

# WEATHER DERIVATIVES

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'I HAVE ALWAYS BEEN A TROUBLE-MAKER, AND VOICED MY SUSPICION THAT THE WEATHER IN FRINTON MIGHT BE DIFFERENT FROM THAT VIEWED BY OUR WEATHER RECORDER THROUGH A WINDOW IN E17'

It happened recently to pluck from the shelves of my local library *Never Mind the Moon: My Time at the Royal Opera House* by Jeremy Isaacs. I had hoped that it might turn out to be a financial thriller, but to my mind it contained too much chatter about Luciano Pavarotti struggling for his high C and about Sylvie Guillem's *entrechats*. In one of the chapters which I really enjoyed, the ROH is about to shut its doors, and is desperately looking for money from the Arts Council. Consultants are hired to carry out a sensitivity analysis on the ROH projections, "showing how they were affected by every variation and sensitivity of wage inflation, grant erosion, supply and demand in goods and services, that intelligence could devise "If they had asked us to take account of the weather," Jeremy Isaacs jokes, "I would not have been surprised." That is no joke, Jeremy, I thought sourly.

The first job in industry I ever had – long before the Rumbley and Widgets and Smartass & Partners, the management consultants – was in dry-cleaning. Recruitment consultants tended to giggle at this, and kept on giggling while I explained that it provided a unique insight into both manufacturing and marketing and...and. As far as I can remember, the business had been founded originally by a French exile family who had fled Paris to avoid having their heads chopped off (or, maybe, it was to escape the rioting by the Communes). The company, though still carrying a posh-sounding French name, had gone into decline in the 1930s and slipped to the brink of receivership; but just in time landed a big contract to dye army uniforms around the time of Dunkirk. (I was too modest to mention earlier that the company combined dyeing and dry-cleaning, but, truth to tell, I have got very tired of people making jokes about a dyeing trade). The company has long since gone. It never was particularly successful, but it held a portfolio of long leases on shops on the High Streets of the South, and in the end it was gobbled up by a property company – shortly after I had moved to Smartass & Partners. When I worked there, it was a very old-fashioned company, with Victorian attitudes, and with tier upon tier of dining rooms. While the workers would crouch by their Hoffman presses eating their chip butties, and the

middle managers would get waitress service in their own dining room, the directors would sip sherry before lunch in an oak-panelled dining-room, complaining that business had fallen off ever since Mr Dry-Cleaning Customer had stopped wearing a three-piece suit in the evenings.

One of my first tasks was to prepare a weekly trading statement, at a time when our Ruling Theory was that our turnover was weather related. The corporate belief was that turnover was at its highest when it rained in the morning, forcing Mrs Dry-Cleaning Customer to notice how shabby her curtains looked, followed by the sun breaking through in the afternoon, encouraging her to take her curtains to one of our shops for dry-cleaning. This theory was so strongly held that we even had a section at the foot of our weekly trading statement to indicate the weather conditions on the morning and afternoon of our six trading days. When I arrived, I had to draw in this section little pictures, such as might be found on a television weather chart. A symbol for Sun, and one for Rain, and one for Partly Clouded – though it was difficult to distinguish between the symbols for Snow and Heavy Rain.

I have always been a trouble-maker, and voiced my suspicion that the weather in Frinton (or Weymouth, or Milton Keynes) might be different from that viewed by our Weather Recorder through a window in E17. The weather is always the same across the South-East, I was told. Well, I persisted, couldn't we show a weighted average of the weather for the week? A numerical measure? Shush up, came the reply. In the end, I managed to get the symbols changed into letters. Instead of a Sun, we showed the letter 'S'. (I think that I won this argument on the grounds of a cost saving, since this we need not buy a yellow backing sheet to transfer that colour to the master sheet).

The answer to my early struggles and Jeremy Isaacs' musings came to me when I was browsing through some old copies of *The Treasurer*. In the September 2000 issue I found an article which told of how US investment banks were starting to offer over-the-counter weather derivatives. Admittedly, they seemed to be based around daily temperatures, but, it cannot be long, I thought, before a creative US investment bank would start dealing in rain/sun combinations, perhaps capable of distinguishing between Walthamstow and Bognor, perhaps being able to separate a heavy, soaking rain from a gentle drizzle. If we had been able to hedge the weather back then, there would have been no earnings volatility. We would have needed to be taken over. We could have reversed the flow of immigration, and opened dry-cleaning shops in Paris.

And with weather derivatives, Jeremy Isaacs could have settled down without worry in his seat in the stalls to watch Sylvie Guillem's *entrechats*. **JF**