
IV. Measures to maintain financial stability

In 2015, against a backdrop of moderate domestic economic growth and steady inflation, Taiwan's financial markets and infrastructure maintained smooth operations and sound development. Profitability of financial institutions stayed healthy, while asset quality and capital positions strengthened further. As a whole, Taiwan's financial system remained stable.

As a result of an uneven economic recovery and the divergence of monetary policies among major economies, international financial markets fluctuated significantly, which, in turn, heightened uncertainties over global economic recovery. Facing changes in global and domestic economic and financial conditions, especially slowing economic growth in Mainland China, expanded quantitative easing monetary policies by the ECB and spillover effects likely induced by US monetary policy normalization in the future, the CBC will continue to closely monitor the influence of these issues on the domestic economy and financial system and adopt appropriate monetary, credit, and foreign exchange policies. Meanwhile, the FSC also continues to amend financial laws and regulations and undertakes measures to strengthen financial supervision, aiming at maintaining the soundness of financial institutions and improving financial stability.

4.1 Measures taken by the CBC to promote financial stability

Since 2015, the CBC has prudently relaxed restrictions on foreign exchange business to foster a more diversified market. Between 2015 Q1 and 2016 Q1, in view of domestic growth deceleration and mild inflation, the CBC cut policy rates three times and conducted open market operations to maintain monetary and credit conditions at an accommodative level. Given that banks have continued strengthening credit risk management on real estate loans, the CBC revised the relevant targeted prudential measures. Moreover, to prevent massive and frequent cross-border capital flows from disrupting the domestic foreign exchange market, the CBC continually followed the managed float regime and stabilized the NT dollar exchange rate.

4.1.1 Adopting appropriate monetary policies to cope with domestic and global economic and financial conditions

The CBC lowered policy rates three times

Owing to a slowdown in global economic growth, worse-than-expected domestic economy, widened negative output gap, and moderate inflation outlook, the CBC lowered policy rates three times by a total of 12.5 bps during the period from September 2015 to March 2016. As a result, the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral fell to 1.5%, 1.875%, and 3.75%, respectively.

Reserve money growth remained moderate

The CBC accommodated financial markets with funds to keep liquidity at an appropriate level through open market operations. In 2015, the excess reserves in all financial institutions remained ample. The total loans and investments of all banks grew by 4.61%, while the monetary aggregate M2 grew by 6.34% year on year, both of which were higher than the GDP growth rate of 0.75%. This indicated that market liquidity was sufficient to support economic activity.

The CBC will continue to implement appropriate monetary policies

The CBC will continue to closely monitor price conditions, the output gap, as well as changes in global and domestic economic and financial conditions, and undertake appropriate monetary policy actions to maintain price and financial stability and, in turn, foster economic growth.

4.1.2 Amending targeted prudential measures for real estate loans

Given that financial institutions have enhanced credit risk management on real estate loans and the government's measures to promote a sound housing market have gradually come into effect, speculative real estate demand decreased and property transactions slowed down. In view of these developments, the CBC made amendments to targeted prudential measures for real estate loans in August 2015, removing six districts from the scope of the designated Specific Areas and raising the loan-to-value ratio ceiling on real estate loans taken out by certain borrowers. In March 2016, the CBC further lifted all relevant measures except those for high-value housing loans. As a sound real estate market is vital to financial stability and

economic growth, the CBC will continue to monitor financial institutions' credit risk management on real estate loans and the enforcement results of targeted prudential measures, so as to undertake appropriate policy actions in a timely manner to ensure financial stability.

4.1.3 Safeguarding stability of the NT dollar exchange rate

Adopting flexible foreign exchange rate policies

Taiwan adopts a flexible managed float exchange rate regime, and the exchange rate of the NT dollar is in principle decided by market forces. Nevertheless, when seasonal or irregular factors (such as massive inflows or outflows of short-term capital) lead to excess volatility and disorderly movements in the NT dollar exchange rate with adverse implications for economic and financial stability, the CBC will, in line with its mandate, conduct leaning against the wind operations to maintain market order.

Maintaining an orderly foreign exchange market and promoting its sound development

After the global financial crisis, advanced economies adopted quantitative monetary easing policies, inducing massive and frequent short-term capital movements, which disturbed the domestic foreign exchange market. In order to prevent excessive exchange rate fluctuations and maintain dynamic stability of NT dollar exchange rate, in 2015, the CBC continued to undertake appropriate management measures to safeguard foreign exchange market order and promote its sound development. These measures included:

1. Implementing the Real Time Reporting System for Large-Amount Foreign Exchange Transactions to monitor the latest transaction information in the foreign exchange market.
2. Urging authorized foreign exchange banks to strengthen their foreign exchange rate risk management.
3. Strengthening examinations on forward transactions to ensure that they are undertaken for real demand purposes; undertaking targeted examinations on foreign exchange businesses when necessary.
4. Requiring that, for each authorized foreign exchange bank, its combined position limit for NTD non-delivery forwards (NDFs) and foreign exchange options may not exceed one-fifth of its total position limit.

4.2 Measures undertaken by the FSC to maintain financial stability

From 2015 onwards, in order to facilitate financial innovation and enhance financial competitiveness, the FSC continued to implement several measures of deregulation to promote policies including financial import substitution, building up a stronger Asian presence for Taiwan's banking industry, creating a digital financial environment, and boosting securities markets. Additionally, in order to strengthen financial supervision and risk management of financial institutions, the FSC continuously enhanced domestic banks' risk controls over exposures to Mainland China and implemented prompt corrective actions for the insurance industry,⁸⁷ as well as undertaking several measures mentioned as follows to maintain financial stability.

4.2.1 Continually reinforcing banks' risk management for complex financial derivatives business

As complex financial derivatives business conducted by banks, such as TRFs and DKO, has caused numerous investment disputes, the FSC introduced four sets of supervisory measures from April 2014 to the beginning of 2016 (see Chapter 3.3) to protect investors and promote sound development of financial markets.

4.2.2 Establishing an off-site monitoring mechanism to detect material risks of financial institutions

The FSC issued the *Guidelines for Material Risk Detection for Financial Institutions* in November 2015 to build a mechanism for identifying material risks in a timely manner. The scope of risk detection is comprised of capital adequacy, asset quality, management capability, profitability, and liquidity of financial institutions. In addition, source of profit, foreign risk exposure, investment position, off balance sheet exposures and petition of consumers are included as key detecting factors. The FSC also requested financial institutions to establish internal risk detection guidelines for the purpose of controlling material risks and ensuring sound management.

⁸⁷ See CBC (2015), *Financial Stability Report*, Chapter IV, May.

4.2.3 Strengthening risk management and enhancing sound operation for the insurance industry

Increasing the risk-bearing capability of insurance companies with respect to real estate mortgage loans

In order to increase the risk-bearing capability of the insurance industry, the FSC, taking bank practices into consideration, amended related regulations in July 2015, which require insurance companies to raise their allowance for bad debts at a ratio of at least 1.5% against loans for home purchase, refurbishment, or construction by the end of 2016.

Reinforcing public disclosure of RBC ratios

With a view to strengthening supervision of the insurance industry, in addition to the prompt corrective action mechanism established in February 2015, the FSC further required insurance companies to disclose their capital adequacy ratios semiannually from the second half of 2015 onwards to enhance market discipline.⁸⁸

Requiring insurance companies to solicit business with reasonable pricing to avoid inappropriate competition

To strengthen sound operation of insurance companies and avoid inappropriate premium competition, the FSC amended the *Regulations Governing Pre-sale Procedures for Insurance Products* in July 2015, requiring that the premiums of both non-life and life insurance products should reasonably reflect their costs and profits. The aforementioned regulations also prohibited insurance companies from soliciting business with unreasonable pricing. Meanwhile, the FSC amended the *Regulations for Establishment and Administration of Insurance Enterprises*, stipulating that insurance companies should set loan prices in consideration of factors such as market rates, operating costs, and reasonable profits, and should not extend loans at unreasonable prices.

4.2.4 Other supervisory measures

1. To conform with international supervisory standards, the FSC amended regulations with respect to the capital adequacy of banks in April 2015, requiring banks to further disclose

⁸⁸ Before the second half of 2015, each insurance company only disclosed its RBC ratio with five tiers: above 300%, above 250% but under 300%, above 200% but under 250%, above 150% but under 200%, and under 150%.

leverage ratios and liquidity coverage ratios.

2. In order to enhance the quality of domestic credit rating services and support sound development of credit rating agencies, the FSC introduced amendments to the *Regulations Governing the Administration of Credit Rating Agencies* in December 2015. The key points of the amendments included: (1) relaxing the establishment criteria and abolishing the requirement that at least one of the founders shall be an internationally recognized credit rating institution; (2) requiring the corporate bylaws to include fee policies and complaint handling mechanisms, etc.; (3) requiring credit rating agencies to comply with international financial reporting standards when preparing financial reports; (4) requiring credit rating agencies to disclose their credit rating procedures, the reasons for the change of the credit rating result, and possible conflicts of interest, etc.; (5) enhancing the credit rating methodologies, models, and key assumptions employed in the rating procedures; (6) adding provisions for preventing conflicts of interest.
3. For the purpose of increasing securities market transparency, additional disclosure was introduced to include simulated transaction and bid/ask information prior to market opening and closing (30 minutes before market opening and 5 minutes before closing when trading orders are accepted), beginning 29 June 2015.