

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**DOMINICAN REPUBLIC**

**STRENGTHENING, SUPERVISION AND REGULATION OF THE  
BANKING SYSTEM**

**(DR-L1001)**

**TECHNICAL COOPERATION LOAN**

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## **ANNEXES**

Annex I      Logical framework

### **BASIC SOCIOECONOMIC DATA**

For basic socioeconomic data, including public debt information, please refer to the following address:

<http://www.iadb.org/int/sta/english/staweb/>

## INFORMATION AVAILABLE IN THE RE2/FI2 TECHNICAL FILES

### **Preparation:**

- Letter of request for technical cooperation
- Reports of the joint mission of the International Monetary Fund, the World Bank, and the IDB
- IDB-MIF TC-9802449 project execution reports
- Identification mission report – 9-19 July 2003
- Economic stabilization program for the Dominican Republic: Stand-By Agreement with the International Monetary Fund, published by the BCRD
- Monetary and Financial Law
- Technical-cooperation matrix agreed with the authorities, 18 July 2003
- Schedule of activities presented by the authorities

## **ABBREVIATIONS**

APTU	Program administrative technical unit
BCRD	Central Bank of the Dominican Republic
BNV	Banco Nacional de la Vivienda [National Housing Bank]
PBL	Policy-based lending
PTU	Program technical unit
SB	Superintendency of Banks



Inter-American Development Bank  
Regional Operations Support Office  
Operational Information Unit

## Dominican Republic

### Tentative Lending Program

**2003**

Project Number	Project Name	IDB US\$ Millions	Status
DR0146	Pension Reform Implementation	5.0	APPROVED
DR0152	Competitiveness Promotion Program	9.4	APPROVED
DR0149	Inform. Society's Institutional Develop	5.4	
DR0151	Financial Reform Consolidation Sector Program	100.0	
DR1001	Strengthening the Banking Sector, Supervision and Regulation	6.0	
DR0159	Sustainable and Protection of Social Reforms	200.0	
<b>Total - A : 6 Projects</b>		<b>325.8</b>	
DR0148	Sector Facility for Foreign Trade	5.0	
<b>Total - B : 1 Projects</b>		<b>5.0</b>	
<b>TOTAL 2003 : 7 Projects</b>		<b>330.8</b>	

**2004**

Project Number	Project Name	IDB US\$ Millions	Status
DR0076	Social Welfare Sector Reform	5.0	
DR0150	Social Reform Program	100.0	
<b>Total - A : 2 Projects</b>		<b>105.0</b>	
DR0141	Housing Program	30.0	
DR0156	Public Investment Project strengthening Management	5.0	
DR0154	Enhancement of Superior Education, Science and Technology	34.0	
DR0157	Fiscal Modernization Program	5.0	
DR0143	Rehabilitation Historical Center Sto Domingo	50.0	
<b>Total - B : 5 Projects</b>		<b>124.0</b>	
<b>TOTAL - 2004 : 7 Projects</b>		<b>229.0</b>	
<b>Total Private Sector 2003 - 2004</b>		<b>0.0</b>	
<b>Total Regular Program 2003 - 2004</b>		<b>559.8</b>	

**\* Private Sector Project**



# DOMINICAN REPUBLIC

## IDB LOANS

APPROVED AS OF AUGUST 31, 2003

	US\$Thousand	Percent
<b>TOTAL APPROVED</b>	<b>2,273,405</b>	
DISBURSED	1,743,464	76.68 %
UNDISBURSED BALANCE	529,941	23.31 %
CANCELATIONS	562,018	24.72 %
PRINCIPAL COLLECTED	683,195	30.05 %
<b>APPROVED BY FUND</b>		
ORDINARY CAPITAL	1,479,901	65.09 %
FUND FOR SPECIAL OPERATIONS	707,277	31.11 %
OTHER FUNDS	86,227	3.79 %
<b>OUTSTANDING DEBT BALANCE</b>	<b>1,060,269</b>	
ORDINARY CAPITAL	640,979	60.45 %
FUND FOR SPECIAL OPERATIONS	412,862	38.93 %
OTHER FUNDS	6,428	0.60 %
<b>APPROVED BY SECTOR</b>		
AGRICULTURE AND FISHERY	508,464	22.36 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	129,612	5.70 %
ENERGY	337,824	14.85 %
TRANSPORTATION AND COMMUNICATIONS	231,932	10.20 %
EDUCATION	253,379	11.14 %
HEALTH AND SANITATION	185,299	8.15 %
ENVIRONMENT	0	0.00 %
URBAN DEVELOPMENT	32,834	1.44 %
SOCIAL INVESTMENT AND MICROENTERPRISE	330,860	14.55 %
REFORM AND PUBLIC SECTOR MODERNIZATION	188,198	8.27 %
EXPORT FINANCING	20,296	0.89 %
PREINVESTMENT AND OTHER	54,706	2.40 %

\* Net of cancellations with monetary adjustments and export financing loan collections.



# DOMINICAN REPUBLIC

## STATUS OF LOANS IN EXECUTION

AS OF AUGUST 31, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<b><u>REGULAR PROGRAM</u></b>				
Before 1997	1	52,000	27,424	52.74 %
1997 - 1998	6	265,460	166,238	62.62 %
1999 - 2000	5	183,700	17,721	9.65 %
2001 - 2002	3	335,000	100,702	30.06 %
2003	1	5,000	0	0.00 %
<b>TOTAL</b>	<b>16</b>	<b>\$841,160</b>	<b>\$312,085</b>	<b>37.10 %</b>

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\* Net of cancellations. Excludes export financing loans.



# STRENGTHENING, SUPERVISION AND REGULATION OF THE BANKING SYSTEM

(DR-L1001)

## EXECUTIVE SUMMARY

<b>Requester:</b>	Dominican Republic	
<b>Executing agency:</b>	Central Bank of the Dominican Republic (BCRD), with the participation of the Superintendency of Banks (SB) and Banco Nacional de la Vivienda [National Housing Bank] (BNV)	
<b>Amount and source:</b>	IDB (OC):	US\$6,000,000
	Local:	US\$ 600,000
	Total:	US\$6,600,000
<b>Terms and conditions:</b>	Amortization period:	20 years
	Grace period	3 years
	Execution period	18 months
	Minimum disbursement period:	24 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	U.S. dollars drawn from the Single Currency Facility
<b>Objectives:</b>	This program will fulfill the prior commitments required for the establishment of a macroeconomic program with the IMF and the financial support of international organizations (IDB and the World Bank). The program objective is to help the Monetary Board launch an on-site assessment of the condition of all banking institutions and to help the authorities to develop and implement their program of financial sector consolidation. The program is also an integral part of the authorities' policy to improve conditions in the banking sector and address present weaknesses in the financial sector. To achieve that end, it will be necessary to review the regulations in force, develop and fully implement the Monetary and Financial Law, examine the information systems and train staff in the inspection and information systems divisions of the SB and the BCRD.	
<b>Description:</b>	This technical-cooperation program is an integral part of the <b>Dominican authorities' program to strengthen the financial</b>	

**system.** The prevailing circumstances and recent developments in the Dominican banking system have drawn the attention of the authorities and the overall market to the serious shortcomings in banking regulations and supervision, the risk of poor accounting practices, and the importance of having banks that are sound participate in the market. In recognition of the importance of these issues for the country and the economy, the authorities are preparing a program to restore confidence and to strengthen the financial system. This program dovetails with efforts that include the negotiation of a program with the IMF, a policy-based lending (PBL) sector program in preparation with the IDB, and a technical-assistance program with the World Bank. It is important to note that the authorities have been in close dialogue with the three multilateral organizations, which have kept an ongoing presence in the country since the problems in the banking sector began to appear.

This technical-assistance program will include the following components:

1. **Assisted inspections.** A series of assisted inspections will be conducted until all of the country's banking institutions have been examined.

**Primary objectives:**

Identify **poor accounting practices** in the banks and their extent

Assess bank **solvency**

**Secondary objective:**

- Transfer **know-how** to the Superintendency of Banks and thereby strengthen its oversight capacity.
2. **Prudential regulations.** The program will review, adjust and, if necessary, draw up appropriate prudential standards for control and supervision of banking institutions that are not provided for in the IDB/MIF operation (TC –99-01-01-9). The most crucial issues for bringing the prudential standards into line with the Basel principles are those related to the definition of financial conglomerates and consolidated supervision. This task includes analysis and discussion with technical teams from the SB and the BCRD, drafting of standards and preparation of the final version. The program will also prepare regulations on sanctions for noncompliance with the regulatory and control standards.

3. **Regulations for operation of the monetary and financial authority.** In pursuance of the development and implementation of the Monetary and Financial Law, this component includes the preparation of operating regulations for the new Monetary Board, which will take up its functions in August 2004. The bylaws of the BCRD and the SB will also be drawn up.
4. **Consulting services to review the regulations for State-owned banks.** This component is intended to advise the authorities on updating and modernization of the regulations for operation and functioning of State banks. Particular emphasis will be placed on a review of the regulations for the Banco Agrícola and the Banco de Reservas.
5. **Conversion of Banco Nacional de la Vivienda [National Housing Bank] (BNV) into a second-tier bank.** The purpose of this component is to supplement the technical-assistance needs so as to achieve an orderly conversion of the BNV into a second-tier bank operating with maximum efficiency.
6. **Coordination of all oversight entities.** The Dominican Republic opted to have separate oversight entities for each activity in the financial sector (i.e., banks, insurance, pensions, securities). The Monetary and Financial Law provides that the Monetary Board shall create the necessary mechanisms for proper coordination and collaboration of the oversight entities. Through this component, the authorities will be advised on the design and implementation of the mechanism for coordination among the oversight entities.

**Environmental  
and social  
review:**

Given the fact that this technical-cooperation project provides only for the hiring of consulting services to perform work relating to inspections, information systems, and the drafting of legal and regulatory provisions, no environmental impact of any kind is expected.

In response to the recommendation from CESI, however, the letter of agreement for the program will contain a provision whereby the regulations pertaining to portfolio risk analysis and evaluation will also consider the potential environmental risks posed by projects in the portfolio that could possibly entail financial risks if not properly addressed.

<b>Benefits and beneficiaries:</b>	The program beneficiaries will be the Monetary Board, the BCRD, the SB, and banking system institutions and users (depositors and borrowers).
<b>Risks:</b>	One possible risk in an operation of this kind is a failure to complete the activities in time for implementation of the reforms envisioned in the sector finance program and the bank consolidation program. This risk is minimal, however, in view of the authorities' commitment to such activities through participation in the financial-sector PBL operation being prepared by the Bank and as one of the conditions of the program they are being negotiated with the IMF. This program will also allow for the hiring of qualified international consultants to move the authorities' financial program forward. Provision has been made for a plan of execution whereby coordination and management of all aspects of the authorities' financial program will be centralized under the Monetary Board secretary.
<b>The Bank's country and sector strategy:</b>	The Bank's strategy for the Dominican Republic is focused mainly on support for maintaining macroeconomic stability and for poverty reduction. For the financial sector, the Bank has set priorities to support: (i) strengthening of the prudential and regulatory framework; (ii) strengthening of oversight; and (iii) adjustments to the information systems used by the monetary authorities. The operation serves the Bank's priorities in that regard.
<b>Coordination with other international organizations:</b>	The Bank is coordinating all of its activities with the Dominican financial authorities, the IMF and the World Bank. So far this year, the Bank has participated in joint missions with the IMF and the World Bank to examine and rectify the problems in the Dominican banking sector. The three institutions are also working together to provide technical assistance to the country to support the recovery and strengthening of its banking system (paragraph 1.7).
<b>Special contractual clauses:</b>	<p>As a condition precedent to the first disbursement of financing, the borrower, through the executing agency, must demonstrate to the Bank's satisfaction that:</p> <ol style="list-style-type: none"> <li>an agreement has been signed for transfer of responsibilities and resources by the borrower and the executing agency;</li> <li>agreements have been signed coexecution of program components by the executing agency, the Superintendency of Banks and Banco Nacional de la Vivienda.</li> </ol>

**Poverty-targeting and social sector classification:**

This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). The program will have an indirect social impact insofar as it will protect small savers and minimize the risk of a financial crisis which affects all members of society with a distributional impact that is regressive (see paragraph 3.2).

**Exceptions to Bank policy:**

None.

**Procurement:**

In response to the request of the Dominican government, and to move ahead with the assisted inspections, the project team will recommend that expenditures incurred since 1 September 2003 be recognized, provided they comply strictly with the criteria set forth in the procurement manual and have been approved by the project team.

## **I. FRAME OF REFERENCE**

### **A. Background**

- 1.1 This technical-cooperation project has been prepared in response to a request from the Government of the Dominican Republic to provide immediate assistance to assist the banking system in its current situation and to address the urgent need to develop and implement the Monetary and Financial Law. The government's strategy is to press ahead with structural reforms in the financial sector while it implements measures to ensure that banks remain solvent. The government has requested assistance from the multilateral organizations in implementing this strategy. As explained below, the technical-cooperation activities will supplement the activities already carried out under other technical-cooperation programs financed by the Bank and will serve as a basis for drawing up the financial sector program currently in preparation.

### **B. The financial sector**

- 1.2 The Dominican authorities carried out major financial sector reforms in the past decade, including the deregulation of interest rates, elimination of subsidies and credit limits, and tying the legal reserve to bank liabilities in local currency. The prudential standards were modernized as well. Despite increases in bank equity, however, the system remains weak and undercapitalized, owing to rapid credit expansion and growing provisions for bad debts. The situation could produce major systemic risks as a result of growing indebtedness in foreign currency, high interest rates in real terms, and considerable concentration of bank loans in few customers, particularly with related parties, in a sector where there is virtually no capital market, a factor that would reduce the term risks that guarantee an adequate flow of medium- and long-term resources to spur productive investment. These conclusions are shared by the IMF and the World Bank, which have conducted a full analysis through a Financial Sector Assessment Program (FSAP). The analysis reveals an inadequate legal framework, weak supervision and lack of reliable and timely information.
- 1.3 The Dominican Republic has an extensive and active network of financial intermediaries that are unregulated and not necessarily connected with formal financial institutions. In part, all the formal institutions may be linked, through their shareholders, to informal entities such as financial groups, over-the-counter securities dealers, credit card companies and offshore groups. The situation therefore calls for several adjustments: give the Superintendency of Banks more power and autonomy to carry out its tasks; improve the quality and depth of on-site and off-site supervision through training for staff in regulation and oversight of financial conglomerates, and by improving the technical, legal and research departments; prudential standards on capital requirements as a function of risk; review, update and modernize the risk management center and introduce solvency ratios for all risks (market, liquidity and interest rates); convergence with

international accounting standards for financial information; prudential limits on loans to related parties; evaluate management quality and internal controls for risk management; and strengthen offshore banking inspections.

**C. Bank strategy in the sector**

- 1.4 The Bank's strategy for the Dominican Republic targets poverty reduction through the fostering of sustainable growth led by gains in competitiveness and increased productive capacity among the poor population. In application of these objectives to the financial sector, the Bank has set priorities to support: (i) strengthening of the prudential and regulatory framework; (ii) strengthening of oversight; and (iii) adjustments to the information systems used by the financial authorities. The Bank hereby proposes a technical-cooperation project with MIF resources to strengthen the Superintendencia de Bancos [Superintendency of Banks] (SB) (TC-99-01-01-9).
- 1.5 The Bank is currently preparing a new PBL (policy-based lending) operation targeted to the financial sector in the amount of US\$100 million, in conjunction with this nonreimbursable technical-cooperation loan (FSO), to finance the implementation of the Monetary and Financial Law, and in particular to conduct assisted inspections through on-site assessments to determine the actual condition of all banks in the system. These operations will be presented to the Board of Executive Directors for its consideration this year.

**D. Program rationale**

- 1.6 In light of the urgency stated by the government, and in order to address the serious problems obtaining in the Dominican banking sector and the pressing need to implement the Monetary and Financial Law and continue the financial sector reforms, the authorities will require technical assistance to supplement the country's limited human resources with expertise in financial crisis issues. This operation will also provide a basis for measures to be taken by the government to implement the reforms envisioned in the Financial Sector Program and to carry out the commitments it has taken on with the IMF.

**E. Coordination with other multilateral organizations**

- 1.7 Since the beginning of this year, when the problems of the Dominican banking sector became apparent, the government has been requesting the cooperation of multilateral organizations, and in particular the IMF. During the year, the Bank has actively participated in joint missions with the IMF and the World Bank to examine and rectify the problems in the Dominican banking sector. The three institutions are also working closely to provide technical assistance to the country to support the recovery and strengthening of its banking system. There is now some possibility that the U.S Treasury will contribute technical assistance. The World Bank has

provided for a technical-assistance loan for the financial sector that could be formalized by the end of this year. The IMF also negotiated a stand-by program with the government to reestablish macroeconomic balance and return the banking system to a sound footing while confidence in the Dominican economy is restored.

## **F. Objectives and description**

- 1.8 The objective of the program is to assist the authorities to develop and implement a **Financial Sector Strengthening Program targeted to the development and full implementation of the Monetary and Financial Law**. The specific objectives include support for the SB in completing an on-site assessment of all banking institutions in order to identify any weaknesses, amend the regulations in force, make adjustments to the information systems and train the staff of the inspection and information system divisions of the SB and the Central Bank of the Dominican Republic (BCRD) to provide effective supervision of the banking system.
- 1.9 This program will fulfill the prior commitments required for the establishment of a macroeconomic program with the IMF and the financial support of the multilateral organizations (IDB and the World Bank). The program objective is to help the Monetary Board to launch an on-site assessment of the condition of all banking institutions and to help the authorities to develop and implement their program of financial sector consolidation. The program is also an integral part of the authorities' policy to improve conditions in the banking sector and address present weaknesses in the financial sector. To achieve that end, it will be necessary to review the regulations in force, develop and fully implement the Monetary and Financial Law, examine the information systems and train staff in the inspection and information systems divisions of the SB and the BCRD.

## **G. Program structure**

- 1.10 To achieve these objectives, the program will include the following components:
  1. **Assisted inspections.** A series of assisted inspections will be conducted until all of the country's banking institutions have been examined.  
**Primary objectives:**
    - Identify **poor accounting practices** in the banks and their extent
    - Assess bank **solvency****Secondary objective:**
    - Transfer know-how to the Superintendency of Banks and thereby strengthen its oversight capacity.
  2. **Prudential regulations.** The program will review, adjust and, if necessary, draw up appropriate prudential standards for control and supervision of



banking institutions that are not provided for in the IDB/MIF operation (TC-99-01-01-9). The most crucial issues for bringing the prudential standards into line with the Basel principles are those related to the definition of financial conglomerates and consolidated supervision. This task includes analysis and discussion with technical teams from the SB and the BCRD, drafting of standards and preparation of the final version. The program will also prepare regulations on sanctions for noncompliance with the regulatory and control provisions. The following aspects will be considered: (i) preparation of the pertinent regulations; (ii) preparation of the applicable oversight methodology; and (iii) training of inspectors concerning the regulations and their application.

3. **Regulations for operation of the monetary and financial authority.** In pursuance of the development and implementation of the Monetary and Financial Law, this component includes the preparation of operating regulations for the new Monetary Board, which will take up its functions in August 2004. The bylaws of the BCRD and the SB will also be drawn up.
4. **Consulting services to review the regulations for State banks.** This component is intended to advise the authorities on updating and modernization of the regulations for operation and functioning of State banks. Particular emphasis will be placed on a review of the regulations for the Banco Agrícola and the Banco de Reservas.
5. **Conversion of Banco Nacional de la Vivienda [National Housing Bank] (BNV) into a second-tier bank.** The purpose of this component is to supplement the technical-assistance needs so as to achieve an orderly conversion of the BNV into a second-tier bank operating with maximum efficiency.
6. **Coordination of all oversight entities.** The Dominican Republic opted to have separate oversight entities for each activity in the financial sector (i.e. banks, insurance, pensions, securities). The Monetary and Financial Law provides that the Monetary Board shall create the necessary mechanisms for proper coordination and collaboration of the oversight entities. Through this component, the authorities will be advised on the design and implementation of the mechanism for coordination among the oversight entities.

## **H. Expected outcomes**

1.11 The following outcomes are expected:

- (i) assessment reports, recommendations, and plan of action (with priorities) for the next 15 months pertaining to the BCRD strategic

plan, the SB strategic plan and the strategic plan for converting the BNV into a second-tier bank;

- (ii) For the assisted inspections: **1. Understanding of group structure:** In order to identify and evaluate poor accounting practices, it is important to have a reasonable understanding of group structure (both financial and nonfinancial groups, including specifically the off-shores), their possible economic condition (based on evaluations including analysis of their areas of economic activity), and the importance of the banking and financial group to the economic group. The teams will be assisted insofar as is possible in the analysis being prepared by the Superintendency of Banks. **2. Integrity of information systems:** The integrity of the information systems is important for the evaluation of poor accounting practices, as well as for solvency. Systems specialists will conduct an evaluation of the information systems, with a focus on: (i) information **processing**, and (ii) system **outputs**. The controls system **inputs** and the interfaces between the information and accounting systems will be evaluated by the inspection teams, with necessary coordination to prevent gaps in the analysis. **3. Internal controls, accounting and specific tests:** The evaluation will focus on procedures that recent experience has identified to be at highest risk for poor accounting practices. At a minimum, the following procedures will be examined: –**Deposits:** Formal and informal procedures for deposit-taking (network, money market desk, and other procedures), as a minimum including deposit-taking at off-shore groups and sources of financing from related companies. –**Cancellation or transfer of loans:** The abuse of external structures often originates in or relates to attempts to avoid reporting doubtful or related-party loans on the bank's financial statements. The evaluations will focus on loan cancellation or transfer procedures, at a minimum including detailed monitoring of the cancellation or transfer of loans that were classified negatively during prior inspections or audits or were classified as related. –**Loans to related companies:** Procedures and controls for approval and granting of loans to related companies. –**Award of assets:** Procedures and controls on award and sale or transfer of awarded assets. –**Preparation of financial statements:** Procedures for preparing financial statements, including manual adjustments, and interfacing with information system outputs. –**Quantification and sampling:** If poor accounting practices are found, sampling methods will be used to extrapolate the results to the total population and thereby quantify the extent of such practices.
- (iii) adaptation to Dominican circumstances of regulations on electronic banking and systems audits; and

- (iv) preparation of methodological procedures for use by the inspection department (systems auditing).

**I. Cost and financing**

- 1.12 The total cost of the program is estimated at US\$6,600,000, of which the Bank will finance US\$6 million. The remaining US\$600,000 will consist of contributions in kind by the Dominican Republic through the SB, the BNV and the BCRD as the local counterpart.

<b>DETAILED BUDGET</b> (in US\$)			
<b>Category</b>	<b>IDB</b>	<b>Local counterpart</b>	<b>Total</b>
1. Assisted inspections			
a. Fees (480 weeks international consultants)	3,600,000		3,600,000
b. Travel and per diems	400,000		400,000
c. Local staff		540,000	540,000
2. Review of regulations for State banks			
a. Fees	80,000		80,000
b. Travel and per diems	20,000		20,000
3. Conversion of BNV to a second-tier bank (FHA insurance included)			
a. Fees	620,000	30,000	650,000
b. Travel and per diems	100,000		100,000
4. Preparation of bylaws for the Monetary Board, the BCRD and the SB (includes coordination of oversight entities)			
a. Fees	150,000		150,000
b. Travel and per diems	20,000		20,000
5. Coordination, definition and monitoring of the authorities' financial program and the SB's strategic plan			
a. Fees	200,000		200,000
b. Travel and per diems	50,000		50,000
6. Oversight regulations (includes financial conglomerates, system of sanctions and liquidations under way)			
a. Fees	80,000		80,000
b. Travel and per diems	13,000		13,000
7. Managerial considerations	137,000		137,000
8. Logistical support incremental expenditure counterpart staff (in kind)		30,000	30,000
9. External audits	30,000		20,000
10. Contingencies	500,000		500,000
<b>Total</b>	<b>6,000,000</b>	<b>600,000</b>	<b>6,600,000</b>

## II. PROGRAM EXECUTION

### A. Borrower and beneficiaries

- 2.1 The borrower under the program will be the Dominican Republic. Through the Presidential Office's Technical Secretary, the borrower will sign a responsibility transfer agreement with the Central Bank of the Dominican Republic to establish

the responsibilities falling to the executing agencies and the manner in which the resources will be transferred. It is proposed that a Program Administrative Technical Unit (APTU) be created under the Monetary Board secretary to coordinate the overall management of resources and report directly to the senior management of the executing agencies (i.e., the Central Bank, the Superintendency of Banks and the Banco Nacional de la Vivienda).

**B. Executing agency**

- 2.2 The program will be executed by the three entities that make up the country's financial system. For its part, the Central Bank will sign individual agreements with the Superintendency of Banks and the BNV to establish the sole and exclusive responsibility of each entity for its particular share in the execution of the activities in each component.
- 2.3 All of the executing agencies, however, will have the same level of administrative support from the APTU, which will be attached to the Secretary of the Monetary Board. Although the technical features of the program and the nature of the executing agencies necessitate a flexible modality for program execution, it will be necessary to draw up a general plan of program execution and an internal control system in order to coordinate monitoring and evaluation activities that will provide feedback for continued improvement.
- 2.4 The proposed decentralization of management will enable the Central Bank to provide effective concurrent and/or ex-post control and monitoring of the Superintendency of Banks and the BNV, on the basis of the following considerations:
  - (i) the activities envisaged for the program respond to legal mandates to various entities that form an integral part of the financial system, and each component is to be executed by the appropriate entity;
  - (ii) the proposed design makes it possible to draw on the outcomes of prior international-cooperation programs and increases flexibility in the implementation of the various program components, so that components can be carried out independently, and delays associated with one agency will not adversely affect the operation of the rest of the program; and
  - (iii) through equitable participation, these entities will strengthen their institutional capacity and retain autonomy.
- 2.5 The responsibilities of each of the three executing agencies will be centralized in Program Technical Units (PTUs) whose configuration will be determined by the senior management of each executing agency. The PTUs will be responsible for:

- (i) approving the terms of reference and other bidding documents for the procurement of goods and services;
- (ii) managing program resources (IDB and local counterpart funding) through specific bank accounts;
- (iii) maintaining a detailed accounting system for the program;
- (iv) keeping systematic records of documentation in support of eligible program expenditures and statements of account; and
- (v) facilitating access to all documentation files for any auditors hired for the program.

2.6 The responsibilities of the APTU will include:

- (i) providing administrative support for the procurement of pertinent goods and services and the hiring of consulting services needed for program execution;
- (ii) processing disbursement requests and issuing statements of account that report on program execution;
- (iii) verifying contract performance;
- (iv) verifying the status of bank accounts used for funds management (IDB and counterpart resources) and financial administration;
- (v) centralizing and processing technical and financial program information to ensure that it is properly filed, and preparing and issuing weekly reports of the program's progress based on information provided by the executing agencies;
- (vi) presenting audited financial statements for the program;
- (vii) designing and implementing the accounting system and internal controls on transactions; and
- (viii) coordinating and performing of monitoring, control and evaluation activities, and maintaining a management monitoring system that provides feedback for continued improvement.

**C. Procurement of consulting services**

- 2.7 **Procurement.** In response to the request of the Dominican government, and to move ahead with the assisted inspections, the project team will recommend that

expenditures incurred since 1 September 2003 be recognized provided they comply strictly with the criteria set forth in the procurement manual and have been approved by the project team.

**D. Execution period and disbursement schedule**

- 2.8 The program execution period will be 18 months, and the disbursement period for the Bank's contribution 24 months from the date on which the technical-cooperation agreement letter is signed. A revolving fund amounting to 10% of the TC resources will be established to facilitate the program execution.
- 2.9 **Accounting and audits.** The Central Bank, through the aforementioned APTU, will be responsible for: (a) the opening of special separate bank accounts to manage the program resources related to the financing from the Bank and the local counterpart; (b) creation and maintenance of appropriate accounting, financial and internal control systems that can store and report detailed information for external auditing purposes; (c) maintenance of an appropriate file of supporting documentation for expenditures drawn on program resources; and (d) preparation and presentation to the Bank of disbursement requests and justifying expenses, and financial statements and other reports as required.
- 2.10 An external audit of the project will be performed upon completion of the program, based on the terms of reference approved by the Bank. The audit report, which may be financed from the Bank's financing, will be presented to the Bank within 90 days after the final disbursement of Bank resources.

**E. Monitoring and evaluation**

- 2.11 The Bank will oversee the project activities through its Country Office in Santo Domingo. The APTU, in cooperation with the PTUs, will forward to the Bank an initial report that includes the schedule of work, the terms of reference for consulting services, and the budget for the activities listed in the logical framework that are to be carried out during the first six months of the project. This report will serve as the model for subsequent reports submitted to the Bank. All other reports provided for in the logical framework are to be sent to the Bank in a timely manner in the interest of complete project monitoring.
- 2.12 The APTU will be required to submit two reports, to the Bank's satisfaction, the first upon disbursement of 50% of program resources and the second at the end of the technical-cooperation project. Both reports must indicate: 1. progress made on the assisted inspections; 2. (i) any electronic interfacing with commercial banks; (ii) the rules established to govern the data input system used with commercial banking; (iii) electronic data-gathering with commercial banks; and (iv) progress on electronic access to operations of banking institutions and all information in the bank portfolios; 3. (a) progress on amendments to the prudential regulations in

force for the banking system to ensure compliance with the Basle principles in regard to: (i) solvency ratio; (ii) capital adequacy; and (iii) loan-loss provisions. The second report will also include a detailed analysis of the extent to which the project objectives have been achieved in terms of the activities and performance indicators provided in the logical framework. The main performance indicators to be included in the program evaluation are: (i) report on findings from on-site inspections at a minimum of 14 commercial banks; (ii) regulations amended and implemented by the Monetary Board, the BCRD and the SB; and (iii) evidence of adjustments to the information systems.

### **III. FEASIBILITY AND RISKS**

- 3.1 Agreement has been reached with the national authorities concerning the activities of the proposed technical-cooperation program and the terms of reference for the consulting firm that will assist the SB's technical teams. The key element of this operation will be the assisted inspections. One possible risk of an operation like the present one is a failure to complete the activities in time for implementation of the reforms envisioned in the sector finance program and the bank consolidation program. This risk is minimal, however, in view of the authorities' commitment to such activities through participation in the financial-sector PBL operation being prepared by the Bank and as one of the conditions of the program being negotiated with the IMF. This program will also allow for the hiring of qualified international consultants to move the authorities' financial program forward. Provision has been made for a plan of execution whereby coordination and management of all aspects of the authorities' financial program will be centralized under the Monetary Board secretary.

#### **A. Socioeconomic feasibility**

- 3.2 This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). The program will have an indirect social impact, insofar as it will protect small savers and minimize the risk of a financial crisis that affects all members of society with a distributional effect that is regressive.

#### **B. Environmental impact**

- 3.3 Given the fact that this technical-cooperation project provides only for the hiring of consulting services to perform work relating to inspections, information systems, and the drafting of legal and regulatory provisions, no environmental impact of any kind is expected.
- 3.4 In response to the recommendation from CESI, however, the letter of agreement for the program will contain a provision whereby the regulations pertaining to portfolio



risk analysis and evaluation will also consider the potential environmental risks posed by projects in the portfolio that could possibly lead to financial risks if not properly addressed.

## STRENGTHENING, SUPERVISION AND REGULATION OF THE BANKING SYSTEM (DR-L1001)

### LOGICAL FRAMEWORK

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<b>Goal:</b> <p>To bring the Dominican financial system back to a sound footing, restore the public confidence in the system, and ensure a sufficient flow of resources to finance productive investment.</p>	<ul style="list-style-type: none"> <li>The stability of the financial system measured in indicators such as capital adequacy, maturity and currency matching.</li> </ul>	<ul style="list-style-type: none"> <li>Statistics from the BCRD and the National Statistics Office.</li> <li>Final project report</li> <li>Evaluation</li> </ul>	<ul style="list-style-type: none"> <li>Suitable macroeconomic and political framework</li> </ul>
<b>Purpose:</b> <p>The Dominican financial authorities given assistance to develop and implement principles embodied in the Monetary and Financial Law, particularly in terms of financial intermediation (Central Bank) and oversight of the banking system (Superintendency of Banks).</p>	<p>At the end of the project,</p> <p>The updated regulatory framework under which the financial system operates has improved transparency, scope and efficiency, measured concretely in terms of:</p> <ul style="list-style-type: none"> <li>Understanding of the structure of financial, nonfinancial and offshore groups;</li> <li>Integrity of information systems in the areas of processing, inputs and outputs;</li> <li>Internal controls (accounting and specific proofs) in terms of deposit-taking, loan cancellation and transfer, related loans, award of assets, preparation of financial statements, quantification of samples.</li> </ul>	<ul style="list-style-type: none"> <li>Final project report</li> <li>Evaluation</li> <li>Publications of the BCRD and the SB</li> <li>Visits to the financial institutions</li> </ul>	<ul style="list-style-type: none"> <li>Suitable macroeconomic and political framework</li> <li>The authorities remain committed to the required reforms.</li> <li>The operating plan remains centralized in coordination with all financial authorities.</li> </ul>
<b>Components:</b> <p>1. Assisted inspections conducted for all banking institutions in the country</p>	<p>During project execution,</p> <ul style="list-style-type: none"> <li>Existence and extent of poor accounting practices at banks detected</li> <li>Solvency of all banks evaluated</li> <li>On-site inspection know-how transferred to SB officials</li> </ul>	<ul style="list-style-type: none"> <li>Auditing reports</li> <li>Project execution reports</li> <li>Periodic financial and management reports from the financial institutions</li> <li>Visits to the financial institutions</li> </ul>	<ul style="list-style-type: none"> <li>Sufficient supply of high-quality services required for technical assistance and training</li> <li>Sufficient cooperation by the Dominican financial institutions</li> </ul>

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p>2. Prudential regulations reviewed and adjusted</p> <p>3. Regulations for operation of the monetary and financial authority developed</p> <p>4. Regulations for State banks updated</p> <p>5. Banco Nacional de la Vivienda converted to a second-tier bank</p>	<ul style="list-style-type: none"> <li>Regulations developed and in force pursuant to the Basel principles, particularly in matters pertaining to: the definition of financial conglomerates and consolidated supervision; and sanctions for noncompliance with the regulatory and control provisions.</li> <li>Oversight methodology developed</li> <li>SB inspectors trained in the regulations and application thereof</li> <li>Regulations under the Monetary and Financial Law developed, including those for the BCRD and the SB (by 2004)</li> <li>Regulations developed for operation and functioning of State-owned banks – Banco Agrícola and Banco de Reservas</li> <li>BNV converted to a second-tier bank operating with maximum efficiency</li> </ul>	<ul style="list-style-type: none"> <li>Project execution reports</li> <li>Publications of the BCRD and SB</li> <li>Banking regulations in force</li> <li>Visits and interviews</li> <li>Project execution reports</li> <li>Publications of the BCRD and SB</li> <li>Regulations under the Monetary and Financial Law</li> <li>Project execution reports</li> <li>Publications of the BCRD and SB</li> <li>Regulations in force for Banco Agrícola and Banco de Reservas</li> <li>Project execution reports</li> <li>Publications of the BCRD, SB and BNV</li> </ul>	
<p><b>Activities:</b></p> <p><b>Component 1</b></p> <p>1.1 Hiring of experts to conduct assisted inspections for all banking institutions in the country</p> <p><b>Component 2</b></p> <p>2.1 Hiring of consulting services to review and amend prudential regulations</p>	<p>Budget</p>	<ul style="list-style-type: none"> <li>Consultants' contracts</li> <li>Consultants' reports</li> </ul>	<ul style="list-style-type: none"> <li>The authorities provide the counterpart funds.</li> <li>Timely hiring of suitable consulting services</li> </ul>

Narrative summary of objectives	Verifiable indicators	Means of verification	Assumptions
<p><b>Component 3</b></p> <p>3.1 Hiring of consulting services to develop regulations for operation of the monetary and financial authority</p> <p><b>Component 4</b></p> <p>4.1 Hiring of consulting services to assist the BNV with its conversion to a second-tier bank</p>		<ul style="list-style-type: none"> <li>• Consultants' contracts</li> <li>• Consultants' reports</li> </ul> <ul style="list-style-type: none"> <li>• Consultants' contracts</li> <li>• Consultants' reports</li> </ul>	