DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

CONTINGENT CREDIT FACILITY FOR NATURAL DISASTER EMERGENCIES

PROPOSAL

This document was prepared by the project team consisting of: Guillermo Collich (ICF/CMF) Project Team Leader; Hector Malarin (INE/RND); Carolin Crabbe (ICF/CMF); Laura Fan (FIN/TRY); Kevin McTigue (LEG/SGO); Juan José Durante (ICF/CMF); Esteban Piedrahita (ICF/CMF); and Annabella Gaggero (ICF/CMF).

CONTENT

ABBREVIATIONS

DDO	Deferred Drawdown Option
FSO	Fund for Special Operations
IDRM	Integrated Disaster Risk Management
NLF	New Lending Framework
NOF	New Operational Framework
OC	Ordinary Capital
PBL	Policy Based Loans
PCR	Project Completion Report
PPMR	Project Performance Monitoring Report

I. EXECUTIVE SUMMARY

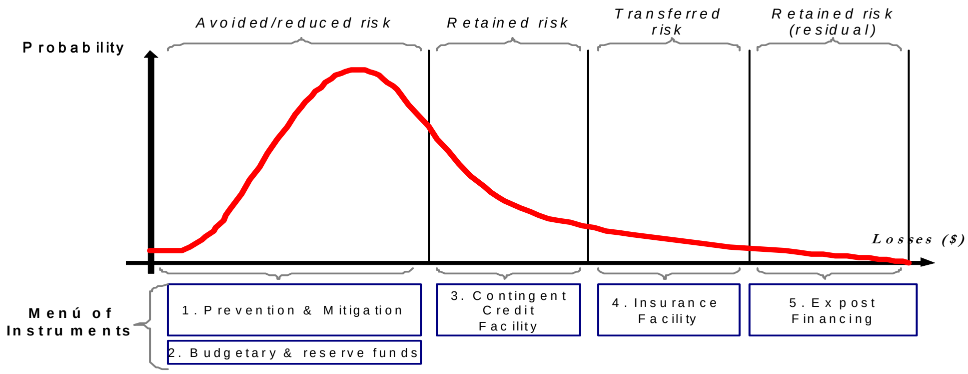
Total Facility amount:	US$600 million
Individual Facility Loan limits:	US$100 million or 1% of Borrowing Country GDP, whichever is less
Disbursement (availability) period:	Up to 5 years
Drawdown eligibility requirements:	(i) Existence of a Country Integrated Disaster Risk Management (IDRM) Program satisfactory to the Bank. (ii) Verification of occurrence of a disaster event of contractually agreed type, location and intensity (the eligible event).
Individual drawdown amounts:	Up to 100% of available undisbursed Facility Loan balances, according to contractually-agreed eligible event intensity.
Alternative drawdown modalities:	(i) From Facility Loan available undisbursed balances. (ii) From a list of automatically redirectable undisbursed IDB loan balances, contractually agreed between the Borrower and the Bank.
Procurement and fiduciary rules:	A request for the waiver of certain investment loan procurement and fiduciary rules for loan operations under this Facility is being made (see section IV.B.10 of this document).

II. FRAME OF REFERENCE

2.1 In line with the growing incidence and impact of natural disasters in the Region and the IDB's renewed emphasis on supporting borrowing member countries in the prevention, mitigation and response to such events, in late 2007, the Bank developed the Integrated Disaster Risk Management and Finance Approach (OP-47). This approach is consistent with the Disaster Risk Management Policy and its Guidelines (documents GN-2354-5 and GN-2354-11, respectively) and the Action Plan for Natural Disaster Risk Management (GN-2339-1).

2.2 The objective of the Integrated Disaster Risk Management and Finance Approach is to improve borrowing member countries' management and financial planning for natural disasters. It provides them with a range of financial options to cover prevention and maintenance (P&M) and reconstruction, as well as to bridge the fiscal gap immediately following a disaster event (see Graph 1 and Chapter II below where the terms and concepts introduced in the graph are explained in detail). These options include several instruments such as reserve funds, contingent credit loans and insurance, that can cover disaster risks depending upon their probability of occurrence and the losses and costs they generate. The probability of occurrence and cost of a disaster event significantly affect the pricing of risk finance and therefore influence the selection and the combination of financial instruments for each particular case.

Graph 1



2.3 For instance, events with a high probability of occurrence, such as annual flooding, are prohibitively expensive to finance through insurance instruments. Budgetary resources and reserve funds would be better suited to finance these regularly occurring, lower loss events. On the other hand, events with lower probability of occurrence but higher losses and costs are better suited for coverage by insurance and reinsurance instruments or contingent credit lines. It is important to underscore this point because the Bank's integrated disaster risk management and finance approach is predicated on the reality that no single instrument is able to cover all levels of risk and thus includes a menu of financial options.

2.4 One of the key tools for financing retained risks are contingent credit lines. This document presents a proposal for the introduction of a mechanism that would enable the Bank to structure contingent credit lines for its borrowing member countries, herein called the Contingent Credit Facility. Through this Facility, the Bank would be able to grant contingent loans for up US$600 million. Individual facility loans will be for up to US$100 million, or 1% of a borrowing member country's GDP, whichever is less. Loan proceeds will be used to cover the extraordinary expenditures that arise immediately after the occurrence of a severe disaster.

2.5 Some examples of eligible types of expenditures are: emergency sanitation equipment; medications, vaccines and prescription drugs; temporary shelter equipment and installations; foodstuffs and feedstuffs for displaced or distressed populations; emergency personnel overtime and hazardous conditions benefits; short term leases of power, transportation and communications equipment and installations and storage facilities.

2.6 All borrowing member countries would be eligible for support through this Facility, provided that they have in place an Integrated Disaster Risk Management (IDRM) Program satisfactory to the Bank.

2.7 Initial demand for finance through this facility is expected to come from the COSEFIM[1] countries and Belize, which have indicated a preliminary interest in a contingent credit support for natural disaster emergencies from the Bank.

2.8 Due to financial instrumentation limitations imposed by the New Lending Framework (NLF), the contingent credit line (CCL) configuration proposed is that of an investment loan with several exceptions, mainly related to procurement and disbursement rules (see IV.B.10). This structure is a compromise solution that takes into account the restrictions of the current NLF, but also allows for a rapid response to country requests for immediate support of this sort. This Facility will be reviewed as part of Management's work on the simplification of the Bank's operational lending instruments, and adjusted accordingly.

III. THE FACILITY

A. Objective and Main Design Features

3.1 The design of the proposed Facility is predicated on the concept that, to be effective, contingent credit lines must be disbursed rapidly and immediately following a disaster event. Moreover, because of their substantial size and consequent significant fiscal impact, their costs and repayment terms must be affordable.

3.2 The objective of this Contingent Credit Facility, ("the Facility"), is to provide member countries with liquid resources to cover urgent financing needs that arise immediately after a natural disaster of unexpected, sudden, and unusual proportions, until other sources of funding can be accessed. The Facility mechanism described below will ensure the rapid transfer of funds following a natural disaster with the specific characteristics defined in the respective Bank Loan Contract. These characteristics, which would be previously agreed to by the borrower and the Bank, would include explicit definition of the type, location, and intensity of event that would be covered.

3.3 As explained below, loans granted under this Facility will be configured as Investment Loans and executed in accordance with the Bank's correspondent operational guidelines. The only operational features that would differ are: (i) the drawdown of proceeds would be contingent upon the occurrence of a natural disaster event of unexpected, sudden, and unusual proportions of a type and intensity described in the related loan contract, and (ii) certain Bank procurement policies will be waived in order to allow fast disbursements immediately after the event occurs, an essential requirement of this new instrument.

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[1] The Council of Treasury Secretaries and Ministers of Finance of Central America, Panama and the Dominican Republic (COSEFIM) includes Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

3.4 If a natural disaster occurs that does not match the contractually agreed coverage provisions, there will be no disbursement of funds under the loan granted through this Facility. Nonetheless, the Bank will endeavor to assist the borrower through other suitable lending instruments available for natural disaster emergency support to meet countries' urgent needs, and as a temporary measure.

3.5 The total initial amount proposed for the Facility is US$600 million. Individual loans granted through it (hereinafter the Facility Loans) will be of up to US$100 million, or 1% of the borrowing member country's GDP, whichever is less.

B. Lending Instrument Selection and Conceptual Justification

3.6 Before settling on the present proposal, several alternative lending instruments available within the NLF were studied, including Performance Driven Loans (PDL), a modified Emergency Lending Facility (ELF), and one tranche Policy-Based Loans (PBL).

3.7 The PDL was deemed unsuitable because reimbursement of eligible expenditures under this lending instrument is conditioned to verification of compliance with outcome targets by a performance consultant. It is not possible to conduct such verification before the disaster occurs and the expenditures have been incurred, and it would take a considerable amount of time to do so afterwards. Therefore, the use of a PDL would defeat the purpose of the contingent line which is to provide liquid resources to fill the fiscal financial gap at the onset of a severe disaster emergency, while other sources of funding are being mobilized.

3.8 The use of a modified ELF could have had some advantages, including its rapid disbursement provisions. However, the use of ELF authority, which is envisioned specifically for financial emergencies, and the necessary extension of amortization periods required for an effective natural disaster contingent credit product would require approval by the Board of Governors, a process that would take considerable time. In addition, countries undergoing a natural disaster would have difficulty facing the high costs of these loans.

3.9 A one tranche PBL option could provide most of the relevant features needed for this new instrument, such as quick disbursements, but the indispensable requirement of establishing and maintaining a country macroeconomic policy framework satisfactory to the Bank is perceived as particularly burdensome. The main concerns are that this would not only require the performance of a normally lengthy assessment under the most complex of circumstances, but, worse still, in most cases it will result in a failing one since severe and catastrophic natural disaster events almost inevitably result in significant disruption and deterioration of the macroeconomic situation in the affected country.

3.10 After thorough analysis, it was concluded that the lending instrument with the most optimal features that the Bank presently has available is an Investment Loan. It must be noted, however that, since quick disbursement of funds is vital to achieve the goals of the Facility, a request for the waiver of certain investment loan procurement and fiduciary rules for loan operations under this Facility is being made (see section IV.B.10 of this document). Once the special features being proposed are incorporated, these kinds of loans would include the key characteristics the Facility requires.

3.11 Another very special feature of the design of this Facility results from the fact that, unlike most other Bank operations, effective disbursement of resources would not occur immediately after Board's approval of the individual loans, and indeed might never occur, if there is no natural disaster event to trigger it. This contingent disbursement feature could be construed as an inefficient usage of scarce Lending Authority resources that would carry considerable opportunity costs for the borrowing countries and, therefore, have a significant negative effect on their demand for Facility loans.

3.12 The issue prompted the exploration of alternative solutions that, without infringing current Lending Authority policies, would give consideration to the Bank's desire to meet its clients' manifest need for contingent credit financing and at the same time be competitive with other similar programs such as the World Bank's Catastrophic Deferred Drawdown Option (CAT-DDO).

3.13 After analyzing different alternatives and their related operational and financial policy constraints, it was decided to include in the Facility an alternative funding scheme by which the Bank and the borrower may contractually agree that, in the event of a drawdown request, Bank disbursement may alternatively come from the Facility Loan or from the automatic redirection (AR) of available undisbursed balances from a specific list of Bank loans already approved (see paragraphs 4.11 to 4.15).

3.14 Notwithstanding the above, and mindful of the constraints embedded in the use of an instrument that was not specifically designed for the task, the proposed Facility will be reviewed and adjusted as part of Management's work in the simplification of the Bank's operational instruments.

IV. OPERATIONAL FRAMEWORK AND PROVISIONS

A. General Operational Framework

4.1 The Disaster Risk Management Policy Guidelines (document GN-2354-5) provide the operational framework for the Facility. The operational provisions set forth in the present document, complemented by the Bank's operating policies and rules for Investment Loans (with the exceptions described herein), as well as the applicable general operational policies and procedures, would apply. Unless otherwise explicitly indicated in this document, Facility Loans will be configured and executed in accordance with the Bank's correspondent Investment Loan policies and procedures.

4.2 The only operational features that would differ are: (i) the drawdown of proceeds would be contingent upon the occurrence of a natural disaster event of unexpected, sudden, and unusual proportions of a type and intensity described in the related loan contract, and (ii) some of the Bank's procurement and fiduciary policies and procedures will be waived, as established in section B.10 below, in order to allow fast disbursements immediately after the event occurs, which is an essential requirement of this new instrument.

B. Specific Operational Provisions

4.3 Management may issue such additional or separate operational guidelines as may be found necessary for the operation of the Facility, within the parameters described herein.

1. Country Eligibility

4.4 All borrowing member countries[2] will be eligible to receive financing through the Facility, provided they have in place an IDRM Program that is satisfactory to the Bank. The IDRM Program should include measures on risk analysis, prevention, mitigation, emergency preparedness and disaster response, as well as provisions for adequate and sustainable financing of the remaining retained or transferred risks, to be executed in a period of no more than five years.[3] Moreover, the IDRM Program must have measurable output and outcome indicators to allow regular monitoring by the Bank.

2. Drawdown Conditions

4.5 Loans granted under this Facility will be configured as Investment Loans and, as mentioned in paragraph 4.1, will be executed in accordance with the Bank's correspondent policies and procedures. However, the drawdown of proceeds would be contingent upon the occurrence of a natural disaster event of unexpected, sudden, and unusual proportions of a type and intensity agreed in the related loan contracts.

3. Lending Limits

4.6 As the Facility is envisioned as a temporary solution to meet client demands, it is proposed that its maximum overall size be limited to US$600 million.[4] It is further proposed that a country limit be set at US$100 million or one percent (1.0%) of a country's gross domestic product (GDP), whichever is smaller.

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[2] Sub-national governments will have access to the facility provided that they have a sovereign guarantee of a borrowing member country.

[3] The suitability of the IDRM Program will be verified by INE/RND.

[4] It is not proposed that lending authority be set aside for this Facility.

4. Funding Sources

4.7 Depending on the loan funding source, Ordinary Capital (OC) or Fund for Special Operations (FSO), and unless explicitly indicated otherwise in the corresponding loan proposal and the respective loan contract, the normal financial terms and conditions of the related funding source will be applied. The Bank's ability to make blended loans would depend upon the availability of FSO resources in accordance with the respective country allocation for the corresponding period.

5. Disbursement Period

4.8 The maximum disbursement period for a loan granted under this Facility will be 60 calendar months starting from the date the loan contract enters into effect, but will not exceed the execution period for the IDRM Program agreed on with the Bank. At the borrower's request, the Bank can grant successive extensions to the disbursement period in accordance with its regular procedures, provided that the IDRM Program is being executed to the Bank's satisfaction and has an execution period equal to or greater than the requested extension.

4.9 The Bank will automatically cancel any Facility Loan Contract that has not been signed by the Borrower within six months from the date of approval of the loan by the Bank's Board of Executive Directors.

6. Parametric Trigger for Disbursements

4.10 Once the Facility loan is approved, in addition to satisfactory IDRM Program performance, the only condition for a Borrower's drawdown of funds available for disbursement would be the verification by the Bank that the country has experienced an event of a certain type, location and intensity specifically described in the loan document. This verification will be based on a contractually agreed technical assessment procedure that will be objective and transparent.

7. Alternative Funding Mechanism

4.11 Loans granted through the Facility will be made against OC or FSO available resources as appropriate. Nevertheless, the Bank and the borrower may contractually agree that, in the event of a drawdown request, Bank disbursement may alternatively come from the Facility Loan or from the Automatic Redirection (AR) of available undisbursed balances from a specific list of Bank loans already approved. When the alternative funding mechanism is included in a Facility Loan, the related contracts will have to specify and list (the Automatic Redirection List) which resources available for disbursement from already approved loans could be subject to Automatic Redirection.

4.12 In the event that the borrower chooses to include the alternative funding mechanism, the Bank will consider Lending Authority usage at the 1:1 ratio and charge the related Credit Fees only on the amounts of the approved and undisbursed Facility Loan that exceed the amount of undisbursed available balances included in the ARL. Whenever the amount of said balances falls below the undisbursed Facility Loan balance during the disbursement period, the 1:1 ratio shall kick in and the borrower shall begin paying Credit Fees on the excess amounts for the period during which they remain uncovered and undisbursed.

4.13 The Bank and the Borrower will be able to remedy the shortfall situation at any time during the term of the Facility Loan agreement through contractual amendments to the ARL or adding or changing the amounts or the loans in the list. However, if a shortfall occurs at a time when the countries do not have additional available undisbursed balances to include in the ARL and the Bank does not have enough uncommitted Lending Authority of the corresponding kind available for the country to cover the shortfall, the availability of the shortfall amounts could be unilaterally suspended by the Bank until the Lending Authority availability shortage with the country is deemed overcome. The Bank will promptly notify the borrower of both the suspension or reinstatement of eligibility for disbursement of the loan in question.

4.14 Notwithstanding the above, once eligibility for disbursement of a Facility Loan has been granted, it would remain eligible for the duration of the period established in the contract unless a formal notification of eligibility suspension, due to the unsatisfactory IDRM Program performance, is delivered by the Bank to the Borrower.

4.15 No Credit Fees shall be charged by the Bank on Facility Loan amounts which have their eligibility for disbursement suspended by the Bank due to the previously described circumstances.

8. Disbursement Requests

4.16 A borrower's IDRM Program in a form satisfactory to the Bank will have to be in place before any Facility Loan approvals by the Bank's Board of Directors for such borrower. Disbursement of the Bank's financing under such a Facility Loan will be triggered by the borrower's submission of a formal Disbursement Request to the Bank within 90 days after an eligible event, as described below.

4.17 In addition to certain standard elements for a disbursement request under an Investment Loan, the Facility Loans Disbursement Requests should contain the following elements:

a. Official declaration that the country is in compliance with the IDRM Program agreed to with the Bank;

b. Confirmation of occurrence of a natural disaster of the type, location and intensity specifically defined under the related Facility Loan Contract; and

c. Notification of the amounts requested for drawdown, identifying, for those cases in which the alternative Funding Mechanism was included in the

Facility Loan Contract, the specific amounts to be drawdown from the Facility Loan itself and from the contractually agreed ARL.

9. Disbursement Memorandum

4.18 Within ten business days from reception by the Bank of a formal and complete Facility Loan Disbursement Request from the borrower acceptable to the Bank, the project team will prepare a Disbursement Memorandum for approval by the corresponding Country Department General Manager and Sector Manager, that shall include:

a. Ratification that the Confirmation of Occurrence of the disaster described in the borrower's Disbursement Request constitutes adequate proof that the event is eligible for financing, in accordance with the related provisions of the respective Facility Loan Contract. The Confirmation of Occurrence should be based on an objective and transparent technical assessment of the characteristics of the event in question.

b. A copy of the drawdown request, in full, as submitted by the Borrower.

c. A recommendation to approve or reject the requested disbursement including, when necessary, a detailed description of specific drawdown amounts by source (Facility Loan itself and/or ARL).

4.19 The processing of the disbursement will have to be completed, and the corresponding transfer of funds be made effective, within five business days of the approval of the Disbursement Memorandum by VPS and VPC management.

10. Procurement and Fiduciary Rules

4.20 In order to ensure timely and adequate fund availability promptly after the onset of an emergency resulting from an eligible natural disaster, Facility Loan disbursement will be subject to the following operational, procurement and fiduciary rules:

a. Once the Bank has accepted a Facility Loan Drawdown Request, the Borrower will be able to obtain up to 100% of the requested amount as a Loan Advance.

b. Facility Loans will enjoy a waiver with regard to the Bank's policies and procedures for procurement of goods and services. The Borrower shall have to apply, instead, its own rules and regulations on procurement of goods and services for extraordinary fiscal expenditures in the event of a natural disaster, as dictated by applicable local regulations and administrative law.

c. Justification of Facility Loan proceeds will be performed by the Borrower through a simple written Declaration of Adequate Use, which should be presented to the Bank within 365 calendar days after the onset of the eligible event for which the Loan Facility proceeds have been disbursed by the Bank.

d. Proceeds of a Facility Loan may be used to pay for expenditures that: (i) are not explicitly excluded in the related Facility Loan Contract (a "negative list"); (ii) are legal under the borrowing country laws; (iii) are directly or indirectly related to the natural disaster emergency for which the financing has been provided; (iv) have verifiable documented and clearly registered acquisitions and payments; and (vi) have been adequately dimensioned and priced.

e. The Bank, at its entire discretion, may verify through independent external audits, without cost for the Borrower, the adequacy of the declared eligible expenditures. Those audits shall be carried out no later than two years after the end of the related Facility Loan Disbursement Period.

f. If as a result of any of the Facility Loan audits the Bank is able to detect that Loan facility proceeds have been used to finance ineligible or inadequate expenditures, the Bank could request from the borrower immediate remedy of the situation or reimbursement of the contended amounts.

g. The Bank will recognize up to 100% of the cost of eligible expenditures effectively incurred and paid by the Borrower from the day on which the eligible event began and up to 180 calendar days immediately thereafter.

11. IDRM Programs: Characteristics and Monitoring

4.21 The borrowing countries' IDRM Programs shall include measures on risk analysis, prevention, mitigation, emergency preparedness and disaster response, as well as provisions for adequate and sustainable financing of the remaining retained or transferred risks, to be implemented in a period of no more than five years. The IDRM Program must have measurable output and outcome indicators to enable regular monitoring.

4.22 During the execution period granted through this Facility, the Bank will periodically evaluate whether the IDRM Program is being executed satisfactorily, based on the indicators established for that purpose. These evaluations shall occur at intervals consistent with the Bank's reporting requirements, not to exceed 12 months.

4.23 If as a result of any of these evaluations the Bank finds that the IDRM Program is not being executed satisfactorily, the borrower will be notified by the Bank of the actions that require implementation within a period no longer than 90 calendar days from the day of the issuance of the notification, to maintain eligibility for disbursement of loan resources granted under the Facility.

4.24 The Bank will promptly notify the borrower of both the suspension or reinstatement of eligibility for disbursement of the loan in question.

4.25 Notwithstanding the above, once eligibility for disbursement of a loan under this Facility has been granted, it would remain eligible for the duration of the period established in the contract; unless a formal notification of eligibility suspension, is delivered by the Bank to the Borrower.

12. Facility Reviews

4.26 Each loan proposal distributed to the Bank's Board of Executive Directors for approval must contain information on the respective country's total available loan balances and the performance of previous operations approved for the country under the Facility.

4.27 In addition to the operational review mentioned in paragraph 4.22, after either the approval of at least three operations under the Facility or three years beginning from the date of approval of the Facility by the Bank's Board of Executive Directors, Management will present to the Board, for information, a performance review of the Facility and of individual operations financed by it, based on available PPMRs and PCRs.

4.28 After six years beginning from the date of approval of the Facility by the Bank's Board of Executive Directors, Management will present to the Bank's Board of Executive Directors, for approval, a performance review of the Facility's portfolio operations approved during the first five years of activities, including a review of the results achieved through individual operations financed during that period.

V. MANAGEMENT RECOMMENDATION

5.1 In view of the foregoing, Management recommends approval of the present proposal by the Bank's Board of Executive Directors.