THE WORLD BANK
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CASE STUDY

Colombia's Cat DDO: Strengthening Resilience to Disasters, Climate Change and Health Risks

The USD 300 million Third Disaster Risk Management Development Policy Loan (DPL) with a Catastrophe Deferred Drawdown Option (Cat DDO) will help Colombia reduce disaster, climate, and public health risks.

Exogenous shocks from disasters, pandemics, and commodity price adjustments can harm a country's fiscal balance. An IBRD loan with a Cat DDO can help countries mitigate such risks by making a line of credit available to them.

On December 17, 2021, the World Bank's Board of Directors approved a USD 300 million Cat DDO for Colombia (Cat DDO III) to reduce fiscal vulnerability to adverse natural and climate-related events, including disease outbreaks. Colombia has proactively used this contingent financing instrument as part of its broader fiscal risk management strategy since 2008.

Background

Colombia has one of the highest rates of disasters caused by natural and climate-induced hazards in the Latin America and Caribbean region[1]. Eighty-four percent of Colombia's population and 86 percent of its assets are exposed to two or more natural hazards[2].

Climate change is also a major concern. The Ministry of Environment and Sustainable Development estimates that about two percent of Colombia's population and capital stock will be affected by floods and the loss of marine and coastal ecosystems.[3]

Disaster and climate risks represent Colombia's largest contingent liability, with an estimated impact of up to 4.4 percent of gross domestic product (GDP).

People with facemask due COVID-19 waiting for public bus at bus stop in Bogota - Colombia. Photo Credit "Working in Media" iStock

In recent decades, Colombia has made important strides in developing comprehensive fiscal risk management strategies. Mitigation measures included managing interest rate risk by significantly reducing the floating rate share of the country's debt portfolio and other fiscal risks by deploying new methodologies to manage contingent liabilities from public-private-partnership (PPP) programs.

For more than 20 years, the Government has partnered with the World Bank on disaster risk management and climate change adaptation framework development, including the use of Cat DDOs and Catastrophe Bonds (Pacific Alliance Cat bond). Cat DDO I disbursed in 2011 during the La Niña 2010-11 phenomenon; Cat DDO II disbursed in 2020 at the onset of the COVID-19 pandemic.

Financial Objective

Meet immediate liquidity needs following an emergency provoked by natural, climate-induced or public health hazards.

[1] Colombia ranks fourth in the region for disaster risk. EU Commission. 2019. INFORM Risk Index.
[2] DNP. 2014. *Bases del Plan Nacional de Desarrollo 2014-2018: Todos por un Nuevo País. Pais.*
[3] DNP, CEPAL y BID. 2014. *Impactos económicos del cambio climático en Colombia. Síntesis.*

Financial Solution and Outcomes

As a contingent financing line, the Cat DDO can play an important role as part of a comprehensive disaster risk management strategy by delivering immediate liquidity in response to shocks related to pre-defined disasters and health-related events.

It serves as early financing while funds from other sources such as bilateral aid or reconstruction loans are being mobilized. Cat DDOs enhance countries' capacity to plan for and manage crises by securing access to financing before disaster strikes. It is approved before the disaster and disburses quickly once the event occurs.

Using the Cat DDO, Colombia will be able to draw down the loan any time over a three-year period, which can be extended up to four times for a maximum of 15 years.

Cat DDO III also highlights Colombia's commitment to the climate change agenda. One of the prior actions for Cat DDO III is the issuance of a sovereign green bond, which along with other prior actions, sets the stage for broader reforms to help the government strengthen its program for reducing natural, climate-driven, and public health related risks.

In September 2021, Colombia issued its first sovereign green bond with technical assistance from the World Bank. The green bond is a vehicle for financing projects that promote climate change mitigation and adaptation. The management of disaster risks associated with climate change is included as one of the eligible uses of the green bond proceeds and could help finance the implementation of relevant sectoral plans and policies. Therefore, the green bond complements the objectives of Cat DDO III. A second green bond was auctioned in October 2021. Colombia plans to issue sovereign green bonds as needed to support green expenditures in the budget.

World Bank Treasury's Role

- The World Bank Treasury team worked with the Urban, Disaster Risk Management, Resilience and Land Global Practice, the Finance, Competitiveness and Innovation Global Practice, and the Ministry of Finance throughout the project cycle. The Ministry of Finance benefited from Treasury's guidance to understand the financial terms and conditions of the financial instrument, including the approval criteria, country limit, drawdown triggers, currency, financial risk, and repayment schedule scenarios. Treasury helped the project team and the client navigate the loan negotiation process to enable timely delivery to the World Bank Board.
- The World Bank Treasury's Sustainable Finance Advisory Program provided technical assistance to the Ministry of Finance to facilitate the issuance of Colombia's first sovereign green bond in the local market, thus meeting the related prior action.

IBRD financial products can play a critical role in strengthening clients' fiscal resilience. Cat DDOs, with their contingent financing lines, can be the first line of financial relief for disasters or health related events. As each client's needs are unique, World Bank Treasury can help clients use the flexibility of IBRD loans to achieve better financial terms for their projects, optimize the cost and risk of their debt portfolios, as well as provide technical assistance for green bond transactions

Summary of Financial Terms	
Approval Date	December 17, 2021
Amount	USD 300 million
Repayment Schedule	19.5 years of final maturity (incl. a 3.5-year grace period) with level amortization of principal. It may be modified upon drawdown at borrowers' request.
Disbursement Period	Three years; renewable up to 4 times, for a maximum duration of 15 years in total
Fees	0.50% Front-End Fee; 0.25% Renewal Fee

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