

Content

Title :	Regulations Governing Derivatives Transactions Conducted by Insurance Companies <b>Ch</b>
Date :	2007.08.29
Legislative :	1.Promulgated on August 29, 2007
Content :	<p>Article 1 These Regulations are formulated in accordance with the provisions of Paragraph 8 of Article 146 of the Insurance Act (hereinafter referred to as the "Act").</p> <p>Article 2 An insurance company ("insurer"), which intends to engage in the derivatives transactions for hedging purpose, shall submit an application together with the following documents to the competent authority for prior approval:</p> <ol style="list-style-type: none"><li>1. statement of law compliance;</li><li>2. Documents of authorization by the board of directors (governors) or other proper personnel;</li><li>3. Documents of proving that the personnel in charge of the aforementioned derivatives transactions have relevant working experience or specialized training;</li><li>4. Procedures for processing derivatives transactions; and</li><li>5. Important policies and procedures governing derivatives transactions and risk management.</li></ol> <p>Any addition or change to the documents specified in Subparagraphs 2 to 5 of the preceding Paragraph shall be reported to the competent authority for reference purpose.</p> <p>Article 3 The "derivatives transactions for hedging purpose" referred to in the preceding Article shall comply with the following provisions:</p> <ol style="list-style-type: none"><li>1. The hedged item is in existence and exposes the insurer to identifiable risk of loss;</li><li>2. The hedging derivatives transactions may reduce the risk of the hedged item and are specified for hedging the aforesaid item; and</li><li>3. When conducting the hedging transactions, where the underlying instrument of the hedging derivatives is different from the hedged item, such instrument and the hedged item shall be specified in a formal document, with a statement certifying the high correlation between them.</li></ol> <p>The "high correlativity" referred to in the preceding Subparagraph 3 means that with all the transaction records of the past three months or more as samples, the correlation coefficient with regard to the rate-of-change of price or rate of return between the underlying instrument of the hedging derivatives or the portfolio thereof is equivalent to 70% or above.</p> <p>Article 4 An insurer with the following qualifications and get approved from the</p>

competent authority may engage in the derivatives transactions for enhancing the investment efficiency :

1. The insurer's risk-based capital ratio is equivalent to 250 percent or above;
2. The value-at-risk calculation is performed every day to measure and manage the risk exposure of derivatives positions;
3. In the immediately preceding year, there are no major violations of performing the insurer's internal control procedure with regard to the use of funds, or the rectification of such violations have been done and get affirmed by the competent authorities;
4. In the immediately preceding year, the insurer has not been subjected to any major disciplinary actions, or the violations resulting in such disciplinary actions have been rectified and the rectification has been affirmed by the competent authorities; and
5. other eligible qualifications required by the competent authority.

The "value-at-risk calculation" referred to in Subparagraph 2 of the preceding Paragraph means that 10-day 99% VAR for the above position is required to be calculated either on a weekly basis for at least three years period or on a daily basis for at least one year period. On top of that, the aforesaid data shall be updated on a weekly basis and back testing of the above VAR shall be performed on a monthly basis.

The insurer intending to engage in the derivatives transactions for enhancing the investment efficiency shall submit the trading proposal which has got approved by the board of directors, together with the application form and the documents in support of the qualification provided in the first Paragraph of this article to the competent authority for getting a prior approval. The trading proposal shall record forth the following information:

1. Types of derivatives;
2. Restrictions on manipulation of derivatives;
3. the objects of investment efficiency enhancement and the way to assess its performance;
4. Mechanism with regard to risk-limit management, including the limit on total position, stop-loss strategies and the frequency of assessment etc.

Where the trading proposal mentioned in the preceding Paragraph is amended and get approved by the board of directors, it shall be submitted to the competent authority for reference purpose after it.

#### Article 5

The insurer which invests in the domestic securities in accordance with Article 146-1 of the Act or extends loans in accordance with Article 146-3 of the Act may, for hedging purpose, engage in the following derivatives transactions relating to the use of funds set forth above:

1. Call (put) warrants traded by Taiwan Stock Exchange Corporation or GreTai Securities Market;
2. Options or futures traded by Taiwan Futures Exchange Corporation;
3. Derivatives which the securities brokers are approved to trade over-the-counter;
4. Derivatives in which the banks are permitted or approved to engage; and
5. Such derivatives referencing to various underlying instruments which are offered by the domestic/overseas financial institutions with tWA-

equivalent or above credit rating suggested by Taiwan Ratings Corp. or other domestic/overseas credit rating agencies accredited by the competent authority in the immediately preceding year.

#### Article 6

The insurer which invests in the foreign securities in accordance with Article 146-4 of the Act and the Regulations Governing Foreign Investment by Insurance Companies may, for hedging purpose, engage in the following derivatives transactions relating to the aforesaid investment set forth above:

1. Overseas futures, in which the futures dealers are entitled to engage, as is announced by the competent authority according to Article 5 of the Futures Trading Act;
2. Such derivatives referencing to various underlying instruments which are traded by the domestic/overseas financial institutions with twA- equivalent or above credit rating suggested by Taiwan Ratings Corp. or other domestic/overseas credit rating agencies accredited by the competent authority in the immediately preceding year.

#### Article 7

An insurer may engage in the following derivatives transactions for enhancing the investment efficiency:

1. Call (put) warrants traded by Taiwan Stock Exchange Corporation or GreTai Securities Market;
2. Futures, in which the futures dealers are entitled to engage, as is announced by the competent authority according to Article 5 of the Futures Trading Act.

#### Article 8

The limits on the derivatives transactions for hedging purpose or enhancing the investment efficiency are listed below:

1. Where the derivatives are held for hedging purpose, the aggregate nominal value of the contracts thereof shall not exceed the aggregate book value of the hedged items.
2. Where the domestic or overseas derivatives are held for enhancing the investment efficiency, the aggregate nominal values of the contracts thereof shall not exceed 5% of the insurer's funds, among which the overseas position shall not exceed 3% of the insurer's funds. The aforesaid overseas derivatives shall be restricted to those derived from the overseas financial commodities only and without any derivatives transactions which based on the domestic securities, combination of securities, interest rates, exchange rates or indices involved in.
3. Where the derivatives are held for enhancing the investment efficiency and linked to single company, the aggregate nominal values of the contracts thereof shall not exceed 0.5% of the insurer's funds.

Where the following conditions are satisfied, the aggregate nominal values of the open long contracts and the open short contracts, held either for hedging purpose or for enhancing the investment efficiency as mentioned in the preceding paragraph, are allowed to be offset:

1. The derivatives are the futures or options derived from the same interest rates, securities, indices, or exchange traded funds.
2. The derivatives are derived from the interest rates highly correlated to price change or the interest rate swaps, futures or options of fixed-income

securities as are highly correlative in terms of the price fluctuations thereof, and no physical settlement shall be involved.

The "aggregate nominal value" referred to in the preceding Subparagraphs under Paragraph 1 means the product of the exercise price times the theoretical hedging ratio and the total number of open-interest positions in the case of a option contract, and the product of the principal of hedged item times the theoretical hedging ratio in the case of a interest rate swap contract.

#### Article 9

The aggregate nominal value of forwards, currency swaps, cross currency swaps and other exchange rate hedging transactions concerning the current foreign investment engaged in accordance with Regulations Governing Foreign Investment by Insurance Companies may be deducted from the limits prescribed in Article 8.

The " aggregate nominal value" referred to in the preceding Paragraph may be calculated as is provided in Paragraph 3 of the preceding Article.

#### Article 10

Structured products fulfilled with the following conditions are allowed to be invested by an insurer and the aggregate amount of such investment shall not exceed 10% of the insurer'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.

The issuing or guarantee institutions of the aforesaid structured products shall have a twA- equivalent or higher credit rating suggested by Taiwan Ratings Corp. or other domestic/overseas credit rating agencies accredited by the competent authority, in the immediately preceding year.

"Structured products" means structured deposits or bonds issued or guaranteed by the financial institutions featuring in being made up of a portfolio of fixed-income instruments and derivatives.

#### Article 11

When engages in derivatives transactions, the formulation and alteration of the processing procedure shall all be subject to the approval of the board of directors.

#### Article 12

The following information shall be involved in the processing procedure for derivatives transactions, and the formation and alteration of the abovementioned procedure shall be carried out with auditors, senior executives and relevant supervisors involved in:

1. Transaction principles and policies, including the types of derivatives transactions, major counterparties, hedging or investment strategies, overall and individual position limits;
2. operational procedure, including the responsible management level, department in charge, authority limits, division of powers and duties and transaction procedure;
3. Internal control system, including the risk identification and assessment, operation and management rules and regulations, transaction

- record keeping procedure, assessment method and frequency, irregularity reporting system;
4. Internal audit system, including internal audit framework, audit frequency, audit scope, audit report submission procedure and follow-up of improvement of deficiencies;
  5. Accounting system, including book keeping and entry processing procedure, recognition of profit and loss, and disclosures in financial statement;
  6. Risk management system, which shall include the identification, assessment, monitoring and reporting of transaction risks which shall at least include credit, market, liquidity, operational, legal and system risks.
  7. Counterparty risk, which requires that when conducting over-the-counter transactions, the insurer shall perform credit risk assessment on the counterparties and assign to individual counterparties different transaction limits according to their credit positions, and the transaction limits shall be subject to constant monitoring; and
  8. The items reported to the board of directors on a regular basis shall include total and net amount of contracts with the obligations which have not become due, compliance with the Procedure for Derivatives Transactions, performance and risk assessment reports on the transactions for hedging or for enhancing the investment efficiency. The insurer engaging in derivatives transactions for enhancing the investment efficiency shall report such information to the board of directors at least once a month.

#### Article 13

The board of directors of the insurer shall ratify the important policies and procedures concerning the derivatives transactions and risk management and perform review thereof at least annually, and shall appoint an senior executive to take responsibility to administer the derivatives transactions in accordance with the following principles:

1. the fulfilment of both the procedure for derivatives transactions and the regular review of the appropriateness thereof are actually being executed;
2. the appointment of the dealers, the authorization of each dealer's limits and the identification of each dealer's knowledge or professional training is sufficient enough are essentially his/her duties;
3. the supervision of transaction performance and the in-time reports to the board of directors concerning the abnormal profit and loss are carried out dutifully;
4. the assessment of the positions of the derivatives, as well as the evaluation of whether the performance is in keeping with the preset strategies for hedging or enhancing the investment efficiency and whether the risk exposure may undermine the financial soundness of the company performance are implemented on a monthly basis;
5. Where the derivatives transactions are for enhancing investment efficiency purpose, the reports of transaction performances are being prepared and submitted to the chairman of board and the general manager on a daily basis.

#### Article 14

The following principles concerning the risk management s of derivatives

transactions shall be obediently fulfilled:

1. An risk management department independent of the dealing department shall be established, and the personnel responsible for the risk management of derivatives transactions shall possess the professional competence in risk identification, assessment, monitoring and reporting and shall not hold any concurrent posts in the derivatives dealing department;
2. The functions of dealing, confirmation and settlement of derivatives transactions shall be performed by different personnel;
3. The risk-bearing capacity of the insurer's funds shall be taken into consideration when determining the risk management limits; and
4. The value of derivatives and the return thereof shall be assessed at fair market prices, and risk measuring methods shall be designed therefor.

#### Article 15

The audit department of the insurer shall perform the following duties and prepare a quarterly audit report which shall be passed by the board of directors and submitted to the competent authority for reference:

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.

#### Article 16

This Regulation shall come into force on the date of promulgation.