

More Businesses Seeking Protection from Noncatastrophe Weather Risks

By Diana Rosenberg

OLDWICK, N.J. July 08 (BestWire) — Catastrophic weather events may have dominated headlines this year, but noncatastrophic weather events — things such as mild winters, cool summers, or above-average periods of rainy days — can have an annual impact of \$485 billion on the U.S. economy, according to a recent study. For businesses looking to hedge against weather-related risks, there's insurance for that.

Although the majority of companies managing their weather-related risk use derivatives, insurance also is an option.

"We really encourage firms not to differentiate so much between the two, because fundamentally the principles are still the same. Whether it is characterized as insurance or as a financial contract, what we're doing is compensating companies for things that occur because of weather events," said Stuart Brown, regional head of origination of the weather business at Swiss Re, which offers traditional insurance, as well as products based on indices for temperature, precipitation and wind; options, swaps and other products.

"We're agnostic to the delivery form. We're just looking to provide protection," said Bill Windle, managing director at RenRe Energy Advisors, a subsidiary of RenaissanceRe Holdings Ltd., who also serves as president of the Weather Risk Management Association.

It depends on what the customer prefers, and some are more comfortable with insurance, Windle said.

Other companies offering weather-risk protection products include Munich Re and Allianz.

The largest users of weather-risk protection products are energy companies. Other industries include construction, agriculture, transportation and retail. Windle predicts "the next big wave" for these products will come from the agriculture sector.

In the products' simplest forms, a ski resort operator could hedge against below-average snowfall, an amusement park could seek to protect itself from depressed gate receipts due to above-normal rainy days, or the operator of a wind plant could seek protection from downside wind risk. Energy companies seek to hedge against demand — or lack thereof — driven by temperature. The products tend to be specialized for specific customers seeking to protect their revenue from specific weather situations.

"Most customers have unique solutions that need to be addressed," Windle said.

Much like shopping for automobile insurance, customers can choose to shop online at sites such as Weatherbill.com or CelsiusPro.com, an affiliate of Swiss Re.

Payment is "virtually automatic," Brown said, based on the terms of the specific contract, for example, the number of days the temperature falls below a certain level or the number of days rainfall exceeds a certain level, and often is made within five to seven days.

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Since the first handful of weather-risk transactions just 14 years ago, demand for these products is growing. For the year ended March 31, 2011, the notional value for over-the-counter traded contracts rose 29.1% to \$2.45 billion compared with the year-earlier period, while the notional value of contracts traded on the Chicago Mercantile Exchange rose 15.9% to \$9.38 billion. Temperature contracts are the most traded customized weather hedge, according to the WRMA.

That growth is likely to continue. A study, led by scientists at the National Center for Atmospheric Research and professors at the University of Colorado at Boulder, found weather can impact as much as 3.4% of U.S. gross domestic product, or \$485 billion based on 2008 GDP.

"Even routine changes in the weather can add up to substantial impacts on the U.S. economy," Jeff Lazo, the study's lead author, said in a written statement.

The study, which looked at 70 years of weather records from across the contiguous United States and 24 years of state-level economic data, found that all sectors of the private sector it studied — industries from agriculture, communications, mining, and finance, insurance and real estate, to name a few — all are impacted.

The study found that every sector of the U.S. economy is "statistically significantly sensitive to at least one measure of weather variability."

"Our findings suggest that, given the magnitude of weather sensitivity across all sectors of the U.S. economy, there is most likely significant economic potential to mitigate weather variability impacts in many sectors not conventionally considered as weather sensitive as agriculture," the authors said.

To hear the entire interview with Brown, visit <http://www.ambest.com/media/media.asp?RC=189562>
(By Diana Rosenberg, senior associate editor, BestWeek)BN-NJ-07-08-2011 1435 ET #