

Helping Governments Insure Against Natural Disaster Risk



Background

Natural catastrophes have increased in frequency and cost because of growing climate change and urban density. Such events have a significant negative impact on public finances as governments are called upon to cover the costs of emergency and relief efforts, as well as reconstruction work. And yet, most do not have access to insurance against such events due to high costs or the insurance industry's inability or unwillingness to absorb the risks of catastrophic events, particularly in high risk areas.

With US\$100 trillion in assets, the international capital markets have the capacity to absorb these risks. Various financial instruments have evolved for this purpose, including catastrophe bonds which pay much higher interest rates to compensate for the risk of the issuer not repaying the principal in the event of a major catastrophe. But for many disaster prone countries, these instruments are too technically complex and expensive.

In response to increasing demand from member countries, the World Bank has developed a catastrophe bond issuance platform—the MultiCat Program—that allows governments to use a standard framework to buy insurance on affordable terms by issuing catastrophe bonds.

Objectives

- Facilitate access to insurance coverage for governments on better terms;
- Enlarge the traditional investor base for catastrophe bonds by offering yields uncorrelated with financial markets;
- Ensure governments' access to immediate liquidity to finance emergency relief and reconstruction work after a natural disaster.

Structure and Description

The program supports a wide variety of structures, including the pooling of multiple risks (earthquakes, floods, hurricanes and other wind storms) in different regions. Each bond issued under the platform carries the MultiCat brand name and uses a common legal structure and documentation, with the World Bank acting as arranger.

Highlights

- The MultiCat Program helps member countries access the international capital markets for insurance against the risk of natural disasters.
- The program supports a wide variety of structures, including the pooling of multiple risks (earthquakes, floods, hurricanes and other wind storms) in different regions.
- Mexico was the first country to issue a US\$290 million series of notes using the MultiCat Program.

A special purpose vehicle (SPV) writes parametric insurance contracts with a government or public body. The SPV issues a catastrophe bond. The World Bank places the bond with institutional investors through investment banks. The SPV invests the proceeds in AAA assets, which form the source of payouts if a covered event occurs. If no event occurs during the life of the bond, the SPV returns the entire principal to the investor. Thus, investors in the bond take the risk that all or part of their principal may be lost if a covered event occurs during the life of the bond and receive a coupon that reflects this risk.

Outcome

Mexico was the first country to issue a US\$290 million series of notes using the MultiCat Program. The bond was very well received by the market, with all tranches oversubscribed, and distributed broadly among investors worldwide. As a result, Mexico efficiently transferred a pool of catastrophic risk — earthquake and hurricane (Pacific and Atlantic) — to the market for the first time.

The availability of data and statistics about the probability and severity of a catastrophic event occurring is a key element for this type of transaction. In Mexico's case, the risk modeling analysis was financed by the Global Facility for Disaster Reduction and Recovery.

The MultiCat Program is an important addition to the World Bank's catastrophe risk financing menu, which also includes the Catastrophe Deferred Drawdown Option and intermediation for weather hedges.

MultiCat Mexico 2009

A US\$290 million series of notes by MultiCat Mexico 2009 was the first offering under the MultiCat Program. The issuer was an SPV that indirectly provided parametric insurance to Mexico's Fund for Natural Disasters (FONDEN) against earthquake, Pacific hurricane and Atlantic hurricane risks in three regions located around Mexico City.

The World Bank Treasury acted as arranger for the transaction, and appointed Goldman Sachs and Swiss Re as co-lead managers and joint bookrunners and Munich Reinsurance Company as advisor in the transaction.

All tranches were oversubscribed, and distributed broadly among investors in Bermuda, Europe, Japan, and the US.

The following table summarizes the key elements of the offering.

Summary of MultiCat Mexico 2009 Notes				
Issuer: MultiCat Mexico 2009 Ltd.				
	Class A: Earthquake	Class B: Pacific Hurricane Zone A	Class C: Pacific Hurricane Zone B	Class D: Atlantic Hurricane
Notional (US\$)	140 million	50 million	50 million	50 million
Maturity	3 years	3 years	3 years	3 years

With this transaction, the Government of Mexico builds on the CatMex bond issued in 2006 and paves the way for other sovereign issuers to access the cat bond market through the World Bank's platform.

Glossary

- Special Purpose Vehicle (SPV): a legal entity created to fulfill a specific or temporary objective, typically used to isolate a firm or country from financial risk.
- Parametric insurance: a type of insurance that does not indemnify pure loss, but *ex ante* agrees to make a payment upon the occurrence of a triggering event.

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