IV. Measures to promote financial stability

4.1 Measures taken by the Bank and the FSC to promote financial stability

4.1.1 Measures taken by the Bank to promote financial stability

From the beginning of 2023 onwards, Taiwan's inflation rate has broadly followed a trend of coming back down. Nevertheless, in order to contain domestic inflation expectations, the Bank continued to conduct monetary tightening in a gradual manner, announcing its sixth rate hike in March 2024. Furthermore, to prevent excessive credit resources from gushing into the real estate market, the Bank adjusted its selective credit control measures for the fifth time and added a regulation imposing a cap on the LTV ratio for a second outstanding home loan of a natural person for housing in the designated specific areas. The Bank also continued to adopt flexible FX rate policies to maintain the dynamic stability of the NT dollar exchange rate, so as to ensure sound development of the domestic financial system and sustainable growth of the whole economy.

The Bank raised the policy rates and conducted open market operations

The ongoing effects of monetary policy tightening by major central banks led global inflation to gradually come down, while Taiwan's CPI and core CPI inflation rates also showed a downward trend. However, considering that a proposed electricity rate hike could shift inflation expectations upwards, the Bank raised the policy rates by 0.125 percentage points on March 22, 2024,[66] taking the discount rate, the rate on refinancing of secured loans, and the rate on temporary accommodations to 2%, 2.375%, and 4.25%, respectively. The policy move was judged to be conducive to containing domestic inflation expectations, sustaining price stability and fostering sound economic and financial development.

Furthermore, based on its assessment of international and domestic economic and financial conditions, the Bank conducted open market operations and managed reserve money at an

[66] The Bank raised the policy rates six times by a total of 0.875 percentage points from March 18, 2022 to March 22, 2024. Among them, the Bank raised the discount rate, the rate on refinancing of secured loans, and the rate on temporary accommodations by 0.25 pps on March 18, 2022. In addition, the policy rates were adjusted upward by 0.125 pps on each of the quarterly meetings on June 17, 2022, September 23, 2022, December 16, 2022, March 24, 2023 and March 22, 2024, respectively.

appropriate level by issuing NCDs. At the end of 2023, the total outstanding amount of NCDs issued was NT$8,135.9 billion, while the average annual growth rate of reserve money registered 5.55% for the year. The weighted average overnight call loan rate trended upwards in line with the Bank's policy rate hikes, rising from 0.556% at the end of 2022 to 0.692% at the end of 2023 and further increasing to 0.808% at the end of March 2024.

The Bank continued to adopt selective credit control measures to guide efficient allocation of bank credit

The Bank adjusted selective credit control measures four times in December 2020 and March, September, and December 2021. Nevertheless, real estate lending still made up a large proportion in total bank lending, the number of second home loans taken out by natural persons was increasing, and the already high average LTV ratio granted to second home loans taken out by natural persons in specific areas continued rising. Against this backdrop, the Bank amended the *Regulations Governing the Extension of Mortgage Loans by Financial Institutions* for the fifth time in June 2023. The amendments, taking effect on June 16, 2023 (Table 4.1), included the introduction of a 70% cap on the LTV ratio for a second home loan of a natural person for housing in one of the specific areas. These measures are judged to have helped prevent excessive credit resources from flowing into the real estate market and enhance banks' risk management of real estate lending.

Table 4.1 The key points of the amendments to the *Regulations Governing the Extension of Mortgage Loans by Financial Institutions* in June, 2023[1]

Loan types		Loan conditions	
		Before	**After**
Housing loans borrowed by corporates		LTV ratio capped at 40%, no grace period	(unchanged)
Natural persons	High-value housing loans	LTV ratio capped at 40%, no grace period	(unchanged)
	Second home loan for housing in specific areas[2]	No grace period	LTV ratio capped at 70%, no grace period
	Third home (and more) loans	LTV ratio capped at 40%, no grace period	(unchanged)

<table>
<tr><th rowspan="2">Loan types</th><th colspan="2">Loan conditions</th></tr>
<tr><th>Before</th><th>After</th></tr>
<tr><td>Land loans</td><td>● LTV ratio capped at 50%, with 10% withheld for disbursement until construction commences
● Requiring the borrower to submit a substantive development plan for the land purchased, and to undertake in writing a specific time frame to commence construction[3]</td><td>(unchanged)</td></tr>
<tr><td>Unsold housing unit loans</td><td>LTV ratio capped at 40%</td><td>(unchanged)</td></tr>
<tr><td>Mortgage loans for idle land in industrial districts</td><td>LTV ratio capped at 40%[4]</td><td>(unchanged)</td></tr>
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Notes: 1. The amendment was announced on June 15, 2023 and took effect on June 16, 2023.
2. Specific areas include Taipei City, New Taipei City, Taoyuan City, Taichung City, Tainan City, Kaohsiung City, Hsinchu County, and Hsinchu City.
3. Regarding the determination of a "specific time frame," financial institutions should carefully verify and assess the actual time required for the borrower to commence construction, with a maximum period of up to 18 months.
4. It shall not apply if the mortgaged land is already under construction, or if the borrower already submits a substantive plan for construction and pledges that construction will begin within one year.

Source: CBC.

To achieve the objectives of adjusting selective credit control measures and to consider the funding needs of homebuyers with actual need for moving, the Bank announced complementary measures to assist owner-occupant home movers in July 2023. For natural persons who already have a first home loan and intend to apply for a second home loan in a specific area because of actual need for moving from an existing home to a new one, they will not be subject to the cap of the LTV ratio after signing affidavits with their lending financial institution. Additionally, the Bank regularly publishes reports on the status of banks' newly-extended loans under the credit controls and has continuously conducted targeted examinations on real estate lending businesses to ensure compliance among financial institutions.

Furthermore, the Bank had conducted monetary tightening in a moderate and gradual manner, which was judged to help strengthen the effectiveness of selective credit control measures. In the future, the Bank will pay close attention to the potential impacts of real estate-related policies on the real estate market, continue to review the status of real estate loans and the effectiveness of selective credit control measures, and fine-tune the regulatory measures as needed, so as to foster financial stability and guide sound banking business.

Adopting a flexible FX rate policy to maintain 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, excessive exchange rate fluctuations could have adverse impacts. Therefore, the Bank adopts a managed float exchange rate regime, where the exchange rate of the NT dollar is, in principle, determined by market forces. When disorderly movements (such as massive inflows or outflows of short-term capital) or seasonal factors 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, maintain the FX market order as warranted.

In recent years, huge and frequent movements of international short-term capital flows have superseded international trade and macroeconomic fundamentals and become the key factor influencing the volatility of exchange rates. To prevent the abovementioned factors from disrupting 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 as a whole.

In addition, the Bank continued to undertake appropriate administrative measures to safeguard FX market order and promote its sound development. These measures mainly included: (1) monitoring up-to-date transaction information in the FX market through the Real-Time Reporting System for Large-Amount FX Transactions; (2) reinforcing off-site monitoring efforts to ensure that forward transactions are 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 of FX businesses in order to maintain the discipline of the FX market.

4.1.2 Measures undertaken by the FSC to maintain financial stability

From the second half of 2023 onwards, in order to bolster the sound development of the financial sector, the FSC planned for the domestic adoption of the IFRS Sustainability Disclosure Standards, assisted the insurance industry to smoothly align with the IFRS 17 and TW-ICS, strengthened the management of platforms involving digital lending and crypto assets, and guided financial institutions to properly use AI. In addition, the FSC continued to strengthen the risk bearing capacity of the insurance industry and management of the ETF market, to pay attention to financial innovation technologies and investment tools, and to actively help the insurance industry align with relevant international standards. In the meantime, the FSC continued to strengthen risk management and other supervisory measures in the financial industry to preserve financial stability.

Strengthening the risk bearing capacity of the insurance industry

(1) In order to understand the risk bearing capacity and the impacts on the capital adequacy of insurers under extreme conditions, the FSC required non-life and life insurers to conduct stress tests based on their financial statements at the end of 2022, covering insurance risks, market risks, and climate change risks. According to the results,[67] the overall capital adequacy ratio and net worth ratio of the insurance industry were higher than the statutory minimums, showing that Taiwan's insurance industry still has the ability to deal with the changes of economic and financial conditions as well as the impacts of climate change.

(2) To facilitate a smooth adoption of the internationally-applied system by insurers in 2026, the FSC reviewed and amended the existing formula for calculating insurers' RBC ratio on a gradual and orderly basis as follows: (A) from December 31, 2023 onwards, an insurer's adjusted net capital must be divided into Tier 1 Unlimited, Tier 1 Limited, and Tier 2 when calculating its RBC ratio; and (B) the risk factors for domestic private equity funds and venture capital funds have been adjusted, and an additional FX risk capital surcharge of 6.61% is applied to any domestic private equity fund that is partially invested overseas.

(3) Considering the limited depth of Taiwan's domestic bond market, the FSC amended the *Directions for Issuance of Bonds with Capital Characteristics by Insurance Companies* in March 2024 in order to increase the fundraising channels available to insurers. The amended directions provided that an insurer may, with approval, establish a special-purpose overseas fundraising enterprise and act via that enterprise to issue corporate bonds overseas as capital instruments, and may also provide guarantees for those bonds.

[67] The results of stress tests carried out by insurers showed the following: (1) insurance risk: the life and non-life insurance industries as a whole would have average capital adequacy ratios of 266.2% and 337.2%, respectively, and average net worth ratios of 5.66% and 19.62%; (2) market risk: the life and non-life insurance industries as a whole would have average capital adequacy ratios of 203.7% and 390.4%, respectively, and average net worth ratios of 3.35% and 23.57%; (3) climate change risk: the non-life insurance industry as a whole would have an average capital adequacy ratio of 337.2%, and an average net worth ratio of 20.52%.

Allowing banks to adopt the IRB approach for calculating credit risk capital

To enhance banks' internal risk management by measuring and managing credit risk and credit assets more precisely, the FSC allowed banks of an asset size over NT$2.5 trillion and meeting the criteria of financial soundness, regulatory compliance, and minimum operational requirements to apply, by the end of June 2024, for using the IRB approach for calculating credit risk capital. And the FSC may review the accuracy of data systems, the rationality of risk models, and the appropriateness and implementation of the applicant's corporate governance and monitoring mechanisms.

Strengthening supervisory measures of the ETF market

In order to protect the interests of investors and promote sound development of the ETF market, the FSC has successively adopted relevant supervisory measures since the second half of 2023, including: (1) requiring the TWSE and the TPEx to review whether the constituent stocks of an index change frequently and to control the turnover rate in the early stage through review procedures; (2) requiring securities investment trust companies (SITCs) to disclose the composition of source of funds for dividend distribution, where the priority order for distribution shall be dividends from constituent stocks, capital gains, and income equalization funds; (3) enhancing the pre-review and post-audit mechanisms of ETF sales documents, and requiring the Securities Investment Trust & Consulting Association to strengthen the review of content appropriateness of ETF advertising and to formulate self-disciplinary rules; (4) supervising the performance of SITCs in enhancing their assessment of the concentration and liquidity of constituent stocks in the ETFs that they issue and the indices that they track; (5) overseeing the TWSE and the TPEx evaluating ETF shareholdings regularly and building transaction databases, and adding ETFs as a focus in the examinations on SITCs; and (6) publishing press releases to enhance the financial knowledge of ETFs among retail investors. In addition, the FSC, consulting international supervisory practices, planned to gradually launch six enhanced supervisory measures in three aspects, namely product structure, information disclosure and liquidity provision.[68]

[68] The six enhanced measures include: (1) requiring ETF issuers to enhance the management and disclosure when engaging external service providers to calculate ETF indicative net asset values (iNAVs); (2) enhancing the management of participating securities firms and liquidity providers; (3) enhancing information disclosures on custom indexes and Smart Beta indexes ETFs; (4) enhancing disclosures regarding ETF dividend distributions from income equalization funds; (5) adding new penal provisions to deal with an ETF that fails to comply with the requirement to select a liquidity provider; (6) taking measures to prevent and monitor ETFs from trading at excessive discounts or premiums, and collecting data on ETF net asset values (NAVs), assets under management, discounts/premiums, and other information for supervisory reference, so as to enhance the efficacy of risk management.

Strengthening financial institutions' risk management for outsourcing operations

In response to financial institutions' growing demand for outsourcing operations and for third-party cloud services, as well as considering the trend of international regulations for outsourcing being moved towards the risk-based approach (RBA), the FSC amended the *Regulations Governing Internal Operating Systems and Procedures for the Outsourcing of Financial Institution Operation* (hereinafter referred to as the *Regulations*) and relevant requirements in August 2023.[69] The main changes included: (1) stipulating the adoption of the RBA to manage outsourcing risks and establishing a comprehensive risk management framework; (2) simplifying the outsourcing application procedures and document requirements; and (3) adjusting the scope of cross-border and cloud service outsourcing where application to the competent authority is required and stipulating relevant enhanced regulations, in order to reinforce the resilience of financial institutions' outsourcing operations, facilitate digital transformation, and improve supervisory efficiency.

Deliberating preventive measures against illegal offshore funds

In view of recent cases of consumers suffering losses from purchasing illegal offshore fund products, the FSC announced four new measures aiming to strengthen the protection of financial consumers' rights. The measures include: (1) requiring the Taiwan Securities Association, the Chinese National Futures Association, and the Securities Investment Trust & Consulting Association to each establish an "investor alert" section on their respective websites for public inquiries; (2) when people report an illegal offshore fund with concrete evidence, the matter will be immediately forwarded to the Ministry of Justice's Investigation Bureau for further action, and the FSC will meet in a joint working session with the Ministry of Justice for collaboration on following up the case; (3) offering higher whistleblower rewards and coordinating with securities and futures industry associations to study the set-up of whistleblower reward systems; and (4) requiring wealth managers at financial institutions to assist in raising public awareness by reminding customers of investing in funds via legitimate distributors to protect their own interests.

[69] In line with the amendment of the *Regulations Governing Internal Operating Systems and Procedures for the Outsourcing of Financial Institution Operation*, the FSC has simultaneously amended the *Directions for Operation Outsourcing by Insurance Enterprises* and the *Regulations Governing the Establishment of Internal Control Systems by Service Enterprises in Securities and Futures Markets*, and requires a service enterprise to incorporate the management of outsourcing operations into its internal control system.

4.2 The Bank will continue to adopt measures to promote financial stability when necessary

In 2023, central banks in the United States and European countries continued with monetary tightening. The cumulative effect of interest rate hikes along with an escalating geopolitical risk owing to the Israel-Hamas conflict have weakened global economic growth momentum. Against this backdrop, Taiwan's financial institutions still maintained robust operations, and the financial infrastructure operated smoothly. As a whole, Taiwan's financial system remained stable. The Bank continued to adopt appropriate monetary, credit and FX policies in response to changes in the global and domestic economic and financial conditions to promote financial stability. Meanwhile, the FSC revamped relevant financial regulations and enhanced financial supervisory measures to facilitate sound operations of financial institutions and preserve financial stability.

Since early 2024, global inflation has moderated, with market expectations for interest rate cuts increasing. In addition, post-pandemic inventory adjustments by the manufacturing sector also gradually concluded. Against this backdrop, the global economy is expected to rebound. However, ongoing geopolitical conflicts such as the Red Sea crisis pose a potential risk to global supply chains, compounding the uncertainties over global economic prospects. Looking ahead, the trajectory of monetary policy stances by major central banks may affect global economic growth and financial stability. Geopolitical risks and climate change would add to the uncertainties over global inflation as well as trade and economic development. Moreover, the high interest rate environment and the spillover effect of economic downturn in China still exist. These, coupled with supply chain restructuring and fragmentation of the global economy stemming from the ongoing US-China competition and the rise of national security awareness influencing the context of globalization, could pose adverse impacts on global economic development and financial stability.

As the international economic outlook remains surrounded by many downside risks, the Bank will continue to pay close attention to the impacts of the subsequent developments on domestic economic and financial conditions and take appropriate response measures in a timely manner with a view to promoting financial stability.