

**DP07**

# **Treasury**

**8 APRIL 2003**

1. Time allowed : Three (3) hours
2. Total number of questions : Six (6) questions
3. Number of questions to be answered : Five (5) questions [20 marks each]
4. Show details of workings where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. A blank page is provided at the end of the question papers for rough work.

## ANSWER FIVE (5) QUESTIONS ONLY

1. (a) (i) What is the difference between “currency exchange” and “currency speculation”? [2]  
 (ii) How are currency values affected by interest rate changes? [2]
- (b) (i) What is a “fixed forward delivery contract”? [1]  
 (ii) Why do companies use fixed forward delivery contracts? [1]
- (c) Geopolitical tensions and disappointing economic reports kept the USD vulnerable on Monday, with the USD taking a sound thrashing from its major counterparts.

The greenback dropped about 1.5yen from its intraday peak, thereby heightening the risk of currency intervention by Japanese monetary authorities, while sinking yet again to multiyear lows against the Euro and the Swiss Franc.

In the local money market, the short-term rates remained stable and stagnant. At the close of the week, the interbank offer rates were as follows:

	1-month	3-month	6-month
KLIBOR	3.00	3.00	3.00
LIBOR (USD)	3.00	3.00	3.50

Based on the above report, answer the following questions:

- (i) Explain how disappointing economic reports could affect the USD. [2]
- (ii) Which foreign exchange dealer, whether a jobber or a positioner, is most likely to be affected by the currency movements as described in the report? [2]
- (iii) What is the likely reason for currency intervention by Japanese monetary authorities? [1]
- (iv) Are 1-month and 3-month forward prices the same as spot prices for USD against the MYR? [1]
- (d) List **three** areas (activities) of banks’ money market operations. [3]
- (e) What are **three** qualities of a good foreign exchange quotation? [3]
- (f) State the title of any **two** of the following Exchange Control Notices issued by Bank Negara Malaysia:
- (i) ECM 3 [1]  
 (ii) ECM 9 [1]  
 (iii) ECM 13 [1]

(Total:20 marks)

2. The following rates are quoted:

	<b>USD/MYR</b>	<b>GBP/USD</b>	<b>USD/SGD</b>
Spot	3.7995/05	1.6110/20	1.7290/00
1-month	37/52	40/30	10/20
2-month	79/94	80/60	20/30
3-month	123/138	120/110	35/45
4-month	168/188	160/150	45/55
5-month	210/230	200/190	65/75
6-month	250/275	250/240	90/100

Based on the above rates, calculate the following (full working of calculations to be shown):

- (a) Bank sells GBP/USD value spot [1]
- (b) Bank sells USD/SGD value spot [1]
- (c) Bank buys GBP/MYR value 1-month fixed delivery [2]
- (d) Bank sells GBP/MYR option spot to 1-month [2]
- (e) Bank sells SGD/MYR option 1-month to 2-month [3]
- (f) Bank buys SGD/MYR 3-month fixed delivery [2]
- (g) Price quoted to exporter for USD/MYR option spot to 3-month [3]
- (h) Price quoted to importer for SGD/MYR option 4-month to 5-month [3]
- (i) Based on the following rates, what is the theoretical quote for USD/MYR outright value today?

O/N USD/MYR Swap	0/2
T/N USD/MYR Swap	0/2
Spot USD/MYR	3.7995/05

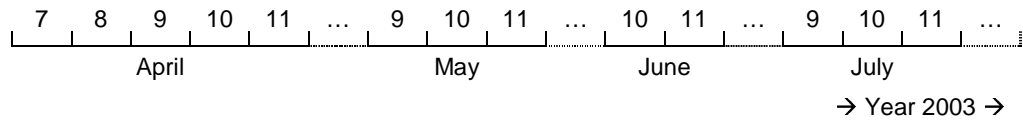
[2]

- (j) You need to buy USD against Euro. From the following banks' quotes, indicate which bank provides the best rate:

Bank A	1.0020/25
Bank B	1.0019/24
Bank C	1.0021/26
Bank D	1.0023/27

[1]  
(Total:20 marks)

3. (a)



The transaction date is 9 April 2003.

Given the information above with the assumption that all dates given are good for transaction, answer the following questions:

- (i) What is the spot date? [1]
- (ii) What is the value “tom” date? [1]
- (iii) What is the date for value 1-month fixed outright delivery contract? [1]
- (iv) What are the dates for 1-month to 2-month option delivery contract? [1]
- (v) What is the date for 3-month fixed outright delivery contract? [1]

(b) Interbank dealer A is long USD5million against JPY at 118.00. At the close of the day, he decided to square his position at JPY118.45.

Interbank dealer B is long USD3million against CHF at 1.3810. He decided to leave a stop loss and/or target order overnight. His order was executed at 1.3880.

Interbank dealer C is short EUR3million against USD at 1.0090. He decided to square his position at 1.0040 at the close of the day.

Based on the above transactions, determine which interbank dealer obtained the highest profit in MYR.

*[Use USD/MYR rate of 3.8000 and the closed-out rate for your calculations.]* [5]

- (c) (i) What is overnight (O/N) funds? [1]
- (ii) Provide an illustration of an O/N USD deposit transaction. [2]

(d) Given the following:

Spot USD/MYR	3.7995/05
6-month USD interest rate	3.00% (181 days)
6-month MYR interest rate	4.50% (181 days)
6-month swap (181 days)	250/275

- (i) Determine the 6-month USD/MYR swap points using the general formula. [2]
- [Use USD/MYR mid-rate in your calculation.]*

- (ii) Assume you have a choice of borrowing USD1million and converting it to MYR equivalent to earn a higher interest rate.

Would you be able to profit from the transaction without taking any exchange rate risk? Support your answer with workings.

*[Use the principles of the general swap formula and the forward rate in your calculation. Assume there is no regulation prohibiting such transactions and there are no transaction costs.]* [5]

(Total:20 marks)

4. (a) Trading in USD deposits can be carried out both in the US domestic money market and in the offshore money market.

What is an “offshore money market” and how does this market differ from a domestic money market? [2]

- (b) An investor is said to be more interested in knowing the “real interest rate” of a currency as against the “nominal interest rate”.

Explain why this is so by highlighting the difference between the **two** interest rates. [2]

- (c) The following are the rates scenario prevailing in the two countries cited below:

	<b>Philland</b>	<b>Faithland</b>
Gross Domestic Product growth (annual)	5.0%	7.0%
Money supply growth (annual)	6.0%	15.0%
Inflation Consumer Price Index (annual)	2.5%	8.0%
Nominal interest rate	3.5%	7.0%

- (i) Calculate the real interest rate in Philland and Faithland. [2]

- (ii) Comment on the relative strength and attractiveness of the currency in Philland as against the currency in Faithland, based on the real interest rate in each country. [2]

- (d) (i) The Malaysian Government Treasury Bills (MGTB) and Bankers’ Acceptance traded in Malaysia are examples of discounted instruments.

What is a “discounted instrument”? [2]

- (ii) Norshah Bank, a Principal Dealer of SSTS Securities in Malaysia, tendered for a new issue of 91 days MGTB of nominal issue size of RM1.0billion at the following tender amount and rates:

- RM50million at 2.800% per annum
- RM50million at 2.805% per annum
- RM100million at 2.810% per annum
- RM50million at 2.815% per annum

As a Principal Dealer of SSTS Securities, what would be the minimum tender amount that Norshah Bank is obliged to tender on tender date? [2]

- (iii) If the tender results for this new MGTB issue are as follows:

Lowest rate accepted	2.795% per annum
Highest rate accepted	2.810% per annum
Average rate accepted	2.807% per annum
Cut-off	25% allocation

- (aa) What is the nominal amount that Norshah Bank would receive on its successful tender? [2]

- (bb) What is the total settlement proceeds that Norshah Bank has to pay for the successful tender? [2]

- (e) In money market terminology, what do you understand by the terms:
- (i) Tom/next fund? [2]
  - (ii) Eligible value date? [2]
- (Total:20 marks)

5. (a) Under normal circumstances, most currency yield curves tend to be positive.
- (i) Explain what is meant by a “positive yield curve”. [2]
  - (ii) Give **two** reasons why yield curves tend to be positive under normal circumstances.[2]
  - (iii) If a yield curve is expected to remain steeply positive for a long period of time, what gapping strategy should a bank pursue to optimise profits? Explain your answer with a graphic illustration of the profit dynamics and risks involved in such a strategy. [4]
- (b) The following is the comparison between the standard market quotation for a three-month deposit as against CUTIE Bank’s quotation for a similar tenor deposit:

	<b>Bid</b>	<b>Offer</b>
Standard market quotation	3.0%	3.5%
CUTIE Bank’s quotation	3.3%	3.8%

- (i) What can you say about CUTIE Bank’s transaction preference from the quotation shown above? [1]
  - (ii) What is CUTIE Bank’s expectation of the trend of future interest rates from the quotation shown above? [1]
  - (iii) If SCRUFFY Bank decides to borrow RM10million, who should SCRUFFY Bank borrow from and at what rate in order to minimise the cost of borrowing? [2]
  - (iv) After closing the transaction in (iii), what two-way quote can SCRUFFY Bank now quote to the market for a three-month deposit to at least break-even assuming a bid/offer spread of 30 basis points in its quotation? [2]
- (c) LQP Bank bought RM10million nominal value of Malaysian Government Securities (MGS) with a remaining tenor of **three** years from the secondary market at a clean price of 99.20. The MGS carries a coupon of 5.35%.
- (i) Based solely on the information provided above, comment on the level of the 3-year interest rate compared to the coupon rate. [2]
  - (ii) Calculate the total settlement proceeds that LQP Bank would have to pay if the settlement date was 70 days since the last coupon payment date and the coupon period in which the settlement takes place is 182 days. [2]
  - (iii) Following LQP Bank’s purchase of the MGS, Bank Negara Malaysia announced a drop in the official intervention rate for interest rates. The MGS price rallied to 99.80-100.10.
- If LQP Bank decides to sell all the MGS it had purchased for the same settlement date to the market, at which price can LQP Bank sell the MGS and what would be LQP Bank’s gain/loss be on this transaction? [2]
- (Total:20 marks)

6. (a) State **two** advantages of Negotiable Certificates of Deposits to the issuing bank. [2]
- (b) For each of the following, state **two** risks that a local bank would be taking if it decides to:
- (i) enter into a 2-year USD/MYR10million fixed forward delivery contract with a local corporate customer. [2]
  - (ii) enter into a 6-month fixed forward delivery contract in an exotic currency that is not commonly traded in the foreign exchange markets with a local bank of a country in Africa. [2]
- (c) The following treasury products are used for investment, speculative or hedging purposes:
- (i) Deposits or Straight Placements (DEPOs)
  - (ii) Currency swaps
  - (iii) Currency options
- Explain briefly how and when you would use each of the above products. [9]
- (d) As a newly appointed treasurer of a local public listed company with worldwide operations, you are required to submit a report detailing the effective management of currency risk for your company.
- Describe briefly the **four** main areas you would cover in your report. [5]
- (Total:20 marks)

## **OUTLINE ANSWERS**

### **Question 1**

Most parts of the question were well answered, with the exception of some candidates who could not differentiate between the Central Bank's and other banks' money market operations when listing down the areas of banks' money market operations.

1. (a) (i) Currency exchange is the exchanging of one currency for another (buying and selling of currency). Currency speculation refers to trading in currency to make a quick profit.
- (ii) Higher interest rates attract foreign investors in search of higher returns. The resulting flow of money in or out of a nation's economy will affect the value of that nation's currency.
- (b) (i) It is a deal concluded today and actual delivery will take place on a fixed future date.
- (ii) When the transaction date is certain and they want to "lock in" their cost or protect the present value of a particular currency from exchange rate volatility.
- (c) (i) Disappointing reports – suggest slowdown in economy – possible lowering of interest rates, stock market decline, loss of investors' confidence, etc. which may in turn affect the demand for the USD.
- (ii) Although the jobber may be affected by the big swing in intraday trading, the positioner is most likely to be affected by the USD sinking to a multiyear lows due to the big position, which he normally holds.
- (iii) To bring about the desired level of JPY – in line with economic/monetary policies.
- (iv) Same – as there is no interest rate differential.
- (d) (i) Areas of banks' money market operations:
  - Trading in short-term "offshore" and domestic deposits
  - Trading of short-term debt instruments
  - Trading in FX swaps
  - Trading in short-term interest rates derivatives
- (ii) Qualities of a good foreign exchange quotation:
  - Quickness to respond to a price request
  - The FX price spread
  - Honouring the amount requested
- (e) (i) ECM 3 – External Accounts
- (ii) ECM 9 – Investments Abroad
- (iii) ECM 13 – Import and Export of Currency Notes, Bills of Exchange, Exchange Policies, etc.

**Question 2**

Most candidates performed well for this question. Candidates who did not show the full working of their calculations (as required by the question) lost valuable marks. However, there were also a few candidates who showed the workings but did not state the correct option rates.

2. (a) GBP/USD value spot = 1.6120
- (b) USD/SGD value spot = 1.7300
- (c) GBP/MYR value 1-month fixed =  $(3.7995 + 37) \times (1.6110 - 40) = 6.1117$
- (d) GBP/MYR value spot =  $(3.8005) \times (1.6120) = 6.1264$
- GBP/MYR value 1-month =  $(3.8005 + 52) \times (1.6120 - 30) = 6.1233/4$
- Option rate = spot rate = 6.1264
- (e) SGD/MYR value 1-month =  $(3.8005 + 52) \times (1.7290 + 10) = 2.1998$   
SGD/MYR value 2-month =  $(3.8005 + 94) \times (1.7290 + 20) = 2.2009/10$
- Option rate = 2-month = 2.2009/10
- (f) SGD/MYR value 3-month =  $(3.7995 + 123) / (1.7300 + 45) = 2.1976$
- (g) USD/MYR value spot = 3.7995  
USD/MYR value 2-month =  $3.7995 + 123 = 3.8118$
- Option rate = spot rate = 3.7995
- (h) SGD/MYR value 4-month =  $(3.8005 + 188) / (1.7290 + 45) = 2.2032$   
SGD/MYR value 5-month =  $(3.8005 + 230) / (1.7290 + 65) = 2.2031$
- Option rate = 4-month = 2.2032
- (i) USD/MYR value today = 3.7991/3.8005
- (j) Bank D

**Question 3**

This question was also well answered, except for part (d)(ii) which required calculations and advanced understanding of the concepts and applications of swaps. Many candidates were not able to apply the correct formula to derive the answers.

3. (a) (i) Spot = 11/4  
(ii) Tom = 10/4  
(iii) 1-month = 11/5  
(iv) 1-month to 2-month option = 11/5 to 11/6  
(v) 3-month = 11/7
- (b) Interbank Dealer A
- |               |   |
|---------------|---|
| Bought at     | 118.00  |
| Sold at       | 118.45  |
| Profit        | = 45 points   |
| Profit in JPY | = $5,000,000 \times 0.45 = \text{JPY}2,250,000 \times 3.8000/118.45 = \text{MYR}72,182.35/36$ |

Interbank Dealer B

Bought at 1.3810  
Sold at 1.3880  
Profit = 70 points  
Profit in CHF =  $3,000,000 \times 0.0070 = \text{CHF}21,000 \times 3.8000/1.3880 = \text{MYR}57,492.79/80$

Interbank Dealer C

Bought at 1.0040  
Sold at 1.0090  
Profit = 50 points  
Profit in USD =  $3,000,000 \times 0.0050 = \text{USD}15,000 \times (3.8000 \times 1.004) = \text{MYR}57,228$

Answer = Interbank Dealer A = MYR72,182.35/36

- (c) (i) One day funds
- (ii) Assume that transaction date is Monday, 7 April 2003. An O/N USD deposition transaction will be for value 7 April 2003 to 8 April 2003. In this instance, the fund flow is effected for value the same day as the transaction date and the principal plus accrued interest will be received or paid the next day.
- (d) (i) Swap Points =  $\frac{\# \times \text{Spot rate} \times \text{Days}}{36000}$ , where # = interest differential
- 6-month swap points =  $\frac{(3.00 - 4.50) \times 3.8000 \times 181}{36000}$   
= 0.0286 or 0.0287
- (ii) Borrow USD 1 million and convert into MYR at 3.7995  
Cover forward @ 3.8005 + 275 = 3.8280  
Differential = 285

Using the formula

$$\begin{aligned} \text{Interest Rate Differential} &= \frac{\text{Swap points} \times 36000}{\text{Spot rate/Forward rate} \times \text{days}} \\ &= \frac{0.0285 \times 36000}{3.8280 \times 181} = 1.48\% \end{aligned}$$

$$\begin{aligned} \text{Borrowing Cost in MYR} &= \text{USD interest rate} + \text{Interest rate differential} \\ &= 3.00 + 1.48\% = 4.48\% \end{aligned}$$

The cost is lower than the 4.5% MYR interest earned, hence it is profitable.

#### Question 4

- Candidates were able to differentiate between “offshore money markets” versus “domestic money markets” as well as “real” versus “nominal” interest rates.
- However, candidates’ understanding of discounted instruments and calculations of Malaysian Government Treasury Bills proceeds was average.
- Most candidates did not understand the concepts of eligible value dates and forward dated money market funds.
- Calculation questions were poorly attempted, and candidates also tend to regurgitate facts with little understanding on the subject matter.

4. (a) An offshore money market is a market where dealers borrow and lend deposits outside their country of origin.

The difference between the offshore market and the domestic market is that in the offshore market, the offshore deposits or Eurodeposits are not subject to regulatory reserve requirements unlike domestic deposits.

- (b) Investors are more interested in the real interest rates as these take into account the investors’ real returns after factoring the rate of inflation. The difference between the two rates can best be summarised by the following equation:

$$\text{Real Interest Rate} = \text{Nominal Interest Rate} - \text{Inflation Rate}$$

- (c) Real Interest Rate = Nominal Interest Rate - Inflation Rate
- |                                 |   |             |
|---------------------------------|---|-------------|
| Real Interest Rate in Philland  | = | 3.5% - 2.5% |
|                                 | = | 1.0%        |
| Real Interest Rate in Faithland | = | 7.0% - 8.0% |
|                                 | = | -1.0%       |

The currency in Philland has a positive 1.0% real interest rate while that in Faithland has a negative 1.0% real interest rate. As such, the currency in Philland should have a higher relative strength and attractiveness compared to the currency in Faithland due to its higher real interest rate.

- (d) (i) A discounted instrument is an instrument where the discount is paid or received upfront and the face value or nominal value of the instrument is paid on maturity date of the instrument.
- (ii) A Principal Dealer of SSTS Securities is obliged to tender for at least 10% of the issuance size of an SSTS issue.

With an issuance size of RM1.0billion, Norshah Bank is therefore obliged to tender for a minimum amount of RM1000 million x 10% = RM100million

- (iii) (aa) Norshah Bank will be successful as follows:
- |   |   |               |
|---|---|---------------|
| At 2.800%                               | = | RM50 million  |
| At 2.805%                               | = | RM50 million  |
| At 2.810%, 25% allocation for RM100mil. | = | RM25 million  |
| Total nominal amount                    | = | RM125 million |
- (bb) Total Settlement Proceeds
- $$\begin{aligned} &= \text{RM}50,000,000 \times (1 - (2.800\% \times 91/365)) + \\ &\quad \text{RM}50,000,000 \times (1 - (2.805\% \times 91/365)) + \\ &\quad \text{RM}25,000,000 \times (1 - (2.810\% \times 91/365)) \\ &= \text{RM}49,650,958.90 + \text{RM}49,650,335.61/62 + \text{RM}24,824,856.16 \\ &= \text{RM}124,126,150.67/68 \end{aligned}$$

- (e) (i) A tom/next fund is usually a one-day placement or borrowing where both parties transact the T/N deal on transaction date, but the actual movement of funds (principal payment) takes place only on the next day (i.e. tom or tomorrow) and the repayment (principal plus accrued interest) value the following day (i.e. next day from tomorrow).
- (ii) An eligible value date is defined as a good business day in the country of the currency that is being transacted. A good business day is day whereby it is not a holiday in the country of the currency that is being transacted and would exclude Saturdays and Sundays in most countries.

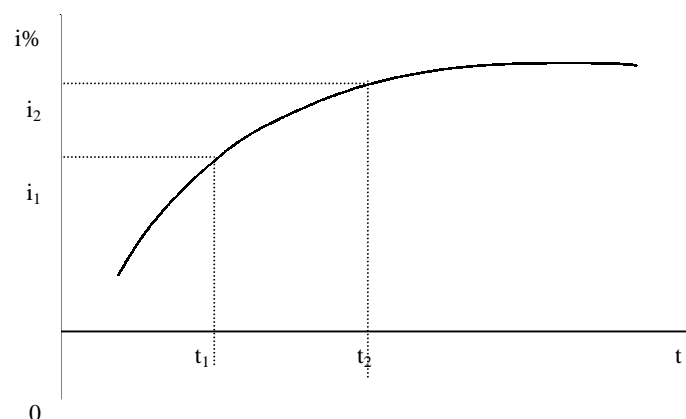
#### **Question 5**

- Most candidates were able to write about “positive yield curves” but showed little understanding of the concept. Answers for negative gapping strategy lacked depth and candidates were not able to explain clearly the risks involved under such a strategy.
- Poor answers were given for the question on market quotations for money market transactions.
- The answers given for the question on Malaysian Government Securities showed that the candidates did not understand the relationship between bond prices, coupon rates and yields.

5. (a) (i) A positive yield curve is an upward sloping yield curve where the interest rates on the longer tenors are higher than the interest rates on the shorter tenors.
- (ii) Under normal circumstances, yield curves tend to be positive for the following reasons:
- The perceived higher credit risk arising from a longer tenor maturity versus a shorter tenor maturity requires the payment of a risk premium for the longer tenor maturity.
  - The expectation of an increase in inflation rates in the future could add a further premium to longer tenor maturities.
  - The mathematical “compounding effect” of interest rates means that longer tenor maturities will fetch higher interest rates than shorter tenor maturities.
- (iii) The gapping strategy to pursue to optimise profits under a steeply positive yield curve that is expected to stay for a long period of time would be a negative gapping strategy, i.e. lending long and borrowing short.

From the illustration below, a bank will lend  $t_2$  at  $i_2\%$  and borrow  $t_1$  at  $i_1\%$ , making a spread of  $i_2\% - i_1\%$ . If the shape of the yield curve does not change until maturity of  $t_2$ , the same spread can be maintained by repeatedly refunding the lending with shorter-end borrowings at lower interest rates till maturity.

The risks involved in carrying out this strategy are interest rate risk, i.e. in this case the risk that interest rate may rise and liquidity risk, i.e. the risk that due to tight money conditions, the bank may not be able to borrow to fund the longer term lending.



- (b) (i) CUTIE Bank's transaction preference would be as a bidder for deposits rather than as an offerer as its bid price of 3.30% is 30 basis points higher than the market standard bid of 3.00%.
- (ii) CUTIE Bank's quotation trend is towards the right, i.e. towards a higher level of interest rates as both its bid and offer prices are higher than the standard market quotation indicating it expects interest rates to move higher.
- (iii) SCRUFFY Bank should borrow from the cheapest offerer, i.e. the standard market quotation whose offer rate is 3.5%.
- (iv) As SCRUFFY Bank is now long RM10.0million at 3.5%, the bank can safely quote an offer price of 3.5% with a bid price of 3.5% minus 0.3% i.e. 3.2%. The two-way quote by SCRUFFY Bank will now be 3.2% - 3.5%.
- (c) (i) As the MGS is trading at a price of 99.20, i.e. below the par value of 100.00, the 3-year interest rate is trading at a rate higher than the coupon rate of 5.35%.
- (ii) Settlement Proceeds  
 $= (\text{Nominal value} \times \text{market price}/100) + [(\text{Nominal value} \times \text{Coupon rate}/2) \times (\text{number of days since last coupon date})/(\text{number of days in coupon period})]$   
 $= (\text{RM}10,000,000 \times 99.20/100) + [(\text{RM}10,000,000 \times 5.35\%/2) \times 70/182]$   
 $= \text{RM}9,920,000 + \text{RM}102,884.61/62$   
 $= \text{RM}10,022,884.61/62$
- (iii) LQP Bank will sell all the RM10million nominal value MGS to the market at the market bid price of 99.80.

LQP Bank will make a gain of  $\text{RM}10,000,000 \times (99.80 - 99.20)/100 = \text{RM}60,000.00$

#### Question 6

- Instead of stating specifically the advantages of NCDs, the risks faced a bank in fixed forward delivery contract, and the main areas of effective management of currency risk, as required by the questions, candidates wrote very general answers.
- Candidates were also not able to explain how and when to use the treasury products, and the answers were superficial as candidates lacked clear understanding of the products.

6. (a) Advantages of Negotiable Certificates of Deposits (NCDs) to the issuing bank:
- An additional source of "wholesale" short term funds
  - Such funds are "committed"
  - Relative cheap source of short term funds
  - Able to control its funding requirements
  - If issued to non-banks, need not utilise the money market lines that other banks have for them.
- (b) Some of the potential risks are:
- (i)
- Credit risk – non-delivery
  - Liquidity risk – unable to hedge in the local market
  - Interest Rate risk
- (ii)
- Country risk
  - Liquidity risk
  - Currency risk

- (c) (i) Deposits or Straight Placements (DEPOs)
- DEPOs are interbank deposits where money is placed by an approved interbank institution with another approved interbank institution for a fixed period of time at a contracted rate
  - Use as “interbank lending”; e.g. institution with excess funds will place out this funds with other institutions
  - Use for “large” placement, e.g. RM5million standard amount
- (ii) Currency swap
- An agreement to exchange interest payments in one currency for interest payments in another currency. In addition, principal amounts are usually exchanged at an agreed exchange rate at the beginning of the swap and re-exchanged at the same rate at maturity. Settlement of interest can be on a fixed or floating basis.
- Used for interest rate and currency management e.g. reduce interest rate and currency risk
  - Used to reduce funding costs, e.g. take advantage of interest differentials
- (iii) Currency options (calls and puts)
- A call option contract gives the holder the right, but not the obligation to buy a commodity at a mutually agreed price (strike price) on or before the expiration date. Whereas, a put option gives the holder the right, but not the obligation, to sell at the strike price, on or before the expiration date.
- Used for hedging purposes, e.g. to protect against unfavourable movement in foreign exchange rates while benefiting in total from favourable movements
  - Used for trading – trade “significant” volume in attempting to make profit from movements in the underlying assets
- (d) Effective Foreign Exchange Risk Management.
- Definition of an organisation’s overall risk management objectives
  - Identification of the various exposure risks
  - Decision to centralise or decentralise risk management
  - Implementation of the necessary control and systems.

Candidates are expected to give a brief definition of each of the above points.