

2. Urging authorized foreign exchange banks to strengthen their foreign exchange risk management in order to mitigate the risk exposures of individual banks and systemic risks of the market as a whole.
3. Strengthening targeted examinations on foreign exchange businesses and forward transactions to ensure they are undertaken for real demand purposes in order to restrain foreign exchange speculation.
4. Requiring that, for each authorized foreign exchange bank, its combined position limit for NTD non-delivery forwards (NDFs) and foreign exchange options not exceed one-fifth of its total position limit.

#### **4.1.4 Strengthening foreign exchange supervision of banks**

Along with the reinforcement of money laundering prevention and the enhancement of supervision in complex high-risk FX derivatives, the CBC amended the following foreign exchange regulations in 2016:

1. The CBC revised the *Directions Governing Banking Enterprises for Operating Foreign Exchange Business*, stipulating that: (1) banks should ensure that know your customer (KYC) procedures are followed when conducting FX business; (2) the electronic messages for FX remittances should include the required information about the payers and the payees; and (3) supplementary measures should be taken when there is a lack of the above-mentioned information in electronic messages.
2. The CBC revised the *Regulations Governing Foreign Exchange Business of Banking Enterprises*, so that pre-approval is required for authorized banks when conducting new, complex, high-risk FX derivatives business for customers except for professional institutional investors and high-net-worth corporate investors.

## **4.2 Measures undertaken by the FSC to maintain financial stability**

From 2016 onwards, in order to facilitate financial innovation, enhance financial competitiveness and shore up economic growth, the FSC has continued implementing several measures including promoting financial technology (FinTech) development, encouraging the financial industry to invest in the green energy industry and startups, as well as supporting industries to realize the new business opportunities under the government's New Southbound

Policy. Additionally, the FSC has strengthened financial supervision and risk management of financial institutions so as to maintain financial stability.

#### **4.2.1 Strengthening Taiwan's AML/CFT mechanisms**

To maintain the reliability and security of Taiwan's financial system and to prepare Taiwan for the *Mutual Evaluation* by the Asia/Pacific Group on Money Laundering (APG) in November 2018, the FSC has continually announced amendments<sup>84</sup> to reinforce Taiwan's AML/CFT mechanisms since 2016. The amendments included incorporating the implementation of AML/CFT by financial institutions into the FSC's examination focus, and directing other financial industry associations to put forward information about businesses and products with high money laundering risk to serve as a reference (see Chapter 3.3.4). Moreover, the FSC also enhanced the customer due diligence requirement of OBUs.

#### **4.2.2 Persistently enhancing banks' risk management and risk-bearing abilities**

1. To reinforce banks' liquidity management and follow the Net Stable Funding Ratio as the globally consistent quantitative indicator of liquidity risk, the FSC and the CBC jointly promulgated the *Standards Implementing the Net Stable Funding Ratio of Banks* in December 2016. The Standards will be implemented on January 1, 2018. The aim is to urge domestic banks to have sufficient long-term stable funding sources in support of business expansion.
2. To improve banks' management of complex high-risk derivatives, the FSC further amended applicable regulations,<sup>85</sup> including: (1) requiring banks to submit application to competent authorities for approval or report the product by letter when offering products to customers that are not professional institutional investors or high-net-worth corporate investors; (2) requiring banks to submit the application for approval before planning to introduce a new complex high-risk derivative product that has not been deregulated or was deregulated within the most recent six months; (3) regulating that traders authorized by a juristic person customer to conduct transactions shall have sufficient professional

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<sup>84</sup> The FSC has formulated regulations related to the *Money Laundering Control Act*. In addition, the FSC introduced amendments to the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Securities and Futures Sector*, the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Insurance Sector*, the *Directions Governing Anti-Money Laundering and Countering Terrorism Financing of Banking Sector*, and the *Rules Governing Offshore Banking Branches* to enhance OBUs' customer due diligence.

<sup>85</sup> The FSC successively amended the *Regulations Governing Internal Operating Systems and Procedures for Banks Conducting Financial Derivatives Business* in September 2016 and May 2017, and revised the *Directions for Offshore Banking Branches Conducting Financial Derivatives Business* in September 2016.

knowledge or trading experience in financial products.

3. To obtain an understanding of the effect on domestic banks when changes in the global economic situation and financial environment occur, the FSC asked domestic banks to carry out an overall position stress test in April 2016. The results of the overall stress test of 37 domestic banks revealed that in both mild and relatively serious scenarios, capital adequacy related ratios of domestic banks were all higher than the minimum capital requirement, showing that banks, to some extent, have the capability to bear risks.<sup>86</sup>
4. In October 2016, the FSC again required domestic banks to examine their exposure to investment in stocks and bonds in Mainland China because of increasing default risk of debt there. Moreover, banks shall enhance risk management to reduce the possible related losses (see Chapter 3.2).
5. In order to improve the effectiveness of internal audit and internal control, the FSC amended the *Implementation Rules of Internal Audit and Internal Control System of Financial Holding Companies and Banking Industries* twice in July 2016 and March 2017. The key amendments included the following: (1) adopting a risk-based internal audit system; (2) reinforcing the functions of the board of directors and audit committee; (3) enhancing internal guidelines to handle material contingencies and strengthen the anti-money laundering mechanisms; (4) introducing new requirements set for the report content of headquarters' compliance officers; and (5) establishing an internal reporting mechanism for monitoring the examination results by foreign competent authorities.

#### **4.2.3 The takeover bid for Chaoyang Life Insurance Co., Ltd. has been made, and the FSC kept strengthening solvency and risk management for the insurance industry**

1. In January 2016, according to an amendment of the *Insurance Act*, which allow the FSC to take prompt corrective actions, the FSC took over ailing Chaoyang Life Insurance Co., Ltd., and entrusted the Taiwan Insurance Guaranty Fund (TIGF) to hold a public auction. In January 2017, Nan Shan Life Insurance Co., Ltd. made the TIGF bailout bid in the second auction. By then, there was no local insurance company with negative net worth in Taiwan.

<sup>86</sup> All the data used in the stress tests are as of the end of 2015. The scenarios set in this test included declining domestic and international economic growth rates, increasing domestic unemployment, falling house prices, shrinking spread between deposit and loan interest rates, and rising market risk. The results of the overall stress test of 37 domestic banks showed that under a mild scenario, the average common equity ratio, Tier 1 capital ratio, capital adequacy ratio, and leverage ratio were 9.55%, 9.83%, 11.68%, and 5.63% respectively; under a relatively serious scenario, the figures were 8.50%, 8.78%, 10.58%, and 5.03%, respectively. All results were higher than the minimum capital requirement for 2016.

2. To continue improving solvency and risk management for the insurance industry, the FSC has implemented an external reviewing actuary system of insurance companies together with an Own Risk and Solvency Assessment (ORSA) mechanism for the insurance industry. Additionally, to reasonably reflect operating risks of the insurance industry, the FSC announced adjustments for the automatically adjusted actuarial formula, which was applied to determine the policy reserve interest rate for a new contract, as well as the calculation of the risk-based capital ratio in 2016.

#### **4.2.4 Calling for stronger cyber security**

Since several securities companies recently suffered distributed denial-of-service (DDoS) attacks, in which attackers overwhelmed the attacked websites and services with excessive traffic, the FSC has required the financial industry to implement stronger cyber security measures<sup>87</sup> and established a platform for reporting cyber-attacks. The FSC also planned to construct a Financial Information Sharing and Analysis Center (F-ISAC) for the purpose of offering financial institutions early-warning information. In addition, the Central Deposit Insurance Company has adopted cyber security as a rating indicator of its risk-based differential premium system.

#### **4.2.5 Reinforcing the public tender offer system**

As the settlement default of XPEC Entertainment stock's purchase revealed an institutional problem, the FSC introduced amendments to the related regulations<sup>88</sup> in November 2016. The key amendments were as follows: (1) requiring the offeror to provide a supporting document to prove their financial capacity for paying the purchase consideration of the tender offer; (2) requiring the board of directors and the review committee of the targeted company to take responsibility for the investigation and verification of their approvals; (3) stipulating that, in principle, the offeror may not change the time, manner, or place for payment of tender offer consideration; (4) modifying the extension of the public tender offer period to a maximum of 50 days; (5) introducing measures for protecting tenderer's rights and interests; and (6) increasing information disclosure requirements for public tender offers.

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<sup>87</sup> The FSC required financial institutions to establish and implement a network-monitoring mechanism. When detecting a DDoS cyber-attack, financial institutions shall inform those telecommunications network operators to block the IP and clear the traffic.

<sup>88</sup> The FSC amended the *Regulations Governing Public Tender Offers for Securities of Public Companies* and the *Regulations Governing Information to be Published in Public Tender Offer Prospectuses* in November 2016.