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## IV. Measures to maintain financial stability

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In 2012, due to slowing global and domestic economies, the industrial sector saw profits shrink and a few companies suffered insolvencies caused by huge losses. However, in spite of the disadvantageous macroeconomic conditions, financial markets in Taiwan continued to function well in 2012. Financial institutions enjoyed considerably increasing profits and good asset quality, while the capital level of all financial institutions, except for a few insurance companies, remained satisfactory. The three main payment systems functioned smoothly as well. Therefore, on the whole, Taiwan's financial system remained stable.

In face of the dramatic changes in economic and financial conditions both domestically and globally, especially the evolving European sovereign debt crisis, the US fiscal cliff and the Japanese yen's sharp depreciation caused by the BOJ's easing monetary policies, the CBC continually monitored the above impacts on the domestic economy and financial system and implemented corresponding monetary and foreign exchange policies. The FSC also reviewed and amended several laws and regulations and took efforts to strengthen financial supervision, all aimed at maintaining the soundness of financial institutions and stability of the financial system.

### 4.1 Measures taken by the CBC to promote financial stability

#### *Adopting sound monetary policies to address the economic environment and maintain price stability*

##### *Policy rates remained unchanged in 2012*

Owing to global economic uncertainties, moderate domestic economic recovery and the alleviation of inflation pressures, the CBC kept policy rates unchanged<sup>73</sup> in 2012 to maintain price and financial stability and promote economic growth.

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<sup>73</sup> From 1 July 2011, the CBC has kept the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral unchanged at 1.875%, 2.25%, and 4.125%, respectively.

***Monetary growth was adequately controlled to support economic activity***

To address slowing economic recovery, the CBC adopted open market operations to maintain reserve money at appropriate levels. In 2012, under the watchful management of the CBC, excess reserves of banks were maintained at a suitable level, and the total loans and investments of all banks grew at 5.08%, while M2 grew by 4.17% year on year, both of which were higher than the GDP growth of 1.26% in the same year. This illustrates that market liquidity was sufficient to support economic activity.

***Inflation rate maintained at low and stable levels***

Relative to other countries, Taiwan's inflation rate remained low and stable. From 1998 to 2012, the average annual growth rate of inflation stood at only 1.06%, with a low volatility of 1.17%. This benefits the purchasing power of citizens and helps people to make reasonable economic decisions. The prudential monetary policies conducted by the CBC have been positively recognized by credit rating agencies.<sup>74</sup>

***The CBC will continue with timely implementation of appropriate monetary policies***

Mindful of current domestic and foreign economic conditions, especially the aftermath of the European sovereign debt crisis and the US debt ceiling and fiscal cliff problems, as well as the impacts of Japanese yen depreciation on domestic economic and financial conditions, the CBC will closely monitor new developments and implement corresponding monetary policies in a timely manner.

***Continually implementing risk management policies for real estate loans to ensure the soundness and financial stability of banks***

To urge banks to strengthen their risk management of real estate loans, the CBC has implemented targeted prudential measures against land collateralized loans and housing loans in specific areas since June 2010. The effort has been come to fruition. Furthermore, in view of banks having granted high-value housing loans with overly high loan-to-value (LTV) ratios, which went against sound principles of credit risk management and undermined banks' soundness, the CBC announced an additional macroprudential measure targeting high-value

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<sup>74</sup> Standard & Poor's indicated in its 2012 Taiwan Sovereign Rating Report that Taiwan's Central Bank has been flexible in its monetary policy while pursuing a low and stable inflation environment. Another credit rating agency, Moody's, also pointed out in its 2012 report that a prudential monetary policy has contributed to Taiwan's low and stable inflation, superior to other countries with Aa and Aaa ratings.

housing loans in June 2012. The key points of the new measure include:

- High-value housing loans refer to the loans for purchasing any one of the properties listed below that are registered as housing:
  - Properties located in Taipei City or New Taipei City with the appraisal value or trading value exceeding NT\$80 million.
  - Properties located in the area outside of Taipei City or New Taipei City with the appraisal value or trading value exceeding NT\$50 million.
- The restrictions on loan terms include: (1) no grace period; (2) the maximum of loans granted should not exceed 60% of the appraisal value or the trading value of the collateral, whichever is the lower; (3) no additional loans against the same collateral for purposes of home refurbishments, current operation or others.

After the implementation of the above measures, the average LTV ratio of high-value housing loans dropped from 80%-90% pre-restriction to 56.74% in April 2013.

### ***Implementing a managed float regime to stabilize the exchange rate of the NT dollar***

Considering that Taiwan is a small highly open economy with large amounts of short-term capital frequently flowing in and out, the CBC implements a flexible managed floating exchange rate regime to ensure the stability of the domestic economy and financial markets. The exchange rate of the NT dollar is in principle guided by the market mechanism. Only when there are aberrations - such as an abnormally large influx or outflow of short-term capital and seasonal changes causing the exchange rate to over-fluctuate with adverse implications - that could destabilize the domestic economy and financial markets, does the CBC step in to maintain an orderly foreign exchange market.

In addition, the CBC will continue to monitor the impacts from the recent monetary easing policy in Japan and Japanese yen depreciation on the NTD exchange rate. Should there be an inordinate inflow or outflow of capital, the CBC will take actions to maintain an orderly exchange market, as its duty requires.

### ***Continuing to open the market for new foreign currency derivatives and expand foreign currency call loan and swap markets***

In order to expand the services provided by financial institutions and satisfy customer demand for portfolio management and risk hedging, the CBC has continually granted licenses to investment trusts, investment consulting firms, securities firms and bills houses to provide onshore and offshore financial services and products. To date, 24 foreign currency derivative products and 5 NTD-linked derivative products have been approved. The total transaction volume of these products totaled US\$3.76 trillion in 2012.

Furthermore, the CBC continued to finance banks through foreign currency call-loans and currency swaps in order to meet the funding needs of industry and maintain sufficient foreign currency liquidity in the domestic banking system. In 2012, the turnover amounts of the Taipei call-loan and interbank USD/NTD currency swaps markets were US\$1.81 trillion and US\$1.13 trillion, respectively, and the outstanding of both markets at the end of the year stood at US\$22.3 billion and US\$145 billion, respectively.

## **4.2 Measures undertaken by the FSC to maintain financial stability**

From 2012 onwards, the FSC continually amended financial laws and regulations, and undertook several supervisory reforms in order to ensure financial stability.

### ***Strengthening risk management of financial institutions***

- Amending the Regulations Governing the Capital Adequacy and Capital Category of Banks and related regulations to raise the quality and level of capital in accordance with the international capital standards stated in Basel III (Box 5).
- Setting the minimum loan coverage ratio<sup>75</sup> of 1% as an important criterion when reviewing the applications submitted by banks, and gradually raising the ratio of loan loss provisions to performing credit assets to above 1%.
- Revising bank soundness criteria to require a bank intending to distribute cash dividends that exceed 15% of its total capital to meet the following conditions: (1) the post-distribution legal reserves of the bank must be higher than 75% of paid-in capital; and

<sup>75</sup> When calculating the loan coverage ratio (allowance for bad debts to total loans), loans to the government have been deducted from the denominator.

(2) the post-distribution capital adequacy ratio and Tier 1 capital ratio must be at least 12.5% and 10.5%, respectively.

- Establishing a mechanism for regulating the aggregate credit risk exposures of domestic banks to Mainland China for the purpose of strengthening banks' management of concentration risk.

### ***Urging financial institutions to reinforce risk management of real estate-related loans and investments***

- Urging financial institutions to strengthen risk management of real estate loans, such as introducing new supervisory measures and conducting target examinations on banks with highly concentrated real estate lending.
- Requiring insurance companies to comply with the instructed criteria of immediate use and reasonable benefit when acquiring usable real estate, and to strengthen internal controls regarding real estate investments.

### ***Enhancing corporate governance***

- Issuing regulations requiring listed companies to adopt electronic voting systems for shareholder meetings in order to encourage shareholders to actively participate in company operations. According to the statistics, of the 113 listed companies that are subject to the requirements, 83 had already adopted electronic voting systems for shareholder meetings in 2012.
- Revising related regulations to strengthen the internal governance and transparency of publicly offered companies, such as (1) establishing asset acquisition and disposal procedures, managing and publicly disclosing interested party transactions, and setting up remuneration committees, etc.; and (2) strengthening board of directors meetings procedures for public companies, such as disclosing the exercise of recusal of directors.
- Promulgating a set of rules to define the range of companies that are required to establish an auditing committee for the purposes of strengthening internal control mechanisms, protecting shareholders' interests and ensuring the sound operation of companies.

### **Promoting risk-oriented supervision and differential examinations to strengthen financial examination effectiveness**

- Periodically disclosing the key focal points of examinations and main examination findings so as to remind financial institutions to take heed; and editing financial inspection educational materials for public and financial industry use.
- Adopting risk-focused supervision and implementing differentiation in the frequency and scope of on-site examinations for seven categories of financial institutions including banks; and conducting target examinations with a supervisory focus and drawing public attention to important issues.

### **Strengthening the financial soundness and solvency of the insurance industry**

- Adopting measures to improve the effective usage of funds and financial soundness of the insurance industry, including (1) requiring that the special reserves set aside by non-life insurance companies on or before 31 December 2012 will continue to be listed as liabilities and will be transferred to special reserves against natural disasters; (2) allowing life insurance companies to establish foreign exchange valuation reserve mechanisms to more flexibly manage exchange rate risk and lower hedging costs; and (3) raising the maximum amount that an insurance company can invest in a company for the purpose of participating in a public infrastructure project from 25% of the investee's paid-in capital to 35%, in order to raise the investment willingness and capabilities of insurance companies.
- Urging life insurance companies to plan out a schedule for enhancing policy reserves for in-force contracts, and requiring those who wish to distribute earnings to submit a policy reserves consolidation proposal first; and modifying the RBC rules to allow life insurance companies to use the arithmetic mean of stock prices for each day during the half year preceding the valuation day, instead of year-end closing prices, when factoring in unrealized gains and losses on stocks, in order to alleviate the impacts of short term stock market fluctuations on the stability of capital adequacy ratios.

### **Reinforcing the disclosure of market information**

- Supervising the TWSE and related institutions to set up warrant information disclosure platforms from July 2012 onwards in order to increase transparency and mitigate information asymmetry in the warrant market.

- Entrusting Taiwan's GTSM to set up an OTC derivatives trade repository (TR) aimed at strengthening supervision and raising market transparency. The database will be completed at the end of June 2013.
- Amending requirements governing public tender offerings to protect shareholder interests and reinforce the disclosure and price reasonability of the offerings; and amending relevant regulations to reinforce the management of capital raising activities and public disclosures of foreign issuers.

### ***Actively promoting companies to adopt the IFRSs***

The FSC required Taiwan's companies to fully adopt the IFRSs via a two-phase process. In the first phase, adopters, including listed companies and primary financial institutions, have started to compile financial reports in accordance with IFRSs from 2013 onwards. Moreover, the FSC has completed the revision of related laws and regulations and has provided reference materials to the public and training for employees from applicable companies.