

3. Foreign Exchange Management

For the year 2016, 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\$8.2 billion mainly owing to returns on investments. With the addition of foreign currency fee collection services, the function of the foreign currency clearing platform is nearly complete. Moreover, from February 6, 2013, when domestic banking units (DBUs) were allowed to conduct renminbi (RMB) business, up to the end of 2016, the total amount of DBUs' cross-strait RMB remittances was RMB1,872.4 billion, and DBUs and OBUs recorded a combined balance of RMB311.4 billion on RMB deposits.

Foreign Exchange Market Management

Taiwan's exchange rate is in principle guided by the market mechanism. The CBC conducts "leaning against the wind" operations when there is excessive exchange rate volatility. Indeed, according to behavioral macroeconomic analysis, "leaning against the wind" policies can effectively eliminate excessive exchange rate fluctuations and enhance FX market efficiency. In recent years, frequent and massive capital movement has replaced trade or economic fundamentals to become the major factor affecting short-term exchange rate variation. This development increases the need for the CBC to maintain foreign exchange market order. Therefore, Taiwan has adopted a managed float regime, which allows exchange rate flexibility and FX intervention and helps diminish or prevent speculative attacks.

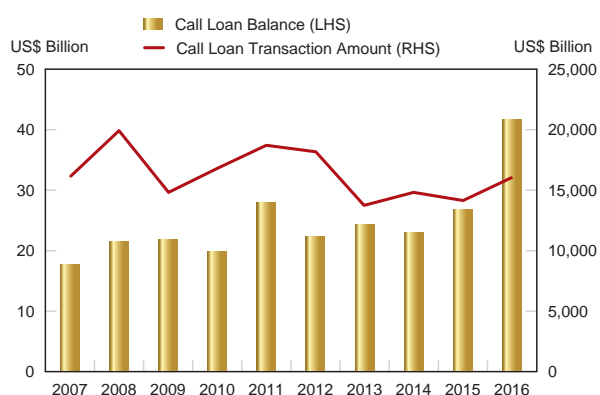
In 2016, the CBC continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions to keep the market orderly. Moreover, reinforced examination efforts were made to ensure that forward transactions were based only on actual transactions. The CBC also urged authorized banks to enhance their exchange rate risk management.

Management of Foreign Currency Call Loan and Swap Markets

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.

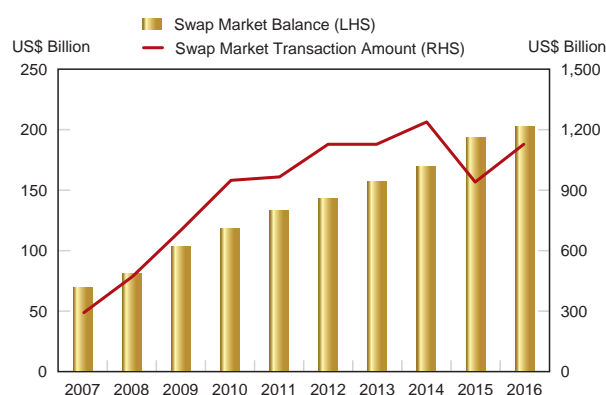
Furthermore, the CBC continued to conduct foreign currency swap transactions with banks and offered foreign currency call loans to banks so as to facilitate smooth corporate financing. During 2016, the volume of foreign exchange call loan transactions reached US\$1,593.4 billion, 13.2% more than that of 2015, while the balance at the end of 2016 was US\$41.4 billion. The volume of

Call Loan Market Transaction Amount and Balance



Source: Department of Foreign Exchange, CBC.

Swap Market Transaction Amount and Balance



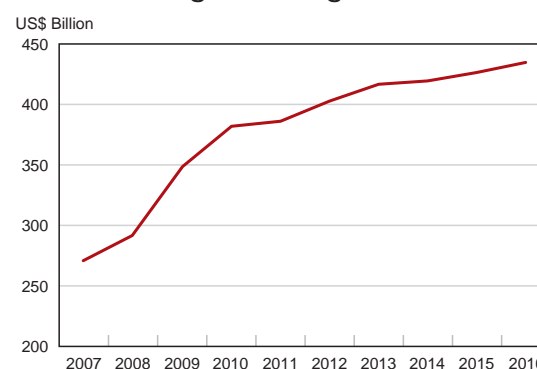
Source: Department of Foreign Exchange, CBC.

foreign currency-NTD swap transactions reached US\$1,130.5 billion, 20% more than 2015, while the balance was US\$205.4 billion at the end of 2016.

Foreign Exchange Reserve Management

At the end of 2016, total foreign exchange reserves stood at US\$434.2 billion, a US\$8.2 billion increase (or 1.9%) from the end of 2015, mainly attributable to 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 2016, foreign currency capital not involving NT dollar conversion has been able to flow freely. Additionally, there are no restrictions on financial flows involving NT dollar conversion for goods and service trade, nor for 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 transaction amount above that threshold requires the approval of the CBC.

Key measures with regard to the management of capital flows in 2016 included:

1. Promoting the internationalization of Taiwan's capital market

CBC-Approved Fund-Raising by Domestic and Foreign Institutions

Institution	Method	Number	Amount
Foreign companies	IPO on TWSE & TPEX and registration on the Emerging Stock Board	15	NTD 7.85 billion
	NTD convertible bonds	7	NTD 4.45 billion
	International bonds	54	USD 47.92 billion RMB 8.22 billion AUD 0.18 billion ZAR 0.45 billion NZD 0.06 billion
Domestic companies	Overseas convertible bonds	7	USD 1.16 billion

Note: TWSE (Taiwan Stock Exchange) ; TPEX (Taipei Exchange) .
Source: Department of Foreign Exchange, CBC.

2. Approving residents' investments in foreign securities

Residents' investments in Foreign Securities Approved by the CBC

Institution	Method/Instrument	Amount
Securities investment trust enterprises (SITEs)	78 domestic SITE funds (including 42 NTD-foreign multiple currency SITE funds)	NTD 1,476.5 billion (multiple currency funds: NTD 781 billion)
	5 SITE private funds	NTD 8.9 billion
	3 domestic futures trust funds for qualified persons	NTD 125 billion
Life insurance companies	Non-discretionary money trusts managed by financial institutions	USD 0.3 billion
	Investment for their own accounts	USD 4.1 billion
	Lowering overseas investment hedge positions	USD 0.7 billion
Five major government pension funds and employment insurance fund	Investment for their own accounts	USD 11 billion
Chunghwa Post	Presell forward FX in order to hedge own investment interest	USD 0.12 billion

Source: Department of Foreign Exchange, CBC.

3. Loosening the regulations regarding foreign exchange remittances

To promote the development of Taiwan as a key offshore renminbi market and to aid the

internationalization and product diversification of the futures market, starting from June 27, 2016, banks were allowed to conduct FX settlement declarations for transactions of renminbi/USD exchange rate options listed on the Taiwan Futures Exchange (TFE) conducted by the TFE or futures firms.

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 the *Foreign Exchange Regulation Act*, the CBC reviews and authorizes banks to conduct FX business and be supervised accordingly. In 2016, the CBC continued to approve bank branches as authorized FX banks and loosened restrictions on FX derivative product business in order to promote authorized FX banks' competitiveness and quality of services. Related developments in 2016 are as follows:

(1) Number of authorized FX banks and overseas branches increased:

- A. At the end of 2016, there were 3,427 authorized FX banks in total, which included 39 head offices and 3,389 branches of domestic banks, 35 branches of 26 foreign banks, three branches of Mainland Chinese banks, as well as 1,265 authorized money exchangers, post offices, and financial institutions authorized to engage in basic foreign exchange business.
- B. The CBC also approved two cases for authorized FX banks to establish branches in Mainland China, and 12 cases for domestic banks to set up branches abroad.

(2) The CBC prudently approved new FX products:

- A. In terms of new FX products, 15 derivatives were approved in 2016 after prudent review.
- B. On September 20, the CBC revised the *Directions for Issuance of Foreign-Currency Denominated Negotiable Certificates of Deposit by Banks*, adding the Australian dollar in the currency denomination of the said product type.

(3) The CBC actively assisted banks to take advantage of business opportunities in the digital age, and promoted related businesses:

- A. On May 16, the CBC announced that customers of authorized FX banks may use internet banking to pre-designate foreign currency deposit accounts, including others' accounts in the same bank or the same person's accounts in other banks, to conduct FX related business.
- B. On June 6, the CBC announced that authorized FX banks may conduct FX ATM business, including cardless same-bank foreign currency withdrawals.

(4) The CBC continued to improve the operating procedures for FX business conducted by authorized FX banks through two amendments of relevant directions:

- A. On April 28, the CBC revised the *Directions Governing Banking Enterprises for Operating Foreign Exchange Business* to be in line with the directions of the Financial Action Task Force (FATF) regarding FX electronic remittances. The amendment stipulated that banks managing FX business should ensure know your customer (KYC) procedures and the electronic messages for FX remittances should include the required information about the payers and the payees.
- B. On September 9, the CBC revised the *Regulations Governing Foreign Exchange Business of Banking Enterprises* so that prior application was required for authorized banks to conduct new, complex, high risk FX derivatives business for customers except professional institutional investors and high net worth corporate investors.

2. Insurance companies

- (1) Up to the end of 2016, 21 insurance companies were allowed to engage in foreign currency investment-linked insurance business, and 22 insurance companies were permitted to conduct business in relation to traditional foreign currency insurance products. The 2016 foreign currency premium revenue was US\$22.9 billion, 1.7% less than that of 2015.
- (2) In order for a timely review and improvement of FX business of the insurance industry, the *Regulations Governing Foreign Exchange Business of Insurance Enterprises* was revised twice within 2016:
 - A. On March 23, the CBC removed the restriction that the subject matter insured of a non-life insurance policy denominated in foreign currency should exclude domestic real estate, and allowed insurance companies to engage in foreign currency loans made as one of the participants of a foreign-currency syndicated loan.
 - B. On December 30, the CBC announced the exceptions where NTD receipt and payment may be used for foreign currency-denominated non-life insurance policies and the relevant settlement matters.

3. Securities firms, bills finance firms, securities investment trust and consulting firms and futures firms

- (1) On May 11, in response to the TWSE's plans to offer foreign currency beneficiary certificates under the corresponding ETFs, the CBC stipulated how the TWSE, the Taiwan Deposit and Clearing Corporation, and securities firms should apply for related FX business, as well as the supporting rules. On May 23, the TWSE was granted the approval to conduct the above business.
- (2) The approved cases granted by the CBC for securities firms, bills finance firms, investment trust and investment consulting firms and futures firms to manage FX business as of 2016, are shown in the following table:

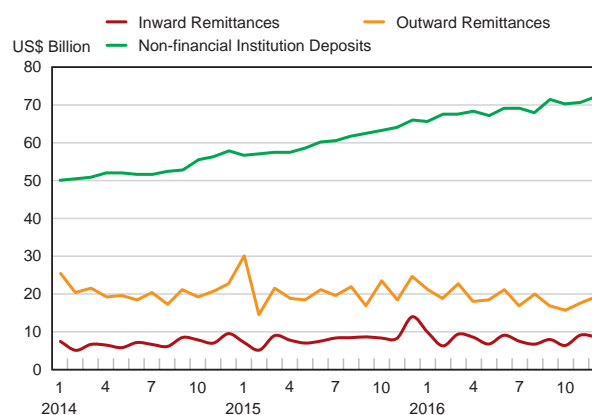
Institution	FX business	Number
Securities firms	Agents for foreign bond trading	2
	Underwriting international bonds	2
	Proprietary foreign securities trading neither belonging to investment with their own funds nor for hedging needs	3
	Non-discretionary individually managed money trust wealth management	1
	FX spot transactions	1
	FX forward transactions	1
	FX SWAP transactions	1
	Brokerage trading of onshore and offshore funds	1
	Domestic foreign currency ETF liquidity providers	2
Bills finance firms	Foreign currency bills certification, underwriting, brokerage and dealing	1
investment trust and investment consulting firms	Mandated institution of private offshore funds	8
	Foreign currency discretionary investments in foreign securities	3
	Conducting public offer or private placement of foreign currency-denominated funds	1
Futures firms concurrently operating leverage transaction merchants	Foreign currency margin trading	1

Source: Department of Foreign Exchange, CBC.

4. Offshore Banking Units (OBUs)

- (1) At the end of 2016, all OBU assets totaled US\$186.0 billion, which was US\$4.1 billion or 2.3% more than the previous year end. Domestic banks owned 88.1% of the OBU assets, while foreign banks owned 11.9%.
- (2) In 2016, the total OBU FX trading amount was US\$683.5 billion, down by 36% from 2015.
- (3) In 2016, the performance of cross-strait OBU financial business was mixed:

OBUs' Non-financial Institution Deposits and Cross-Strait Remittances



A. The cross-strait remittances decreased by 7.6% from a monthly average of US\$28.53 billion in 2015 to US\$26.36 billion in 2016.

B. At the end of 2016, non-financial institutions' deposits reached US\$72.24 billion, a 9.2% increase from a year ago.

5. Offshore Securities Units (OSUs)

At the end of 2016, 17 OSUs were approved and established, and total OSU assets reached US\$3.58 billion; total OSU pretax net profits in 2016 were US\$52 million.

6. Offshore Insurance Units (OIUs)

Up to the end of 2016, 20 insurance firms were approved to establish OIUs, and 18 of the approved cases were set up. Total OIU assets reached US\$0.21 billion; total OSU pretax net profits in 2016 were US\$1.6 million.

RMB Exchange Business Slowed During 2016

1. Since February 6, 2013, when authorized FX banks or DBUs began to conduct RMB business, domestic RMB business has been flourishing. However, the pace of progress slowed during 2016.

2. By the end of 2016, there were 68 DBUs and 59 OBUs engaging in RMB business. The balance of RMB deposits amounted to RMB311.4 billion, 2.5% lower than the end of 2015; RMB remittances totaled RMB1,872.4 billion in 2016, 38.5% lower than 2015; and RMB settlement through the Taipei Branch of the Bank of China totaled RMB4,036.6 billion, 21.4% lower than 2015.

3. RMB investment business conducted by financial institutions as of the end of 2016 is shown in the following table.

RMB Business Conducted by Financial Institutions

Unit: RMB Billion

Business items	Amount
Deposit balance (include NCDs, end of 2016)	311.4
Total remittances (February 2013 till December 2016)	6,889.1
Total settlement through the Taipei Branch of the Bank of China (February 2013 to December 2016)	14,675
Total value of 109 RMB-denominated bonds issued (up to the end of 2016)	70.8
Accumulated premium receipts from RMB-denominated investment-linked insurance business (up to the end of 2016)	1.8
Accumulated premium receipts from RMB-denominated traditional insurance business (up to the end of 2016)	1.7

Source: Department of Foreign Exchange, CBC.

Expanding Foreign Currency Clearing Platform

1. The CBC began efforts to establish a domestic USD clearing mechanism in September 2008 and officially launched the system on December 6, 2010. Afterwards, the CBC cosigned the Financial Information Service Co. to set up a foreign currency clearing platform, which started operating in March 2013. The platform also began services for domestic and cross-border US dollar and RMB remittances, and adopted a payment-versus-payment (PVP) mechanism among banks and a liquidity-saving mechanism for foreign currency remittances. In 2015, the CBC made domestic and cross-border yen and euro remittances available on the platform, as well as a delivery-versus-payment (DVP) mechanism for foreign currency bonds and bills.
2. By the end of 2016, the scope of services provided by the platform was nearly complete. It helps to promote the efficiency of foreign currency remittances, significantly reduces the remittance fees, improves the safety and efficiency of payment systems, and boosts the development of financial services.

The Development of Domestic Foreign Currency Settlement Business

Currency	Domestic participating units	Settlements in 2016	
		Transactions	Amount
US dollar	70	999,765	USD1,000.8 billion
Renminbi	61	183,145	RMB 401.1 billion
Yen	42	26,144	JPY 967.5 billion
Euro	41	15,678	EUR 3.8 billion
Australian dollar	29	1,387	AUD 137 million

Source: Department of Foreign Exchange, CBC.