
IV. Measures to promote financial stability

In 2018, against a backdrop of slowing economic growth at home and abroad and mild domestic inflation, Taiwan's financial markets and financial infrastructure maintained smooth operations and sound development. Profitability of financial institutions remained satisfactory, while asset quality stayed at an appropriate level and capital levels remained sound. As a whole, Taiwan's financial system remained stable.

Facing the changes in global and domestic economic and financial conditions, especially prolonged US-China trade tensions, monetary policy normalization by major economies moving on an unclear path, Brexit uncertainties, and slowdown in economic growth in Mainland China, possible negative impacts on the global economy and increasing financial market risks persist. Therefore, the Bank will continue to closely monitor the influences on the domestic economy and financial system and adopt appropriate monetary, credit, and FX policies as warranted. Meanwhile, the FSC also continues to amend financial laws and regulations and undertakes measures to strengthen financial supervision, aiming to foster the soundness of financial institutions and improve financial stability.

4.1 Measures taken by the Bank to promote financial stability

In view of a slowdown in domestic economic growth and mild inflation, the Bank held policy rates unchanged in 2018. Moreover, the Bank persistently implemented restrictions on high-value housing loans on concerns about their higher price volatility. The Bank also continued to adopt flexible FX rate policies and maintained dynamic stability of the NT dollar exchange rate, as well as timely amending relevant FX regulations.

4.1.1 Adopting appropriate monetary policies in response to domestic and global economic and financial conditions

The Bank kept policy rates unchanged

On account of an uncertain international economic and financial outlook, as well as slower domestic economic growth, coupled with the actual output level remaining below potential

output, mild future inflation pressures, and domestic nominal and real interest rates ranking in the middle compared to major economies, the Bank kept policy rates unchanged in 2018. The discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral remained at 1.375%, 1.75%, and 3.625%, respectively.

Reserve money growth remained moderate

The Bank conducted open market operations to keep market liquidity at an appropriate level. In 2018, the excess reserves in all financial institutions remained at a higher level. The total loans and investments in the banking industry grew by 5.26%, while the monetary aggregate M2 increased by 3.52% year on year. Both rates were higher than the GDP growth rate of 2.63%, indicating that market liquidity was sufficient to support economic activity.

The Bank will continue to implement appropriate monetary policies

The Bank will continue to closely monitor price conditions, the output gap, as well as changes in global and domestic economic and financial conditions, and undertake appropriate monetary policies to maintain price and financial stability, as well as fostering economic growth.

4.1.2 The Bank promoted smooth interbank clearing

With instant interbank clearing significantly increasing year by year, the Bank raised the ceiling on the amount of financial institutions' end-of-day balances in the Guarantee Account to be counted as part of the required reserves from 4% to 8%, effective from January 2019. This adjustment aimed to ensure that financial institutions had an adequate supply of funds and that retail payment systems operated smoothly at all times.

4.1.3 The Bank continued to implement targeted prudential measures on high-value housing loans

In March 2016, the Bank repealed most of the targeted prudential measures imposed on real estate loans, except for high-value housing loans because of higher risks faced by banks resulting from greater volatility in high-value housing prices, and urged banks to exercise self-discipline on mortgage-related credit risk management. In the future, the Bank will continue to monitor financial institutions' credit risk management on real estate loans and the developments in the real estate market and undertake appropriate policy actions in a timely manner as needed to ensure financial stability.

4.1.4 Safeguarding the dynamic stability of the NT dollar exchange rate

Adopting flexible FX rate policies

Considering that Taiwan's economy has a relatively small scale and is heavily dependent on international trade, the Bank adopts a managed float exchange rate regime to contain sharp fluctuations of exchange rate. Under this regime, the exchange rate of the NT dollar is in principle decided by market forces. Nevertheless, when seasonal factors (such as massive inflows or outflows of short-term capital) lead to excess volatility and disorderly movements in the NT dollar exchange rate with adverse implications for domestic economic and financial stability, the Bank will, in line with its mandate, aptly maintain FX market order.

In the event of excessive exchange rate volatility caused by movements of large international short-term capital flows, the Bank would conduct “leaning against the wind” operations to stave off adverse implications for economic and financial stability and to enhance FX market efficiency. The Bank continues to maintain the dynamic stability of the NT dollar exchange rate to foster the long-term development of domestic economic growth.

Maintaining an orderly FX market and promoting its sound development

In 2018, the Bank continued to undertake appropriate management measures to safeguard FX market order and promote its sound development. These measures mainly included: (1) continuing to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions to record the updated transaction information in the FX market; (2) reinforcing examination efforts which were made to ensure that forward transactions were based only on actual transactions; (3) urging authorized banks to enhance their exchange rate risk management in order to reduce FX exposure of individual banks and systemic risk in the FX market; and (4) continuing to strengthen targeted examinations on foreign exchange business in order to maintain the order of the FX market.

4.1.5 Strengthening the AML/CFT mechanism in FX business

In accordance with the recommendations of the FATF to strengthen the AML/CFT regulations, the Bank continued to revise foreign exchange regulations as follows:

1. The Bank revised *the Regulations Governing the Establishment and Administration of Foreign Currency Exchange Counters* in June 2018. These revisions mainly included: requiring the applicant to provide the responsible persons' police criminal record certificates showing no conviction record in Taiwan when applying for the establishment of foreign currency exchange counters or change of its responsible person; requiring compliance with standard operating procedures of AML/CFT; requesting to reject suspicious money laundering or terrorist financing (ML/TF) transactions; and amending terrorist financing reporting procedures.
2. In view of Recommendation 16 and assessment methodology of the FATF, the Bank amended *Directions Governing Banking Enterprises for Operating Foreign Exchange Business* in November 2018, such that upon receiving a request from the competent authorities, banks must provide the originator and beneficiary information available within three business days.

4.2 Measures undertaken by the FSC to maintain financial stability

From 2018 onwards, the FSC has continued promoting green financing and FinTech development, as well as paving the way for setting up internet-only banking and amending regulations relating to incentive measures for mergers of financial institutions. Additionally, the FSC has strengthened AML/CFT measures and regulatory compliance programs of financial institutions, as well as enhancing risk management and compliance effectiveness of financial institutions so as to maintain financial stability.

4.2.1 Strengthening Taiwan's AML/CFT measures

In response to the mutual evaluations of the APG and to fully align with the 40 Recommendations of the FATF, the FSC has introduced amendments to the related regulations:

1. In November 2018, the FSC amended the *Regulations Governing Anti-Money Laundering of Financial Institutions*. With regard to the regulation on customer due diligence for occasional transactions, the existing requirement applicable to cash transactions exceeding certain amounts has been amended to be not limited to cash transactions only. Moreover, suspected ML/TF transactions shall be filed promptly after approval by the responsible chief compliance officer at the institution, and the report shall be filed within two business days after the approval.

2. The FSC promulgated three regulations in November 2018, through amendments that made the “directions” governing AML/CFT internal control systems of financial institutions into “regulations”. The main contents of the regulations cover internal control and auditing systems for AML/CFT, ML/TF risk assessment, appointment of dedicated chief compliance officers and unit establishment.

4.2.2 Enhancing risk management, corporate governance and legal compliance of the financial industry

1. In October 2018, the FSC amended related regulations governing qualification requirements, concurrent serving restrictions and matters for compliance by the responsible persons of banks, as well as founders or responsible persons of financial holding companies. The amendments added the provisions for implementing non-compete clauses and raised the required proportion of professional natural person directors on the board of directors of financial institutions. Moreover, the FSC urged each industry’s association to revise corporate governance best-practice principles, and stipulated term limits for independent board directors of financial institutions.
2. The FSC required 36 domestic banks to conduct stress tests in 2018, applying the methodology adopted by advanced economies and including two-year period stress tests for the first time. The results of the overall stress tests revealed that in both mild and relatively serious scenarios, capital adequacy related ratios of domestic banks were all higher than the minimum requirements, showing that banks still have strong capacity to bear risks.
3. In April 2019, the FSC amended the *Banking Act* and the *Securities and Exchange Act* in order to strengthen regulatory compliance of the financial industry. The amendments raised the maximum fine for violating regulations and posing a hindrance to financial examinations, as well as adding regulations governing prohibition of conflicts of interest for responsible persons of banks.

4.2.3 Continually reinforcing the insurance industry’s risk management

1. In November 2018, to strengthen insurance companies’ management of FX-related risk associated with their overseas investments, the FSC amended the relevant requirements that the total amount of investments in international bonds plus foreign investments of insurance companies shall not exceed 145% of its approved foreign investment.

2. In order to further strengthen the mechanisms for FX valuation reserves held by life insurance companies, the FSC introduced the amendments to related directives in January 2019. The amendments required life insurance companies to raise the monthly fixed setting ratio of reserves set aside from 0.05% to 0.06%, and to raise both the monthly additional reserve setting ratio and the monthly additional offsetting ratio from 50% to 60% when the hedging cost in the foreign exchange market reaches 2% or more.

4.2.4 Strengthening mechanism for whistleblower and InfoSec of financial industry

1. In March and May 2018, the FSC amended the related rules governing internal control and auditing systems of financial holding companies, as well as banking, insurance, and securities and futures industries. The amendments required those financial institutions to establish an internal whistleblower mechanism and designate an independent unit to take charge of review and investigation of reported cases.
2. The FSC urged each industry's association to review and establish self-disciplinary regulations of InfoSec and required financial institutions to establish an InfoSec unit and appoint a chief officer to take charge of InfoSec activities. Moreover, the FSC set up the F-ISAC with the aim of building a joint financial defense system for InfoSec in Taiwan.

4.2.5 Promoting risk-based internal audit system

To urge internal auditors of financial institutions to focus on primary risks and conduct audits in depth, the FSC has approved the adoption of risk-based internal audit systems at 10 domestic banks. Additionally, the FSC encouraged large domestic banks to actively adopt this system, with a step-by-step plan divided into two stages according to asset scale.