Colonial Life Insurance Company Limited - From Growth to Failure: An Analysis of Reported Financial Activity 2003-2008

Gordon, Leo-Rey

Wilmington University

December 2013

Colonial Life Insurance Company Limited - From Growth to Failure

An Analysis of Reported Financial Activity 2003-2008

Dr. Leo-Rey C. Gordon
Assistant Professor
College of Business
Wilmington

December 2013

Abstract

The collapse of Colonial Life Insurance Company (Trinidad) Limited caused one of the most significant financial events in recent history in the Eastern Caribbean region. The significance of the groups collapse warranted the establishment of a commission to gather information on its root causes. There is however still uncertainty in much of the detail of CLICO's operations. This paper utilizes evidence presented in the national commission of enquiry of CLICO's collapse and other associated financial documents to discuss the reported financial activity of the group between 2003 and 2008. The analysis shows investments in unproductive asset expansion, declining income, bleeding cash positions over the period, and a business structure unlike a typical insurance company. The paper provides useful analysis for those in need of information regarding the failure of the region's most prominent firm.

Acknowledgement: This study was made possible by the Council of International Exchange of Scholars - Core Fulbright U.S Scholars Program. Thanks to Mr. Wayne Charles-Soverall for much discussion on related issues.

Keywords: CLICO; Financial Analysis; Insurance

Introduction

Prior to the bankruptcy and collapse of Colonial Life Insurance Company (Trinidad) Ltd. and it's holding group CL financial, the conglomerate was the largest of the Caribbean region. The speed of ruin of the organization took policy makers and stakeholders by tremendous surprise, the consequence of which was wide spread amongst others leaving thousands unemployed. The significance of this event is highlighted by the Commission of enquire called by the government of Trinidad and Tobago into the failure of CL financial.

The commission and others (Soverall & Persuad, 2011; Soverall, 2012) attempt to understand and document some of the fundamental causes for the group's demise. A host of factors have been put forth ranging from week corporate governance, an overly leveraged capital structure, excessive interrelated party transaction, and a Ponzi scheme type business model for the financing and repayment of intra-group investments.

This paper presents an analysis of the reported financial activity of Colonial Life Insurance Company Limited (CLICO) over the period 2003 to 2008. It utilizes the witness statements made during the commission of enquiry (Republic of Trinidad and Tobago, 2013a, 2013b, 2013c, 2013d), the published annual reports of CLICO (CL Financial Limited, 2007; CLICO, 2005, 2006;, 2012, 2013; PricewaterhouseCoopers, 2005) , and the 2011 independent auditor's report of KPMG (KPMG, 2011), to present the major characteristics of CLICOs business activity.[1]

[1] The scope of the paper is limited to objective deductions that can be made from the publicly available reports and refrains from any exposition of subjective theories or opinions on the reasons for CLICO's eventual collapse.

The study unveils some clear and common themes. CLICO demonstrated significant business growth with its asset size more than doubling over the time period. This growth did not however materialize in subsequent income generation. In fact CLICO's business growth resulted in declining profitability. In addition, CLICO's asset expansion often required twice the amount of cash than that generated from operations. The company demonstrated no free cash available to security holders, relying predominantly on cash from debt issuance to finance its business growth.

Finally, after the bailout of CLICO it was made evident that the company operated more as an investmenet firm than one specializing in insurance. The external audits reclassified more than 50% of CLICO's existing insurance contracts as investment contracts. This reclassification resulted in a capital structure unlike other regional insurance competitors with the a revaluation of assets of less than half thought prior. The paper demonstrates these findings in detail in the sections below.

CLICO's Business Growth

CLICO[2] demonstrated strong business growth by the expansion of over three billion dollars in assets each year between 2003 and 2007[3].The company's yearly asset growth was attributable to growth in investments in associates and in cash positions. Total assets grew by $12.5 billion in five years from $9.525 billion in 2003 to $22.010 billion in 2007. Five billion in asset growth was derived in one year alone between 2003 and 2004. During this time cash flow increased by $2.181 billion.

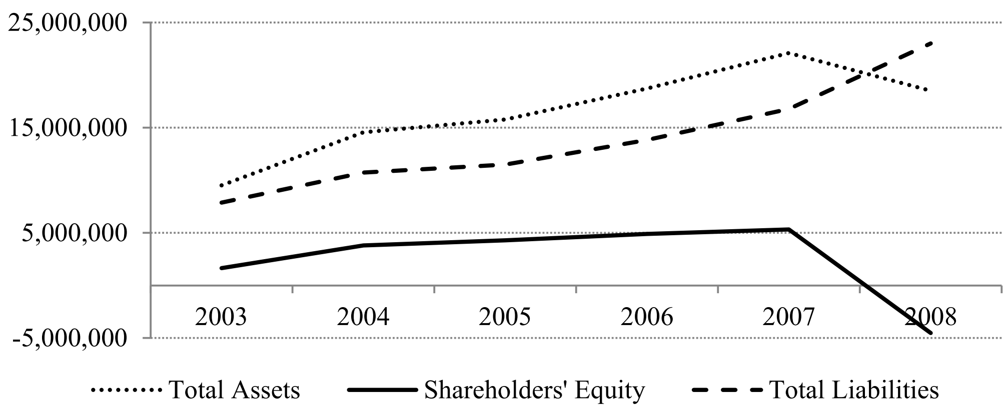
The growth in CLICO's total asset base was not equally spread across its various asset items, but asset growth was disproportionately represented by holdings in associated companies.

---

[2] See Soverall (2012) and International Monetary Fund (2011) for descriptions of the holding group, business operations and structure.
[3] All currency will be quoted in Trinidad and Tobago dollars.

The table below demonstrates the significance of each line item in CLICO's asset growth. More specifically it presents the abosolute change in the value of each major line item as a share of the change in total asset base. Figure 1 below presents this trend in CLICO's financial position.

Figure 1. CLICO Financial Position ($000's)



Changes in property, plant and equipment generally acounted for a minor portion of asset growth. This is with the exception of 2005 in which 16.8 percent of total asset growth in that year was attributable to this category. In this year the value of land and buildings more than doubled from $93 million to $269 million due to its revaluation and the reported transfer of investment properties.

Table 1. Change in Asset Items Relative to the Change in Total Assets (%)

	2004	2005	2006	2007	2008
Property, plant and equipment	0.4	16.8	1.6	1.8	-0.5
Investment properties	0.6	9.1	2.7	1.6	-1.3
Investment in associates	67.4	29.9	37.5	34.4	-2.5
Investment in subsidiaries	0.0	0.2	1.0	3.5	0.9
Financial assets – available-for-sale	-1.7	-28.9	24.5	32.5	-31.0
Due from related parties	0.6	51.4	-3.6	24.2	62.9
Loans and receivables	0.0	37.4	-0.8	7.3	-14.9
Cash and cash equivalents	43.4	-34.3	21.1	19.5	-113.8
Absolute change in Total Assets ($000's)	5,029,908	1,225,402	2,963,007	3,355,615	-3,583,294

The value of other forms of property such as furniture, equipment, and motor vehicles stayed relatively steady. The holding of investment property showed a similar trend. It accounted for only minor changes in total assets yearly, with the exception of in 2005, in which there was the addition of $164 million in investment property to the existing $147 million worth. This investment property holding was reported as predominantly used for rental income.

Financial assets for sale, financial positions due from related parties, and cash equivalents accounted for significant shares of CLICO's growth but demonstrated major swings yearly. Though CLICO demonstrated a general increase in asset holdings, some categories showed a significant fall in value during the period. For example between 2005 and 2008 debt and equity holdings fell by $353 million and $1.111 billion respectively. In 2005 this was represented through a fall in equity holdings from $602 million in 2004 to approximately $366 million in 2005. While in 2008 $855 million was written off as an impairment loss. Cash also demonstrated significant swings increasing from $1.658 billion in 2003 to $3,839 billion in 2004, and falling from $4.697 billion in 2007 to $618 million in 2008.

Increases in amounts due from related parties did however represent a significant proportion in the increases in total assets. In 2005 that due from related parties increased from $288 million to $918 million in 2005. This change was predominantly from an increase of $498 million due from its parent company, CL Financial, and an additional $251 million due from its associate Methanol Holdings. Even though there was a decline in total asset value between 2007 and 2008 the value of that due from related parties more than doubled from $1.622 billion to $3.877 billion. This increase was accounted for by increases in amounts due from its holding company from $284 million in 2007 to $2.655 billion in 2008. An additional $5.839 million was reported as being due from CLICO's subsidiaries and other companies under CL Financial umbrella.

Asset Impact of Forensic Audit

In 2009 a forensic audit of CLICO's financial positions was conducted for the prior two years. During this audit a significant amount of assets were written off as being impaired. The basis of such write-off would include:

"Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the Company about the following events:

i. Significant difficulty of the issuer or debtor

ii. A breach of contract, such as a default or delinquency in payments;

iii. It becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganization;

iv. The disappearance of an active market for that financial asset because of financial difficulties; or

vi. Observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Company" (KPMG, 2011)

The audit significantly impacted the value of assets derived through credit and reported income. In 2008, \$855 million in investments securities, \$3.454 billion due from related parties, and \$899 million in loans was written off as impaired. These included \$2.539 billion of fixed deposits and \$497 worth of corporate bonds associated with CLICO Investment bank and a further \$2.304 billion of current account assets in 2008.

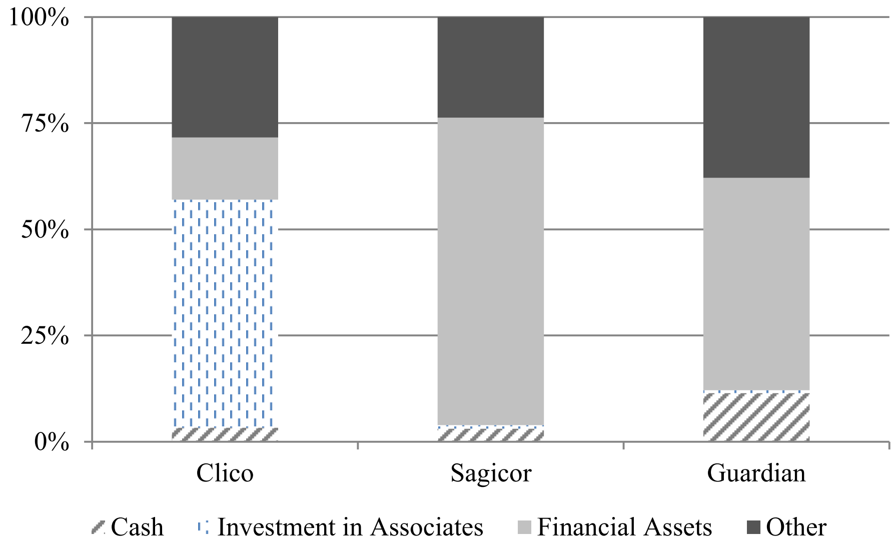
Composition of Asset Holdings

Movement in cash and equivalent holdings, financial assets, and investments in associated companies accounted for the majority of the change in CLICO's asset base. In 2004 cash holdings predominantly took the form of short-term deposits maturing in less than 3 months ($2.130 billion). A further $1.515 billion was held in deposit accounts maturing in more than three months, while a further $193 million was held in cash deposits. The majority of CLICO's cash holding ($3.232 billion) was held with CLICO Investment Bank.

Investments in associated companies accounted for the majority of CLICO's growth in assets between 2003 and 2008. In 2005 alone CLICO reported investments in 13 associated companies ; reporting investments in 15 associated companies by 2008. The largest investments in associated companies were those associated with Republic Bank Ltd. and Methanol Holding Trinidad. These investments accounted for thirty two percent and forty nine percent of company shares, which was equivalent to $4.681 billion and $2.016 billion in assets respectively. Other significant investment in associated companies included a twenty nine percent shareholding in Caribbean Communication Network worth $138 million, and thirty two percent shareholding in Angostura worth $335 million.

By 2008 the reported asset value of investments with associated companies stood at $9.954 billion, 54% of its asset base. This allocation of asset holdings is unlike other insurance business models generally observed. Sagicor Financial Corporation and Gaurdian Holding Ltd. are used for comparisons (Guardian Holdings Limited, 2008; Sagicor 2005, 2008). Both are regional industry competitors and are comparable in size to CLICO with $25 billion and $23 billion in assets respectively. The figure below provides the major asset composition for each of the three firms.

Figure 2. Asset Composition in 2008



CLICO's proportion of investments in associated companies contrasts that of the comparison group. Investment assets in associated companies for both Sagicor and Guardian were less than 1% of their total asset base. Sagicor and Guardian primarily held bonds and securities. In the case of Sagicor, financial assets accounted for 72% of total assets. Guardian's investment in financial asset stood at 50% of total assets, but demonstrated a significant share of cash holdings. CLICO's reported holding of financial assets not affiliated with associates accounted for only15% of its total asset base.

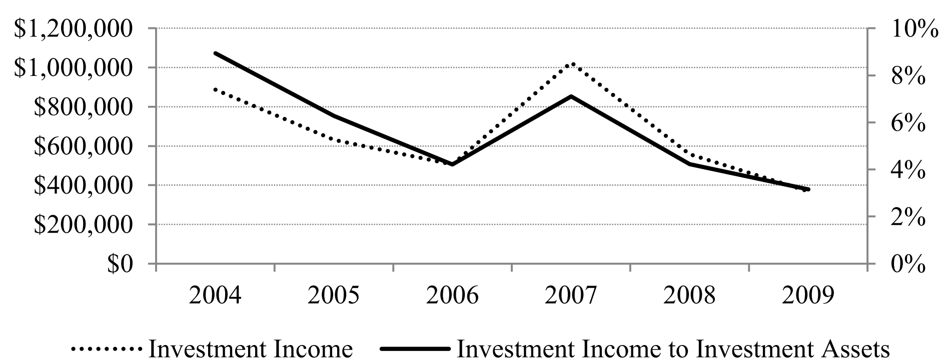
CLICO demonstrated tremendous growth in firm size. This growth predominantly took the form the financing of its associated companies. Investments in associates and balances due from related parties would account for 68% percent of all company assets in 2008. Subsequently, audited reports of the balances with related companies resulted in an evaporation of almost all of CLICO's cash holding deeming the company insolvent. With this tremendous company growth focused primarily through growth in related companies CLICO's utilization of these assets for income generation is next examined.

The utilization of asset for income

The purpose of business growth is for the creation of additional revenue. CLICO's asset size more than doubled between 2003 and 2008 by predominantly investing in associated companies. The level of income and subsequent cash flow reported from these investments is next discussed. Attention is first placed to the extent of income associated with its investment acitivities. Figure 3 shows CLICO's investment income and investment income as a share ot investment assets.

CLICO demonstrated volatility in its investment income stream. Generally, CLICO had a declining level of investment income over the time period with notable spikes of $884 million and $1.025 billion in 2004 and 2007. When assessed relative to CLICO's asset base however we see a general downward trend in investment income relative to investment assets. Investment income fell from 9.1% of investment asset value in 2003 to less than half that amount in 2008. Here we see that the growth in investment assets did not result in growth in investment income.

Figure 3.



Investment assets is the sum of investment properties, associates, subsidiaris, and financial assets

The table below presents the reported sources of investment income. CLICO demonstrates a slight shift in these sources over the time period. In the years 2003 and 2004 short term deposit income accounted for a significnat share of investment income summing to 40% and 60% of total income in these years. Income earned from cash and deposits subsequently fell to under 10% of investment income in the remaining years. Interest and dividend income from company securities accounted for the majority of investment income. CLICO's best year for income derived from security holdings was in 2007 in which $525 million was earned. The level of investment income received from government securiteies, loans, and other forms of investment were general steady over the period. These categories accounted for approximately 20% of income revenue earned.

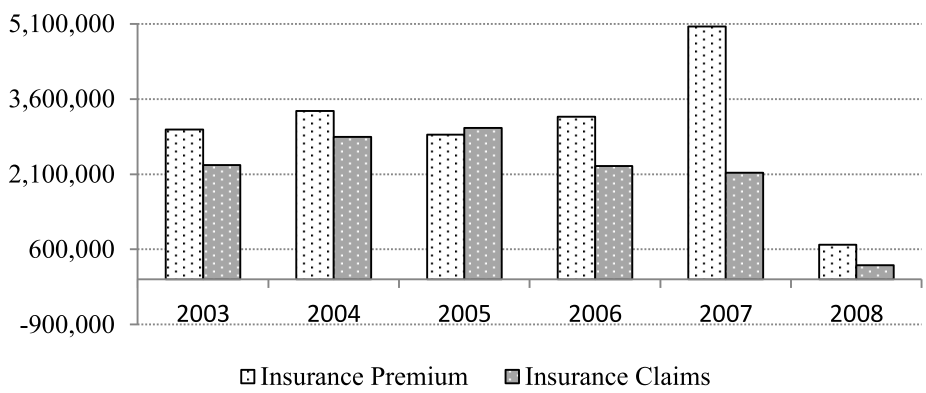
Table 2. Investment Income by Asset Type ($000's)

	2003	2004	2005	2006	2007	2008
Cash and Deposits	321,862	702,946	74,926	44,011	100,289	3,103
Company Securities	335,477	191,388	428,733	331,706	525,813	428,628
Government Securities	98,808	94,194	109,343	89,466	85,457	77,917
Loans	9,672	6,573	6,903	5,347	5,729	5,545
Other	42,014	184,807	10,871	24,952	22,296	6,647

CLICO reported yearly asset growth predominantly through transactions with associated and subsidiary companies. Even tho there was yearly expansion in investment assets, income associated with these assets remained flat over the time period. Further when assessed relative to the level of investment assets, investment income performance fell over time. CLICO also demonstrated significant cash outflow for investements in affiliates and other non-affiliated investment porperties. Looking beyond income from investment assets, what was CLICO's general income and cash flow gerenation from its total asset base?

Betweeen 2003 and 2006 CLICO demonstrated a relatively flat level of revenue from insurance premiums. This trend equated in an average yearly growth rate of 1.9 percent in insurance premiums. Revenue from insurance premiums increased tremendously however in 2007 climbing to $5.047 billion, one and half times the previous year.

Figure 5. Insurance Premiums and Claims Over Time ($000's)



Based on insurance premiums CLICO demonstrated flat top line sales performance. Bottom line income, net income after taxes, was also generally flat over the time period. The average level of net income after taxes was $65.4 million. The trend in net income did show some outliers the largest of which was between 2003 and 2004. Net income after tax increased by $27.5 million, more than half of its 2003 value. Conversely between 2005 and 2006 there was a decline of $28.8 million, equivelent to approximately half of the subsequent value.

The forensic reports reclassified portions of CLICO's insurance products as investment products. Insurance premiums in 2008 subsequently demonstrated a stark contrast from the previous year, falling in value to only $695 million. The reclassification debited $4.656 million of insurance premium revenue and subsequently associated sums with investment contracts. The forensic report also impaired a significant portion of CLICO's assets, this impairment created a total of $6.099 billion in impairment expense in 2008.

Table 4. Net Income after Tax ($000's)

	2003	2004	2005	2006	2007	2008
Net Income After Taxes	46,603	74,196	79,750	50,864	75,784	-9,850,179
Net Income After Taxes to Assets	0.49	0.51	0.51	0.27	0.34	-53.20

Table 4 above shows that that CLICO's net income was flat over the period and its return on assets never exceeded 1%. Between 2003 and 2007 CLICO's return on assets averaged 0.42 percent. This income performance matched that of Guardian which demonstrated return on assets of only 0.9%, but was still lower than industry average.

CLICOS annual reports between 2003 and 2007 demonstrated flat net insurance revenue, declining investment income, but still steady increases in asset purchases. CLICO's generally flat level of investment income between 2003 and 2008, coupled with expansive asset growth, resulted in falling investment asset performance. CLICO continuously earned less investment income relative to the value of its investment assets and general low profitability ratios. The following section outlines CLICO's activity relating to the yearly generation and use of cash.

Cash Flow

CLICO's cash expenditure associated with investments progressively expanded between 2003 and 2007. Over this time period the company demonstrated net outflow of cash for investments in excess of $3.746 billion. This cash outlflow for investment was paritcularly high in 2003, 2006, and 2007. In 2003 net cash used for investment topped 11% of the value of assets. CLICO's 2007 net cash outflow from investment activity was valued a $1.033 billion, just under 5% the value of company assets.

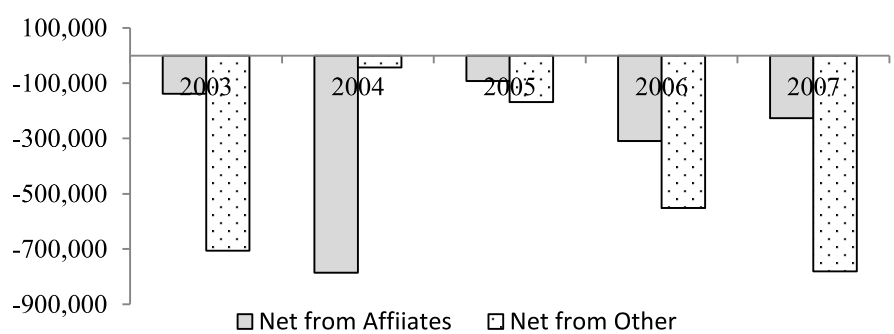
The major use of cash for investment was associated with the purchase and sale of "affiliated or other investment assets".

Table 3. Cash Flow from Investing ($000's)

	2003	2004	2005	2006	2007	2008
Net cash from Investment	-1,112,193	-340,190	-315,474	-945,600	-1,033,472	1,656,121
Net cash from Investment to Total Assets	-11.68%	-2.34%	-2.00%	-5.04%	-4.68%	8.94%
Net Cash from Operations	906,854	596,173	419,215	-573,433	3,094,423	-4,230,304

The graph below demonstrates the yearly net cash flow from the of these proceeds. There was net purchases of investment assets in most years. Over the time period CLICO's always demonstrated an outflow of cash with affiliates and other non affiliates. On average, yearly cash flow associated with the purchase or sale of investment property was $310 million summing to a total of $1.550 billion over the five year period. This net cash flow of investment properties not attributable to associates was $450 million totalling $2.249 billion over the five year period. In total net cash outflow associated with net purchases of investment property alone was 1.5 times accumulated net income after taxes over the time period.

Figure 4. Net Cash from Investment Associated with Affiliates ($000's)



Sound business activity should generate cash available for secturity holders. This can be measured as net cash flow after operating and investment activity. Figure 6 below presents this measure. CLICO did not demonstrate consistency in net cash flow after operations and investment. It was negative in 2003, 2006, and 2008, signaling no cash generation for securtiy holders. The company demonstrated positive free cash flow in the interim years, however the extent of which was negligable, less than one percent of the value of total assets.

Figure 6.Free Cash Flow ($000's)

The impairment of assets in 2008 resulted in a decline in CLICO's balance sheet cash position from $4,697 million to only $618 million. Total assets fell in one year by $3.583 billion, 16% of the total asset base. This impairment of asset claims was also reflected in cash flows for which the change in the amount due from related parties demonstrated a cash outflow of $7.098 billion. This resulted in a net outflow of cash from operations in that year of $4.230 billion.

In general, CLICO's financial statements showed weak performance in cash generation. The net movement of cash was often negative. Further any net balance in cash generated from operation was often fully utilized for investments. This activity would signal positive growth outlook by the firm. However, this minimal and often non-existent free cash flow also demonstrats the lack of internal cash available for the company's security holders. The reported trends in the sources of the firm's financing is next discussed.

Source of Financing

CLICO's business growth must be facilitated by its growth in insurance contracts and more generally its growth in total liabilities. Except for 2005, the company demonstrated total liability growth of over $2 billion each year. Liability growth was particularly high in 2008 in which liabilities grew by over $6 billion, more than doubling any prior year's growth. In 2005 insurance liabilities was valued at $7.586 billion accounting for 66% of all liability contracts. The majority of these contracts were categorized as long-term insurance. This included ordinary life, conditional illness contracts, individual and group annuity insurance, valuing $7.536 billion. In 2008 however insurance liabilities was valued at $4.937 billion only 21% of the total.

Table 5 below presents the changes in major liability line items relative to the absolute change in total liabilities. The data provides the relative contribution of various liability categories to the annual change in CLICO's liability position.

Changes in short and long term loans, trade and accounts payables generally accounted for a small portion of liability growth. In fact debt fell annually demonstrating a value of $549 million in 2003 falling steadily to $198 million in 2007. CLICO lowered its debt liabilities yearly. Between 2003 and 2004 it paid off $173 million in loans. The remaining $361 million loan balance was held as a ten year note payable to Angostura holdings.

Table 5. Change in Liability items Relative to the Change in Total Laibilities

	2004	2005	2006	2007	2008	2009
Insurance contracts	49.7	-115.1	53.4	-212.9	38.1	37.6
Investment contracts			1.0	345.7	44.3	-71.7
Borrowings	-5.6	-0.9	-0.2	-6.1	-0.1	10.0
Bank overdraft and short-term loans	8.5	-8.4	6.7	47.7	3.6	-110.3
Due to related parties			1.6	-21.9	0.5	110.5
Mutual fund guarantee			6.3	6.0	11.5	6.0
Trade and accounts payable	1.1	2.6	-0.3	-2.5	2.6	-4.4
Absolute change in Total Liabilities	2,858,337	753,233	2,347,720	2,949,226	6,240,815	1,547,011

Bank overdrafts, short term loans, and accounts payables did not demonstrate yearly declines as did long term loans. Short terms loans account for the majority of these balances. For example in 2006 of the $2.167 billion in overdraft and loan liability, $2.141 billion was in the form of short term loans. These short term loans were associated with Clico investment bank and

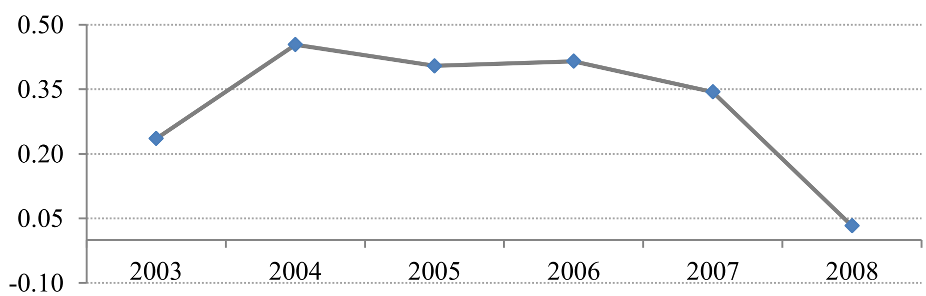
Republic bank of Trinidad affiliates of CLICO. These loan balances were reported as being collatorized by deposits with these banks.

Yearly changes in trade and accounts payables also represented a small proportion of the growth in liabilities, showing the largest change in 2007 falling from its 2006 value of $168 million to $95 million. In general these trade debts were stated as miscellaneous credit the financing of which was used for operations.

CLICO demonsrated yearly increases in mutual fund gaurantees. In 2005 these liabilities stood at $349 million almost doubling to $674 million in 2007 and again doubling in the subsequent year to $1.389 million in 2008. CLICO gauranteed fund holders both fund products, “Core” and “Power”, the value of interest obligations and the principal associated with each.

Growth in liability obligations without sufficient expansion of liquid assets often proves to be a key business risk. CLICO’s level of liquidity was measured by the value of its cash and equivalent assets as a share of its insurance and investment contract liabilities. The value of this measure peaked in 2004 in which cash and equivalents held was 45% of insurance and investment liabilities. The value of which declined steadily over time.

Figure 7. Liquidity—Insurance and Investment Contract Liabilities as a share of Cash and Equivalents



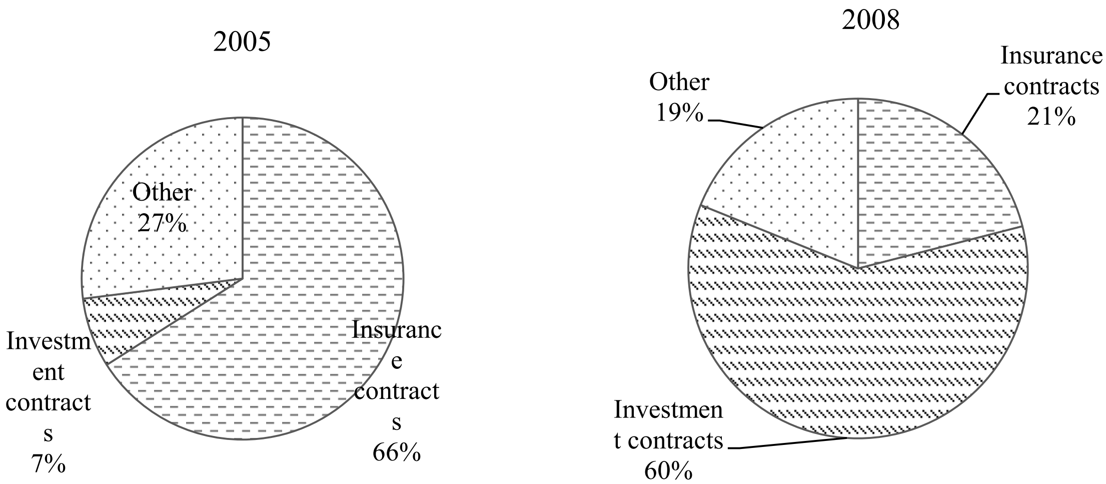
The Reclassification of Investment Contracts

CLICO's annual reports up until 2007 demonstrated a company having insurance contracts as its major liability. The forensic report (KPMG. 2011) changed this however by reclassifying the majority of CLICO's insurance liabilities as investments products. Traditionally the company's insurance products included ordinary life insurance, critical illness contracts, individual and group annuity contracts. Individual and group annuity contracts provided for the payment of a "regular income upon maturity of the contract in the case of deferred annuities and for immediate commencement of payments in the case of an immediate annuity."

The company offered investment contracts classified as "Deposit Administration" contracts and "Managed Fund". Deposit Administration products were sold to pension plans for the purpose of accumulating retirement benefits. CLICO reports using deposit administration income for the purchase of immediate annuities. Managed Fund business products were also sold to pension plans. However the pension plans holding these contracts were said to bear any inherent investment risk. The benefits offered under the company's investment contracts were stated as being based on the return on company assets.

The forensic audit reclassified a significant proportion of insurance contracts as investment contracts. Products were reclassified if they were not perceived as insurance contracts under International Financial Reporting Standards. These included CLICO's Executive Flexible Accounts (EFPAs) and GAP contracts. Figure 8 below compares the composition of CLICO's liability positions before and after the forensic review. Products classified as investment contracts accounted for only 7% of the company's total liabilities in 2005. After reclassification, liabilities then comprised of 60% investment contracts.

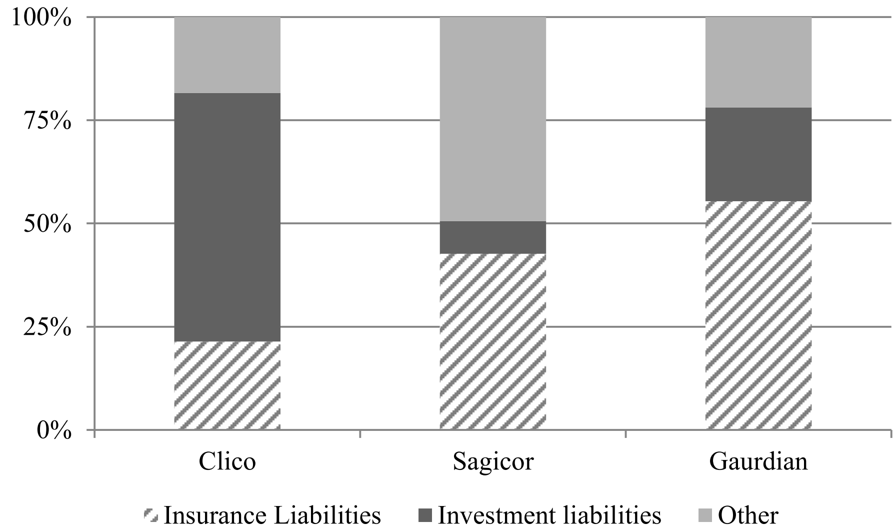
Figure 8 Liability Composition 2005 & 2008



In 2007 CLICOs reported $11.801 billion in insurance liabilities. This was comprised of $10.188 billion in EFPA contracts and only $1.394 billion in ordinary life insurance liabilities and other annuity insurance liabilities. After reclassification insurance contract liabilities was valued at only $2.563, while investment contracts jumped from $797 million $11.085 billion. In 2008 investment liabilities stood at $13.851 billion of which $12.946 billion were EFPA investment contracts.

CLICO's liability position is compared to that of regional competitors Sagicor and Gaurdian life. In the case of Sagicor investment liabilities comprised only 8% of the total. These investments include a "deposit administration fund" in which the full return on the supporting assets is paid to the pension scheme investor. Sagicor's deposit administration fund was predominantly held as debt securities and mortgage loans. Sagicor's other liability components included fifteen percent equity, sixty one percent insurance liabilities, and approximately twenty three percent in deposits accounts, notes and loans payable.

Liability comparison to other Caribbean 2008



Guardian life demonstrated a higher proportion of investment liabilities but still significantly less than CLICO. Guardian's insurance liabilities account for 55% while investment liabilities accounted for a little over 22%. In the case of Guardian Holdings Ltd. these investment liabilities included deposit administration and annuity products.

Overall, liability growth was strong between 2003 and 2007 total liabilities more than doubled its size growing from $7.879 billion to $16.787 billion. Growth in core business, that is insurance and investment products, accounted for $6.613 billion of this value. With this rapid liability expansion CLICO did not demonstrate sound liquidity. The the ratio of short term assets to short term liabilities fell steadily year by year. Further, upon the forensic report it was determined that the products sold by CLICO classified as investment products more so insurance policies.

Associated Companies

CLICO reports significant yearly transactions with associated companies under the CL Financial Ltd umbrella. Assets associated with these companies totaled $19.559 billion in 2007,

89% of CLICO assets. In the case of total liabilities, that associated with related companies totaled $3.375 billion.

More specifically, the majority of CLICO's debt securities and bank deposits were held with affiliated firms. Sixty nine percent of its debt securities were held with CL financial while seventy nine percent of bank deposits were held at Clico investment bank in 2007. Also a significant amount of short term loans, seventy one percent, was associated with Clico investment bank. A further $211 million in liabilities were short term payables with various companies affiliated with CL Financial group. Table 6 presents some of the asset and liability positions associated with CL Financial, Clico Investment Bank, and Republic Bank (Ernst & Young, 2007, 2008).

Table 6. Selected Inter Company Balances 2007 ($000's)

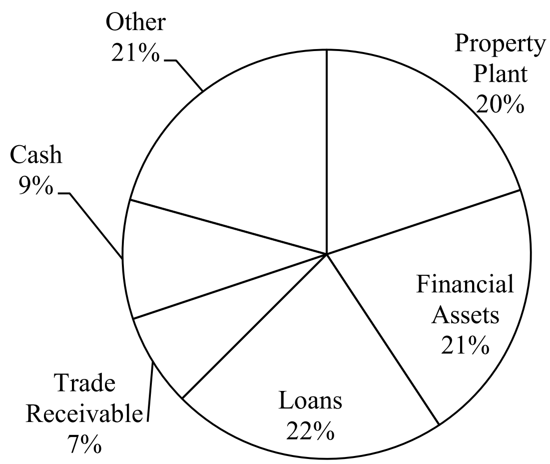
	CL Financial	Clico Investment	Republic Bank
Assets (total)			
Debt Securities ($1,642)	1,141	500	___
Bank and Term Deposits ($4,697)	___	3,727	78
Liabilities (total)			
Short-term loans ($1,912)	___	1,361	546

CLICO demonstrated substantial amounts of investment, loans, and deposits in associated companies. The majority of which were through CL Financial and Clico Investment bank. For example cash raised by CLICO was often transfered to CL Financial to fund its investments. This would result in yearly receivables due to CLICO from its parent company. Despite accounting for a significant portion of its financial position, only 17% of income before expenses was derived from related companies. The financial reports of CL Financial and Clico Investment Bank are obtained to discuss the asset composition, extent of leverage, and liquidity of these firms.

CL Financial & Clico Investment Bank

The consolidated financial statements of CL financial showed that the company had $101 billion in group assets in 2007. Figure 9 presents a pie chart of the asset composition of CL financial in 2007.

Figure 9. CL Financial Asset Composition 2007



The group's asset holdings of land and property just equaled that in loans and financial assets. The majority of value of which was through plant and machinary, accounting for just half of the CL financials property asset values. CL financial assets were valued at $20.939 billion in 2007. The majority of which were held as quoted securities, $10.977 billion. As a group only $2.840 billion of its financial assets were held as bonds or government notes. "Other" forms of assets acounted for the balance.

On the liability side of its books CL financial group demonstrated heavy reliance on loans and deposits though its subsidiary companies. Loans, customer deposits, and other short term payables accounted for $65 billion, just over 65% of all liabilities. Further the group showed an illiquid financial position, holding $21 billion in short term assets, less than half the $55 billion in current liabilities.

CL financial demonstrated heavy administrative and operating expense. In 2007 CL financial reported $9.500 billion in gross income with $5.064 billion used for administrative and operating expenses. Despite demonstrating yearly increases in asset size in 2005, 2006, and 2007, CL financial group earned declining levels of income over the time period. More precisely between 2005 and 2007 CL financial's asset base grew by 33% , while net income after taxes fell from $2.333 billion in 2005 to $1.740 billion in 2007. The group also demonstrated declining income performance based on its return on asset ratio. CL financial's return on assets fell from 3.1 percent in 2005 to 1.7 percent to only by 2007.

CL financial showed declining income preformance while demonstrating significant business expansion. In 2007 CL financial showed no strategy of the cash distribution to security holders as there was no free cash flow avalaible. In both 2006 and 2007 CL finanical showed positive cash flow from operations. In these years however CL group showed much optimism in capital expenditures in which cash outflow was twice the amount generated from operations. In fact $7.259 billion in cash was spent in 2007 to purchase property and plants alone. This was supported by cash from the sale of financial assets worth $1.639 billion and net cash from borrowings totaling $4.649 billion.

Generally the holding group demonstrates a culture of capital expansion; brick and mortar investment financed by borrowings. In addition there was no significant income generation reported from these investment.

In 2007 some five billion in CLICO cash, short term depostis, and loans were attributed to Clico investment bank. The financial reports of CLICO investment bank for 2005 and 2006, audited then by Price Water House Coopers, are obtained via the commission of enquiry. Like CLICO and the broader holding Group, Clico Investment bank demonstrated significant growth in its asset base. Reported asset balances show an increase from $9.525 billion to $12.225 billion, a jump of 28% in one year. As expected from an investment bank, this asset growth was predominantly derived from increases in security holdings by some $2.000 billion dollars. Other forms of asset holdings such as loans, cash, and investments in subsidiares were reported to be relatively flat.

The investment bank's method of asset financing was predominantly through bank deposits. This accounted for 50% of its liability position in 2004, while debt instruments accounted for approximate 30% of liabilties. These included $1.174 billion in short term and margin loans, and another $1,587 billion in bonds issued. Its equity capital was 9 percent of the total liabilites during the year. For the two years obtained the composition of liabilities stood relatively unchanged with its growth in bank size.

Clico investment bank reportedly offered investment products with returns between 6 percent and 11 percent. However, ss demonstrated by other affiliated companies Clico Investment Bank's asset growth did not result in increased income. Net profits after taxes fell by 39% from $277 million in 2005 to $167 million in 2007. Relative to assets the bank's return fell from 3% to 1.4% in the subsequent year. In 2006 the fall in net income after taxes not only represented poor performance, but in fact the bank's investment interest expenses outweighed income generated from loans and investments. This resulted in negative net investment income for the investment bank. The bank's source of profits was derived from bond managment fees and other non-interest related income.

Similar to its affilitates the investment bank generated no free cash flow for security holders in either year. The bank spent more cash on investment than was genrated from operations. Despite the banks negative net cash from operations in 2005, it spent almost five times the amount of cash for investment in 2006 than in 2005. Utilizing proceeds from bond financing and other forms of debt as its main cash source.

CLOSING

Questions remain on the characteristics of CLICO's business model leading up to its collapse. Some have stated that the company predominantly acted as a source of cash for other related entities. Others state that the key risk faced by the company was its misalignment of short term liabilities with long term assets. This resulted in the eventual liquidity problems faced prior to failure. This study obtained CLICO's financial statements between 2003 and 2008 in an effort to assess any key observations.

A few prominent themes arise. CLICO more than doubled in size over a five year period; investing predominantly in companies within CL Financial holding group. Almost all of CLICO's asset base was associated with these firms. This is unlike that expected of the average insurance company which invests in international securities as the main source of revenue generation. Regardless, the key observation made relates to the issue of revenue, and in the case of CLICO the under performance of its assets for revenue generation. CLICO's asset growth did not create equal growth in revenue, but in fact profitability fell over time. Declining profitability was also mirrored with non-existent free cash for the company's security holders. In most years, cash used for investment significantly surpassed any generated from operations.

Perhaps the benefits of CLICO's immense asset growth through investments in affiliated companies was absorbed by the group of companies as a whole. The paper further conducts a similar analysis, albeit less thorough, of the holding group and the investment bank accounting for the majority of CLICOs intercompany transactions. The key findings remain the same. Both CL Financial and Clico investment bank demonstrated remarkable asset growth unaccompanied by paralleled income performance. The group as a whole and the investment bank demonstrated low profitability and no evidence of free cash flow.

CLICO's collapse came with great speed. The study highlights in hindsight that the poor income and cash performance of the company would have been a signal to security holders, potential investors, and management of the failing business strategy used by the company.

References

CL Financial Limited (2007). Annual Report. Retrieved from http://www.clico.com/pdf/AR07/AR2007.pdf

CLICO (2005). Directors Report & Financial Statements. Retrieved from www.**clico**.com/pdf/AR05/AR**2005**.pdf

CLICO (2006). Directors Report & Financial Statements. Retrieved from www.**clico**.com/pdf/AR06/AR**2006**.pdf

Ernst & Young (2007). Independent Auditor's Report Republic Bank Limited 2007.

Ernst & Young (2008). Independent Auditor's Report Republic Bank Limited 2008.

Guardian Holdings Limited (2008). Annual Report. Retrieved from http://myguardiangroup.com/uploads/annual_reports/GHL_annual_report2008.pdf

International Monetary Fund (2011). Trinidad and Tobago: Selected Issues. IMF Country Report No 11/74.

KPMG (2011). Separate Financial Statements of Colonial Life Insurance Company (Trinidad) Limited 2009.

KPMG (2012). Separate Financial Statements of Colonial Life Insurance Company (Trinidad) Limited 2010.

KPMG (2013). Separate Financial Statements of Colonial Life Insurance Company (Trinidad) Limited 2011.

Republic of Trinidad and Tobago(2013a). Commission of Enquiry into the failure of CL Financial Limited, Colonial Life Insurance Company Limited, Clico Investment Bank Lmited, British American Insurance Company (Trinidad) Limited, Caribbean Money Market Brokers Limited and Hindu Credi Union Co-operative Society Limited- Witness Statements and Exhibits – Carl Hiralal. Retrieved from http://www.clfhcuenquiry.org/10thStatements/Carl%20Hiralal%20Witness%20Statement%20and%20Exhibits.pdf

Republic of Trinidad and Tobago (2013b). Commission of Enquiry into the failure of CL Financial Limited, Colonial Life Insurance Company Limited, Clico Investment Bank Lmited, British American Insurance Company (Trinidad) Limited, Caribbean Money Market Brokers Limited and Hindu Credi Union Co-operative Society Limited- Witness Statements and Exhibits – Richard Trotman PWC. Retrieved from http://www.clfhcuenquiry.org/review

Republic of Trinidad and Tobago (2013c). Commission of Enquiry into the failure of CL Financial Limited, Colonial Life Insurance Company Limited, Clico Investment Bank Lmited, British American Insurance Company (Trinidad) Limited, Caribbean Money Market Brokers Limited and Hindu Credi Union Co-operative Society Limited- Witness Statement of Michael Everton Carballo. Retrieved from http://www.clfhcuenquiry.org/Carballo/MEC3.pdf

Republic of Trinidad and Tobago (2013d). Commission of Enquiry into the failure of CL Financial Limited, Colonial Life Insurance Company Limited, Clico Investment Bank Lmited, British American Insurance Company (Trinidad) Limited, Caribbean Money Market Brokers Limited and Hindu Credi Union Co-operative Society Limited- Witness Statement of Afra Raymond. Retrieved from http://www.clfhcuenquiry.org/ARaymond/AR%204.pdf

PricewaterhouseCoopers (2005). Clico Annual Report 2004.

Sagicor (2005). Sagicor Financial Corporation Financial Statements. Retreived from https://www.sagicor.com/Documents/Financials/Reports_Annual/2005_Annual_Report.pdf

Sagicor (2008). Sagicor Financial Corporation Financial Statements. Retreived from http://www.uniflip.com/catalogs2/11630/25815/pub/index.html

Soverall, W., & Persuad, W. (2011) “The CLICO Meltdown: Reckless Corporate Governance or Too Big To Fail?” Journal of Social and Economic Studies.

Soverall, W. (2012). CLICO’s Collapse: Poor Corporate Governance. American International Journal of Contemporary Research, 2, 1-13.