Procedures for the Handling of Derivative Transactions

Note: The original version of this regulation is published in Chinese. In case of discrepancy between the Chinese and English versions the Chinese version shall prevail.
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1.0 Purpose

These Procedures are adopted to strengthen management and risk control in derivative transactions.

2.0 Scope

2.1 The Corporation shall conduct derivative transaction operations in accordance with these Procedures.

3.0 Applicable documentation

3.1 The Regulations Governing the Acquisition and Disposal of Assets by Public Companies issued by the Financial Supervisory Commission.

3.2 The Corporation's Procedures for the Acquisition or Disposal of Assets (THSRC-BE2-000-004).

3.3 The Corporation's Procedures for the Handling of Public Announcements and Reporting over the Market Observation Post System (THSRC-BE2-000-023).

3.4 The Corporation's Rules Governing Rewards and Disciplinary Action (THSRC-BA2-000-003).

3.5 The Corporation's Operational Rules for Confirmation and Settlement of Derivative Transactions (THSRC-BE3-000-002).

3.6 The Corporation's "Internal Control System - Attachment VII, Investment Cycle" (THSRC-AM1-000-001).

3.7 The Corporation's "Chart of Functional Authorities and Responsibilities - Finance Division."

4.0 Definitions

4.1 Derivatives

Means forward contracts, options contracts, futures contracts, leverage contracts, and swap contracts whose value is derived from specific interest rates, price of financial tools, commodity prices, foreign exchange rates, price or pricing indices, credit ratings or credit indices, or other variables; a combination of the aforementioned contracts, or contracts including combinations of derivative goods or structured notes and so on. The term "forward contracts" does not include insurance contracts, performance contracts, after-sales service contracts, long-term leasing contracts, or long-term purchase or sales contracts.

4.2 Date of occurrence

With respect to a transaction, means the earliest of the date of signing of a transaction contract, date of payment, date of order execution, date of transfer, date of Board of Directors ("Board") resolution, or other date from which the transaction counterparty and transaction amount can
be determined, or, if the transaction is an investment requiring the approval of the competent authority, the earliest of the aforesaid dates or the date of receiving approval from the competent authority.

4.3 Positions

Means the total amount of outstanding derivative contracts.

4.4 Transaction personnel

Means derivative transaction operators, who are responsible for collecting information regarding derivatives and applicable laws and regulations, as well as formulating, recommending, and executing hedging strategies. The transaction personnel are appointed by the head of the Finance Department. Before the effective date of their appointment or removal, the fact shall be notified to all financial institutions with which the Corporation conducts transactions, so as to safeguard the rights and interests of the Corporation.

5.0 Authorities and responsibilities

a) The Finance Department under the Finance Division shall be responsible for the formulation, amendment, or repeal, and triennial review of these Procedures.

b) These Procedures, and any amendment or repeal hereof, shall be implemented after adoption at a shareholders' meeting.

c) All units and personnel involved in the execution of operations related to derivative transactions shall comply with the provisions of these Procedures.

6.0 Descriptions

6.1 Transaction principles and policy

6.1.1 Operational and hedging strategy

When the Corporation engages in derivative transactions and selects derivative products, it shall do so based on the principle of risk avoidance.

6.1.2 Scope of risk management

a) Credit risk management. A transaction counterparty shall be a creditworthy financial institution with which the Corporation transacts business.

b) Market price risk management. Keep watch on the potential influence of market price movement on the profit/loss of position holdings.

c) Liquidity risk management. Exercise liquidity risk management over transaction positions. In principle, select financial products with higher liquidity.

d) Cash flow risk management. Keep watch on cash flows to ensure sufficient funds for settlement.
e) Operational risk management. Follow the established operational processes to avoid operational risks.

f) Legal risk management. A contract (e.g., an ISDA Master Agreement, a master agreement for financial transactions, or a transaction agreement) shall be signed with the transaction counterparty, and before signing opinions from the legal division shall be sought to avoid legal risks.

6.2 Products and maximum amount limits

The eligibility of individual products and authorization limits on transactions of those products shall take effect after approval by the Chairman of the Board, and shall be submitted to the Board for review and recordation. In addition, to enable transaction counterparties to cooperate with the Corporation in its monitoring and management activities, a list of authorized transaction personnel shall be notified to the transaction counterparties.

6.3 Division of authorities and responsibilities

6.3.1 With respect to the conduct of derivative financial product transactions, the Board shall have the following authorities and responsibilities:

a) Grant approval and authorization for general transactions and product types, or decide on individual derivative transactions beyond the original scope of approval and authorization.

b) Decide a maximum contract amount and a maximum loss amount for individual transactions and for all transactions.

c) Grant discretionary authority to the Chairman to take adjustment or control actions when necessary and subsequently submit the matter to the Board for retroactive recognition.

6.3.2 The head of the Finance Department shall have the following authorities:

a) Formulate and adopt risk assessment and performance assessment measures.

b) Submit a list of transaction personnel to the Board.

c) Grant approval for a list of transaction counterparties and a maximum transaction amount for each counterparty.

6.3.3 The transaction personnel shall have the following authorities and responsibilities:

a) Conduct transactions within the scope of authorization.

b) Timely provide transaction vouchers.

6.3.4 Funds Management Section Personnel and Accounting Department personnel shall have the following authorities and responsibilities:

a) Funds Management Section Personnel
Includes transaction confirmation and settlement personnel for derivative transactions.

Responsible for settlement operations related to derivative transactions, including confirming transactions and verifying the content of confirmation documents, producing transaction contracts and affixing seals thereto, preparing relevant documents, and planning cash flows according to the utilization of relevant funds to ensure timely settlement of transaction contracts.

i) Transaction confirmation

   (1) Sign contracts with transaction counterparties and carry out account-opening and review operations.

ii) Transaction settlement personnel

   (1) Carry out settlement and clearing operations relevant to transactions.

b) Accounting Department personnel

   Responsible for account processing and other relevant operations and timely reporting of hedging transactions and profits/losses in itemized statement form.

6.3.5 The authorized transaction amount and level of authority for eligible transactions and product types as approved by the Board shall be determined in accordance with the Corporation's "Chart of Functional Authorities and Responsibilities - Finance Division."

6.4 Approval and executive

6.4.1 When making a transaction within the authorized amount, the transaction personnel shall immediately fill out a transaction voucher and submit it to their immediate superior management personnel for signed approval.

6.4.2 Before making a transaction beyond the authorized amount, the transaction personnel shall first obtain prior written approval from the authorized management personnel. After completing the transaction, the transaction personnel shall, as soon as practicable, fill out a transaction voucher and submit it to the authorized management personnel for signed approval.

6.4.3 The transaction personnel shall deliver the transaction voucher to the transaction confirmation personnel on the transaction date.

6.4.4 The types of products allowable for the Corporation's conduct of derivative transactions are those set out in 4.1. Those products are divided into hedging transactions and non-hedging transactions. For hedging transactions, hedge effectiveness assessment documents shall be prepared periodically.

6.4.5 The total amount of derivative transaction contracts engaged in by the Corporation may not exceed the total amount of foreign exchange required for the purposes of high speed rail procurements, construction subcontracting agreements, and other relevant expenses. For hedging transactions, the derivative contract amount is not subject to a maximum loss
percentage limit if it is maintained at a level below the cost amount of the construction subcontracting agreements. For non-hedging transactions, the maximum loss for all contracts may not exceed 10 percent of the total amount of non-hedging contracts and the maximum loss for individual contracts may not exceed 20 percent of the amount of the individual non-hedging contract.

6.5 Performance assessment

6.5.1 The Corporation shall periodically assess the value of and risks associated with the positions it holds and submit the assessment results to the senior management personnel authorized by the Board for recordation.

6.5.2 The assessment of positions shall use the market price on the assessment date as the basis of valuation.

6.6 Public announcement and reporting

6.6.1 If either of the following circumstances exists with respect to its conduct of derivative transactions, the Corporation shall publicly announce and report the event within 2 days from the date of occurrence:

a) Any transaction loss that reaches the maximum loss amount for all or individual contracts set out in these Procedures.

b) Any change, termination, or rescission of a contract signed in connection with an originally announced and reported transaction.

6.6.2 The Corporation shall publicly announce and report the monthly status of its derivative transactions, current as of the end of the previous month, by the 10th day of each month.

6.6.3 Any public announcement or reporting as required above or otherwise by applicable provisions shall be handled in a timely manner by the transaction personnel in accordance with the format and time-limit requirements prescribed by the relevant competent authority and in the Corporation's Directions for the Handling of Public Announcements and Reporting over the Market Observation Post System (THSRC-BE2-000-023).

6.6.4 When an item that the Corporation is required to publicly announce and has publicly announced is found to contain an error or omission and correction is required, all items of the public announcement shall be again publicly announced and reported in their entirety within 2 days from the date of notification.

6.7 Accounting treatment

6.7.1 Accounting treatment
The Corporation shall present fairly the transaction process and economic results in conformity with generally accepted accounting principles and applicable laws and regulations, using complete accounting vouchers and records as the basis of reporting, and according to the natures and methods of treatment of the different transactions.

6.7.2 Journal entries

Journal entries shall be processed in conformity with the Statements of Financial Accounting Standards (SFASs) and other applicable requirements.

6.7.3 Financial disclosure

Relevant information shall be disclosed in financial statements in conformity with SFASs.

6.8 Monitoring and control

6.8.1 The Board shall duly perform its oversight and management functions in accordance with the following principles:

a) Authorize senior management personnel to monitor and control derivative transaction risks on an ongoing basis.

b) Periodically assess whether derivative financial product transaction performance accords with established operational strategies and whether risks assumed are within a tolerable range set by the Corporation.

6.8.2 The senior management personnel authorized by the Board shall manage derivative transactions in accordance with the following principles:

a) Periodically assess whether the risk management measures currently in use are appropriate and are duly implemented in accordance with the Regulations Governing the Acquisition and Disposal of Assets by Public Companies as well as these Procedures.

b) Monitor the transaction and profit/loss statuses. When discovering any irregularity, take necessary measures, report to the Chairman immediately, and submit the matter to the next Board meeting. If the position of Independent Director has been established, the Independent Director(s) shall be present and express an opinion at the Board meeting.

6.8.3 Any grant of derivative transaction authorization to relevant personnel in accordance with these Procedures shall be subsequently reported at the next Board meeting.

6.9 Risk management

6.9.1 The transaction, confirmation, and settlement operations shall be handled by different personnel, who may not concurrently serve in more than one of those positions.

6.9.2 Risk measurement, monitoring, and control personnel shall be members of a different department from the personnel described in the preceding subparagraph, and shall report to the Board or senior management personnel authorized by the Board.

6.9.3 Positions held in derivative transactions shall be assessed at least once a week. However,
positions in hedging transactions held to meet business needs shall be assessed at least twice a month. The assessment reports shall be submitted to the senior management personnel authorized by the Board.

6.9.4 Handling of irregularities. Any transaction irregularity shall be immediately reported to the chief financial officer or his or her deputy.

6.10 Internal audit

6.10.1 The internal audit personnel shall periodically plan audit activities taking account of associated risk factors such as the materiality and complexity of derivatives.

6.10.2 The internal audit personnel shall periodically check the adequacy of internal controls over derivative transactions. They shall also perform monthly audits on the transaction department's compliance with these Procedures and prepare written audit reports accordingly. If any material non-compliance is found, it shall immediately be reported in writing to the Audit Committee and independent directors.

6.11 Descriptions of operational processes

a) Inform transaction counterparty of transaction rules

Before conducting derivative transactions, the Corporation shall first provide a list of authorized transaction personnel to the corresponding financial institutions with which the Corporation will transact business hereunder.

b) Carry out transaction with transaction counterparty

The Corporation's transaction personnel shall carry out transactions with transaction counterparties within their authorized amount and in accordance with transaction rules.

c) When exceeding authorized amount

When a transaction amount exceeds the authorized amount of the transaction personnel, the transaction may be executed only after approval by a management personnel who has an authorization limit sufficient for the execution of the transaction.

d) Approval

The management personnel at various levels shall provide approvals for transactions in ascending order within their authorization limits.

e) Completion of transaction

Once a transaction is completed, the transaction personnel shall: (1) fill out a transaction voucher; (2) notify the Funds Management Section personnel to confirm the transaction; (3) notify the Funds Management Section personnel to produce a transaction contract; and (4) prepare transaction vouchers and documents.

f) Confirmation of transaction
After receiving the transaction notice from the transaction personnel, the Funds Management Section personnel shall immediately confirm the transaction.

**g) Transaction contract**

After receiving the transaction notice from the transaction personnel, the Funds Management Section personnel shall immediately carry out subsequent operations such as preparing a transaction contract and a transaction confirmation slip or statement and affixing seals thereto.

**h) Approval of transaction slip and transaction contract**

The transaction slip shall be submitted to the authorized management personnel for signed approval in ascending order of their authority. After being affixed with seals, the transaction contract shall be delivered back to the Funds Management Section personnel for returning to the transaction counterparty.

**i) Confirmation of transaction statement**

The Funds Management Section personnel shall track the progress of the transaction statement and, after receiving the transaction statement and verifying the amount, affix seals thereto and conduct other relevant operations.

**j) Returning transaction contract after affixing seals**

After affixing seals to the transaction contract, the Funds Management Section personnel shall promptly return it and other relevant documents to the transaction counterparty.

**k) Keeping on file**

After completion of the transaction, the transaction personnel shall keep the transaction voucher and other relevant documents on file for future reference.

**l) Mailing back to transaction counterparty**

After completion of the transaction, the Funds Management Section personnel shall mail the transaction statement affixed with seals back to the transaction counterparty.

**m) Account processing**

The Accounting Department personnel shall conduct relevant account processing operations.

**n) Settlement upon expiration**

Upon expiration of the transaction, the Funds Management Section personnel shall duly perform the settlement procedures. They shall also periodically monitor the cash flow status to ensure timely settlement of transaction contracts.

**o) Periodical review**
In accordance with the requirements of 6.9.3, profits/losses on outstanding transactions shall be assessed and reviewed periodically, twice every month.

p) Assessment report

In accordance with the requirements of 6.9.3, twice every month, derivative transaction assessment reports shall be submitted to the senior management personnel authorized by the Board for comments or instructions. In principle, mid-month reports shall be submitted no later than the 30th day of the current month, and month-end reports no later than the 15th day of the next month.

6.12 Notes for attention

6.12.1 The Corporation shall establish a log book for its derivative transaction activities and shall record the itemized details of each derivative transaction, including the type, amount, date of passage by the Board, and the results of the prudent assessments that are required under 6.4.4, 6.8.1(2), 6.8.2(1), and 6.9.3, in the log book for future reference.

6.12.2 The Corporation shall keep at its headquarters all contracts and meeting minutes and the log book relevant to its conduct of derivative transactions, to be retained for at least 5 years unless otherwise provided by law.

6.12.3 When an in-charge person or management personnel violates these Procedures or applicable requirements of the competent authority, the violation shall be handled in accordance with the Corporation's Rules Governing Rewards and Disciplinary Action (THSRC-BA2-000-003).

6.13 Supplementary provisions

6.13.1 After adoption through passage by the Board, these Procedures, and any amendments hereto, shall be sent to the Audit Committee and submitted to a shareholders’ meeting for approval. When a Director expresses dissent and such dissent is on record or in a written statement, the Corporation shall forward the materials containing the Director's dissent to the Audit Committee. If the Corporation has established the position of Independent Director, when these Procedures are submitted to and discussed at the Board meeting pursuant to the preceding provisions, the opinions of each Independent Director shall be given full consideration, and each independent Director's opinion of assent or dissent and the reasons therefor shall be recorded in the meeting minutes.

7.0 Records

a) Log book for derivative transactions (retention period: 5 years)

b) Audit reports on derivative transactions (retention period: 5 years)

c) Account processing records shall be retained in accordance with the Accounting System (THSRC-AD1-000-001).

d) Contracts and meeting records relating to transactions of derivative goods (retention period: 5 years)
e) Documents relating to evaluations on hedging effectiveness (retention period: 5 years)

f) Letters of notification sent to financial institutions regarding appointment and removal of transaction personnel (retention period: 5 years).

8.0 Attachments

None