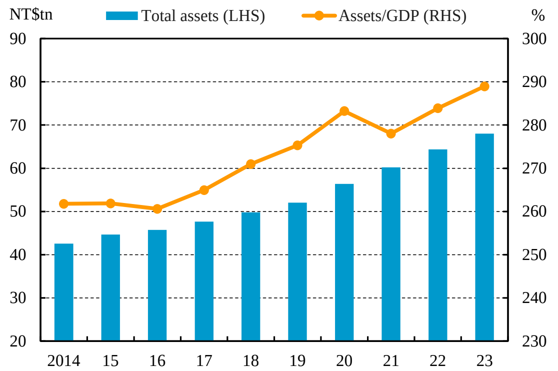
3.2 Financial institutions

In 2023, the performance of domestic financial institutions varied. Domestic banks achieved record-high profits, with improvements in asset quality and capital adequacy ratios. Life insurance companies saw a notable rebound in profits after experiencing a significant decline, and overall capital levels remained adequate, yet they still faced higher market risk. Bills finance companies suffered a drop in profits and continued to face elevated liquidity risk, while their capital adequacy ratios increased. Overall, domestic banks, life insurance companies, and bills finance companies were able to operate stably.

3.2.1 Domestic banks

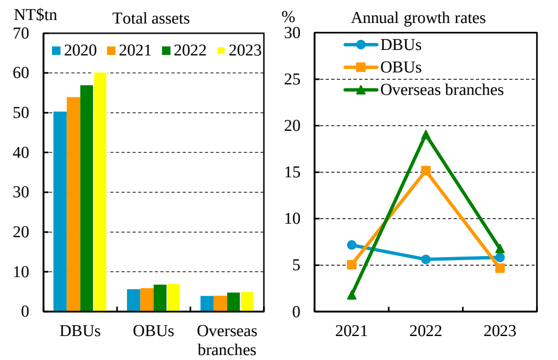
In 2023, the total assets of domestic banks[35] continued to expand, while asset quality improved. The sectoral concentration in corporate loans declined marginally, and exposures to China continued to decline. However, real estate-secured credit remained at a high level, and credit quality of overseas real estate-secured credit deteriorated. The estimated value at risk (VaR) of market risk exposures slightly increased, but its impacts on capital adequacy ratios were limited. Liquidity in the banking system was ample, and overall liquidity risk remained relatively low. The profitability of domestic banks continuously increased in 2023 and reached a historical high. The average capital adequacy ratio rose and maintained an adequate capital level, suggesting satisfactory capacity to bear losses.

Chart 3.18 Total assets of domestic banks



Sources: CBC and DGBAS.

Chart 3.19 Total assets of domestic banks by sector



Note: Figures for total assets include interbranch transactions.
Source: CBC.

Total assets kept growing

The total assets of domestic banks kept growing, albeit at a slower pace, and reached NT$68.03 trillion at the end of 2023, with an annual growth rate of 5.66% compared to

[35] Includes the Agricultural Bank of Taiwan.

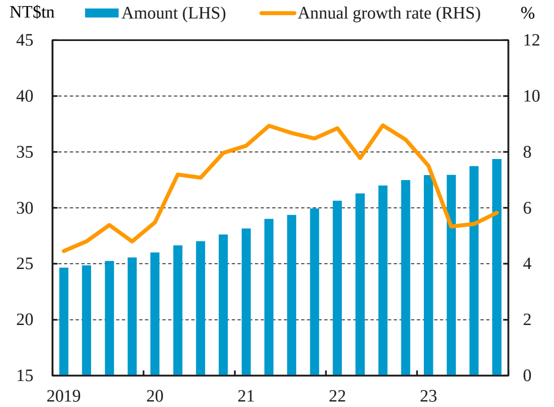
6.91% a year earlier. The ratio of total assets to annual GDP continuously rose to 288.95% (Chart 3.18). Broken down by sector, the annual asset growth rates of domestic banking units (DBUs) rebounded slightly, whereas the rates of offshore banking units (OBUs) and overseas branches experienced sharp drops (Chart 3.19).

Credit risk

Customer loan growth slowed

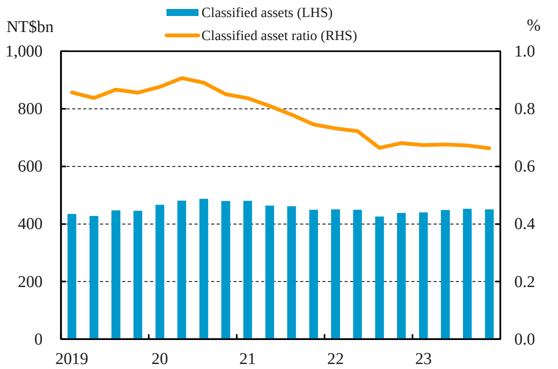
Customer loans were the major source of credit risk for domestic banks. The outstanding customer loans of DBUs stood at NT$34.37 trillion at the end of 2023, accounting for 50.52% of total assets with its annual growth rate decreasing to 5.83% (Chart 3.20). Among them, the annual growth rate of household borrowing rose marginally to 7.03%, while the growth rate of corporate loans declined to 5.61% owing to decreasing corporate funding demand amid international and domestic economic downturns. Moreover, the annual growth rate of government loans continued to drop to -5.91%, mainly because increasing government tax revenues reduced borrowing demand from banks.

Chart 3.20 Outstanding loans in domestic banks



Note: Loans of OBUs and overseas branches are excluded.
Source: CBC.

Chart 3.21 Classified assets of domestic banks



Note: Classified asset ratio = classified assets/total assets.
Source: CBC.

Asset quality improved

The outstanding classified assets[36] of domestic banks increased by 2.85% from a year earlier to NT$450.9 billion at the end of 2023. However, the average classified asset ratio slightly decreased by 0.02 pps from the end of the previous year and stood at 0.66% (Chart 3.21), showing that the asset quality of domestic banks improved. Although the expected losses of classified assets[37] increased by NT$0.3 billion from a year earlier to NT$50.4 billion, they

[36] Assets of domestic banks are broken down into five categories: normal, special mention, substandard, doubtful, and loss. The term "classified assets" herein includes all assets classified under the latter four categories.
[37] Loss herein refers to losses from loans, acceptances, guarantees, credit cards, and factoring without recourse.

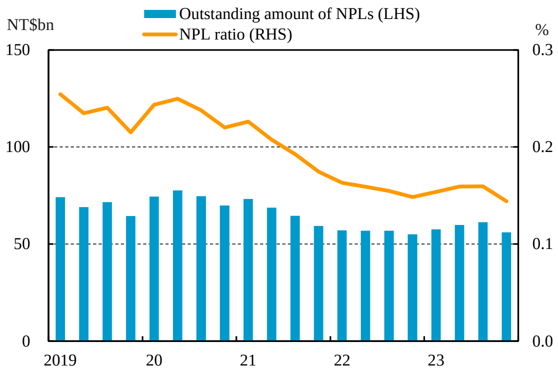
only accounted for 8.62% of allowances for doubtful accounts and loss provisions, indicating sufficient provisions to cover expected losses without eroding equity.

The outstanding NPLs of domestic banks registered NT$56.0 billion at the end of 2023, decreasing by 1.84% from the end of the previous year. The average NPL ratio also declined and reached a record low of 0.14% (Chart 3.22). In addition, at the end of 2023, the loan coverage ratio and the NPL coverage ratio increased to 1.38% and 960.96% (Chart 3.23), respectively, owing to a greater increase in total provisions. The overall ability of domestic banks to cover potential loan losses remained satisfactory.

The share of real estate-secured credit increased

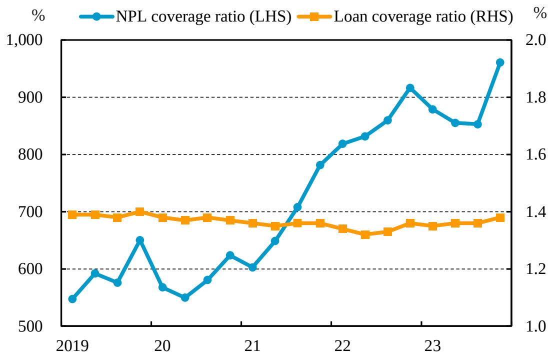
At the end of 2023, real estate-secured credit granted by domestic banks amounted to NT$23.44 trillion, accounting for 57.99% of total credit.[38] The ratio increased over the previous year, indicating a rise in concentration (Chart 3.24). As the government lanched the enhanced program of Preferential Housing Loans for the Youth, transactions in the housing market gradually gained momentum and housing prices remained high. However, owing to owner-occupant homebuyers' limited ability to chase market prices as well as a continual increase in unsold newly built residential housing units from

Chart 3.22 NPLs of domestic banks



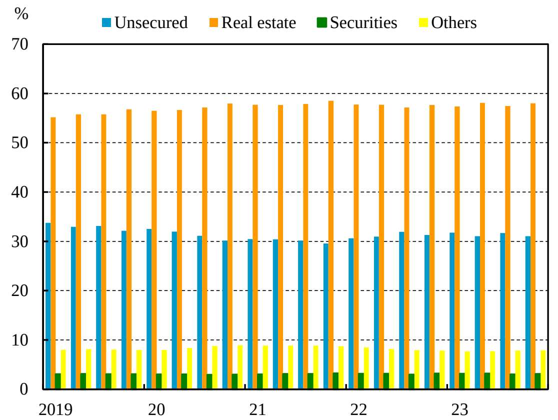
Note: Excludes interbank loans.
Source: CBC.

Chart 3.23 NPL coverage ratio and loan coverage ratio of domestic banks



Notes: 1. NPL coverage ratio = total provisions/non-performing loans.
2. Loan coverage ratio = total provisions/total loans.
3. Excludes interbank loans.
Source: CBC.

Chart 3.24 Credit by type of collateral in domestic banks

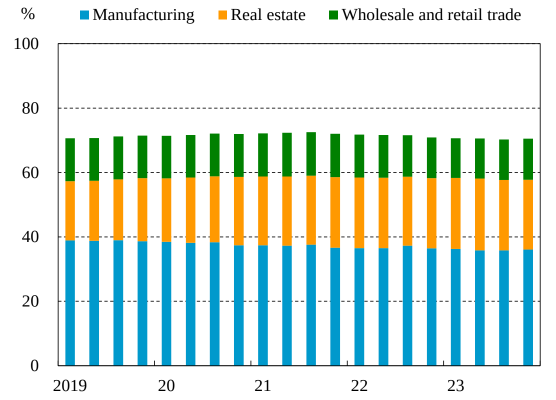


Source: CBC.

[38] The term "credit" herein includes loans, guarantee payments receivable, and acceptances receivable.

2022 Q1, the impact from changes in housing supply and destocking of unsold residential housing units on banks' credit quality merits close attention.

Chart 3.25 Shares of corporate loans of the three largest industries



Note: Exposures of OBUs and overseas branches were excluded.
Source: CBC.

Credit concentration in corporate loans slightly decreased

Corporate loans granted by the DBUs of domestic banks stood at NT$15.18 trillion at the end of 2023. Among the borrowers, the largest three industries combined accounted for 70.52%, slightly lower than the 70.90% of the previous year (Chart 3.25), indicating that credit concentration in corporate loans decreased modestly. Among loans to the manufacturing sector,[39] which represented the largest segment, loans to the electronics industry constituted the largest share at 32.36%, slightly increasing from 31.88% the previous year.

Credit quality of overseas CRE deteriorated

In 2023, affected by serveral factors such as the rising trend of working from home after the pandemic, the Fed's rapid rate hikes, high inflation, and worsening CRE market conditions, the credit quality of US and Euporean CRE loans granted by domestic banks deteriorated. Nonetheless, the risk was manageable because CRE loans were less than 0.5% of total loans.

Given that the IMF and regulatory authorities such as the US Fed and the Financial Stability Oversight Council recently all regarded the vulnerability related to the CRE industry as one of the main financial stability risks,[40] changes in credit quality of overseas CRE loans still require close attention.

Exposures to China continued to decrease, but potential risks remained high

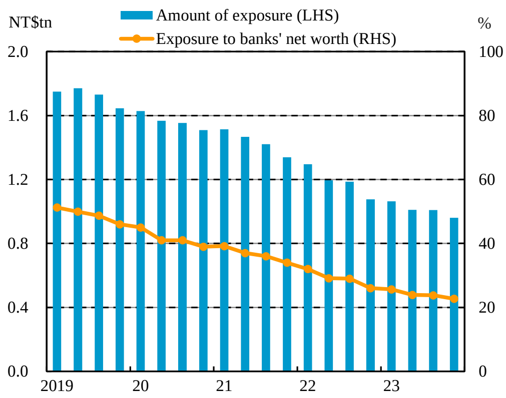
At the end of 2023, the exposures of domestic banks to China stood at NT$0.96 trillion, representing a 10.66% decrease from the previous year, mainly attributed to a 14.53% reduction in credit granted. The above exposures as a percentage of net worth also reached

[39] Loans to the manufacturing sector are divided into five categories by industry, including: (1) electronics, (2) mining of metals and non-metals, (3) petrochemicals, (4) traditional manufacturing, and (5) others.
[40] For more details, please refer to Federal Reserve (2023), *Financial Stability Report*, May; IMF (2023), *Global Financial Stability Report*, October; FSOC (2023), *Annual Report*, December.

a new record low of 23% (Chart 3.26).

China's economy is currently experiencing a contraction in the real estate market, subdued domestic demand, and a worsening local government debt crisis, all contributing to a protracted economic deceleration. In addition, with escalating global geopolitical risks, it is essential to closely monitor how these evolving conditions might affect the quality of credit risk exposure.

Chart 3.26 Exposures of domestic banks to China



Source: FSC.

Market risk

Estimated value-at-risk for market risk exposures witnessed a marginal increase

Based on the Bank's VaR model,[41] the estimated total VaR for market risk exposures of domestic banks stood at NT$172.5 billion at the end of 2023, increasing by NT$3.2 billion or 1.89% compared to a year earlier. Among the market risk exposures, the interest rate VaR rose slightly by 1.11% year on year due to higher net positions in debt securities. The equities VaR climbed by 19.66% as banks significantly expanded their net positions in equity securities. The

Table 3.1 Market risks in domestic banks

Unit: NT$bn

Type of risk	Item	End-Dec. 2022	End-Dec. 2023	Changes	
				Amount	pps
Foreign exchange	Net position	200.5	178.5	-22.0	-10.97
	VaR	4.4	3.6	-0.8	-18.18
	VaR/net position (%)	2.19	2.02		-0.17
Interest rate	Net position	1,760.9	2,034.1	273.2	15.51
	VaR	153.2	154.9	1.7	1.11
	VaR/net position (%)	8.70	7.62		-1.08
Equities	Net position	59.2	95.1	35.9	60.64
	VaR	11.7	14.0	2.3	19.66
	VaR/net position (%)	19.76	14.72		-5.04
Total VaR		169.3	172.5	3.2	1.89

Source: CBC.

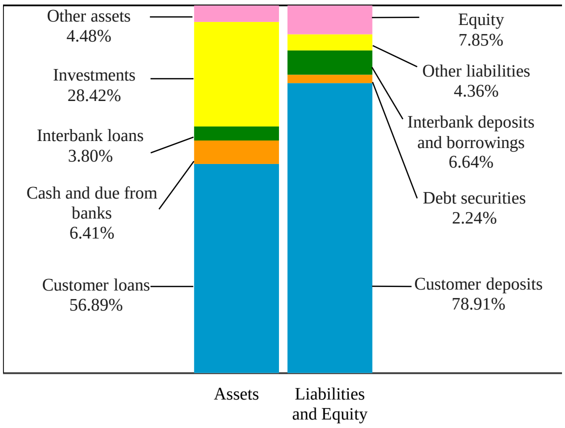
[41] For more details about the Bank's VaR model, please see CBC (2016), Box 2, *Financial Stability Report*.

FX VaR diminished by 18.18% compared to the end of the previous year, owing to a reduction in net positions and a notable decline in the volatility of the NT dollar exchange rate against the US dollar (Table 3.1).

The impact of market risk on capital adequacy ratios was limited

According to the estimation mentioned above, the total VaR would lead to a decrease of 0.42 pps[42] in the average capital adequacy ratio of domestic banks, causing the ratio to drop from the current 15.33% to 14.91%. Nevertheless, it would still be higher than the statutory minimum standard of 10.5%. Considering the uncertainty surrounding the pace of interest rate cuts by the Fed and central banks in other advanced economies, along with potential heightening of financial market volatility resulting from the spillover effects of global geopolitical risks, market risk could further increase, which warrants close attention.

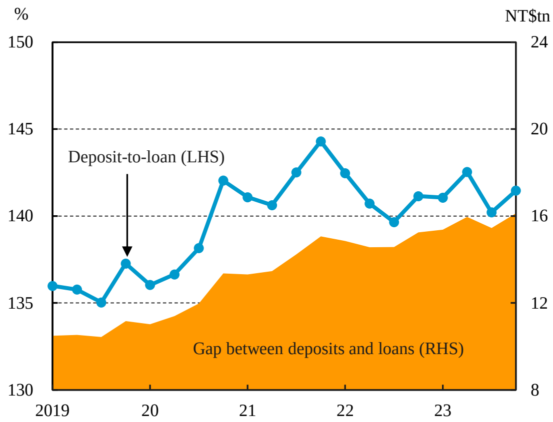
Chart 3.27 Asset/liability structure of domestic banks



Notes: 1. Figures are as of end-December 2023.
2. Equity includes loss provisions. Interbank deposits include deposits with the CBC.

Source: CBC.

Chart 3.28 Deposit-to-loan ratio of domestic banks



Source: CBC.

Liquidity risk

Liquidity in the banking system remained ample

The asset and liability structure of domestic banks remained roughly unchanged in 2023. For the sources of funds, customer deposits, which tend to be relatively stable, still made up the largest share with 78.91% of the total, followed by equity at 7.85%. As for the uses of funds, customer loans accounted for the biggest share with 56.89%, followed by security investment at 28.42% (Chart 3.27).

[42] Domestic banks had already set aside capital for market risk in accordance with relevant regulations. To avoid double counting, the impacts of market risk on the capital adequacy ratio herein were estimated using capital shortfalls after considering the aforementioned market risk capital.

At the end of 2023, the average deposit-to-loan ratio of domestic banks slightly rose to 141.46%, higher than the end of the previous year, and the funding surplus (i.e., deposits exceeding loans) was NT$16.12 trillion (Chart 3.28). The overall liquidity of domestic banks remained abundant.

Overall liquidity risk remained relatively low

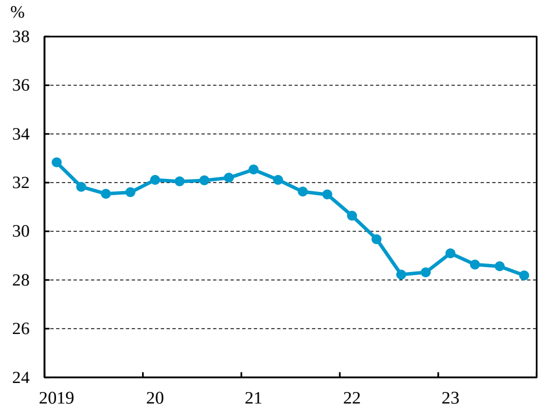
The average NT dollar liquid reserve ratio of domestic banks was much higher than the statutory minimum standard of 10% in every month of 2023 and stood at 28.19% in December (Chart 3.29), a slight decrease compared to the same period of the previous year, while the ratios of individual banks were each higher than 15%. At the end of 2023, the average liquidity coverage ratio (LCR) of domestic banks dropped marginally to 133%; the net stable funding ratio (NSFR) of domestic banks remained at 138% (Chart 3.30). The overall liquidity risk of domestic banks was relatively low.

Profitability

Profits in 2023 hit new historical highs

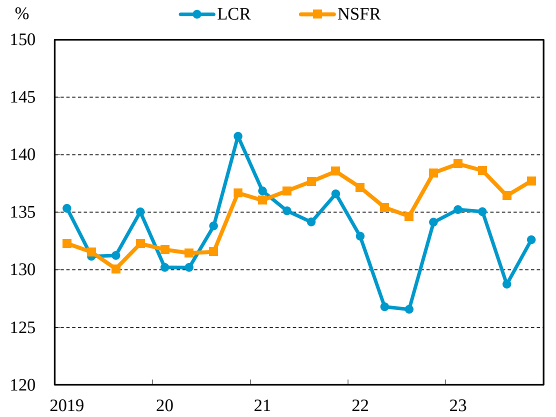
Benefiting from increases in investment profits , gains on disposal, and valuation from FX swap transactions, the net income before tax of domestic banks kept rising to a new historical high of NT$472.6 billion in 2023, increasing by 20.30% over the previous year. The average ROE and ROA also went up to 10.33% and 0.70%, respectively (Chart 3.31).

Chart 3.29 Liquid reserve ratio of domestic banks



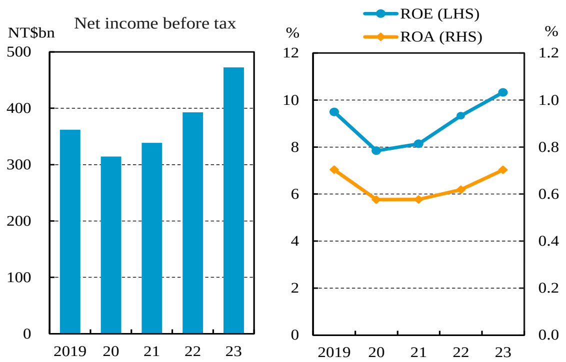
Note: Figures are the average daily data in the last month of each quarter.
Source: CBC.

Chart 3.30 LCR and NSFR of domestic banks



Source: CBC.

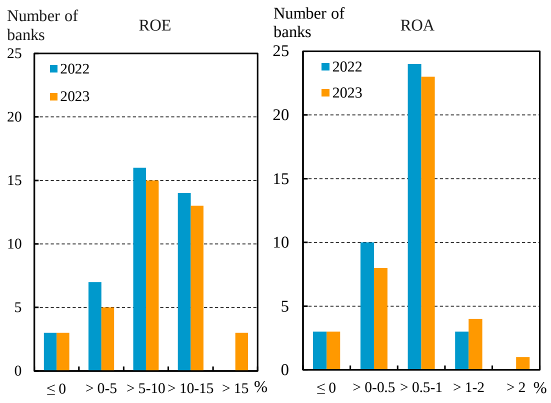
Chart 3.31 Net income before tax of domestic banks



Notes: 1. ROE = net income before tax/average equity.
2. ROA = net income before tax/average assets.
Source: CBC.

In 2023, three internet-only banks, which officially began operations in recent years, posted operating losses, whereas all the other banks made profits. Most banks' ROEs and ROAs were higher than the previous year. Sixteen banks achieved a profitable ROE of 10% or more, compared to fourteen banks in 2022. Meanwhile, five banks recorded ROAs above the international standard of 1%, more than the three banks in 2023 (Chart 3.32).

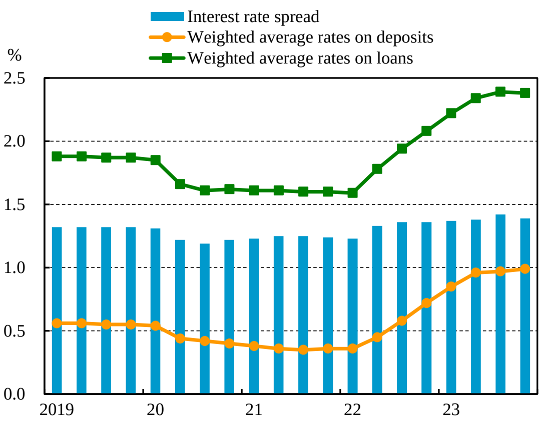
Chart 3.32 Domestic banks classified by ROE and ROA



Source: CBC.

Factors that might affect future profitability

Chart 3.33 Interest rate spread of domestic banks



Notes: 1. Interest rate spread = weighted average interest rates on loans - weighted average interest rates on deposits.
2. The weighted average interest rates on deposits and loans exclude preferential deposits of retired government employees and central government loans.

Source: CBC.

Affected by the policy rate hikes, the average interest rate spread between deposits and loans of domestic banks continued to widen to 1.39% at the end of 2023 from 1.36% a year earlier (Chart 3.33), which helped to raise the profitability of domestic banks. However, there are still some uncertainties warranting close attention, including: (A) In 2024, gains from FX swap transactions have gradually decreased owing to subdued market demand. Additionally, relatively high lending interest rates may affect corporate loan demand. Both of the aforementioned could be detrimental to banks' future profit growth. (B) The escalation of geopolitical risks and the resultant global supply chain disruptions and trade fragmentation could drag down global economic growth. This, in turn, may impact corporate profits and real household income, ultimately threatening banks' profitability and loan quality.

Capital adequacy

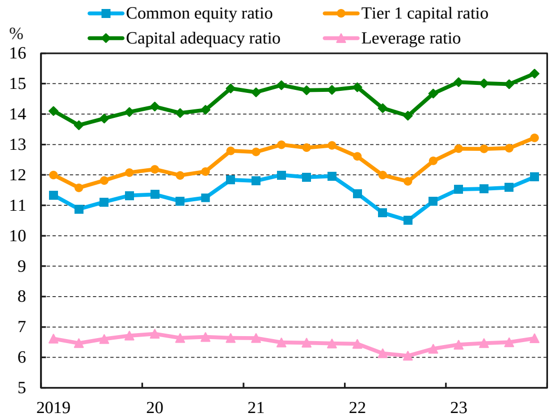
Capital ratios rose

In 2023, benefiting from accumulated earnings, an increase in valuation gains on financial assets and capital injections in cash by several banks, the average common equity ratio, Tier 1 capital ratio, and capital adequacy ratio rose to 11.93%, 13.22%, and 15.33%, respectively, at the end of 2023 (Chart 3.34). Among them, the Tier 1 capital ratio and capital adequacy ratio both reached new record highs in 20 years.

Among the components of regulatory capital, common equity Tier 1 (CET1) capital accounted for 77.83%. The high share of CET1 capital, which features the best loss-bearing capacity, showed that the capital quality of domestic banks was satisfactory. Furthermore, according to the latest regulatory stress tests requested by the FSC,[43] domestic banks maintained sound capital adequacy, reflecting satisfactory risk management capability.

Moreover, the average leverage ratio of domestic banks stood at 6.63% at the end of 2023 (Chart 3.34), higher than 6.28% a year earlier and well above the 3% statutory standard, indicating that financial leverage remained sound.

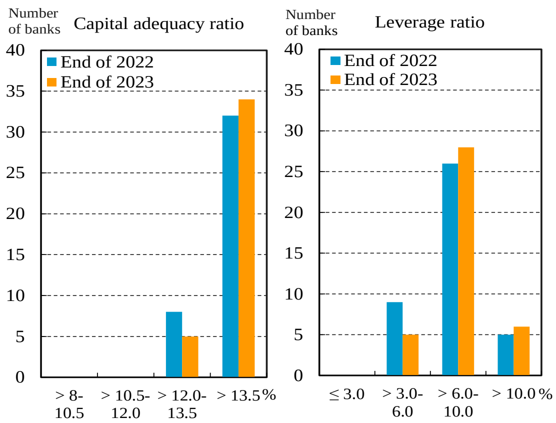
Chart 3.34 Capital ratios and leverage ratios of domestic banks



Notes: 1. Common equity ratio = common equity Tier 1 capital/risk-weighted assets.
2. Tier 1 capital ratio = Tier 1 capital/risk-weighted assets.
3. Capital adequacy ratio = regulatory capital/risk-weighted assets.
4. Leverage ratio = Tier 1 capital/total exposure.

Source: CBC.

Chart 3.35 Capital ratios and leverage ratios of domestic banks



Source: CBC.

All domestic banks had capital ratios and leverage ratios higher than the statutory minimum standards

At the end of 2023, the capital ratios of six domestic systemically important banks (D-SIBs) and non-D-SIBs were all above statutory minimum standards or the relevant capital buffer requirements set by the FSC in 2023.[44] Leverage ratios of all domestic banks also exceeded the statutory minimum standard of 3% (Chart 3.35).

[43] According to the press release published by the FSC on September 14, 2023, 38 domestic banks carried out regulatory stress tests. The result revealed that in the serious scenario, the average common equity ratio, Tier 1 capital ratio, capital adequacy ratio and leverage ratio of domestic banks were all higher than the statutory minimum standards, reflecting that domestic banks have sound risk management and capital adequacy in the face of changes in the global economy and financial environment.

[44] The statutory standards for the common equity ratio, Tier 1 capital ratio, and capital adequacy ratio of non-D-SIBs are 7%, 8.5% and 10.5%, respectively. D-SIBs are required to set aside an additional 2% of buffer capital and 2% of internal management capital according to the requirement of the FSC. The additional capital must be achieved before the end of each of the four years equally starting from the next year after the designated date (the enforcement of the internal management capital requirement was postponed for one year and must be achieved before each year-end of the four years equally from 2022 onwards).

Credit ratings

Average credit rating level remained steady

Of the overall risk assessments of Taiwan's banking system made by credit rating agencies, Standard & Poor's kept Taiwan's Banking Industry Country Risk Assessment (BICRA) [45] unchanged at Group 4 with moderate risk. Compared to other Asian economies, the systemic risk level of Taiwan was the same as that of Malaysia, but much lower than those of the Philippines, China, Thailand and Indonesia. Moreover, the assessment of Taiwan's banking system by Fitch Ratings in its Banking System Indicator/ Macro-Prudential Indicator (BSI/MPI)[46] also remained unchanged at level bbb/2 (Table 3.2).

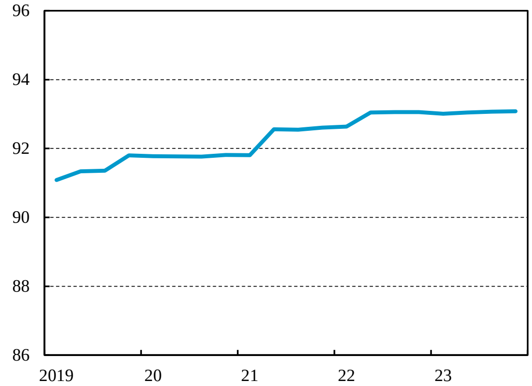
In addition, the weighted average credit rating index[47] was broadly the same as the end of the previous year (Chart 3.36). Overall, the credit rating level remained steady.

Table 3.2 Systemic risk indicators for the banking system

Banking System	Standard & Poor's		Fitch	
	BICRA		BSI/MPI	
	2023/2	2024/2	2022/7	2023/7
Singapore	2	2	aa/2	aa/2
Hong Kong	2	2	a/2	a/2
Japan	3	3	a/3	a/3
South Korea	3	3	a/2	a/2
Taiwan	**4**	**4**	**bbb/2**	**bbb/2**
Malaysia	4	4	bbb/1	bbb/1
Philippines	5	5	bb/1	bb/1
China	6	6	bb/1	bbb/1
Thailand	7	7	bbb/1	bbb/1
Indonesia	6	6	bb/1	bb/1

Sources: Standard & Poor's and Fitch Ratings.

Chart 3.36 Credit rating index of domestic banks



Sources: Taiwan Ratings, Fitch Ratings and CBC.

Rating outlooks for most domestic banks remained stable or positive

As of the end of 2023, most of the 39 domestic banks[48] maintained credit ratings of twAA/twA (Taiwan Ratings) or AA(twn)/A(twn) (Fitch Ratings) and none had credit ratings lower than

45 BICRA is scored on a scale from 1 to 10, ranging from the lowest-risk (group 1) to the highest-risk (group 10), which indicates the assessment results by Standard & Poor's of economic and industry risks of a country's banking system.

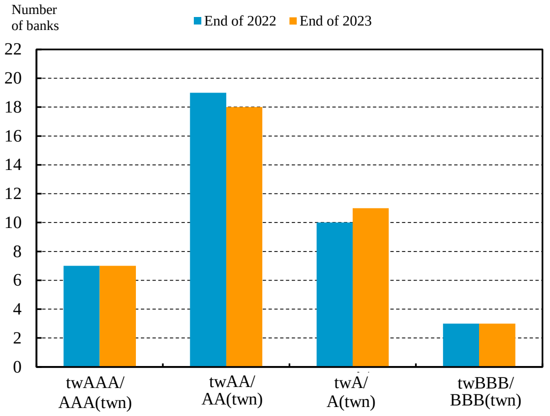
46 Fitch Ratings assesses banking system vulnerability with two complementary measures, the BSI and the MPI. These two indicators are brought together in a Systemic Risk Matrix. The BSI represents banking system strength on a scale from aaa (strongest), aa, a, bbb, bb, b, ccc, cc, c to f (fail). The MPI indicates the vulnerability of the macro environment on a scale from 1 (lowest vulnerability), 2, 2* to 3 (highest vulnerability).

47 The credit rating index is an asset-weighted average rating score of rated domestic banks, measuring the overall creditworthiness of those banks on a scale from 1 (weakest) to 100 (strongest). The rating score for banks is determined according to their long-term issuer ratings from Taiwan Ratings or national long-term ratings from Fitch Ratings. The higher the index is, the better the bank's overall solvency.

48 With JihSun Bank (AA-(twn)) merged into Taipei Fubon Bank (twAA+) on April 1, 2023, the number of domestic banks dropped to 39, and all of them received credit ratings.

twBB/BB(twn) (Chart 3.37).[49] In terms of rating outlooks, except for one bank whose rating outlook was negative, those of the rest remained stable or positive.

Chart 3.37 Number of domestic banks classified by credit ratings



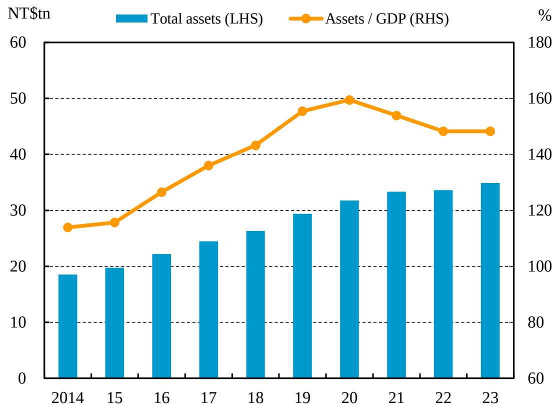
Sources: Taiwan Ratings and Fitch Ratings.

Taiwan Ratings projected that Taiwan's banking industry outlook would remain stable in 2024 and indicated that credit costs would stay at a low level amid the stable domestic economic situation and a cautious overseas growth environment. This, together with banks' adequate capital levels, could support their business growth and ability to withstand unexpected market fluctuations.[50]

3.2.2 Life insurance companies

In 2023, the total assets of life insurance companies continued to increase. The average equity to asset ratio improved, and overall credit ratings remained stable. Although their profits significantly declined, there was a notable rebound in 2024 Q1. With the expansion of foreign investment positions, life insurance companies still faced higher FX risk, interest rate risk and equity risk. In addition, considering their premium income is generally lower than their benefit payment, their future cash flows warrant continuous attention.

Chart 3.38 Total assets of life insurance companies



Sources: FSC and DGBAS.

Assets kept growing

The total assets of life insurance companies reached NT$34.90 trillion at the end of 2023, equivalent to 148.24% of annual GDP (Chart 3.38). The annual growth rate of total assets increased to 3.81% from 0.84% a year earlier, indicating continuous asset growth. The market

49 Since Line Bank was rated BBB+(twn) for the first time, Hwatai Bank's credit rating changed from twBBB+ to A-(twn) as of changing the rating agency, and JihSun Bank merged into Taipei Fubon Bank, the number of domestic banks with credit ratings of twAA/AA(twn) decreased by one, twA/A(twn) increased by one, and twBBB/BBB(twn) remained unchanged as of the end of 2023.

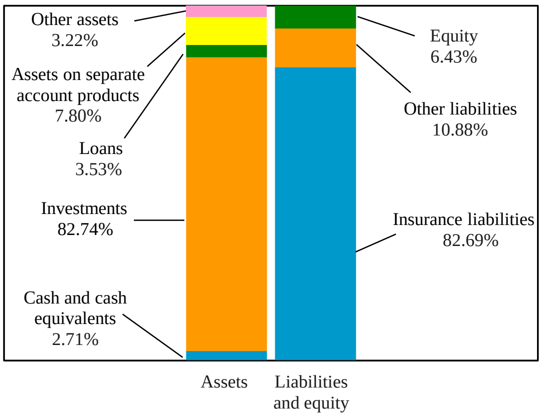
50 Press release by Taiwan Ratings on December 14, 2023.

structure of the life insurance industry remained roughly unchanged at the end of 2023, as the top three companies in terms of assets held a combined market share of 54.67%.

Investment positions continued to grow

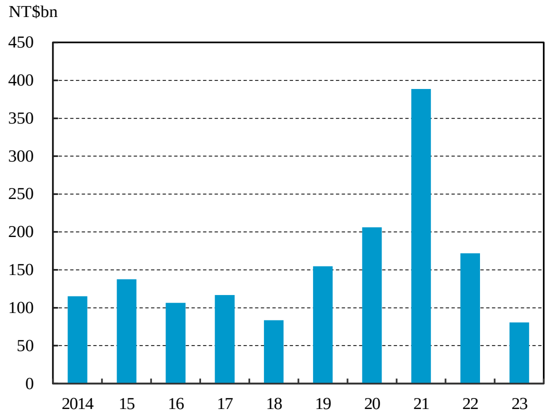
In terms of the usage of funds of life insurance companies as of the end of 2023, investments continued to take up the primary share of total assets, with the share rising to 82.74% owing to an increase in foreign investments.[51] As for the sources of funds, insurance liabilities accounted for the largest share of 82.69%. Meanwhile, the share of equity increased to 6.43% mainly owing to the reclassification of financial assets by some life insurers and a substantial reduction in unrealized valuation losses from financial assets (Chart 3.39).

Chart 3.39 Asset/liability structure of life insurance companies



Note: Figures are as of the end of 2023.
Source: FSC.

Chart 3.40 Net income before tax of life insurance companies



Source: FSC.

Pretax income slumped in 2023 but rebounded substantially in 2024 Q1

Life insurance companies reported a net income before tax of NT$80.6 billion in 2023, a considerable year-on-year decrease of 53.09% from NT$171.9 billion a year earlier (Chart 3.40). This mainly resulted from a huge drop in FX gains and a rise in hedging costs.[52] Their average ROE and ROA reached near 10-year lows after dropping to 4.20% and 0.24%, respectively, from 7.97% and 0.51% a year earlier (Chart 3.41). In 2024 Q1, driven primarily by improvements in FX gains and investment revenue, the net income before tax totaled NT$96.0 billion, indicating a significant increase from the same period of the previous year.

51 Foreign investments and domestic portfolio investments (including investments in insurance-related enterprises) made up 62.62% and 17.14% of total assets, respectively.

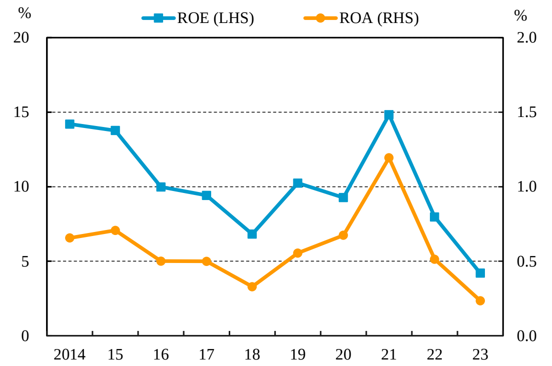
52 In 2023, the NT dollar depreciated by 0.09% against the US dollar compared to a depreciation of 9.83% in 2022, leading to a plunge of NT$1,275.1 billion in FX gains. Hedging costs in 2023 amounted to NT$360.2 billion, a rise of NT$210.6 billion or 140.78% compared to the previous year.

Average RBC ratio and equity to asset ratio both rebounded

At the end of 2023, mainly because of a marginally larger increase in total capital than in risk-based capital, the average RBC ratio slightly rose to 298.09% from 297.82% a year earlier (Chart 3.42).[53] Among life insurers, two life insurance companies were below the minimum statutory ratio of 200% (Chart 3.43).

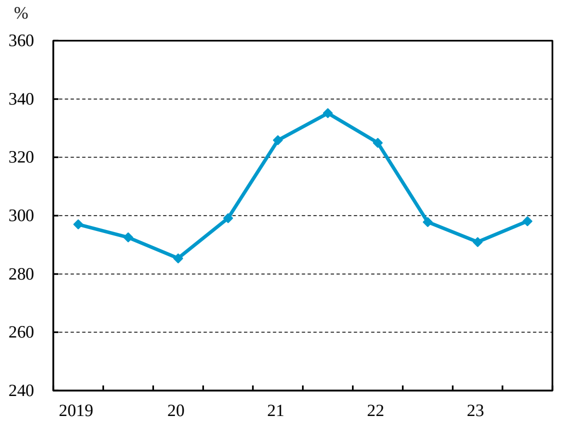
Furthermore, with some life insurance companies conducting financial asset reclassification, as well as a surge in US government bond prices and stock rallies, the average equity to asset ratio climbed to 7.12% at the end of 2023, much higher than the 5.27% registered a year earlier (Chart 3.44). Nonetheless, there was still one life insurance company with the ratio below the statutory minimum of 3%.

Chart 3.41 ROE & ROA of life insurance companies



Notes: 1. ROE = net income before tax/average equity.
2. ROA = net income before tax/average assets.
Source: FSC.

Chart 3.42 RBC ratio of life insurance companies



Notes: 1. RBC ratio = regulatory capital/risk-based capital.
2. Figures are exclusive of life insurance companies in receivership.
Source: FSC.

Overall credit ratings remained stable

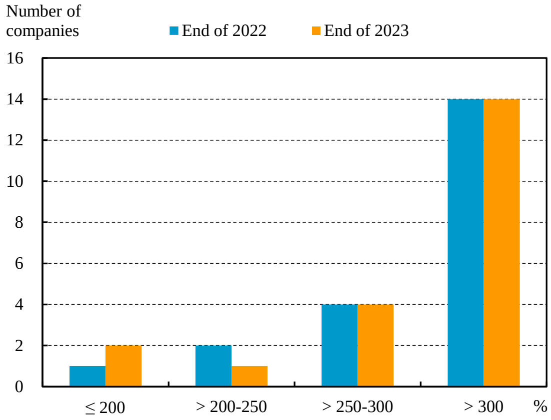
Among the 15 life insurance companies rated by credit rating agencies in 2023, only one was downgraded to twA- by Taiwan Ratings owing to its weakened profitability and a capital level below the industry average, while ratings for other companies remained unchanged. At the year-end, except for one company rated twA-, all the other life insurance companies maintained credit ratings above twA or its equivalent. Among them, the top three companies in terms of assets all retained twAA ratings, representing a strong capacity to meet their financial commitments. As for rating prospects, most of them were rated with a stable outlook, except for two being rated with a negative outlook.

Taiwan Ratings indicated[54] that life insurers' profitability in 2024 would continue to face

[53] Life insurance companies are required to report their capital adequacy ratio data to the regulatory authority every six months.
[54] Taiwan Ratings (2023), "2024 Taiwan Credit Outlook," December.

challenges, such as the elevation of FX hedging costs and the difficulty of timely disposal of investment positions amid drastic volatility in financial markets. As these factors could lead to weakening capital buffers, the rating outlook was maintained as negative.

Chart 3.43 Number of life insurance companies classified by RBC ratios

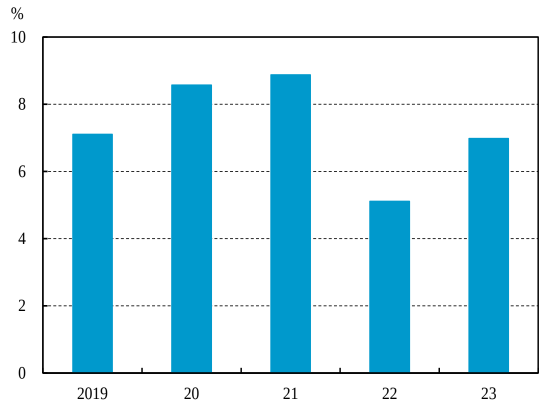


Source: FSC.

Foreign investment positions faced higher market risk

Foreign investment positions of life insurance companies grew continuously and reached NT$21.86 trillion at the end of 2023. Securities investments constituted the largest share, of which about 90% went to bills and bonds and 10% to equities. As the FOMC continued to be cautious about cutting interest rates, the future direction of its monetary policy remained uncertain. Additionally, the Russia-Ukraine war and ongoing tensions in the Middle East could affect the performance of domestic and foreign stock and bond markets. As a result, life insurance companies still faced higher equity risk and interest rate risk.

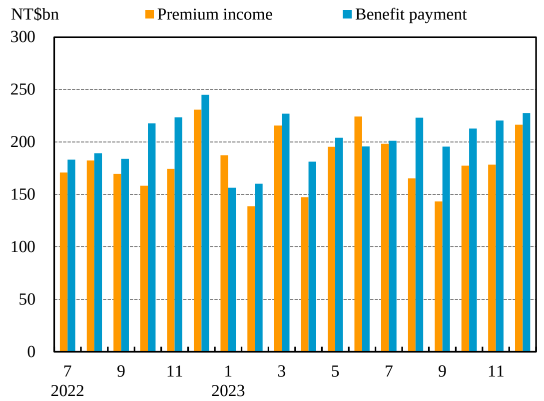
Chart 3.44 Equity to asset ratios of life insurance companies



Notes: 1. Equity to asset ratio of 2023 is audited figure.
2. For assets, the assets of investment-linked insurance products in separate accounts are excluded.
Source: FSC.

Furthermore, more than 90% of foreign investment positions of life insurance companies were in US dollars. In order to alleviate the impacts of exchange rate fluctuations, life insurance companies actively used derivative financial instruments for FX hedging, as well as building up FX valuation reserves in compliance with the relevant regulations. However, as the FX risk inherent in large-value open FX positions of life insurance companies remained high, it warrants constant close attention. Given the recent surge in FX hedging costs for life insurance companies, the FSC amended the regulations related to FX valuation reserves in March 2023. These amendments aimed to help life insurers to improve exchange rate risk management in a more flexible manner and stabilize hedging costs, thereby strengthening their solvency and financial soundness.

Chart 3.45 Premium income and benefit payment of life insurance companies



Note: Benefit payment includes maturity, survival repayment and termination.
Source: Taiwan Insurance Institute.

Decline in premium income narrowed, but future cash flow changes warrant continuous monitoring

Affected by a slump in the sales of interest-sensitive policies and continued shrinkage in the sales of investment-linked annuities, the monthly premium income has been mostly lower than benefit payment since July 2022 (Chart 3.45). In 2023, premium income amounted to NT$2.19 trillion with a 6.27% year-on-year decrease, representing a more moderate decline than the 21.43% drop experienced the year before. After deducting benefit payment from premium income, the net cash outflow for the entire year was approximately NT$217.5 billion. Nevertheless, cash and cash equivalents reached NT$944.3 billion at the end of December 2023, which was sufficient to cover the cash outflows. Furthermore, the FSC actively monitored the cash flows of life insurance companies and relaxed the types of bonds and notes with reverse repurchase agreements (reverse repo) or repo agreements that insurance enterprises may engage in, which should help alleviate funding pressure on these companies. However, some life insurance companies have had their financial assets reclassified to be measured at amortized cost, which potentially limited their ability to realize the capital gains from bond investments.[55] Additionally, with benefit payment continuing to increase in 2024 Q1, it remains crucial to monitor the evolving cash flow dynamics of life insurance companies.

To smoothly transition towards the new generation solvency regime, large life insurance companies have been issuing long-term subordinated bonds

To enhance fundraising flexibility, the FSC relaxed the regulations on the issuance of long-term corporate bonds by the insurance industry in April 2023.[56] Large life insurance companies have successively issued long-term subordinated bonds since the second half of 2023, with a total issuance amount surpassing NT$105 billion for the year. This initiative was aimed at a

[55] In accordance with the FSC Insurance Bureau's meeting resolution on July 23, 2020, regarding the "Constant Materiality Standards for Early Sale of 'Financial Assets Measured at Amortized Cost (AC)'," the insurance industry is not allowed to sell AC bonds annually at a ratio exceeding 5% of the bonds initially classified as AC. Should this threshold be surpassed, from the following year until the implementation of IFRS 17 (i.e., before the effective date in 2025), no newly acquired bonds are permitted to be classified as AC assets.

[56] The primary amendment was to lift the restriction to allow insurers to issue long-term corporate bonds with maturities of 10 years or more, and to include these bonds in Tier 2 capital.

smooth transition toward compliance with the Insurance Capital Standard (ICS), as well as strengthening the financial structure, enriching self-owned capital, and improving the capital adequacy ratio of the insurance industry.

3.2.3 Bills finance companies

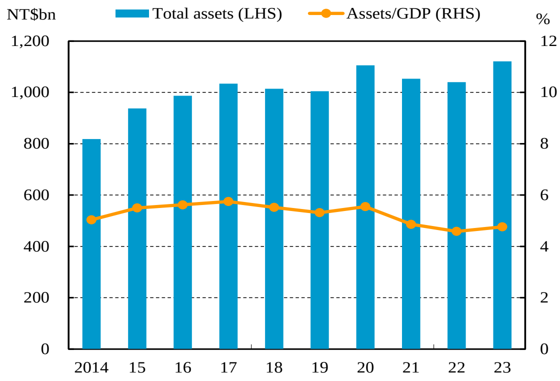
In 2023, the total assets of bills finance companies rose, along with an increase in their guarantee business. Meanwhile, the concentration of credit secured by real estate declined, and the quality of credit assets improved. Although profitability continued to subside and liquidity risk and interest rate risk were still high, the capital adequacy ratio went up.

Total assets increased

The total assets of bills finance companies stood at NT$1.12 trillion at the end of 2023, an increase of 7.84% compared to a year earlier mainly owing to greater investments in corporate bonds and in negotiable certificates of deposit. The ratio of their total assets to annual GDP rebounded to 4.76% over the same period (Chart 3.46).

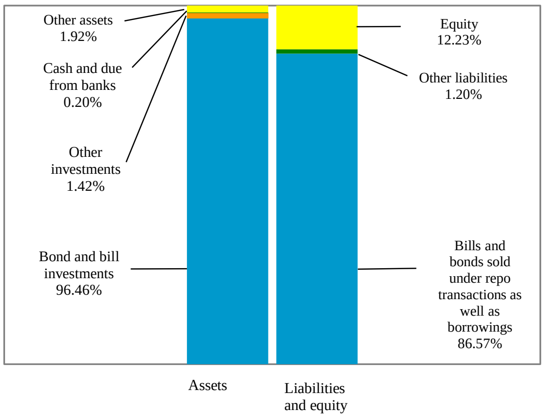
In terms of the asset and liability structure of bills finance companies, bill and bond investments constituted the largest share of 96.46% of total assets as of the end of 2023. On the liability side, bills and bonds sold under short-term repo transactions as well as borrowings accounted for 86.57% of total assets, while the proportion of equity increased to 12.23% (Chart 3.47). The asset and liability structure remained roughly unchanged compared to a year earlier.

Chart 3.46 Total assets of bills finance companies



Sources: CBC and DGBAS.

Chart 3.47 Asset/liability structure of bills finance companies

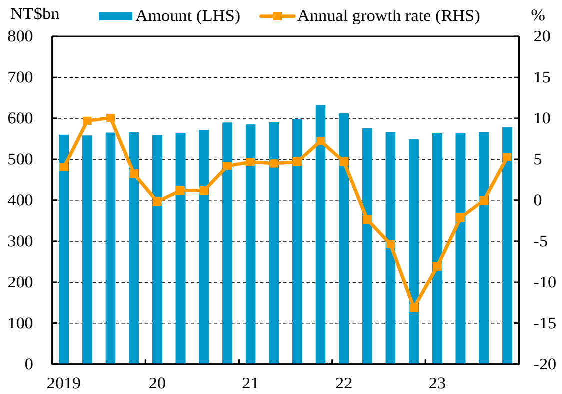


Note: Figures are as of the end of 2023.
Sources: CBC and FSC.

Credit risk

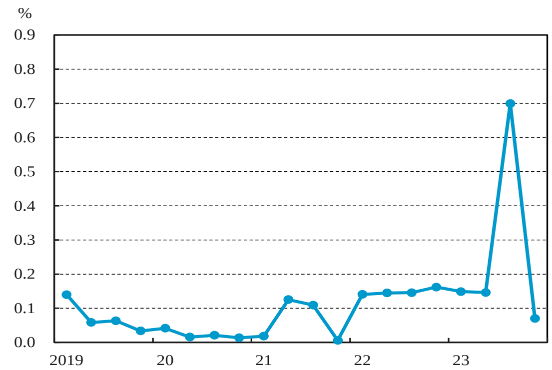
Guarantee liabilities increased, while the concentration of credit secured by real estate declined

Chart 3.48 Outstanding CP guaranteed by bills finance companies



Sources: CBC.

Chart 3.49 Guaranteed advances ratio of bills finance companies



Note: Guaranteed advance ratio = overdue guarantee advances/(overdue guarantee advances + guarantees).
Source: CBC.

The amount of CP guaranteed by bills finance companies registered NT$577.7 billion at the end of 2023 (Chart 3.48), increasing by 5.28% year on year. This was because of a lower base effect as bills finance companies reduced their risky asset positions for CP guarantees in the previous year to maintain an adequate capital ratio. Consequently, the average ratio of guarantee liabilities to equity increased to a multiple of 4.96 times, and the ratio for each company remained below the regulatory ceiling of 5.5 times.

At the end of 2023, guarantees granted to the real estate and construction industries decreased from 31.45% a year earlier to 29.48% of the total credit of bills finance companies. Among these, the proportion of real estate industry guarantees regulated by the FSC shrunk to 25.57%, still below the regulatory ceiling of 30%. In addition, the share of credit secured by real estate also decreased from 42.05% a year earlier to 38.78%. Considering the recent resurgence in domestic real estate market transactions, still-high house prices, and an increase in unsold newly built residential housing units, bills finance companies should monitor closely the above-mentioned impacts on the asset quality of mortgage-related credit.

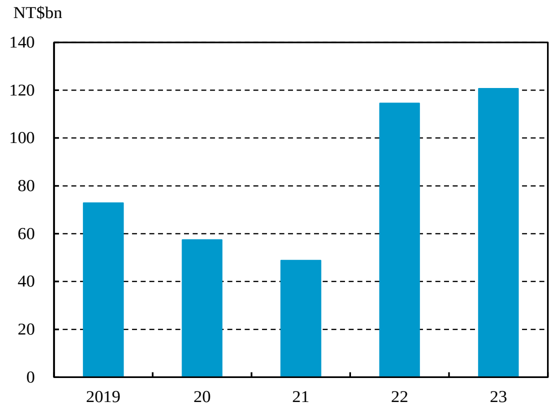
Guaranteed advances ratio declined, while credit quality improved

At the end of 2023, the guaranteed advances ratio of bills finance companies was 0.07% (Chart 3.49), reflecting improved credit quality. Consequently, the credit loss reserves to guaranteed advances ratio[57] increased to 18.68 times, with the provision sufficient to cover potential credit losses.

Investment in non-guaranteed CP issued by the leasing industry shrank, but its potential credit risk warrants attention

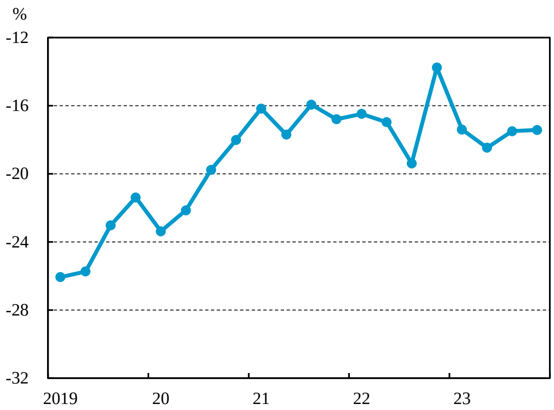
The non-guaranteed CP investment of bills finance companies stood at NT$120.7 billion at the end of 2023, representing an increase of 5.39% year on year (Chart 3.50). This was because the positions of their non-guaranteed CP had been increased to expand yield spreads between their long-term bonds and short-term reverse repos amid ample liquidity in the money market in the fourth quarter. Each company's ratio of non-guaranteed CP investment to equity remained below the self-disciplinary ceiling of 2 times.[58] However, the investment in non-guaranteed CP issued by the leasing industry kept decreasing, reaching NT$30.8 billion at the end of 2023. The leasing industry could pose a higher potential credit risk owing to the fact that it tends to rely on short-term sources for funding long-term investments, hence warranting close attention to such impact on the asset quality of bills finance companies.

Chart 3.50 Outstanding amount of non-guaranteed CP investments of bills finance companies



Source: CBC.

Chart 3.51 0-30 day maturity gap ratio of bills finance companies



Note: 0-30 day maturity gap ratio = net NTD cash flow within 0-30 days/total assets denominated in NTD.
Source: CBC.

Liquidity risk increased

The business models of bills finance companies are characteristic of deploying short-term funds for long-term objectives. At the end of 2023, more than 80% of their funding sources relied on short-term interbank borrowing and repurchase agreements with financial institutions,

[57] Credit loss reserves to guaranteed advances ratio = (provisions + loss reserves to guarantees)/guaranteed advances.
[58] According to the *"Self-Disciplinary Rules for Members of the R.O.C. Bills Finance Association on Handling Non-Guaranteed Commercial Paper Transactions,"* a bills finance company shall hold non-guaranteed commercial paper (including those of state-owned enterprises) to no more than twice its net worth.

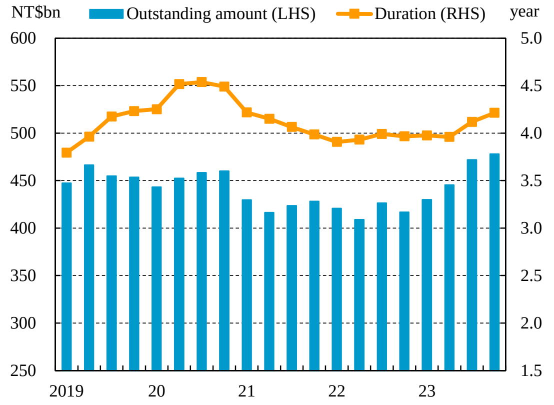
while more than 90% of their assets were invested in bills and bonds, 44.10% of which were long-term bonds, continually showing maturity mismatch between assets and liabilities. Nevertheless, the average ratio of 0-30 day maturity gap to total NTD-denominated assets increased further and registered -17.43% at the end of the year (Chart 3.51), highlighting an escalating liquidity risk.

Moreover, the average ratio of major liabilities[59] to equity rose to 8.34 times at the end of 2023 because the expansion in bill and bond repo transactions conducted resulted in an increase in major liabilities and led to a higher degree of overall financial leverage. However, the leverage ratios of all bills finance companies stayed below the regulatory ceilings of 10 or 12 times.

Interest rate risk of bond investments rose

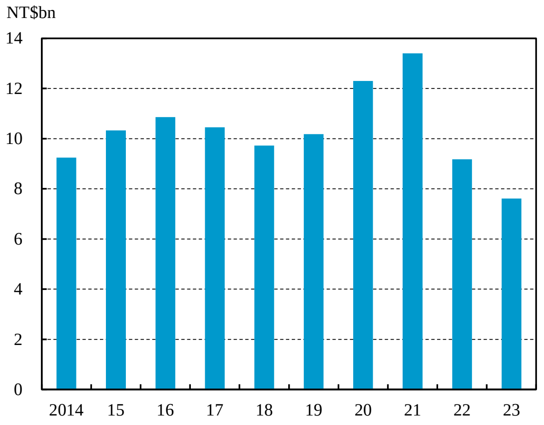
In 2023, the outstanding amount of fixed-rate bond investments of bills finance companies increased by 14.65% to NT$478.0 billion with the average duration lengthening to 4.21 years (Chart 3.52). Although the Fed has adopted a more cautious stance towards interest rate cuts recently, if US government bond yields continue to stay at a high level, with the strong correlation of government bond yields between domestic and US markets, the interest rate risk of bond investments would still be high, meriting close attention.

Chart 3.52 Outstanding amount of fixed-rate bond investments and bond duration of bills finance companies



Source: FSC.

Chart 3.53 Net income before tax of bills finance companies



Source: CBC.

[59] Major liabilities include call loans, repo transactions, as well as issuance of corporate bonds and CP.

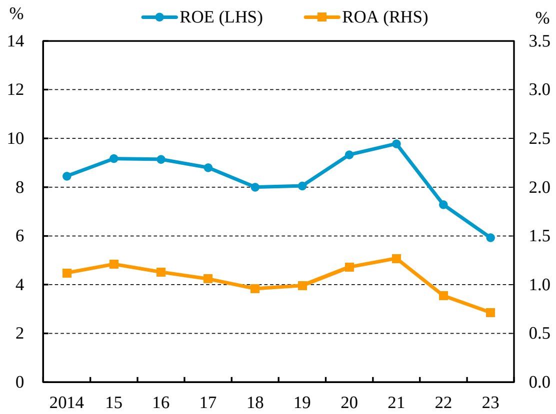
Profitability declined continuously

The net income before tax of bills finance companies decreased by 17.05% year on year to NT$7.6 billion in 2023 (Chart 3.53). This was due to a reduction in net interest income resulting from a narrowing yield spread by way of hoarding bills for arbitrage and an increase in reserves against guarantee liabilities. Thus, the average ROE and ROA decreased to 5.93% and 0.71% (Chart 3.54), respectively, reflecting declining profitability.

Average capital adequacy ratio rose

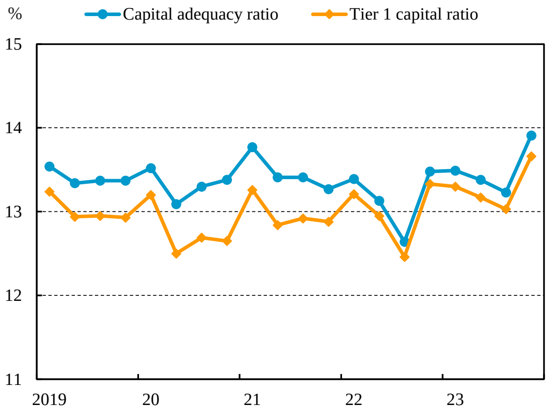
Benefiting from a decrease in unrealized valuation losses on investments in marketable securities and an injection of earnings, the average Tier 1 capital ratio and capital adequacy ratio rose to 13.66% and 13.91%, respectively, at the end of 2023 (Chart 3.55). The capital adequacy ratio stayed well above the statutory minimum of 8% for each company.

Chart 3.54 ROE & ROA of bills finance companies



Notes: 1. ROE = net income before tax/average equity.
2. ROA = net income before tax/average assets.
Source: CBC.

Chart 3.55 Average capital adequacy ratios of bills finance companies



Source: CBC.