## Box 5
## Implementation of Basel III in domestic banks in Taiwan

In order to tackle deficiencies in financial supervision exposed during the global financial crisis of 2008-09, the Basel Committee on Banking Supervision (BCBS) has progressively published several documents relating to international capital and liquidity standards for banks since 2010. These standards, collectively known as Basel III, urged national authorities to strengthen microprudential supervision, including increases in the levels and quality of capital, the expansion of the coverage of risk-weighted assets, and the introduction of a leverage ratio and two liquidity ratios. Furthermore, aiming at systemic risks that could be caused by procyclicality and interconnectedness of banking activities, Basel III introduced macroprudential measures, comprising a new capital conservation buffer, a countercyclical capital buffer and an additional capital surcharge for systemically important banks. In Taiwan, the standards will be phased in beginning 2013, with full implementation as of 1 January 2019.

With a view to raising the risk-bearing capacity and international competitiveness of domestic banks, and in compliance with global regulatory reforms, the Financial Supervisory Commission (FSC), referring to Basel III, revised the Regulations Governing the Capital Adequacy and Capital Category of Banks in November 2012, effective from January 2013. Summarized below are the contents of Basel III-related regulations in Taiwan and the work to be further promoted in the future.

***1. Contents of the capital adequacy regulations in Taiwan***

The new capital adequacy regulations are Basel III compliant in principle but fine-tuned according to the operational characteristics of banks in Taiwan. Key points are as follows:

**1.1 Raising capital quality**

The FSC, referring to the Basel III capital standards, introduced the definition of common equity Tier 1 capital, amended the requirements of non-common equity Tier 1 capital and Tier 2 capital (including bail-in provisions),[1] and removed the category of Tier 3 capital from the regulations. Additionally, those capital instruments that were issued before 12 September 2010 and not qualified as non-common equity Tier 1 capital and Tier 2 capital will be required to be phased out beginning January 2013 by setting a cap of 90% of the nominal amount of these instruments in 2013 and reducing the cap by 10 percentage points in each subsequent year.

**1.2 Lifting capital levels**

The regulations introduce a capital conservation buffer and incorporate it into minimum regulatory capital standards. Furthermore, the regulations set out the minimum capital requirements during the transition period for each year of 2013-2019 and specify that the common equity, Tier 1 capital and capital adequacy ratios should be no less than 7%, 8.5% and 10.5%, respectively, commencing 2019 (Table B5.1).

**1.3 Introducing a leverage ratio**

The minimum leverage ratio is set at 3% during the period of parallel run testing between 2013 and 2018. The ratio requirement will be formally implemented on 1 January 2018.

**1.4 Introducing a countercyclical capital buffer**

In order to avoid the occurrence of systemic risks, the FSC will consult with the CBC and other relevant agencies, when necessary, to impose on banks an additional provision of countercyclical capital buffers of up to 2.5%.

**Table B5.1 Minimum capital requirements and transition period**

| Items | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 onwards |
|---|---|---|---|---|---|---|---|
| Capital adequacy ratio (%) | 8.0 | 8.0 | 8.0 | 8.625 | 9.25 | 9.875 | 10.5 |
| Tier1 capital ratio (%) | 4.5 | 5.5 | 6.0 | 6.625 | 7.25 | 7.875 | 8.5 |
| Common equity ratio (%) | 3.5 | 4.0 | 4.5 | 5.125 | 5.75 | 6.375 | 7.0 |

Source: CBC.

***2. Future work to be further promoted***

Based on the timeline set out by the BCBS, Taiwan will phase in Basel III capital requirements beginning 2013. Nevertheless, with the major contents of implementation focused on microprudential dimensions, capital requirements related to macroprudential dimensions will also need to be strengthened, and liquidity ratio regulations should, therefore, be deliberated and laid down.

**2.1 Considering the operational mechanisms of a countercyclical capital buffer**

Article 5 of the Regulations Governing the Capital Adequacy and Capital Category of Banks provides the legal basis for implementing countercyclical capital buffers. However, the relevant guidelines and operational mechanisms of a capital buffer have not been stipulated. In view of the fact that a countercyclical capital buffer is within the scope of macroprudential supervision and highly pertinent to the CBC's credit policy, the CBC will promote relevant study and cooperate with the FSC in the stipulation of provisioning criteria and regulations that are applicable to the domestic banking system.

**2.2 Imposing additional supervisory requirements on systemically important domestic banks to reduce potential risks**

In November 2011, the BCBS issued a final version of the document - Global Systemically Important Banks (G-SIBs): Assessment Methodology and the Additional Loss Absorbency Requirement. Subsequently, the Financial Stability Board (FSB) published a list of G-SIBs[2] and suggested that national authorities should identify their domestic systemically important banks (D-SIBs) and adopt appropriate policy measures to mitigate their negative externalities.[3]

Domestic banks in Taiwan were not included in the list of G-SIBs. Nevertheless, the authority will adopt additional supervisory measures for local banks that possibly could induce systemic risks, so as to improve their loss absorbency ability and reduce potential impacts.

**2.3 Deliberating on the liquidity ratio regulations**

The BCBS introduced two liquidity ratios: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). Both ratios are currently being observed and under adjustment and expected to be implemented from 2015 and 2018, respectively.[4] In line with the timeline for the implementation of liquidity ratios set out by the BCBS, the FSC and the CBC, weighing the Basel III standards and the domestic practices of banks' liquidity management, have actively embarked on deliberations related to the liquidity regulations applicable to domestic banks.

Notes: 1. The bail-in provision means that the priority order for the distribution of the earnings and assets of the holder of non-common equity Tier 1 and Tier 2 capital instruments is the same as that of a common stock holder when the relevant authority assigns officials to take conservatorship over the issuing bank, orders such a bank to suspend and wind up business, or liquidates the bank.

2. The FSB published an initial list of 29 banking groups identified as G-SIBs in November 2011. It updated the list in November 2012, indicating the number of G-SIBs was reduced to 28. See FSB (2012), *Update of group of global systemically important banks*, November 1.
3. BCBS (2012), *A Framework for dealing with domestic systemically important banks,* October.
4. The BCBS introduced standards on LCR and NSFR in December 2010. Subsequently, taking into account their latent impacts on financial markets, credit supply and economic growth, it revised the calculation of LCR in January 2013. The revised standards will adopt a phase-in

arrangement that introduces the LCR as planned on 1 January 2015, but with the minimum requirement set at 60%. This will then rise by 10 percentage points per annum to reach 100% on 1 January 2019.