



WRMA Highlights Growing Need for Weather Risk Tools in an Expanding Market at 13th Annual Meeting

Houston, TX (May 26, 2011) – Emerging players, better forecasting and a growing need for weather risk management products were key topics at the Weather Risk Management Association’s 13th Annual Meeting. The meeting was held on May 18-20, 2011 at The Houstonian in Houston, Texas.

Houston we don’t have a problem

Keynote speaker and Apollo 13 Astronaut Fred Haise opened the meeting with a multi-media presentation on hedging and mitigating risk on earth and in space. As a survivor of five crashes and near misses, Haise reinforced the need to avoid being controlled by fear and worry when there is no Plan B.

Haise noted that weather, especially temperature, plays a significant role in mission take-off and in the ultimate success of a voyage. Haise related this to the tragic example of Challenger’s O-ring failure when cold temperatures caused the O-rings in the fuel boosters to be less resilient. The lack of a tight seal resulted in the explosion of the shuttle. Attendees engaged Haise in a philosophical question and answer session, asking him how one does not become complacent with repetitive training and how to avoid being paralyzed by fear.

Managing commodity risks

Participants in the “Power and Natural Gas: Using Weather to Manage Commodity Positions” panel agreed that energy markets continue to be the primary users of weather risk management tools. The panel also discussed instances where the correlation between the energy markets and the weather markets broke down, specifically last winter when the correlation between weather and natural gas was affected due to an oversupply of natural gas in Europe.

France continues to be a strong user of weather derivatives, where the main market drivers are nuclear, hydro and temperature. Cold temperature is a primary focus for weather hedging. “If electricity demand is very high, there’s a need to buy power in the market” said Jens Boening of EDF Trading. “Setting up the hedge is critical. You don’t want it to go wrong, so structure it properly,” said Direct Energy’s Kevin Krcil.

“As wind power develops the need for weather hedges will continue to grow, particularly for new products. Spikes in wind-based generation show the need for hourly weather derivatives,” said Krcil. “Better wind forecasting is also needed since it’s difficult to plan more than a couple of days out.”

Improvements in forecasting

While forecasting models have vastly improved, the best decisions are made by people, according to the Meteorologists panel. Models are increasing accuracy of longer-range forecasts with better resolution and better data. Yet even the best forecasts can be incorrect as we saw during the winter of 2010-2011 where the actual temperatures were opposite of long-term forecasts. While meteorologists don’t want to admit that their forecasts were wrong, they also don’t want to look like they are flip-floppers. “Our clients look for consistency,” said Larry Heitkemper of MDA EarthSat Weather.

Asked if there is more severe weather occurring than in the past, Geoff Flint of Custom Weather commented, “there are a lot more people living in areas where weather hits. It’s really a media-driven perception” that there’s been an increase in weather events. Noted Tom Paylor of RenRe Energy Advisors, “If you look around the world, there’s always going to be something happening that’s a one in a 100 years event.”

Emerging players

Internet-based weather risk platforms are emerging as a key segment of the weather risk market. Online aggregators have two roles in the weather risk market – transparency and efficiency, said Mark Rueegg of CelsiusPro. They are also serving to broaden the market. Half of CelsiusPro’s customers had never heard of weather derivatives until the company approached them, said Rueegg.

To introduce the idea of trading weather, CelsiusPro has implemented test accounts, which allow interested parties to purchase virtual weather derivatives online. This is in addition to the company’s actual trading platform.

“There’s tremendous application in trading weather and grains,” noted Brian O’Hearne of eWeatherRisk, a US-based provider of weather risk management solutions to the agriculture, energy, construction and heavy equipment leasing markets. The company uses over 500 agents to sell its agriculture products, said O’Hearne. Outside of the US, O’Hearne’s firm receives calls from companies in Australia, South America and Europe looking to offset weather risk.

Active hurricane season

Following the quiet 2010 hurricane season, most forecasters are expecting a more active weather pattern in 2011. The National Hurricane Center sees 12-18 named storms, 6-10 hurricanes and 3-6 major hurricanes. Meteorologist Jeff Manna of Citigroup Energy is predicting 12 named storms, 7 hurricanes and 3 major hurricanes. Weather expert Larry Heitkemper of MDA EarthSat Weather sees 14 named storms, 7 hurricanes and 5 major hurricanes.

Manna isn’t convinced that we are in an El Niño pattern now. However, El Niño could develop later in the summer. He believes the hurricane season will begin earlier than usual and that the western US Gulf’s risk of hurricane activity is slightly below average.

Heitkemper pointed out that while the Atlantic Ocean is cooler than 2010, it is still warmer than usual. He mentioned an interesting correlation: when there's increased cocoa production in western Africa, there's usually a busier hurricane season. Looking at the Pacific, Heitkemper sees La Niña persisting in the western Pacific, which will result in more weather threats for Asia.

Regulatory risk

Legislation in the US and Europe relating to risk management tools has been in the works for several years. But the financial meltdown has spurred governments to enact changes more quickly. With the deadlines for enactment of these new laws approaching, Claude Brown of Clifford Chance discussed the rules that will have the greatest impact the weather risk management market.

In the US, the Dodd-Frank financial reforms will affect all of the swaps market participants to a certain extent. Said Brown, the key question is: Is your company a "swap dealer" or a "major swap participant" or a "financial entity" or an "end user?" All of those categories have different reporting rules. These rules may apply to non-US companies depending on their swaps positions with US counterparties.

In Europe, European Union (EU) legislation for OTC derivatives applies to all OTC derivatives. However non-financial firms that use OTC derivatives to mitigate risk arising from their core business activities are exempt from central counterparty requirements. The EU rules are designed for transparency, reducing counterparty and operational risk.

In both the EU and US, there are open issues that need to be resolved and could potentially affect when the requirements go into place.

How to trade weather in a growing market

In advance of the 13th Annual Meeting, WRMA held a workshop on how to trade weather. This well-attended event covered a wide range of strategic and tactical aspects of trading, including why a company should trade weather, financial factors to consider, gathering and utilizing data, and the types of weather contracts available.

The event closed with the announcement of the 2009/2010 and 2010/2011 WRMA Industry Survey results, which showed a 20% increase in the customized weather derivatives market and an overall market increase of 20%.

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