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## IV. Measures to maintain financial stability

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In 2017, under the circumstances of modest international and domestic economic recoveries as well as mild inflation, Taiwan's financial markets and financial infrastructure maintained smooth operations and sound development. Profitability of financial institutions remained satisfactory, while asset quality, though slightly declining, stayed at an appropriate level, and capital levels continued improving. As a whole, Taiwan's financial system remained stable.

In spite of stable growth in advanced and emerging economies, international financial markets are likely to fluctuate sharply during the period of gradual monetary policy normalization by major central banks. Facing the changes in global and domestic economic and financial conditions, especially monetary policy normalization by the Fed, ECB and BOJ, the rise in trade protectionism, elevated debt levels in Mainland China, a possible major correction in global financial markets and capital outflows from emerging economies, the CBC will continue to closely monitor their influence on the domestic economy and financial system and adopt appropriate monetary, credit, and FX policies as warranted. Meanwhile, the FSC also continues to amend financial laws and regulations and undertake measures to strengthen financial supervision, aiming to foster the soundness of financial institutions and improve financial stability.

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

In view of moderate domestic economic recovery and mild inflation, the CBC held policy rates unchanged in 2017. Moreover, the CBC persistently implemented restrictions on high-value housing loans owing to their higher price volatility. The CBC also continually adopted a managed floating exchange rate regime and maintained dynamic stability of the NT dollar exchange rate, as well as timely amending relevant FX regulations.

### ***4.1.1 Adopting appropriate monetary policies in response to domestic and global economic and financial conditions***

#### ***The CBC kept policy rates unchanged***

On account of an uncertain global economic outlook and a moderate domestic economic growth, coupled with a negative output gap, mild inflationary pressures and future inflation expectations, tightening financial conditions, and an appropriate level of real interest rates compared to major economies, the CBC kept policy rates unchanged in 2017. The discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral remained at 1.375%, 1.75%, and 3.625%, respectively.

#### ***Reserve money growth remained moderate***

The CBC conducted open market operations to keep market liquidity at an appropriate level. In 2017, the excess reserves in all financial institutions remained at a higher level. The total loans and investments in the banking industry grew by 4.79%, while the monetary aggregate M2 increased by 3.75% year on year. Both rates were higher than the GDP growth rate of 2.89%, indicating 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 policies to maintain price and financial stability and, in turn, foster economic growth.

### ***4.1.2 The CBC continued to implement targeted prudential measures on high-value housing loans***

In March 2016, the CBC repealed most of the targeted prudential measures imposed on real estate loans, except for high-value housing loans because of higher risks faced by banks resulting from greater volatility in high-value housing prices, and urged banks to exercise self-discipline on mortgage-related credit risk management. In the future, the CBC will continue to monitor financial institutions' credit risk management on real estate loans and the developments in the real estate market, and undertake appropriate policy actions in a timely manner as needed to ensure financial stability.

### 4.1.3 Safeguarding stability of the NT dollar exchange rate

#### **Adopting flexible FX rate policies**

In order to maintain dynamic stability of the NT dollar exchange rate, the CBC adopts a flexible managed floating exchange rate regime. 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 FX market order.

#### **Maintaining an orderly FX market and promoting its sound development**

In 2017, the CBC continued to undertake appropriate management measures<sup>69</sup> to safeguard FX market order and promote its sound development. These measures mainly included: (1) continuing to adopt management measures targeting international capital inflows and outflows; (2) urging authorized FX banks to strengthen their FX risk management; (3) strengthening targeted examinations on forward transactions to ensure they are undertaken for real demand purposes; (4) requiring combined position limits of NTD non-delivery forwards (NDFs) and FX options for each authorized FX bank not to exceed one-fifth of its total positions.

### 4.1.4 Strengthening the AML/CFT mechanism in FX business

Along with the reinforcement of money laundering supervision, the CBC successively amended the regulations governing the FX business of securities firms and banks in December 2017 and January 2018, respectively. Those amendments aimed at urging the banking and securities industries to comply with the *Money Laundering Control Act*, the *Counter-Terrorism Financing Act* and the associated directions when conducting FX business related to confirming customer identity, keeping records, reporting cash transactions exceeding certain amounts as well as declaring suspicious money laundering or terrorism financing transactions, and reporting entities or individuals designated on the sanction list of terrorism financing.

<sup>69</sup> See CBC (2017), *Financial Stability Report*, Chapter IV, May.

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

From 2017 onwards, the FSC has continued promoting green financing and building a digital financial environment, as well as encouraging the development of FinTech and supporting industries to realize 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 measures

1. To enhance Taiwan's AML/CFT mechanisms and to prepare Taiwan for the *Mutual Evaluation* by the APG in November 2018, the FSC has introduced amendments to the related regulations:
  - (1) In May and August 2017, the FSC amended the rules governing OBUs, offshore securities units (OSUs) and offshore insurance units (OIUs), requiring them to perform customer due diligence and incorporate relevant schemes into their internal control and audit systems according to the regulations related to money laundering, as well as industry codes issued by each industry's association.
  - (2) The FSC completed and put the *Regulations Governing Anti-Money Laundering of Financial Institutions* into effect in June 2017. The directions governing internal control systems of AML/CFT of the banking sector, securities and futures industry, as well as the insurance industry were also amended in line with the contents of the aforementioned regulations.
2. The FSC has brought the compliance with AML/CFT regulations into its financial examination focus. The FSC will strengthen financial inspection and urge financial institutions to remedy deficiencies found during examinations.

### 4.2.2 Persistently enhancing risk management of the banking industry and financial holding companies

1. To enhance banks' risk management of financial derivatives and to protect customers' interests, the FSC introduced amendments to the regulations in May 2017 and February 2018, requiring banks to conduct better "Know Your Customer" procedures and evaluation of customer attributes and control of structured product transactions.

2. The FSC amended the *Implementation Rules of Internal Audit and Internal Control System of Financial Holding Companies and Banking Industries* in March 2018. The key amendments were as follows: (1) requiring big banks<sup>70</sup> to set up legal compliance units; (2) stipulating that banks should establish an InfoSec unit and appoint a delegate in charge of InfoSec activities; and (3) requiring financial holding companies and banks to establish an internal whistleblower mechanism.
3. In November 2017, to reinforce the supervisory mechanisms relating to financial holding companies and banks reinvesting in their financial leasing subsidiaries, the FSC required them to establish supervision and management mechanisms and to ensure full implementation of such mechanisms.

#### **4.2.3 Continually reinforcing the insurance industry's risk management and risk-bearing abilities**

1. In June 2017, the FSC amended the *Regulations Governing Foreign Investments by Insurance Companies* in order to address insurers' maturity mismatch between assets and liabilities. The amendments require that insurance companies can only invest in callable international bonds that may be redeemed no less than five years from the issue date. For such callable bonds traded in the secondary market, insurance companies can only purchase those that will be redeemed no less than three years after the settlement date.
2. In January 2018, the FSC amended the mechanisms for FX valuation reserves held by life insurance companies. The amendments include: (1) increasing the fixed percentage that shall be set aside for monthly reserves to 0.05%; (2) changing the calculation formula for minimum reserve requirements after FX loss offsetting; (3) raising the valuation change reserves ratio to 75% when the reserves decrease to the minimum level for three consecutive months until the actual reserves recover to more than three times the minimum reserve requirements.

#### **4.2.4 Urging banks to enhance credit checking and post-loan management of syndicated loans**

The FSC required banks to strengthen credit checking and loan management of syndicated loans, including: (1) reinforcing credit investigation and financial analysis prior to providing a loan; (2) strengthening the evaluation of each customer's working capital gap and own funds; (3) verifying transaction authenticity and capital flows; (4) fully carrying out post-loan management; and (5) establishing borrower's early warning mechanism.

<sup>70</sup> Big banks include those with total assets of the previous year over NT\$1 trillion as audited by a CPA.

#### **4.2.5 Constantly making efforts to establish mechanism for reinforcing management of InfoSec in financial markets**

In view of Fintech development and InfoSec incidents that have taken place at home and abroad, the FSC urged financial institutions to strengthen the management of InfoSec in 2017. The measures included reporting the results of InfoSec execution to the board of directors on an annual basis and promoting the integration of financial supervision and InfoSec. Moreover, the FSC conducted InfoSec targeted examinations focusing on both digital financial services and their SWIFT systems, and required financial industry associations to review relevant InfoSec rules and guidelines.