

# *Central Bank Operations*

## III. Central Bank Operations

### 1. Overview

For the year 2014, uncertainties lingered in the global economy, the domestic output gap remained negative, and the inflation outlook was mild. Against such a backdrop, the CBC kept policy rates on hold so as to fulfill its legal mandates of maintaining price and financial stability and fostering economic growth.

In response to economic and financial conditions, the CBC continued to conduct open market operations and issue certificates of deposit (CDs) to manage market liquidity, maintain reserve money at appropriate levels and sustain steady growth in monetary aggregates. Moreover, in order to meet financial institutions' portfolio diversification needs, the CBC raised the bidding amounts of 364-day CDs and 2-year CDs. With regard to money supply, M2 recorded an annual growth rate of 5.66 percent, within the CBC's target range of 2.5 percent to 6.5 percent, which was sufficient to fully support economic activity.

To further strengthen financial institutions' management of real-estate associated credit risks and ensure sound banking operation, the CBC decided to expand the scope of Specific Areas to include four more districts in New Taipei City and four districts in Taoyuan City, revise the definition of high-valued housing, and introduce a loan-to-value ratio cap of 50 percent on, among others, new loans for the third (or more) home purchase, all effective from June 27, 2014.

In terms of foreign exchange management, the CBC steadily promoted the internationalization of capital markets and revised relevant foreign exchange regulations in continual cooperation with the FSC. Furthermore, from September 9, 2014, overseas branches of domestic banks were eligible to conduct NT dollar non-delivery forwards business with prior approval. This measure was expected to help expand the business scope of overseas branches of domestic banks and promote their international competitiveness. Meanwhile, the CBC also permitted authorized foreign exchange banks to offer online banking services to a wider customer base and allowed interbank ATM cash withdrawal in foreign currency.

To enhance the safety and efficiency of payment system operation, the CBC continued to improve financial infrastructure. During 2014, the CBC expanded the functions of the foreign currency

clearing platform, which significantly reduced the charges for remittances paid by the general public and the processing time. In addition, the CBC assisted the Financial Information Service Co., Ltd., the Taiwan Clearing House, and the National Credit Card Center of R.O.C. in founding the Taiwan Mobile Payment Co., which later launched the Payment Service Provider Trusted Service Manager platform on December 30, 2014, aiming to facilitate the development of mobile payments.

## 2. Monetary Management

In 2014, owing to lingering uncertainties in the global economy, a negative output gap and a mild inflation outlook in the domestic economy, the CBC maintained its monetary policy stance, leaving policy rates unchanged. In addition, the CBC continued to monitor financial institutions to manage their credit risks and ensure financial stability. The CBC also continued to enhance the financing mechanism for small and medium-sized enterprises (SMEs) in order to expand banks' lending to SMEs while at the same time absorbing excess funds from the financial market to an appropriate liquidity level.

### Policy Rate Unchanged to Maintain Price and Financial Stability

In view of global economic uncertainties, a negative domestic output gap, and a mild outlook for inflation, the CBC kept policy rates unchanged so as to maintain price and financial stability and to promote economic growth.

At the end of 2014, the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral remained at their current levels of 1.875 percent, 2.25 percent, and 4.125 percent, respectively.

### CBC Policy Rates

Unit: % (percent per annum)

Effective Date	Discount Rate	Accommodation Rate with Collateral	Accommodation Rate Without Collateral
2010 / Jun. 25	1.375	1.750	3.625
Oct. 1	1.500	1.875	3.750
Dec. 31	1.625	2.000	3.875
2011 / Apr. 1	1.750	2.125	4.000
Jul. 1	1.875	2.250	4.125

Source: *Financial Statistics Monthly*, CBC.

### Absorbing Excess Liquidity Through Open Market Operations

In 2014, the CBC continued to conduct open market operations by issuing certificates of deposit (CDs) to maintain reserve money and overnight call loan rates at appropriate levels. The average annual growth rate of reserve money in 2014 was 6.94 percent, while M2 recorded an annual growth rate of 5.66 percent, within the CBC's target range of 2.5 percent to 6.5 percent.

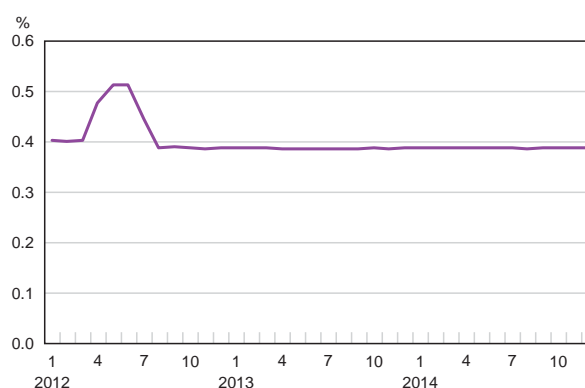
In response to the demands for asset allocation of financial institutions, the monthly amount of

364-day CDs issued increased from NT\$100 billion to NT\$120 billion from February onwards, and the monthly amount of 2-year CDs issued rose from NT\$10 billion to NT\$20 billion beginning August 2014. The total value of CDs issued amounted to NT\$67,187 billion in 2014, and the total outstanding amount of CDs issued by the CBC was NT\$7,106 billion at the end of the year.

Keeping in line with policy rates, the CBC also kept its non-competitive bidding rates for new CDs unchanged. Consequently, in 2014, the rates on 30-day, 91-day, and 182-day CDs remained at 0.87 percent, 0.93 percent, and 1.05 percent, respectively. In addition, the rates on 364-day CDs exhibited a downward trend from 0.58 percent in January to 0.52 percent in June. Subsequently, it showed an upward trend to 0.64 percent in October, and then dropped to 0.60 percent at the end of the year. Meanwhile, the rates on 2-year CDs displayed a similar pattern, staying within the range of 0.69 percent to 0.85 percent.

In 2014, the average overnight call loan rate remained broadly stable in each month, within the range of 0.386 percent to 0.388 percent.

### Overnight Call Loan Rate



Source: Financial Statistics Monthly, CBC.

### Open Market Operations

Unit: NT\$ Billion; %

Year/ Month	Amount Absorbed	Amount Offered	Weighted Average Rate on CDs Issued				
	Issues of CDs	Redemptions of CDs	1-30 Days	31-91 Days	92-182 Days	274-364 Days	2 Years
2012	54,831	54,912	0.87	0.93	1.05	0.85	-
2013	63,122	63,074	0.87	0.93	1.05	0.66	0.77
2014	67,187	66,955	0.87	0.93	1.05	0.58	0.79
2014/ 1	5,022	5,110	0.87	0.93	1.05	0.58	0.76
2	5,550	5,444	0.87	0.93	1.05	0.57	0.74
3	5,650	5,611	0.87	0.93	1.05	0.56	0.73
4	5,728	5,692	0.87	0.93	1.05	0.53	0.71
5	5,461	5,433	0.87	0.93	1.05	0.52	0.69
6	5,624	5,602	0.87	0.93	1.05	0.52	0.70
7	6,356	6,319	0.87	0.93	1.05	0.54	0.75
8	5,322	5,287	0.87	0.93	1.05	0.60	0.80
9	5,518	5,512	0.87	0.93	1.05	0.61	0.84
10	5,968	5,963	0.87	0.93	1.05	0.64	0.85
11	5,145	5,138	0.87	0.93	1.05	0.63	0.85
12	5,844	5,844	0.87	0.93	1.05	0.60	0.81

Source: Financial Statistics Monthly, CBC.

## Amending the Regulations Governing Real Estate Loans and Continuing Relevant Risk Management Policy

- (1) Since June 2010, the CBC has introduced several rounds of targeted macro-prudential measures governing housing loans in the stipulated Specific Areas, and high-valued housing loans and land collateralized loans nationwide. Furthermore, since March 2013, in view of a more pronounced price increase in districts outside Specific Areas, the CBC has urged banks to exercise self-discipline to enhance risk management of housing loans in these districts.
- (2) In order to further strengthen financial institutions' management of real-estate associated credit risks, the Board amended the *Regulations Governing Home mortgage Loans and Land Loans Extended by Financial Institutions* on June 26, effective from June 27, 2014. Important amendments related to the above mentioned regulations included:
- A. Expanding the scope of Specific Areas to include four more districts in New Taipei City (Wugu, Taishan, Bali and Yingge) and four districts in Taoyuan City (Taoyuan, Luzhu, Zhongli and Guishan) .
  - B. Introducing a loan-to-value (LTV) ratio cap of 50 percent on a new housing loan taken out by a single borrower for his/her third or more home purchase, applicable to properties across the country.
  - C. Revising the definition of high-valued housing, of which the LTV ratio ceiling was lowered to 50 percent.
  - D. Lowering the LTV ratio ceiling on housing loans taken out by corporate legal entities to 50 percent.
- (3) Since measures were introduced to further enhance banks' real estate-related risk management in June 2014, the concentration of real estate lending in banks' loan portfolios has eased. Banks were also found to have granted loans for housing in the designated Specific Areas and high-valued housing across the country at lower LTV ratios and higher mortgage rates. This is conducive to sound banking operation and to the attainment of financial stability.

The risk management measures for real estate lending implemented by the CBC have achieved the following results:

- A. The outstanding amount of housing loans increased at a slightly slower pace through 2014, accounting for 26.75 percent of total loans at the end of the year, down by 0.87 percentage points from June 2010. In addition, the concentration of housing loans in the stipulated Specific Areas improved markedly.

### Housing Loan Ratios

Date	Housing Loans to Total Loans	Unit: %	
		New Housing Loans in "Specific Areas" to Total New Housing Loans	
2010 / Jun.	27.62	70.20	
2014 / Dec.	26.75	51.46	

B. The average LTV ratio of housing loans in Specific Areas fell by 6.6 percentage points to 57.31 percent, and the average mortgage rate rose to 2.15 percent at the end of 2014.

### Housing Loans in “Specific Areas”

Unit: %

Date	Loan-to-Value Ratio	Mortgage Rate
2010 / Jul.	63.91	1.97
2014 / Dec.	57.31	2.15

C. The average LTV ratio of newly-extended land collateralized loans declined to 60.30 percent, and the average mortgage rate climbed to 2.78 percent at the end of 2014.

### Newly-Extended Land Collateralized Loans

Unit: %

Date	Loan-to-Value Ratio	Mortgage Rate
2010 / Dec.	68.36	2.08
2014 / Dec.	60.30	2.78

D. The average LTV ratio of housing loans taken out by corporate legal entities decreased to 43.67 percent, and the average mortgage rate edged down slightly to 2.25 percent at the end of 2014.

### Housing Loans by Corporate Legal Entities

Unit: %

Date	Loan-to-Value Ratio	Mortgage Rate
2011 / Dec.	56.11	2.30
2014 / Dec.	43.67	2.25

E. The efforts of the aforesaid policy measures had successfully pushed the average LTV ratio of high-valued housing loans down to 47.93 percent, and brought the average mortgage rate upwards to 2.08 percent in December 2014.

### High-Valued Housing Loans

Unit: %

Date	Loan-to-Value Ratio	Mortgage Rate
Pre-restriction	80-99 (maximum)	1.84 (minimum)
2014 / Dec.	47.93 (average)	2.08 (average)

F. The average LTV ratio on loans for third home purchase dropped sharply to 48.7 percent, while the average mortgage rate trended up to 2.29 percent at the end of 2014.

## Loans for Third Home Purchase

Unit: %

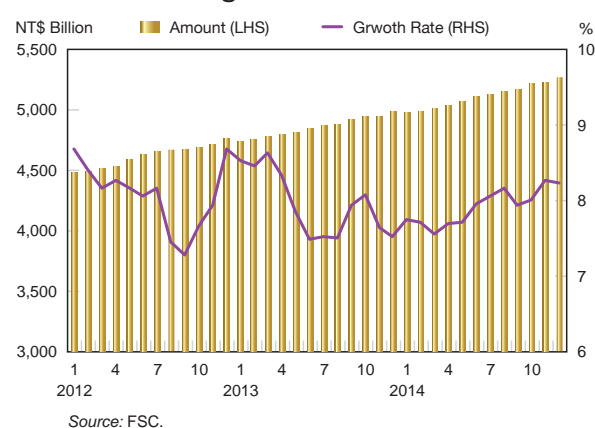
Date	Loan-to-Value Ratio	Mortgage Rate
2014 / Jun.	58~72	1.97
2014 / Dec.	48.7	2.29

## Enhancing the SME Financing Mechanism

To provide easier access to financing for SMEs, the CBC supported the Financial Supervisory Commission (FSC) to continue the program of encouraging SMEs lending by domestic banks. Furthermore, the CBC also continued to urge commercial banks to increase lending to SMEs.

At the end of 2014, the outstanding loans extended to SMEs by domestic banks amounted to NT\$5,164 billion, growing by NT\$403 billion from the end of the previous year and far exceeding the annual target of increased lending of NT\$240 billion set by the FSC.

### Outstanding Loans Extended to SMEs



## Redeposits of Financial Institutions

Accepting redeposits from Chunghwa Post and commercial banks is another instrument for the CBC to influence banks' reserve positions to promote financial stability. At the end of 2014, outstanding postal savings redeposits and commercial banks' redeposits stayed unchanged at NT\$1,624 billion and NT\$396 billion, respectively.

The Agricultural Bank of Taiwan accepted deposits from community financial institutions and made redeposits with the CBC. At the end of 2014, its outstanding redeposits were NT\$165 billion. In addition, the Central Deposit Insurance Corporation's time deposits at the CBC totaled NT\$54 billion, which was a NT\$15 billion increase from 2013.



### 3. Foreign Exchange Management

For the year 2014, the CBC followed the established managed float regime to maintain an orderly foreign exchange (FX) market. Sufficient seed funds were provided by the CBC for the Taipei Foreign Currency Call Loan Market. The CBC's foreign exchange reserves increased by US\$2.2 billion owing to returns on investments. The payment-versus-payment (PVP) mechanism was added to the foreign currency clearing platform. Moreover, from February 6, 2013, when domestic banking units (DBUs) were allowed to conduct renminbi (RMB) business, up to the end of 2014, DBUs recorded a balance of RMB 302.3 billion on RMB deposits, and the balance of DBUs' cross-strait RMB remittances was RMB1,970.7 billion.

#### Foreign Exchange Market Management

Taiwan's exchange rate is in principle guided by the market mechanism; the CBC only steps in when there is excessive exchange rate volatility. In recent years, the US, Japan and the euro area have adopted quantitative easing (QE) policies one after the other. The spillover effects caused frequent large scale foreign capital movements in and out of Taiwan, which affected the NTD exchange rate and financial market stability. To prevent QE policies from disrupting the domestic FX market, the CBC conducted “leaning against the wind” operations to eliminate excessive exchange rate fluctuations in order to maintain the dynamic stability of the NTD exchange rate. Indeed, according to behavioral macroeconomic analysis, leaning against the wind can effectively eliminate excessive exchange rate fluctuations and enhance FX market efficiency.

At the end of 2014, the NT dollar exchange rate depreciated against the US dollar by 5.57 percent from the previous year end's 29.950 to 31.718, in the middle ground of stability as compared to the euro's 11.84 percent depreciation, the RMB's 2.48 percent depreciation, the Korean won's 3.36 percent depreciation and the Japanese yen's 12.24 percent depreciation.

In 2014, the CBC continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions to keep the market orderly. Moreover, reinforced examination efforts were made to ensure that forward transactions were based only on actual transactions. The CBC also urged authorized banks to enhance their exchange rate risk management.

#### Management of the Foreign Currency Call Loan and Swap Business

In order to provide the financial system with sufficient foreign currency liquidity to meet funding needs, including those for corporations to venture into overseas markets, the CBC provided seed

funds for the Taipei Foreign Currency Call Loan Market, including US\$20 billion, €1 billion and ¥80 billion.

Furthermore, the CBC continued to conduct foreign currency swap transactions with banks and extended foreign currency call loans to banks so as to facilitate smooth corporate financing. During 2014, the volume of foreign exchange call loan transactions reached US\$1,474.6 billion, 8.2 percent more than that of 2013, while the balance at the end of 2014 was US\$22.7 billion. The volume of foreign currency-NTD swap transactions reached US\$1,240.3 billion, 9.6 percent more than 2013, while the balance was US\$170.4 billion at the end of 2014.

### Foreign Exchange Reserve Management

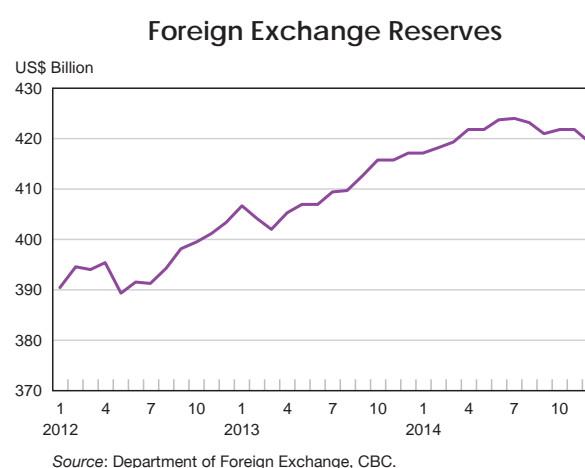
At the end of 2014, total foreign exchange reserves stood at US\$419.0 billion, a US\$2.2 billion increase from the end of 2013, mainly attributable to higher returns from foreign exchange reserve investments.

### Capital Flow Management

The CBC's foreign exchange management mainly relies on the market mechanism, and capital can, in principle, flow freely in and out of Taiwan. As of 2014, foreign currency capital not involving NT dollar conversion can flow freely; neither is there any restriction on financial flows involving NT dollar conversion for goods and service trade, as well as direct and securities investments approved by the competent authorities. However, regulation exists for short-term remittances. Annual remittances for an individual resident within US\$5 million and for a juridical person within US\$50 million can be settled by banks directly, while annual remittances above the aforementioned amounts require the approval of the CBC. Each transaction for a non-resident within US\$0.1 million can be settled by banks directly, whereas any amount of transaction above that threshold requires the approval of the CBC.

Key measures with regard to the management of capital flows in 2014 included:

- (1) Promoting the internationalization of Taiwan's capital market
- (2) Increasing residents' investments in foreign securities



### CBC-Approved Fund-Raising by Domestic and Foreign Institutions

Institution	Method	Number	Amount
Foreign companies	IPO on TWSE & TPEX	22	NTD10.87 billion
	NTD convertible bonds	6	NTD4.40 billion
	International bonds	29	USD14.66 billion
			RMB3.30 billion
			AUD0.17 billion
			ZAR0.60 billion
Domestic companies	Overseas convertible bonds	7	USD2.11 billion
	Overseas depositary receipts	3	USD0.88 billion
	RMB-denominated bonds	2	RMB1.20 billion
Mainland Chinese banks	RMB-denominated bonds	6	RMB16.30 billion

Note: TWSE (Taiwan Stock Exchange) ; TPEX (Taipei Exchange) .

Source: Department of Foreign Exchange, CBC.

### Residents' investments in Foreign Securities Approved by the CBC

Institution	Method/Instrument	Amount
Securities investment trust (SIT) companies	85 domestic SIT funds (including 59 NTD - foreign multiple currency SIT funds)	NTD1,360.00 billion (multiple currency funds: NTD965.00 bn)
	3 SIT private funds	NTD4.60 billion
	1 domestic futures trust fund	NTD5.00 billion
Life insurance companies	Non-discretionary money trusts managed by financial institutions	USD2.13 billion
	Investment for their own accounts	USD3.40 billion
	Foreign securities investment remittances to presell forward FX contracts	USD0.09 billion
	Lowering overseas investment hedge positions	USD6.00 billion
Five major government funds	Investment for their own accounts	USD3.36 billion
	Overseas investment remittances	USD0.09 billion

Source: Department of Foreign Exchange, CBC.

- (3) Loosening the regulations regarding foreign exchange remittances In line with the Financial Supervisory Commission's (FSC's) approval of the cooperation agreements signed by the Taiwan Futures Exchange and foreign futures exchanges , the CBC relaxed related remittance regulations. Starting from May 15, 2014, banks may handle the declaration of FX settlements of futures commission merchants, foreign futures clearing houses or foreign futures commission merchants in conducting FSC-approved NTD-denominated futures contracts listed on the aforementioned foreign futures exchanges per the cooperative agreements.

## Management of the Foreign Exchange Business of Financial Institutions

### (1) Authorized FX banks

Pursuant to *The Central Bank of the Republic of China (Taiwan) Act* and *Foreign Exchange Regulation Act*, the CBC reviewed and authorized banks to manage FX business and supervised accordingly. In 2014, the CBC continued to approve bank branches as authorized FX banks and loosened restrictions on FX derivative product business.

- A. At the end of 2014, there were 3,407 authorized FX banks in total, which included 39 head offices and 3,329 branches of domestic banks, 36 branches of 27 foreign banks, three branches of Mainland Chinese banks, as well as 992 authorized money exchangers, post offices and financial institutions authorized to engage in basic foreign exchange business.
- B. The CBC also approved 14 cases for authorized FX banks to establish branches in Mainland China, 26 cases for domestic banks to set up branches abroad.
- C. In terms of new FX products, 28 derivatives were approved in 2014 after prudent review.
- D. To boost international competitiveness of domestic banks' foreign branches with a more extensive business scope, on September 9, the CBC announced that overseas branches of domestic banks may apply for NTD non-delivery forward (NDF) business.
- E. On October 8, the CBC announced that authorized FX banks could accept and handle internet banking or mobile banking FX business for non-resident natural persons with resident certificates and natural persons with Identification Cards issued according to the Ministry of Foreign Affairs' *Directions for Issuing Identification Cards to the Staff of Diplomatic Missions in the Republic of China (Taiwan) and Their Family Members*. The aforesaid business includes: NTD remittances with the equivalent value below NT\$500 thousand, foreign currency outward remittances, foreign currency transfers with the same person's bank account or with a pre-defined third person account.

### (2) Insurance companies

In 2014, 21 insurance companies were allowed to engage in foreign currency investment-linked insurance business, and 24 were permitted to conduct business in relation to traditional foreign currency insurance products.

### (3) Securities firms

- A. As securities firms and their offshore securities units (OSUs) were allowed to engage in securities business-related spot transactions between foreign currencies, starting from August 26, 2014, the CBC required securities firms and OSUs to declare their FX receipts and disbursements or

transactions.

B. As of end-2014, the approved cases granted by the CBC for securities firms, investment trust and investment consulting firms to manage FX business are as follows:

### **CBC-Approved FX Business Managed by Securities Firms and Investment Trust and Investment Consulting Firms (As of End-2014)**

Institution	FX business	Number
Securities firms	Agents for foreign bond trading	10
	Brokering trades in foreign securities	38
	Underwriting international bonds	32
	Proprietary trading of and investments in international bonds	8
	Proprietary foreign securities trading neither belonging to investment with their own funds nor for hedging needs	10
	Issuance of warrants linked to foreign securities or indexes	7
	Issuance of warrants linked to domestic securities	1
	Non-discretionary individually managed money trust wealth management	11
	Issuance of onshore foreign currency bills	21
	Participating dealers of offshore exchange traded funds	4
Securities firms; investment trust and investment consulting firms	Master agents for offshore public funds	47
	Mandated institution of private offshore funds	22
	Foreign currency discretionary investments in foreign securities	27
	Conducting public offer or private placement of foreign currency-denominated funds	18
	Master agents for offshore exchange traded funds	2

Source: Department of Foreign Exchange, CBC.

### **RMB Exchange Transactions**

- (1) Since February 6, 2013, when authorized FX banks or DBUs began to conduct RMB business, domestic RMB business has been flourishing.
- (2) By the end of 2014, there were 67 DBUs and 59 offshore banking units (OBUs) engaging in RMB business. The balance of RMB deposits amounted to RMB302.3 billion; RMB remittances totaled RMB1,970.7 billion; and RMB settlement through the Taipei Branch of the Bank of China totaled RMB5,502.3 billion.

- (3) Along with the development of RMB business, RMB investment products were further diversified. As of the end of 2014, RMB investment business conducted by financial institutions were as follows:

### RMB Investment Business

Institution and number	Type of RMB Business and Amount
49 DBUs and 4 securities firms	Offering RMB derivative financial products and structured products
21 banks and companies	Issuing 44 RMB bonds totaling RMB31.40 billion
23 companies	Issuing 40 funds, denominated in RMB or including an RMB currency class, with the amount totaling RMB7.10 billion
15 companies	Conducting RMB-denominated investment type insurance business, with accumulated premium receipts totaling RMB0.53 billion
12 companies	Conducting RMB-denominated traditional insurance business, with accumulated premium receipts totaling RMB0.23 billion

Source: Department of Foreign Exchange, CBC.

### Expanding Foreign Currency Clearing Platform

- (1) For better consumer protection and higher efficiency of domestic USD remittance, the CBC began efforts to establish a domestic USD clearing mechanism in September 2008 and officially launched the system on December 6, 2010.
- (2) To further reinforce Taiwan's financial infrastructure, and in line with the establishment of the cross-strait RMB clearing mechanism, the CBC consigned the Financial Information Service Co. to set up a foreign currency clearing platform in conformity with international standards. The platform went online on March 1, 2013, to handle domestic US dollar remittances. From September 30 onward, domestic and cross-strait RMB remittances were included.

In 2014, cross-strait USD remittance began to be settled via the platform. The CBC also set up a PVP mechanism among banks and a liquidity-saving mechanism for foreign currency remittances. In addition, the CBC selected the Taipei Branch of Mizuho Bank and Taiwan's Mega Bank as the respective clearing bank for the yen and the euro, with remittances of the two currencies expected to be settled on the platform in the first half of 2015. The CBC plans to establish a delivery-versus-payment (DVP) mechanism for foreign bonds and bills in the early second half of 2015.

- (3) By the end of 2014, the foreign currency clearing platform had achieved the following:
- A. 76 domestic banks participated in US dollar settlement with a daily average of 3,594 transactions and an amount of US\$6.10 billion;

B. 57 domestic banks participated in RMB settlement, with a daily average of 594 transactions and an amount of RMB1.90 billion;

C. domestic bank remittance fees were lowered from NT\$600-1,400 to NT\$320-1,020 per transaction.

## Offshore Banking Units and Securities Units

(1) At the end of 2014, all OBU assets totaled US\$184.0 billion, which was US\$14.4 billion or 8.5 percent more than the previous year end. Domestic banks owned 84 percent of the OBU assets, while foreign banks owned 16 percent.

(2) OBU cross-strait financial business kept growing.

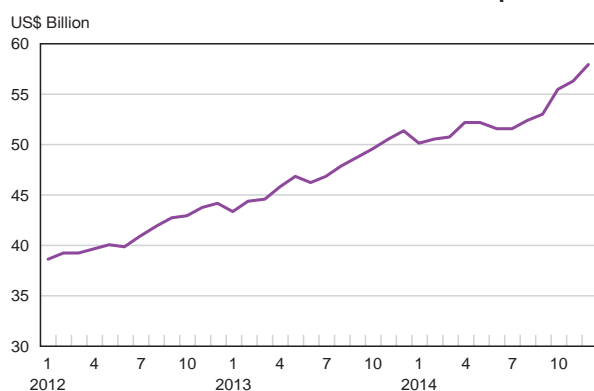
A. At the end of 2014, non-financial institutions' deposits reached US\$57.82 billion, a 13.0 percent increase from a year ago.

B. Cross-strait remittances increased by 2.2 percent from a monthly average of US\$26.43 billion in 2013 to US\$27.02 billion in 2014.

(3) Offshore Securities Units (OSUs)

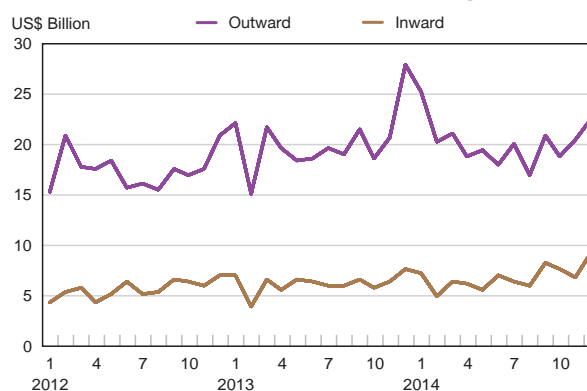
At the end of 2014, total OSU assets reached US\$0.59 billion; from the official launch in April 2014 to the end of December, total OSU net profit was about US\$3.0 million.

**OBU's Non-financial Institution Deposits**



Source: Department of Foreign Exchange, CBC.

**Cross-Strait Remittances Through OBUs**



Source: Department of Foreign Exchange, CBC.

**Box****NTD NDF – Features and Development**

On September 9, 2014, the CBC announced that the overseas branches of domestic banks could apply for NTD Non-delivery Forward (NDF) business, drawing lots of attention from the markets. The definition, features, and development of NTD NDFs and the rationale for deregulation and related supervisory framework are as follows.

**I. Definition and Features of NDFs****1. Definition of NDF**

A foreign exchange forward contract is a financial derivative instrument through which two parties agree to exchange underlying currencies at a predetermined exchange rate on a settlement date beyond two business days. Depending on whether the notional amounts are exchanged on settlement date, forward contracts are categorized into two types: Delivery Forward (DF) and NDF. NDF means that the profit or loss is calculated between the two parties based on the difference between the originally agreed exchange rate and the spot exchange rate on the fixing date without the delivering principal at maturity.

**2. Features of NDFs**

As NDF contracts are cash-settled, customers do not need to prepare the full principal amounts for delivery. Therefore, NDFs are regarded as low cost, yet highly leveraged financial derivative instruments and could be used for speculation besides hedging. Consequently, fluctuations in spot rates driven by NDF trading are much larger than those driven by DF transactions.

**II. The Development of NTD NDFs****1. Launching the NTD NDF Business in July 1995**

Following the opening of foreign professional institutional investor trading in Taiwan's financial markets in December 1990, the CBC opened the NTD NDF market to domestic and foreign legal entities trading with authorized banks in July 1995. When conducting NTD NDFs, in contrast to NTD DFs, there was no need to provide underlying transaction documents or exchange full principal on the maturity date, providing great convenience.

Initially, in order to prevent enterprises from using NTD NDFs to speculate in the FX market, which may cause excessive volatility in NTD exchange rate movements, the CBC set up a firewall to limit the NTD NDF trading position of authorized banks to one third of their total foreign exchange position.

**2. Re-regulating the NTD NDF Market in May 1998**

The Asian financial crisis broke out in July 1997. Hedge funds and international speculators aggressively attacked Asian currencies. Offshore speculators kept putting downward pressure on the NTD mainly through NDF trading. Although there was a cap on NTD NDF trading positions,



some banks sold NDFs to foreign entities and simultaneously longed NDFs and shorted DFs with domestic entities, intending to offset the NDF trading positions on their balance sheets and thus create more room for further NDF trading. Therefore, it opened the door for overseas speculators to attack the domestic foreign exchange market, causing a sharp depreciation of the NTD and undermined the stability of domestic financial markets.

After thorough consideration by the CBC and the Taipei Foreign Exchange Market Development Committee, the CBC announced that only the authorized banks could carry out NDF trades with other authorized counterparts and their overseas branches or headquarters. This move proved to help safeguard Taiwan from the Asian Financial Crisis.

Without NTD NDFs, non-banking entities still could hedge their foreign exchange exposures through DFs, FX Swaps, CCS, and FX options, etc.

### **III. The Rationale and Supervisory Framework for Deregulating the NTD NDF Market in September 2014**

According to the related provisions, besides adhering to local laws, overseas branches of domestic banks should seek the approval for conducting overseas business from the Financial Supervisory Commission, which in turn would examine the case by consulting the CBC before approval. Based on the assessment of the potential impact of NTD NDFs on the domestic foreign exchange market, the CBC had expressed disagreement for years when inquiries from banks were received.

Currently, foreign banks dominate the overseas NTD NDF market. In order to help domestic banks compete with foreign banks, the CBC announced that overseas branches of domestic banks could apply for NTD NDF business from September 2014. This will not only increase the range of hedging tools available to enterprises, but also enhance the international competitiveness of overseas branches of domestic banks by expanding their business scope.

On the other hand, in order to manage risks, the CBC introduced related supervisory provisions. First, eligible counterparties are limited to foreign legal entities, domestic legal entities with foreign investment, foreign financial institutions, overseas branches of domestic banks and their headquarters. Second, FX positions should be hedged overseas. If carried out in domestic markets, the total position of NTD NDFs and NTD FX options is limited to one fifth of the authorized foreign exchange position.

In the recent wave of financial liberalization, the CBC has continued to approve new financial instruments and encourage financial innovations that are consistent with the mandate of maintaining financial stability. Market discipline and risk management are both of utmost importance. The headquarters of domestic banks should prudentially enact NTD NDF internal controls, and safeguard the interests of customers and strengthen risk management. Carefully implemented, this new initiative will maintain financial stability and enhance the international competitiveness of overseas branches of domestic banks.

## 4. Financial Inspection

Pursuant to the *Central Bank of the Republic of China (Taiwan) Act*, the CBC conducts target examinations to ensure effective enforcement of policies related to monetary, credit, and foreign exchange management. To fulfill its mandate of financial stability, the CBC has established an off-site monitoring system and a financial stability assessment framework to systematically monitor and assess potential risks and risk sources in order to deploy appropriate policies and measures in a timely manner.

### On-Site Target Examinations

Target examinations in 2014 inspected the handling of land collateralized loans and housing loans, required reserves, banks' offered rates, counterfeit money detection and follow-up, the promotion of the usage of NTD200 notes, notes and coins withdrawn from circulation, forward foreign exchange transactions and reporting, Treasury Marketing Units (TMUs), foreign exchange business of securities enterprises, spot foreign exchange financial trading across foreign currencies, foreign exchange remittances, and the correctness of reporting to the CBC, etc.

### Follow-up on Banks' Compliance with Examination Findings

In 2014, in light of the CBC's target examination findings and the Financial Supervisory Commission's examination findings related to the CBC's operations or regulations, the CBC continued monitoring how the examined financial institutions had improved and urged them to rectify related deficiencies, thus ensuring successful implementation of the CBC's policies.

### Off-Site Monitoring

Based on financial conditions, the amendments to relevant laws and regulations as well as the monitoring of financial institutions' dynamic operations, the CBC reviews and amends as necessary the format and content of periodical statistical data submitted by financial institutions. In 2014, developments related to off-site monitoring for the above purposes included the following:

- (1) In line with the increasing asset growth of domestic banks, the threshold for bank classification by asset size was raised from NT\$200 billion to NT\$600 billion.
- (2) The assessment criteria of "risk weighted capital adequacy ratio," "allowance for uncollectible accounts," and "valuation reserves" for domestic banks were adjusted.
- (3) For foreign and Mainland Chinese banks, the assessment criteria of "ROE" and "internal management commentaries" were adjusted, and the formulas for "valuation reserves" and

“expected loss on credit” were adjusted.

- (4) A compliance indicator, “the ratio of guaranteed and endorsed bills to total equity, greater than 5.5 times, for bills finance companies” was added.
- (5) The indicators of “capital to stockholders' equity ratio” and “pre-tax income/capital” were added as assessment criteria for securities finance companies. Meanwhile, the risk weight of individual indicators was adjusted.

### **Financial Institution Information Transparency**

The CBC regularly compiles and publishes financial institution statistics, such as “Condition and Performance of Domestic Banks (Quarterly)” and “Major Business Statistics of Financial Institutions,” as well as the latest financial regulations. It also discloses related information on its website. As a result, operational transparency of financial institutions has strengthened, and market self-discipline has been reinforced.

### **Financial Stability Assessment**

The CBC compiles financial soundness indicators so that the relevant authorities, market participants and the public are kept informed of the status and sources of financial system risks in Taiwan. In 2014, the 8th Financial Stability Report was published. The publication also promotes cross-border communication and information sharing with regard to Taiwan's financial stability and surveillance.

### **International Cooperation in Financial Supervision**

In 2014, the CBC continued to actively engage in international cooperation related to financial supervision, as follows:

- (1) Participating in international meetings/conferences or research programs

- A. The 5th SEACEN Financial Stability Forum and 5th Meeting of Deputy Governors in Charge of Financial Stability and Banking Supervision, the 16th SEACEN Conference of Directors of Supervision of Asia-Pacific Economies, the 27th Meeting of SEACEN Directors of Supervision, SEACEN Web-Based Supervisory Discussion Room, and 2014 Research Project “Building on the Counter-cyclical Buffer Consensus: Asian Empirical Test.”

- B. BIS “IBFS 2014 Compilers Workshop.”

- C. The 4th ECB Conference on Accounting, Financial Reporting and Corporate Governance for Central Banks.

D. APEC Financial Regulators Training Initiative: 19th Advisory Group Meeting.

E. The 17th Asia/Pacific Group on Money Laundering (APG) 2014 Annual Meeting.

(2) Information-sharing with international institutions

A. Completing questionnaires from the SEACEN Centre and the Asian Development Bank, respectively. The former was to be used for a Financial Reporting Symposium with regard to curriculum design. The latter was regarding the APEC Financial Regulators Training Initiative.

B. Exchanging views with the US Fed's supervisory officials with regard to their "Final rules to strengthen the oversight of operations of foreign banks."

## 5. Payment and Settlement Systems

The CBC Interbank Funds-Transfer System (CIFS) is the backbone of Taiwan's payment system, linking payment and remittance systems operated by the Financial Information Service Co., Ltd. (FISC), the National Credit Card Center of R.O.C. (NCCC), the Taiwan Clearing House (TCH), the Taiwan Depository and Clearing Corporation (TDCC), the Taipei Exchange (TPEX), and the Taiwan Stock Exchange Corporation (TWSE) together to construct a comprehensive system.

Accordingly, the CBC plays a key role in the functioning of Taiwan's payment systems and operates the CIFS and the Central Government Securities Settlement System (CGSS). In addition, the CBC also monitors major payment systems based on international standards to ensure sound operation of these systems and to promote stability of the financial system.

### Operation of Payment and Settlement Systems

#### (1) Funds Transfers via the CIFS

The CIFS is a large-value electronic funds-transfer system. In addition to dealing with interbank funding, reserve requirement adjustments and funds settlements in financial markets, the CIFS also provides interbank final settlement services to each clearing institution.

At the end of 2014, participants of the CIFS included 70 banks, eight bills finance companies, and seven other institutions including Chunghwa Post, the TWSE, the TPEX, and the NCCC, etc. In the year 2014, the daily average amount of funds transferred via the CIFS was NT\$1,970.7 billion, while the daily average number of transactions reached 2,981, growing by 4.67 and 9.28 percent, respectively.

#### (2) Transactions via the CGSS

The CGSS was established in September 1997. It is a system for issuance, transfer, redemption, and interest payment of book-entry central government securities. Since its inception, central government bonds have been issued in book-entry form. In October 2001, treasury bills were included in this system and have been issued in book-entry form ever since.

The CGSS linked up with the CIFS in April 2008. Since then, fund settlements, principal redemptions and interest payments have been handled through the CIFS using a delivery-versus-payment (DVP) mode. The DVP mode, promoted by the Bank for International Settlements, is an arrangement in a securities settlement system to ensure that securities delivery occurs almost at the same time as the funds transfer, effectively mitigating potential risks during the transaction process.

There were 16 clearing banks with 1,707 branches that handled the registration of central government securities transfers at the end of 2014. During 2014, 278,000 transfers with a total amount of NT\$27.8 trillion were processed by this system.

### Monitoring Payment Systems

The CBC monitors the payment systems on a periodic basis to maintain their safety and efficiency. In 2014, the CBC's monitoring activities in this regard included the following:

- (1) Requiring payment system operators and payment instrument issuers to provide detailed information on their operations and activities as a basis for monitoring payment systems.
- (2) Ensuring clearing institutions set up backup systems and contingency plans for business continuity in case of emergency.
- (3) Inviting the Financial Supervisory Commission (FSC) and clearing institutions such as the FISC, the TDCC, and the TCH to jointly hold conferences themed the “Development and Planning of Third-Party Payment and Mobile Payment Services” and “Enhancing the Effectiveness of System Operations while Taking Innovation and Safety into Account” in May and November 2014, respectively, to promote sound operation of the payment systems.
- (4) Providing comments on the draft of the *Act Governing Electronic Payment Institutions* and the amendment to the *Act Governing Issuance of Electronic Stored Value Cards* to the FSC in order to strengthen the legal basis of electronic payment supervision.

### Expanding the Foreign Currency Clearing Platform

The foreign currency clearing platform planned by the CBC and established by the FISC was launched in March 2013, aiming to strengthen financial infrastructure and facilitate the development of the financial services sector. Functions of this platform have been gradually expanded in 2014 as follows:

- (1) Settlements for domestic US dollar call loan transactions between the CBC and banks could be processed on this platform, starting from January.
- (2) Cross-strait US dollar remittances and the interbank PVP (payment-versus-payment) mechanism were launched in February.
- (3) PVP settlements for NTD-USD foreign exchange swap transactions between the CBC and authorized banks were included in this platform in March. In addition, a liquidity saving mechanism for foreign currency remittances was incorporated into its services in July.
- (4) The process of selecting clearing banks for the Japanese yen and the euro was completed in

June and October, respectively. Settlements for USD-euro and USD-yen transactions will be available on this platform, starting from January and June 2015, respectively.

### **Building the Bills Payment Backup Mechanism**

To ensure the smooth functioning of the payment system, the CBC established a backup mechanism of bills payment in July 2014. The backup mechanism would promptly continue processing the payment and delivery in case of disconnection between the Check Clearing House System (CCHS) and the CIFS.

### **Assisting in Establishing a Mobile Payment Platform**

To enhance the safety and efficiency of mobile payment services, the CBC assisted the FISC, the TCH, the NCCC and financial institutions in founding the Taiwan Mobile Payment Co. in September 2014. Subsequently, this company launched the payment service provider trusted service manager (PSP TSM) platform in December 2014, aiming to facilitate mobile payment processing.

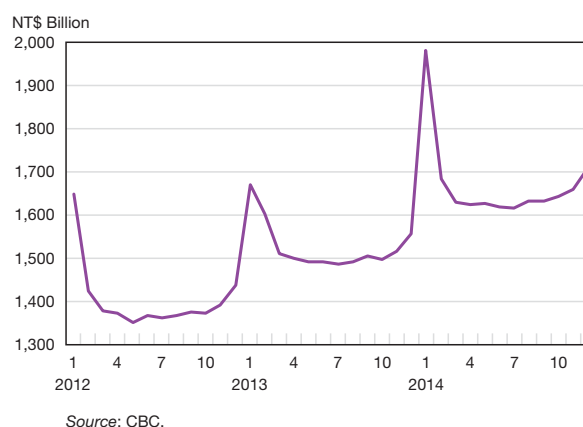
## 6. Currency Issuance

For the year 2014, the CBC conducted currency issuance with a focus on maintaining an adequate supply of currency to meet public demand, which is dependent on the level of economic activity, seasonal factors, and the development of noncash payment instruments, etc.

### Currency Issuance Increased

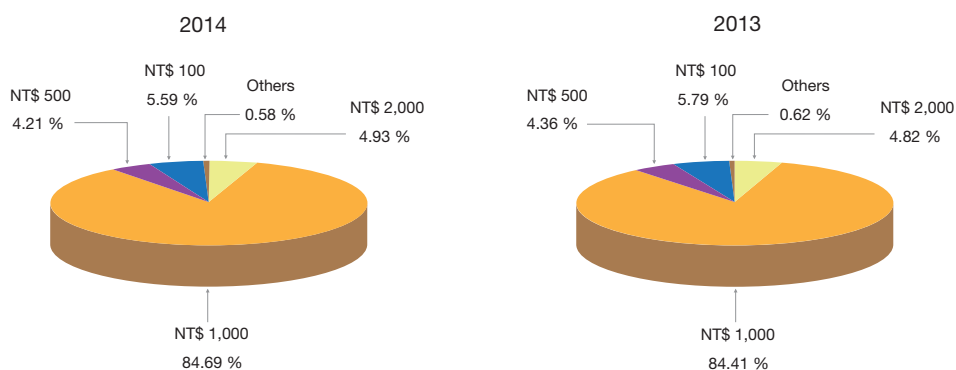
In 2014, the CBC implemented an appropriate currency issuance plan for delivering banknotes and coins. The currency issued peaked at NT\$1,981.0 billion on January 29, the day before the Lunar New Year holidays, reflecting a temporary seasonal surge in cash demand. At the year end, the outstanding amount of currency issued was NT\$1,706.7 billion, representing an increase of NT\$150.7 billion or 9.69 percent over the previous year end.

### Currency Issued



At the end of 2014, the composition of NT dollar banknotes in circulation by denomination was similar to the end of 2013. The NT\$1,000 note accounted for the lion's share at 84.69 percent, followed by the NT\$100 (5.59 percent) and the NT\$2,000 (4.93 percent) notes.

### Composition of NT Dollar Banknotes Issued (Year-End Figures)



Source: CBC.



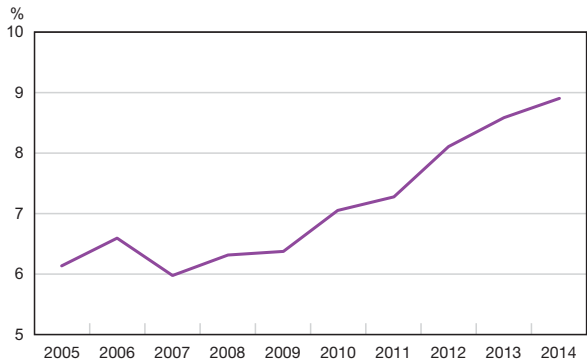
**Currency in Circulation to GDP Ratio Increased**

Owing to the low interest rate environment since September 2008, the public began to increase their currency holdings, and the ratio of currency in circulation to GDP rose significantly. It stood at 8.90 percent in 2014, a 0.32 percentage point gain over the previous year.

**Two Commemorative Coin Sets Were Issued**

With the authority of currency issuance, the CBC may also issue gold and silver coins and commemorative notes and coins from time to time, such as for important ceremonies, national holidays, major international events or other significant national events. During 2014, the CBC issued a casting set of coins for the Chinese Zodiac Year of the Horse, and the third coin set of the National Parks of Taiwan series - Yangmingshan National Park.

**The Ratio of Currency Held by the Public to GDP**



Sources: 1. CBC.  
2. DGBAS, Executive Yuan.

## 7. Fiscal Agency Functions

The CBC acts as a banker to the central government as well as to other banks. As the fiscal agent of the government, the CBC performs various services for the national treasury. These services include handling the treasury deposit account (TDA) , managing central government agency deposit accounts, and undertaking the issuance, registration, redemption, and interest payment of central government bonds and treasury bills.

### Managing the Treasury Deposit Account

The CBC manages the TDA on behalf of the Ministry of Finance (MOF) , processing receipts and disbursements of the central government. For the convenience of government agencies and the general public, the CBC delegates the handling of treasury transactions to 13 financial institutions and their 357 branches, including three overseas branches located in New York, Los Angeles, and Paris. In addition, there are another 4,795 tax collection agencies set in financial institutions. In 2014, the CBC received a total of NT\$3,156.7 billion in treasury deposits, an increase of NT\$69.3 billion or 2.24 percent over the previous year. Payments made on behalf of the national treasury were NT\$3,170 billion, increasing by NT\$80 billion or 2.59 percent from 2013. At the end of 2014, the TDA balance was NT\$10 billion, a decrease of NT\$13.3 billion or 57.08 percent from the previous year end.

### Handling Central Government Agency Deposits

Central government agencies are required to make their deposits with the CBC or other delegated banks. However, the delegated banks are required by law to redeposit 60 percent of the deposits with the CBC, except those in interest-bearing accounts. At the end of 2014, the balance of central government agencies' deposits with the CBC amounted to NT\$116.1 billion, a decrease of NT\$8.4 billion or 6.75 percent over 2013. Deposits with other delegated banks were NT\$455.6 billion at the end of 2014, increasing by NT\$30.8 billion or 7.25 percent. Among them, redeposits with the CBC registered NT\$10.1 billion, decreasing by NT\$4.3 billion or 29.86 percent from the end of 2013.

### Managing Central Government Bonds

As a fiscal agent, the CBC provides services related to the issuance, registration, transfer, redemption, and interest payment of central government bonds. The CBC also conducts the auctions of central government bonds. There are 61 domestic dealers qualified to directly participate in the auctions, including 27 banks, 20 securities companies, eight bills finance companies, five insurance companies, and Chunghwa Post.

In 2014, the CBC handled 20 issues of central government bonds in book-entry form worth NT\$675.3 billion and paid NT\$405 billion in principal and NT\$115.7 billion in interest for central government bonds. At the end of 2014, the outstanding amount of central government bonds was NT\$5,338.5 billion, an increase of NT\$270.3 billion or 5.33 percent from the previous year end.

### **Managing Treasury Bills**

The CBC also conducts the auctions of treasury bills, which are issued at a discount. Currently, direct bidders include banks, insurance companies, securities companies, bills finance companies, and Chunghwa Post.

In 2014, the CBC handled 10 issues of book-entry treasury bills with a total amount of NT\$244.9 billion. At the end of 2014, the outstanding amount of treasury bills was NT\$130 billion, a decrease of NT\$84.6 billion or 39.42 percent from the previous year end.

### **Improving Operational Efficiency**

To encourage central government bond dealers to actively participate in auctions, and avoid yields of competitive bids submitted deviating too much from those in the prevailing bond market, the CBC amended the criteria of subtracting dealers' scores. For dealers who submit yields that are more than a one percentage point deviation from the weighted average yields, the deducted points would be raised to four from two, effective from January 22, 2014.

In addition, from September onwards, the MOF authorized the CBC to transfer a NT\$3 billion remittance fund from the TDA to the Interbank Fund Transfer Guarantee Special Account at the Department of Banking of the CBC each day before daily operations of treasury deposit remittance. At the end of the same day, the CBC would transfer the fund back. The mechanism helped streamline the operation of the TDA.

## 8. Participation in International Activities

The endeavors to take part in international activities continued in 2014. As a member of various international organizations, the CBC hosts conferences, provides training courses, and attends numerous forums, including the annual meetings organized by the Asian Development Bank (ADB), the Central American Bank for Economic Integration (CABEI), and the South East Asian Central Banks (SEACEN) group. In addition, the CBC also maintains close relationships with the Inter-American Development Bank (IDB), the European Bank for Reconstruction and Development (EBRD) and the Bank for International Settlements (BIS). Meanwhile, the CBC strengthens its cooperation with other central banks and related institutions through meetings on macroeconomic and financial issues.

The CBC is a founding member of the ADB and, through this platform, has played an active role in promoting financial cooperation and stability in Asia. In May 2014, the CBC participated in the 47th annual meeting of the ADB held in Astana, Kazakhstan, and shared views with other members, including the concern that QE policies implemented by a number of advanced economies might create significant spillover effects and undermine regional stability. In light of this, the ADB could offer the necessary assistance to member economies, and even step forward to coordinate a regional policy response to help the region deal with large external shocks.

The CBC is also a member of SEACEN. In November 2014, the CBC attended the 50th annual conference of governors held in Port Moresby, Papua New Guinea, exchanging views on the challenges to regional financial and macroeconomic stability, including volatile capital flows and increasing financial integration, as well as shadow banking activities.

Furthermore, the CBC participated in the meetings held by other international organizations, such as the IDB's annual meeting of the Board of Governors held in Costa do Sauipe, Brazil, during March 27 to 30, the CABEI's ordinary meeting of the Board of Governors which took place in San Jose, Costa Rica, on April 24 and 25, the EBRD's annual meeting of the Board of Governors held in Warsaw, Poland, on May 14 and 15, and the BIS annual general meeting in Basel, Switzerland, on June 28 and 29.