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

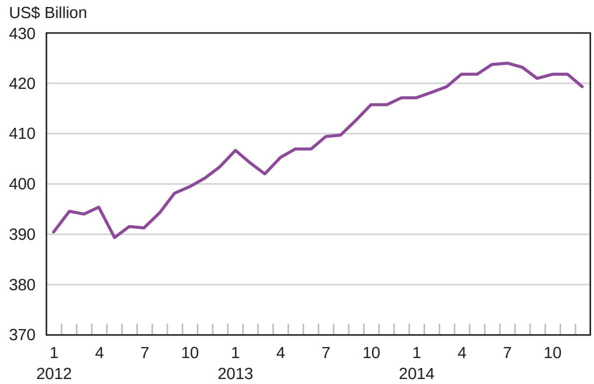
In order to provide the financial system with sufficient foreign currency liquidity to meet funding needs, including those for corporations to venture into overseas markets, the CBC provided seed funds for the Taipei Foreign Currency Call Loan Market, including US$20 billion, €1 billion and ¥80 billion.

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.

Foreign Exchange Reserves



Source: Department of Foreign Exchange, CBC.

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.

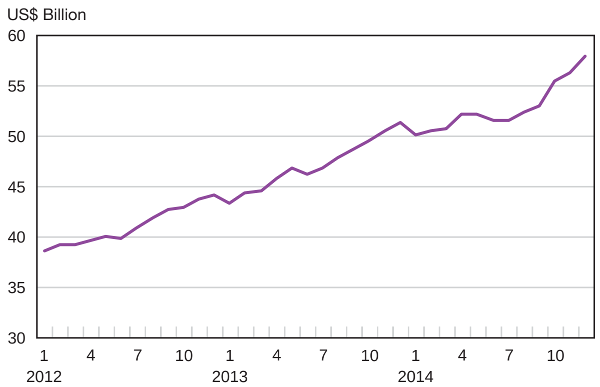
A. At the end of 2014, non-financial institutions' deposits reached US$57.82 billion, a 13.0 percent increase from a year ago.

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)

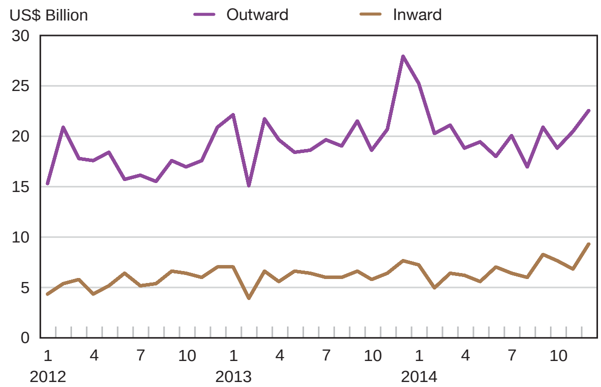
At the end of 2014, total OSU assets reached US$0.59 billion; from the official launch in April 2014 to the end of December, total OSU net profit was about US$3.0 million.

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.