

# KWONG LUNG ENTERPRISE CO.,LTD.

## Procedures for Derivative Trade

### Chapter 1 General Provision

#### Article 1 Purpose

This Procedure is instituted for the management of risk deriving from derivative trade and as internal control system for information transparency and the protection of investment.

#### Article 2 Legal reference

This Procedure is instituted pursuant to Article 36-1 of the Securities and Exchange Act and the “Procedure for the Acquisition and Disposition of Assets” of the Company.

#### Article 3 Definition of financial derivatives.

Forwards contracts, option contracts, futures contracts, leverage contracts, and swap contracts which values are derived from assets, interest rate, exchange rate, index or other benefits, and the composite contracts with a combination of the aforementioned commodities. Futures contracts will exclude insurance contracts, performance agreement, post-delivery service agreement, long-term lease agreement and long-term buy-sell agreements.

### Chapter 2 Policy and procedure of trade

#### Article 4 1. Type of trade

##### (1) Subject matter

- 1). Pertinent to the business operation of the Company.
- 2). Pertinent to the inherent or expected exposure of the assets and liabilities to the risk of market price fluctuation.

##### (2) Type of derivatives: as specified in Article 3 of This Procedure and shall be in conformity to the following principles:

- 1). The transaction price shall be clear with transparent information so that the Company can properly control and assess the risk deriving from the transaction.
- 2). A large number of participants in market with high liquidity that the Company can settle its position at any time and withdraw from market.
- 3). The dealing personnel of the Company shall properly understand, acknowledge, control, and assess the risk inherent to the derivatives.

##### 2. Operation or hedge strategy

- 1). Derivative trade shall be conducted for protection the profit position of the Company.
- 2). Further to the current positions of the Company in assets and liabilities (including overseas facilities and subsidiaries) and specific purpose of assets and liabilities in the next quarter (such as direct investment, capital expenditures and the repatriation of profit from subsidiaries), the net positions for assets and liabilities in the year ahead shall also be considered as the basis for hedging. Hedging is the operation not for purpose of operation in itself. If financial hedge can meet the conditions of hedge accounting, the transactions of which shall be processed under hedge accounting. To the contrast, if the conditions cannot be satisfied, all items for financial hedge shall be recognized as financial assets or liabilities at fair value. The influence of the profit or loss thereof could be offset by the changes of the value of the instruments for hedging so as to yield the effort of hedge accounting.

3). The Company is not engaged in derivative trade for business purpose (non-hedge).

### 3. Nature of transactions

#### 1). Hedge transaction (financial hedge)

- i. Meeting the conditions of hedge accounting: if the transaction meets the conditions set forth by IFRS No. 39, apply hedge accounting.
- ii. Not meeting the conditions of hedge accounting: the transaction targets at financial purpose but cannot meet the conditions of hedge accounting shall be recognized as financial assets or liabilities at fair value through income statement and the profit and loss thereof shall be recognized as income or loss in current period.

#### 2). Non-hedge transaction: transaction for trading purpose.

## Article 5 Authority and Responsibility

### 1. Function of the Board:

- (1) Senior personnel are instructed to pay close attention to the supervision and control over the risks deriving from derivative trade.
- (2) Conduct routine assessment of the performance of derivative trade and make sure the trade is congruent with the business strategy of the Company and within the risk tolerance of the Company.

### 2. Authority and responsibility of senior personnel to the authorization of the Board:

- (1) Conduct routine assessment of the risk management policy to make sure the policy is appropriate and effective and if all the derivative trades are conducted in conformity to the policy and procedure.
- (2) Monitor the transactions and the profit status of the trade. In case of abnormality, take necessary response and report to the Board at once. If the seats for Independent Directors have been established, the presence of Independent Directors in Board meeting with opinions will be necessary.

### 3. The Company authorizes related personnel to conduct derivative trade and report to the nearest session of the Board on the result of trade.

### 4. The authority and responsibility of the person in charge of the finance of the Company (the manager administering the dealing department):

- (1) Map out the strategy of derivative trade of the Company.
- (2) Gather information related to the changes in the market and make judgment on the trend and assessment of the risks. Familiarize financial products and applicable laws and study on the foreign exchange and financing position of the Company for mapping out the operation strategy. This strategy shall be pursued at the approval of the Chairman and the Chief Executive Officer for hedging.
- (3) Design the format of management report and data sheet and control the overall limits of the Company to the authorization of the Board.
- (4) Design the risk assessment model and performance evaluation model for the Company.
- (5) Determine the position of the Company in foreign exchange on the basis of the business value and import and export volume and the bottom line for hedging for each period (monthly or quarterly) to prevent exposure of foreign exchange position to risk.
- (6) Map out the strategy for trade within the authorized limit and directly proceed to trade with counterparties.

(7) Provide dealing slips and documents timely.

5. Authority and responsibility of back-end personnel:

- (1) Sign agreement, open account and review with counterparties.
- (2) Review the dealing slips and all related statements and reports presented by the dealing department.
- (3) Confirm, deliver, and settle of related trade.
- (4) Compile statements on derivative trade.

Article 6 The person in charge of the functional department designated for derivative trade in the centralized market shall present the types of products, the issuing amount, hedge strategy, method of trade, upper limit of loss and related matters to the Board for approval before proceeding to action.

Article 7 The person in charge of the functional department designated for derivative trade in the centralized market shall present the type of products and the total limit of trade to the Board for authorization. This person shall report to the Chairman on any sudden change or other needs in market for approval, and to the Board for ratification for changing the total limit of authorization.

Article 8 Performance evaluation

Conduct separate evaluation and reports by hedge trade or special purpose trade:

1. Hedge trade

- (1) Effectiveness assessment: if hedge accounting is adopted, it has to be highly effective (80%~125%) in hedging off the change of fair value or cash flow.
- (2) It is necessary to conduct self-assessment on the position of derivative trade marked to market for the effective and full control and presenting the evaluation risk of the trade. The evaluation in the last week of the month shall be based on the evaluation reports provided by the counterparties for bookkeeping.
- (3) Present the report on comparison between the actual position of derivative trade and the net position in book.
- (4) The aforementioned assessment reports shall be submitted to the Chief Financial Officer and the Chief Executive Officer. Routine meetings shall also be called for to discuss the position that will be generated in the future and the hedge strategy in response to the change as the policy for action in the future. This information shall also be made known to the auditing department.

2. Special purpose trade

Provide the statements and reports on performance and positions in the same way as for the performance evaluation of hedge trade and reporting on the trade to the Chief Financial Officer and the Chief Executive Officer as reference with acknowledgement to the auditing department.

Article 9 Set the total contract sum and the upper limit of loss

1. Total contract sum

(1) Hedge trade

- 1). Exchange rate hedge: Up to the net position of the assets and liabilities of the Company (including overseas facilities and subsidiaries) plus the special purpose use in the next quarter (such as direct investment, capital expenditures, and repatriation of profit from subsidiaries). In addition, the net position of the needs in assets and liabilities in the year ahead shall also be considered.
- 2). Interest rate hedge: Up to the limit of financing from banks as approved by the Board.

- (2) Special purpose amount: The finance department of the Company shall map out the hedge strategy and the total contract sum on the basis of the approved budget or capital plan quarterly.
2. Set the upper limit of loss
    - (1) Hedge trade: the upper limit of loss on particular contract shall be 20% of the contract amount or NT\$10 million. The upper limit of loss for all contracts shall be 20% of the total contract amount. In case of significant influence of the exchange rate and interest rate (exceeding the upper limit), report to the Chief Executive Officer and Chairman for response.
    - (2) Special purpose trade: The upper limit of loss on particular contract shall be 20% of the contract amount or NT\$10 million. The upper limit of loss for all contracts shall be 20% of the total contract amount. In case of significant influence of the exchange rate and interest rate (exceeding the upper limit), report to the Chief Executive Officer and Chairman for response.

### Chapter 3 Operation Procedure

#### Article 10 Gate approval under authorization

1. Hedge trade (including special purpose trade)
  - (1) The Chief Executive Officer has the highest decision latitude.
  - (2) The daily trade authority and accumulated net amount of trade shall be determined by the Chief Executive Officer under authorization.

<u>Dealer</u>	<u>Upper limit of daily trade</u>	<u>Authority of net accumulated position of trade</u>
Chief Executive Officer	>USD20M	>USD40M
Chief Financial Officer	≤USD20M	≤USD40M
Finance Supervisor	≤USD6M	≤USD20M

- (3) If the daily trade amount or the accumulated net position before offsetting exceeds the authorized limit, the approval of authorized personnel is necessary for execution.
  - (4) For special purpose trade, the plan for hedge trade is necessary and report along the line of authority up to the Chief Executive Officer for approval before execution of trade.
2. Non-hedge trade: the Company is not engaged in trade for business purpose (non-hedge).

#### Article 11 Operation

	<u>Note to Operation</u>	<u>Person in charge</u>
1.	Prepare the operation strategy of the year, report to the Chief Executive Officer and Chairman for approval and proceed to operation as planned.	Finance Supervisor
2.	Gather related information all the times, revise the operation strategy as dictated by business needs and market situation. Report to the Chief Executive Officer and Chairman.	Finance Supervisor
3.	The finance department of the Company places orders with financial institutions within the authorized limit. If further authorization is required, the approval of the Chief Executive Officer in writing is necessary.	Finance Supervisor

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| 4. | Confirm the reply from financial institutions on successful trade, and fill in the “Derivative Trade Dealing Slip” on the basis of the confirmation detail and compile related statements for further approval along the line of authority. | Back-end staff        |
| 5. | If official stamp is necessary for confirmation of transaction documents from banks, attach a photocopy of the “Derivative Trade Dealing Slip”.   | Back-end staff        |
| 6. | In case of exchange gains from foreign exchange transactions, the processing staff shall base on the “Derivative Trade Dealing Slip” for bookkeeping at the time of payment request/delivery.   | Back-end staff        |
| 7. | Compile a monthly statement on derivative trade with the attachment of dealing slips for the review of the Chief Executive Officer at the authorization of the Board, and present before the nearest session of the Board.                  | Back-end staff        |
| 8. | Make monthly announcement as required by the competent authority.   | Accounting department |

Chapter 4                      Announcement and declaration procedure

Article 12 The finance department of the Company shall conduct evaluation of the net gains/loss of unsettled contract sum of the derivative trade conducted by the Company and its subsidiaries to the end of the previous month by classification of trading for business purpose/not for business purpose, the amount of premium paid and the amount of income or loss recognized, and present all the materials to accounting department with the monthly report on operation for entering into the designated website of the competent authority for declaration by the 10<sup>th</sup> day of each month.

If the loss resulted from derivative trade exceeds the overall limit of loss as stated in This Procedure or the upper limit of particular contract, announce at the designated website of the competent authority within 2 days after the day of deed.

Chapter 5                      Principle and procedure of accounting

Article 13 The Company shall prepare a registry for tracking derivative trade by type of trade, amount of trade, the date of resolutions by the Board, and special attention in full detail.

Article 14 In compiling routine financial reports, the Company shall disclose the detail on derivative trade in the notes to financial statements under the accounting principles generally accepted in Taiwan.

Chapter 6                      Internal Control System

Article 15 1. Internal control of operation process

- (1) The duties of dealing, confirmation, and delivery in derivative trade shall be performed by different persons.
- (2) The dealing personnel shall forward the “Derivative Trade Dealing Slip” to the confirmation staff for registration.
- (3) The confirmation staff shall cross-check the statements with the transaction banks on the details and total amount of trade.

- (4) The dealing personnel shall pay close attention to the total amount of trade all the times to ensure control within the authorized limit of total contract amount.

## 2. Risk management policy

### (1) Credit risk management

In light of the variety of factors in market that may result in operation risk to derivative trade, market risk management shall be performed in accordance with the following principles:

- 1). Trade orders shall be placed with domestic banks and branches of foreign banks legally established at the approval of the competent authority and other financial institutions shall undergo professional credit rating.
- 2). The products for trading shall be limited to products provided by banks and at the approval of the competent authority for trade.
- 3). Trade orders shall be placed for the best interest of the Company.
- 4). If the subject matter of trade is designated product of communist countries, prepare the plan for credit risk hedge and submit the plan for the Chairman for approval before proceeding to trade.

(2) Market risk management: The Company shall not engage in derivative trade beyond hedging and only deal with hedge trade so as to offset the hedge instrument and hedge content to reduce market risk.

(3) Liquidity risk management: For ensuring liquidity of trade, products of high liquidity will be of high priority (which could be squared up in market at any time) and banks of high trading volume and sound quotation will be the first choice.

(4) Operation risk management: For complying with the authorized limit of the Company, the operation process shall be included into internal audit to avoid operation risk.

(5) Legal risk management: Contracts commonly used in market shall be adopted. Before signing documents in exclusivity with banks, refer the documents to professional staff of foreign exchange and legal affairs for review to avoid legal risk.

## 3. Method of routine evaluation

(1) The Board shall authorize senior officers or appoint the auditing department to pay attention to the supervision and control of the risk deriving from derivative trade to ensure conformity to the trading procedure of the Company. If the evaluation report at market value is unusual, report to the Board at once and take necessary measures to respond to the situation. Independent Directors shall attend the session of Board as observers to express their opinions.

(2) The Finance Supervisor shall conduct routine assessment on the performance of derivative trade to ensure they are congruent with the business strategy of the Company and falling within the risk tolerance.

(3) The finance department of the Company shall assess the rationality and market value of the position held by the Company in derivative trade at least once a week. In addition, assess the performance of derivative trade for hedging purpose at least twice a month. The assessment reports shall be submitted to the Chief Financial Officer and the Chief Executive Officer for review with acknowledgment to the auditing department.

## Chapter 7 Internal Control System

Article 16 The internal auditors shall keep track on the suitability of the internal control of derivative trade at regular interval and audit on the dealing department in the conduct of derivative trade in compliance with the trading procedure of the Company with analysis of the transaction cycle monthly. The audit findings will

be compiled into audit reports. Notify the Supervisors and Independent Directors on any material breach of regulations discovered.

Article 17 The internal auditors shall declare the internal control and audit findings on derivative trade on an annual (monthly) basis and the status of corrective actions taken on the shortcomings detected at the designated website of Financial Supervisory Commission by designated deadline.

Chapter 8                      Miscellaneous

Article 18 Subsidiaries of the Company that are not domestic public companies shall comply with This Procedure in the conduct of derivative trade.

Article 19 This Procedure shall come into full force at the resolution of the Board with distribution to the Supervisors and the ratification of the General Meeting of shareholders. The same procedure is applicable to any amendment thereto. If there is any adverse opinion from the Directors on record or in written declaration, forward related information to the Supervisors.

If the Company has established seats for Independent Directors, and has referred the motions to the Board for discussion, fully consider the opinions from the Independent Directors. If there is any adverse opinion or qualified opinion from the Independent Directors, note down as minutes of the Board meeting on record.

Article 20 This Procedure is instituted on July 25 1996

Amended for the 1<sup>st</sup> instance on March 29 2000

Amended for the 2<sup>nd</sup> instance on June 27 2000

Amended for the 3<sup>rd</sup> instance on June 26 2001

Amended for the 4<sup>th</sup> instance on June 27 2002

Amended for the 5<sup>th</sup> instance on March 27 2003

Amended for the 6<sup>th</sup> instance on October 24 2003

Amended for the 7<sup>th</sup> instance on June 11 2004

Amended for the 8<sup>th</sup> instance on June 24 2005

Amended for the 9<sup>th</sup> instance on June 23 2006

Amended for the 10<sup>th</sup> instance on June 20 2013

Amended for the 11<sup>th</sup> instance on June 22 2017.

Amended for the 12<sup>th</sup> instance on May 30 2019.