

Risk Management & Mitigation Strategies

Sembcorp is fully committed to a robust system of internal controls and risk management.

The Group manages risk under an overall strategy determined by the board of directors, supported by the board-level Risk Committee and the Internal Audit department. Formed in August 2003 to assist the board of directors, the Risk Committee, comprising three directors, reviews and enhances the effectiveness of the Group's risk management plans, systems, processes and procedures. The Risk Committee also reviews Group-wide risk policies, guidelines and limits as well as significant risk exposure and their risk treatment plans. Since April 2005, the Sembcorp Marine Risk Committee has assumed oversight responsibility for the Marine business' risk management activities and practices.

Enterprise Risk Management

The Group has established an Enterprise Risk Management Framework to standardise the risk management methodologies within the Group. In line with Sembcorp's commitment to deliver sustainable value to its shareholders, the objective of the Enterprise Risk Management Framework is to provide guidance to the operating units in implementing a comprehensive and consistent approach to identifying and managing the risks that they face. The Enterprise Risk Management Framework applies to the action of all employees of the Group and is implemented at each operating unit.

Within this framework, critical and major risks of the Group and the operating units are identified and assessed to determine the appropriate type of risk treatment plans to be implemented and which are to be monitored at the Group level as well as by each strategic business unit (SBU).

The Enterprise Risk Management Framework sets out a systematic and ongoing process for identifying, evaluating, controlling and reporting risk, comprising the following key elements:

- Identification and assessment of all risks.
- Formulation of risk management strategies.
- Design and implementation of risk management and mitigation action plans.
- Monitoring and reporting of risk management performance and risk exposure levels.
- Continuous improvement of risk management and mitigation action plans and capabilities.

These processes are put in place to manage and monitor the Group's risk management activities on a regular and timely basis.

System of Financial Discipline

Since 2003, a systematic approach has been in place for Sembcorp Industries and its subsidiaries and associates, to ensure financial discipline across

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the Group. We have set up a self-check, review and certification process called the 'System of Financial Discipline' for all subsidiaries to confirm their commitment to and compliance with a prudent financial discipline framework.

At the SBU level, the process involves a comprehensive self-review exercise by management at various levels to ensure that transactions are in compliance with the accounting standards and acceptable accounting policies, and that the internal controls in place are adequate. The System of Financial Discipline also sets out a structured approach to identifying and facilitating the continued assessment of key risk areas with financial implications, such as provisioning for project losses, asset impairment, significant long outstanding debtors, fraud incidents and any transactions and / or events with material impact or potential material impact on the SBU's financial results.

On a quarterly basis, SBUs' operating and finance heads are required to certify and report the results of their self-review exercise to Sembcorp Industries. This process serves to facilitate oversight over accounting treatments adopted by SBUs and allows early identification of areas of potential exposure that can be addressed to minimise adverse impact to the Group. The reporting also serves as a periodic platform for all SBUs' operating and finance heads to highlight any transactions and / or events with material or potential material financial impact to the Group.

Whistle-Blowing

Since 2005, Sembcorp Industries has had a whistle-blowing policy and procedures, which provide employees with well-defined and accessible channels within the Group through which they may, in confidence, raise concerns about possible improprieties in matters of business activities, financial reporting or other matters to the Audit Committee. This arrangement facilitates independent investigation of such matters for appropriate resolution.

Internal Audit

The Group also has a Group Internal Audit department, which focuses on providing an independent

resource and perspective to both the board and the Audit Committee on the processes and controls that help to mitigate major risks.

Mitigation Strategies

Our risk management efforts are focused on the following risks:

- a. Financial and counterparty / credit risk
- b. Operational risk
- c. Investment risk
- d. Compliance and legal risk
- e. Interested person transaction risk
- f. Human resource risk

a. Financial and counterparty / credit risk

The Group's activities expose it to a variety of financial risks, including changes in funding and liquidity risks, interest rates, foreign exchange risks, commodity risks and counterparty / credit risks.

To manage these risks, the Group's Treasury Policies and financial authority limits are documented, reviewed periodically and communicated to the Group's entities. The policies set out the parameters for management of Group liquidity, counterparty risk, foreign exchange and other transactions and financing.

The Group utilises approved financial instruments to manage exposure to interest rate, foreign exchange and commodity price risks arising from operational, financing and investment activities. The commodities involved basically include fuel oil, coal and natural gas. Transactions such as foreign exchange forwards, interest rate swaps, commodities swaps, purchase of options and contracts for differences are used, as appropriate, to manage these risks. It is the Group's overall Treasury Policy that transactions for speculative purposes are strictly not allowed. Transactions are allowed only for hedging purposes based on the underlying business and operating requirements. Exposure to foreign currency risks is also hedged naturally where possible.

The financial authority limits seek to limit and mitigate operational risk by setting out the threshold of approvals required for the entry into contractual obligations and investments.

Liquidity risk

The Group manages its working capital requirements with a view to balance the risk of non-availability of funding, the cost of funding and an optimal level of liquidity appropriate to the operating environment and expected cash flow of the Group. Working capital requirements are maintained within the credit facilities established and are adequate and available to the Group to meet its obligations.

Interest rate risk

The Group's policy is to maintain an efficient and optimal interest cost structure using a mix of fixed and variable rate debts and long-term and short-term borrowings. The Group enters into interest rate swaps to minimise its interest rate risk. A minimum of 50% of the Group's loan portfolio having fixed interest rates is targeted for the Group.

Foreign exchange risk

The Group operates globally and is exposed to foreign currency exchange rate movements, primarily for the US dollar, pound sterling, euro, Australian dollar and *renminbi*. Such risks are either hedged by forward foreign exchange contracts in respect of actual or forecasted net currency exposure or hedged naturally by a sale or purchase of a matching asset or liability of the same currency and amount. No speculative foreign exchange transactions are allowed.

Commodity risk

The Group hedges against fluctuations in commodity prices that affect revenue and cost. Exposure is managed via swaps, purchase of options, contracts for differences and forward contracts.

Contracts for differences are entered into with appropriate counterparties to hedge against adverse price movements on the sale of electricity. Exposure to price fluctuations arising on the purchase of fuel is managed via fuel oil swaps, where the price of fuel is indexed to a benchmark fuel price index, for example the Singapore High Sulphur Fuel Oil (HSFO) 180-CST.

For precious metal commodities, such as gold, exposures to fluctuations in price are hedged through the use of forward contracts or purchase of options

that fix the purchases at an agreed price. The quantum of commitment is based on actual or forecasted requirements.

Counterparty / Credit risk

The Group monitors its exposure to credit risk arising from sales to trade customers and default risks from suppliers and contractors on an ongoing basis. Credit evaluations are done on these counterparties from time to time. The Group generally deals with pre-approved customers, suppliers, contractors and financial institutions with good credit rating. On a case to case basis, the Group will require additional securities when dealing with counterparties of lower credit standing. At balance sheet date, except as disclosed, there were no significant concentrations of counterparty / credit risks with any single counterparty.

b. Operational risk

Operational risk, which is inherent in all business activities, is the risk of potential financial loss and / or business instability arising from failures in internal controls, operational processes or the systems that support them.

It is recognised that operational risk can never be entirely eliminated and that the cost of minimising it may outweigh the potential benefits. Accordingly, the Group manages operational risk by focusing on risk management and incident management. The Group has also put in place operating manuals, standard operating procedures, delegation of authority guidelines and a regular reporting framework, which encompasses operational and financial reporting. This allows for early identification of areas of potential exposure which can be addressed to minimise adverse impact to the Group. Independent checks on the operating units' internal controls and risk management process are undertaken by the Internal Audit department to ensure their effectiveness and adequacy. Where appropriate, this is supported by risk transfer mechanisms such as insurance.

Insurance

It is not practicable to insure every insurable risk event to the fullest extent as the insurance market may lack the capacity, both as to breadth and extent of

coverage, and in some cases external insurance is simply unavailable or is not available at an economical price. The Group regularly reviews both the type and amount of insurance coverage that it buys, bearing in mind the availability of such cover, its price and the likelihood and magnitude of the risks involved.

During the year, the Group renewed its global insurance programme for property damage, business interruption and public liability for its Utilities operations in Singapore and the UK under the advice of established global insurance broker and risk adviser Marsh (Singapore) and maintained insurance levels deemed appropriate in the light of the cost of cover and risk profiles of the businesses.

The Group's wholly-owned captive insurance subsidiary, Sembcorp Captive Insurance, which is advised and managed by Marsh Management Services, also participates in the property damage and business interruption portion of the Group's global insurance programme as a reinsurer, retaining a maximum exposure of S\$2.5 million for each and every loss with an annual maximum of S\$5 million in aggregate in excess of the existing retentions of the business entities within the Group.

c. Investment risk

The Group's capital investment decision process is guided by investment parameters instituted on a Group-wide basis. All investments are subject to rigorous scrutiny to ensure that they are in line with the Group's strategic business focus, meet the relevant hurdle rates of return and take into account all other relevant risk factors, such as market risks, operating risks, environmental risks and foreign exchange risks.

In addition, the board requires that each major investment proposal submitted to the board for decision is accompanied by a comprehensive risk assessment and management's proposed mitigation strategies.

d. Compliance and legal risk

The Group's operations are subject to regulation and future changes in regulation that may adversely affect results, particularly in the areas of corporate law, competition law, consumer protection and environmental law. The responsibility of compliance

with applicable laws and regulations lies with the respective operating business heads, and oversight of the discharge of their responsibilities is provided by the Group's Legal department.

Legal risk is the risk that the business activities of the Group may have unintended or unexpected legal consequences. This includes risks arising from:

- Actual or potential violation of laws or regulations (which may attract a civil or criminal fine or penalty).
- Inadequate documentation, legal or regulatory incapacity, insufficient authority of a counterparty and uncertainty about the validity or enforceability of a contract in a counterparty insolvency.
- Failure to protect the Group's property (including its interests in its premises and its intellectual property, such as Sembcorp Industries' logo and other related logos, brand names and products).
- The possibility of civil claims (including acts or other events that may lead to litigation or other disputes).

The Group identifies and manages legal risk through effective use of its internal and external legal advisers. Sembcorp's internal legal department assists in identifying, monitoring and providing the support necessary to identify and manage legal risks across the Group.

e. Interested person transaction risk

In respect of transactions entered into by the Group, its subsidiaries and associated companies that are "entities at risk" with interested persons (namely its controlling shareholders, Chief Executive Officer, directors and their respective associates), the Group is guided by and complies with the provisions of Chapter 9 of the SGX-ST Listing Manual, to ensure that such interested person transactions (IPTs) are entered into on an arm's length basis and on normal commercial terms, which are generally no more favourable than those extended to unrelated third parties.

The Group has internal control procedures to ensure that transactions carried out with interested persons comply with the provisions of Chapter 9 and Sembcorp Industries' Shareholders' Mandate. This mandate is renewed on an annual basis and will be updated at the extraordinary general meeting to be convened on April 22, 2010. These internal control

procedures are intended to ensure that IPTs are conducted at arm's length and on normal commercial terms that are not prejudicial to the interests of minority shareholders.

The Group maintains a register of all IPTs, recording the basis on which they are entered into, including quotations obtained to support such basis. The Group's annual internal audit plan incorporates a review of all IPTs for the relevant financial year.

The Audit Committee periodically reviews Group Internal Audit's IPT Reports to ascertain that the guidelines and procedures on IPTs have been complied with. The review includes the examination of the nature of the IPTs and relevant supporting documents or other such information deemed necessary by the Audit Committee. If a member of the Audit Committee has an interest in an IPT, he or she abstains from participating in the review and approval process of that IPT.

f. Human resource risk

In order to develop, support and market the products and services offered by the Group and to grow our businesses internationally, it is necessary to hire and retain skilled and professional employees with the relevant expertise. The implementation of the Group's strategic business plans could be undermined by failure to recruit or retain competent key personnel, the unexpected loss of such key senior employees or failure in the Company's succession planning.

In this respect, the Group places great emphasis on establishing comprehensive human resource policies for the recruitment, compensation and development of staff. This ensures that the Group's human assets – its skilled workforce and competent senior management – are nurtured and retained, so that the Group's competitive edge is preserved. The board's Executive Resource & Compensation Committee has oversight of the Group's remuneration policies and oversees management, development and succession plans for key management positions. Further details on the Executive Resource & Compensation Committee as well as on Sembcorp's human resources management may be found at pages 60 to 61 and 86 to 90 of this annual report.