

## ANALYSIS | INTERVIEW

# “I expect the weather market to continue to grow. It’s certainly been showing a lot of promise.”

**Sandeep Ramachandran of Swiss Re is positive about the future for customised weather derivatives as players seek to cut the risk of trading in an unpredictable market. By Emile Mehmet**

THE past year has seen the market for customised weather derivatives grow by almost a third, according to a recent survey by the Weather Risk Management Association (WRMA). Sandeep Ramachandran, head of weather and energy products at Swiss Re and board member of WRMA, believes the future for this market is bright.

“There are several reasons for (the past year’s) growth. One of the key reasons is the globalisation of the weather market. We have clients not only in the US and Europe, but in other parts of the world who have adopted these products.”

These new clients are becoming more and more familiar with how they can reduce risk and manage exposures, Mr Ramachandran noted. “We’ve seen significant growth globally in the use of these products and I think that’s one of the reasons why we’ve seen increased growth in numbers from the WRMA survey.”

Worldwide temperature contracts continue to be the most customised weather hedge, according to the WRMA survey. However, there has also been an increased interest in rainfall, snow, hurricane and wind contracts. This has been put down to increased end user participation from a wider variety of industries.

“There’s been a lot of product innovation where we offer products on stream flow and wind, and not just temperature. It’s also combined with commodity prices so you have a complete revenue solution as opposed to something that was covering only the volumetric component of the risk,” Mr Ramachandran observed.

In value terms, the global weather risk market reached \$11.8bn over the last year. In the 12 months to March 31, the market for over the counter (OTC) weather derivatives grew 30% to \$2.4bn, up from \$1.9bn in the previous year, the survey, which was conducted by consultancy PwC, showed on May 20.

Survey respondents reported trading 998 OTC contracts in 2010/11, almost three times the number reported in the previous year’s survey. The number of contracts traded on the Chicago Mercantile Exchange (CME) – the leading platform for weather trading – increased by 18% to 466,000. Farmers are increasingly active in the weather market.

While CME accounted for the bulk of reported trading – just below 80% of the total value – OTC activity was the highest reported level since 2004/05. The combined value of OTC and exchange-traded contracts rose 18%, up from just under \$10bn in 2009/10.

“I expect the weather market to continue to grow. It’s certainly been showing a lot of promise. One of the positives we’ve had is that a lot of customers who hedge using these products always tend to return to the market, so from that perspective it’s a very comforting sign,” said Mr Ramachandran.

Something that is becoming more and more common with a lot of clients is that once there’s an extreme weather event that impacts their earnings and profitability, they tend to focus on hedging those in the future.

“Clearly we’ve had quite a few events recently and I think it also boils down to figuring out how you can translate that risk into a specific weather structure. Basis risk – the difference between what you really purchase and your actual exposure – is an important aspect. That’s another possible reason why we continued to see growth in these customised products.”

The number of contracts increased during the past year in North and South America, Europe, Asia and Australia, with the biggest growth being in Europe. “Also in emerging weather markets – Australia, Asia or India specifically, and South America,” said Mr Ramachandran.

The energy sector has always been one of the core sectors for which weather derivatives have been traded. But agricultural commodity players have also shown a healthy interest in weather derivatives this year, due to increasing weather volatility. However, there isn’t one particular soft commodity that’s driving demand. “It’s pretty much across the board,” he remarked.

Additionally, Mr Ramachandran pointed to increased interest in new online platforms for weather derivatives as another reason for recent market expansion.

“There’s also this concept of online aggregators or online platforms, where as a small or medium-sized industry you can go and purchase weather protection online. There has been a lot of interest in that recently although it’s still a small source of end user business. So if you’re a farmer, for example, or a small company that has a specific weather exposure and want to hedge it, you go to these websites and use the tools available there to correlate your revenue with a weather index and structure a hedge based on that.

“These are mostly small transactions but if you can get several hundred of them, then the overall portfolio at some point gets to be meaningful enough. In the next several years clearly that’s one area I think there could be a lot of growth,” Mr Ramachandran concluded. ●

## PEOPLE AND PLACES

**AARHUSKARLSHAMM**, the Swedish-based producer of high value-added speciality vegetable fats, has announced its team of directors following its annual general meeting on May 17. The meeting re-elected **Melker Schorling, Carl Bek-Nielsen, Martin Bek-Nielsen, John Goodwin, Mikael Ekdahl, Marit Beckeman, Ulrik Svensson, Arne Frank** and **Harald Sauthoff** as directors. Melker Schorling was re-elected chairman of the board and Carl Bek-Nielsen was re-elected deputy chairman of the board.

**CHRISTINE Lins** has been appointed the new executive secretary of the **REN21** steering committee with effect from July 1. She will succeed Virginia Sonntag-O’Brien. For the last 10 years Ms Lins was secretary general of the European Renewable Energy Council. REN21 is the Renewable Energy Global Policy Network for the 21st Century.



**ANDY James** has been appointed to direct the convenience store sector of **Coffee Planet**, a United Arab Emirates-based multi-solutions coffee company. Coffee Planet supplies every sector in the coffee retail chain.

**NANA Addo Dankwa Akufo-Addo**, 2012 presidential candidate of Ghana’s new patriotic party, has congratulated the country’s cocoa farmers on their hard work and enterprise as Ghana moves closer to achieving its production target of 1m tonnes of cocoa by 2012.

**GERRY Ritz** has been re-appointed as Canada’s agriculture minister. Mr Ritz said he hopes to have substantive changes in place for the 2012 crop year. While it is not clear exactly what the end result will be or when they might occur, he said the government will build a strategy that doesn’t stifle (farmers) and hold them back.



**CARGILL** has named **Sarena Lin** as corporate vice president of strategy and business development. Ms Lin succeeds **Jim Haymaker**, who will retire after 38 years of service to the company.

## NEXT WEEK

### INTERVIEW

After a year of volatility and increased speculative behaviour, Keith Flury, senior commodity analyst at Rabobank, talks about supply/demand, prices, and production prospects for the coffee and cocoa markets in the coming season.