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World Bank sells first ever ‘cat bond’

Robin Harding in Washington JUNE 26, 2014

The World Bank has issued its first ever catastrophe bond as hunger for yield allows developing countries to transform their fiscal position.

The $30m deal will help provide earthquake and hurricane coverage for a group of 16 Caribbean island nations over the next three years.

It is a sign of the growing appetite for catastrophe risk as investors seek out high-yielding assets in a world of low central bank interest rates.

“This is the first time the World Bank has issued a catastrophe bond and the first time it is doing a non-AAA bond,” said Madelyn Antoncic, treasurer of the World Bank Group. It is likely to be a model for future deals, which could be larger.

Under the structure, the development bank will stand between investors and the Caribbean Catastrophe Risk Insurance Facility, which covers a group of islands including the Bahamas, Dominica and Jamaica and will pay for the protection.

If the islands are struck by a catastrophe, investors could suffer a loss of capital on their bond. That risk of capital loss means the bond is not rated AAA, despite the World Bank's own AAA credit rating.

Ms Antoncic said the deal "priced very well" with demand from specialist catastrophe funds, hedge funds and a standard investment management company.

"Catastrophe risk was previously in swap or reinsurance form," said Ms Antoncic. "Doing it on capital markets creates transparency and much better pricing."

The deal also enables the CCRIF to lock in coverage for three years instead of an annual renewal.

The deal highlights how emerging economies are taking advantage of low global interest rates to protect their fiscal stability as well as raise cheap finance.

Natural disasters can devastate vulnerable economies. The 2011 floods in Thailand caused a 13 per cent fall in output, for example, while a severe hurricane in the Caribbean could cause losses in excess of 100 per cent of gross domestic product for some economies.

In the wake of a crisis, national governments have to wrestle not only with the costs of reconstruction but with loss of tax revenues due to lower production.

That means exposure to natural disasters can increase a country's borrowing costs because lenders regard it as more prone to fiscal shocks. Developing countries are therefore trying to improve their risk management.

"Planning for catastrophe risk is becoming more and more important to developing countries," said Ms Antoncic. "It protects their fiscal buffer."

Catastrophe bonds have boomed recently because of the opportunity to earn a higher yield from assets that are not correlated with the rest of an investor's portfolio.

Low pricing for risk has prompted Warren Buffett's Berkshire Hathaway, one of the world's largest reinsurers, to pull back from the market as a result.

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