

Managing Catastrophe in Costa Rica

OVERVIEW

The Catastrophe Deferred Drawdown Option (Cat DDO) is a form of contingent financing offered by IBRD to help countries take a proactive stand towards reducing exposure to catastrophic risk and access funds immediately after a natural disaster.

Costa Rica was the first country to sign a Cat DDO with the World Bank and subsequently drew down the loan after a natural disaster. The Cat DDO complements other financial instruments and disaster risk management measures in place in the country.



Background

Costa Rica is a small, middle-income country with substantial exposure to natural disasters, including earthquakes, floods, hurricanes, landslides, and volcanic eruptions. According to a World Bank funded natural disaster study, Costa Rica ranks number two in the world among countries most exposed to multiple hazards, with 80 percent of the country's GDP and 78 percent of Costa Rica's population in high-risk areas.

Costa Rica has built an efficient disaster response system and established an effective system of building codes, environmental standards, and land use planning to mitigate the impact of natural disasters. It has also made substantial progress in strengthening its institutional and legal framework and mainstreaming catastrophe risk management in its national development program.

Financing Objectives

Natural disasters can throw important long-term development programs off course by diverting budgetary resources to respond to a crisis. Costa Rica needed to ensure access to funds immediately after a natural disaster to provide assistance to affected populations without hampering the continuity of other development programs.

IBRD Financial Solution

The Catastrophe Deferred Drawdown Option (Cat DDO), a form of contingent financing offered by IBRD to help countries take a proactive stand towards reducing exposure to catastrophe risk was the answer to Costa Rica's challenge. Costa Rica became the first country to request and benefit from a 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 due to a natural disaster. The Cat DDO also has a revolving feature, that is, amounts repaid prior to the closing date are available for subsequent drawdown. Costa Rica also has the flexibility to change the repayment schedule for each new drawdown before it is disbursed, which allows it to achieve the best combination of grace period and final payment maturity. As part of the terms of the Cat DDO, Costa Rica is expected to maintain a proactive program to reduce its exposure to disaster risk.

Outcome

In January 2009, just months after securing the Cat DDO, a 6.2 magnitude earthquake struck 20 miles north of San José, affecting more than 120,000 people. Costa Rica drew down US\$24 million of the Cat DDO to rebuild damaged infrastructure.

Cat DDOs provide bridge financing while other financial resources such as bilateral aid and reconstruction loans are mobilized following a natural disaster. This financial product is most effective as part of a broader risk management

strategy adopted by the country. The Cat DDO in Costa Rica complements other financial instruments and disaster risk management measures in place. In particular, it addresses two key policy areas of the country's disaster risk management program: (a) strengthening the institutional and legal framework and (b) mainstreaming disaster risk management in the National Development and Investment Programs.

Terms & Conditions

Amount	US\$65 million
Approval Date	September 16, 2008
Repayment Schedule	29.5 years of final maturity (incl. a 5-year grace period) with level amortization of principal
Interest Rate	Variable: Based on 6-month LIBOR plus a fixed spread
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.