



Ohio Administrative Code Rule 3901-3-12 Derivative use plan.

Effective: November 27, 2014

(A) Purpose

The purpose of this rule is to establish the content of the derivative use plans to be filed with the superintendent as required by sections 3906.12, 3907.14, and 3925.08 of the Revised Code.

(B) Authority

This rule is promulgated pursuant to the authority vested in the superintendent under sections 3901.041, 3906.12, 3907.14 and 3925.08 of the Revised Code.

(C) Derivative use plan

(1) The insurer shall submit a derivative use plan, or amendment thereto, to the superintendent. The derivative use plan or the amendment thereto will be referred to as "the plan" hereinafter. The filing shall include a certified copy of the authorization by the insurer's board of directors, or a committee thereof charged with the responsibility for supervising investments, pursuant to sections 3906.12, 3907.14 and 3925.08 of the Revised Code. When submitting its plan, the insurer shall also provide to the superintendent:

(a) In the event the plan is adopted by a committee of the insurer's board of directors, information with respect to the composition, in terms of title and position, of such committee; and

(b) The name and title of the senior most investment person responsible for derivative transactions; a description of his or her duties and responsibilities, as well as a curriculum vitae or equivalent document. Such information shall be updated and provided to the superintendent as changes occur.

(2) The plan shall contain written guidelines to be followed in engaging in derivative transactions. The guidelines shall include or address:



- (a) The type, maturity and diversification of derivative instruments;
 - (b) The limitation on counterparty exposures, including limitations based on credit ratings;
 - (c) The limitations on the use of derivatives;
 - (d) Asset/liability management practices with respect to derivative transactions;
 - (e) The liquidity needs and the company's capital and surplus as it relates to the derivative use plan;
 - (f) The policy objectives of management specific enough to outline permissible derivative strategies;
 - (g) The relationship of the derivative strategies to the insurer's operations;
 - (h) A requirement that management establishes and executes management oversight standards as required by paragraph (D) of this rule and a description of these standards;
 - (i) A requirement that management establishes and executes internal controls and reporting standards as required by paragraph (E) of this rule and a description of these standards; and
 - (j) A requirement that management establishes and executes documentation and reporting standards as required by paragraph (F) of this rule and a description of these standards.
- (3) The plan shall contain, to the extent applicable to the specific derivative transactions authorized, guidelines for the insurer's acceptable levels of basis risk, credit risk, foreign currency risk, interest rate risk, market risk, operational risk and option risk. The plan shall also provide that the board of directors, or a committee thereof charged with the responsibility for supervising investments, and senior management shall comply with risk oversight functions and adhere to laws, rules, regulations, prescribed practices or ethical standards.
- (D) Management oversight standards



(1) In order to address the need for appropriate oversight by senior management and by the board of directors, or a committee thereof charged with the responsibility for supervising investments, and to provide for a comprehensive risk management process for derivative instruments, an insurer shall establish the following with respect to derivative transactions:

(a) Appropriate limits for various identified risks relevant to the derivative transactions used by the insurer;

(b) Procedures and practices that control the nature and amount of such risks;

(c) Adequate systems or processes for identifying and measuring such risks;

(d) Systems or processes for documenting, monitoring and reporting risk exposures on a timely basis; and

(e) Systems or processes of internal review and audit to ensure the integrity of the overall risk management process.

(2) The board of directors, or a committee thereof charged with the responsibility for supervising investments, shall receive and review quarterly reports which shall include:

(a) Information to ascertain that all derivative transactions have been made in accordance with delegations, standards, limitations and investment objectives contained in the derivative use plan;

(b) The outstanding derivative positions; the unrealized gains or losses thereon;

(c) The derivative transactions closed during the report period;

(d) A performance review of the derivative transactions;

(e) An evaluation of the risks and benefits of the derivative transactions; and

(f) Other information necessary to ensure that the internal control procedures are being followed.



(3) The board of directors, or a committee thereof charged with the responsibility for supervising investments, shall establish the following management oversight standards for derivative transactions:

(a) The board of directors, or a committee thereof charged with the responsibility for supervising investments, has an affirmative obligation to prior approve its desired risk tolerance levels.

Management shall appropriately translate these risk tolerance levels into effective policies and procedures that address both individual transactions and entire portfolios;

(b) Management and the board of directors, or a committee thereof charged with the responsibility for supervising investments, shall receive sufficient information to assess the strengths and limitations of the insurer's risk measurement systems in order to determine appropriate risk limits. The board of directors, or a committee thereof charged with the responsibility for supervising investments, shall also review management's response to strengths and limitations identified through oversight processes such as stress testing, independent validation and back-testing of risk measurement models. Management and the board of directors, or a committee thereof charged with the responsibility for supervising investments, shall consider the information identified by the oversight processes, including the potential for indirect effects of downside performance beyond the insurer's finances, when they determine and communicate their risk profile;

(c) When management or the board of directors, or a committee thereof charged with the responsibility for supervising investments, identifies weaknesses in the risk management process, they shall consider alternatives and take steps to strengthen that process;

(d) Actions shall be taken to correct any deficiencies in internal controls relative to derivative transactions, including any deficiencies determined by the independent certified public accountant in the evaluation of accounting procedures and internal controls;

(e) Risk oversight functions shall possess independence, authority, and expertise; and

(f) Issuer and counterparty credit decisions for each transaction shall be consistent with the overall credit standards of the insurer.



(E) Internal controls and reporting

Before engaging in derivative transactions, an insurer shall establish adequate internal control procedures to deal with derivatives, which shall include but not be limited to:

- (1) Systems or processes for periodic valuation of derivative transactions including mechanisms for compensating for any lack of independence in valuing trading positions;
- (2) Systems or processes for determining whether a derivative instrument used for hedging has been effective;
- (3) Credit risk management systems or processes for over-the-counter derivative transactions that measure credit risk exposure using the counterparty exposure amount and clearly articulated policies for the establishment of collateral arrangements with counterparties;
- (4) A determination of whether the insurer has adequate professional personnel, technical expertise and systems to implement and control investment practices involving derivatives;
- (5) Systems or processes for regular reports to management, segregation of duties and internal review procedures; and
- (6) Systems or procedures for conducting initial and ongoing legal review of derivative transactions including assessments of contract enforceability.

(F) Documentation and reporting requirements:

The insurer shall maintain documentation and records relating to each derivative transaction including:

- (1) The purpose or purposes of the transaction;
- (2) The assets or liabilities (or portfolios thereof) to which the transaction relates;



- (3) The specific derivative instruments used in the transaction;
- (4) For over-the-counter derivative transactions, the name of the counterparty, and counterparty exposure amount; and
- (5) For exchange-traded derivative instruments, the name of the exchange and the name of the firm handling the trade.

(G) Severability

If any paragraph, term or provision of this rule is adjudged invalid for any reason, the judgment shall not affect, impair or invalidate any other paragraph, term or provision of this rule, but the remaining paragraphs, terms and provisions shall be and continue in full force and effect.