IV. Measures to promote financial stability and address the COVID-19 pandemic's impact

4.1 Measures taken by the Bank and the FSC for promoting financial stability in 2020

4.1.1 Measures taken by the Bank to promote financial stability

In 2020, considering that the domestic economy still suffered from the COVID-19 pandemic, the Bank cut policy rates and introduced a special accommodation facility to support bank credit to SMEs. Furthermore, to avoid excessive flows of bank credit into the real estate market, the Bank twice adjusted targeted macroprudential measures regarding real estate loans. The Bank also continued to adopt flexible FX rate policies to maintain dynamic stability of the NT dollar exchange rate and to duly review relevant FX regulations.

Reducing the policy rates in March 2020 to mitigate the impact of the pandemic

Impacted by the pandemic that broke out in China in the beginning of 2020, Taiwan's manufacturing industries faced interruptions in supply chains, from which SMEs suffered the greatest. In order to mitigate the pandemic's repercussions on the domestic economy and employment, the Bank cut the discount rate, the rate on refinancing of secured loans, and the rate on temporary accommodations each by 25 bps to 1.125%, 1.5%, and 3.375% in March 2020.

Introducing a special accommodation facility for SME loans

In view of the economic impacts arising from the pandemic, the government consecutively launched relief loan programs both for enterprises and for workers. The Bank also initiated the Special Accommodation Facility to Support Bank Credit to SMEs ("the Facility") in April 2020, followed by a rolling review of the details of the Facility, the deadline of applicable preferential interest rates, total amount of the Facility's accommodations, and the application deadline (Table 4.1) in order to help banks better serve as financial intermediaries and to provide SMEs with easier access to funding. As of the end of 2020, banks had received 195,075 applications with the amount totaling NT$248.8 billion, and the annual growth rate of SME loans extended by domestic banks stood at 13.17% at the end of December 2020.

Table 4.1 Key points of amendments to the CBC's special accommodation facility for SMEs

Date of announcement	Content	Effective date
Mar. 31, 2020	Formulating the *Regulations for the CBC's Handling of the Special Accommodation Facility to Support Bank Credit to SMEs Affected by the Coronavirus Disease (COVID-19)*	Apr. 1, 2020
Apr. 17, 2020	Adding a program for relief lending to small-scale business entities (Program C) so that banks would be able to better help them acquire working capital as soon as possible	Apr. 20, 2020
Apr. 23, 2020	Lowering the interest rates applicable under the Facility from 0.25% to 0.1% to further incentivize banks to lend to SMEs	Apr. 27, 2020
Apr. 23, 2020	Allowing community financial institutions to engage in relief lending to small-scale business entities, thereby enhancing the effectiveness of the Facility	May 4, 2020
Jul. 22, 2020	Adjusting the maximum credit lines for each applicant: Program A (those cases with at least 90% guarantees covered by Taiwan Small & Medium Enterprise Credit Guarantee Fund (SMEG)): Amount raised from NT$2 million to NT$4 million; Program B (those provided with collateral, including at least 80% guarantees covered by Taiwan SMEG): Amount raised to NT$16 million from NT$6 million	Jul. 24, 2020
Aug. 10, 2020	Extending the deadline for preferential interest rates to apply to newly-filed loan applications to June 30, 2021	Aug. 10, 2020
Sep. 22, 2020	Raising the total amount of the Facility to NT$300 billion from NT$200 billion	Sept. 22, 2020
Dec. 10, 2020	Extending the deadline for SMEs to apply for credit support from December 31, 2020 to June 30, 2021, and the deadline for preferential interest rates to apply to newly-filed loan applications to December 31, 2021	Dec. 10, 2020
Mar. 19, 2021	Extending the deadline from March 27, 2021 to December 31, 2021 for accommodations and applicable preferential interest rates for cases that banks applied during the period from April 1, 2020 to August 9, 2020 for the approval of the Bank	Mar. 19, 2021

Source: CBC.

Conducting open market operations to manage market liquidity

To maintain sufficient liquidity in the financial market, the Bank conducts open market operations and manages reserve money at an appropriate level by issuing NCDs. At the end of 2020, the total outstanding amount of NCDs issued by the Bank was NT$9,168 billion, while the average annual growth rate of reserve money registered 8.59% for the year 2020.

Furthermore, from April 2020 onwards, the Bank adjusted the issuance frequency of NCDs to strengthen the effect of NCD rates on market rates. The Bank also flexibly adjusted the total issuance amount of CDs so as to maintain ample funds in the banking system. As a result, the weighted average overnight call loan rate was 0.167% during January and March in 2020 and held at about 0.080% starting from April. To improve the operational readiness and ensure the completeness of the various instruments used for open market operations, the Bank regularly conducted small-scale testing of repo operations with counterparties from April 2020 onwards.

Adjusting targeted macroprudential measures twice to guide efficient allocation of bank credit

In order to promote financial stability and sound banking operations and to preclude excessive flow of bank credit into the real estate market, the Bank used moral suasion at meetings with banks in November 2020 and carried out on-site inspections. Furthermore, it amended the *Regulations Governing the Extension of Mortgage Loans by Financial Institutions* twice in December 2020 and March 2021, introducing LTV ratio caps on and cancelling the grace periods for housing loans granted to corporate entities, the third (or more) housing loans to natural persons, high-value housing loans, land loans, unsold housing unit loans, and idle industrial land mortgage loans (Table 4.2) to attain efficient allocation and proper use of credit resources outlined in the government's Healthy Real Estate Market Plan and to help banks enhance risk management of real estate lending.

Table 4.2 The CBC adjusted twice the *Regulations Governing the Extension of Mortgage Loans by Financial Institutions*

<table>
<tr><th colspan="2" rowspan="2">Loan items</th><th colspan="2">Loan conditions</th></tr>
<tr><th>2020.12.7 amendement[1]</th><th>2021.3.18 amendement[1]</th></tr>
<tr><td rowspan="2">Corporates</td><td>The first housing loan</td><td>LTV cap of 60%, no grace period</td><td>LTV cap of 40%, no grace period</td></tr>
<tr><td>The second (or more) housing loan</td><td>LTV cap of 50%, no grace period</td><td>LTV cap of 40%, no grace period</td></tr>
<tr><td rowspan="3">Natural persons</td><td>The third housing loan</td><td>LTV cap of 60%, no grace period</td><td>LTV cap of 55%, no grace period</td></tr>
<tr><td>The fourth (or more) housing loan</td><td>The same as the third housing loan, no other requirements</td><td>LTV cap of 50%, no grace period</td></tr>
<tr><td>High-value housing loans</td><td>LTV cap of 60%, no grace period</td><td>● No house-purchasing loans or below two housing loans: LTV cap of 55%, no grace period
● Over three housing loans: LTV cap of 40%, no grace period</td></tr>
<tr><td colspan="2">Land loans</td><td>● LTV cap of 65%, 10% may not be disbursed until construction begins
● Submit substantive plan for construction</td><td>No change</td></tr>
<tr><td colspan="2">Unsold housing unit loans</td><td>LTV cap of 50%</td><td>No change</td></tr>
<tr><td colspan="2">Idle industrial land mortgage loans</td><td>Banks internal rules</td><td>LTV cap of 55%[2]</td></tr>
</table>

Notes: 1. The 2020.12.7 amendment took effect on December 8, 2020; the 2021.3.18 amendment took effect on March 19, 2021.
2. It shall not apply if mortgaged land is already under construction, or if the borrower already submits a substantive plan for construction and pledges that construction will begin within a certain period of time.

Source: CBC.

Additionally, the Bank has consecutively conducted targeted examinations of real estate lending business since January 2021 to encourage banks to abide by the Bank's regulations. The Bank also invited ten banks in Q1 for communication to further understand their viewpoints on the real estate market and opinions about carrying out the Bank's regulations. The Bank will closely monitor the developments in the real estate market and financial institutions' credit risk management in real estate lending, examine and evaluate the effectiveness of the relevant regulations, and timely revisit and fine-tune the regulatory measures via a rolling process.

Adopting flexible FX rate policies to safeguard the dynamic stability of the NT dollar exchange rate

As Taiwan is a small open economy that is highly interconnected through trade with other economies, the Bank suitably adopts a managed float exchange rate regime to contain sharp fluctuations in exchange rates. 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 recent years, the huge and frequent movements of international short-term capital flows have superseded international trade and economic fundamentals and become the key factor influencing the volatility of exchange rates. With a view to avoiding disturbance from the abovementioned factor on the domestic FX market, the Bank conducts “leaning against the wind” operations to maintain order in the FX market when necessary so as to mitigate volatile movements of the NT dollar exchange rate and foster FX market efficiency. The dynamic stability of the NT dollar exchange rate is conducive to the long-term sound development of the domestic economy.

Additionally, the Bank continued to undertake appropriate management measures in 2020 to safeguard FX market order and promote its sound development. These measures mainly included: (1) taking hold of the updated transaction information in the FX market through the Real-Time Reporting System for Large-Amount FX Transactions; (2) reinforcing off-site monitoring efforts made to ensure that forward transactions were based on genuine needs, so as to curb FX speculation; (3) urging authorized FX banks to enhance their exchange rate risk management, thereby reducing FX exposures of individual banks and systemic risks in the FX market; and (4) strengthening targeted examinations on FX businesses in order to maintain the discipline of the FX market.

4.1.2 Measures undertaken by the FSC to maintain financial stability

To assist the sound development of Taiwan’s financial industry, from 2020 onwards, the FSC launched several measures, including “Capital Market Roadmap,” “Green Finance Action Plan 2.0,” “Corporate Governance 3.0 - Sustainable Development Roadmap,” “Trust 2.0 - The Promotion Plan for Full Functions of Trust Services,” and “FinTech Development Roadmap,” among others. In addition, the FSC revised financial regulations in accordance with international standards, such as adopting the LTV approach for capital requirements for real estate mortgages granted by banks. Furthermore, the FSC took flexible and responsive measures in a timely manner to counter the impact of the COVID-19 pandemic on the domestic financial system. It also urged financial institutions to reinforce credit risk management of exposures to real estate lending and assessed their risk bearing abilities so as to preserve financial stability.

Measures taken in response to the impact of the COVID-19 pandemic on domestic financial markets and financial institutions

(1) To mitigate the impact of the COVID-19 pandemic on domestic stock markets, the FSC announced restrictions on the short selling of securities and expanded the range of eligible collateral for margin calls in March 2020 with a view to maintaining orderly stock markets and safeguarding investor interests. These interim measures were then repealed in June 2020 when the stock markets gradually stabilized.

(2) The requirement for D-SIBs to set aside a 2% internal capital buffer could be deferred for one year, which will then be implemented over the four years from 2021 to 2024. Meanwhile, the deadline for D-SIBs to report their contingency plans for business crises could be deferred until the end of August 2021.

(3) The FSC required insurers to report the evaluations of the pandemic's impact and the responses taken to their board of directors. In addition, it provided temporary measures to help insurers and their distressed tenants work out rent relief arrangements.

Requiring banks and insurers to conduct stress tests to evaluate their risk bearing capacities

In view of the severe impacts of the COVID-19 pandemic on international and domestic economic and financial conditions, the FSC required domestic banks to report the results of the Pillar II stress tests in April 2020 for the sake of understanding their capabilities to cope with the impacts. The stress scenarios included the impact of the pandemic and could also help reflect the effects of the relief package launched by the government. All domestic banks passed the stress tests based on the results released by the FSC in May 2020,[74] with banks showing sound risk bearing capacities. Also, to understand the impacts on the resilience of financial

[74] After the relief measures were introduced, as a test result of the minor scenarios, the average common equity ratio, Tier 1 capital ratio, capital adequacy ratio and leverage ratio of domestic banks reached 10.67%, 11.44%, 13.13% and 6.36%, respectively. As a test result of the severe scenarios, the above-mentioned four ratios reached 9.81%, 10.59%, 12.27% and 5.87%, respectively.

institutions in the context of low interest rates and a protracted pandemic, the FSC required domestic banks and insurers to conduct year 2021 supervisory stress tests, for the purpose of assessing how their capital adequacy ratios change and where their risk bearing capacities stand under consistent test scenarios.

Strengthening financial institutions' credit risk management of real estate lending and incorporating relevant measures in targeted examinations

With a view to urging financial institutions to prudently control the credit risk incurred by real estate-related exposures, the FSC adopted numerous measures successively from November 2020, which included requiring banks and bills finance companies to improve internal control and operating procedures of real estate lending and conducting targeted examinations on the risk control of banks' unsold newly-built house loans, land and construction loans, loans to real estate investors, and high-value housing loans. Targeted macroprudential measures adjusted recently by the Bank were included as part of the focus of these examinations as well.[75] Moreover, to enhance risk control for real estate lending by bills finance companies, the FSC included their business of guarantees for the real estate industry in the key items of 2021 on-site examinations, and drafted measures to prevent their credit resources from excessively flowing to the real estate market.

Continually strengthening the risk bearing capacity of insurance companies

(1) The insurers in Taiwan are expected to adopt IFRS 17 Insurance Contracts and begin to measure insurance liabilities at fair value in 2026. To align accounting standards of insurers with the solvency regime and help insurance companies fulfill asset and liability management comprehensively, the FSC, emulating the "Insurance Capital Standard (ICS) 2.0" issued by the International Association of Insurance Supervisors (IAIS), planned to implement the "new generation insurance solvency regime"[76] in three phases.[77] The regime is scheduled to be officially launched in 2026, in step with the domestic adoption of IFRS 17.

[75] Between December 2020 and March 2021, the FSC conducted targeted examinations of housing and construction loans granted by domestic banks and real estate credit extended by bills finance companies. The examinations focused on unsold newly-built house loans, land and construction loans, real estate lending to property investors, and high-value housing loans, with the aim of grasping whether banks can prudently evaluate lending purposes and repayment sources and earnestly implement loan reviews and other risk management mechanisms.

[76] The emphases of the new generation insurance solvency regime include: (1) using the market value approach, i.e., evaluation of assets and liabilities at fair value; (2) insurance capital being classified as Tier 1 and Tier 2; (3) adoption of stress scenario methods for risk capital calculation, taking the resulting changes of net worth or liabilities into consideration and including catastrophe risks.

[77] Phase I (2020-2021) is the on-site field testing period. Phase II (2022-2024) will be the parallel run period, and phase III (2025) will be the preparatory period.

(2) The FSC amended the *Insurance Act*, adding new provisions that set the net worth ratio - along with the capital adequacy ratio currently in use - as dual supervisory indicators and classification standards of capital categories in order to reinforce the risk bearing capacity of insurance companies. Also, the restrictions on insurers investing in domestic industries, public utilities, and social welfare enterprises were loosened.[78] The Legislative Yuan passed these amendments in May 2021.

[78] The basis for calculation of corporate bond investment caps has been changed from "paid-in capital" to "shareholders' equity." In addition, the restriction on the maximum number of directors and supervisors that an insurance company may appoint to the board of a public utility or a social welfare enterprise has been eased from less than 1/3 to 2/3 of the members of that board.