4.2 Non-deposit taking financial institutions

4.2.1 Life insurance companies

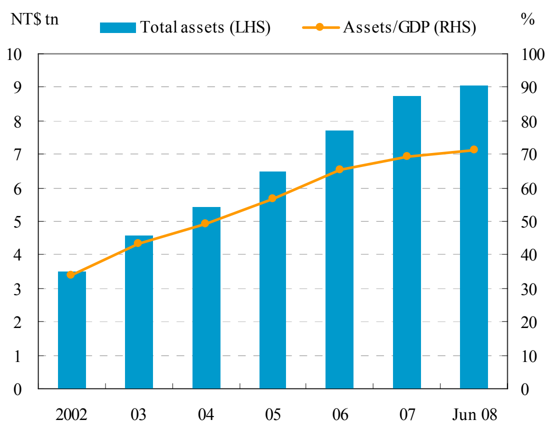
The asset size of Taiwan's life insurance companies increased slowly, while they showed huge losses of NT$77 billion in the first half of 2008. Although the depreciation of the NT dollar was expected to significantly reduce the losses on foreign exchange positions in 2008 Q3, the deepening global financial crisis and plummeting stock prices may continue to undermine future profitability. The average risk-based capital (RBC) ratio declined sharply, exerting the pressure of capital injection on some companies. Among the top three insurers, the credit ratings for Cathay Life and Shin Kong Life remained stable. In contrast, Nan Shan Life was downgraded to AA (twn) amid the adverse impact stemming from the financial crisis at its parent company, the AIG Group, and once experienced a surge of termination of insurance policies and an increase in policy collateral lending. However, the disturbance was eased following active measures taken by the company and the government, as well as a capital injection of NT$47.2 billion from the parent company.

Total assets increased slowly

The total assets of life insurers reached NT$9.04 trillion, equivalent to 71.38% of annual GDP at the end of June 2008, while the year-on-year growth rate rose at a slower pace, down to 9.09% from 12.70% at the end of 2007 (Chart 4.28). Compared to 2007, the increase was mainly supported by a surge of investments in domestic securities along with the continued growth of insurance products held in segregated custody accounts.[46]

The structure of Taiwan's life insurance market changed slightly. As of the end of June 2008, twenty-three domestic life insurers held a 98.87% market share by assets, while seven foreign life insurers commanded a share of only 1.13%. The top three life insurers held a combined market share of 56.94% and 46.20% in terms of assets and premium income, respectively, reflecting high market concentration.

Chart 4.28 Total assets of life insurance companies



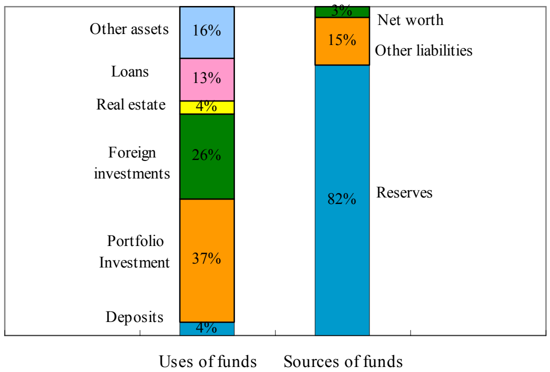
Note: End-of-period figures.
Source: FSC.

[46] When a life insurer sells a product held in segregated custody accounts, the amount of insurance coverage offered under the policy is booked both under "insurance product assets held in segregated custody account" and "insurance product liabilities held in segregated custody account."

Funds invested in domestic securities increased the most

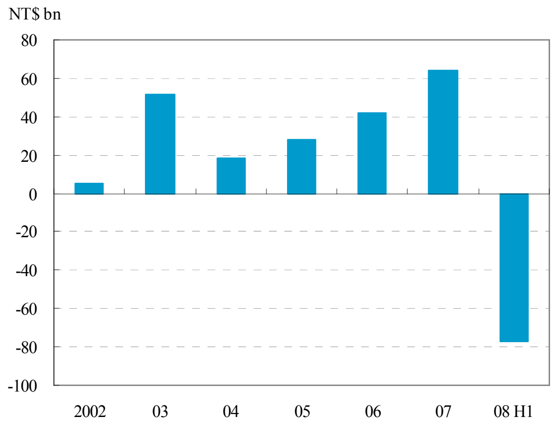
Securities investments and loans constituted the two main uses of funds by life insurers at the end of June 2008, with 37% of funds invested in domestic securities, 26% in foreign securities, and only 13% in loans. As to sources of funds, various policy reserves constituted 82%, while net worth accounted for 3% of funds (Chart 4.29). Affected by the deteriorating foreign investment environment and an optimistic perspective on the development of the cross-strait relationship, investment in domestic securities registered a marked increase of NT$186.8 billion, or 5.89%, from the end of 2007, whereas that in foreign securities only increased slightly by NT$18.2 billion, or 0.78%. Other assets and liabilities also continued to account for a growing share of insurer balance sheets due to the rapid growth of insurance products held in segregated custody accounts.

Chart 4.29 Sources and uses of funds in life insurance companies



Note: Figures are as of end-June 2008.
Source: FSC.

Chart 4.30 Pre-tax net income of life insurance companies



Source: FSC.

Poor operating performance in the first half of 2008

Life insurers as a whole registered a considerable loss of NT$77 billion in the first half of 2008 (Chart 4.30), posting a substantial year-on-year decrease of NT$126.9 billion, or 254.21%, in net income before tax. This was mainly led by sizable foreign exchange losses on the positions of foreign investments due to the appreciation of the NT dollar, as well as the enormous loss recognition of investments in US subprime mortgage-related products. Average ROE and ROA also turned negative, registering -43.53% and -1.73%, respectively (Chart 4.31), indicating that overall operating performance was poor. The foreign exchange losses on the positions of foreign investment were expected to shrink significantly as the NT dollar exchange rate has depreciated gradually since the second half of 2008, reaching the level seen at the end of 2007. Nevertheless, average return on investment was only 3.24% in the first half of 2008, lower than the 3.78% registered in 2007, reflecting the deterioration in the negative interest rate spread. Moreover, the deepening global financial crisis and falling stock prices since September 2008 may continue to erode future profitability.

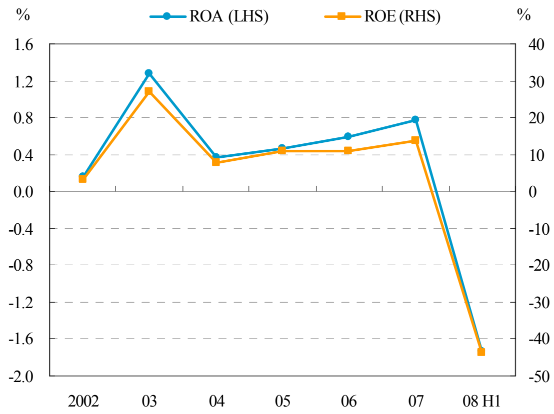
Average RBC ratio decreased considerably

Affected by the huge losses in the first half of 2008, the average RBC ratio[47] for life insurers decreased considerably from 263.29% at the end of 2007 to 162.37% (below the statutory minimum standard of 200%) at the end of June 2008. There were seven companies with a ratio of over 300% and eleven under the statutory minimum (Chart 4.32). The total assets of these latter firms accounted for 33.55% of the total assets of all life insurers, and some of these companies faced the pressure of capital increase.[48]

Credit ratings for the top three life insurers remained at twAA or AA (twn) above

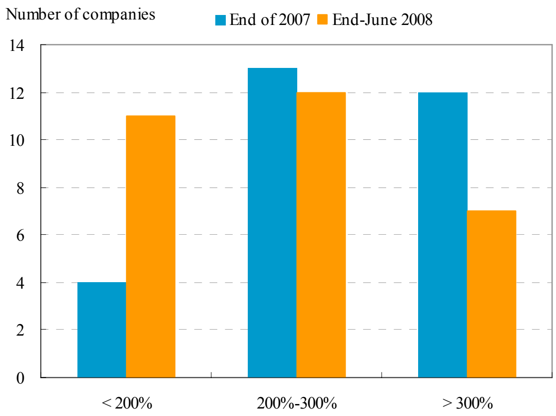
Of Taiwan's twenty-three domestic life insurers, only twelve[49] are rated by credit rating agencies. Among the top three insurers, Cathay Life and Shin Kong Life were rated at twAAA and twAA, respectively, signifying an extremely strong or strong ability to meet their financial commitments, whereas Nan Shan Life was downgraded from AAA(twn)to AA(twn)[50] amid the unfavorable impact stemming from the financial crisis in its parent company, the AIG Group. In the meantime, three insurers were listed on CreditWatch

Chart 4.31 ROE & ROA of life insurance companies



Note: ROA = net income before tax / average assets.
ROE = net income before tax / average equity.
Source: FSC.

Chart 4.32 RBC ratio of life insurance companies



Source: FSC.

47 Risk-Based Capital (RBC) ratio for life insurers = regulatory capital/risk-based capital. Under Article 143-4 of the Insurance Act, this ratio must be at least 200%.

48 In view of the global impact of the financial crisis and to maintain the operating function of RBC and the stability of the domestic insurance market, the FSC amended the capital system of the insurance industry in October and November 2008, respectively. The main content included: (1) additional issuance of bonds with a capital nature can be included in equity capital, and a relaxation of bonds with a capital nature and preferred stock of a liability type may be included in the limit of equity capital; (2) relaxation of the funds invested in bonds with a capital nature or preferred stock of a liability type of the insurance industry that need not be deducted from equity capital before the end of 2009; (3) the special reserve of major events may be included in equity capital; and (4) equity capital can recognize an unrealized gain or loss of 20% for stock and equity-related funds of domestic or foreign investment. The above amendments apply only until the end of 2009.

49 Life insurance companies rated by credit rating agencies include Taiwan Life, Cathay Life, China Life, Nan Shan Life, Shin Kong Life, Fubon Life, Allianz Taiwan Life, Prudential Life, Aegon Life, Metlife Taiwan, Antai Life, and First-Aviva Life.

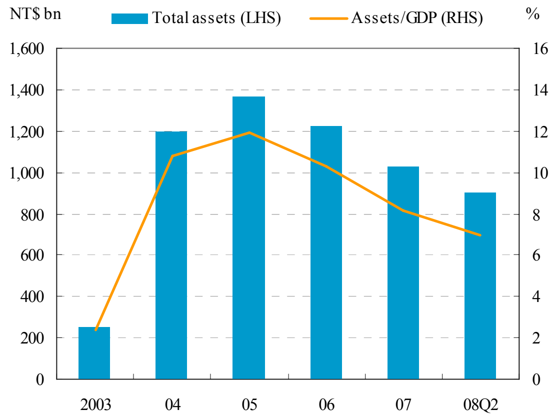
50 Ratings prefixed with "tw" are from the Taiwan Ratings Corporation, while ratings suffixed with "(twn)" are from Fitch Ratings.

negative.[51] This was mainly led by the fact that Taiwan Life faced the suspension of its scheduled capital increase, while Antai Life and Fubon Life both faced uncertainty in the consolidated capital levels and integrated risks of their respective conglomerates after Antai Life was acquired by Fubon Life. The rating outlook for the other six domestic life insurers was either stable or positive.

4.2.2 Bills finance companies

The total assets of bills finance companies continued to contract in the first half of 2008. At the same time, profitability declined with asset quality remaining satisfactory and average capital adequacy ratios in excess of regulatory minimum requirements. Affected by the global financial crisis, bills finance companies were vulnerable to the risk of deterioration in the quality of credit extensions secured by stocks as Taiwan stock prices declined sharply after September 2008. It also led to some of companies with greater exposure to liquidity risk. Besides, the bills issuance market was likely to shrink, having a negative influence on expanding bills business.

Chart 4.33 Total assets of bills finance companies

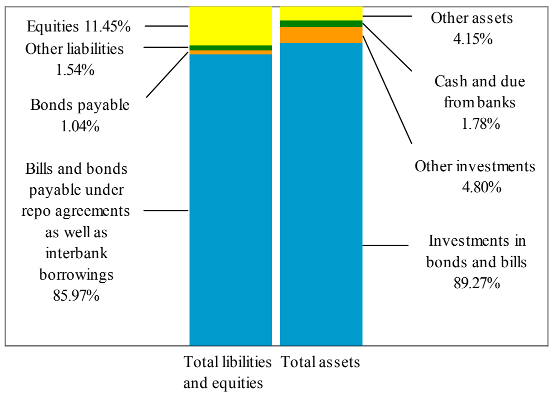


Note: Total assets are end-of-period figures.
Sources: CBC and DGBAS.

Assets continued to contract

The total assets of bills finance companies continued to decline and stood at NT$900.6 billion, equal to 7.11% of annual GDP, as of the end of June 2008 and decreased by 12.60% year on year (Chart 4.33), mainly driven by two factors. The first factor was that two bills finance companies (Chinaturst Bills Finance and Hua Nan Bills Finance) were merged respectively by their affiliated banks, and the second factor was that some bills finance companies' assets shrank. The three largest bills finance companies (Mega Bills

Chart 4.34 Asset/liability structure of bills finance companies



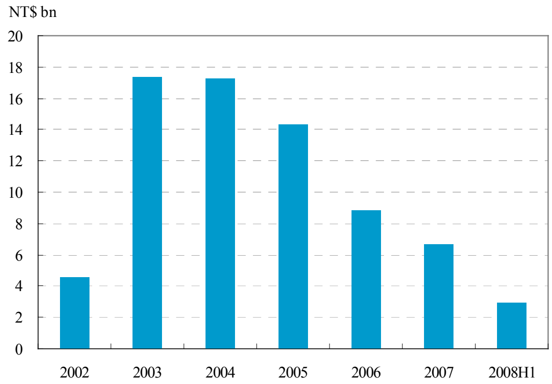
Note: Figures are end-June 2008.
Source: FSC.

[51] CreditWatch highlights the potential direction of a short- or long-term rating. The "positive" designation means that a rating may be raised; "negative" means a rating may be lowered; and "developing" means that a rating may be raised, lowered, or affirmed.

Finance, International Bills Finance, and China Bills Finance) commanded market shares by assets of 26.88%, 23.39%, and 18.72%, respectively, for a combined market share of 68.99%. No other firm had a market share as high as 10%.

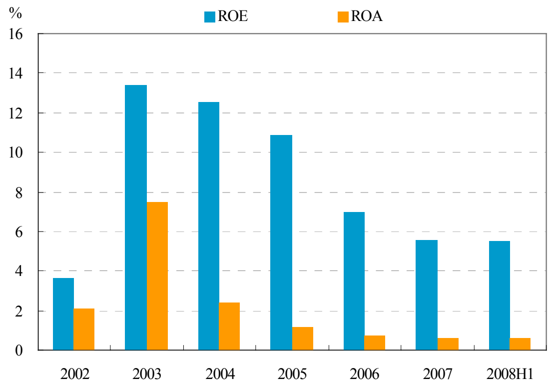
As for asset / liability structure, investments in bonds and bills accounted for 89.27% of total assets, an increase of 1.44% compared to the end of 2007, indicating a more considerable concentration in the uses of funds, while bills and bonds payable under repo agreements as well as interbank borrowings accounted for 85.97% of liabilities, a slight increase of 0.63 percentage points compared to the end of 2007, indicating that the sources of funds were mostly short-term (Chart 4.34).

Chart 4.35 Pre-tax net income of bills finance companies



Source: CBC.

Chart 4.36 ROE & ROA of bills finance companies



Notes: 1. ROA = net income before tax / average assets.
ROE = net income before tax / average equity.
2. Ratios for 2008 H1 are annualized.
Source: CBC.

Overall profitability continued to deteriorate

Bills finance companies posted net income before tax of NT$2.93 billion in the first half of 2008, a decrease of NT$0.44 billion, or 12.96%,[52] year on year (Chart 4.35), showing that profitability continued to deteriorate. At the same time, however, ROE and ROA changed little, reaching 5.50% and 0.61%, respectively, due to the obvious reduction in equity and assets (Chart 4.36).

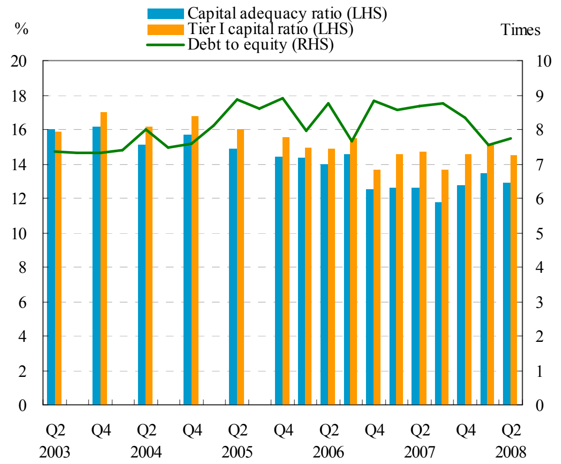
Capital adequacy ratios rose higher than statutory requirements

The average capital adequacy ratio of bills finance companies reached 12.88% at the end of June 2008, slightly higher than the figure recorded at the end of the previous year, as all companies had a ratio above 10%, higher than the statutory minimum of 8%. The average

[52] Excluding the factor of two merger cases (Chinatrust Bills Finance Corp.-Chinatrust Commercial bank and Hua Nan Bills Finance Corp.-Hua Nan commercial bank), bills finance companies posted net income before tax as of the first half of 2008, a further decrease of 17.61% compared with the same period last year.

Tier 1 capital ratio was 14.50%, slightly lower than the figure recorded at the end of the previous year. The average ratio of debt to equity slid to 7.74 times as of the end of June 2008, down from 8.33 times at the end of 2007 (Chart 4.37) as a result of a marked reduction in debt, reflecting improved leverage.

Chart 4.37 Capital adequacy ratio of bills finance companies

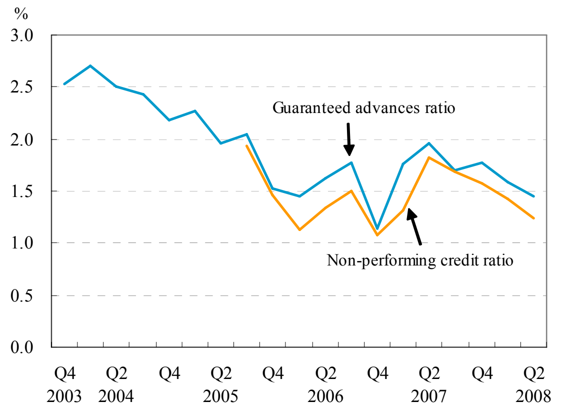


Note: The debt figures before 2003 included securities sold under repo agreements.
Source: CBC.

The risk of stock-secured credit increased

The guaranteed advances ratio and non-performing credit ratio [53] for the guarantee business were down to 1.45% and 1.23%, respectively, at the end of June 2008, lower than the figure recorded at the end of the previous year. Overall, the quality of credit assets at bills finance companies remained satisfactory (Chart 4.38). However, the outstanding amount of stock-secured credit was NT$74.7 billion at the end of 2007, accounting for 19.67% of total credit. With the high level of stock-secured credit and the recent sharp falls in the stock market, bills finance companies might not fully preserve their rights owing to the deep decline in the value of pledges of stocks. The risk of related credit extension could increase.

Chart 4.38 Guaranteed advances ratio of bills finance companies



Notes: 1. Guaranteed advances ratio = overdue guarantee advances / (overdue guarantee advances + guarantees). Non-performing credit ratio = non-performing credit / (non-performing credit + guarantees).
2. The data of non-performing credit ratios are compiled from September 2005 onwards.
Source: CBC.

Liquidity risk of some companies increased

Investments in bonds and bills constituted nearly 90% of the assets of bills finance companies as of the end of June 2008. Bonds, in particular, accounted for about 50% (Chart 4.39). An apparent mismatch in asset-liability maturity persisted, with short-term interbank loans and repos making up over 86% of funding sources. As a result of the global financial crisis,

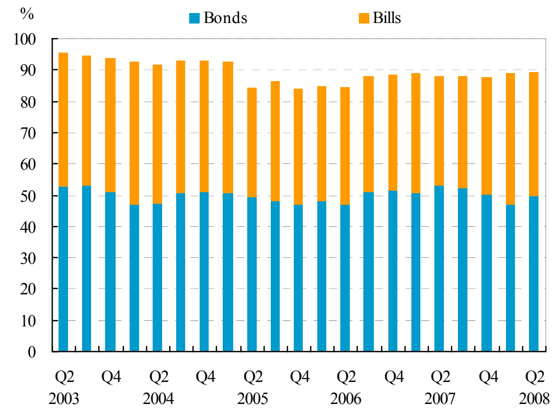
[53] Non-performing credit for guaranteed advances refers to those guaranteed advances that are more than three months overdue.

financial institutions in Taiwan became cautious and conservative in lending to bills finance companies after September 2008. Bills finance companies were exposed to higher liquidity risk as funding from the interbank call-loan market was dramatically reduced.

The shrinking of supply in bills finance market may have a negative effect on future business

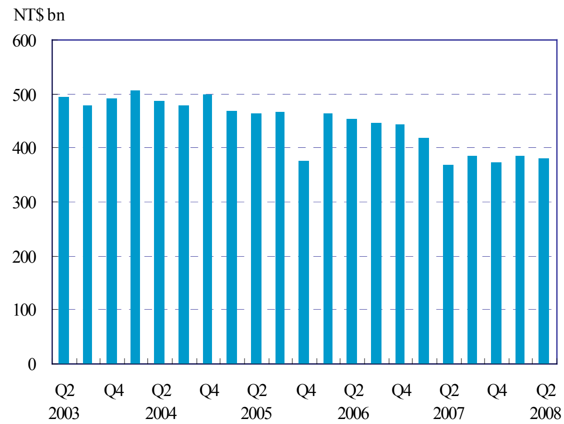
The outstanding balance of commercial paper guaranteed by bills finance companies gradually declined and remained at a low level. This figure was NT$379.5 billion at the end of June 2008, up 1.71% from the end of the previous year (Chart 4.40). With slightly weakened confidence in Taiwan's financial market resulting from the global financial crisis, a number of bills finance companies found it somewhat difficult to obtain financing from the interbank call-loan market. In response to a condition of such tight liquidity, they appeared to reduce the credit lines of their customers or to reluctantly issue new bills as commercial paper guarantees came due. If this situation persists, the supply in bills finance market would be reduced, thereby affecting the future business of bills finance companies.

Chart 4.39 Bond & bill positions as percentage of assets at bills finance companies



Note: End-of-period figures.
Source: CBC.

Chart 4.40 Outstanding of CP guarantees



Note: End-of-period figures.
Source: CBC.