Closing the gap

Drought threat to Uruguay’s reliance on hydropower

Uruguay is fortunate to have four river basins within its borders, two of which feed its hydroelectric plants. Hydropower can supply up to 90% of the country’s electricity demand in a humid year. A dry year, however, can be costly.

Weather insurance protection to reduce energy expenditures

Established: January 2014 (18 months)

Insured peril: Drought

Insurance instrument: Weather derivative

Policy coverage: USD 450 million

Index: Level of rainfall monitored at weather stations

Trigger: Customised rainfall index (CRI)

Insured party: Administracion Nacional de Usinas y Transmisiones Electricas (UTE)

Primary risk taker: Swiss Re Corporate Solutions
Uruguay’s drought in 2008 forced the country to import oil and electricity from Brazil and Argentina, costing more than USD 500 million. Low rainfall was also behind the country’s deficit in 2012.

Managing key weather and market risks
To meet this challenge Uruguay’s state-owned electric company entered into a USD 450 million weather coverage agreement with the World Bank Treasury. Swiss Re is the primary risk taker.

Under the terms of the agreement, a payout is triggered when water levels fall to a pre-determined point. The final amount of the payout depends on drought severity and the six-month daily average of the price of crude oil. The payout is then used to purchase oil to make up for the hydroelectric shortfall.

How it works
The transaction uses rainfall data from 39 weather stations. The stations are managed by the Brazilian and Uruguayan weather services, and data is impartially verified by a third party. The measurements are converted to a weather index that serves as a proxy for hydroelectric generation.

The transaction reduces budget uncertainty for the Government of Uruguay while at the same time guaranteeing a reliable source of power to Uruguay’s citizens. In principle such a structure could provide protection for other perils — such as excess rainfall, heat, frost, wind speed and solar irradiation — as well as price fluctuations in commodities such as natural gas, heating oil, propane, coal, corn, soybeans, or wheat.

About Swiss Re
The Swiss Re Group is a leading wholesale provider of reinsurance, insurance and other insurance-based forms of risk transfer.

Dealing direct and working through brokers, our global client base consists of insurance companies, mid-to-large-sized corporations and public sector clients.

From standard products to tailor-made coverage across all lines of business, we deploy our capital strength, expertise and innovation power to enable the risk-taking upon which enterprise and progress in society depend.

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