CASE STUDY

Managing Catastrophe Risk in Guatemala

OVERVIEW

The Catastrophe Deferred Drawdown Option (Cat DDO) provides assurance of rapid access to funds at cost-effective levels after a natural disaster has occurred. Guatemala, one of the top five high-risk countries in the world in terms of vulnerability to three or more hazards, requested and received a Development Policy Loan (DPL) with a Cat DDO that complements other financial instruments and disaster risk management measures in place in the country. Two major disasters struck the country in 2010, and Guatemala used the Cat DDO to finance reconstruction and other expenses related to the natural disasters.

Background

Guatemala, one of the largest economies in Central America, made significant progress in achieving macroeconomic and democratic stability after a 36-year civil war. Prudent macroeconomic management enabled an annual average growth of 4.2% between 2004 and 2007. However, the global economic crisis of 2008-2009 had a significant impact on the country. Remittances —a key driver of Guatemala's economy— dropped by 9.5% in 2009. Exports to the US, its main trade partner, also fell. Guatemala is also challenged by significant exposure to natural disasters. Between 1902 and 2005, the country experienced 62 natural disasters, which affected approximately six million people.

Since 1969, Guatemala has been building institutions in order to better respond to events affecting its macroeconomic stability. Since 2005, the country has taken significant steps to move from a reactive to a proactive approach to addressing disaster risk by investing in risk mitigation measures.

Financing Objectives

Natural disasters can throw important long-term development programs off course by forcing a government to divert resources to respond to an immediate crisis. The Government of Guatemala wanted to ensure that they had access to funds immediately after a natural disaster, while other sources of financing (concessional funding, bilateral aid, and reconstruction loans) were being mobilized. This would allow them to respond quickly to emergency needs, without hampering the continuity of development programs.

Financial Solution

A loan from the International Bank for Reconstruction and Development (IBRD) with a Catastrophe Deferred Drawdown Option (Cat DDO), a form of contingent financing offered by the Bank that provides countries with assurance of rapid access to funds at cost-effective levels after a natural disaster has occurred, was part of the solution to Guatemala's challenge. Guatemala requested and received a US$85 million Development Policy Loan (DPL) with a Cat DDO in April 2009.

The Cat DDO provides immediate liquidity up to US$500 million or 0.25% of GDP (whichever is less) to IBRD member countries in the event of a natural disaster. Funds may be disbursed (partially or in full) when a state of emergency is declared by the government.

The Cat DDO has a revolving feature, that is, amounts repaid prior to the closing date of the project are available for subsequent disbursements. Guatemala also has the flexibility to change the repayment schedule for each new disbursement before it is disbursed, which allows it to achieve the best combination of grace period and final payment maturity.

The Cat DDO is most effective as part of a broader risk management strategy adopted by the country. To qualify for the Cat DDO, Guatemala had to have an adequate macroeconomic framework and disaster risk management program in place, which is periodically reviewed by the World Bank.

Outcome

The Cat DDO allowed the government to quickly respond to the damages caused by the eruption of the Pacaya volcano and the Agatha tropical storm in May 2010. The cost of the two disasters was US$982 million, approximately 2.6% of the 2009 GDP.

In June 2010, the government disbursed the full balance of the Cat DDO to finance part of the reconstruction and other expenses.

Terms & Conditions

Approval Date	April 14, 2009
Amount and Currency	US$85 million
Repayment Schedule	24 years of final maturity (including a 9 year grace period) with leveled amortizations of principal)
Interest Rate	Fixed at 4.77% for 24 years
Disbursement Period	3 years; renewable up to 15 years if original program remains in place
Fees	0.25% Front-End Fee[1]

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[1] On August 5, 2009, IBRD increased the front-end fee from 0.25 percent to 0.50 percent and introduced a 0.25 percent renewal fee for new DPLs with a Cat DDO

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