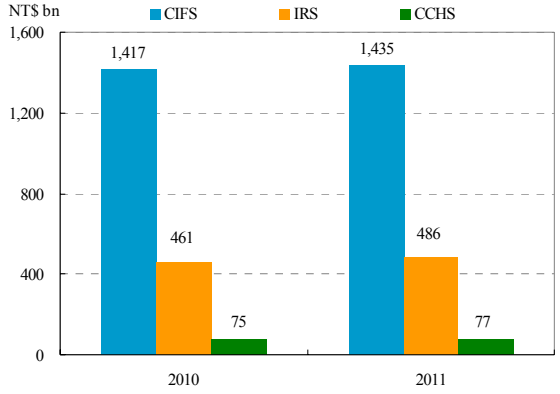
4.3 Financial infrastructure

4.3.1 Payment and settlement systems

Overview of systemically important payment systems

In 2011, the average daily transaction value of the three systemically important payment systems (SIPSs)[89] processing domestic interbank payments increased moderately compared to the previous year. Among them, the CBC Interbank Funds-Transfer System (CIFS), which handles large payments and the final settlement of interbank fund transfers, continued to be the most important one in 2011. Its average daily transaction value reached NT$1.43 trillion and accounted for 72% of the total (Chart 4.54).

Chart 4.54 Average daily transaction value of the three SIPSs



Source: CBC.

Reinforcing risk management of the transit of checks

The Check Clearing House System (CCHS) is a crucial part of the payment systems. In the past, the Taiwan Clearing House (TCH) and some financial institutions transited checks for clearing by express delivery service providers. However, if checks were lost or damaged during the process, it would harm the rights of check holders and adversely impact the smooth operation of the financial system. To reinforce risk management of check transitions, under the CBC's requirement, the TCH stipulated regulations and related standard procedures for dealing with checks being reported lost or damaged when delivered by express delivery service providers. All banks processing the operation of check clearing and settlement and all branches of clearinghouses were informed to comply with the regulations and standards.

New redemption mechanism through CIFS for NCDs issued by banks

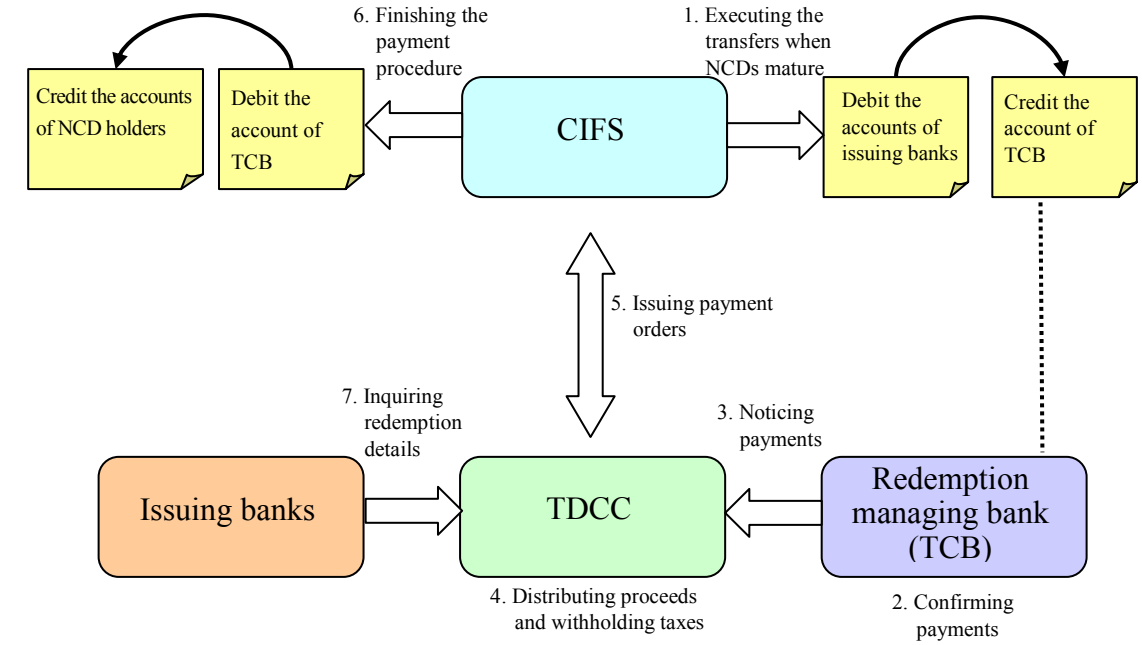
Commencing on 3 January 2011, NCDs newly issued by banks and initially purchased by dealers would be dematerialized and registered and entrusted to the Taiwan Depository &

[89] The three SIPSs include the CBC Interbank Funds-Transfer System (CIFS), the Interbank Remittance System (IRS) and the Check Clearing House System (CCHS).

Clearing Corporation (TDCC) for central custody. When NCDs were due, issuing banks would remit repayment amounts through interbank remittance systems to a special account of the TDCC, managed by the redemption managing bank (the Taiwan Cooperative Bank, TCB), for NCD redemption.

To simplify the redemption procedures of NCDs issued by banks, the TDCC got the approval from the CBC to complete the redemption of NCDs through the CIFS. Namely, issuing banks could notify the CBC before the second business day of NCD issuance and repay them on their due days through the CIFS. The new operating procedure of NCD redemption is shown in Chart 4.55.

Chart 4.55 New redemption procedures of NCDs issued by banks



Sources: CBC and TDCC.

The new procedure started on 7 May 2012 and the total estimated redemption value of NCDs through it is expected to reach NT$193 billion annually. Related benefits are as follows:

- Diminishing credit risks and liquidity risks of cash settlement assets and fulfilling the Recommendations for Securities Settlement Systems jointly issued by the CPSS and the Technical Committee of the IOSCO, which suggests using central bank money to settle ultimate settlement obligations.

- Reducing the operating costs and enhancing the efficiency of clearing and settlement operations by providing automated redemption services.

4.3.2 New Era for the Protection of Financial Consumers in Taiwan

Investment controversies caused by the recent global financial crisis fully demonstrated the lack of laws that existed to protect the rights of consumers of financial products. In order to protect the rights of these relatively disadvantaged financial consumers, the Financial Consumer Protection Act was enacted and promulgated by the President on 29 June 2011, and was implemented from 30 December of the same year. This, coupled with the Financial Ombudsman Institution, which was set up according to the Act and commenced work from 2 January 2012, has opened up a new era for the protection of financial consumers in Taiwan.

After the enactment of the Financial Consumer Protection Act, the protection mechanisms for financial consumers have become more extensive and wide-ranging. Apart from putting more emphasis on financial education, it also places responsibility on the due care of good administration of those parties in the financial industry, including, but not limited to, ascertaining the suitability of products or services offered to financial consumers, clear explanation of the contents of contracts, and full disclosure of any risks that are involved. In addition, to deal with disputes related to the consumption of financial services, the law also provides another mechanism outside of legal courts that is financially proficient and deals with these contentions fairly, quickly and efficiently. This is designed to improve the confidence and trust between consumers and financial institutions, and to decrease financial disputes. For further information about the Financial Consumer Protection Act, please refer to Box 3.

In addition, the government has also taken steps to enforce other mechanisms to protect financial consumers in the recent year. For example:

- The amendment of Article 12-1 and 12-2 of the Banking Act states that when granting mortgages for personal residences and consumer loans, banks cannot require their debtors the provision of joint and several guarantor(s) for whatsoever reasons. In addition, when an applicant provides sufficient collateral to cover the entire amount of the mortgage, banks may not require the borrower to provide general guarantor(s). When banks require the borrower to provide general guarantor(s), they should be subject to certain restrictions.

- Institutions engaging in credit card business must provide cardholders who make long-term use of revolving credit and keep up to date on payments with an option of either paying off the balance in installments or taking out a consumer loan to pay it off.

4.3.3 Gradual lifting of restrictions on cross-strait financial activities

Since the signing of the Cross-Straits Economic Cooperation Framework Agreement (ECFA) and the amendment of the Regulations Governing the Banking Activity and the Establishment and the Investment by Financial Institution between the Taiwan Area and the Mainland Area in 2010, Taiwan's financial institutions have been actively setting up branches, taking equity stakes and expanding business in Mainland China, and Mainland China's financial institutions also have started to establish representative offices in Taiwan. Cross-strait financial interaction has become more frequent and common. In order to gradually open up cross-strait financial activities, improve the competitiveness of Taiwan's banking industry and strengthen relative risk management, the regulatory authorities in Taiwan, in the recent year, actively reviewed and revised regulations related to cross-strait financial activities and relaxed investment restrictions step by step. The FSC and Mainland China's banking regulatory agency also twice held meetings of the Cross-Strait Banking Supervisory Cooperation Platform with a view to reinforcing supervisory collaboration.

Mainland China has already become the target market of Taiwan's banks. As the opening is in the early stage, domestic banks' risk exposures to Mainland China are still limited. However, as financial business expansion in Mainland China speeds up, related exposure will magnify rapidly. Financial institutions should thus strengthen their relative risk control regarding their exposure to Mainland China in order to ensure Taiwan's financial stability. Regulatory authorities should also improve prudential supervision on monitoring and supervising this exposure and the concentration of the domestic financial system to Mainland China so as to adopt adequate responsive measures.

Relaxation of regulatory restrictions on investments and business activities of banks in Mainland China

In response to the needs of Taiwan's banking industry, the FSC once again amended the Regulations Governing the Banking Activity and the Establishment and the Investment by Financial Institution between the Taiwan Area and the Mainland Area on 7 September 2011 with a view to relaxing regulatory restrictions on financial investments and business activities between the two sides of the Strait and requiring domestic financial institutions to enhance related risk control. Primary revisions are summarized in Table 4.3.

Table 4.3 Major amendments of the Regulations Governing the Banking Activity and the Establishment and the Investment by Financial Institution between the Taiwan Area and the Mainland Area

Key Points	Major amendments
1. Adjust the types of entity and forms of operation of Taiwan's banks when entering into the Mainland market	1. Lift the "choose one of two" restriction on the investing entity: Banks in the Taiwan area and/or their subsidiary banks in a third area can at the same time apply to establish branches, set up subsidiary banks, and/or make equity investments in the Mainland Area. 2. Lift the "choose two of three" restriction on the form of investment: Banks in the Taiwan area and/or their subsidiary banks in a third area can freely choose to set up branches, establish subsidiary banks, and/or make equity investments when entering the Mainland China market. 3. Remove the provision that Taiwan's financial institutions can only make an equity investment in a single financial institution in Mainland China.
2. Broaden the scope of cross-strait financial business	1. Broaden the scope of cross-strait financial business: Expanding the scope of financial business conducted by overseas branches, offshore banking units (OBUs), and/or domestic banking units (DBUs) of Taiwan's banks with individuals and/or juridical persons in Mainland China, except for those activities prohibited by the supervisory authorities. 2. Lift the restrictions of loan applicants: Overseas branches and OBUs of Taiwan's banks permitted to undertake loans to individuals and/or juridical persons in the Mainland area and not limited to Taiwanese and/or foreign invested enterprises.
3. Reinforce risk management mechanisms	1. Revise the calculation of investment limits in the Mainland area to be on a bank-wide (group-wide) basis: The total of cumulative allocated operating capital and investments in the Mainland by Taiwan's banks and their subsidiaries may not exceed 15% of an individual bank's net worth, and the total amount of equity investment in the Mainland by Taiwan's financial holding companies and their subsidiaries may not exceed 10% of their net worth. 2. Establish a total-exposure mechanism: The total amount of credit extension, investment, and interbank loans and deposits in Mainland China may not exceed an individual bank's net worth following their final budget for the previous year. 3. Establish proper risk management mechanism: Taiwan's banks engaging in business with individuals, juridical persons, groups and other institutions in the Mainland area, and their branches in countries and/or areas other than Mainland China shall establish risk management mechanisms and adequately evaluate the risks of relevant transactions to ensure the safety of their assets.

Source: FSC.

Moreover, Paragraph 3 in Chapter 4 of the regulation mentioned above that sets out eligibility requirements and regulatory provisions governing equity investments by Mainland banks or Mainland-funded banks in Taiwan's financial institutions has already entered into force on 2 January 2012. Mainland banks wishing to invest in Taiwan's financial institutions will be able to apply for approval in accordance with Article 73 of the same regulation. It also stipulates that (1) the investments in Taiwan's financial institutions are limited to banks and financial

holding companies, (2) Mainland banks can only individually acquire up to 5% of a Taiwanese bank or financial holding company, and (3) the combined equity stakes of all Mainland investors in any one bank or financial holding company must not exceed 10% of the investees paid-in capital.

Opening up the renminbi business and investment in securities issued in Mainland China

In order to respond to the trend of internationalization of the renminbi, to help Taiwan's banks to develop renminbi business, and to provide stable financing channels for Taiwanese enterprises operating in Mainland China, the FSC and the CBC officially promulgated a piece of regulations in July 2011 allowing the OBUs and overseas branches of Taiwanese banks to apply to conduct renminbi business.

Moreover, the FSC announced that guarantees extended by a financial institution in the Mainland area can be considered as qualified collateral prescribed in Article 12 of the Banking Act as long as those financial institutions meet certain requirements.[90] In November 2011, the FSC also allowed OBUs and overseas branches of Taiwan's banks to invest in securities issued by government authorities or companies in Mainland China. With more and more cross-strait financial interactions, the linkages between Taiwan's and Mainland China's financial systems will become more important in the future.

Establishment of the Cross-Strait Banking Supervisory Cooperation Platform

In order to implement supervisory cooperation in accordance with the agreements signed in the Cross-Strait Financial Cooperation Agreement and the Memorandum of Understanding on Banking Supervision, and to build up a mechanism for periodic meetings between both sides of the Strait for discussing financial issues such as financial market access, business operations and banking supervision, the FSC and Mainland China's banking regulatory agency jointly held two meetings of the Cross-Strait Banking Supervisory Cooperation Platform in April and November 2011 and reached several concrete conclusions (Table 4.4). The consensus agreed upon in the meetings can help Taiwan's regulatory authorities to better know the operation and exposure of Taiwan's financial institutions in Mainland China so as to fulfill their responsibility of consolidated supervision.

[90] The requirements are: (1) they have branches in Taiwan; or (2) for those without branches in Taiwan, their total assets or capital in the most recent year should rank among the top 1,000 banks worldwide.

Table 4.4 Conclusions reached in meetings of the Cross-Strait Banking Supervisory Cooperation Platform in 2011.

Supervisory cooperation items	Concrete Conclusions
Supervisory Communication and Cooperation	1. Strengthen regular communication: Increase liaison windows and confirm eleven mutual contact items and communication methods. 2. Establish a periodic meeting mechanism: (i) Participants, who are the heads of the relevant authorities or appointed by the heads, either from Taiwan or Mainland China, should hold positions on an equal basis; (ii) In the early stage, meetings will be held twice a year, and then adjust to once a year depending upon circumstances; (iii) The two sides will take turns to host meetings.
Financial Inspection	1. Inspection plans should be passed to the other side through the liaison window. 2. The receiving side should reply to inspection plans as soon as possible. 3. After the inspections are completed, both sides should exchange opinions.
Strengthen Supervisory Technical Cooperation	1. Enhance banking supervision technical cooperation between both sides. 2. Jointly hold a seminar on the Basel III.
Expedite the Review of Applications	1. Expedite the review of applications for the establishment of commercial representations on either side. 2. Mainland authorities will seek to complete as quickly as possible their review of applications by six Taiwanese banks for their Mainland branches to conduct renminbi business.
Others	Confirm the scope of "green corridors" in the Midwestern and Northeastern regions of Mainland China, which was committed to in the early harvest provisions of the ECFA.

Source: FSC.

4.3.4 Taiwan will implement Basel III progressively

The recent global financial crisis highlighted problems of excessive leverage, inadequate and deteriorated capital bases and insufficient liquidity buffers in the banking sector. In response to these issues, the BCBS has introduced several capital and liquidity reforms (Basel III) since 2009 and finalized them in December 2010. The key points of Basel III are summarized in Table 4.5.[91]

[91] For details, please see Box 2 in Financial Stability Report No. 5 issued by the CBC in May 2011.

Table 4.5 Basel III: capital and liquidity reforms

Dimension	Key points
Microprudential supervision	1. Raise capital quality by employing common equity as the predominant form of capital. 2. Increase capital ratios progressively. 3. Enhance risk coverage, especially in strengthening capital charges for securitization transactions, market risk in the trading book and counterparty risk. 4. Introduce a non-risk based leverage ratio. 5. Propose international liquidity standards, including the Liquidity Coverage Ratio and the Net Stable Funding Ratio.
Macroprudential supervision	1. Propose capital conservation buffers and countercyclical capital buffers to reduce procyclicality. 2. Require global systemically important financial institutions (G-SIFIs) to hold an additional systemic capital surcharge of 1-2.5%.

Source: BCBS.

Although Basel III targeted issues arising in the European and US banking systems, Taiwan always endeavors to meet international standards for financial supervision. In order to follow international reform trends and enhance bank soundness, the FSC, with due consideration on the characteristics and business climate of the financial industry in Taiwan, has declared to phase in Basel III from 2013.[92] It will raise bank capital adequacy standards progressively and ask banks to raise capital quality, as well as to adopt long-term capital planning. The FSC is working on amendments to Basel III-related regulations and, by the end of 2011, had completed two amendments referring to the BCBS guidance of July 2009[93] as follows:

- Revising the requirements for the public disclosure of information on capital adequacy of banks in March 2011. Banks have been obliged to establish a "capital adequacy and risk management section" on their websites for disclosing more qualitative and quantitative information since 30 June 2011.

- Amending capital charge requirements for securitization transactions and market risk in October 2011, such as introducing capital requirements for resecuritizations, increasing credit conversion factors for eligible liquidity facilities, raising capital charges for specific risk for equities in banks' trading books and requiring banks that use internal models for market risk to set aside an incremental risk capital charge and to calculate stressed value-at-risk weekly. The amendment became effective in January 2012.

The aforementioned amendments focused on the capital charge requirements of securitization

[92] The FSC, press release of amendments for "Regulations Governing the Capital Adequacy Ratio and Capital Category of Banks," 23 April 2012.
[93] See Note 72.

and trading book transactions. While the size of securitization transactions that domestic banks are involved in is still small, and thus far no bank in Taiwan has been approved to use internal models for market risk, the impact of such amendments is expected to be limited. However, the subsequent amendments—including: revising the definition of eligible capital, raising regulatory capital levels, and introducing capital conservation buffers, countercyclical capital buffers, a leverage ratio and liquidity measures—are expected to have significant impacts on domestic banks in regard to long-term capital plans, risk management (especially liquidity risk management) and business strategies. Therefore, banks are advised to make assessments of the potential impacts and take countermeasures as soon as possible.

Box 3
Implementation of the Financial Consumer Protection Act in Taiwan

The Financial Consumer Protection Act was put into action on 30 December 2011. The Financial Ombudsmen Institution that was set up in accordance with the law was also put into effect on 2 January 2012. This symbolizes a huge step forward in the protection of financial consumers in Taiwan.

1. Main content of the Financial Consumer Protection Act

The Financial Consumer Protection Act has four chapters and thirty-three articles in all. It is applicable to banks, securities firms, futures firms, insurance companies, electronic stored value card enterprises, and enterprises in other financial services. It is mainly concerned with mechanisms for financial consumer protection and also sets up an institution that deals with disputes in financial consumerism. The highlights are below:

1.1 Target of this law

The target group for the Financial Consumer Protection Act is financial consumers who are at a disadvantage, whether it is from a financial, information or professional standpoint. Therefore, the legal definition for financial consumers is those who accept services or products from financial institutions, but excludes qualified institutional investors and natural or legal persons with a prescribed level of financial capacity or professional expertise[1] in order to more effectively utilize the resources needed to settle financial disputes.

1.2 Key protection measures

- When a financial services enterprise enters into a contract with a financial consumer for the provision of financial products or services, the enterprise shall act in conformity with the principles of fairness, reasonableness, equality, reciprocity, and good faith. Contractual provisions entered into by a financial services enterprise and a financial consumer that are clearly unfair shall be invalid. If there is a disagreement over the meaning of any contractual provision, the provision shall be interpreted in favor of the financial consumer.
- A financial services enterprise, in publishing or broadcasting advertisements or carrying out solicitation or promotional activities, shall not engage in falsehood, deception, concealment, or other conduct sufficient to mislead another party, and shall verify truthfulness of the content of its advertisements. The obligation it bears to

financial consumers shall not be less than that indicated in the content of the aforementioned advertisements or in materials or explanations provided to financial consumers in the aforementioned solicitation or promotional activities.

- Before a financial services enterprise enters into a contract with a financial consumer for the provision of financial products or services, the enterprise shall fully understand the information pertaining to the financial consumer in order to ascertain the suitability of those products or services to the financial consumer.
- Before a financial services enterprise enters into a contract with a financial consumer for the provision of financial products or services, the enterprise shall fully explain important aspects of the financial products or services, and of the contract, to the financial consumer, and shall also fully disclose the associated risks.
- A financial services enterprise violating the rules of the suitability and the obligation of disclosure with fault or not has to compensate the consumers for any injury or loss arising therefrom. And the burden of proof is on the side of the enterprise.

1.3 Mechanism to deal with disputes concerning financial consumers

1.3.1 The Financial Ombudsmen Institution

The Financial Ombudsmen Institution is an organization that specializes in dealing with financial disputes. It is made up of an arbitration committee that hires around 9 to 25 arbitration members. The members are mainly comprised of scholars, professionals or unbiased persons who specialize or have experience in related fields, and are responsible for dealing with ombudsman cases. In addition, the institution has an "arbitration office" which helps the arbitration members to deal with cases that come before them. There is also an education and promotional planning division that informs and educates financial consumers about financial knowledge, assists financial services enterprises in dealing with disputes and complaints, and provides advice for financial consumers.

1.3.2 Financial consumers must make a complaint with financial institutions first before applying to the ombudsman body

Financial consumers shall deal with a financial consumer dispute by first filing a complaint with the relevant financial services enterprise. The financial services enterprise shall appropriately handle the matter within 30 days from the day the complaint is received. If the financial consumer does not accept the disposition or the financial services enterprise fails to handle the matter before the aforementioned time limit, the

financial consumer may, within 60 days from either the day they receive notification of the disposition or the day the time limit expires, apply to the ombudsman body to institute an ombudsman case. After the ombudsman body entertains an application to institute an ombudsman case, it may seek to institute mediation proceedings.

1.3.3 Arbitration decisions made for an amount of money under a certain threshold are binding for financial institutions

If financial service providers have already agreed to abide by the rulings of the law to settle disputes on paper, then they should agree to the decisions made by the arbitration committee for amounts that are less than NT$1 million (for investment products or services) or less than NT$100 thousand (for non-investment products). However, a decision of the arbitration committee is non-binding for related consumers of financial products, and if they do not agree with the ultimate decision, they can continue with legal proceedings.

1.3.4 An arbitration decision has the same effect as a ruling on civil cases in a court

Financial consumers can, within 90 days after the decision by the arbitration committee, apply for approval from the court. After approval, the arbitration decision will have the same legal power as any rulings on civil cases, and the parties involved may not pursue any more legal actions or ask for arbitration according to this law.

1.3.5 Consumers who apply for the process of arbitration do not need to pay

Consumers who apply for arbitration do not need to pay any fees. However, the institution shall ask for annual fees and service fees from financial services enterprises. The annual payment is calculated as 0.008% of the entire financial industry's income as of the previous year, and then under preset rules the fees that each individual financial product or service provider has to pay are calculated. The service fee depends on the amount that a financial institution has to pay, which is decided by the arbitration members, with a ceiling of NT$10 thousand.

2. Current operation

According to the information provided by the Financial Ombudsmen Institution, from 1 January to 13 March 2012, financial dispute cases totaled 1,251. Of these cases, insurance industry related cases were the most at 1,050 (or 83.93%), with the banking industry's 186 cases (or 14.87%) coming in second and the securities and the futures

market's 15 cases (or 1.20%) coming in third.

A deeper analysis shows that, concerning different types of disputes, the banking industry's disputes mostly center around banks' methods of enticing customers, whilst the insurance industry's disputes mainly lie with the sum of compensation, the ways that they entice customers and the services which are not provided according to relative regulations.

3. Expected effect

The government hopes that the Financial Ombudsmen Institution can improve the quality of provision of financial products and services, and also effectively protect consumers of financial products. It also hopes to achieve the following goals:

- To integrate the laws that are separate under the status quo into a single mechanism for consumers of financial products and services to apply for arbitration in order to lessen the resources spent.
- To use the mechanism for dealing with financial disputes such that it will lessen the burden of civil courts.
- To use the arbitration provided in order to get greater insight into the problems concerning financial disputes so as to get a greater grasp on the goals and targets of financial supervisory policies.

Note: As the regulation of the Order No. 10000707320 promulgated by the Financial Supervisory Commission on 12 December 2011.