

Public Disclosure Authorized

CONFORMED COPY

CREDIT NUMBER 3800-HO

Development Credit Agreement

(Financial Sector Technical Assistance Project)

between

REPUBLIC OF HONDURAS

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated October 16, 2003

Public Disclosure Authorized

CREDIT NUMBER 3800-HO

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated October 16, 2003, between the REPUBLIC OF HONDURAS (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement (the Project), has requested the Association to assist in the financing of the Project; and

WHEREAS (B) the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Development Credit Agreements” of the Association, dated January 1, 1985 (as amended through October 6, 1999) (the General Conditions), constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “AML/CFT” means anti-money laundering and combating financing of terrorism;

(b) “BCH” means *Banco Central de Honduras*, the Borrower’s central bank established pursuant to the Borrower’s BCH Law;

(c) “BCH Law” means *Ley del Banco Central de Honduras*, the Borrower’s Central Bank Law of February 3, 1950, as amended to the date of this Agreement;

(d) “CNBS” means *Comisión Nacional de Bancos y Seguros*, the Borrower’s national banking and insurance commission, established pursuant to Article 245, Section 31 of the Borrower’s Constitution, and governed by the CNBS Law;

(e) “CNBS Law” means *Ley de la Comisión Nacional de Bancos y Seguros*, the Borrower’s National Banking and Insurance Commission Law issued by Decree No. 155-95 of November 18, 1995 and effective as of December 8, 1995, as amended to the date of this Agreement;

(f) “Cooperation Agreement” means the agreement referred to in Section 3.01 (b) of this Agreement;

(g) “Eligible Bank” means a bank that meets the criteria set forth in Part A.4 (a) (i) (A) of the Project;

(h) “Financial Institutions Law” means *Ley de Instituciones del Sistema Financiero*, the Borrower’s Financial Institutions Law issued by Decree No. 170-95 of November 10, 1995 and effective as of November 16, 1995, as amended to the date of this Agreement;

(i) “FMR” means each financial monitoring report prepared in accordance with Section 4.02 of this Agreement;

(j) “FOSEDE Law” means *Ley de Seguros de Depósitos en Instituciones del Sistema Financiero*, the Borrower’s Deposit Insurance Fund Law issued by Decree No. 53-2001 of May 7, 2001 and effective as of May 30, 2001, as amended to the date of this Agreement;

(k) “FSPC” means the Financial Sector Policy Committee referred to in 3.04 (b) of this Agreement;

(l) “Implementation Letter” means the letter of even date herewith, from the Borrower to the Bank, containing the performance indicators for Project monitoring and evaluation;

(m) “PCU” means the Project coordination unit referred to in Section 3.04 (a) of this Agreement;

(n) “Project Operational Manual” means the manual referred to in Section 3.03 (a) of this Agreement;

(o) “SEFIN” means *Secretaría de Estado en el Despacho de Finanzas*, the Borrower’s Ministry of Finance;

(p) “Special Account” means the account referred to in Section 2.02 (b) of this Agreement;

(q) “Technical Assistance Agreement” means an agreement referred to in Section 3.05 (a) of this Agreement; and

(r) “UIF” means *Unidad de Información Financiera*, the Borrower’s financial intelligence unit under the CNBS, established pursuant to Article 44 of the Borrower’s Anti-Asset Laundering Law (*Ley Contra el Delito de Lavado de Activos*) issued by Decree No. 45-2002 of March 5, 2003 and effective as of June 3, 2002.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to seven million two hundred thousand Special Drawing Rights (SDR 7,200,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit.

(b) The Borrower may, for the purposes of the Project, open and maintain in Dollars a special deposit account in BCH on terms and conditions satisfactory to the Association. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 4 to this Agreement.

Section 2.03. The Closing Date shall be September 30, 2007 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set

by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on May 15 and November 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each May 15 and November 15 commencing November 15, 2013 and ending May 15, 2043. Each installment to and including the installment payable on May 15, 2023 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall: (i) carry out Parts A, C.1, and D of the Project through CNBS; and (ii) cause BCH to carry out Parts B and C.2 of the Project (with the assistance of and in close cooperation with CNBS) with due diligence and efficiency and in conformity with appropriate economic, social, financial and administrative practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) The Borrower, through CNBS, shall enter into an agreement with BCH (the Cooperation Agreement) under terms and conditions acceptable to the Association, whereby: (i) BCH agrees to carry out Parts B and C.2 of the Project and to provide CNBS all information required for Project coordination purposes, including, *inter alia*, for procurement and financial management purposes; and (ii) CNBS agrees to provide all necessary in-kind support (including, *inter alia*, procurement and financial management assistance) to enable BCH to carry out Parts B and C.2 of the Project.

(c) The Borrower shall exercise its rights and carry out its obligations under the Cooperation Agreement through CNBS in such a manner as to protect the interests of the Borrower and the Association and to accomplish the purposes of the Credit. Except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate, waive or fail to enforce the Cooperation Agreement or any provision thereof. In case of any conflict between the terms of the Cooperation Agreement and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods and consultants' services required for the Project and to be financed out of the proceeds of the Credit (including without limitation the procurement of the technical assistance covered by a Technical Services Agreement) shall be governed by the provisions of Schedule 3 to this Agreement.

Section 3.03. (a) The Borrower, through CNBS, shall issue an operational manual, satisfactory to the Association, setting forth rules and procedures for the carrying out of the Project, such manual to include, *inter alia*:

- (i) the procedures for the carrying out, monitoring and evaluation of the Project (including the procurement and financial requirements thereof);
- (ii) the standard bidding documents for procurement of goods and services under the Project;
- (iii) the designation of a secure area for record keeping;
- (iv) the functions and organization of the PCU and the FSPC; and
- (v) the plan for the implementation of the Project.

(b) The Project Operational Manual may be amended by CNBS from time to time with the approval of the Association. In the case of any conflict between the terms

of the Project Operational Manual and those of this Agreement, the terms of this Agreement shall prevail.

Section 3.04. The Borrower shall, throughout the course of Project implementation:

(a) maintain, within CNBS, a project coordination unit (the PCU), to be staffed with, *inter alia*, (i) a coordinator (who will work under the joint supervision of the President of the CNBS and the FSPC); (ii) a procurement officer; (iii) a financial management officer; (iv) at least two designated officials from each of the CNBS and the BCH (on a full-time basis); and (v) other personnel in numbers and with qualifications and experience satisfactory to the Association, to coordinate Project implementation;

(b) maintain a financial sector policy committee (the FSPC) which shall be the decision-making entity for the Project and which shall include, *inter alia*, representatives of SEFIN, CNBS, and BCH, with composition, functions and responsibilities satisfactory to the Association; and

(c) maintain a task force, consisting, *inter alia*, of the officials referred to in (a) (iv) above and headed by the coordinator referred to in (a) (i) above, to direct implementation of Part A of the Project.

Section 3.05. (a) The Borrower, through CNBS, shall enter into an agreement (a Technical Assistance Agreement) with each of the Eligible Banks on terms and conditions which shall have been approved by the Association, for purposes of carrying out Part A.4 (a) (ii) of the Project. The Technical Assistance Agreement shall include, *inter alia*, the right of the Borrower (through CNBS) to terminate said agreement in the event that a generalized crisis of the Borrower's banking system occurs as evidenced by the criteria described in (c) below. In addition, each Technical Assistance Agreement shall specify that the Borrower and the relevant Eligible Bank shall each pay fifty percent of the fees of reputable international management consulting firms (in an amount not to exceed \$500,000 per party) to advise said Eligible Bank on, *inter alia*, market strategy and business organization (e.g., credit risk management processes, approach to troubled debt restructuring governance and management structures).

(b) The Borrower, through CNBS, shall exercise its rights and carry out its obligations under each Technical Assistance Agreement in such a manner as to protect the interests of the Association and the Borrower and accomplish the purposes of the Credit. Except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate, waive or fail to enforce any Technical Assistance Agreement or any provision thereof. In case of any conflict between the terms of any Technical Assistance Agreement and those of this Agreement, the terms of this Agreement shall prevail.

(c) In the event that a generalized crisis occurs in the Borrower's banking system as evidenced by: (i) a sudden and unexpected large scale withdrawal of deposits from the financial institutions threatening the liquidity of the banking system and requiring intervention by the BCH; (ii) three or more of the largest banks in terms of assets becoming subject to intervention and subsequent resolution; (iii) banks holding fifty percent or more of the total deposits in the system becoming subject to intervention and subsequent resolution; or (iv) any other situation which in the opinion of the FSPC severely affects the banking system's stability, the Borrower shall, upon notice from the Association, suspend the execution of Part A.4 (a) of the Project and instead carry out Part A.4 (b) of the Project.

Section 3.06. Without limitation to the provisions of Section 3.01 (a) above, the Borrower shall open and maintain an account in BCH, until completion of the Project, under terms and conditions satisfactory to the Association, for purposes of depositing therein, on a yearly basis, the required counterpart funds required for the implementation of the Project.

Section 3.07. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower, through CNBS and with the assistance of BCH, shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan designed to ensure the continued achievement of the Project's objectives; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

Section 3.08. The Borrower, through CNBS, shall:

(a) maintain, and cause BCH to maintain, policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the performance indicators specified in the Implementation Letter, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, not later than six months after the Effective Date and bi-annually thereafter during the period of Project implementation, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the

efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) review each such report with BCH and the Association not later than two months after the date of such report, or such later date as the Association shall request, and thereafter take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower, through CNBS, shall establish and maintain a financial management system, including records and accounts, and prepare financial statements in a format acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

- (i) have the records, accounts and financial statements referred to in paragraph (a) of this Section and the records and accounts for the Special Account for each fiscal year audited, in accordance with auditing standards acceptable to the Association, consistently applied, by independent auditors acceptable to the Association;
- (ii) furnish to the Association as soon as available, but in any case not later than four months after the end of each such year, (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited, and (B) an opinion on such statements, records and accounts and report of such audit, by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and
- (iii) furnish to the Association such other information concerning such records and accounts, and the audit thereof, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

- (i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;
- (ii) retain, until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (iii) enable the Association's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Section 3.08 of this Agreement, the Borrower shall prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of

such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) the Cooperation Agreement has been executed by the Borrower (through CNBS) and BCH;

(b) the PCU has been established and staffed as set forth in Section 3.04 (a) of this Agreement, and the task force referred to in Section 3.04 (c) of this Agreement has also been established;

(c) the FSPC has been established;

(d) the diagnostic and first-cut classification of the Borrower's banking system following criteria satisfactory to the Association has been carried out by the CNBS;

(e) the Project Operational Manual has been issued and put into effect;

(f) the financial management system referred to in Section 4.01 (a) of this Agreement has been established by the Borrower; and

(g) the auditors referred to in Section 4.01 (b) of this Agreement have been appointed by the Borrower on the basis of terms of reference acceptable to the Association.

Section 5.02. The following is specified as an additional matter, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association, namely, that the Cooperation Agreement has been duly authorized or ratified by the Borrower (through CNBS) and BCH and is legally binding upon the Borrower and BCH in accordance with its terms.

Section 5.03. The date January 14, 2004 is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Secretary of SEFIN is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Secretaría de Estado en el Despacho de Finanzas
Tegucigalpa, M.D.C.
Honduras

Cable address:	Telex:	Facsimile:
HACIENDA Tegucigalpa	1308 FINANZAS HO	(504) 237-4142

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Tegucigalpa, Honduras, as of the day and year first above written.

REPUBLIC OF HONDURAS

By /s/ Arturo Alvarado

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Jane Armitage

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Consultants' services	3,830,000	90%
(2) Goods	1,560,000	100% of foreign expenditures and 88% of local expenditures
(3) Training	570,000	98%
(4) Audits	70,000	90%
(5) Incremental Operational Costs	450,000	64%
(6) Unallocated	720,000	
	<hr/>	
	7,200,000	
	<hr/>	
TOTAL	<hr/> <hr/>	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) the term "training" includes only: (i) reasonable travel, room, board and per diem expenditures incurred by trainers and trainees in connection with their training and by non-consultant training facilitators; (ii) course fees; (iii) training facility rentals; and (iv) training material preparation, acquisition, reproduction and distribution expenses not otherwise covered under this paragraph; and

(d) the term "incremental operational costs" means reasonable expenditures which would not have been incurred absent the Project, for the maintenance and leasing of vehicles and equipment, for fuel, office supplies and other consumables, salaries of incremental PCU staff, utilities and travel, transportation and accommodations.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of: payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR 370,000, may be made on account of payments made for expenditures within twelve months before that date but in any case after June 1, 2003.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (a) goods under contracts costing less than \$50,000 equivalent each; (b) training; and (c) incremental operational costs, under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Borrower to develop the institutional capacity it requires to be able to address the systemic vulnerabilities of its financial system, through: (a) the design and implementation of a banking sector consolidation program; (b) the reform of the Borrower's payment system; and (c) the improvement of selected aspects of the Borrower's financial system infrastructure.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objective:

Part A: Technical Assistance for Banking Sector Consolidation Program

1. Provision of technical assistance to the FSPC for the drafting of legal amendments necessary to improve the Borrower's legal and regulatory framework for the banking sector, including, *inter alia*, amendments to: (a) the Financial Institutions Law; (b) the FOSEDE Law; (c) the BCH Law; (d) the CNBS Law; (e) the current prudential norms and regulations; and (f) norms and regulations related to bank corporate governance and risk management standards.

2. (a) Provision of technical assistance to support the CNBS in the design of standardized templates and a financial projection model for rehabilitation plans to be requested by the CNBS from commercial banking institutions in the Borrower's territory;

(b) carrying out of in-depth viability diagnostics for selected troubled banking institutions in the Borrower's territory that present a combination of highly negative conditions related to solvency, risk and governance; and

(c) provision of technical assistance for the resolution of up to three banking institutions rated as unviable following the in-depth diagnostics described in (b) above.

3. (a) Provision of technical assistance to the BCH and the CNBS to design a detailed contingency plan to enhance preparedness in case a systemic crisis erupts in the banking sector;

(b) provision of technical assistance to the CNBS to establish an elaborated system of ongoing diagnostics at systemic and individual bank levels; and

(c) provision of technical assistance to the CNBS to design and implement a specific program of intensified supervision of adversely rated banking institutions.

4. (a) (i) Provision of technical assistance to design an incentive package, which package shall consist of: (A) provision of technical assistance on a cost-sharing basis to the five banking institutions deemed by the PCU (and not objected by the Association) to be the best implementors of the rehabilitation plans referred to in 2 (a) above (Eligible Banks), excluding banking institutions that are subsidiaries of financial entities incorporated under the laws of the Organization for Economic Cooperation and Development (OECD) countries; and (B) a capitalization scheme funded by the Borrower to facilitate mechanisms for banking sector consolidation; and
- (ii) implementation of the incentive package component referred to in 4 (a) (i) (A) above, by means of the execution of a Technical Assistance Agreement between the Borrower (through CNBS) and each Eligible Bank; or

(b) in the event a generalized crisis occurs in the Borrower's banking system, the provision of technical assistance to support the management of the crisis according to the policies and procedures set forth in the contingency plan referred to in 3 (a) above.

5. (a) Provision of technical assistance to elaborate at least two different options for the design of a more efficient mechanism for the liquidation of assets of intervened banks and of the foreclosed assets (*activos eventuales*) in the balance sheets of banking institutions; and

(b) provision of technical assistance to implement the design selected by the Borrower out of the options referred to in (a) above.

Part B: Reform of the Borrower's Payment System

1. Provision of technical assistance and training to formulate a reform strategy for the Borrower's payment system, to define the scope of said reform, and to set up adequate organizational arrangements to carry out said reform.

2. Carrying out of an upgrade of the current payments system at the BCH to launch a special purpose large value payments system that will allow for the separation of large

and low value payments, through the provision of technical assistance, goods and training.

3. Implementation of a central securities depository through the provision of technical assistance, goods and training.

Part C: Improvement of the Borrower's Financial System Infrastructure

1. (a) Provision of technical assistance, equipment and training to: (i) strengthen UIF's organizational structure and its analytical capabilities; and (ii) build capacity within the UIF for on-site examinations for AML/CFT purposes; and

(b) (i) provision of technical assistance for the design of a training program (in partnership with the private sector) covering AML/CFT issues for the financial community (i.e., employees, compliance officers, internal auditors and senior management from banks, insurance companies, money remitters, exchange houses and other non-bank financial institutions), financial regulators, the UIF, prosecutors and judges; and (ii) provision of training to implement said program.

2. (a) Establishment of a monitoring unit in BCH for large corporate risks, including a system of ongoing analysis and monitoring of the structure, soundness and evolution of the Borrower's corporate sector, as well as its ties with local financial institutions, through the provision of technical assistance, equipment and training;

(b) provision of technical assistance to improve the Borrower's current legal framework for insolvency proceedings to reflect internationally recognized best practices regarding the regulation of: (i) court supervised insolvency proceedings (formal), including corporate reorganization and liquidation; (ii) out-of-court (informal) or minimally supervised (quasi-formal) mechanisms for corporate restructuring negotiations and plans ("workouts" and "prepackaged plans"); (iii) secured transactions regarding all kinds of tangible and intangible assets; and (iv) related laws, as necessary (e.g., tax legislation relating to treatment of debt writeoffs);

(c) provision of technical assistance and training to initiate the implementation of the improved framework for corporate restructuring mechanisms (judicial and extra-judicial) resulting from (b) above; and

(d) provision of technical assistance to design a safe, efficient, modern and cost-effective registration method for property rights, licensed rights and secured interests.

3. (a) Provision of technical assistance to review the instruments currently used by the Borrower to facilitate and reactivate lending to small agricultural producers and to identify possible options for improvement of said instruments based on international best practices; and

(b) provision of technical assistance to prepare the implementation of the improvements selected by the Borrower from the options identified in (a) above.

Part D: Project Coordination

Provision of technical assistance, equipment, training and incremental operational costs as necessary to establish, operate and strengthen the PCU to enable it to effectively monitor and evaluate the implementation of the Project components (including audit services for purposes of Section 4.01 (b) of this Agreement).

* * *

The Project is expected to be completed by March 31, 2007.

SCHEDULE 3

Procurement

Section I. Procurement of Goods

Part A: General

Goods shall be procured in accordance with the provisions of Section I of the “Guidelines for Procurement under IBRD Loans and IDA Credits” published by the Bank in January 1995 and revised in January and August 1996, September 1997 and January 1999 (the Guidelines) and the following provisions of Section I of this Schedule.

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.
2. To the extent practicable, contracts for goods shall be grouped in bid packages estimated to cost \$150,000 equivalent or more each.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Goods estimated to cost less than \$150,000 equivalent per contract and more than \$25,000 equivalent per contract, up to an aggregate amount not to exceed \$300,000 equivalent, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. Shopping

Goods which cannot be grouped into larger bidding packages and estimated to cost \$25,000 equivalent or less per contract, up to an aggregate amount not to exceed \$150,000 equivalent, may be procured under contracts awarded on the basis of shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Association of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods shall be undertaken in accordance with such procurement plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

2. Prior Review

With respect to each contract for: (a) goods to be procured in accordance with the procedures referred to in Part B above; and (b) goods to be procured in accordance with the procedures referred to in Part C.1 above estimated to cost the equivalent of \$50,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 and revised in September 1997, January 1999 and May 2002 (the Consultant Guidelines), paragraph 1 of Appendix 1 thereto, Appendix 2 thereto and the following provisions of Section II of this Section.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of

the Consultant Guidelines, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

Services for assignments of standard or routine nature estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

2. Selection Based on Consultants' Qualifications

Services for the implementation of Part C of the Project and audits under Part D of the Project estimated to cost \$100,000 equivalent or less per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

3. Individual Consultants

Services of individual consultants for specialized advisory services that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines estimated to cost up to an aggregate amount of \$3,000,000 equivalent shall be procured under contracts awarded in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Association of the Selection of Consultants

1. Selection Planning

A plan for the selection of consultants, which shall include contract cost estimates, contract packaging, and applicable selection criteria and procedures, shall be furnished to the Association for its review and approval prior to the issuance to consultants of any requests for proposals. Such plan shall be updated every six months during the execution of the Project, and each such updating shall be furnished to the Association for its review and approval. Selection of all consultants' services shall be undertaken in accordance with such selection plan (as updated from time to time) as shall have been approved by the Association.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms, the procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of individual consultants, the report on the comparison of the qualifications and experience of candidates, terms of reference and terms of employment of the consultants shall be furnished to the Association for its prior review and approval. The contract shall be awarded only after the said approval shall have been given. The provisions of paragraph 3 of Appendix 1 to the Consultant Guidelines shall also apply to such contracts.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 4

Special Account

1. For the purposes of this Schedule:
 - (a) the term “eligible Categories” means Categories (1) through (5) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;
 - (b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and
 - (c) the term “Authorized Allocation” means an amount equivalent to \$750,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3(a) of this Schedule.
2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.
3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:
 - (a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.
 - (b)
 - (i) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.
 - (ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association

shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all

such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.