

Table 1 . The Dominican Republic: Quantitative Targets for 2003-2004 1/

|   | Jun-03<br>Est. | Aug-03 | Oct-03 | Dec-03 | 2004<br>Indicative |
|---|----------------|--------|--------|--------|--------------------|
| <b>A. Quantitative Performance Criteria</b>                                       |                |        |        |        |                    |
| (In millions of Dominican Republic pesos)   |                |        |        |        |                    |
| 1. Non financial public sector (NFPS) balance (cumulative floor from Jan. 1)      | 609            | -1,834 | -3,071 | -3,393 | 6,248              |
| 2. NFPS borrowing from the domestic banking system (cumulative ceiling) 2/ 3/     | 0              | 0      | 0      | 0      | -2,015             |
| 3. Net domestic assets of the Central Bank (ceiling)                              | 53,475         | 63,129 | 54,578 | 61,715 | 65,294             |
| 4. Accumulation of arrears by the public sector (continuous ceiling)              | 0              | 0      | 0      | 0      | 0                  |
| (In millions of US dollars)   |                |        |        |        |                    |
| 5. Contracting of external debt by the NFPS (cumulative ceiling from Jan.1) 4/ 5/ | 900            | 1,127  | 1,546  | 1,692  | 1,060              |
| 6. Net international reserves (floor) 6/  | 267.2          | 10.0   | 50.0   | 32.3   | 176.2              |
| (In millions of Dominican Republic pesos)   |                |        |        |        |                    |
| <b>B. Indicative Targets</b>  |                |        |        |        |                    |
| 1. Central government expenditure (cumulative ceiling from Jan.1) 7/              | 35,555         | 52,521 | 68,132 | 84,568 | 103,904            |
| 2. Quasi-fiscal losses of the Central Bank (cumulative ceiling from Jan.1)        | 3,204          | 5,608  | 9,311  | 13,543 | 21,219             |
| 3. Central Bank certificates (ceiling)  | 38,454         | 42,907 | 59,174 | 55,026 | 69,448             |

1/ As defined in the Technical Memorandum of Understanding.

2/ In 2003, cumulative change from end-June 2003. In 2004, change from end-December 2003.

3/ Adjusted upward by the increase in domestic debt as a result of the recognition of debt incurred prior to 2002, with a limit of RD\$14 billion.

4/ Excludes the impact of debt management operations whereby additional financing from multilateral banks is used to buy back central bank certificates.

5/ Excluding valuation changes.

6/ Excluding reserve requirements on domestic deposits in foreign currency.

7/ Adjusted upward whenever below-the-line-financing is higher than central government balance reported from above-the-line.

Table 2. The Dominican Republic: Prior Actions, Structural Performance Criteria, and Structural Benchmarks 2003-2004

|  |                    |
|--|--------------------|
| <b>A. Prior Actions</b> (MEP, para. 27)  |                    |
| 1. Resolve <i>Baninter</i> , with clear procedures and timetable to transfer remaining legitimate liabilities to other banks (MEP, para. 7.a.).  |                    |
| 2. Immediately strengthen the banking system by addressing problems of weak banks (placing overseers, introducing rehabilitation plan); taking immediate actions to detect fraud, applying sanctions and initiating legal proceedings in cases of malpractice (MEP, para. 7.b., c., and 8.a.). |                    |
| 3. Finalize the terms of reference for conducting internationally assisted inspections of banks (MEP, para. 8.b.).   |                    |
| 4. Introduction of short term tax measures (airport exit tax, import surcharge, tax on checks, and tax on windfall gains) (MEP, para. 15).   |                    |
| 5. Unification of official and private exchange rate (MEP, para. 20).  |                    |
| 6. Introduction of public auctions to place central bank paper (MEP, para. 23).  |                    |
| 7. Submission to Congress of a law for bank resolution under systemic risk (MEP, para. 9)  |                    |
| 8. Design and start implementing an appropriate communication strategy (MEP, para. 3).   |                    |
| <b>B. Structural performance criteria</b>  |                    |
| 1. Approval of by-law of the MFL regarding, deposit insurance fund, sanctions and lender of last resort. (MEP, para.10.a.)   | End-September 2003 |
| 2. Congressional approval of the law for bank resolution under systemic risk. (MEP, para. 9)   | End-September 2003 |
| 3. Congressional approval of a Budget bill for 2004 consistent with fiscal targets in the program. (MEP, para.15)  | End-December 2003  |
| 4. Completion of unification of the foreign exchange market. (MEP, para. 20)   | End-December 2003  |
| <b>C. Structural Benchmarks</b>  |                    |
| 1. Full implementation of the Lombard and overnight deposit windows.   | End-September 2003 |
| 2. Development of a comprehensive institutional strengthening plan for the superintendency of banks.   | End-September 2003 |
| 3. Submission to Congress of a bill on financial crime.  | End-September 2003 |
| 4. Issue prudential regulation governing loan classification and provisioning in line with best international practice.  | End-December 2003  |
| 5. Approval of by-laws of the MFL regarding the definition of economic groups and criteria for consolidated accounts.  | End-December 2003  |
| 6. Completion of all internationally assisted inspection reports. 1/   | End-December 2003  |
| 7. Approval of by-law of the MFL regarding capital adequacy, consolidated supervision and requirements for external auditors.  | End-March 2004     |
| 8. Submission to congress of tax reform proposal. 1/   | End-July 2004      |

1/ To provide a basis for a structural performance criterion to be set at future reviews.

**BOX 1: DOMINICAN REPUBLIC—FINANCIAL SECTOR REFORMS—ACTION PLAN**

| <b>Objective</b>   | <b>Action</b>   | <b>Date of Implementation</b>   |
|--|---|---|
| I. Resolve Baninter  | a. Resolve Baninter minimizing systemic risk while reducing the monetary impact and quasi-fiscal cost to the extent possible. Legitimate deposits and external credit lines should be transferred to other private banks without imposing losses or freezings. Baninter's assets should be transferred along with deposits to minimize the monetary impact, or alternatively put under a management contract with adequate incentives. The difference between the market value of Baninter's assets and its legitimate liabilities will be covered by BCRD certificates and/or cash. Once all transfers and sales of assets have been completed, the bank should be liquidated.   | <i>July</i>   |
| II. Address other problem institutions in the financial system | a. Place a permanent overseer in all financial institutions using liquidity support in excess of 75 percent of capital. Place financial institutions found to be weak, according to the criteria of the MFL and the Superintendency of Banks (SB) under a time-bound regularization plan aimed at correcting the observed weaknesses. Resolve immediately the banks in case they do not comply with the regularization plan or the situation further deteriorates. Strictly apply the Monetary and Financial Law (MFL) and the financial emergency framework (action III.a) to any bank requiring liquidity support from BCRD in future.  | <i>July for those institutions currently found to be weak, and on a continuous basis thereof.</i> |
| III. Implement a bank resolution framework                     | a. Pass a law to enable the use of bank resolution instruments adequate to address potential systemic weakness, including enabling the use of public funds for bank recapitalization and resolution, under strict guidelines. Apply this legal framework for resolving any weak bank in the system that may have systemic implications.   | <i>Draft law submitted to Congress by July, approval by September.</i>                            |
| IV. Strengthening the financial system                         | <p>a. Develop and approve a communication plan to clearly explain the steps to be implemented to ensure banking soundness and transparency, in a way that reinforced creditor confidence</p> <p>b. Take immediate actions to detect the existence of malpractice in other banks:</p> <ul style="list-style-type: none"> <li>i. request from all main bank shareholders and top management a sworn statement that they are not engaged in accounting practices that hide part of the bank's activity;</li> <li>ii. compare the inflows received by the banks through the clearing house against the reported increase in their deposits during the first two weeks of Baninter's intervention;</li> <li>iii. compare bank branches' balance sheets against official financial statements;</li> <li>iv. carry out inspections of vault documents in all banks' main branches and compare the results with the corresponding accounting registries.</li> </ul> | <p><i>July</i></p> <p><i>July</i></p>   |

|   |   |  |
|---|---|--|
|   | <p>c. In cases where malpractice is discovered, the SB and/or the Monetary Board will impose maximum penalties according to the law, will impose a regularization plan on the bank, and require it to prepare new financial statements which reflect the true financial situation of the bank in a period of no more than 30 days. The SB will conduct a second round of checks after the new financial statements have been submitted and, if new evidence of malpractice is found, management will be removed and a new regularization plan will be imposed focusing on a full-scale review of the bank's information and control systems.</p> <p>d. Design and agree terms of reference (TOR) for an internationally-assisted inspection process aimed at determining the existence and extent of accounting malpractice and providing an assessment of the banks' capital solvency. Hire the international firm, with financial and technical assistance from the IFIs, to lead the operational aspects of the internationally-assisted inspections.</p> <p>e. Develop specific TOR for the internationally-assisted inspection process, including (1) banks' IT, accounting and control systems; and (2) banks' asset quality, based on both national regulations and best international practices. The TOR will include specific proofs and checks on assets acquired as payment in kind or through foreclosure, related-party lending, foreign exchange credits, and deferred expenses' accounts.</p> <p>f. Approve a strategy to implement the results of the audit, including agreement on a decision-taking matrix. The strategy may have to include (1) special transition periods to meet prudential requirements; and/or (2) public recapitalization funds.</p> <p>g. Conclude internationally-assisted inspections, including by taking actions according to the decision-taking matrix. Banks not in compliance with prudential regulations and requirements will be sanctioned, put under regularization plans and other intensified supervisory actions, or will be resolved through strict application of the law mentioned in action III.a and the MFL.</p> <p>h. Obtain a satisfactory assessment from an independent and qualified overseer on the overall transparency of the process, that it was carried out according to the TOR, and that the banks were acted upon according to the strategy (decision-taking matrix) agreed with the authorities.</p> | <p><i>July for first round</i></p> <p><i>July</i></p> <p><i>August</i></p> <p><i>August</i></p> <p><i>December</i></p> <p><i>January, 2004</i></p> |
| <p>V. Strengthen prudential regulations</p> | <p>a. Critical by-laws required to enforce the MFL should be developed, including on:</p> <ul style="list-style-type: none"> <li>i. bank resolution procedures (article 63 and 65), the implementation of the deposit insurance fund (article 64), sanctions (articles 66 to 72), and the use of central bank lender-of-last-resort facilities (article 33),</li> <li>ii. definition of economic groups and criteria for consolidated accounting (article 58)</li> <li>iii. capital adequacy (article 46), consolidated supervision (article 58), and requirements (including establishing a registry) for external auditors (article 54.c)</li> </ul>  | <p><i>September</i></p> <p><i>December</i></p> <p><i>March, 2004</i></p>   |

|   |   |   |
|---|---|---|
|   | <p>b. Bring prudential regulations in line with international best practices. This will require actions on:</p> <ul style="list-style-type: none"> <li>i. loan classification and provisioning, related party credit, risk concentration, fit and proper conditions for bank management and main shareholders,</li> <li>ii. off-shore subsidiaries (establishing procedures for effective supervision and phasing-in the disinvestment in financial places where effective supervision is not possible according to the SB's criteria)</li> <li>iii. treatment of market risk,</li> <li>iv. governance rules for financial institutions and code of conduct for their staff, management and main shareholders (article 55.c of the MFL), including sworn declarations of related-party interests and establishing appropriate checks and balances; and others needed to solve the weaknesses identified in the FSAP.</li> </ul> <p>c. Approve and implement the by-law and procedure that will allow the SB to complete the liquidation of the financial institutions currently in liquidation under its control.</p> <p>d. Finalize the liquidation of the institutions mentioned in the previous paragraph, except for those which have been challenged in court.</p> <p>e. Approve and implement the remaining by-laws for the full implementation of the MFL.</p> | <p><i>December</i></p> <p><i>January, 2004</i></p> <p><i>April, 2004</i><br/><i>July, 2004</i></p> <p><i>November</i></p> <p><i>July, 2004</i></p> <p><i>July, 2004</i></p> |
| <p>VI. Strengthen banking supervision</p> | <p>a. Develop a comprehensive institutional strengthening plan for the SB with the assistance of the IFIs.</p> <ul style="list-style-type: none"> <li>i. A restructuring plan of all human, technological and financial resources will be developed and integrated into the institutional strengthening plan. SB staff will be evaluated, strengthened, and trained to ensure proper qualifications and skills focused on supervisory functions.</li> <li>ii. The plan should address critical areas first, including on-site supervision, reinforcing specifically the capabilities to inspect information and control systems, and inspectors' recruitment, training and professional career.</li> <li>iii. Develop the SB's capacity to obtain and analyze data on a daily basis, including by developing and implementing adequate IT instruments.</li> </ul>   | <p><i>Approved Sept., implementation by July, 2004. September</i></p> <p><i>July, 2004</i></p>  |