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# Guatemala Cat DDO

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**Providing Countries with Rapid Access to Funds after a Natural Disaster**

## Highlights

- The DPL with Cat DDO provides immediate access to liquidity following a declaration of emergency.
- 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 DPL with a Cat DDO that complements other financial instruments and disaster risk management measures in place in the country.
- Guatemala disbursed the full value of its DPL with Cat DDO following two major adverse natural events that struck the country in 2010, using the funds to finance reconstruction and other expenses.

## Background

Guatemala, one of the largest economies in Central America, has 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. The global economic crisis of 2008-09, however, had a significant impact on the country. Remittances — a key driver of Guatemala's economy — dropped by 9.5% in 2009, and 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. From 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.

## Objective

Disasters from adverse natural events often force the government to divert resources from important long-term development projects, which can seriously inhibit the country's progress on its development goals. The Government of Guatemala wanted to ensure immediate access to funds following a natural disaster while other sources of financing (i.e., concessional funding, bilateral aid, and reconstruction loans) were being mobilized. Immediate liquidity would allow the government to respond quickly to emergency needs without hampering the continuity of development programs.

## Structure

Guatemala decided to strengthen its response capacity with the help of a Development Policy Loan (DPL) with a Catastrophe Deferred Drawdown Option (Cat DDO), a form of contingent financing offered by the World Bank that provides countries with access to immediate liquidity at cost-effective levels following the declaration of a natural disaster. To qualify for the Cat DDO, Guatemala had to have an adequate macroeconomic framework in place and its disaster risk management program will be periodically reviewed by the World Bank. In April 2009, Guatemala requested and received a US$85 million Development Policy Loan (DPL) with a Cat DDO.

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 has the flexibility to change the repayment schedule for each new drawdown before it is disbursed, which allows it to balance its need for a grace period and with timing the loan's final payment maturity.

## 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 obtain liquidity and finance part of the reconstruction and other expenses.

## Lessons Learned

**1. The Cat DDO is most effective as part of a broader disaster risk financing program, complementing other risk retention tools (such as reserves) and risk transfer instruments (including catastrophe insurance).** The primary benefit of the Cat DDO is that it is quick-disbursing, providing the government with an immediate source of bridge financing following a natural disaster.

**2. Specific institutional arrangements need to be in place to allow for quick disbursement of funds after the declaration of an emergency.** Without a legal process in place that allows for approving the use of Cat DDO funds in a post-disaster environment, the government will not fully benefit from the quick-disbursing nature of the Cat DDO.

**3. It is beneficial for the government to fully understand its fiscal exposure to natural disasters when requesting a Cat DDO.** Fiscal impact studies can help the government understand its expected post-disaster short-term recovery funding gap, which the Cat DDO can help to close. This understanding will equip the government to make informed choices about what size of the Cat DDO will best suit its needs and will enable the government to quickly determine how much to draw down on the Cat DDO following a natural disaster.

## Glossary

**Exposure:** In a natural catastrophe model, the property at risk of being destroyed by a natural catastrophe.

**Risk financing:** The process of managing risk and the consequences of residual risk through products such as contingent loans, insurance contracts, Cat bonds, reinsurance, or options.

## Main Terms and Conditions: Guatemala Cat DDO

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| **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] |

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

## Further Reading


Cummins, J.D., and Mahul, O. (2010). *Catastrophe Risk Financing in Developing Countries: Principles for Public Intervention.* Washington, DC: World Bank.

World Bank Treasury Disaster Risk Financing: http://treasury.worldbank.org/bdm/htm/risk_financing.html


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