
IV. Measures to maintain financial stability

In 2016, under the circumstance of modest domestic economic recovery and stable inflation, Taiwan's financial markets and financial infrastructure maintained smooth operations and sound development. Profitability and asset quality of financial institutions slightly declined but remained at an appropriate level, while capital levels continued improving. As a whole, Taiwan's financial system remained stable.

In spite of stable recovery in advanced economies and improving growth momentum in emerging economies, international financial markets are likely to fluctuate sharply owing to heightened uncertainties from economic policies and politics in the euro area and the US. Moreover, changes in global and domestic economic and financial conditions facing Taiwan are likely to have consequences for financial stability, especially the evolution of future policies in the US, the Fed's interest rate hike trajectory, the rise in trade protectionism, the Brexit negotiation process, the political and economic conditions of the euro area, and the spillovers from Mainland China's economic restructuring and financial risks. Therefore, the CBC will continue to closely monitor the influence of these issues on the domestic economy and financial system and adopt appropriate monetary, credit, and foreign exchange policies as warranted. Meanwhile, the FSC also continues to amend financial laws and regulations and undertakes measures to strengthen financial supervision, aiming at maintaining the soundness of financial institutions and improving financial stability.

4.1 Measures taken by the CBC to promote financial stability

In the first half of 2016, in view of lower-than-expected domestic growth yet mild inflation, the CBC cut policy rates twice, conducted open market operations, and continued adopting an accommodative monetary policy to boost economic growth. Given that financial institutions have kept strengthening credit risk management on real estate loans, the CBC removed most restrictions on the relevant targeted prudential measures in March 2016. The CBC continually followed a managed float regime, stabilized the NT dollar exchange rate, and examined foreign exchange regulations to reinforce anti-money laundering practices and risk management related to banks' foreign exchange business.

4.1.1 Adopting appropriate monetary policies to cope with domestic and global economic and financial conditions

The CBC lowered policy rates twice in the first half of 2016 and then kept them unchanged

In the first half of 2016, owing to a slowdown in global economic growth and an uncertain economic outlook, coupled with a subdued domestic economy and widened negative output gap, the CBC lowered policy rates twice by 12.5 bps each time against the backdrop of a moderate inflation projection. As a result, the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral were cut to 1.375%, 1.75%, and 3.625%, respectively, so as to maintain a stable financial environment and boost economic growth. In the second half of 2016, considering modest international economic growth and a stable domestic economy, the policy rates remained unchanged.

Reserve money growth remained moderate

The CBC conducted open market operations to keep market liquidity at an appropriate level. In 2016, the excess reserves in all financial institutions remained at a higher level. The total loans and investments of all banks grew by 4.12%, while the monetary aggregate M2 grew by 4.51% year on year, both of which were higher than the GDP growth rate of 1.50%. This indicated that market liquidity was sufficient to support economic activity.

The CBC will continue to implement appropriate monetary policies

The CBC will continue to closely monitor price conditions, the output gap, as well as changes in global and domestic economic and financial conditions, and undertake appropriate monetary policy actions to maintain price and financial stability and, in turn, foster economic growth.

4.1.2 Unwinding most targeted prudential measures on real estate loans

Since the CBC has implemented targeted prudential measures for real estate loans in June 2010, financial institutions have continuously enhanced self-discipline on credit risk of real estate loans, and the government has successively carried out relevant taxation schemes to promote a sound housing market. As a result, speculative real estate demand tapered off;

however, the concentration in new high-value housing loans of financial institutions stayed at a high level. Therefore, the CBC repealed most regulations imposed on real estate loans in March 2016, except for high-value housing loans. In the future, the CBC will continue to monitor financial institutions' credit risk management on real estate loans and development of the real estate market so as to undertake appropriate policy actions in a timely manner to ensure financial stability.

4.1.3 Safeguarding stability of the NT dollar exchange rate

Adopting flexible foreign exchange rate policies

After the global financial crisis, the divergence of monetary policy stances in major advanced economies induced massive and frequent international short-term capital movements in emerging markets, sharp fluctuations in international financial markets, and an appreciation of the NT dollar exchange rate. In order to maintain dynamic stability of the NT dollar exchange rate, the CBC adopts a flexible managed float exchange rate regime, and the exchange rate of the NT dollar is in principle decided by market forces. Nevertheless, when seasonal or irregular 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 CBC will, in line with its mandate, aptly maintain foreign exchange market order.

Maintaining an orderly foreign exchange market and promoting its sound development

In 2016, the CBC continued to undertake appropriate management measures to safeguard foreign exchange market order and promote its sound development. These measures mainly included:

1. Continuing to adopt management measures targeting international capital inflows and outflows, including (1) implementing a Real Time Reporting System for Large-Amount Foreign Exchange Transactions to monitor the latest transaction information in the foreign exchange market; (2) overseeing that funds of NTD demand deposit accounts of foreign investors are transferred in accordance with the purpose laid out in their declaration; (3) requiring foreign investors to use the US dollar as margins for securities lending; (4) requesting the amount of investment in bills and bonds by foreign investors not exceed 30% of net inward remittances.

2. Urging authorized foreign exchange banks to strengthen their foreign exchange risk management in order to mitigate the risk exposures of individual banks and systemic risks of the market as a whole.
3. Strengthening targeted examinations on foreign exchange businesses and forward transactions to ensure they are undertaken for real demand purposes in order to restrain foreign exchange speculation.
4. Requiring that, for each authorized foreign exchange bank, its combined position limit for NTD non-delivery forwards (NDFs) and foreign exchange options not exceed one-fifth of its total position limit.

4.1.4 Strengthening foreign exchange supervision of banks

Along with the reinforcement of money laundering prevention and the enhancement of supervision in complex high-risk FX derivatives, the CBC amended the following foreign exchange regulations in 2016:

1. The CBC revised the *Directions Governing Banking Enterprises for Operating Foreign Exchange Business*, stipulating that: (1) banks should ensure that know your customer (KYC) procedures are followed when conducting FX business; (2) the electronic messages for FX remittances should include the required information about the payers and the payees; and (3) supplementary measures should be taken when there is a lack of the above-mentioned information in electronic messages.
2. The CBC revised the *Regulations Governing Foreign Exchange Business of Banking Enterprises*, so that pre-approval is required for authorized banks when conducting new, complex, high-risk FX derivatives business for customers except for professional institutional investors and high-net-worth corporate investors.

4.2 Measures undertaken by the FSC to maintain financial stability

From 2016 onwards, in order to facilitate financial innovation, enhance financial competitiveness and shore up economic growth, the FSC has continued implementing several measures including promoting financial technology (FinTech) development, encouraging the financial industry to invest in the green energy industry and startups, as well as supporting industries to realize the new business opportunities under the government's New Southbound

Policy. Additionally, the FSC has strengthened financial supervision and risk management of financial institutions so as to maintain financial stability.

4.2.1 Strengthening Taiwan's AML/CFT mechanisms

To maintain the reliability and security of Taiwan's financial system and to prepare Taiwan for the *Mutual Evaluation* by the Asia/Pacific Group on Money Laundering (APG) in November 2018, the FSC has continually announced amendments⁸⁴ to reinforce Taiwan's AML/CFT mechanisms since 2016. The amendments included incorporating the implementation of AML/CFT by financial institutions into the FSC's examination focus, and directing other financial industry associations to put forward information about businesses and products with high money laundering risk to serve as a reference (see Chapter 3.3.4). Moreover, the FSC also enhanced the customer due diligence requirement of OBUs.

4.2.2 Persistently enhancing banks' risk management and risk-bearing abilities

1. To reinforce banks' liquidity management and follow the Net Stable Funding Ratio as the globally consistent quantitative indicator of liquidity risk, the FSC and the CBC jointly promulgated the *Standards Implementing the Net Stable Funding Ratio of Banks* in December 2016. The Standards will be implemented on January 1, 2018. The aim is to urge domestic banks to have sufficient long-term stable funding sources in support of business expansion.
2. To improve banks' management of complex high-risk derivatives, the FSC further amended applicable regulations,⁸⁵ including: (1) requiring banks to submit application to competent authorities for approval or report the product by letter when offering products to customers that are not professional institutional investors or high-net-worth corporate investors; (2) requiring banks to submit the application for approval before planning to introduce a new complex high-risk derivative product that has not been deregulated or was deregulated within the most recent six months; (3) regulating that traders authorized by a juristic person customer to conduct transactions shall have sufficient professional

⁸⁴ The FSC has formulated regulations related to the *Money Laundering Control Act*. In addition, the FSC introduced amendments to the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Securities and Futures Sector*, the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Insurance Sector*, the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Banking Sector*, and the *Rules Governing Offshore Banking Branches* to enhance OBUs' customer due diligence.

⁸⁵ The FSC successively amended the *Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business* in September 2016 and May 2017, and revised the *Directions for Offshore Banking Branches Conducting Financial Derivatives Business* in September 2016.

knowledge or trading experience in financial products.

3. To obtain an understanding of the effect on domestic banks when changes in the global economic situation and financial environment occur, the FSC asked domestic banks to carry out an overall position stress test in April 2016. The results of the overall stress test of 37 domestic banks revealed that in both mild and relatively serious scenarios, capital adequacy related ratios of domestic banks were all higher than the minimum capital requirement, showing that banks, to some extent, have the capability to bear risks.⁸⁶
4. In October 2016, the FSC again required domestic banks to examine their exposure to investment in stocks and bonds in Mainland China because of increasing default risk of debt there. Moreover, banks shall enhance risk management to reduce the possible related losses (see Chapter 3.2).
5. In order to improve the effectiveness of internal audit and internal control, the FSC amended the *Implementation Rules of Internal Audit and Internal Control System of Financial Holding Companies and Banking Industries* twice in July 2016 and March 2017. The key amendments included the following: (1) adopting a risk-based internal audit system; (2) reinforcing the functions of the board of directors and audit committee; (3) enhancing internal guidelines to handle material contingencies and strengthen the anti-money laundering mechanisms; (4) introducing new requirements set for the report content of headquarters' compliance officers; and (5) establishing an internal reporting mechanism for monitoring the examination results by foreign competent authorities.

4.2.3 The takeover bid for Chaoyang Life Insurance Co., Ltd. has been made, and the FSC kept strengthening solvency and risk management for the insurance industry

1. In January 2016, according to an amendment of the *Insurance Act*, which allow the FSC to take prompt corrective actions, the FSC took over ailing Chaoyang Life Insurance Co., Ltd., and entrusted the Taiwan Insurance Guaranty Fund (TIGF) to hold a public auction. In January 2017, Nan Shan Life Insurance Co., Ltd. made the TIGF bailout bid in the second auction. By then, there was no local insurance company with negative net worth in Taiwan.

⁸⁶ All the data used in the stress tests are as of the end of 2015. The scenarios set in this test included declining domestic and international economic growth rates, increasing domestic unemployment, falling house prices, shrinking spread between deposit and loan interest rates, and rising market risk. The results of the overall stress test of 37 domestic banks showed that under a mild scenario, the average common equity ratio, Tier 1 capital ratio, capital adequacy ratio, and leverage ratio were 9.55%, 9.83%, 11.68%, and 5.63% respectively; under a relatively serious scenario, the figures were 8.50%, 8.78%, 10.58%, and 5.03%, respectively. All results were higher than the minimum capital requirement for 2016.

2. To continue improving solvency and risk management for the insurance industry, the FSC has implemented an external reviewing actuary system of insurance companies together with an Own Risk and Solvency Assessment (ORSA) mechanism for the insurance industry. Additionally, to reasonably reflect operating risks of the insurance industry, the FSC announced adjustments for the automatically adjusted actuarial formula, which was applied to determine the policy reserve interest rate for a new contract, as well as the calculation of the risk-based capital ratio in 2016.

4.2.4 Calling for stronger cyber security

Since several securities companies recently suffered distributed denial-of-service (DDoS) attacks, in which attackers overwhelmed the attacked websites and services with excessive traffic, the FSC has required the financial industry to implement stronger cyber security measures⁸⁷ and established a platform for reporting cyber-attacks. The FSC also planned to construct a Financial Information Sharing and Analysis Center (F-ISAC) for the purpose of offering financial institutions early-warning information. In addition, the Central Deposit Insurance Company has adopted cyber security as a rating indicator of its risk-based differential premium system.

4.2.5 Reinforcing the public tender offer system

As the settlement default of XPEC Entertainment stock's purchase revealed an institutional problem, the FSC introduced amendments to the related regulations⁸⁸ in November 2016. The key amendments were as follows: (1) requiring the offeror to provide a supporting document to prove their financial capacity for paying the purchase consideration of the tender offer; (2) requiring the board of directors and the review committee of the targeted company to take responsibility for the investigation and verification of their approvals; (3) stipulating that, in principle, the offeror may not change the time, manner, or place for payment of tender offer consideration; (4) modifying the extension of the public tender offer period to a maximum of 50 days; (5) introducing measures for protecting tenderer's rights and interests; and (6) increasing information disclosure requirements for public tender offers.

⁸⁷ The FSC required financial institutions to establish and implement a network-monitoring mechanism. When detecting a DDoS cyber-attack, financial institutions shall inform those telecommunications network operators to block the IP and clear the traffic.

⁸⁸ The FSC amended the *Regulations Governing Public Tender Offers for Securities of Public Companies* and the *Regulations Governing Information to be Published in Public Tender Offer Prospectuses* in November 2016.