



Volcanoes, historical weather events and EU proposed regulation discussed at WRMA's 11th European Meeting

KRAKOW, POLAND (17 September 2010) -- Attendees at the Weather Risk Management Association's (WRMA) 11th European Meeting gained insight into the impact of volcanoes on weather patterns, the new EU proposed derivatives legislation, and how weather extremes affect risk. The meeting was held 15-17 September 2010 at the Sheraton Krakow Hotel in Krakow, Poland.

With the memory of the recent Icelandic volcano eruption impacting business activity still fresh, attendees were keen to hear the analysis of tephrochronologist Dr. Simon Blockley from Royal Holloway, University of London. Volcanic activity is just one of many climate-forcing mechanisms that come into play, he said, noting that volcanic activity can have a serious impact. While it's rare to have very large eruptions or eruptions of supervolcanoes, these can happen. When they do, these eruptions are "highly explosive and produce massive volumes of ash and gas," he said. It's been suggested that these large eruptions "can have significant climatic impacts" as well as impacting human evolution.

Reviewing historical data, Blockley pointed out that following the 1991 eruption of Pinatubo in The Philippines, the next two winters in North America, Europe and eastern Asia were warmer than usual. Large eruptions "clearly cause one to two years of anomalous conditions," Blockley said. Due to the injection of sulfur dioxide at high latitudes, large eruptions usually cause cooling for one to two years, while low latitude eruptions can "induce anomalous warming for one to two years."

While large eruptions garner a great deal of attention, smaller eruptions are important, too, and we need to do more significant research to understand the weather effects from these events, said Blockley. He also addressed the reactive relationship between volcanoes and climate change.

How does the weather risk market handle weather extremes? By sharing risk. In his presentation on "Looking at the Tails," an analysis of weather hedging and historical weather extremes, Stephen Doherty, CEO of Speedwell Weather Derivatives Ltd., pointed out that extreme events or tails "seem to happen worryingly often." These tails could be colder than normal weather or warmer than normal weather. "Stuff happens. That is why the weather market exists," Doherty said.

"There are powerful economic arguments for sharing risk and this is predicated on first understanding risk which must include extreme events," said Doherty. "Even if the advice ... is ignored, a corporation is in a better position to understand its business having gone through the analysis process."

Further, he said that “the process of sharing risk leads to a better understanding of risk. This is because in the process of sharing risk, risk has to be *priced* by those inviting participation and by those participating.”

For those trading in European markets, a proposed regulation from the European Commission will affect participants. The regulation is designed to make markets more transparent, noted Claude Brown, partner and co-chair of the Environmental and Climatic Trading Group at Clifford Chance LLP.

The proposed regulation (COM(2010)484/5) would apply to all over-the-counter (OTC) derivatives and calls for standardized OTCs to be cleared through central counterparties (CCPs) as well as collateralization of non-CCP cleared derivatives. The regulation seeks to reduce operational risk.

The proposed regulation contains several issues affecting the weather markets including trades that are between two end-users and are below the “information threshold” will be exempt reporting requirements; contracts with non-financial firms below a “clearing threshold” will be exempt from clearing; “commercial hedging activities” will be deducted from overall positions; thresholds will be set by European Securities Market Authority and the European Systemic Risk Board by asset class and sub-asset class; thresholds will be set by systemic relevance of net position and by exposure by counterparty per asset class; commodities will be included as an asset class and have sub-classes; and required mandatory clearing by a top down/bottom up approach, Brown said.

The proposed regulation must be approved by the European Parliament and European Union member states. The regulation is slated to apply from the end of 2012 onward.

The meeting also featured informative presentations on weather derivatives fundamentals and risk management issues. WRMA was honored that former Polish President and Nobel Peace Prize recipient Lech Wałęsa gave the closing keynote presentation. Wałęsa reminded attendees that we need to all take part in the creation of a global economic system with high values. “We are merchants, not warriors,” he told attendees. “Europe and the world no longer contain borders and we must agree on the traffic rules on the global economic roads.”

About WRMA

Founded in 1999, WRMA is an international trade organization dedicated to promoting the industry, both to those within it and to end users. The weather risk industry offers companies the opportunity to control their financial exposure to weather conditions. WRMA initiates surveys of the industry, advocates the standardization of contracts and other documentation used for transactions and sponsors forums and conferences around the world for members to meet and discuss a range of topics, such as international markets, data collection issues, and tax and legal matters. Visit us at <http://www.wrma.org/>

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