DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

DOMINICAN REPUBLIC

LIQUIDITY PROGRAM FOR GROWTH SUSTAINABILITY

(DR-L1040)

LOAN PROPOSAL

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3. Environmental and social management report (ESMR)
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Abbreviations

BCRD	Central Bank of the Dominican Republic
ESMR	Environmental and social management report
FDI	foreign direct investment
IFI	Intermediary financial institution
IMF	International Monetary Fund
LPGS	Liquidity Program for Growth Sustainability
MCP	Multisector credit program

PROJECT SUMMARY

DOMINICAN REPUBLIC
LIQUIDITY PROGRAM FOR GROWTH SUSTAINABILITY
(DR-L1040)

<table>
<tr><th colspan="4">Financial Terms and Conditions</th></tr>
<tr><td colspan="2" rowspan="3">Borrower: Dominican Republic
Executing agency: Central Bank of the Dominican Republic (BCRD)</td><td>Amortization period:</td><td>5 years</td></tr>
<tr><td>Grace period:</td><td>3 years</td></tr>
<tr><td>Disbursement period:</td><td>12 months *</td></tr>
<tr><td>Source</td><td>Amount
(US$ million)</td><td>Interest rate:</td><td>6-month LIBOR plus 400 basis points annualized</td></tr>
<tr><td>IDB (Ordinary Capital)</td><td>300</td><td>Front-end fee:</td><td>1%</td></tr>
<tr><td>Local</td><td>0</td><td>Credit fee:</td><td>0.75%</td></tr>
<tr><td>Total</td><td>300</td><td>Currency:</td><td>US dollars from the Single Currency Facility</td></tr>
</table>

Project at a Glance

Project objective/description:

The objective of the program is to help restore the flow of credit to the real economy, offsetting in part, and on a temporary basis, shortfalls in normal credit flows to the productive sector resulting from the global financial crisis. Its purpose is to channel credit in foreign exchange to the productive sector through intermediary financial institutions (IFIs) (see paragraph 1.22).

Special contractual conditions:

As conditions precedent to the first disbursement, the executing agency will demonstrate to the Bank's satisfaction that: (i) an interagency agreement has been signed between the Ministry of Finance and the BCRD for program execution; (ii) a legal opinion has been issued, confirming that the content and mechanisms of such agreement are valid and enforceable by the BCRD; and (iii) the BCRD's Monetary Board has approved and implemented (a) a framework agreement governing the onlending of funds from the BCRD to IFIs, and (b) the Credit Regulations; and (iv) the program coordination team has been formally established within the BCRD (see paragraph 3.6).

Other execution conditions:

In addition, the program will have the following special execution conditions: (i) the terms of the financing (see paragraph 2.3); (ii) eligibility of businesses and eligible subloans (see paragraph 2.4); (iii) environmental management mechanism (see paragraph 2.9); (iv) a revolving fund of up to 10% of total program amount (see paragraph 3.7); and (v) delivery of quarterly reports by the BCRD (see paragraph 3.8).

Amendments to Bank policies:

Not applicable.

Project consistent with country strategy: Yes [X] No [ ]

Project qualifies as: SEQ [ ] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]

Procurement: Not applicable.

Verified by CESI on: 24 February 2009

* See paragraph 3.6.

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, rationale

1.1 In response to the current global financial crisis, the IDB created the Liquidity Program for Growth Sustainability (LPGS) to support the efforts of the region's governments to mitigate the impact of the crisis on macroeconomic stability, growth, and employment. The purpose of the program is to help restore the flow of credit to the real economy, offsetting in part, and on a temporary basis, shortfalls in normal credit flows to the productive sector resulting from the crisis. By restoring credit for working capital in United States dollars and foreign trade transactions, the program seeks to: (i) support domestic production; (ii) protect employment levels; and (iii) preserve macroeconomic and social stability.

1.2 The proposed program will provide US$300 million in financing to the Dominican Republic, so that it can provide, through the Central Bank of the Dominican Republic (BCRD) and first-tier regulated financial institutions, credit lines for working capital in dollars and foreign trade financing to: (i) exporters; (ii) other firms within the export chain; and (iii) domestic firms that are heavily dependent on direct financing from foreign sources (foreign suppliers and banks), but have been cut off due to the current global financial environment and must now seek financing from local banks.

1. Recent macroeconomic performance and outlook

1.3 The economy of the Dominican Republic recovered quickly after the economic and financial crisis of 2003-2004. On average, GDP grew at double-digit rates in 2005-2006, and by 8.5% in 2007, higher than the average for the region. In a stable fiscal and monetary environment, large flows of foreign direct investment (FDI) and a significant expansion in lending to the private sector spurred consumption, productive investment, and, consequently, aggregate domestic demand.

1.4 In 2008, however, the economy had to contend with an adverse external environment that gradually slowed growth. Rising international oil prices had a sharp impact on inflation, external accounts, and the fiscal position. Inflation reached the double-digits in April 2008, external accounts deteriorated when faced with an oil bill equivalent to 10% of GDP, and fiscal accounts became imbalanced, due largely to increases in liquefied petroleum gas (LPG) subsidies and electricity rates equivalent to 3% of GDP. To mitigate external and domestic inflationary pressures, and in the midst of still high domestic demand and an expansive fiscal policy, the BCRD tightened monetary policy, making domestic credit more expensive. At the same time, the Dominican economy began to feel the effects of the economic and financial crisis in the United States, which resulted in a decline in exports, remittances, tourism, and flows of external financing.

1.5 Combined, these factors caused a deceleration of growth (5.2% by end-2008) and a current account deficit equivalent to 9.6% of GDP, the highest in 10 years. This deficit could be financed through a strong inflow of FDI, equivalent to 6.1% of GDP (US$2.884 billion) and an increase in net public-sector borrowing, since

portfolio investment through holdings of foreign private securities and foreign commercial lending have contracted. The economic downturn has shrunk government revenues. This contraction, combined with larger subsidies to the energy sector, weakened the country's balanced fiscal position in 2007 to a deficit of nearly 3% of GDP in 2008.

1.6 The impact of the worldwide crisis on the Dominican economy is expected to worsen in 2009. On the real side, exports are projected to contract further, and remittances and tourism revenues to stagnate or even contract. Although lower foreign exchange revenues will be mitigated by a smaller oil bill and a reduction in the value of other imports, the current account is expected to record a deficit equivalent to 6% of GDP. The expectation is that this deficit will be financed with new inflows of FDI (US$2.321 billion) and an increase in net public-sector borrowing, since private portfolio, direct, and commercial borrowing are likely to continue to decline.

1.7 In response to the crisis, the government aims to maintain macroeconomic stability by rebalancing fiscal and monetary policies within the context of a post-program monitoring program with the International Monetary Fund (IMF). On the fiscal side, the authorities have committed to attain a primary surplus of 0.5% of GDP by cutting subsidies to the energy sector and to LPG, and by reducing total spending to a level consistent with the financing available. With lower inflationary pressure, this adjustment would help make monetary policy more flexible, and so improve domestic lending terms. With regard to growth, the full impact of the global crisis is still uncertain and will depend to a large extent on what happens in the United States. Therefore, although preliminary official estimates suggest 2.6% to 3% growth in 2009, there is a risk that the slowdown will be even more pronounced. (Sector considerations 1)

2. Financial system

1.8 ***Background.*** The Dominican financial system comprises 70 intermediary financial institutions: 12 all-purpose banks, 26 savings and loan banks, 16 savings and loan associations, 14 credit corporations, and 2 public institutions. The all-purpose banks account for 81.6% of the system's US$17 billion in assets (37% of GDP), and are the only ones authorized to make loans denominated in foreign currency. (Sector considerations 2)

1.9 The three main banks hold 76% of the sector's assets; the largest (Banco Reservas) is State-owned and accounts for 32% of banking sector assets.[1] There are also two foreign international banks (Scotiabank and Citibank), which own a relatively small share of the banking system's assets (7% and 2%, respectively).

1.10 ***Recent developments.*** In 2004, the financial system began a strong recovery and strengthening after the deep crisis of 2002-2003, which originated in the banking sector and, because of its magnitude, spread to the rest of the economy. Monetary

[1] The two remaining banks, Banco Popular (30%) and B.H.D. (14%), are part of private financial groups with majority domestic shareholders.

and financial authorities successfully recovered and preserved the confidence of economic agents in the financial sector by implementing a program to strengthen banking regulation and oversight. For this purpose, they received support from multilateral lenders within the context of a stand-by arrangement with the IMF. The evolution of the financial system's performance indicators shows a systematic improvement in solvency, portfolio quality, profitability, and liquidity.

Banking System Indicators
(percentages)

Indicator	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Capital adequacy	8.9	12.9	12.5	12.3	13.1	14.5
Overdue portfolio/Total portfolio	9.2	7.9	7.4	4.5	5.0	3.5
Provisions/ Overdue portfolio	59.5	101.8	105.3	145.5	135.2	130.0
Return on capital	-0.2	19.2	23.3	26.1	28.0	28.3
Cash on hand/Deposits	40.1	44.5	45.9	32.1	28.2	30.1

1.11 The financial system's liquidity reached 45% after the 2002 crisis. By December 2008 it stood at a comfortable 30%, after the banks built these levels back up in the last months of the year. Since the start of the 2002 crisis, the banking sector has received sizable capital injections that enabled it—despite a high rates of credit growth—to significantly to improve the capital assets ratio (CAR), which was 14.5% in 2008. The banking system's favorable performance after the crisis was accompanied, and in some cases spurred, by improvements in bank regulation and supervision with the enactment of the new Monetary and Financial Act and the approval of a series of regulations by the Superintendency of Banks and the BCRD.[2]

1.12 ***Current conditions.*** The performance of the banking system in 2008 was stable, and no significant impacts of the current global crisis were observed on banks' financial stability. Nevertheless, since the financial system and the local economy are not immune to prevailing global conditions, it is necessary to consider certain recent trends and special features of the sector that could make it more vulnerable.

a. *Recent developments in lending.* The most notable trend in 2008 was the abrupt restriction of lending to the private sector: (i) from 20% and 30% growth rates in 2006 and 2007, respectively, to 4% annualized growth in 2008; and (ii) from annual flows of US$886 million and US$1.569 billion in 2006 and 2007, to a flow of US$297 million in 2008 (down US$1.272 billion from 2007). This was due to a combination of two independent factors: the contractionary monetary policy adopted by the BCRD, and a crowding out caused by public sector borrowing from local banks (up US$685 million in

[2] Of special note were improvements in the procedures for the resolution and liquidation of financial institutions, prudential rules on liquidity and market risk, limits on related-party lending, and early warning mechanisms. Nevertheless, important challenges remain for consolidated supervision of local financial groups in their offshore operations.

2008). These two factors exerted strong upward pressure on interest rates in Dominican pesos, crowding out private sector demand for lending toward dollar-denominated loans. Dollar-denominated lending to the private sector grew by US$358 million,[3] which increased the level of dollarization of the system's portfolio from 18% to 23% in 2008.

b. *Sources of funding.* The banking sector responded to higher demand for dollar-denominated loans by: (i) sharply increasing its short-term lines of external financing (by US$244 million), which quadrupled in proportion to total short-term dollar-denominated loans (dependency) during 2008 from 7% to 29%; and (ii) rebuilding its assets to the detriment of external investments. However, given the declining trend in domestic dollar-denominated deposits, and since these are the main source of U.S. dollars, access to external financing key to sustaining the flow of credit for the export sector.

1.13 ***Outlook.*** The financial system appears well positioned to weather the international crisis in terms of both capital adequacy and liquidity. Yet there is considerable risk that the flow of dollar-denominated credit for the export sector will not be sustained, given the likely continuation and possible accentuation of the following observed trends:

a. *Rising cost of local funding in foreign currency.* The rising trend in the cost of funds in U.S. dollars is likely to steepen in 2009, given slackening dollar-denominated deposits and banks' rising demand for such resources. In addition, the process of rebuilding external assets in liquidity seems to be reaching its limit.

b. *Restrictive terms of external financing.* Local banks have begun to report a hardening of their correspondent bank lines in terms of cost and accessibility; these terms are likely to harden further in 2009.

c. *Decline in credit portfolio quality*. Lower growth expectations for 2009 and higher interest rates will put pressure on borrowers' ability to pay (especially in the retail sector).

d. *Poor conditions for local financial conglomerates.* The global crisis is likely to adversely affect the financial health of local economic groups, to which certain domestic banks belong. These conglomerates are active in the real sector of the economy and in financing activities (i.e. offshore banks) not subject to effective consolidated oversight.

3. Problem to be addressed and rationale

1.14 Given the macroeconomic and financial outlook described above, the proposed program seeks to mitigate the problems of access to external financing that the

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[3] Whereas at December 2008 the portfolio of peso-denominated loans to the private sector held steady at 2007 levels (US$5.55 billion), the dollar-denominated portfolio grew by US$358 million, to US$1.623 billion; of these loans, US$1.095 billion have terms of up to 12 months.

private sector has been facing in recent months, so as to maintain the pace of domestic economic activity in an especially difficult and uncertain international economic and financial environment that shows no clear signs of recovery. In fact, significant declines were reported in the fourth quarter of 2008 in commercial lending (down US$396 million) and in direct foreign lending to businesses (down US$556 million in 2008). (Sector considerations 3)

1.15 This hardening of terms for dollar-denominated external financing has been exacerbated by: (i) an increase in the cost of correspondent bank lines of credit, from LIBOR +1% to +1.5% early last year to LIBOR +2.5% to +5% this year; and (ii) a progressive drying up of these credit lines (down US$53 million), or tighter restrictions on their use as a source of funding, especially for working capital. Moreover, as of February 2009 domestic dollar-denominated bank lending was characterized by: (i) an average 3.4% borrowing rate on U.S. dollar deposits, up one percentage point from August 2008 (2.4%); and (ii) a US$275 million decline in U.S. dollar deposits since August 2008. (Sector considerations 4)

1.16 This explains the government's decision to identify and secure alternative sources of external financing, such as the proposed program, to enable the productive sector to adjust gradually to the new world economic and financial environment.

1.17 The program is consistent with the competitiveness pillar of the Bank's country strategy with the Dominican Republic, which aims to reduce critical barriers to private investment and sustainable growth, through means including strengthened financial intermediation.

1.18 The Bank's exposure with the Dominican Republic is within the established limits. Specifically: (i) with outstanding debt of US$1.275 billion, representing 2.8% of GDP, the exposure is 2.3% of the Bank's total portfolio (well within the 18% limit); and (ii) servicing of the debt overhang represents, on average, 15.6% of the country's total external debt service (within the 30% limit) and 1.2% of exports of goods and services (within the 8% limit). With this operation, the outstanding debt would rise to around 4% of GDP, and exposure would increase to approximately 3.2% of the total portfolio. The country's debt stock with the Bank represents 55% of its multilateral debt, making the Bank its leading lending partner. Total public debt is expected to hold steady at 32% of GDP, while external public debt fluctuates around 18% of GDP. These levels are considered reasonable and sustainable in the medium term, and are lower than regional averages. Moreover, under this program the government's debt repayments will be covered by the private sector.

4. Coordination with other multilateral institutions

1.19 In preparing this operation, the Bank has maintained ongoing contact with IMF and World Bank macro and financial authorities, respectively. With regard to macro sustainability, in line with the policy governing this type of operation (document GN-2492-3), the IMF was informed that this operation was in preparation and asked to provide an assessment letter on recent macroeconomic conditions. Noteworthy in this regard: (i) the IMF Executive Board completed its last Article

IV consultation with the Dominican Republic on 19 February 2008; and (ii) the Dominican authorities signed a post-program monitoring arrangement with the IMF in January 2009, which is usual at the conclusion of a stand-by arrangement when the country's debt with the IMF exceeds 100% of its quota. This program will be supported by semiannual missions to supplement the annual Article IV consultations.

1.20 With regard to the stability of the financial system, a joint IMF-World Bank mission finished updating the Financial Sector Assessment Program (FSAP) on 6 February. The Bank's project team had occasion to discuss the current situation and outlook of the financial system with the IMF-World Bank team, and the outcomes were taken into account in the analysis of this operation.

1.21 The project team also coordinated its efforts with the IDB team designing the fiscal emergency operation (loan DR-L1043). The financial support provided under that operation will help bridge the fiscal gap projected for this year, minimizing the likelihood of crowding out in the domestic financial sector.

B. Objectives, description, and components

1.22 ***Objective.*** The objective of the program is to help restore the flow of credit to the real economy, offsetting in part, and on a temporary basis, shortfalls in U.S. dollar-denominated credit flows to the productive sector resulting from the global financial crisis. Its *purpose* is to channel credit in foreign exchange to the productive sector through intermediary financial institutions (IFIs).

1.23 ***Description.*** The program fits into the Bank's strategy to support private sector development. It will provide public funds to support financial intermediation processes where the market is not functioning effectively, specifically by making up the shortfall in correspondent bank dollar facilities and in commercial lending in dollars.

1.24 In the current economic climate, given the additionality the program would bring to this objective, the government has requested that program financing: (i) be drawn on the Bank's public financing window; (ii) be part of the liquidity emergency facility; and (iii) be implemented with the Government of the Dominican Republic as borrower and the Central Bank of the Dominican Republic (BCRD) as executing agency. (Sector considerations 5).

1.25 The program will not be a trade finance program, strictly speaking. Although the purpose of the financing is the same, it will have different features. In a traditional trade finance program with international banks, financing conditions (rates, terms, etc.) are based on export guarantees. In this program, the BCRD will not be required to assume counterparty risk. Accordingly, the BCRD will have to secure sufficient guarantees, so as not necessarily to require a lien on the assets generated with its funding. In addition, the BCRD will ensure that the IFIs use the funds received for eligible loans, and will control and monitor the use of funds disbursed and recovered.

1.26 The current structure of market rates suggests that IFIs will use the BCRD lines (now more expensive) only if the dollar-denominated funding available on the local market and international lines currently available are insufficient to meet their needs. A further deterioration in the global economic environment could impact the situation under two additional scenarios: (i) if the rates charged for correspondent bank facilities tend to exceed the rate charged under the program; and (ii) if foreign banks continue to cut back or close existing facilities. In either case, the program would enable local banks to borrow funds so long as the business projects can support the new lending rate, based on the new funding rate and spread.

1.27 ***Components.*** The program will have a single loan component in the amount of US$300 million.

C. Results indicators

1.28 This operation will take the form of a multisector credit program (MCP)[4] (see Sector considerations 6). The IFIs will select the most viable enterprises and projects. Therefore, if the economy's structural variables remain constant, the impact of the projects will be determined by the market. The IFIs will select the best enterprises and projects and, if the latter maintain sufficiently low arrears rates in repaying the loans, the market mechanism itself will: (i) ensure selection of the best enterprises and projects; and (ii) establish the indicator levels. From this perspective, any indicator of "goal" or "purpose" could be considered only an a priori estimate of what the market may achieve, and therefore not used to judge the success or failure of the operation.

1.29 On this basis, the indicators in the Results Matrix are: (i) as outputs*:* the establishment of second-tier lines (the only factor determined by the program itself); and (ii) depending on the basic assumptions for this type of program (the mutual willingness of borrowers and IFIs to obtain and extend credit) and therefore exogenous to the operation: (a) as an intermediate outcome, requests for credit lines and their allocation to IFIs under the program; and (b) as final outcome, the volume of disbursements. Additionally, the evaluation plan includes a table of indicators (goal). In both cases, the program evaluation will employ a naïve methodology, generating indicators periodically using information available at the BCDR.

1.30 In accordance with the guidelines of the Bank's Office of Evaluation and Oversight (OVE) for the evaluation of MCPs and assuming that the necessary resources are obtained, in addition to the evaluation plan described above, the Bank may conduct a more exhaustive external evaluation 48 months after the start of disbursements, to assess fulfillment of the program objectives and development impact (see paragraph 3.10).

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[4] The evaluation of global multisector credit operations (document RE-336) by the Bank's Office of Evaluation and Oversight (OVE) presents empirical evidence of their effectiveness.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing mechanism

2.1 The financing will be offered on the same conditions as emergency loans from the Bank's Ordinary Capital: (i) the loan contract must be signed within 60 days after the date of approval by the Bank's Board of Executive Directors, and take effect within 180 days after the signature date; (ii) the amortization period will be five years, and the grace period three years; (iii) the annual interest rate will be six-month dollar LIBOR plus 400 basis points; (iv) the front-end fee will be 1% of principal, and the commitment fee 0.75% on undisbursed balances.

2.2 The borrower will be the Dominican Republic, acting through its Ministry of Finance, and the executing agency will be the Central Bank of the Dominican Republic (BCRD), which lend the program resources to intermediary financial institutions (IFIs) to onlend to the productive sector for eligible projects.

2.3 The terms of financing will be governed as follows: (i) for BCRD financing to the IFIs, by the framework agreement; and (ii) for IFI financing to the subborrowers, by the Credit Regulations.[5] The basic features will be: (i) LIBOR plus 400 basis points plus the corresponding spreads; (ii) BCRD assumes IFI risk; (iii) the IFIs assume the subborrowers' risk; and (iv) in no case will the BCRD bear losses associated with program intermediation activities. Essentially, BCRD will fund the IFIs on the following terms:

a. *Eligibility.* The institutions eligible for the program will be all-purpose banks (commercial banks subject to supervision by the Superintendency of Banks) that meet the financial criteria established in the framework agreement.

b. *Financing conditions.* The lines will be five-year revolving credit lines in U.S. dollars. The maximum term of each disbursement will be two years. Each disbursement must be relent within the maximum time period established in the framework agreement. The ceiling for each line will be based on: (i) each bank's volume of lending in U.S. dollars; and (ii) a maximum percentage of the total volume of program financing, also set in the framework agreement. The IFIs must either relend loan recoveries within the time period indicated in the framework agreement or repay them.

2.4 The IFIs will provide financing to subborrowers on the following terms:

a. *Eligible companies.* The enterprises eligible for the program will be: (i) those with projects geared to the export of goods and services; and (ii) enterprises in the supplier chain that need financing in United States dollars.[6]

[5] These two governing documents will be developed by the country authorities with technical support from the project team.

[6] The term United States dollar (US$) is understood to mean any hard currency used as a basis for foreign trade operations as defined by the Credit Regulations.

b. *Eligible subloans.* Eligible subloans within this universe of enterprises will be: (i) denominated in U.S. dollars; (ii) used to finance exports, imports, and working capital; (iii) made for a maximum term of two years; and (iv) below the ceiling established in the Credit Regulations.

2.5 The program costs are summarized in the following table:

Program cost by source of financing
(US$ millions)

Investment component	**IDB**	**Local counterpart**	**Total**
Credit	297	0	297
Front-end fee	3	0	3
Total	300	0	300

B. Risks

2.6 *Macroeconomic risk.* The program's success will depend on a macroeconomic framework and investment climate favorable to productive investment and private-sector demand for credit. In the current international context, authorities are redoubling their efforts to maintain macroeconomic stability. (Sector considerations 1)

2.7 *Fiduciary risk.* The program is deemed to entail low fiduciary risk. The BCRD is an autonomous entity organized and operating under public law with separate legal status and its own assets, established and governed by the Monetary and Financial Act (Law 183-02 of 21 November 2002). The BCRD: (i) enjoys administrative autonomy; (ii) is subject to its establishing act for governance; and (iii) bears responsibility for performance of the functions established under its establishing act.

2.8 *Financial risk.* Since the proposed program will be implemented by the BCRD, it poses less financial risk than an ordinary MCP. Its financial viability and risks will be determined by: (i) the quality of BCRD supervision; (ii) the interest rate; (iii) the profitability/risk of the BCRD loans to IFIs; (iv) the profitability/risk of the IFI subloans under market conditions; and (v) the guarantees obtained by the BCRD from the IFIs and, to a lesser degree, those obtained by the IFIs.

2.9 *Environmental risk.* The nature and impacts of the products and activities to be financed by the subloans cannot be known in advance, but will be subject to the environmental mechanisms and legislation of the Dominican Republic. In accordance the Bank's policies, specifically Directive B.13 of the Environmental and Safeguards Compliance Policy, the program does not require an environmental classification. In light of its status, the BCRD is not required to verify each subloan, and enforcement of legislation will be left to the first-tier entities. Nevertheless, the Credit Regulations establish the following: (i) a negative list of activities ineligible for financing; (ii) a list of those sectors eligible for financing upon presentation by the subborrower of the proper environmental documentation (including licenses and

permits); (iii) subborrower operations not included in the first two points will be eligible for financing, provided they comply with national environmental legislation; (iv) violations of environmental legislation will result in early termination of the loan and loss of eligibility for the enterprise; and (v) contracts between subborrowers and IFIs will require a representation by the subborrower that it complies with applicable environmental legislation.[7] As part of the processes discussed in paragraphs 3.8 to 3.10, the Bank will review subloans to verify that they conform to these provisions and, if necessary, request additional information from the IFIs. (See ESMR)

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

1. Borrower and executing agency

3.1 The Dominican Republic, acting through its Ministry of Finance, will be the borrower for this program. Given its authority and capacities, the Central Bank of the Dominican Republic (BCRD) will be the executing agency, acting through its International Department, which will establish the program coordination team. To make the program viable, the two agencies will sign an interagency agreement establishing the terms for the onlending of funds.

2. Execution and administration

3.2 The BCRD will: (i) allocate resources to the eligible IFIs; (ii) ensure proper custody and management of the securities and/or credit instruments received as security; (iii) supervise and monitor subloan eligibility; (iv) provide the personnel and technological and budget resources for program execution; (v) present the required documentation to the Bank for the fulfillment of disbursement conditions; and (vi) conduct other operational activities required for program execution. Individualized accounts will be established in the BCRD financial statements for program execution and administration.

3.3 The program will be executed in accordance with the framework agreement and the Credit Regulations, both of which will: (i) be consistent with the Bank's and the BCRD's rules and policies, and with financial legislation and practices in force in the Dominican Republic; (ii) stipulate that violation of their provisions will result in denial of access to financing; and (iii) require the Bank's no objection for their approval and amendment. The main provisions concerning IFI financing will include:

a. *Eligibility*. In accordance with paragraph 2.3(a), the institutions eligible for the program will be all-purpose banks (as established in the framework agreement).

[7] This environmental management system was developed by the country authorities with technical support from the project team.

b. *Currency and amount.* The lines of credit to IFIs will be denominated in U.S. dollars and granted on a first-come first-served basis as program funding is made available. As established in the framework agreement, the credit line maximum for each IFI will determined on the basis of: (i) its total obligations as of a given date; (ii) the total volume of external financing; and (iii) a maximum percentage of the total program financing. The financing will count toward the maximum total credit the BCRD may extend to the same IFI based on the most recent financial reporting to the Superintendency of Banks.

c. *Term.* The program will grant revolving lines of credit to IFIs for a maximum period of five years. Starting in year three, when amortization begins, the existing lines of each IFI will be reduced by a corresponding proportion. Each BCRD disbursement to IFIs under the program lines will be made for a maximum period of two years, or shorter as established in the framework agreement.

d. *Interest rate and fees.* The interest rate charged on disbursements to IFIs will be equal to the interest rate of the Bank's line plus a spread set by the BCRD, sufficient to cover the program costs and financial risks. The payment of interest will be synchronized with the finance ministry's payments to the Bank in order to avoid a maturity mismatch. The BCRD will pass along the following fees to the IFIs: (i) an front-end inspection and supervision fee on the total line approved for each IFI; and (ii) a commitment fee on the undisbursed balances of the approved line.

e. *Amortization.* The balance of each disbursement must be repaid at maturity. However, IFIs may prepay all or part of their credit lines. Recoveries of loans not used within the term specified in the framework agreement must be returned to the BCRD. The same will apply to amounts disbursed to IFIs but not onlent to businesses.

f. *Security.* Financing provided to IFIs must be secured by first-tier assets in United States dollars or Dominican pesos, including: (i) deposits in the BCRD; (ii) debt securities issued by the Dominican Republic and/or the BCRD; (iii) portfolio of eligible loans of the requesting IFI, rated A or B by the Superintendency of Banks; and/or (iv) other BCRD instruments deemed eligible by the BCRD, with the Bank's prior agreement. The financing will be less (by a spread established in the framework agreement) than the value of the security, as determined by the BCRD, taking the currency denomination into account. Security appraisals will be updated periodically.

g. *Principal obligations of IFIs.* The principal obligations of IFIs include: (i) requesting the line of credit from the BCRD and signing the respective loan contract; (ii) reviewing and evaluating the activities to be financed, as well as the subborrowers' creditworthiness, ability to pay, and security; (iii) requesting timely guarantees in accordance with the Credit Regulations; (iv) onlending funds to the subborrowers in accordance with the Credit Regulations; (v) signing a securities custody agreement for the deposit of

security in accordance with the framework agreement; (vi) assuming all credit risks relating to the subloans; (vii) ensuring that subborrowers use the funds properly for the stated eligible purposes; and (viii) providing the Bank and the BCRD with information requested or required concerning the portfolio of loans made with program funds.

h. *Noncompliance and penalties.* An IFI's participation in the program will be understood to mean that it is familiar with, and accepts, the applicable laws and regulations and authority of interpretation, and agrees to regulation and oversight by the BCRD and Superintendency of Banks (in areas within their purview). Eligible IFIs will assume full responsibility for proper processing and performance of transactions with their clients. Thus: (i) if an IFI fails to comply with any of the terms, conditions, or obligations in the framework agreement and/or the Credit Regulations; or (ii) if an IFI and/or the subborrowers uses the funds in violation of them; or (iii) if an IFI provides false or incomplete information, or fails to provide information: (a) the IFI will be suspended from the program, and all loans received will become immediately due and payable; (b) the BCRD may execute the guarantees and, if necessary, debit the amount owed from the IFI's accounts with the BCRD; and (c) the foregoing will be without detriment to the applicable penalties established by the legal and regulatory framework in force.

3.4 With respect to subborrower financing, eligibility rules and restrictions on the use of funds are indicated in paragraph 2.4 above, and in the Credit Regulations.

3. Disbursement and execution mechanisms

3.5 The program will require no work plan (strictly speaking) or procurement plan, since the outputs will be the second-tier lines of credit opened and maintained with the BCRD.

3.6 The execution and disbursement period will be 12 months. This period may be automatically extended for an additional 6 months, if 50% of the loan proceeds have been disbursed during the first 12 months or, otherwise, by prior agreement of the parties. As conditions precedent to the first disbursement, the executing agency must provide evidence of the following, to the Bank's satisfaction: (i) an interagency agreement has been signed between the Ministry of Finance and the BCRD for program execution; (ii) a legal opinion has been issued, confirming that the content and mechanisms of such agreement are valid and enforceable by the BCRD; and (iii) the BCRD's Monetary Board has approved and implemented (a) a framework agreement governing the onlending of funds from the BCRD to IFIs, and (b) the Credit Regulations; and (iv) the program coordination team has been formally established within the BCRD.

3.7 Once the program has met these conditions: (i) it will be declared eligible; (ii) expenses incurred since 9 December 2008 will be recognized retroactively up to 25% of the program amount; and (iii) given the nature of the program, a revolving fund up to 10% of the program amount will be opened. Subsequent disbursements will be made via the revolving fund or the reimbursement method. The

disbursements/reimbursements will be processed as requested by the IFIs, which will determine the pace. As a condition precedent to successive disbursements to the revolving fund or reimbursements, as the case may be, the Bank must receive the list of subborrowers and corresponding subloans certified by the internal audit or comptroller department of each IFI. (Monitoring and evaluation arrangements)

B. Summary of arrangements for monitoring results

3.8 The program will comply with the general monitoring and evaluation procedures established by the Bank. Specifically: (i) the BCRD, at the Bank's request, will deliver quarterly progress reports for the duration of the program; (ii) disbursements will be subject to ex post review; and (iii) the Bank, in coordination with the program coordination team, will schedule inspections of the IFIs to verify compliance with program contractual conditions and, if necessary, may engage technical consulting services in addition to the BCRD audits of the program, to verify the eligibility of the subloans.

3.9 The program-financed audits will be performed: (i) within 120 days after the end of each fiscal period during program execution; and (ii) by the BCRD Office of the Comptroller, according to terms of reference agreed upon with Bank,[8] subject to the annual opinion and certification of the external audit firm that audits and certifies the BCRD's financial statements, pursuant to Article 16 (b) of the Monetary and Financial Act.

3.10 Based on the availability of resources, and without detriment to paragraph 1.29 as it relates to evaluation, the Bank may conduct an external evaluation, 48 months after the first disbursement. This evaluation would be performed to assess the extent to which program objectives have been met, and their impact.

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[8] On the rationale that the Office of the Comptroller is independent of BCRD management and reports directly to the Monetary Board.

Dominican Republic: Liquidity Program for Growth Sustainability (DR-L1040)
Annex I
Development Effectiveness Matrix
Summary

Criterion	Score
Section 1. IDB Strategic Development Objectives – Area Rating	3.78
Country Diversification	2.20
Corporate Initiatives	0.00
Harmonization and Alignment	1.58
Beneficiary Target Population	0.00
Section 2. Country Strategy Development Objectives – Area Rating	9.60
Country Strategy Sector Diagnosis	6.00
Country Strategy sector objective and indicator	3.60
Section 3. Program Logic – Area Rating	8.67
Program Diagnosis	3.00
Proposed Solutions (@ PP)	0.67
Proposed Solutions (@ POD)	2.00
Results Matrix Quality	3.00
Section 4. Evaluation & Monitoring – Area Rating	5.57
I. Evaluation	2.57
II. Monitoring	3.00
Section 5. Economic Performance –Area Rating	0.00
Economic Rate of Return	0.00
Cost-effectiveness S saved as % of loan	0.00
Section 6. Risk Management – Area Rating	10.00
Environmental & social risk classification	
Environmental & social risk policy compliance	
Risk Matrix Score	5.00
Mitigation Matrix Score	5.00
Section 7. Additionality- Area Rating	6.67

LIQUIDITY PROGRAM FOR GROWTH SUSTAINABILITY
(DR-L1040)
RESULTS MATRIX

Objective	To strengthen the competitiveness of businesses in the export productive sector or export supply chains.
Purpose	To channel credit in foreign exchange to the productive sector through intermediary financial institutions (IFIs), in order to mitigate the consequences of the international financial crisis.

The results indicators contained in the progress reports to be delivered by the BCRD to the Bank through program completion will be monitored on a quarterly basis. The source of information for both the results indicators and goal indicators described in the table below will come directly from the BCRD: (i) the individualized accounts established in the BCRD financial statements for program execution and administration; and (ii) its statistical database on the financial system.

Indicators[1]						**Description**
	Baseline	**Year 1**	**Year 2**	**Year 3**	**Target**	
Component I: The Central Bank of the Dominican Republic (BCRD) opens lines of credit to intermediary financial institutions (IFIs).						
Output						
IFIs are able to access lines of credit financed with Bank resources.	0	Up to 100%	Up to 100%	Up to 100%	Up to 100%	This percentage indicates the BCRD's theoretical capacity to lend the program funds (if market interest exists).
Purpose: The productive sector obtains funds to mitigate the effects of the international financial crisis.						
Intermediate outcome						
	Baseline	**Year 1**	**Year 2**	**Year 3**	**Target**	
IFIs apply to the BCRD for lines to access the program resources (based on market conditions).	0	Up to 100%	Up to 100%	Up to 100%	Up to 100%	The BCRD allocates lines of credit to IFIs, based on the criteria and limits established in the program's Credit Regulations.
Final outcome						
IFIs with access to BCRD financing obtain program funds and onlend to the productive sector .	0	Up to 100%	Up to 100%	Up to 100%	Up to 100%	Level of program financing absorbed by existing demand. This percentage represents cumulative lending as a proportion of the total amount of Bank financing. This lending will be used immediately for eligible financing to benefit the productive sector of the export chain.

[1] In this operation, as in any multisector credit program, the IFIs will select the most viable enterprises and projects, and therefore the projects' impacts will be determined by market conditions. Accordingly, the proposed indicators are only an estimate of what the market could achieve.

In order to provide more information to quantify the impact of the operation, in addition to the Table of Indicators, an evaluation will be performed using the following indicators:

Table of Indicators (Goal)

Indicators	**Year 1**	**Year 2**	**Year 3**	**Description**
Level of program activity				The indicator will reflect: (i) the number of subloans made by the IFIs; (ii) the total volume of subloans made by the IFIs; and (iii) the number of program beneficiary enterprises.
Evolution of subloan portfolio of IFIs participating in the program, compared to trends in equivalent portfolio of the financial system.				The program is intended to alleviate the shortage of short-term financing facilities. This indicator is intended to show whether the program is helping to maintain the IFIs' capacity to provide this type of financing to the productive sector in light of current market conditions, considering that the portfolio of credit for working capital and trade financing may be affected by various factors exogenous to the program. This indicator will be calculated as a percentage change in the proportion of eligible loans in the total portfolio of participating IFIs, compared to the change in relative weight of this portfolio for the banking system as a whole.[2]
Proportion of system represented by IFIs participating in the program.				This indicator shows the ratio of total assets of participating IFIs to total assets of the national banking system.

[2] This indicator was calculated using information provided by the Monetary Statistics Consolidation Division of the BCRD's Monetary Programming and Economic Research Department. The amount of the eligible portfolio (trade finance and working capital) was compared with the figure reported for short-term credits (up to 12 months).