RiskNews

MARIM

Malaysian Association of
Risk & Insurance Management

Issue 7: Jan, 2009

Dear readers,

Throughout the years, MARIM has worked very hard to organize activities for members' benefits, and we are proud to have successfully organized 3 tea talks/short seminars, 1 social visit, 1 bowling tournament, 1 international conference and 1 golf tournament. Not only that, we have managed to raise a considerable amount of fund to support the operation of the association. I would like to take this opportunity to thank all the Exco members for their hard work.

For year 2008, MARIM has attracted 3 new corporate members and 5 new individual members. We would like to welcome Iltizam Perkasa, Konsortium Abas, Malaysian Assurance Alliance, and ValueCap.

It is our vision to promote MARIM to all companies as risk management is everyone's business and sharing of information among members is vital for further development in the field.

At this stage, we have planned various activities for members throughout year 2009. We announce the tentative dates so that members can plan their schedule next year and of course making sure to attend MARIM's event. As a non-profit organization MARIM stand on members support and members' satisfaction is all that we want to hear.

Your contribution will certainly ensure the success of the events.

Happy reading!

Chairman

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MARIM RISK MANAGEMENT CONFERENCE 2009
15-17 JUNE 2009
GENTING HIGHLANDS

"Building Corporate Resilience via Effective ERM"

FEATURE ARTICLE

MANAGING FOREX…PART 2

By: Dr. Ahmad Shukri Yazid, Universiti Darul Iman Malaysia (UDM)

This article is the continuation of the article from the last issue of RiskNews. In the last issue, I have discussed foreign exchange (forex) risk exposure, types of forex exposures and several hedging techniques. This issue will cover several financial tools that are available in financial market to manage forex risk.

Companies can use traditional risk management methods in managing forex risk. For example, they can reduce forex risk by building a plant in a foreign country. However, this traditional method is often expensive and inefficient. Building a plant in other country exposes the company to other types of risks. Therefore, to cope with forex risk, most companies seek out more efficient tools, such as forwards, futures, options and swaps. This is one of the reasons why there have been a growing number of corporate treasurers who now engage in the use of these instruments to protect their businesses. Similarly, the recent literature almost uniformly recommends the use of futures, forwards, options and swaps as forex risk management tools.

Futures

Futures are the least popular, among the four primary financial instruments. A future is an obligation to buy or sell a specified quantity of an asset at a specified price on a specified future date. Some futures contracts, especially in agriculture, require the actual delivery of the asset on the specified date. Other futures like index futures or currency futures are settled in cash. Many of these futures contracts are not held to maturity and normally these positions are closed through the reversing of the futures contract before the maturity date. Futures contracts are traded in organised exchanges like the New York Commodity Exchange, London Futures and Options Exchange, and Hong Kong Futures Exchange. The Malaysian Monetary Exchange regulates the trade in futures contracts in Malaysia.

The futures market is very liquid and, thus, the bid-offer spread is usually very tight. If there are mis-pricings leading to arbitrage, the market quickly makes the necessary adjustments. Indeed, due to this transparency, the futures market can provide a useful benchmark for the forward market in determining the prices of the forward contracts.

Futures contracts have a low risk of default due to daily settlement, margin requirements and the involvement of the clearinghouse. Futures contracts are settled daily or marked-to-market. At the end of each trading day, either the buyer or seller, depending on the closing price of the futures contract, settles the contract. If the price rises then the seller has to pay the buyer and vice-versa. Thus, default risk is reduced.

Margin requirements are needed before one can buy or sell in the future market. The margin acts as a bond or guarantee for contract performance. The initial margin is normally enough to cover the price change during a day. At the end of each trading day, if the price rises, the buyer's account is credited and seller's account is debited. If the seller’s margin is below the maintenance margin, he has to add money to the maintenance margin account.

The clearinghouse will register all buying or selling deals that have been matched. The clearinghouse ensures the integrity of the futures market. For the Malaysian Monetary Exchange, the clearinghouse is the Malaysian Derivatives Clearing House.

Table 1 lists some advantages and disadvantages of the use of futures contracts. One of the advantages of futures is their high liquidity. Disadvantages arise among others from the limited trading hours. All trading activities must be conducted within the stated business hours. Future contracts are quite rigid, and therefore can be less favourable to corporate clients who have different needs to hedge their risks in several time periods.

Table 1 Advantages and Disadvantages of Using Futures Contracts
Source: Brian A. Eales (1995) Financial Risk Management. pg. 72

Advantages:	Disadvantages:
Standardised contract sizes and delivery dates	Margin required
Market transparency	Exchange trading hours may be limited
Highly liquid market which generates small bid-offer spread	If maximum price limits operate, future contracts may become totally illiquid
Market regulated by rules laid down the exchange	Basis difference between spot (cash) market and futures market instrument
Ease of buying and selling contracts	Contracts may be withdrawn from the market
	Dealing restricted to members of the exchange

Table 2: Advantages and Disadvantages of Using Forward Contracts.
Source: Brian A. Eales (1995) Financial Risk Management. pg. 56

Advantages:	**Disadvantages:**
Forwards are over-the-counter instruments	The contracts are not subject to an exchange's regulations
Contracts amounts are flexible	Contracts may be difficult to cancel if one party wishes to close the transaction
Contracts delivery dates are flexible (range from few weeks to a number of years)	There may exist a penalty clause if one party wishes to close the contract early
Dealings are not limited to exchange	Bid-offer may make forward contract expensive
Trading times (??)	

Forwards

A forward contract is a contract between two parties in which one party agrees to buy or sell a certain amount of currency at a specified price (delivery price) on a future date (maturity date). A party who wants to buy a currency in the future is said to be taking a long position, whereas another party who is selling a currency in the future is said to be taking a short position. Forward contracts are mainly used to hedge short-term forex exposure.

The spot rate quote is the current exchange rate for immediate delivery of any currency. The forward rate is the future exchange rate for exchanging currencies on a future date.

Table 2 lists some advantages and disadvantages of forward contracts. One of the advantages of forward contracts is their flexibility which can be utilised to suit a company's needs. A company can arrange forward contracts with another party, such as a commercial bank, for any chosen amount and maturity time since it is offered over-the-counter (OTC). Therefore, it is not surprising to see many companies use it to manage forex risks.

Suppose that a Malaysian company is going to exchange £100,000 in nine months time. The company is exposed to transaction exposure because if the sterling weakens, it will receive less Malaysian ringgit. Thus, in such a situation, the company can enter into a short forward contract to sell £100,000 to a bank nine months from now at a fixed rate. By doing so, the company protects itself from fluctuations in foreign exchange rates.

Options

Options are the third most popular instrument used by companies as a hedging tool. An option denotes the right to buy or sell an underlying asset before or on the expiration date. It is not an obligation, but a right to buy or sell an underlying asset like a foreign currency at a specified rate (exercise price). An American option can be exercised before and on the expiration date, whereas a European option can only be exercised on the expiration date.

A call option is the right to buy a specified amount of foreign currency at a specific exercise rate on or before the expiration date. A put option is the right to sell a specified amount of forex at a specified exercise rate on or before the expiration date. These techniques enable a multinational to lock in its forex risk exposure. The company that buys either a call or put option, limits its losses to the price paid (premium) for the option contract. However, its potential profit is unlimited depending on the spot price when the option is exercised.

Option versus Forward Contract

Under a forward contract, a buyer is obligated to buy or sell a specified amount of foreign currency at a fixed exercise rate on the expiration date. It is an obligation on the part of the buyer and seller to fulfill the contract. It is not a right to buy or sell a certain amount of foreign currency as would be the case in an option contract. Sometimes buying or selling a forward contract might not be suitable to a company. For example, if a company is bidding for a contract in foreign countries, it might secure the contract or otherwise. If it is successful, it may be important for the company that the forex rate is equal to the one used in preparing the contract. The company is exposed to forex risk and needs to hedge the foreign currency rate. Buying or selling foreign currency forwards may not be a good idea because the contract is fixed and if a company fails to secure a contract, it still has to exercise the contract. In such a case, an option contract is more appropriate, because it gives the company the right, but not the obligation, to buy or sell foreign currency. If it fails to get the contract, it can abandon the option contract and only suffer a limited amount of loss, which is equivalent to the premium of the option contract. In terms of cost, a forward contract is cheaper than an option contract, since the contract using options is required to pay a premium.

Swaps

A swap is another instrument that can be used to hedge forex risk. Foreign currency swaps are amongst the most popular financial risk management tool. This is because swaps can be used to hedge long term currency exposure, such as interest and debt payment obligations on foreign currency loans. The two parties involved in a swap contract are called counter parties. A swap contract is an arrangement whereby the two counter parties agree to exchange a certain currency for another currency. Usually the swap contract extends for over two years. The currency swap is the most common swap contracts.

Suppose, counter party A agrees to pay counter party B at a predetermined exchange rate M$4.00 per £1 every six months for five years for an amount of £100,000, commencing on January 1, 2000. In this arrangement, the counter party B agrees to pay counter party A at the spot exchange rates every six months for the same amount. If on January 1, 2000 the spot exchange rate is M$4.20 per £1 then counter party A pays to counter party B at the exchange rate of M$4.00 per £1 and counter party B pays to counter party A at the exchange rate of M$4.20 per £1. In this case, this is the same as counter party B paying to counter party A M$20,000 [(M$4.20 – M$4.00) * £100,000]. The transaction on January 1, 2000 is similar to a forward contract, in fact, this swap contract consists of 20 forward contracts at the prevailing spot exchange rates for every six-month interval for five years.

Conclusion

It appears that prior to 1997, there were very few multinationals involved in hedging activities in order to avoid or minimise financial risks. Malaysian multinationals were very passive and reactive in managing their risks, including forex risk. Today, there is a consensus that in light of the current volatile market, forex risk management capabilities may need to be enhanced. This implies that multinationals should proactively manage their forex risk. They should identify their exposure and protect themselves through hedging activities and financial tools. They may have to totally or partially hedge, depending on their resources and capabilities to self assumed risks.

During the financial crisis in 1997, many of these multinationals have been deeply affected by forex and interest rate losses. For example, Tenaga National Bhd. (TNB), suffered forex losses of M$2.47 billion for the first six months after the crisis began. MAS, for example, suffered from similar losses of between M$300 million to M$400 million for the first six months of 1998 due to its foreign debt of about M$3.16 billion. Most of this debt was in US dollars. TELEKOM also suffered from translation losses worth M$158 million. It is reported that Yeo Hiap Seng Bhd. also suffered forex losses worth M$4.4 million for the financial year ending December 31, 1997.

It is argued that the impact of the crisis could have been greatly minimised if they had been proactive in hedging their forex risk. Therefore, financial institutions need to assist their corporate clients on sound forex risk management.

Even though forex risk management in Malaysia is still at an infancy stage, a number of companies have begun to acknowledge the importance of forex risk management. With the recent developments in the financial market, in particular the active role of MME and Kloffe, and other financial institutions, the role of forex risk management is likely to be enhanced.

ACTIVITIES 2009

Event	Date	Venue
1. RM Roundtable Discussion	22 Jan	TNB PJ
2. Social Visit	26 Feb	Westport
3. Seminar 1: The financial meltdown: Consequences & Strategies for Property Insurance	26 Feb	Wesport
4. Bowling Tournament	28 Mar	MidValley
5. 18th AGM	29 Apr	TNB PJ
6. Tea Talk 1: Director's & Officer's Liability Insurance	29 Apr	TNB PJ
7. MARIM Risk Management Conference	15-17 Jun	Genting Highlands
8. Risk Management Award of Excellence and Annual Dinner	16 Jun	Genting Highlands
9. Social Visit: Tan Chong Manufacturing Plant	23 July	Serendah
10. Golf Tournament	Oct	TBA
11. Seminar 2	Oct	TBA
12. Tea Talk 2	Nov	TBA

SPECIAL REPORT

By Arpah Abu Bakar, MARIM

INTERNATIONAL RISK MANAGEMENT CONFERENCE (IRMC 2008)

25-26 Aug 2008
Equatorial Hotel, Bangi

From left: En Mohamad Mohd Zain (TM), Associate Prof Dr Muhd Rasid Husin (UiTM), Mr Kevin Knight (FAPARMO)

Participants of IRMC 2008

The conference was successfully organized with the Malaysian Insurance Institute (MII) as the co-organizer. With a theme of "Enhancing Shareholders' Value via ERM", the conference attracted one hundred participants from various background and industries. The keynote address was delivered by Mr Shahab Din, the Chief Executive Officer of the Malaysian Institute of Corporate Governance (MICG).

Eighteen papers were presented and deliberated during the 2-day conference. The speakers, representing various countries such as Hong Kong, Japan and Australia, bring in their expertise to be shared and benefited by the local practitioners.

Among vital issues discussed were the Risk Management Standards and the Need for Risk Management Education and Certification.

The AS/NZS 4360:2004 was compared with COSO ERM Framework and the forthcoming ISO 31000. These key papers were presented by Mr Kevin Knight, President of FAPARMO, Associate Prof Dr Mohd Rasid Hussin, Universiti Teknology MARA (UiTM) and Azura Abd Wahab, Deputy Chief Auditor of Telekom Malaysia.

The issue on education and certification were raised to emphasize the importance of human capital investment in creating value for the organization. Among the options are certification offered by the Malaysian Insurance Institute (MII) and the bachelor degree in risk management offered by Universiti Utara Malaysia (UUM).

Zalina Jaflus (MARIM) presenting a souviner to Hussian Ahmad

MARIM @ A GLANCE

RISK MANAGEMENT ROUNDTABLE DISCUSSION

July 25, 2008
TNB Theatre, 20th Floor, Wisma TNB, PJ

Risk Management Best Practices Among the Public Listed Companies in Malaysia
Presenters: Associate Professor Dr Hj Mohd Rasid Hussin
Dr. Ahmad Shukri Yazid

In this roundtable discussion, the speakers presented their research findings in an exploratory study to document the model of "Best Practices" in risk management among Malaysian major corporations. The study was funded by the Ministry of Higher Education (MOHE) Malaysia under the Fundamental Research Grant Scheme (FRGS). The objectives of this scholarly study are two-fold: (a) to examine the risk management practices among Malaysian major corporations, all of which are Public Listed Companies (PLC) and (b) to examine the "Best Practices" in Risk Management by these major corporations in terms of their strategies and approaches including the techniques adopted. The findings were based on an interview of twenty (20) major corporations from various industrial sectors as listed under the Malaysian Bourse (Bursa Malaysia).

You may request a copy of the presentation papers from our Secretary, Ms Nabilah at 03-79550284 or marim_my@streamyx.com. There will be minimal charges for printing, postage & handling.

MARIM-MNRB STUDENT AWARD

25 August 2008
Equatorial Hotel, Bangi

The MARIM-MNRB Student Award was initiated by MARIM as an effort to promote and support education in risk and insurance management. With the support from MNRB Holdings Berhad (MNRB), who generously contributed RM10,000, the MARIM-MNRB Student Award Fund was founded in year 2007. Aside from academic achievement, the students must be a member of the MARIM Student Chapter to be eligible.

Student Award Winners with Prof Dr Nor Hayati (3rd from left), Mr Anuar Mohamad Hasan and Tn Hj Kamal Ariffin Abdullah.

The winners for the year 2008 are as follows:

- Lim Lee Shyan
- Fadzlin Syazana Kamarudin
- Noor Wahidah Idris
- Wong Jin Yee
- Siti Rawaidah Mohd Razikin

The selection was based on achievement during the academic session 2006/2007. All are students from Universiti Utara Malaysia, majoring in Risk Management and Insurance.

MARIM @ A GLANCE

MARIM GOLF TOURNAMENT

24 August 2008
Perangsang Golf Templer Park

Labuan Re

Jerneh INSURANCE

Mr Yap Kim Pin and Mr Carl Lewis

Tn Hj Kamal and Mr Yap Kim Pin

Congratulation to all winners

Main Prize
1st : Yap Kim Pin (Thomas)
2nd: HM Choong
3rd : Sabtu Jalil

A - Medal
1st : Ahmad Sabri Ismail
2nd: Razak Karim
3rd : Kamal Izat
4th : Abd Aziz Hussin
5th : Dr Shamsul Anuar

B - Medal
1st : Mohd Suhaimi Ahmad
2nd: Hj Mohd Amin Mat Jidon
3rd : Ismail Mahbob
4th : Ganeswaran
5th : Ahmad Yani Aziz

Novelties

Nearest to Line
Hole #4 : Shukri Harun

Nearest to Pin
Hole #4: Razak Karim
Hole #6: Azlan Lewis
Hole #11: Abdul Shukor

Longest Drive
Hole #2: CB Lim
Hole #18: Dr Shamsul Anuar

Special Thanks to:

CIMB Aviva Takaful Bhd, Iltizam Perkasa Sdn Bhd, Crawford & Co Adjusters (M) Sdn Bhd, Marsh Insurance Brokers Sdn Bhd, Willis (M) Sdn Bhd

Allianz Ins, Tahan Ins, Mestari Adjusters Sdn Bhd, Etiqa Ins, MNRB Retakaful Bhd.

Kurnia Ins, Malene Ins Broker, GAB Robin, McLaren Saksama, Agilentrisk Limited

From left: En Ismail Mahbob, En Anuar Mohd Hassan, En Abdullah Md Zahid and Mr Lim Sun

Hole-in-one Prize

Member gets Member

Get 3 **free seats** to our half-day seminars in 2009 when you introduce one new corporate member.

Hurry!!!

Get 1 **free seat** to our half-day seminars in 2009 when you introduce one new individual member.

FOR MEMBERSHIP INQUIRIES	
Please address to: Malaysian Association of Risk and Insurance Management (MARIM) No 9B, Lorong 8/1E 46050 Petaling Jaya Selangor, Malaysia	Contact person : Ms Nabilah Contact No : 03-7955 0284 Fax No.: 03-7954 2451 Email : marim_my@streamyx.com / marim.secretariat@gmail.com Website : http://www.marim.org

Living at risk is jumping off the cliff and building your wings on the way down.

~Ray Bradbury

FOR CONTRIBUTION OF ARTICLES	
You can write on: • Activities at your company • Recent promotion • Risk issues at your organization • Your own experience in risk management implementation • Other related topics	Please address to: Dept. of Risk Mgmt. & Insurance Faculty of Finance & Banking Universiti Utara Malaysia 06010 Sintok, Kedah Contact person : Arpah Abu Bakar Email : arpahabubakar@gmail.com