

# **CENTRAL REINSURANCE CORPORATION**

## **Procedures for Transaction of Financial Derivatives**

### **Article 1**    Accordance

The Procedures are set forth in accordance with the provisions of Article 12 of the “Regulations Governing Derivatives Transactions Conducted by Insurance Companies” and Paragraph 3 of Article 7 of the “Regulations Governing the Acquisition and Disposal of Assets by Public Companies”.

### **Article 2**    The Types of Derivatives That May be Traded

The term “financial derivatives” as used herein shall mean any forward contracts, option contracts, futures contracts, leveraged margin trading contracts, swap contracts, and the combination thereof with a worth derived from traditional financial market tools, including currency, bond, stock and foreign exchange.

“Transactions of structured products” mean transactions of portfolios combining fixed-income instruments and derivatives issued or guaranteed by financial institutions.

The Company may engage in the above mentioned derivatives transactions for hedging purpose, structured products and any other tools approved by the competent authority. The Company may not engage in derivatives transactions for anticipated investment positions and enhancing the investment efficiency.

### **Article 3**    Operating and Trading Strategies

The operating strategies for financial derivatives transactions are as follows:

1. To set the total amount of derivatives contracts that may be traded.
2. To conduct performance evaluation of financial derivatives periodically.
3. To strictly evaluate the credit situation and professional competence of counterparties of financial derivatives and issuers or guarantee institutions of structure products.
4. All the transactions and relevant operation shall be in accordance with the “Insurance Act” and the relevant regulations.

**Article 4** Authority Limits and Responsible Management Level

1. Derivatives transactions shall be guided in accordance with the Company's table governing the delegation of authority and responsibility.
2. The board of directors authorizes the Chairman to determine the total amount of financial derivatives transactions.

**Article 5** Segregation of Duties

Division functions in regard to the financial derivatives transactions made by the Company shall be as follows:

1. Monitoring Division:

- (1) Board of Directors: Designate senior management personnel to pay continuous attention to monitoring and controlling financial derivatives trading risk. Periodically evaluate whether derivatives trading performance is consistent with established operational strategy and whether the risk undertaken is within the Company's permitted scope of tolerance.
- (2) Senior management personnel authorized by the board of directors: Periodically evaluate the risk management measures currently employed are appropriate and are faithfully conducted in accordance with the Procedures. When irregular circumstances are found in the course of supervising trading and profit-loss circumstances, appropriate measures shall be adopted and a report immediately made to the board of directors, where an independent director shall be present at the meeting and express an opinion.
- (3) The Audit Division: Periodically audit the compliance of the Procedures for Derivatives Transactions as well as of the relevant laws and regulations.

2. Operating Divisions:

- (1) The Investment Department: conduct financial derivatives transactions.
- (2) The Finance Department: conduct settlement and confirmation of financial derivatives transactions, and periodical evaluation as well as risk assessment, monitoring and control.
- (3) The Accounting Department: conduct accounting and book keeping procedure.

**Article 6** Gross Contract Amount and The Maximum Loss Limit

Where the derivatives are held for hedging purpose, the aggregate nominal value of

total and individual contracts thereof shall not exceed the individual and aggregate book value of the hedged items. The maximum evaluation loss limit of derivatives shall not exceed the aggregate nominal value of the individual and total undue hedged items.

If the evaluation loss exceeds the preceding limit, the Investment Department shall submit senior management personnel a report with reasonable analysis, suggestion, and improvement measures.

Structured products fulfilled with the following conditions are allowed to be invested and the aggregate amount shall not exceed 10% of the Company's funds:

1. The final maturity date shall be no longer than 10 years;
2. The principal-guaranteed rate on the maturity date shall be 90% equivalent or above provided that the final maturity date is no longer than 5 years, or the aforesaid principal-guaranteed rate shall be 100%;
3. The operational risk relating to the underlying derivatives instruments shall be borne by the issuing institutions.

#### **Article 7** Counterparties and Each Transaction Limits

Derivatives transactions counterparties shall meet the following requirements:

1. Domestic financial institutions with their risk-based capital ratio, ratio of regulatory capital to risk-weighted assets, regulatory capital adequacy ratio, or the percentage accounted for by adjusted net capital in the total amount of customer margins required for the open positions of futures traders meeting regulatory criteria.
2. Foreign financial institutions with BBB+ equivalent or above credit rating suggested by foreign credit rating agencies in the immediately preceding year.

Where conducting derivatives transactions in the OTC market, different transaction limits are designated according to counterparty's credit positions as follows:

1. The transaction maximum limit is 200 million US dollars for the counterparty with twAAA credit rating suggested by Taiwan Ratings Corp. or a AA-equivalent or higher credit rating suggested by internationally renowned rating agencies.
2. The transaction maximum limit is 150 million US dollars for the counterparty with twAA- equivalent or higher credit rating suggested by Taiwan Ratings Corp. or a A- equivalent or higher credit rating suggested by internationally renowned rating agencies.

3. The transaction maximum limit is 70 million US dollars for the counterparty with twA+ equivalent or higher credit rating suggested by Taiwan Ratings Corp. or a BBB+ equivalent or higher credit rating suggested by internationally renowned rating agencies.
4. The transaction maximum limit is 30 million US dollars for the counterparty with credit rating below the requirements in previous 3 subparagraph but meet the qualifications in paragraph 1.

The issuing or guarantee institutions of structure products shall be the domestic and foreign financial institutions meeting the requirements in this article paragraph 1 and the trading limits for each counterparty shall follow the regulations in this article paragraph 2.

The selection and evaluation criteria of the collateral management agency:

1. Qualifications:

- (1)The capital or net worth of the immediately preceding year is ranked within the top 500 banks in the world.
- (2)The long-term debt credit rating of the immediately preceding year has been assessed as A- or equivalent level by foreign credit rating agencies.

2. The selection and evaluation items and procedures of the collateral management agency:

The Company shall prepare the assessment reports regarding the credit status, the size of the assets, the provision of services, the rationality of charge rate, the safety of the assets and the soundness of the delivery process of the collateral management agency subject to the preceding subparagraph. The reports shall be submitted to the Department Compliance Supervisor and Financial Risk Control unit. All of the reports and relevant recommendations should be documented for auditing thereafter. The relevant contracts should be submitted to Legal & Compliance Department and signed in the name of the Company. Finance Department shall evaluate the collateral management agency periodically.

3. The signing and amendment of the contracts with the collateral management agency and the change of the authorized persons shall be subject to the approval of the Chairman. The contracts for managing collateral reception and delivery activities shall contain the following requirements:

- (1)The authorized scope of the collateral management agency and the manner in which the authorization and change of the authorized person of the Company

are informed.

- (2) The services provided by the collateral management agency.
- (3) The responsibility and the obligations of a good administrator of the collateral management agency.
- (4) The confidentiality obligations of the collateral management agency.
- (5) The calculation of custodian fee and the way of receipt and delivery.
- (6) The termination of the contract.
- (7) Dispute handling, breach of the contract and its liability, litigation jurisdiction and applicable laws.
- (8) The mechanism of the firewall between the unit responsible for the collateral management business in the collateral management agency and the unit of the financial derivatives trading business in the Company.
- (9) The competent authority may designate persons or order the Company to entrust an accountant or other professional personnel to check the execution status of the collateral management agency in accordance with the contract. The collateral management agency shall not reject the investigation about the relevant matters.

#### **Article 8** Transaction Procedure and Department in Charge

The operation procedures of Investment Department shall be as follows:

1. To confirm the transaction position.
2. To analyze and determine the relevant trend.
3. To determine the hedge method based on the specific investment target, counterparties, targeted price range and trading strategies.
4. To obtain the approval of transactions.
5. To execute transactions:
  - (1) Counterparty: Discreetly evaluate the counterparty's management performance, financial status and professional competence and obtain the Chairman's approval in advance.
  - (2) Dealers: Dealers executing financial derivatives transactions shall get the Chairman's approval in advance. Counterparties shall be informed that the persons who are not in the Company's Letter of Authorization are prohibited from trading.

The operation procedures of Finance Department shall be as follows:

- (1)Confirmation: The confirmation personnel shall confirm with the counterparty whether the transaction terms are in accordance with deal notice and obtain relevant supervisory ratification.
- (2)Settlement: Once the trade is confirmed correctly, the settlement personnel shall perform the delivery on settlement date.
- (3)Risk management: the personnel responsible for the risk management is in charge of identification, assessment, monitoring and reporting of transaction risks.

#### **Article 9** Performance Evaluation

The performance of derivatives transactions shall be evaluated based on the Company's hedging strategies.

#### **Article 10** Public Disclosure

The Accounting Department shall compile monthly reports on the status of derivatives trading engaged in up to the end of the preceding month and enter the information in the prescribed format into the information reporting website designated by the Financial Supervisory Commission(hereinafter referred to as "FSC") by the 10th day of each month.

When losses from derivatives trading reaching the limits set out in the Procedures, the Finance Department shall publicly announce and report the relevant information on the FSC's designated website two hours before the beginning of trading hours on the next business day following the date of occurrence of the event.

#### **Article 11** Accounting system

The Accounting system of financial derivatives transactions shall be set forth in accordance with "Rules for the Preparation of Financial Reports by Insurance Institutions" and the "Generally Accepted Accounting Principles".

#### **Article 12** Risk Management System

The risk identification, assessment, response, monitoring and reporting of financial derivatives transactions shall be done according to the Company's "Operation Guidelines for Investment Risk Management". These risks as below shall be noted:

1. Credit Risk: Credit risk is controlled by restricting the counterparties principally to those who have banking relationship with the Company or are internationally renowned and can provide professional information.
2. Market Risk: Market risk arising from the fluctuations of interest rates and foreign exchange rates or from other factors shall be closely monitored and controlled.
3. Liquidity Risk: Liquidity risk shall be controlled by restricting counterparties to those who have adequate facility, sufficient information, and sizable trading capacity and capability to enter into transactions in any markets around the world. The financial derivatives transactions shall be restricted to standardized products that are listed in internationally notable exchanges or traded over the banks' counter.
4. Operational Risk: Authority limits and operating procedures shall be stipulated explicitly to avoid operational risk.
5. Legal Risk: Any legal documents, except standard contracts of banks, shall first be reviewed by legal personnel or legal counsel and be executed after going through administrative approval procedures.
6. System Risk: The Company shall execute the stop loss mechanism of financial derivatives transactions.
7. Cash Flow Risk: The Company shall maintain adequate level of cash to meet the cash settlement requirement in time.

### **Article 13** Risk Control Measures and Internal Control System

Risk control measures and internal control system taken by the Company for financial derivatives transactions shall be as follows:

1. Personnel engaged in derivatives trading may not serve concurrently in other operations such as confirmation and settlement.
2. Evaluation method and frequency: Finance Department shall evaluate the financial derivatives positions regularly in accordance with the "Regulations Governing Derivatives Transactions Conducted by Insurance Companies". The evaluation reports shall be submitted to senior management personnel authorized by the board of directors and the president. The evaluating method shall be in accordance with "Rules for the Preparation of Financial Reports by Insurance Institutions" and the "Generally Accepted Accounting Principles".
3. With regard to risk identification, assessment, monitoring and control, legality of derivatives transactions, Finance Department shall periodically submit a

performance report to the senior management personnel authorized by the board of directors.

4. Finance Department shall report to the board of directors and the Risk Management Committee at least once every six months including total and net amount of contracts with the obligations which have not become due as well as unrealized gain or loss evaluated in accordance with the fair value, compliance with the Procedures, the performance and risk assessment reports on the financial derivatives transactions.
5. Finance Department shall regularly make the confirmation of the financial derivatives position and the evaluation, receipt and delivery, replacement, dispute settlement and interest management of the collateral provided by the collateral management agency. When the Company conducts the collateral management by itself, the Financial Department shall regularly evaluate the suitability of the financial derivatives position and the collaterals.
6. Finance Department shall establish a log book in which details of the types and amounts of financial derivatives trading engaged in, board of directors' approval dates, and the matters required to be carefully evaluated and retain it at least for 5 years for reference.
7. When irregular circumstances are found in the course of supervising trading and profit-loss circumstances, the senior management personnel authorized by the board of directors shall adopt appropriate measures and report to the board of directors. Independent directors shall be present at the meeting and express an opinion.

#### **Article 14** Internal Audit System

The Audit Division shall audit whether all derivatives transactions are in compliance with the Procedures at least once every quarter; and shall perform the following duties and prepare a quarterly audit report which shall be approved by the board of directors:

1. To audit the compliance of the processing procedure for Derivatives Transactions as well as the relevant laws and regulations;
2. To audit the internal control measures, including the functions of internal checks and cross reference;
3. To assess the independence of the risk management operations and implementation of the risk limitation measures;



4. To verify the reliability of the sources of transaction documents and information;  
and
5. To audit the hedging effectiveness of the hedging derivatives transactions.

The deficiencies mentioned in the audit report shall be continually followed up until improved. If any severe violation is found, a written notice shall be submitted to the Audit Committee as well as the senior management personnel authorized by the board of directors.

#### **Article 15** Supplementary Provisions

Any amendment of the Procedures and any transaction involving major derivatives shall be approved by more than half of all Audit Committee members and submitted to the board of directors for a resolution.

If approval of more than half of all Audit Committee members as required in the preceding paragraph is not obtained, the Procedures and the transaction involving major derivatives may be implemented if approved by more than two thirds of all directors, and the resolution of the Audit Committee shall be recorded in the minutes of the board of directors meeting.

The terms "all Audit Committee members" in paragraph 1 and "all directors" in paragraph 2 shall be counted as the actual number of persons currently holding those positions.

When the Procedures and a financial derivatives transaction are submitted for discussion by the board of directors, the board of directors shall take into full consideration each independent director's opinions. If an independent director objects to or expresses reservations about any matter, it shall be recorded in the minutes of the board of directors meeting.

#### **Article 16** Outstanding Issues

Any matter or event not mentioned in the context of the Procedures shall be in accordance with "Regulations Governing Derivatives Transactions Conducted by Insurance Companies" and the "Regulations Governing the Acquisition and Disposal of Assets by Public Companies".

#### **Article 17** Effectiveness

Any amendment of the Procedures shall be approved by the Audit Committee, and

submitted to the Board of Directors for resolution, and then submitted to the Shareholders' Meeting for approval.

**The History of “Procedures for Transaction of Financial Derivatives”**

1. The Procedures was made on October 15, 2002.
2. The 1st amendment was made on June 15, 2007.
3. The 2nd amendment was made on June 15, 2011.
4. The 3rd amendment was made on June 13, 2013.
5. The 4th amendment was made on June 11, 2014.
6. The 5th amendment was made on May 27, 2015.
7. The 6th amendment was made on May 31, 2017.
8. The 7th amendment is made on May 30, 2018.