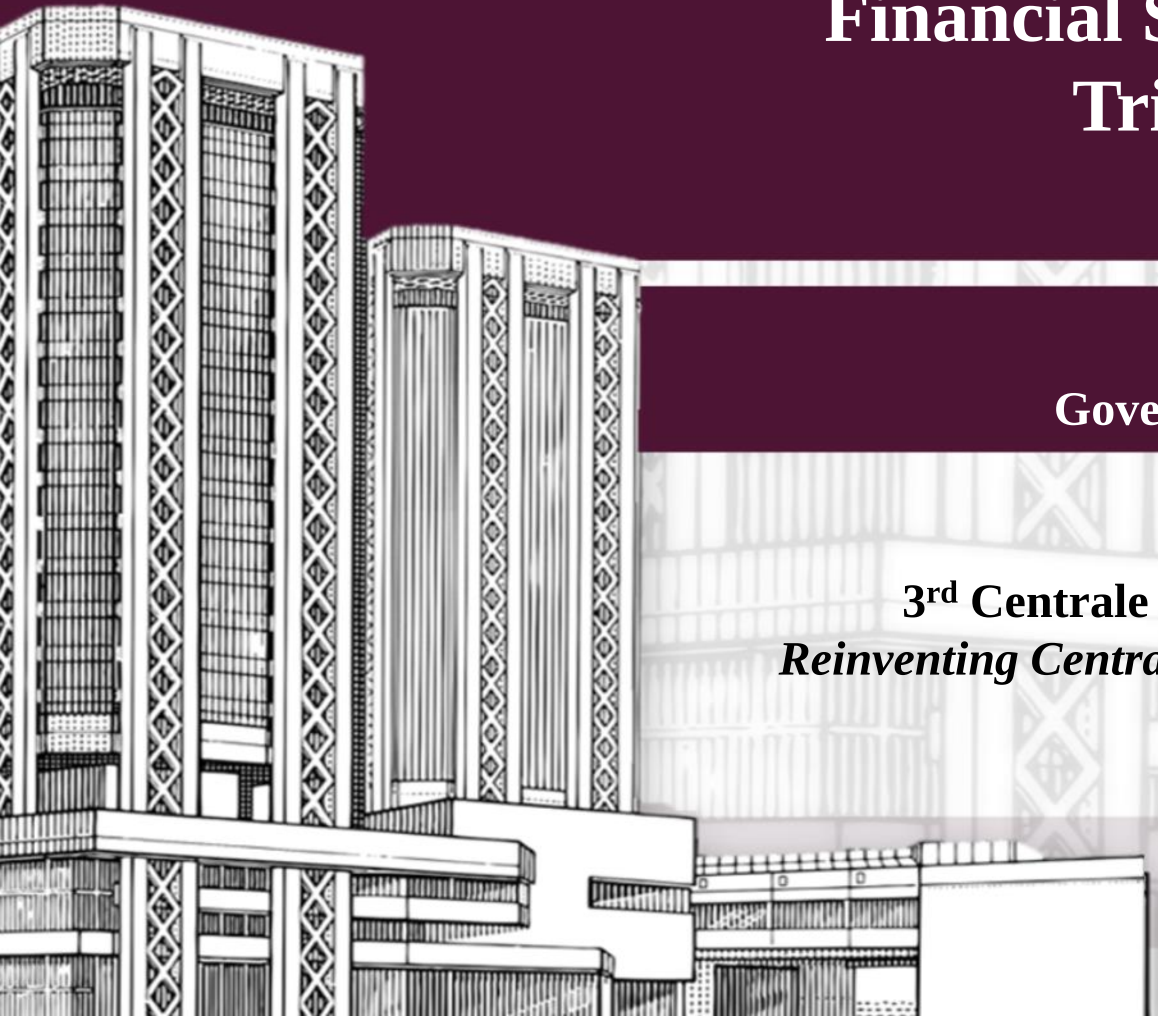
CENTRAL BANK OF TRINIDAD & TOBAGO

Financial Sector Resolutions: Lessons from Trinidad and Tobago's Experiences



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3rd Centrale Bank van Curaçao en Sint Maarten Central Banking Conference

Reinventing Central Banking: Supporting Inclusive Growth and Financial Innovation

June 6-7, 2019 Willemstad, Curaçao

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Financial Sector Resolutions: Lessons from Trinidad & Tobago's Experiences: Summary

A. The Theory

- The nature of the financial sector is such that there will necessarily be periodic failures.
- Systemic failures however can threaten financial stability and involve high costs to an economy.
- In the wake of the global financial crisis, international efforts were intensified to formalize and bolster resolution regimes.

B. Trinidad & Tobago's Experiences

- Trinidad and Tobago is a small open energy-based economy with a dynamic financial sector.
- The energy-led economic cycles, compounded by governance issues, led to episodes of financial stresses.
- In the 1980s, several nonbank financial institutions collapsed as the economy entered into recession.
- In the 1990s, three indigenous banks faced difficulties and their operations were merged.
- In late 2000s, a major financial conglomerate collapsed with wide-ranging repercussions.

C. The Lessons

1. Countries should always be in 'ready mode' to deal with financial resolutions or crises.
2. Action should not be delayed because of gaps in the resolution framework.
3. The availability of fiscal space will increase the pressure for bailouts.
4. Close coordination among regulators and the fiscal authorities is essential.
5. Deposit insurance provides a good safety net but by itself is unlikely to calm markets in cases of systemic crises.
6. Legal costs can be very high and legal challenges protracted.
7. A wide range of highly specialized skills must be devoted to the resolution.
8. It is essential to record and keep track of the resolution details.

A. THE THEORY

The nature of the financial sector is such that there will necessarily be periodic failures.

Financial intermediation involves risk taking: *"Finance is not merely prone to crisis, it is shaped by them"*, The Economist

- Banks take money from excess savers and lend to excess spenders. This can be profitable but risky as sometimes:-
  - borrowers don't repay (default);
  - banks miscalculate how much and when they need to repay depositors (liquidity problems);
  - panic sets in among depositors (deposit run);
  - mismanagement and corruption occurs (governance issues);
  - the economy gets into trouble (adverse macroeconomic situation).

- As a result, some banks get into difficulty:
  - They may be able to weather the storm depending on the circumstances and how they respond;
  - This may involve a fundamental restructuring of how they do business;
  - But they may fail outright and need to exit the industry;
  - It is healthy when some weak institutions exit as they may not have the capacity to do the job;
  - However, some depositors may suffer;
  - And if the bank is large enough, the impact of their failure could affect other institutions (contagion).

All other financial institutions (nonbanks, insurance companies, pension funds etc. are also prone to risk).

Systemic failures however can threaten financial stability and involve high costs to an economy.

- When a large financial institution is in trouble, the repercussions on the entire financial system can be severe.
- Even if the institution is relatively small, many low income depositors can be affected so that a social dimension is involved.
- The situation can be especially sensitive for domestic-owned financial institutions.
- As a result of these so called 'spillover effects', the state may get involved and provide a 'bailout'.
- Such action may help to contain the situation but carries moral hazard issues.

- And sometimes domestic financial problems spill over to larger regions and even globally…

Some Regional and Global Financial Crises
The Great Depression, 1932
The Suez Crisis, 1956
International Debt Crisis, 1982
Nordic Financial Crisis, early 1990s
East Asian Crisis, 1997
Latin American Debt Crisis, mid 1990s–early 2000s
Global Financial Crisis, 2008
European Crisis, 2010 - 2013

In the wake of the global financial crisis, international efforts were intensified to formalize and bolster resolution regimes.

Key Attributes of Effective Resolution *(Financial Stability Board, 2014)*

- **Scope:** coverage of systemically important financial institutions (SIFIs).
- **Resolution authorities:** independent, with clear mandates, roles and responsibilities.
- **Toolkit:** authorities should have broad resolution powers.
- **Set-off, netting, collateralization, segregation of client assets:** these arrangements should be preserved.
- **Legal safeguards:** decisions must be subject to judicial review.
- **Funding of firms in resolution:** authorities should minimize the use of public funds to resolve firms.
- **Framework for cross-border cooperation:** cooperative solutions with foreign authorities should be encouraged.
- **Crisis management groups:** should be maintained and used in resolution planning process.
- **Institution-specific cross-border cooperation agreements:** should be in place to manage the sharing of information and specify responsibilities.
- **Resolvability assessments:** should be able to require changes to business practices, structure or organization.
- **Recovery and resolution planning:** required for firms that could by systemically significant.
- **Information sharing:** impediments to exchange of information should be eliminated.

Source: Pazarbasioglu et al, 2012.

...on a micro level, the process can be represented by a decision tree.

The Resolution Decision Process

Is the bank no longer viable?

Yes

Is the bank systematically significant or critical?

Yes

Resolution regime

Which stabilisation option(s)?
(continuity)

Transfer assets, liabilities to:		Bail-in	Temporary Public ownership (last resort, only)
Another bank	Bridge institution		

How to deal with the residual institutions? (asset management vehicle, liquidation

No

Liquidation and deposit insurance schemes *(orderly wind-down)*

Source: Bank for International Settlements.

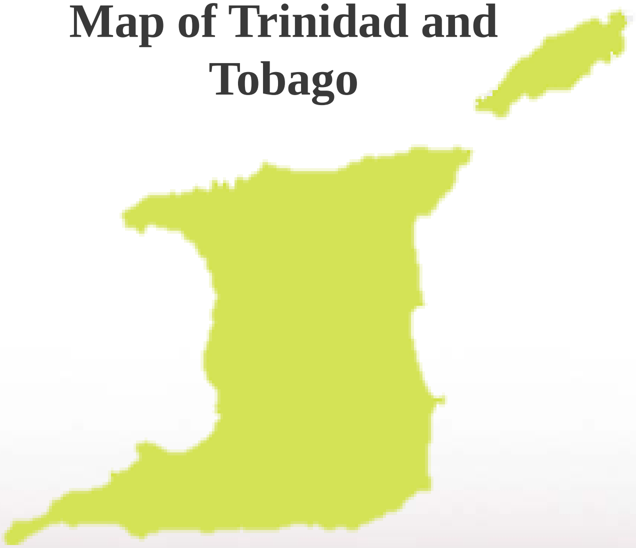
B. TRINIDAD & TOBAGO’S EXPERIENCES

T&T is a small open energy-based economy with a dynamic financial sector.

- Population: 1.4 million
- Size: 5,131 km^2
- GDP per capita: US$17,300 (2018 est.)
- Energy Sector-to-GDP: 26.1% (2018 est.)
- Degree of Openness: 72% (2017 est.)

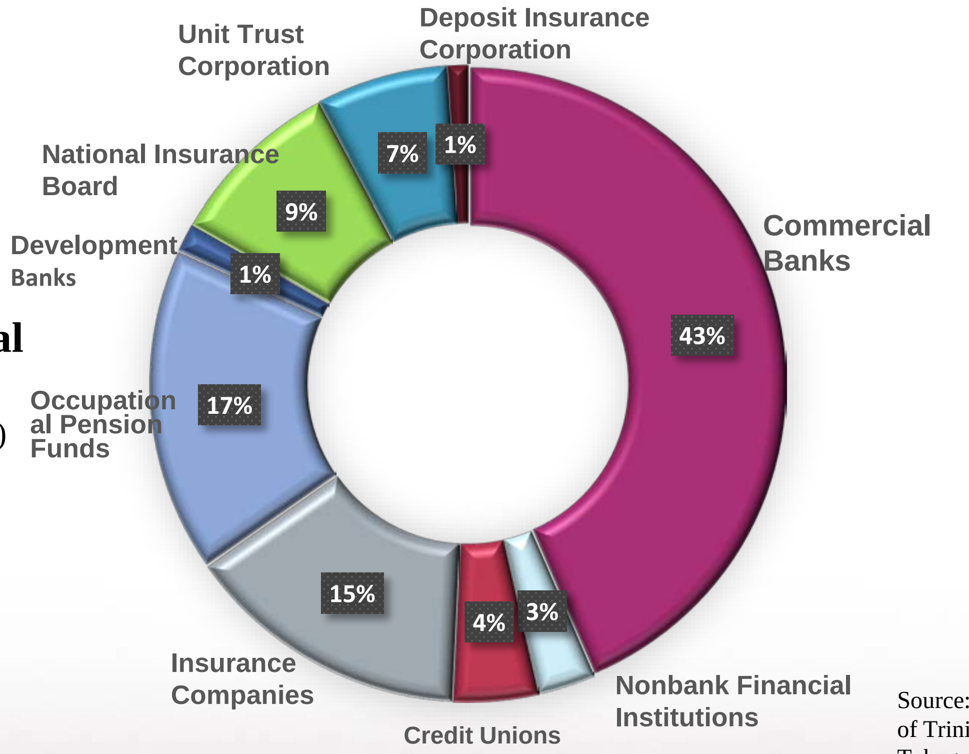
- Financial Sector Assets-to-GDP: 202% (2018 est.)
- Number of commercial banks: 8 (2018)
- Number of insurance companies: 31 (2018)

Map of Trinidad and Tobago



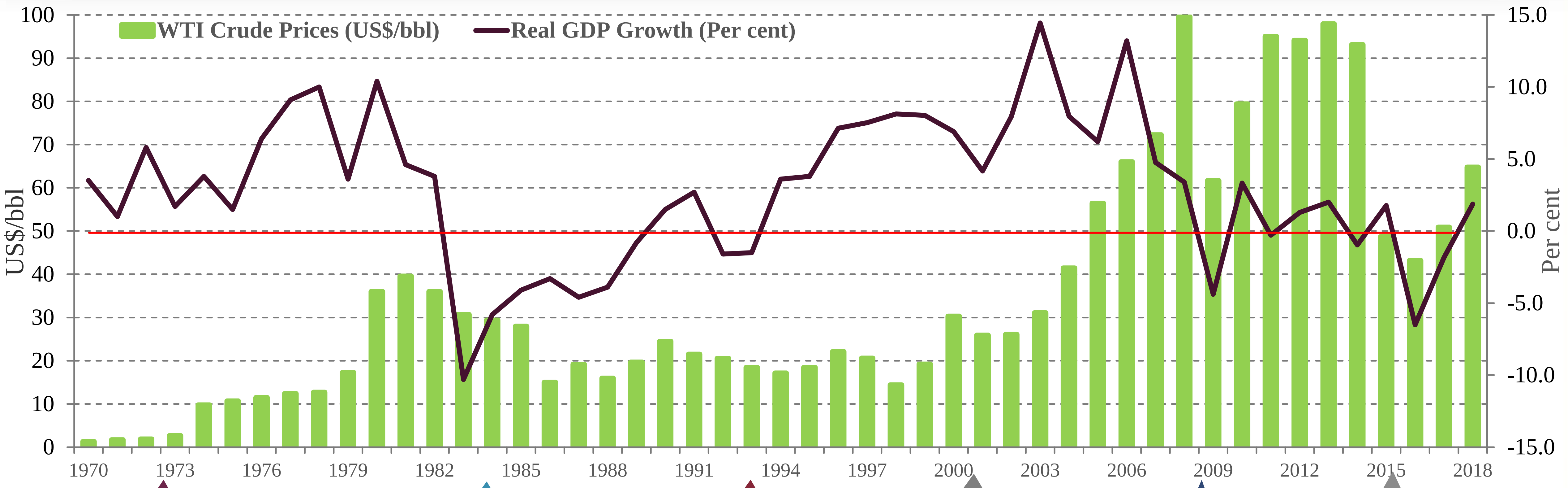
Structure of the Financial Sector, 2018

(% of total financial sector assets)



Source: Central Bank of Trinidad and Tobago.

The economic cycles have for the most part been energy-led;…



1970s
Oil Boom

1980s
Economic Recession and Financial Sector Failures

1990s
Economic Restructuring and Floatation of the TT Dollar

Early 2000s
Move to a gas-based economy followed by another boom period

2009
The CLICO crisis

2015 onward
Energy prices decline to 'new normal'

Sources: Central Statistical Office and Bloomberg.

…which, compounded by governance issues, led to episodes of financial stresses.

1970s

1970s oil boom

The number of financial institutions mushroomed during the oil boom era.

1980s

Financial failures of the 1980s

International Trust Ltd (1986)
The 5 Non-Banks (1986)
Workers' Bank (1989)

1990s

Continued challenges into the early 1990s

Workers' Bank (1993)
National Commercial Bank (1993)
Trinidad Cooperative Bank (1993)

2000s

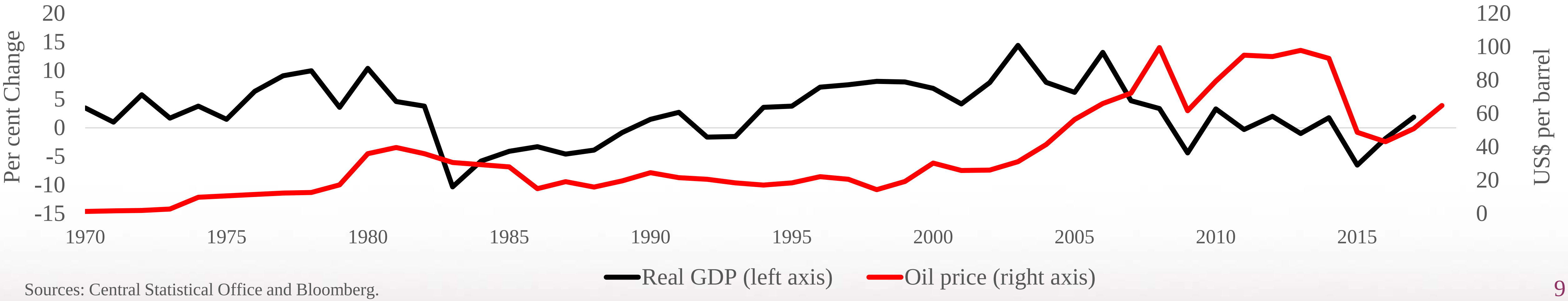
The CLICO collapse

Clico Investment Bank (2009)
CLICO (2009)
BA (2009)

2010s

Period of resilience

The financial system has been resilient in the face of difficult domestic economic conditions.



Sources: Central Statistical Office and Bloomberg.

In the 1980s, several non-bank financial institutions collapsed as the economy entered into recession.

Non-bank Financial Institution (NBFI) Failures

1983 International Trust Ltd

1984 Southern Finance

1986 Trade Confirmers

SWAIT Finance

Summit Finance

Commercial Finance

MAT Securities

- As a consequence of the oil boom of the 1970s there was a mushrooming in the number and scope of financial institutions.
- Several nonbanks were set up and took advantage of buoyant financial conditions by attracting deposits with offers of high interest rates, while also lending at high rates.
- When economic conditions changed, they found themselves with heavy debt commitments, along with loan defaults.
- In summary, there was a combination of:
  - Aggressive lending practices;
  - High interest rate funding strategy;
  - Heavy involvement in real estate projects;
  - Poor governance structures and management.
- At the same time, the regulatory and supervisory frameworks lagged developments in the financial sector.

The resolution strategies for the nonbanks were influenced by the introduction of Deposit Insurance.

I. Pre-Deposit Insurance

International Trust Ltd (ITL, 1983) and Southern Finance (1984)

- These institutions were placed in commercial receivership.
- The costs were borne largely by depositors.
- In the case of ITL, depositors received 26 cents to the dollar and the resolution took nearly 10 years to finalize.

II. With Deposit Insurance

The Five NBFIs Failures in 1986

- Amendments were made to the Central Bank Act and the Deposit Insurance Corporation (DIC) was established in 1986.
- The Central Bank provided liquidity support between 1984 – 1986.
- In 1986, the Central Bank suspended the operations of the failing institutions.
- DIC was appointed liquidator of the five NBFIs.
- Depositors received insurance coverage of up to TT$50,000 (US$14,000).

In the late 1980s, an indigenous bank faced difficulties…

Issues

- Workers' Bank Ltd (WBL) was considered socially important being a creation of the working class and Government.
- WBL was a major banker to the low and middle class segments of the population, and provided residential mortgage loans to these groups.
- However, with the unemployment rate reaching 22% in the late 1980s, the bank's asset quality deteriorated significantly.
- There were also concerns stemming from WBL's inter-bank relationships and contagion effects.

Resolution Strategy

- In 1989, the Central Bank and Government decided that WBL was sufficiently systemic to justify support.
- Taurus, an asset management company, was created.
- WBL's distressed assets (mostly residential mortgage loans) were 'sold' to Taurus.
- WBL was recapitalized, with the Government, the National Insurance Board, commercial banks and insurance companies subscribing to shares in the entity.
- Suitably qualified staff was sourced/seconded from commercial banks.

…and its operations were eventually merged with two other indigenous banks.

Issues

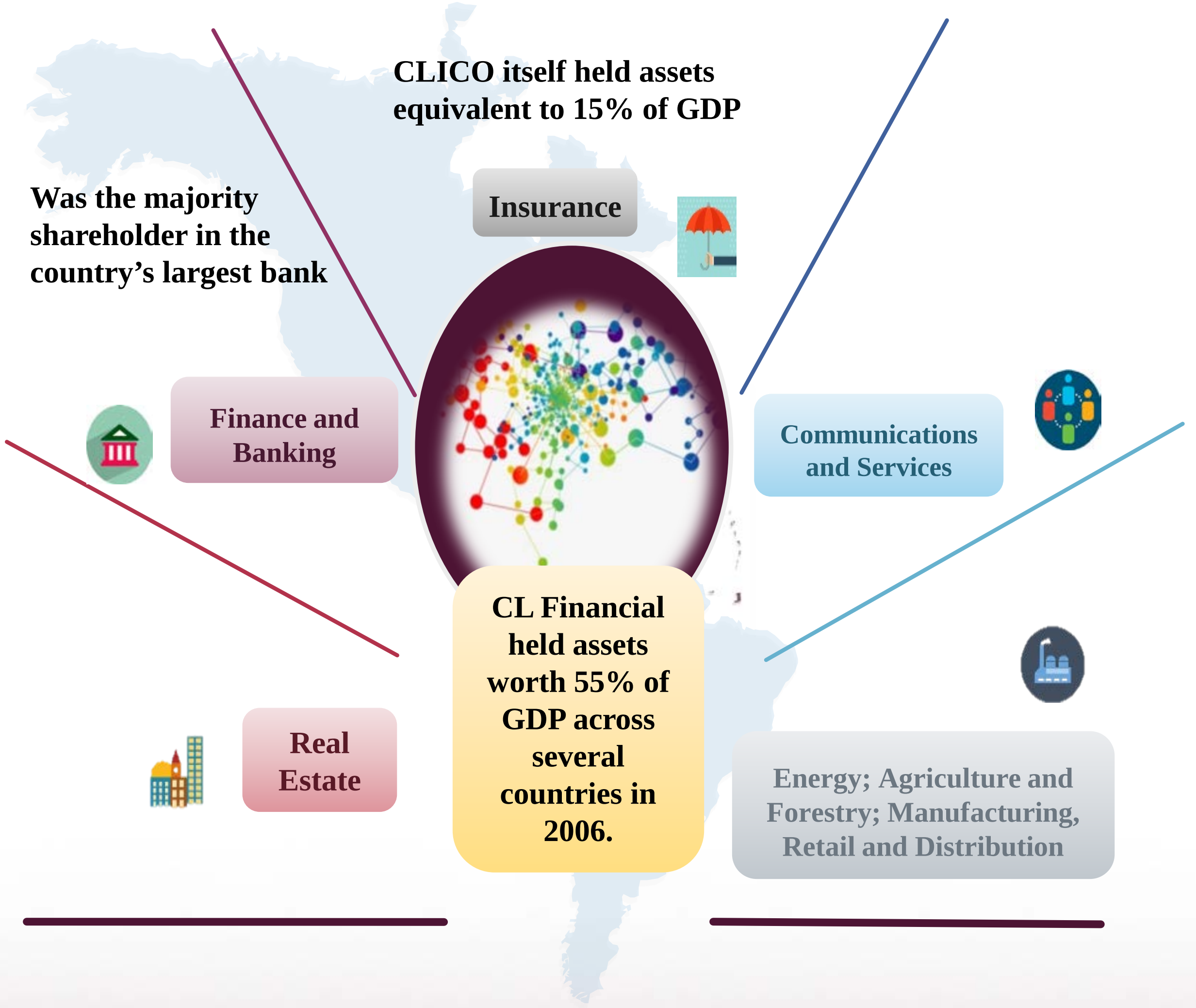
- Trinidad Cooperative Bank (TCB) and National Commercial Bank (NCB) – both state-owned banks – were also experiencing financial difficulties.
- WBL was also in the early stages of recovery.
- It also became apparent that these institutions would not be able to meet stronger capital requirements under the impending Financial Institutions Act which was passed into law in 1993.
- As such, the authorities deemed that these institutions were in need of further support.

Resolution Strategy

- In collaboration with key stakeholders (banks' CEOs, Government, Central Bank) a decision was taken to merge WBL, TCB and NCB into one institution – First Citizens Bank.
- The scope of Taurus was expanded to purchase the distressed assets of TCB and NCB.
- The authorities provided capital injections into the banks, raising the funding via bonds.
- The Central Bank appointed the first board and management team of First Citizens Bank.

In the late 2000s, a major financial conglomerate collapsed with wide-ranging repercussions.

The Size and Far Reach of CL Financial



Issues

- CL Financial's business model was unsustainable:
  - Excessive related party transactions;
  - An aggressive high interest rate funding strategy;
  - Highly leveraged assets.
- The company's governance structure was poor:
  - Board met infrequently;
  - Weak due diligence on acquisitions;
  - Audit and investment committees did not function effectively.
- There were also regulatory gaps.

The resolution process involved public financial support and liquidation.

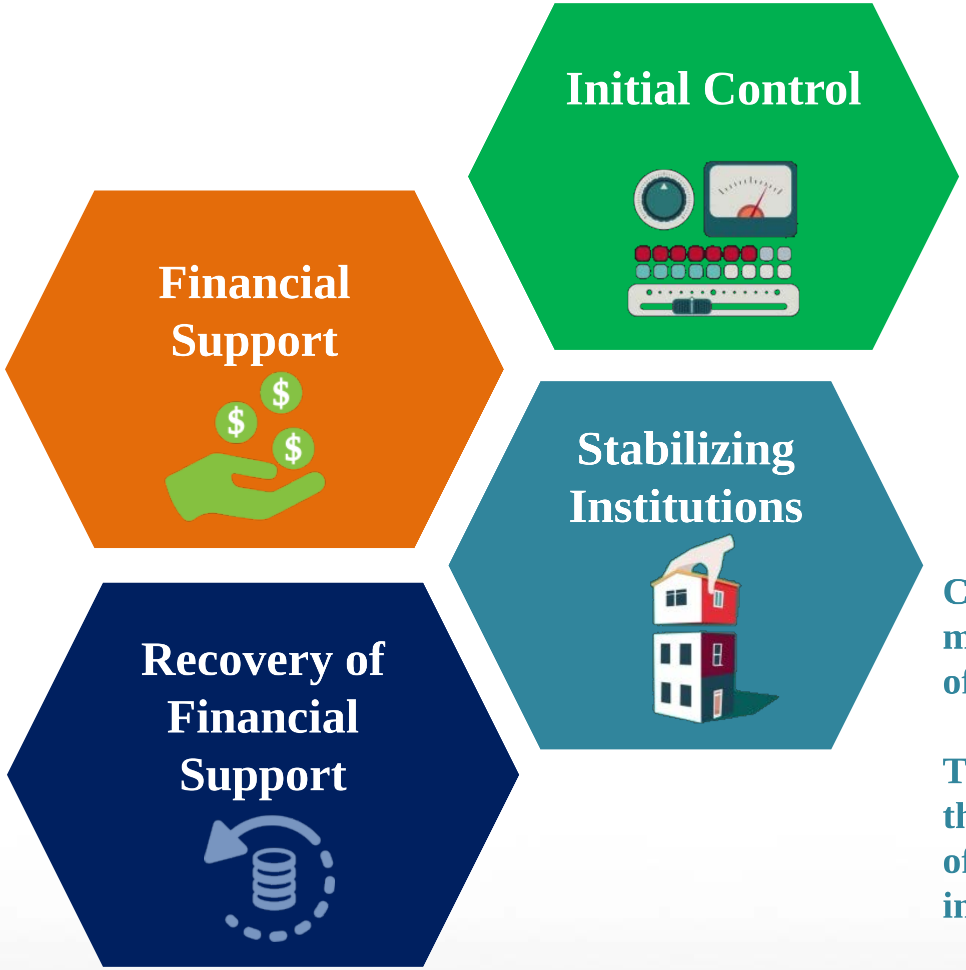
Four Overlapping Phases Over a Decade

The Central Bank assumed control of CIB/CLICO using powers provided by the Central Bank Act.

Additionally, in exchange for financial support, the Government was provided an equity interest in CLICO

Government provided TT$24bn (17% of GDP).

Although T&T had some fiscal space, public sector debt levels rose.



Central Bank appointed new management of
of CIB/CLICO/BA.

The main focus was to restructure the operations and business model of CLICO to traditional life insurance business lines.

The Government has recovered just under 80% of the financial support provided to CLICO as at September 2018.

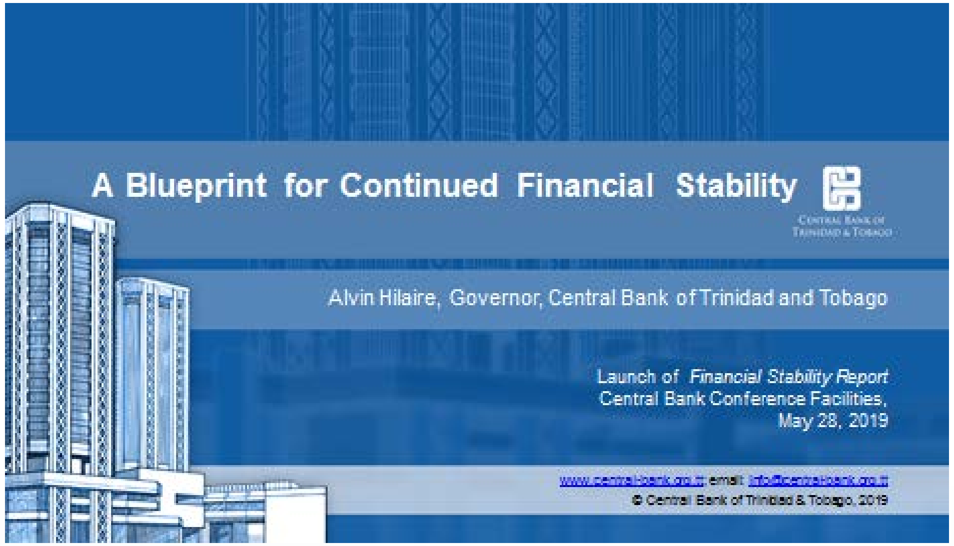
A process is underway to find an appropriate buyer for CLICO/BA’s traditional life insurance business.

C. THE LESSONS

1. Countries should always be in ‘ready mode’ to deal with financial resolutions or crises.

- Financial problems will occur so a plan should always be at the ready to quickly deal with circumstances.
- There is no need to reinvent the wheel as the literature on strategies and country experiences is vast.
- The FSB’s *Key Attributes* provide a good reference point to formalizing a resolution strategy.
- In Trinidad & Tobago, a key project in the Central Bank’s current Strategic Plan is to: *Strengthen technical and analytical capacity in supervision and resolution.*
- We’ve also put together *A Blueprint for Continued Financial Stability* last month to guide our efforts.
- Development of a National Financial Crisis Management Plan is underway.
- The Caribbean Central Bank Governors have commissioned a Regional Financial Crisis Management Plan.

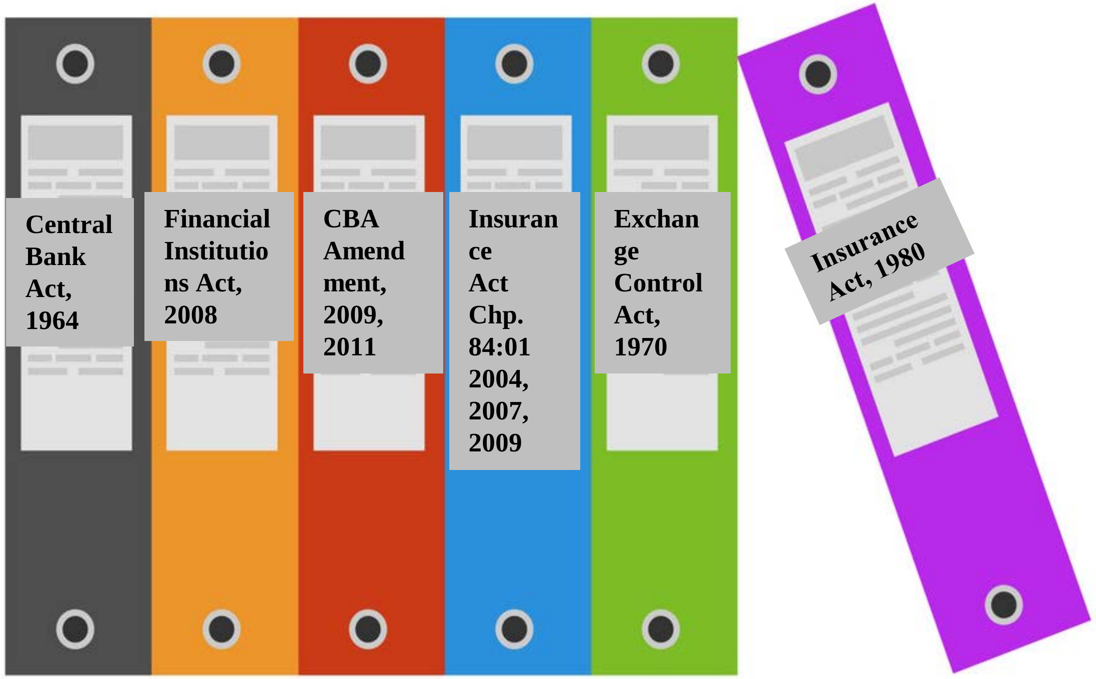
https://www.central-bank.org.tt/about/strategic-plan



https://www.central-bank.org.tt/sites/default/files/presentations/2018-fsr-presentation-blueprint-for-continued-financial-system-stability.pdf

2. Action should not be delayed because of gaps in the resolution framework.

- Resolution frameworks evolve and will likely never be perfect but this should not delay action.
- The suddenness, severity and potential contagion effects from crises may demand immediate responses.
- In the global financial crisis involving developed countries and sophisticated financial systems, a lot of improvisation was necessary.
- Drawing on other country experiences can be very useful; this can give a good idea of potential reactions to policies and pitfalls.
- There is therefore need for a degree of flexibility, accompanied by appropriate safeguards, to assure that the process has integrity.
- In Trinidad and Tobago, financial sector problems pushed needed legislative reforms higher on the Parliamentary agenda, for example amendments to the Central Bank and Financial Institutions Acts.
- Deposit insurance was also introduced.



3. The availability of fiscal space will increase the pressure for bailouts.

- In order to foster market discipline, private markets (creditors and shareholders) should ultimately bear the cost of a resolution.
- Nonetheless, at times public support may be necessary depending on the spill overs involved.
- In such cases, the support should be only what is deemed essential, and there should be transparency and a plan to recover the public resources.
- In some cases, countries may not be able to afford to provide a large bailout given their fiscal circumstances.
- Trinidad and Tobago had the fiscal space to accommodate a resolution costing 17 per cent of GDP and the recovery process is proceeding.

Table I: Reducing the Cost of Resolutions

Minimizing Spillovers in Bail-ins	*Minimizing Moral Hazard in Bail-outs*
Enhance loss-absorbing capacity	*Bail-outs to be provided:*
Clarity on:	Only in systemic cases
which claims qualify	On a temporary basis
how much of these claims are needed	After bail-in of shareholders and some creditors
where these claims are located within a financial group's structure	After the use of ex ante resolution funds
Limit who can hold these claims	Subject to ex post recovery through levies
Unsecured/uninsured creditors that understand the risks and can absorb the losses	*... and accompanied with:*
	Good governance
Improve resolvability	Strict oversight
Periodic assessments and living wills	Exit planning
Powers to remove legal/operational impediments to resolution	Review and transparency
Cross-border planning	

Source: IMF, 2018.

4. Close coordination among regulators and the fiscal authorities is essential.

- Any large resolution will involve many actors, apart from those directly impacted by the problems such as shareholders, creditors, depositors and managers of the institution/s in question.
- Some of the main actors in the resolution process include (depending on country circumstances): the Regulators/Supervisors; the Central Bank; the Government/Ministry of Finance; the Deposit Insurance Institution; the Parliament; and the Courts.
- Each agency has its own objectives and powers and it is critical that there be focus and coordination to achieve the goals of the resolution.
- In some cases, countries have established *ex ante* Financial Stability Committees involving some of these actors to plan ahead for financial crises.
- The situation may be complicated when cross-border resolution is involved as foreign regulators get into the picture.
- Properly coordinated communication to the public on developments is indispensable to maintain confidence in the financial system and the transparency of the resolution, especially where public funds are involved and there is concern about contagion.

5. Deposit insurance provides a good safety net but by itself is unlikely to calm markets in cases of systemic crises.

- Deposit insurance gives comfort to depositors that some of their deposits are secure.
- Given that banks contribute to such insurance, it limits the potential exposure of the state.
- However where problems are large, the deposit insurance fund may be inadequate, e.g.:
  - the Deposit Insurance Fund of the US Federal Deposit Insurance Corporation (FDIC) was more than fully depleted during the global financial crisis. It stood at US$52.4 billion prior to the crisis, and went into deficit as the number of banks closed or supported by the FDIC increased substantially. These costs were dwarfed by broader support provided by US authorities during the crisis, including US$434 billion of cumulative disbursals under the Trouble Asset Relief Program (TARP).
- The Deposit Insurer may also be tasked with liquidation—in Trinidad and Tobago all 9 companies were put under DIC liquidation—and this can be a complex exercise especially when large financial institutions are involved.

Table II: Deposit Insurance Payouts

Name of Institution	Year of Closure	No. of Deposits	Dep. Ins. Paid (TT$ Million)
Commercial Finance Company Limited	1986	7,452	100.1
Summit Finance Corporation (Trinidad and Tobago) Limited	1986	2,097	28.8
Trade Confirmers Limited	1986	3,647	55.7
SWAIT Finance Limited	1986	350	6.7
Mat Securities Limited	1988	366	8.0
Bank of Credit and Commerce International (Trinidad and Tobago Merchant Bankers) Limited	1991	377	43.0
Caribbean Mortgage and Funds Limited	1991	162	3.9
Principal Finance Company Limited	1993	179	5.3
Clico Investment Bank Limited	2009	128	4.3
Total		**14,758**	**255.8**

Source: Trinidad and Tobago Deposit Insurance Corporation.

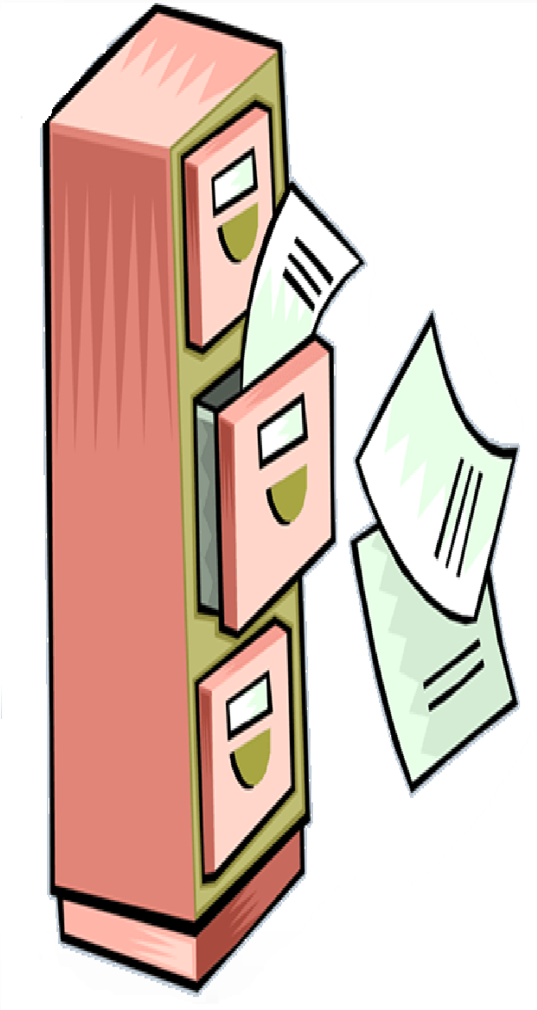
6. Legal costs can be very high and legal challenges protracted.

- Any resolution is almost certain to involve legal challenges, especially when substantial sums of money are involved.
- The resolution may also entail civil or criminal proceedings being brought against managers or agents of the financial entities.
- Depending on the magnitude of the resolution, investigations may escalate into parliamentary scrutiny and commissions of enquiry.
- Many aspects of the legislation may be untested given the general infrequency of financial crises.
- A practical concern in small countries is that there may be a limited pool of lawyers dealing with financial matters, and potential conflicts of interest may arise when the lawyers are approached by both claimants and defendants for advice or representation.
- Differences in legal systems when dealing with cross-border entities can complicate resolution, especially asset recovery.

7. A wide range of highly specialized skills must be devoted to the resolution.

- A multiplicity of professional staff is required from disciplines such as accounting, economics, actuarial science, human resources, informational technology, communications, etc. to effectively carry out resolutions.
- Finding talent can be challenging in small countries with a limited pool of skilled persons.
- It may be necessary to use foreign expertise, but attention must be paid to assuring transfer of skills to local professionals.
- Often, regulatory staff may need to be appointed to temporarily manage institutions being resolved; this in itself gives rise to a potential conflict of interest from the dual role as regulator and appointed manager.
- Managing a resolution can be very stressful for supervisory staff when it involves firing persons, conducting investigations and working alongside personnel in problem institutions.
- In Trinidad and Tobago, the Central Bank as regulator sometimes relied on Bank staff to go into the companies and manage the affairs in the immediate aftermath of a resolution.
- Staff involved in resolutions may find themselves legally exposed to matters relating to confidentiality, capacity, judgement etc. and appropriate indemnities should be provided for their protection in the legitimate exercise of their roles.

8. It is essential to record and keep track of the resolution details.



Details matter in conducting a resolution.

- For the most part, troubled banks may have poor documentation, disorganized systems and may deliberately try to hide evidence of wrongdoing.
- Some of the information uncovered may be required for legal proceedings and must therefore be verified and stored appropriately, at times for retrieval years into the future.
- Transparency in the conduct of the resolution requires that processes for investigations be documented and records be retained of how the actions were carried out and by whom.
- Apart from paper documents, computer files need to be stored and systems secured.
- Detailed tracking is necessary on resolution expenses such as legal, personnel, administrative costs, etc.
- At the same time, protocols must be established for information sharing, while respecting confidentiality restrictions.

Appropriate resolutions are necessary to ensure financial stability.

Thank you.

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