

4. Banking Supervision

Pursuant to the *Central Bank of the Republic of China (Taiwan) Act*, the Bank conducts target examinations to ensure effective enforcement of related regulations, and establishes a financial report auditing system and a financial stability evaluation framework to systematically monitor, analyze, and evaluate the potential sources of financial system risks in order to adopt appropriate policies and measures in a timely manner.

Implementing On-site Examinations

The Bank conducts target examinations related to monetary, credit, and foreign exchange policies and payment systems when necessary. The target examinations in 2008 inspected the handling of counterfeit money by financial institutions, interest rate announcements, provision of deposit reserves, forward foreign exchange transactions, foreign exchange remittances, correctness of reporting to the Bank, and the operation of foreign currency exchanges by authorized money exchangers, etc.

Following up on Banks' Compliance with the Examination Opinions

In light of the Bank's examination opinions and the Financial Supervisory Commission's examination opinions related to the Bank's business or regulations, the Bank monitors how the examined financial institutions have done for improvement, urges the financial institutions to rectify related deficiencies, and thus ensures the successful implementation of the Bank's policies.

Report Auditing

Based on the periodical reports submitted by financial institutions and utilizing the computerized report auditing system, the Bank assesses the operation, financial conditions and regulatory compliance of individual financial institutions. In 2008, there were a total of 60 documents about report auditing and important business analyses.

Moreover, starting from 2008, the report auditing system of foreign bank branches in Taiwan was changed from a CARSEL system to a SMAC (support from the head office, management and control, asset quality, compliance) system. The latter incorporated the evaluation of a parent company's support capability in order to reflect its risk bearing ability and business situation. Furthermore, to assure consistency and accuracy, the reporting material of domestic banks, foreign bank branches in Taiwan, and bills finance companies were since to be reported through a single window.

Financial Stability Evaluation

The Bank compiles financial soundness indicators and issues financial stability reports so that related competent authorities, market participants and the society can understand the status and sources of financial system risks in this country and adopt appropriate actions accordingly.

In June 2008, the Bank issued the first Chinese edition of Taiwan's financial stability report. The issuance of the coming English edition in 2009 will help promote cross-border exchange of information on banking supervision and boost Taiwan's international visibility.

Monitoring Mismanaged Financial Institutions

The Bank closely monitors mismanaged financial institutions and collects related information for the Bank's policy decisions. Moreover, the information is forwarded to the Financial Supervisory Commission and/or the Bureau of Agricultural Finance in order to adopt prompt corrective actions to deal with mismanaged financial institutions.

Other Important Measures

To reinforce the evaluation of financial stability, the Bank collaborated with academia in the research project regarding the "Stress Test of Taiwan's Financial System" in order to gradually establish Taiwan's macro stress test model for the financial sector. The databank of listed companies' financial data and statistical information of financial institutions' non-performing loans were established as part of the financial stability report framework.

Box**Publication of Financial Stability Report**

In step with the global trend of safeguarding financial stability and publishing financial stability reports, coupled with a renewed focus on the statutory objective of promoting financial stability, the Bank took measures with reference to the proposal of the IMF and the experiences of other central banks as follows: (1) setting up the Financial Stability Assessment Section within the Department of Financial Inspection in January 2006; (2) compiling financial soundness indicators of Taiwan's financial system; and (3) establishing an effective financial stability framework.

The Financial Stability Report aims to provide financial authorities, market participants, and others interested in financial stability issues with an insight into the current financial status, potential vulnerabilities and main sources of risks that might undermine the stability of the financial system. The Report reviews the following: (1) international and domestic economic and financial conditions; (2) the financial sectors (i.e. financial markets, financial institutions and financial infrastructure); and (3) non-financial sectors (i.e. corporate sector, household sector and real estate market). The Report was prepared by the Department of Financial Inspection under the guidance of the Financial Stability Assessment Committee, which was chaired by the deputy governor of the Bank and consisted of four director generals from related departments as well as two academics. To offer a broader perspective, the Financial Supervisory Commission and other supervisory agencies were also consulted during the compilation of this report.

The Financial Stability Report of the Republic of China (Taiwan) would be issued semiannually starting from 2008. The first Report was issued on June 27, 2008.

According to the conclusion of the recent Report issued in January 2009, the financial markets functioned normally in the first half of 2008. Asset quality and capital adequacy at domestic financial institutions remained satisfactory despite the declining profits, and their intermediary functions were unimpaired. The payment and settlement system remained sound and its efficiency continued to improve. Since the third quarter of 2008, with the increasing spillover effect amid the deepening global financial crisis, the turbulence in domestic financial markets posed some risks to Taiwan's financial system. However, Taiwan's financial institutions remained sound and resilient, and the government has taken prompt and effective actions to stabilize the financial sector and the economy. As a result, the impact of the global financial crisis on Taiwan was relatively limited.

Overall, the financial system in Taiwan remained relatively stable as compared with other countries. Nevertheless, whether the risks to the financial system would be further aggravated warranted closer monitoring.