

Integrated Risk Management Strategies: Example of Malawi Food Security Strategy

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From Financing to Financial Solutions: World Bank Better Equipped to Help Clients Today

Traditionally...

Serving: Member countries

Providing: Access to finance
for development

Offering: One-size-fits all
loans

...Today

Serving: Member countries and global
community

Providing: Financial solutions through financial
products and advisory services to
access, protect and manage
development resources

Offering: Broad menu of financial services

- Flexible Loans
- Credit Enhancement
- Risk Management Tools
- Contingent Financing

✓ *Shift in delivery model to client-focused approach:
Customized financial solutions based on needs/risks of each client*

IBRD Financial Solutions Can Help Protect Ongoing Investments & Enable Future Projects



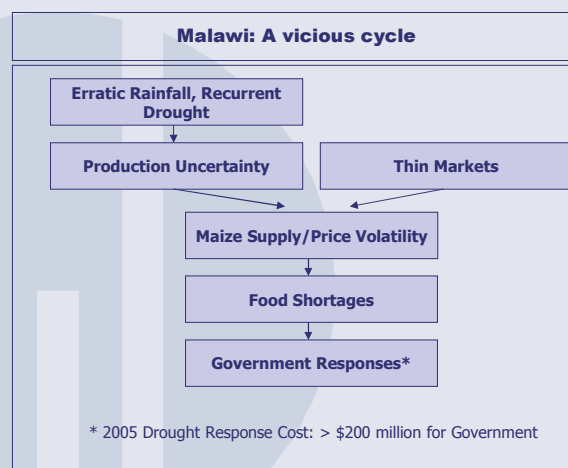
Loans	<ul style="list-style-type: none"> ➤ IBRD Flexible Loan (IFL) ➤ Local currency loans ➤ Sub-National finance
Contingent Financing	<ul style="list-style-type: none"> ➤ Deferred Drawdown Option (DDO)
Credit Enhancement	<ul style="list-style-type: none"> ➤ Partial risk guarantees (IBRD and IDA) ➤ Partial credit and policy-based guarantees
Hedging Products	<ul style="list-style-type: none"> ➤ Currency swaps ➤ Interest rate swaps ➤ Interest rate caps and collars ➤ Commodity price swaps
Catastrophe Risk Management	<ul style="list-style-type: none"> ➤ Weather hedges ➤ CAT DDO ➤ Insurance pools ➤ Catastrophe bonds
Client Advisory Services	<ul style="list-style-type: none"> ➤ Asset management ➤ Public debt management ➤ Asset-liability management ➤ Capital market access strategy & implementation ➤ Transaction processing, reporting, and IT

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The Problem: Uncertainty Related to Drought



- Malawi's maize marketing policy is dominated by concerns about food insecurity



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Potential Solution: Integrated Use of Weather Derivatives and Commodity Hedges



Identifying financial risks

- Recurrent droughts which affect the production of maize and lead to food insecurity and malnutrition
- High volatility in the supply of maize leading to high volatility in the price of maize

Disaster Risk

Commodity Risk

Financial Solution

Malawi bought a **weather derivative** from the Bank in order to receive a payout when severe droughts occur. The payout is triggered when a rainfall index falls below a certain level, reflecting the loss in maize production. This was the **first time a market-based hedging tool was offered to a IDA country**.

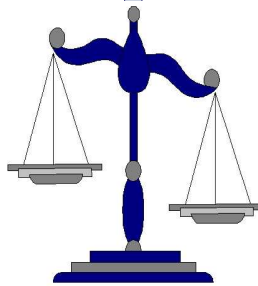
The payout from the weather derivative can be used to cap the price of maize imports used to cover shortages in the country. This will help to **stabilize supply and in turn stabilize prices**, without market distortion.

Weather derivatives: Advantages and Disadvantages



Advantages

- No proof of loss needed
- No insurable interest needed
- Use standard ISDA agreements
- Broader risk takers' market



Disadvantages

- Basis risk - only pays out based on specified parameters
- Need capacity to provide reliable weather data

The Product: Index-based Derivatives

- Index-based derivatives are risk transfer instruments, available to IBRD and IDA clients
- The client pays a premium and, in case of a weather event, receives a payout

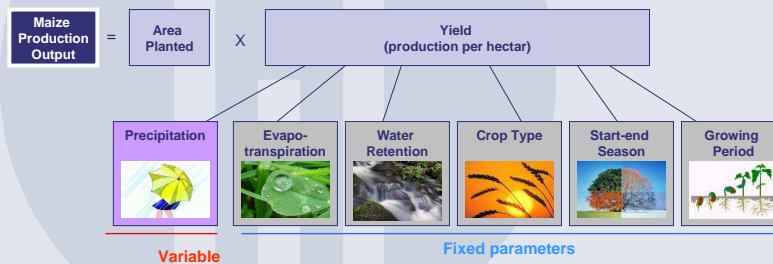


- The World Bank will enter into a mirroring transaction with a market counterpart
- The weather event is measured by an index, estimating the actual loss

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Index Used by Malawi Government

- Malawi Maize Index is designed as a proxy of maize production
- Rainfall is the only variable in the index
 - Measured by 23 weather stations around the country
 - Data verified by independent third party



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Partnership approach in Malawi Crucial for Success



- Government of Malawi – Ministries of Finance & Agriculture
- DFID
- European Union, All ACP Agricultural Commodities Program
- USAID
- Swiss Secretariat for Economic Affairs
- Government of Norway
- World Food Programme
- World Bank - Agriculture & Rural Development; Treasury

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Next steps in Malawi: 2009 Onwards



Investments

- Funded as part of World Bank 5-yr ADP Support Project:
 - Further investment in Met Office network
 - Improve Government's Maize Yield Assessment Model
 - Link with national early warning system to strengthen drought preparedness and planning
 - Understand the role of weather insurance in Government's suite of risk management tools
- Establish budget line for premiums

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Discussion Points: Challenges to Moving Forward?



- Political risk for policy makers - concern about backlash if it turns out the risk management product was not needed (i.e. "wasted" investment)
- Governance issues, policy frameworks, and guidelines that protect decision-makers
- Finding ways to finance ex ante solutions as opposed to ex post
 - shift in mentality is needed for both government and donors
- Careful risk assessment and thoughtful customization of the product
- Capacity of all stakeholders to understand technical & financial issues related to the product
- Negative perception of derivative instruments
 - Underlying complexity
 - Current financial crisis

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