conduct aspects of the insurance business.

Similar issues hampered home country supervision of CLICO Barbados. A 2009 FSSA update (IMF, 2009) found that limitations in supervision of the insurance sector exposed the sector to material risks, and that profitability and capital adequacy were difficult to assess because of incomplete, late, and inadequate data. Although the regulator had broad legal powers, they were not implemented, and some insurance sector regulations were inadequate.[5] The agency did not make use of its powers, owing partly to both limited resources and forbearance. Moreover, capital requirement rules did not comply with standard actuarial principles. Supervision was weakened by a lack of adequate information and compliance. Companies were allowed significant delays in reporting (more than a year), and penalties allowed by the law were not imposed. No protocols were in place for the exchange of information among domestic or foreign supervisors, which is necessary for consolidated supervision. The FSSA update concluded that the lack of adequate supervision of the insurance sector exposed it to material risks and that single negative events could significantly damage the sector's reputation. As a result of inadequate regulations, staff limitations, and late reporting, the insurance sector was essentially self-regulated.

COLLAPSE AND INTERVENTION

With the deterioration of global economic conditions in 2008, many of CLF's subsidiaries faced liquidity and solvency pressures. Methanol Holdings, one of the largest methanol producers in the world and a big contributor of dividends to CLF, suffered a collapse in methanol prices (Figure 12.3). Real estate investments in Florida held by regional BAICO and CLICO affiliates turned sour (Figure 12.4). As news of CLF's difficulties spread, withdrawal requests from policyholders increased, and shortfalls in the statutory funds of many of its insurance entities became acute.

The Trinidad and Tobago authorities intervened in CLF in January 2009 and announced a financial support package for three domestic subsidiaries: CLICO Trinidad, British American Trinidad, and CLICO Investment Bank. In the announcement, the CBTT identified the key factors leading to the intervention as

[5] The Insurance Act of 1996 in Barbados regulates the domestic insurance sector, with the supervisory agency under the jurisdiction of the Ministry of Finance. The insurance supervisor has broad powers of supervision and enforcement, including seeking information, restricting or directing company actions, and intervening in all aspects of company operations.

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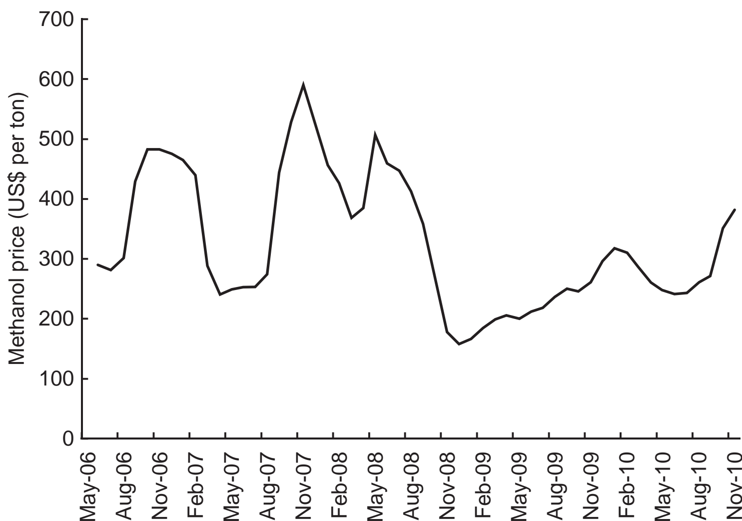

Figure 12.3 Average Cost and Freight Methanol Prices of Major Exporters

Source: Bloomberg L.P.

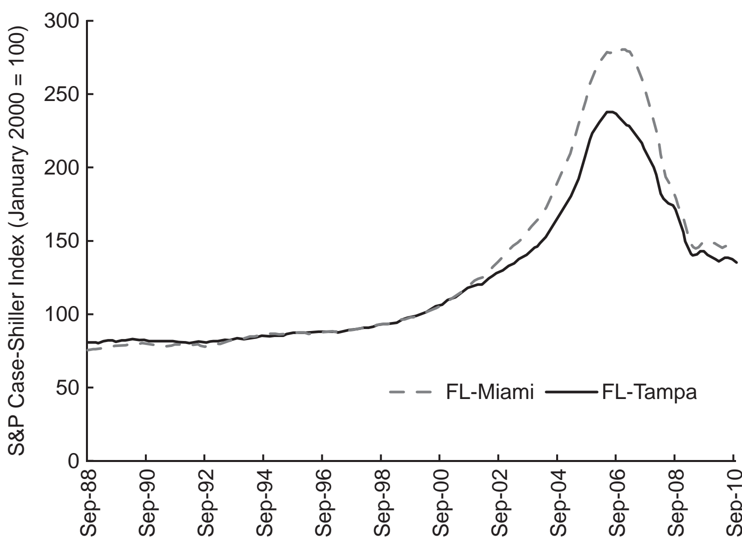

Figure 12.4 Florida Real Estate Price Index

Source: Standard & Poor's.

- excessive related-party transactions, which carry significant contagion risks;
- an aggressive high-interest-rate resource mobilization strategy to finance equally high-risk investments; and
- very high leveraging of CLF's assets, thus constraining the potential amount of cash that could be raised from asset sales.

The CBTT indicated that it was aware of these deficiencies but had been "stymied by the inevitable challenge of change and by inadequacies in the legislative framework which do not give the central bank the authority to demand these changes."[6]

[6] Remarks by Mr. Ewart S. Williams, Governor of the Central Bank of Trinidad and Tobago, for the CIB/CLICO Media Conference, Port-of-Spain, January 30, 2009.

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As part of the Trinidadian government's intervention, an agreement was reached with the shareholders of CLF. Under the January 2009 memorandum of understanding with the government, the shareholders of CLF agreed to take steps to correct the financial conditions of CLICO Investment Bank, CLICO Trinidad, and British American Trinidad by selling CLF's stakes in Republic Bank, Methanol Holdings Trinidad, Caribbean Money Market Brokers, and any other assets as necessary. The CBTT assumed control of CIB; CLF agreed to sell assets to meet the statutory fund requirements for CLICO Trinidad and BAICO Trinidad; and the government agreed to provide loan financing to meet those requirements. The government injected an initial US$191 million. An amendment to the Insurance Act in February 2009 addressed shortcomings in the legal framework by requiring quarterly reporting, by requiring that statutory fund requirements be met on an ongoing basis and not only at the end of the year, by implementing requirements for timely corrective action by insurance companies, and by authorizing information sharing among regulators. It was also announced in February that CIB's third-party deposits would be transferred to First Citizens Bank.

Another agreement was signed in June 2009 under which the authorities gained a greater say in management to ensure that the assets owned by and managed by CLF would provide a source for repaying the Trinidadian government. The new agreement required the appointment of a new Board of Directors of CLF with majority government representation and established an escrow account for the proceeds of any asset sales. The chairman of CLF was replaced shortly thereafter.

CLICO's difficulties were initially perceived to be a liquidity problem that would be resolved as assets were sold and as the economy recovered. The objective stated at the time of the intervention was to "return CLICO to its original moorings."[7] Annuity holders were encouraged by the authorities to roll over policies, and payouts were made to the extent possible.

In June 2010, the new Trinidadian government elected in May announced that repaying principal only to CLICO policyholders would require a further injection of capital. It charged a Select Committee with recommending a preferred solution for the repayment of CLICO's traditional and nontraditional insurance liability products; a financial reorganization plan for CLF that demonstrated financial stability and ensured full satisfaction of commercial and intercompany debt; and a clear path and timetable for how the government would exit its loan capital position and restore public confidence.

In line with the committee's recommendation, the September 2010 budget speech announced a restructuring plan that would pay all investors in full up to a threshold similar to that for bank deposits (TT$75,000 or about US$12,000) and pay the remainder over 20 years with no interest. Payments by CLICO to holders of nontraditional annuity products stopped at that time. The traditional insurance businesses of CLICO and BAICO in Trinidad and Tobago would be combined and divested. The plan to restructure payments met strong opposition from policyholders and after a review, was modified to provide a liquidity support window for credit unions and a compassionate window for vulnerable individuals. The government mostly completed paying all CLICO claims up to the threshold (TT$75,000 or about US$12,000), but following public debate and legal actions it developed an alternative treatment for the remaining claims. The 2011/12 budget announced a revised plan that offers the option to swap the bonds coming due in years 11 to 20 for equity in a trust that will hold key assets such as shares in Republic Bank. In addition, Parliament has passed an amendment to the Central Bank Act that would prevent CLICO claimants from suing to enforce their claims.

[7] Remarks by Mr. Ewart S. Williams, Governor of the Central Bank of Trinidad and Tobago, for the CIB/CLICO Media Conference, Port-of-Spain, January 30, 2009.

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SPILLOVER EFFECTS ON THE OECS/ECCU

The collapse of CLF had large spillover effects on the OECS/ECCU region through CLICO Barbados and BAICO Bahamas. The flow of funds from the OECS/ECCU through BAICO Bahamas and CLICO Barbados before the crisis was largely in one direction—funds were taken in locally and the corresponding assets were, for the most part, held elsewhere.

Following CLICO Barbados's liquidity difficulties, the government of Barbados intervened in February 2009 to provide liquidity. The Central Bank of Barbados deposited US$5 million into the mortgage subsidiary and provided access to a special credit window in the event that additional liquidity was needed. An oversight committee was set up to conduct the resolution process. The mortgage and general insurance businesses have been sold, but the life insurance company faces a significant shortfall. In December 2010, the Barbadian government requested the appointment of a judicial manager for CLICO Barbados; this appointment became effective in April 2011.[8] The judicial manager tabled a range of restructuring options in September 2011, and work is proceeding on a resolution plan that addresses the statutory gap in CLICO Life while protecting small individual investors. The fiscal costs of such a plan would be bound by CLICO Life's net liabilities of 3¼ percent of GDP and would ultimately depend on the extent to which liabilities to larger investors are guaranteed. Because CLICO Barbados operated in the OECS/ECCU through branches, the key decisions are being made in Barbados in consultation with the Regional Advisory Group, which includes representatives from the OECS/ECCU, the Caribbean Development Bank, and Barbados. The judicial manager has begun the process of identifying potential investors in CLICO Life and has requested a forensic audit to trace assets.

BAICO's branches in the OECS/ECCU were placed under judicial management between July and September 2009, and a judicial manager for BAICO Bahamas was appointed in September 2009. Trinidad and Tobago contributed US$50 million through its Petroleum Fund toward the resolution of BAICO. However, progress has been slow. The attempt to set up a new company to take over BAICO's assets and liabilities, predicated on Trinidad and Tobago's financial contribution, faced major challenges, and as a result the OECS/ECCU governments announced a new strategy in February 2011. This strategy contemplated a phased approach, including (1) the setting up of a health fund to provide relief to health policyholders (effective May 2011); (2) the sale of the traditional business (which was announced in June 2012); and (3) relief for nontraditional policyholders, depending on financial support available from Trinidad and Tobago.

POLICY RECOMMENDATIONS

Strengthening the legal and regulatory framework to avoid a repeat of the experience with CLF is essential. Country experience shows that good supervision matters. For instance, the stronger framework Jamaica put in place after its crisis in the 1990s discouraged CLICO from entering its market and successfully insulated the country from the CLF crisis (see Appendix 12A). In addition, in Saint Lucia, CLICO's and BAICO's statutory fund deficits were significantly smaller than in other OECS/ECCU countries, reflecting Saint Lucia's stronger supervisory regime. More broadly, a key lesson from the international financial crisis is to prevent the creation of complex entities that undermine supervision and transparency. This section provides policy recommendations for strengthening the legal and regulatory framework.

The quality of insurance sector supervision can be assessed against internationally established and accepted "core principles" (see Box 12.1). The supervision of nonbanks, including insurance companies, is not unlike the underlying principles for the supervision of commercial banks. The

[8] CLICO branches in some OECS/ECCU jurisdictions (St. Kitts and Nevis and Saint Lucia) were placed under judicial management but others still have to follow suit.

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BOX 12.1 Core Principles for Effective Insurance Supervision

According to the core principles established by the International Association of Insurance Supervisors, effective supervision of the insurance sector requires

- an appropriate policy, institutional, and legal framework;
- a supervisory authority with adequate powers, legal protection, and financial resources; operational independence; adequate capacity; transparent operations; the ability to undertake group-wide supervision; and capacity for market analysis;
- sharing of information with other supervisors domestically and abroad;
- clear, objective, and public licensing, with fit and proper owners, board members, and management;
- supervisory authority to approve or reject significant changes in ownership, and a corporate governance framework that recognizes and protects rights of all interested parties;
- insurers with adequate internal controls, risk management, reinsurance, and tools to establish adequate premiums;
- effective reporting, off-site monitoring, and on-site inspections;
- preventive and corrective measures that are timely, suitable, and necessary, and enforcement of corrective actions and sanctions;
- a range of options for orderly exit of insurers from the market;
- adequate technical provisions;
- investment standards including requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management;
- standards on the use of derivatives;
- capital adequacy requirements with suitable forms of capital that enable the insurer to absorb significant unforeseen losses;
- requirements for the conduct of intermediaries; and requirements for consumer protection, including timely, complete, and relevant information to consumers both before and after a contract is signed;
- disclosure of relevant information on a timely basis to stakeholders; and
- measures to prevent, detect, and remedy insurance fraud and to deter, detect, and report money laundering and the financing of terrorism.

overarching criteria for effective supervision of nonbanks are similar to the regulatory powers expected in banking supervision:

- an effective legal framework;
- rigorous licensing powers and powers to revoke licenses;
- powers of investigation such as on-site examinations, reporting, and off-site supervision;
- effective corrective and preventive measures; and
- enforcement powers, including the power to request the subscription of additional capital.

Among these general principles of effective insurance supervision, the CLF collapse underscores the particular importance of several factors in light of cross-border activities:

- Systemic oversight. The country-based structure of insurance supervision in the OECS/ECCU has proved inadequate to oversee regional and potentially systemic companies.
- Regional cooperation. Regulators can get a complete picture of insurance companies operating in many jurisdictions only through extensive sharing of information. To this end, an agreement was reached at the thirtieth meeting of heads of state of the Caribbean Community in July 2009 to create a College of Regulators to share information regularly to address cross-border financial issues and to provide for consolidated supervision—both cross-border and cross-functional.
- Trusteeship. An especially difficult aspect of the CLF experience was that liabilities and assets were in different jurisdictions. For protection to be meaningful, assets should be

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under the control of a trustee—for instance, a domestic commercial bank. However, the authorities should retain the option of recognizing foreign resolution measures.

The cross-border aspects of CLF's resolution have raised a number of issues. There is a need to improve legal frameworks for insurance resolution and establish procedures for coordination with nonregional resolution proceedings. Other issues include whether the existing court-based procedures should be reorganized as administrative procedures; how the resolution tools may be strengthened, by addressing, for example, the procedures for changing contractual terms without retroactive effects, debt restructuring, official administration, and resolution transactions; and whether to create policyholder protection funds.

The OECS/ECCU countries are mindful of the need to strengthen insurance regulation and supervision. The Monetary Council, at its meeting in October 2011, approved the principle of a consolidated insurance sector and the implementation of enhanced regulations and prudential requirements. The main areas of focus follow:

- Enhance systemic oversight. The countries have agreed to set up a regional insurance supervisory authority to enhance the supervision of systemic insurers. Since the collapse of CLICO/BAICO, supervision efforts have focused on enforcing statutory funds requirements in all the islands; although this is a welcome development, it does not permit effective supervision of systemic insurers and their interconnectedness with the wider financial system. Thus, a regional supervisor has been agreed to in principle, but its detailed responsibilities need to be carefully fleshed out because countries wish to maintain supervision at a country level. It will be critical to ensure that the regional authority has enough supervisory powers, legitimacy, and resources to carry out its missions.
- Revamp the insurance law. The OECS/ECCU countries have agreed to revise the model Uniform Insurance Act to make it more consistent with the International Association of Insurance Providers' Insurance Core Principles and to give a legal basis to the regional supervisor. The governments of the member countries will have to move much more quickly if they want to adopt uniform legislation that reasonably complies with international standards and best practices.[9] In addition, the insurance act must be consistent across all the islands, with no gold-plating from national jurisdictions.
- Consolidate the industry. The OECS/ECCU countries have too many insurance companies for supervision to be performed effectively. It is probable that some insurers are not truly professional underwriters and are not providing adequate value to policyholders.[10] There is a debate about whether industry consolidation should happen naturally as a result of the enforcement of more stringent regulations, or under a more direct approach. In any case, the current structure of the industry is not sustainable from a supervisory point of view.

CONCLUSION

The collapse of CLF has had a devastating impact on the OECS/ECCU region, and has been costly to governments, public and private pension schemes, bank and nonbank financial institutions, and individuals. The cost could be as high as 15 percent of the OECS/ECCU's 2009 GDP. Although the resolution of the crisis is nearly complete in countries with smaller exposures, it is

[9] The Uniform Insurance Act was first drafted in 1995. As of 2011, two OECS/ECCU members had adopted it.
[10] With 161 registrants and a total premium of only EC$849 million (US$315 million), the average premium is less than US$2.0 million per registrant. Whether serious, professional insurance companies are interested in maintaining a presence within the region based on an average premium of less than US$2.0 million per company per license is questionable.

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still ongoing in the OECS/ECCU and other countries with larger exposures, that is, Trinidad and Tobago and Barbados.

The crisis was caused by rapid growth in illiquid assets through connected exposures financed by comparatively liquid liabilities. The inadequate legal and supervisory framework provided supervisors with insufficient authority to address these issues. The OECS/ECCU authorities relied excessively on home country supervision. The OECS/ECCU and other Caribbean authorities have substantial work ahead to address the remaining challenges, including completing current crisis-resolution efforts and strengthening the regulatory and supervisory framework. Also, to allow for effective regulation and supervision, more regional cooperation is needed and some consolidation of the sector is warranted.

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APPENDIX 12A. PARALLELS WITH PREVIOUS INSURANCE CRISES

The collapse of CLF differs from previous insurance sector crises in the extent to which it crossed jurisdictional boundaries to affect a large number of countries. However, there are many parallels with previous crises that provide a useful context for understanding why CLF collapsed and how to avoid a future crisis.

Jamaica

Insurance companies played a key role in triggering the second stage of the Jamaican financial sector crisis during the late 1990s. Life insurance companies offered new insurance products, known as investment or lump-sum policies, which enabled them to take deposits disguised as insurance premiums. Only a small portion of deposits went toward insurance coverage, while the majority was used to invest in real estate, stocks, bonds, and securities. The interest paid to depositors was unrelated to the performance of insurance company assets. Rising interest rates brought the maturity mismatch of assets and liabilities into the open, as insurance companies borrowed from connected banks.

In 1996, a group of chief executive officers of life insurance companies approached the government for help with what they described as liquidity problems. Further examination revealed that there were, in fact, insolvency problems to various degrees, and moreover, that the banking sector was also affected through linkages within conglomerates. Almost 500,000 policyholders and more than 2 million depositors were at risk. The government announced that it would bear the losses of covering the total exposure of depositors, life insurance policyholders, and pensioners. The bailout of the banking and insurance sectors led to a partial nationalization of the domestically owned financial sector at a cost of more than 40 percent of GDP.

The government established a new institution in 1997, the Financial Sector Adjustment Company (FINSAC), that had the objective of restructuring, merging, and recapitalizing financial institutions. FINSAC took ownership stakes in five commercial banks, seven insurance companies, three building societies, and three investment banks. In each case, FINSAC purchased ownership stakes of at least 25 percent to obtain veto power over management decisions, and in some cases FINSAC took over management of the institutions.

The government also pushed through a number of reforms to strengthen financial sector supervision. These reforms led to the establishment of the Financial Services Commission in 2001. Apparently as a result of these reforms, CLICO and BAICO chose not to operate in Jamaica, which was therefore unaffected by the CLF crisis.

Republic of Korea

In 1997, the Republic of Korea faced a systemic collapse of its financial sector not limited to insurance. Eighteen life insurers were found not to meet regulatory requirements by the end of 1997. Both life and general insurers had been encouraged to become shadow banks, partly to fund their chaebol (conglomerate) parents. The Asian financial crisis then exposed the chaebol balance sheets and those of their creditors, a number of which had also engaged in risky real estate investments.

Korea's Financial Supervisory Commission (FSC) asked these 18 life insurers to submit rehabilitation plans. Immediately following assessment of the plans, four seriously undercapitalized life insurers were ordered by the FSC to close their businesses and had their policy contracts transferred immediately to other large insurers. Although the Korea Deposit Insurance Corporation (KDIC) provided 925 billion won of financial assistance to these acquirers to top up losses, partly because contracts were transferred without changing their terms, one acquirer

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became insolvent within two years. The remaining 14 insurers were required to submit further detailed plans or memoranda of understanding to the FSC to revamp their businesses, but seven more of them became insolvent in 1999. These seven insurers were nationalized by the KDIC writing off all existing capital. The nationalization of Daehan Life, the third-largest life insurer, was set aside by the courts because of procedural violations. By redoing nationalization and acquiring four insolvent life insurers, financial assistance to Daehan Life reached 4.8 trillion won by June 2003. Furthermore, in 2000 the collapse of a conglomerate, Daewoo Group, hit Seoul Guarantee Insurance, which held a significant amount of its corporate bonds, and the KDIC provided 4.6 trillion won to compensate for losses in those corporate bonds.

A critical feature of insurance resolution in Korea during the Asian financial crisis was that a failed insurance company was often first nationalized by the KDIC and then resolved by merger or transfer of insurance contracts. Seven out of 14 failed insurance companies from 1998 to 2003 were actually resolved by nationalization. Despite statutory limitations on the amount of policyholder protection, all insurance contracts were fully protected until 2000. These resolution actions were funded by the KDIC through financing from markets under government guarantees and other state financial support. The insurance sector received more than 19 trillion won by 2004 from the KDIC, mostly in the form of capital injections to failed insurance companies and their acquirers. The key principles adopted in using public money for resolution under the Public Fund Oversight Special Act were (1) to minimize the use of public money and maximize its efficiency (Article 13(1)), (2) to impose losses on parties responsible for the failure of financial institutions in an equal and fair manner (Article 14(1)), and (3) to encourage self-restructuring of financial institutions. A key regulatory outcome was that insurers must comply with solvency margin requirements and be subject to prompt corrective action plans based on the level of their solvency margin ratios.

Canada

Confederation Life of Canada entered liquidation in August 1994, following large losses in its real estate and mortgage portfolios. Confederation Life was a life insurance company with 1.8 million Canadian policyholders. It also had operations in the United States and the United Kingdom. At the end of 1993, 71 percent of its assets of US$14 billion were in real estate and mortgages.

Failed rescue attempts had been made by another company in 1993 and by the six leading Canadian life insurers in 1994. Regulators became concerned that public apprehension about the company could lead to a wave of withdrawals and cancellations, with potential systemic implications. The liquidator ultimately determined that the company was not, in fact, insolvent. No policyholders incurred losses, and the cost to the industry-financed compensation fund was only Can$5 million (about US$4 million).

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