Chapter 1 : Introduction

The world is becoming smaller with the advancements and innovations in telecommunication technologies. Political economic and social trends criss-cross the globe with less and less regard for national borders. Countries are increasingly becoming integrated with these developments. This integration phenomenon is also taking place in the financial environment in which investors and corporations operate. Another significant phenomenon that is apparent in the financial markets around the globe is the continuing deregulation of these markets. More and more countries are deregulating their financial markets for purpose of efficiency.

One effect of theses changes in the financial markets Is increased volatility in these markets. With the phenomenally strong economic growth of the Asia-Pacific region, the move towards industrialisation among the region's developing economies has created an upsurge in the demand for capital and an inevitable need for risk-management facilities. Investors and corporations will want to manage their risk exposures and exchange-traded derivatives instruments that provide for efficient, transparent and regulated risk-transfer.

Financial futures and options, alternatively known as financial derivatives, render possible a vast variety of strategies for managing financial risk with the intention to reducing the exposure - in other words, hedging. For example a company has a project to finance six months from now, it is possible that in six months time the interest rate in which it can borrow at may have risen As a result , the company may faced with higher than expected borrowing cost in six months time if it cannot purchase an instrument that allowed it to borrow at a predetermined rate now. An interest derivative product will allow this company to lock in the rate now and avoid the risk of incurring higher interest cost if the interest rate in fact moves higher in six months time. Likewise, a portfolio manager may anticipate that the stock market is bearish in the near future. Rather than letting its portfolio value diminish if the market is in fact bearish, the portfolio manager can hedge the portfolio through an equity derivative product.

After years of planning and preparatory work and in line with the Malaysian government's aim to establish Kuala Lumpur as the Asia-Pacific region's premier financial centre, the timing certainly right as expectations run high with much more demand than supply of corporate memberships available in the two new exchanges established for financial derivatives : the Malaysia Monetary Exchange (MME) and the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE). Both exchanges will offer mutually-exclusive product categories with MME focusing on interest rate and currency products and KLOFFE on equity products.

The Kuala Lumpur Options & Financial Futures Exchange ("KLOFFE" or the "Exchange") is set to play a key role in the development of Malaysia's financial markets. The KLOFFE Berhad was initiated to introduce and develop financial derivatives in Malaysia for domestic and international investors, both retail and institutional. This is in recognition of the importance and usefulness of derivatives products as investment avenues as well as risk management instruments. Malaysia's first stock index futures contract, the KLSE CI futures contract, was successfully launched by KLOFFE on 15 December 1995. Malaysian Monetary Exchange Bhd (MME), a wholly owned subsidiary of the Kuala Lumpur Commodity Exchange (KLCE) was incorporated on 19 August 1992, to spearhead KLCE's diversification programme into financial futures.

MME operates under the jurisdiction and supervision of the Securities Commission (SC) and is governed by Futures Industry Act(FIA) 1993, thus offering investors the security of trading on a regulated Exchange. The trading and settlement system and procedures of MME are proven and meet international standards for operational efficiency and financial prudence. MME plans to launch a range of financial products. Initially, the products will be as follows:-

- Three-month KLIBOR Futures
- Bond/Bond Index Futures
- Currency Futures
- Options on Futures

Derivatives trading in Malaysia can be expected to become more active when Bank Negara introduces regulations for this activity. The Banking and Financial Institutions (Amendment) Bill 1996 passed on 25 April 1996 at the Dewan Rakyat enables the Central Bank; i.e. Bank Negara of Malaysia (BNM) to establish such regulations. "The amendments are aimed at ensuring the growth of a international banking regime that is in line with developing a domestic and international financial system." (Deputy Finance Minister Datuk Wong See Wah.,1996)