Bank van de Nederlandse Antillen

The Debt Relief: Challenges for Monetary Supervision

Willemstad, January 17, 2008

Outline

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1. **Monetary supervision and institutional investors**
   - **60/40 investment rule**
2. **Debt relief and local investments**
3. **Final remarks**

Monetary Supervision and Institutional Investors

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Tasks BNA

1. Safeguarding the stability of the external value of the Netherlands Antilles guilder (Art. 10 Central Bank Act).
2. Managing the foreign exchange reserves (Art. 12 Central Bank Act).
3. Safeguarding the soundness of the financial system (Art. 11 Central Bank Act).
4. Issue of banknotes and circulation of coins (Art. 7 Central Bank Act and art. 144 Coin Fund).
5. Promote a reliable and efficient payments system.
6. Banker of the government (Art. 14 Central Bank Act).
7. Financial-economic advisor of the government.

Monetary Supervision

- **Maintaining the fixed exchange rate of the NAf with the US$ (US$1=NAf1,79 since 1971).**
- **Operational goal: maintaining a level of official reserves (excl. gold) sufficient to cover 3 months of merchandise imports.**

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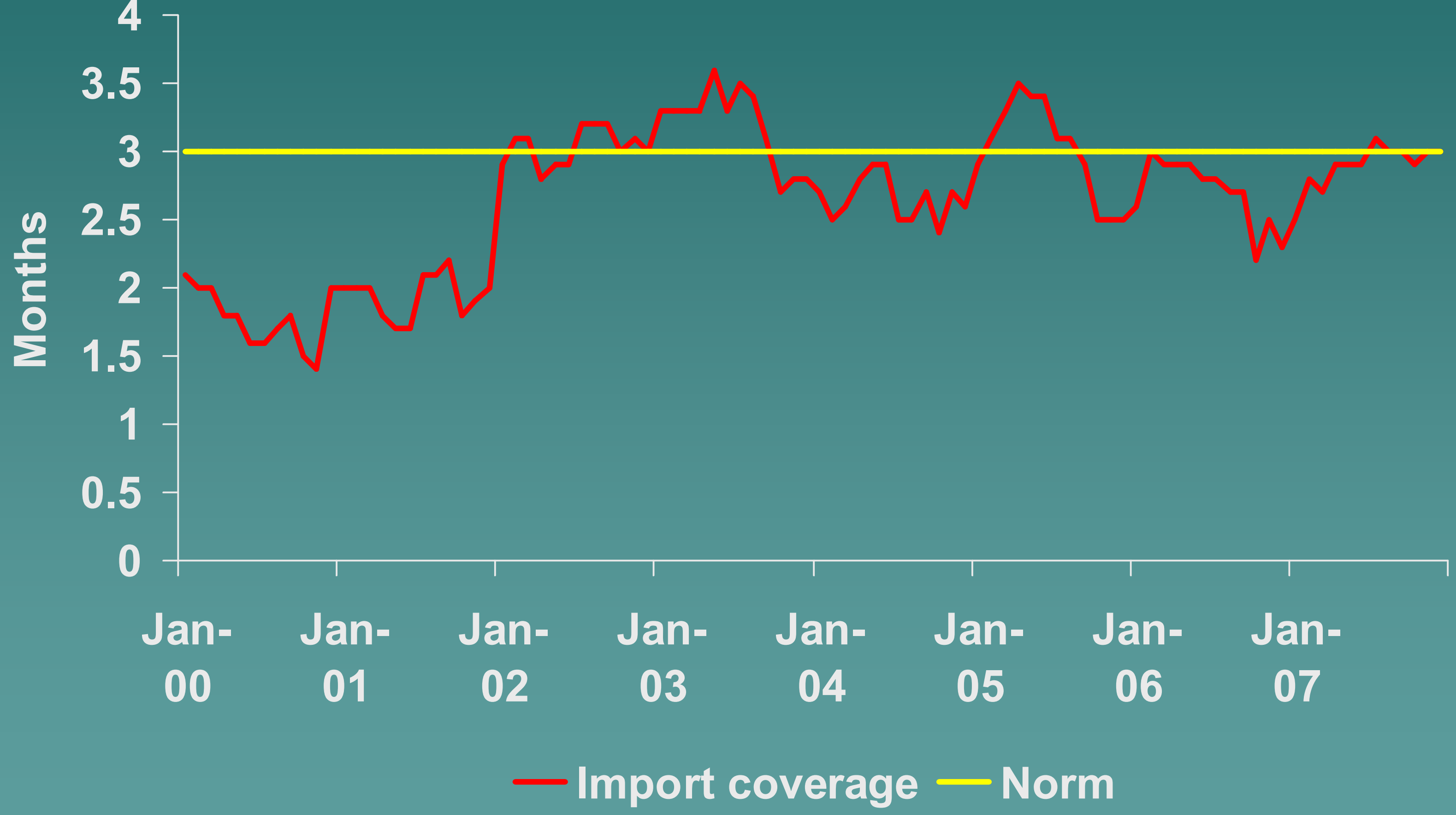
Monetary Supervision



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Instruments Monetary Supervision

1. Monetary policy
2. Foreign exchange policy
   - Licenses for capital transactions
   - 60/40-investment rule for institutional investors

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60/40-Investment Rule

Publication concerning foreign exchange transactions 2000/K.7 of July 1, 2000:

Local insurance companies and pension funds are granted a general license to invest abroad, provided that a minimum of local investments are made according to the following rule:

- **40% of the first NAf 10 million of reserves and debts**
- **50% of the second NAf 10 million of reserves and debts**
- **60% of the remaining reserves and debts**

60/40-Investment Rule

Motives for this rule:

1. **Safeguarding the level of foreign exchange reserves**
2. **To stimulate that local savings are used for the development of the local economy**
3. **Development of the local capital market**

Bottlenecks:

- **Limited availability of local investment opportunities with an acceptable (competitive) risk/return profile**
- **Prudential supervision institutional investors**

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60/40-Investment Rule

First steps towards a flexibilization of the rule:

1. **Publication concerning foreign exchange transactions 2005/K.7A of October 1, 2005:**
   - **Under certain conditions local institutional investors may invest more abroad if an equal amount is put in a qualifying local investment.**
2. **Publication concerning foreign exchange transactions 2006/K.7B of April 1, 2006:**
   - **Local institutional investors may invest less locally than the required minimum, but the difference is subject to a penalty (5.90% in 2007-IV).**

60/40-Investment Rule

Shares %	2003	2004	2005	2006
Pension funds				
- Domestic	39	42	51	51
- Foreign	61	58	49	49
Life insurance companies				
- Domestic	52	54	56	64
- Foreign	48	46	44	36
General insurance companies				
- Domestic	63	64	69	66
- Foreign	37	36	31	34

Debt Relief and Local Investment

Debt Relief

- **Maximum interest burden 5% of average revenues previous 3 years.**
- **Dutch government willing to take over the outstanding debt as of 31-12-2005 till the level corresponding with the maximum interest burden**
  - **Outstanding debt 31-12-2005: NAf 5 billion**
  - **Approximately 85% (NAf 4.25 billion) will be taken over**
- **Objective: sound financial position**

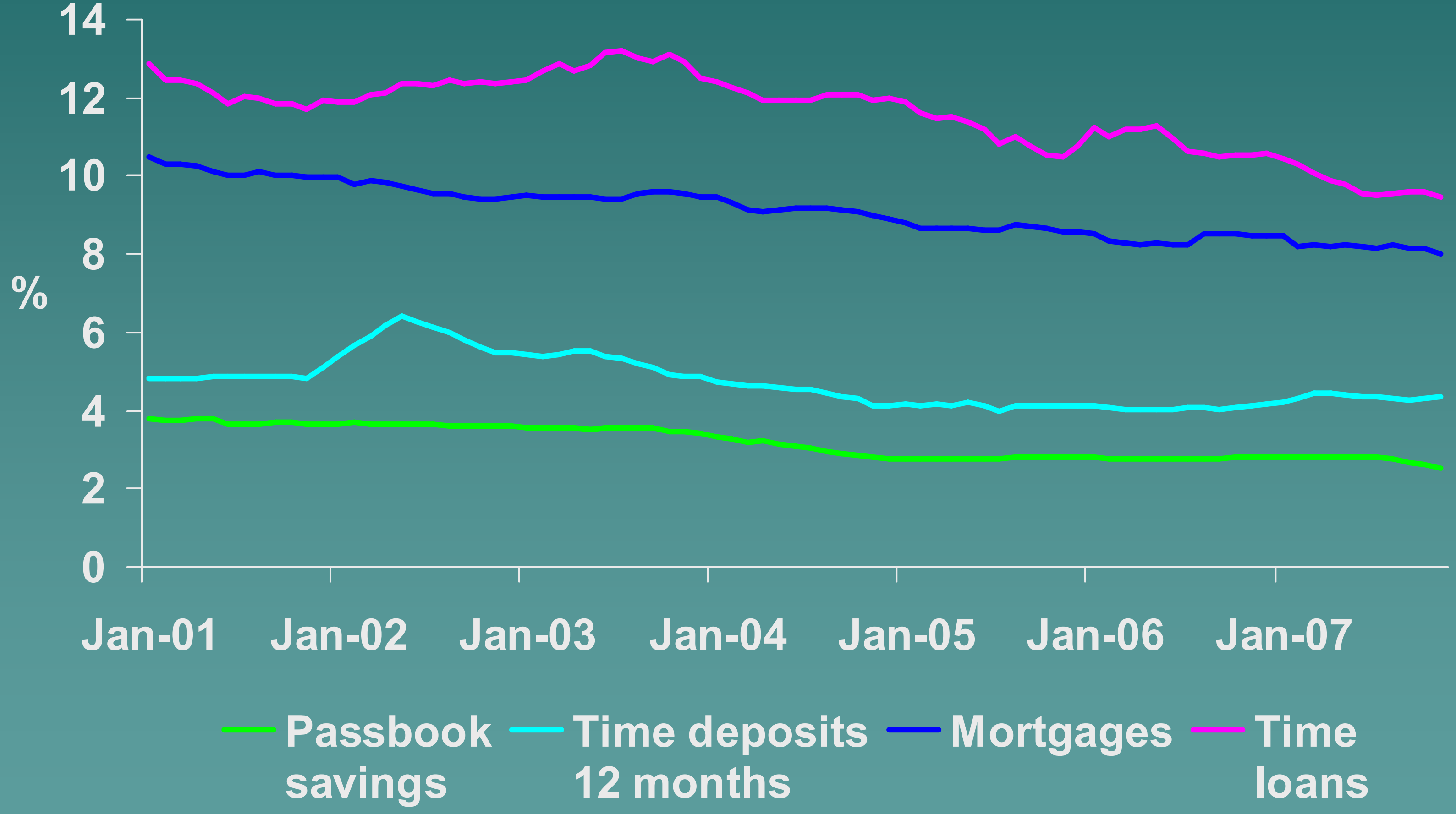
Debt Relief

- **Conditions**
  - **Financial supervision**
  - **Balanced current budget**
  - **Adherence to maximum interest burden**
  - **Improvement financial management and control**

Consequences

- NAf 3.5 billion liquidity inflow in the economy in the coming years
- Part will leak abroad but substantial amount will remain in the economy
- Availability of funds for the private sector will increase putting domestic interest rates under pressure
- Higher domestic consumption and investment
- Risk of asset price inflation

Domestic Interest Rates



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Impact on Institutional Investors

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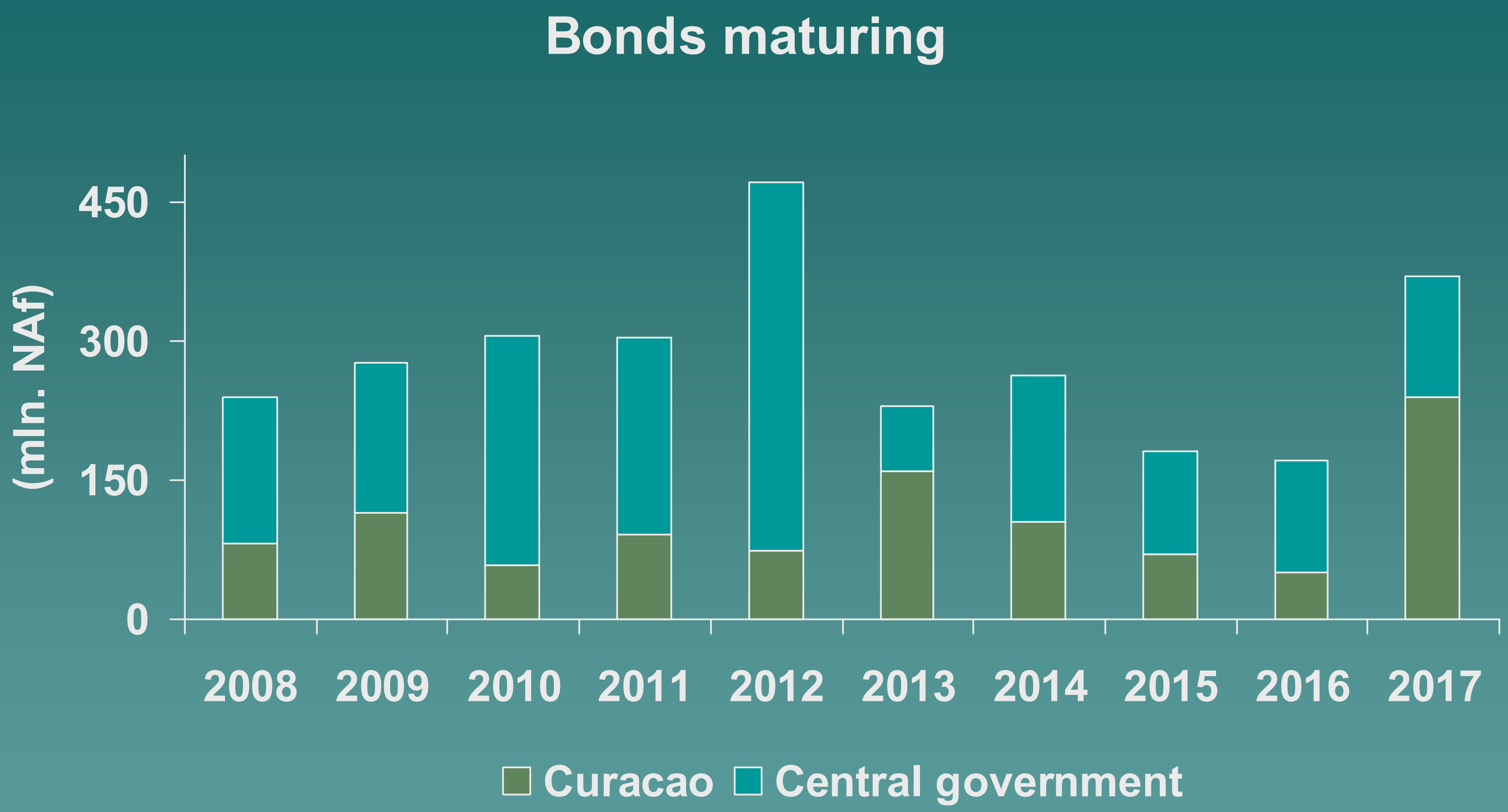
- 50% outstanding debt 31-12-2005 consists of government bonds (NAf 2.5 billion)
- 76% of government bonds (NAf 1.9 billion) is in the portfolios of institutional investors
- Government bonds are the main domestic investment instrument for institutional investors but availability will decline substantially
- Insufficient local alternatives at comparable risk/return rates
- Flexibilization 60/40 investment rule

Spread Government Bond Yield

Antilles/US

Flexibilization 60/40 rule: example



- An average NAf 275 million of government bonds matures per year

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Flexibilization 60/40 rule: example (cont.)

- **Institutional investors hold 76% of bonds and 85% will be paid back: NAf 181 million per year**

- **Reserves and debts grow by 5% per year on average**

- **60% minimum local investment requirement could be reduced on average by 2 percentage points per year without negative impact on forex reserves**

- **Ultimately a 42% minimum local investment requirement after 85% of bonds are paid back**

Flexibilization 60/40 rule: complication

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- **A general flexibilization is only equitable if:**
  - **share of local government bonds in investment portfolios is equal among institutional investors**
  - **% of local government bonds redeemed each year is equal among institutional investors**
- **Solution: take into account specific situation of each institutional investor**
  - **an amount equal to the amount of local government bonds redeemed may be invested abroad**
- **Reporting requirements**

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Flexibilization 60/40 rule: example

Different shares local government bonds		Minimum local investment				
		40/60	40/58	Exemption	Diff.	Diff.
		(1)	(2)	(3)	(2)-(1)	(3)-(1)
Company A						
Reserves and debt	300	177	171	167	-6	-10
Redemption local government bonds	10					
Share	3%					
Company B						
Reserves and debt	500	297	287	291	-10	-6
Redemption local government bonds	6					
Share	1%					

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Flexibilization 60/40 rule: example

Equal shares local government bonds		**Minimum local investment**				
		40/60	**40/58**	**Exemption**	**Diff.**	**Diff.**
		(1)	(2)	(3)	(2)-(1)	(3)-(1)
Company A						
Reserves and debt	300	177	171	171	-6	-6
Redemption local government bonds	6					
Share	2%					
Company B						
Reserves and debt	500	297	287	287	-10	-10
Redemption local government bonds	10					
Share	2%					

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Final Remarks

1. **Flexibilization investment rule is justified given the redemption of large part of government bonds and insufficient local alternatives at comparable risk/return.**

2. **Further development local capital market becomes even more important to offer a broader variety of attractive investment products for local investors:**
   - **Government bonds are now the dominant securities in the local capital market but their significance will decline considerably**
   - **Private bonds**
   - **Stocks**
     - **Privatization**
     - **Venture capital fund**
     - **Stock/securities exchange**

Thank You

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