



The Sembcorp NEWater Plant, Singapore

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 Audit Committee. Formed in August 2003 to assist the board of directors, the Board Risk Committee, which now comprises three directors, reviews and enhances the effectiveness of the Group's risk management plans, systems, processes and procedures. The Board Risk Committee regularly reviews group-wide risk policies, guidelines and limits as well as significant risk exposures in foreign exchange, commodities, major investment projects and their risk mitigation plans. Since April 2005, the Sembcorp Marine Risk Committee has assumed responsibility for oversight of the Marine business' risk management activities and practices.

Enterprise Risk Management

The Group has established the Sembcorp Industries 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 actions of all employees of the Group and is implemented in 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 management plans to be implemented and which are to be monitored at the Group level as well as by each operating unit.

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; and
- 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

To ensure financial discipline across the Group, we have implemented a self-check, review and certification process since 2003 called the System of Financial Discipline for all subsidiaries, joint ventures and associates, to confirm their commitment to and compliance with a prudent financial discipline framework. The Group conducts periodic reviews of the System of Financial Discipline to ensure its relevance, effectiveness and compliance.

The System of Financial Discipline is a comprehensive self-review exercise by management at various levels to ensure that transactions are in compliance with Singapore accounting standards and that 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 debts, fraud incidents and any transactions and events with material impact or potential material impact on the business unit's financial results.

On a quarterly basis, business units' operating and finance heads are required to certify and report the results of their self-review exercise to the Group. This process serves to facilitate and ensure consistency of accounting treatments adopted by business units 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 business units' 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 has a whistle-blowing policy and procedure which provides 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. The policy is subject to review on a regular basis.

Internal Audit

The Group Internal Audit department assists the Audit Committee in promoting a sound system of internal controls and good corporate governance across the Group. Our internal auditors perform periodic audits to assess the effectiveness and efficiency of the Group's internal control system in addressing financial, operational and compliance risks, as well as its information technology controls and risk management system using a risk-based methodology. For more information on the company's independent internal audit function, please refer to the relevant section on page 50 in the Corporate Governance chapter of this annual report.

Mitigation Strategies

Our risk management efforts are focused on the following risks:

- a. Financial and counterparty / credit risk
- b. Operational risk
- c. Investment and commercial risk
- d. Compliance and legal risk
- e. Interested person transaction risk
- f. Human resource risk
- g. Fraud risk
- h. Crisis risk
- i. Information technology risk

a. Financial and counterparty / credit risk

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

To manage these risks, the Group's Treasury Policies and Financial Authority Limits are reviewed periodically and communicated to the Group's entities. The policies set out the parameters for management of the Group's liquidity, counterparty, foreign exchange and other risk exposures.

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 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. Under the Group's overall Treasury Policies, 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 entering into contractual obligations and investments.

Liquidity risk

The Group manages its working capital requirements with a view to balancing the risk of non-availability of funding, the cost of funding and an optimal level of liquidity appropriate for the operating environment and expected cash flow of the Group. Working capital requirements, which are maintained within the credit facilities established, 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, and targets to have a minimum of 50% of its loan portfolio in fixed rate debts.

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, Indian rupee and *renminbi*. Such risks are either hedged by foreign exchange forward 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. The Group does not engage in any form of proprietary trading.

Commodity risk

The Group endeavours to incorporate pricing formulae for oil, natural gas and raw material costs such that these costs may be passed on to and be

borne by its customers and, in accordance with its risk management policy, hedges the residual risks arising from price fluctuations. The Group hedges against fluctuations in commodity prices that affect revenue and cost 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 from 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 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 performed 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 by case basis, the Group will require additional securities when dealing with counterparties of lower credit standing.

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 processes are undertaken by the Group 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 in terms of the breadth and extent of coverage, and in some cases external insurance is simply unavailable or 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 view 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 as a reinsurer in the property damage and business interruption portion

of the Group's global insurance programme. Sembcorp Captive Insurance retains 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.

During the year, the Group also established a global insurance programme for property damage, business interruption and public liability for its water operations in the UK, South Africa and the Americas, under the advice of established global insurance broker and risk adviser Willis. This enables the Group to provide more dedicated and focused insurance for our portfolio of global water operations.

c. Investment and commercial 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 political risks, market risks, operating risks, environmental risks and foreign exchange risks. In 2012, the Group also formalised a Country Investment Limit framework to provide better clarity and guidance for country investment decisions based on prevailing country ratings and the Group's strategic intent. 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's logo and other related logos, brand names and products); and
- 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, Group President & CEO, directors and their respective associates), the Group is guided by and complies with the provisions of Chapter 9 of the SGX-ST Listing Manual. This is 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 not any 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 25, 2013. 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 people development may be found on pages 45 to 46 and 116 to 120 of this annual report.

g. Fraud risk

The Group has established the Group Fraud Risk Management Framework to manage the risks of fraud and misconduct. In 2011, as part of its ongoing framework review and continuous improvement process, the Group has enhanced its Fraud Risk Management Framework by updating its strategies and improving its existing anti-fraud measures to manage the risks of fraud and misconduct more effectively. In 2012, all major businesses within the Group have undergone fraud awareness training as part of the Group's Fraud Risk Management Framework. In addition, all major businesses have put in place fraud control plans to guide them in fraud management. The Group Fraud Risk Management Framework, together with the various anti-fraud initiatives, will be reviewed on a regular basis.

h. Crisis risk

As the Group grows its presence globally and expands its operations into overseas markets and the municipal sector, it becomes increasingly important for the Group to continuously review

its crisis management framework and maintain a robust and effective framework that is relevant to the current business environment. This will enable us to safeguard the company's image and reputation as well as prevent or minimise the loss of assets and disruption to business operations. In 2012, the Group enhanced its Group Crisis Management Framework to formulate and update its strategies with regard to crisis management and to improve existing crisis management, communication and emergency response protocols across the various business entities. The Group also addresses crisis and emergency events through the implementation of appropriate prevention, preparedness, response and recovery programmes.

i. Information technology risk

The Group has maintained an uncompromising stand on information availability, control and governance, as well as data security. Over the years, the Group has adopted a multi-pronged approach to effectively manage our information risks. Up-to-date information security policies are implemented and enforced group-wide. High availability and resilience are built into all critical information systems. The corporate information technology (IT) systems and infrastructures are constantly monitored to proactively identify and mitigate risks. IT disaster recovery exercises are carried out regularly to ensure uptime business recovery objectives are met. At the staff level, regular information security awareness programmes are put in place to educate employees of the prevailing risks when handling corporate data. Finally, to ensure effective IT risk management, external security consultants are engaged annually to review and enhance our IT risk posture.