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Paramaribo, May 17, 2013

Mr. Luis Alberto Moreno
President
Inter-American Development Bank
Washington, DC

Dear President Moreno,

This Policy Letter serves to reiterate the strong commitment of the Government of Suriname (GOS) to the implementation of a comprehensive policy and institutional reform program to strengthen and increase the efficiency and effectiveness of the financial sector as we pointed out at the beginning of the Programmatic Program agreed with the IDB. As it was envisaged, the design and implementation of the reform measures are being led by the Central Bank of Suriname (CBvS), but the program also includes policy measures to be implemented by other institutions. We believe that the implementation of this program is critical for accelerating the overall economic and social development of Suriname. In this regard, we expect that the program will contribute to: (i) enhanced macroeconomic stability as the Central Bank will have more effective market based policy instruments; (ii) the strengthening of financial institutions that are less vulnerable to external shocks via an enhanced legal and regulatory framework and enhanced supervision; (iii) a more competitive, diversified and growing economy as a result of a deepening and broadening of private sector access to finance; and (iv) increased living standards by enhancing households access to financial services.

To support the design and implementation of key components of the reform program, we have requested from the IDB a series of three Programmatic Policy-Based Loans totaling an estimated US\$155 million, US\$105 million of Ordinary Capital Resources and US\$50 million from the China Co-financing Fund. The first loan (SU-L1023) was for US\$40 million, this second loan will be US\$ 100 million. A complementary Operational Inputs, Technical Cooperation (SU-T1058), is actually in execution. In addition to the IDB, we have and will continue to receive support from other multilateral financial institutions (MFIs) as well as from Central Banks in the Region. The support from the IDB has been designed to be coordinated with the assistance from these other institutions.

As was pointed out from the beginning, our financial sector strengthening reform program is a medium term initiative that has been progressing substantially in the last two years. We expect that most of its measures will be completed over a three to five year period. It currently includes seven components: (i) the maintenance of a macroeconomic policy framework that supports the sound and sustained development of the financial sector; (ii) legislative and regulatory reforms; (iii) the strengthening of the supervision of financial institutions and markets; (iv) the institutional strengthening of the CBvS; (v) money and capital market development; (vi) public banks reform; and (vii) enhancing the enabling environment for greater access to finance. Below, this letter will explain the key policy and institutional measures of the program and the challenges, which it is designed to address.

I. Macroeconomic Policy Framework

Since 2011, the government undertook a coordinated series of measures to address potential threats to maintaining macroeconomic stability posed by: (i) a widening fiscal imbalance, caused in large part by a civil service wage reform, which substantially, increased overall wage levels and expenditures, and (ii) an increasingly wide gap between the official and parallel foreign exchange market. To expand fiscal revenues, measures included an increase in the fuel levy and the application of luxury taxes on alcohol, cigarettes and casino activities. To address foreign exchange problems, the currency was devalued about 20% against the US dollar which eliminated the aforementioned gap. In addition, the devaluation also boosted revenues and helped to enhance the competitiveness of the economy. The IMF has estimated that the new official exchange rate is in line with macroeconomic fundamentals. The willingness of the government to take these unpopular measures is an indication of its commitment to establishing and maintaining sound macroeconomic policies that are also consistent with the objectives of the overall financial sector reform program.

During 2012 the government has maintained tightened fiscal and monetary policies that have contributed to an impressive stabilization of the economy, with the fiscal accounts improving noticeably and inflation coming down to lower single digits. In fact, the economy continues to recover at a steady pace, buoyed by strong activity in the oil and gold sectors, as well as public investment. The balance of payments also strengthened significantly, boosting reserves to nearly US\$1 billion (over 5 months of imports) at September 2012. With still tight monetary conditions, 12-month inflation rate dropped to 3.7 percent in September 2012, from a peak of over 22 percent in April 2011.

The policies implemented in recent years have helped set the stage for strong and sustainable growth. The authorities believe in the need to ensure that public finances remain well managed and the domestic financial market is appropriately regulated and supervised. In the area of public finances, we envisage that it would be critical, as mineral revenues increase over the medium term, to save the surpluses for future generations. In this context, the authorities are planning to establish a sovereign wealth fund (SWF) by year's end. We also would like to reaffirm our plans to restrain current spending growth, with a view to making space for carefully selected and executed capital projects. Finally, the authorities also believe that there might be some space for easing monetary conditions in the coming months, provided that inflation and demand pressures remained in check.

II. Legal and Regulatory Framework

The previous legal and regulatory framework created a condition that limited the development of more stable financial markets, more effective and stronger financial institutions, and a primary factor contributing to the Central Bank's difficulties to conduct effective and comprehensive financial market supervision. Under the previous legislation, the Central Bank did not have the legal authority to conduct supervision in a manner consistent with international standards, and many important regulations of the banking system have not been established. There is no special legislation for the insurance sector or securities markets and mutual evaluations by the Caribbean Financial Action Task Force (CFTAF) have found important deficiencies in the legal and regulatory framework with regard to anti-money laundering as well as terrorism financing.

To address these shortfalls, the GOS has been conducting a comprehensive reform of the legal and regulatory framework. This reform will give the CBvS the legal authority to conduct financial supervision that meets international standards. It includes: (i) new legislation for banking, enacted in 2011, and (ii) legislation for other credit institutions, insurance, securities markets, foreign exchange activities and policy, money transfer activities, as well as anti-money laundering and terrorism financing; all will be approved before the end of 2013. It can be argued that banking legislation was the most important, given that we have a bank-dominated financial system, where the banking sector holds over 80% of financial sector assets. All the complementary regulations for the enforcement of the banking law will also be enacted during the first half of 2013. For the other laws we expect that all required regulations will be issued by the end of 2013.

III. Enhanced Supervision of Financial Institution and Market

In addition to the constraints imposed by the legal and regulatory framework, effective supervision is also limited by shortfalls in terms of human resource capacities, supervisory procedures, and information systems. To address these shortfalls, the CBvS, with technical assistance from the IDB Project Team, has developed a medium-term Financial Institutions Supervision Enhancement Plan that has been under implementation and substantial progress has been achieved. This Plan has been approved by the CBvS and technical assistance has been received from a range of development institutions, including the IDB to assist with its implementation. The Plan, that includes measures covering the aforementioned legal and regulatory reforms, supervision processes and procedures, information and analysis, as well as the strengthening of the technical abilities of supervisory staff and ensuring sufficient staffing, has been implemented and important progress has been achieved, as to date a new model to conduct on-site and off-site supervision has been developed and three banks have been supervised under the new standard, with the assistance of an external consultant.

IV. Upgrading of the Institutional Capacities of the CBvS

The Central Bank is responsible for the supervision of all financial institutions and financial markets in addition to conducting traditional central bank responsibilities. Authorities consider, and recent evaluations strongly confirm that comprehensive institutional strengthening was needed for the Central Bank to more effectively assume its responsibilities. To ensure that the Central Bank has these capacities, we have developed a comprehensive institutional strengthening program that is

under implementation. For these developments, we also have been receiving technical assistance from the IDB and the other type of institutions noted above for the design of different components and for its implementation. The program is under execution and substantial progress has been achieved.

V. Development of Inter-Bank Money and Securities Markets

There is almost a complete absence of money markets and securities markets in Suriname. The lack of secondary markets for public debt limits the ability of the CBvS to conduct more efficient market based monetary and foreign exchange policies. Currently, the CBvS needs to rely on the rather blunt instrument of bank reserve requirements to manage liquidity. Without a functioning securities market, investment opportunities for potential institutional investors, including insurance companies, pension funds and banks, are limited, and alternative sources of finance for the private and public sectors are not available. Moreover, the limited level of development of these markets contributes to the narrowness of financial instruments available and the relatively limited level of finance available for both the private and public sectors from financial markets. While it is understood that the development of capital markets is a long-term process, the government is taking measures to accelerate its development, with an initial focus on inter bank markets in order to allow for the development and use of market-based liquidity management instruments. Other aspects of our initiative will include an enhanced legal and regulatory framework and supervisory capabilities for these markets, as well as the institutional strengthening of the Suriname Stock Exchange. The government hopes to be able to use the Stock Exchange for the issue of equity by public enterprises in several years.

The Bank is on track to start implementing the public debt and inter-bank market plan during the first quarter of 2013; following that appropriate regulations to guide inter-bank debt activity should be in place by the end of 2013. A security market supervision unit has already been established in the Bank. This would become operationally functional once the security market law is passed in parliament. The Bank expects the draft legislation to be submitted to parliament during the first quarter of 2013. The second draft of the Act has been presented to CARTAC, the main consultants for comments. Discussions are also ongoing with the Stock Exchange. The drafting and issue of appropriate regulations should become available by end-2013. On the other hand, the draft legislation governing Foreign Exchange Market (Cambios and money transfers) was passed in Parliament in October 2012.

VI. Public Bank Reform

The GOS owns three commercial banks. Unfortunately, these institutions have had weak financial performance for a significant period. While the banks provide a full range of commercial bank services, they do have some focus, on specific markets; two on middle to lower income urban markets, and the third on agricultural finance. However, their policy mandates are not clear, nor have they developed in most cases specialized instruments to meet the needs of these markets. In this area, our Government has decided to sell one to the private sector and merge the two others. The merged bank would have: (i) clear social economic policy goals; (ii) financing mechanisms that

address market failures; and (iii) a commercial strategy and corporate governance that ensure financial sustainability. It is important to mention that, recently the Government has engaged an external auditor to analyze and assess the condition of all the assets and liabilities of the three public banks in order to clarify the options that we have to address and what public banks' policy to adopt.

VII. Enabling Environment for Greater Access to Finance

Some factors that contribute to the relatively limited level of access to finance for both firms and individuals include the relatively high costs faced by financial institutions to obtain information on potential clients upon which to make estimates for credit. In addition, currently financial institutions in general only accept real estate assets as collateral for loans. By not accepting other types of assets, firms and households often cannot meet the collateral requirements of financial institutions. To address these limitations, the Government is planning to support the establishment of a credit bureau as well as a property registry for non-real estate assets. Good progress has been made in the drive to set up a credit bureau to facilitate financial institutions' access to customers' credit history. Draft legislation to guide the process has been completed and has been passed on to the stakeholders for comments. It is envisaged that the Bill would be passed in Parliament during the first quarter of 2013. Meanwhile, a Legal and Regulatory working group, including 3 persons from the Bankers Association to push the process, was installed in July 2012. We are planning to hold a public seminar to educate the general public about the importance of credit bureau in the second quarter of 2013. On the other hand, with the support of the IDB's 'Compete Caribbean Initiative', we have started to analyze and define a Roadmap for action to improve the access to finance for Small and Medium Enterprises, in particular to review the legislation governing secured transactions and assess alternative models for a collateral registry.


VIII. Conclusion

As the foregoing makes clear, the Government of Suriname is, and will continue, working substantively to strengthen and increase the efficiency and effectiveness of the financial sector.

The government is committed to pursue these efforts, for which it will require the continuing support of the IDB in the areas described.

In closing, we would like to express our appreciation to the IDB for its support in the development and implementation of our financial sector strengthening program.

Sincerely,



H.E. Adelson Wijnerman
Minister of Finance
Government of Suriname