GRF_114_2 Derivatives Activity

These instructions must be read in conjunction with the general instruction guide.

Explanatory notes

Derivatives

Derivatives are generally defined as those instruments/contracts where the value is based on other products, and/or on prices associated with financial products. Derivative contracts involve: future delivery, receipt or exchange of financial items such as cash or another derivative instrument; or future exchange of real assets for financial items where the contract may be tradeable and has a market value.

The contracts can either be binding on both parties (e.g. as with a currency swap) or subject to the exercise by one party of a right contained within the contract (as with options).

Contract types

- Interest rate contracts

  An interest rate contract is any contract that transfers the interest rate risk of an underlying asset from one party to another.

- Foreign exchange contracts (including gold)

  A foreign exchange contract is any contract that transfers the exchange rate risk of an underlying asset from one party to another. A gold contract is any contract that transfers the gold price risk associated with an underlying asset from one party to another.

- Equity contracts

  An equity contract is any contract that at least partly transfers the equity risk of an underlying equity security from one party to another.

- Precious metal contracts (excluding gold)

  A precious metal contract is any contract that transfers the precious metal price risk associated with an underlying asset from one party to another. A precious metal is a classification of metals that are considered to be rare and/or have high economic value and includes silver, platinum and palladium but excludes gold.

- Other market-related contracts

  This represents any derivatives contract that is not an interest rate contract, foreign exchange contract, equity contract or precious metal contract.

Principal amount

This refers to the face value or notional principal amount of the derivative financial contract.

Principal amounts should always be recorded as positive values, even for short positions.

Fair value

The fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value should be able to be determined through observation of similar transactions, quoted market prices, independent valuations or if there is no readily observable market, through the ability to liquidate the item or through assessing the net present value of future cash flows.

For section 2, report the aggregate fair value of the derivative exposure by summing the absolute fair value of each exposure.

Instructions for specific items

Section 1: Direct over the counter derivatives

The contracts to be reported in this section do not include derivatives traded on recognised futures and options exchanges.

(1) Contract type

This is the contract type for the derivative financial instrument.

From the drop-down menu, choose either: Interest rate, Foreign exchange, Equity, Precious metal or Other.

(2) Residual maturity

This refers to the time remaining from the reporting date to the maturity date of the derivative financial contract.

From the drop-down menu choose either: Less than 1 year, 1 year to less than 5 years or 5 years or more.

(3) Counterparty grade

This is the counterparty grade of the counterparty to the derivative contract, determined in accordance with *Prudential Standard GPS 001 Definitions* (GPS 001).

(4) - (7) Principal amount and Fair value separated into Long and Short positions

Report the principal amount or fair value of each derivative exposure, separated into long or short positions.

A long position in an asset or instrument means that the holder of the position owns the asset or instrument. With regard to options, this refers to the purchase of the option contract itself. A short position relates to assets, or instruments, that have been contracted to be sold at a future date without the reporting insurer actually owning them at the time of entering into the contract. With regard to options, this refers to the sale of the option contract itself.

Section 2: Total contracts

1. Total over the counter derivative financial instruments classified into:

The derivative instruments to be reported in this section are those that are not traded on recognised exchanges.

1.1. Forwards

A forward contract is an agreement to exchange a predetermined amount of currency, commodity, or other financial instrument at a specified future date and at a predetermined price.

1.2. Swaps

A swap is a financial instrument representing a transaction in which two parties agree to swap or exchange some obligation, generally a series of cash flows, on differing terms.

1.3. Bought option positions

These are option positions where the reporting insurer has purchased an option position and has the right, but not the obligation, to exercise the option against the writer and request delivery or sale of the underlying security or cash settlement.

1.3.1. Call options

A bought call option gives the holder of the option the right, but not the obligation, to require the writer of the option to sell the underlying security / asset to the holder.

1.3.2. Put options

A bought put option gives the holder of the option the right, but not the obligation, to require the writer of the option to buy the underlying security / asset from the holder.

1.4. Written (sold) option positions:

These are option positions where the reporting insurer has written / sold an option position, and as a result has the obligation to deliver or purchase the underlying product of the option or settle in cash, if exercised by the holder of the option position.

1.4.1. Call options

A written call option gives the writer of the option the obligation to sell the underlying security / asset when the option is exercised by the holder of the option.

1.4.2. Put options

A written put option gives the writer of the option the obligation to buy the underlying security / asset when the option is exercised by the holder of the option.

1.5. Credit derivatives

A credit derivative enables the user to transfer the credit risk of an underlying asset from one party, the protection buyer, to another, the protection seller, in isolation from other risks.

1.5.1. Credit derivatives in which the reporting insurer is providing credit protection

This refers to credit derivatives that have been sold, or written, by the reporting insurer.

1.5.2. Credit derivatives in which the reporting insurer is purchasing credit protection

This refers to credit derivatives that have been purchased by the reporting insurer.

1.6. Other

This is defined as the totality of all other over the counter derivative financial instruments not separately identified above.

It is automatically calculated as Item 1.7 less the sum of Items 1.1, 1.2, 1.3.1, 1.3.2, 1.4.1, 1.4.2, 1.5.1 and 1.5.2.

1.7. Total over the counter derivative financial instruments

This is the total of derivative financial instruments that are not traded on recognised exchanges.

2. Total exchange traded derivative financial instruments:

2.1. Exchange traded derivatives subject to daily mark-to-market & margin payments

This refers to derivatives that are transacted on a recognised futures or options exchange and which are subject to daily mark-to-market and margin payment. These contracts are transacted in standardised parcels and a clearing house effectively becomes the counterparty to all derivative positions.

3. Total derivative financial instrument exposure

This is the total of derivative financial instruments that are over the counter and traded on recognised exchanges.

It is automatically calculated as the sum of Items 1.7 and 2.1.

3.1. Investment portfolio

This refers to derivatives exposures that relate to the reporting insurer's investment assets, either as hedging a component of the underlying investments or as an outright investment.

3.2. Other assets

This refers to derivatives exposures that relate to assets other than those classified as the reporting insurer's investment assets.

3.3. Claims liabilities

This refers to derivatives exposures in relation to claims liabilities as determined in accordance with *Australian Accounting Standard AASB 1023 General Insurance Contracts*. Claims liabilities represent the total estimated ultimate cost to an insurer of settling all claims arising from events which have occurred as at the relevant date, whether reported or not.

3.4. Debt funding / borrowings

This refers to derivatives exposures in relation to debt funding / borrowing.

3.5. Other

This refers to derivatives exposures in relation to off-balance sheet exposures of the reporting insurer, or on-balance sheet liabilities not classified as claims liabilities or debt funding / borrowing.

It is automatically calculated as Item 3 less the sum of Items 3.1 to 3.4.

4. Total derivative financial instruments which are with the following related parties:

4.1. Parent entity

This refers to derivatives that are purchased from or sold to the parent entity of the reporting insurer.

4.2. Controlled entities / other branches of the parent entity

This refers to derivatives that are purchased from or sold to a subsidiary of the reporting insurer, or another branch of the parent entity for a Category C insurer.

4.3. Associates / Joint ventures

This refers to derivatives that are purchased from or sold to an associate or joint venture of the reporting insurer.

4.4. Other related parties

This refers to derivatives that are purchased from or sold to a related party of the reporting insurer that is not the parent entity, a subsidiary, an associate or a joint venture of the reporting insurer.