Operations Policy and Country Services

GUIDANCE NOTE

Including Contingent Emergency Response Components in Standard Investment Projects
Guidance Note to Staff

1. The Operational Policy/Bank Procedure OP/BP 8.00 *Rapid Response to Crises and Emergencies* encourages mainstreaming of disaster risk management in Bank operations, especially in countries that are vulnerable to recurring disasters.[1] Contingent financing is an important instrument in this regard, providing incentives to prevention and preparedness activities and allowing a rapid response once an emergency occurs. Contingent financing can take the form of self-standing contingent loans[2] or *ex-ante* emergency components of standard investment operations, which are the subject of this note.[3] Such contingent components can finance the overall emergency response and/or specific emergency works, goods and services.

2. This note is organized in three sections. Section I provides general guidance on the design of contingent emergency response components. The next two sections provide guidance on (i) financing for quick-disbursing components, and (ii) financing for specific emergency works, goods and/or services.

I. General Features of Contingent Emergency Response Components

3. Contingent components: (i) are embedded in standard investment operations, (ii) strengthen a Borrower's emergency preparedness and response, and (iii) are normally prepared in advance of an emergency following procedures applicable to regular investment operations.[4] In the event of an emergency, contingent components are implemented following the rapid response procedures governed by OP/BP 8.00. Once triggered, OP/BP 8.00 facilitates rapid utilization of loan proceeds by minimizing the number of processing steps and modifying fiduciary and safeguard requirements so as to support rapid implementation.

4. ***Characteristics of Contingent Components***. These include:

- Development objective: The overriding aim of a contingent component is to improve the response capacity of the Borrower in case of an emergency. The project development objective (PDO) should specifically reflect this feature of the project;
- Disbursement condition: Contingent components are designed to disburse only after an emergency has occurred, or is about to occur. A disbursement condition for the contingent component should define the circumstances when the funds under the component will become available.[5] One option is for the project to include specific disbursement categories to provide for flexibility for the contingency, such as: (i) goods, works and consultant services

[1] See also the related Board paper, *Toward a New Framework for Rapid Response to Crises and Emergencies*, April 10, 2007.
[2] "Loans" includes IDA credits and grants and financing from Bank-administered trust funds; "Borrower" includes grant recipient.
[3] Contingent loans are provided for in OP 8.00 para 2 (e). A self-standing contingent IBRD loan instrument, the Catastrophe Deferred Draw-down Option (CAT-DDO), was approved by the Board in February 2008 (for guidance see http://go.worldbank.org/IPUXG3DET0). Constraints on IDA allocations are likely to make self-standing contingent IDA credits/grants relatively rare. Inclusion of contingent components in regular investment operations is fully in line with OP/BP 8.00 and should be promoted to improve disaster risk management.
[4] See OP/BP 10.00 *Investment Lending: Identification to Board Presentation*.
[5] See OP/BP 12.00, *Disbursement*, for additional details.

(including audit costs) for emergency response and recovery and (ii) a quick-disbursing component (a positive list of imported and locally-manufactured goods).

- Contingent windows and allocation of financing: Contingent components can be either fully funded (by commitment from IBRD, IDA (performance-based allocation), or trust funds) or designed as a contingent window, or a combination of both. A contingent window is a component that is an integral part of the project, but receives only a small or no allocation at the time of project approval. In case of an emergency, funds can be re-allocated to this window from other components.[6] In some cases, components from which the funds are transferred may become low-priority, or even obsolete, because of the emergency. In other cases, funding can be restored to components from which funds were transferred by provision of Additional Financing.[7]
- Disbursement arrangements: The initial Disbursement Letter for the project should identify the disbursement methods and corresponding supporting documentation requirements for disbursement under the contingent component, if known. Alternatively, a revised Disbursement Letter may be issued once the arrangements become more clear or if circumstances change.
- Disbursement profile: The project's disbursement profile should reflect the amount allocated to the contingent component in the last quarter of the project's implementation period.

5. ***Constraints on IDA Allocations***. For IDA-eligible countries, *ex ante* funding of contingent components comes from a country's IDA allocation. IDA's policy is to consider *ex post* provision of additional allocations in the aftermath of major natural disasters. Such additional allocations would be available to provide Additional Financing to components from which funds were transferred to the contingent window and/or to augment the contingent window. Where the financing allocated to a contingent component remains unused (for instance, if no emergency occurs during the lifespan of the project), the balances are either cancelled at project closing and returned to the IDA pool or, if such provisions are included in project design, some or all of unused financing may be reallocated to other components of the project.

[6] Where the possibility of a reallocation is included in the project description, the reallocation will not constitute a formal restructuring of the project. If the approved project does not describe the necessary reallocation, a project restructuring may be necessary. The Regional Operations Adviser will determine whether the reallocation constitutes a second-order restructuring (requiring RVP approval of the EPP) or a first-order restructuring (requiring Board approval of the EPP, which is sought on an absence-of-objection basis in 8 working days). For guidance on project restructuring, see Processing Restructuring of Investment Projects, available at http://go.worldbank.org/G2FFX7JIE0.

[7] See OP/BP 13.20 *Additional Financing for Investment Lending*. For IDA countries this funding would be from (a) the annual performance-based allocation or (b) from cancelled funds from other projects already approved. In the latter case, the date of approval of the restructured project matters: (i) If the project releasing resources was approved during a previous replenishment period, then the cancelled funds are not made available as Commitment Authority in the ongoing replenishment period. Therefore, to affect the necessary increase in Commitment Authority (which is reviewed by the Board annually), the Country Director must seek agreement from FRM on the amount and operation concerned before notifying the Borrower of the cancellation. (ii) It is less problematic if the funds are cancelled from a project approved during the ongoing replenishment period. However, in this case as well, the Country Director must seek prior approval from FRM, to enable tracking of allocations and commitments.

II. Financing for Quick-disbursing Components

6. OP/BP 8.00 as approved in April 2007 allows the financing of expenditures on a positive list of goods (imported or locally manufactured) by the public and private sectors. This provision applies to both self-standing emergency operations and to contingent components of investment operations.[8] This feature of OP/BP 8.00 will be particularly useful to lower-income countries that lack sufficient liquidities to face emergencies. IBRD borrowers should be encouraged to consider availing themselves of the new Catastrophe Deferred Draw-down Option (CAT-DDO) instrument, which was approved by the Board in February 2008 (see Footnote 3 above).

7. ***Characteristics of Quick Disbursing Components.*** These include:

- Development objective: Generally, the objective of emergency financing is to increase the financial resilience of the Borrower when emergency strikes, but not to provide general budgetary support. This is achieved by provision of liquidity to the Borrower, to help finance the government's overall response to the emergency and/or to protect its fiscal accounts.[9]
- Positive list of goods: OP/BP 8.00 allows for the financing of public and private sector expenditures on a positive list of goods, both domestic and imported, required for the Borrower's emergency recovery program.

8. ***Specifying a Positive List of Goods.*** In designing the contingent component, the team should identify goods for which expenditures can be documented (i) fast, so as to allow for rapid disbursement of the loan proceeds and (ii) in sufficient quantities, so as to allow for disbursement of the desired amount. The positive list includes the type or categories of goods against which disbursements will be made. A generic positive list may be combined with a list of excluded goods that could trigger safeguard policies (for example, fertilizers, nuclear products, and military items). The positive list may include second-hand goods. A sample positive list is in Attachment A. A recent example is provided in Box 1.

9. ***Procurement Methods for Goods on Positive List.*** Some countries may have national emergency procedures for procurement. These procedures and commercial practices of the private sector may be followed, provided they are acceptable to the Bank. The project appraisal document should specify clearly the acceptable procedures and address any associated risks and mitigation measures. If mitigation measures are required, they may include a technical and financial audit of the component. Such audits would cover: (a) the contracting approach, (b) the appropriateness of prices relative to market prices, (c) the adherence to acceptable and agreed commercial practices or emergency procedures, and (d) the appropriate use of funds for intended eligible purposes.

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[8] The previous policy, OP/BP 8.50, *Emergency Recovery Assistance*, provided for the reimbursement for expenditures on a positive list of imports. This was often used to make available to the Borrower the necessary liquidities to face an emergency.

[9] An additional instrument of assistance is lending under OP/BP 8.60 *Development Policy Lending* (see http://go.worldbank.org/4ZJTMZI990), which is available for provision of general budgetary support.

Box 1. Providing Liquidity by Using a Positive List

Financing expenditures on imports and/or domestic goods is an effective and simple mechanism to provide liquidity to a government affected by a major disaster. This quick-disbursing mechanism was used under many projects, including the following.

The Pakistan *Earthquake Emergency Recovery Project* (Cr. 41340-PK) financed expenditures on a positive list of items such as fuel and petroleum products and other construction materials, prefabricated and temporary structures for providing medical services, and construction and earth-moving machinery and spare parts. This, in turn, supported early reconstruction, the rehabilitation of assets, and the restoration of economic activity, while mitigating pressure on the balance of payments.

The *Emergency Project to Mitigate the Impact of the Financial Crisis* in the Democratic Republic of Congo (Cr. H4530) finances essential goods and commodities. Disbursements will be made against a positive list of goods and commodities; this list was finalized during project appraisal. The list includes food products, construction materials, telecommunication equipment, and oil products. Assessment of major imports contracts from June 2008 to January 2009 concluded that a retroactive financing of up to US$24 million could be provided to finance import expenditures incurred within twelve months before Grant signing. A consultant was recruited during project preparation to review private importers' commercial practices and ensure they could be considered acceptable by the Bank. The consultant's assessment confirmed that: (i) procurement of import commodities by private sector of US$1 million and above can follow modified International Competitive Bidding (ICB) procedures in accordance with paras 2.66-2.67 of the *Procurement Guidelines* and that procurement of such imports below a threshold of US$1 million can be based on established commercial practices pursuant to footnote 55 of the Bank *Procurement Guidelines*; and (ii) supporting documentation was available for the amount proposed for the retroactive financing, so that the initial disbursements can be made in March 2009, within one month after project effectiveness. Conclusions of the report have been assessed satisfactory by the Bank.

10. ***Identifying Documentation to Support Disbursement.*** OP 12.00, *Disbursement*, requires the Bank to verify "that the application for withdrawal and any required supporting documentation … are sufficient … to satisfy the Bank" that loan proceeds have been or are being used to finance eligible expenditures. The manner in which the Bank (i.e., LOA) implements this policy is by reviewing the supporting documentation and, in the case of reimbursements of amounts already financed by the borrower, requesting *proof of payment* before authorizing the disbursement. In ordinary circumstances, the borrower should be able to provide *proof of payment* in the form of receipts, or project bank statements evidencing the payments made. For a contingent component, where the emphasis is on quick disbursement and immediate emergency response, this requirement could prove difficult and cause delays. Some alternative approaches to satisfying the *proof of payment* requirement are described in Box 2 below. TTLs should determine an appropriate approach in consultation with the country finance officer.

Box 2. Proof of Payment and Documenting Expenditures

Example 1: Documentation of Diesel Fuel for Electricity Production

Following Hurricane Ivan in September 2004, the Bank provided immediate liquidity to the Government of Grenada under the Hurricane Ivan Emergency Recovery Project (Ln. 7262-GD). Funds were disbursed against customs receipts and proofs of payment by the Power Utility for diesel fuel used to maintain electricity production during the month following the disaster.

Example 2: Proof of Currency Purchase

The requirement to obtain proof of payment can be met by substantively equivalent means. For example, under the Dominican Republic Hurricane George Emergency Recovery Project (Ln. 4420-DO), expenditures were documented by the Central Bank. All releases of foreign exchange to commercial banks for private sector imports were made against equivalent Dominican peso deposits by the commercial bank into the Government's counterpart fund account. As a result, the Central Bank had the ability to ensure compliance with the disbursement arrangements and to provide regular reports on expenditure incurred.

Example 3: Documentation of Imports

The Disaster Vulnerability Reduction Project (Ln. 7293-CO) was designed to help Colombia mitigate the potential impact of adverse natural events such as earthquakes and floods. A key part of the project was the contingent component that would provide liquidity to the government should a disaster occur during project implementation. This component represented $150 million out of a total operation of $260 million.

For disbursements under the contingent component, the borrower agreed to provide a customs report on imports (from both public and private sources) incurred up to six months before and one month after the disaster. Because customs receipts do not constitute definitive *proof of payment*, the Financing Agreement specifies that disbursements by the Bank would be equal to 50% of the documented imports included on a positive list. Together with the borrower and in consultation with the country finance officer, the Bank has made an assumption that at least 50% of the imports are eventually paid. It was also agreed that the government would provide to the Bank a report showing that expenditures on the overall recovery effort were greater than disbursements under the contingent component.

11. ***Time Limits.*** Goods purchased up to twelve months before the emergency[10] can generally be financed by the Bank.

12. ***Monitoring of the Expenditure Program.*** It is important to recognize the purpose of the quick-disbursing component, which is to provide the necessary liquidities to a client country in an emergency. Because the purpose of the component is to provide liquidity by means of disbursement to finance a positive list of goods required for the emergency recovery program, documentation on specific uses of the particular goods financed by the loan proceeds is not required. However, it will be important to provide sufficient guarantee that the loan proceeds are used for the agreed purposes. Examples of approaches include:

[10] OP/BP 8.00 Procedural Guidelines (para. 25) provide for retroactive financing up to 40 percent of the loan amount for payments made by the Borrower no more than 12 months prior to the expected dates of signing of the legal documents of a new emergency operation. When this policy is applied to contingent components, the 12-month period is from the date when the implementation of the contingent component is triggered. The amount available for retroactive financing is up to 40 percent of the contingent component amount (after reallocation, if any).

- Reimbursement of the oil purchases by the power utility (based on documented use of at least that amount of oil). The Bank checked that average fuel consumption was in line with the amount purchased.
- Submission by the Borrower of an acceptable recovery plan. In the case of the Colombia Disaster Vulnerability Reduction Project (Ln. 7293-CO), such a plan was required for the President to declare an emergency under Colombian law; the plan is a short "living" document that is then further elaborated as needed.

III. Financing for Emergency Works, Goods and/or Services

13. OP/BP 8.00 also offers flexibility with respect to contingent financing for specific works, goods, and/or services. As noted in para. 4 above, the overriding aim is to improve the response capacity of the Borrower in case of an emergency. Once implementation of the contingent component is triggered, the Borrower is allowed to use the loan proceeds with the added flexibility provided under OP/BP 8.00 as detailed below.

14. ***Emergency Procurement.*** The contingent component should specifically reference the provisions of OP/BP 8.00 for additional flexibility in procurement of consultant, goods, works and services in case of emergency. This flexibility includes, but is not limited to: (i) use of emergency procurement procedures of the Borrower, (ii) applying higher prior-review thresholds; (iii) using simplified procurement methods; and (iv) drawing on pre-qualified procurement and project management agents through streamlined selection methods. For a more detailed explanation of the flexibility permitted in procurement, see paragraphs 26-31 of the Rapid Response to Crises and Emergencies: Procedural Guidelines and Streamlined Procurement Procedures: Guidance to World Bank Staff (OPCPR, forthcoming, spring 2009).

15. ***Use of Stand-by Arrangements.*** Starting of procurement of emergency works, goods and services need not wait for the emergency to occur. Borrowers are encouraged to undertake advance procurement. Stand-by arrangements allow for tendering and signing of draft contracts, for which implementation is triggered when an emergency occurs. Such stand-by arrangements are common in the transport and power distribution sectors (for example, the service provider maintains clearing and repair crews ready to intervene after heavy storms).

16. ***Emergency Disbursement Procedures.*** The contingent component should also specifically reference provisions of OP/BP 8.00 for rapid processing of withdrawal applications and additional flexibility on financing eligibility and direct payments/use of letters of credit. For a more detailed explanation of the flexibility permitted in disbursements, see paras. 22-25 of the Rapid Response to Crises and Emergencies: Procedural Guidelines.

17. ***Safeguard Concerns.*** Components involving works and/or goods may give rise to various safeguard issues. For guidance on using the flexibility permitted with respect to safeguards issues, see para 32 of the Rapid Response to Crises and Emergencies: Procedural Guidelines.

Attachment A

Sample Positive List of Imports

Schedule 6 of the Loan Agreement for the Colombia National Disaster Vulnerability Reduction Project, dated October 4, 2005 (as amended through April 21, 2007)

SCHEDULE 6

List of Eligible Critical Imports to be Financed Under Part E. 2 of the Loan

1. Construction materials.
2. Water, land and air transport equipment, including spare parts.
3 Agricultural equipment and inputs (excluding pesticides).
4. School supplies and equipment.
5 Medical supplies and equipment.
6. Petroleum and fuel products.
7. Construction equipment and industrial machinery.
8. Communications equipment.
9. Seeds and fertilizer.
10. Food and water containers and any other items which may be acceptable to the Bank and agreed to by the Borrower and the Bank.