13. Foreign Exchange Management

Management of Foreign Exchange Market

In order to strengthen the functioning of the local inter-bank foreign exchange market, the Bank has adopted the following measures: (a) implementing a real-time reporting system on large transactions to monitor the foreign exchange market; (b) auditing documents related to forward foreign exchange to prevent foreign exchange speculation in the forward market; (c) strengthening banking examination and imposing penalties on banks violating relevant foreign exchange regulations; and (d) urging banks to enhance their foreign exchange risk management to prevent systematic market risk.

In addition, the Bank carried on swap transactions and foreign currency call-loan transactions to provide banks with sufficient foreign currency liquidity so as to meet funding demand from the business sector. These measures were particularly taken to meet banks' demand for short-term foreign currency funds following the September 11 terrorist attacks in the U.S. and typhoon Nari in Taiwan.

Management of Foreign Exchange Reserves

At the end of 2001, total foreign exchange reserves amounted to US$122.2 billion, a US$15.5 billion increase from the end of 2000. The bulk of these foreign exchange reserves are deposited in foreign correspondent banks and overseas branches of domestic banks that have excellent ratings. In addition to maintaining liquidity, security, and profitability, the objectives of the management and utilization of foreign exchange reserves also include promoting economic development and upgrading industries.

The following measures have been adopted in order to utilize foreign exchange reserves more efficiently:

a. Through the foreign exchange market, the Bank accommodated the funds needed by local enterprises to import major items of machinery and equipment.

b. The Bank has already appropriated US$10 billion, Eur 1 billion, and ￥15 billion as seed funds for the Taipei Foreign Currency Call-Loan Market. Taipei Foreign Currency Call-Loan Market has linked with brokerage firms in the major financial centers, including Tokyo, Hong Kong, and Singapore.

c. The Bank has deposited a portion of its foreign exchange reserves in the overseas branches of domestic banks to promote their international financial activities and to support Taiwanese firms operating overseas.

d. The Bank has appropriated US$10 billion from foreign exchange reserves as refinanced funds for local banks to finance major investment projects relating to the promotion of domestic industrial upgrading and economic development.

Management of Capital Flows

With the progress of financial liberalization in recent years, capital movements not involving NT dollar transactions can flow in and out of Taiwan freely. With regard to capital movements that involve NT dollar transactions, not only are current-account related transactions completely liberalized, but financial account-related transactions for trade purposes and investment purposes with prior approval by the competent authorities are also completely free. Only financial account transactions of a short-term nature are mildly restricted. At present, each non-resident person, foreign company, and qualified foreign institutional investor (QFII) may invest up to US$5 million, US$50 million, and US$3 billion, respectively, in domestic securities; each resident and domestic company may inwardly or outwardly remit up to US$5 million and US$50 million, respectively, in each year. The Bank endorsed the Ministry of Finance's proposal to extend the timeframe for inward remittances of approved equity funds by QFIIs from 1 year to 2 years.

Key measures with regard to capital flows include:

a. The ceiling on the amount of investment that each QFII can invest in domestic securities was raised from US$2 billion to US$3 billion.

b. Several well-known international financial institutions, including the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the Inter-American Development Bank (IADB), issued bonds worth a total of NT$40.5 billion in Taiwan in 2001. To avoid undue fluctuations of the NT dollar exchange rate, these international financial institutions were required to use swap derivatives when remitting the funds outwardly.

c. The foreign exchange settlements relating to the borrowings of domestic companies from their overseas subsidiaries and the repayments thereof were excluded from the general US$50 million annual remittent quota set by the CBC. This measure is to encourage the flow-back of outbound capital.

d. Insurance companies were allowed to invest in foreign securities by conducting swaps or cross-currency swaps to hedge their foreign exchange risk. By the end of the year, seven insurance companies were approved to remit out a total of US$5.5 billion. Domestic securities investment and trust companies were also allowed to raise funds from the domestic market to invest in foreign securities, and the aggregate ceiling was set at NT$60 billion at the end of 2001.

Management of Authorized Foreign Exchange Banks

The Bank continued to approve applications from new bank units as the authorized banks to handle business related to foreign exchange activities or to engage in foreign exchange derivatives activities. At the end of 2001, there were 981 authorized foreign exchange bank units in total, and 51 applications for engaging in new foreign exchange derivatives were approved by the Bank in 2001 during the year.

The Bank also accepted the proposal by the Ministry of Finance to allow 8 domestic commercial banks to set up representative offices in Mainland China. In addition, the Bank approved 12 banks to engage in internet banking in foreign exchange business.

Management of Offshore Banking Business

Offshore banking units (OBUs) in the local financial system have grown rapidly since their inauguration in 1984. OBUs allow enterprises, financial institutions, and individuals to efficiently engage in international financial activities, such as raising and managing funds from international markets, foreign currency trading and remittances, with tax exemption. At the end of December 2001, there were 68 OBUs in operation. The combined assets of all OBUs amounted to US$50.9 billion at the end of the year, which was an increase of US$3.6 billion or 7.54 percent from the year before.

The Bank and the Ministry of Finance also worked together to develop offshore banking units as the funding center for domestic enterprises operating overseas. OBUs were allowed to do business with financial institutions or organizations based in Mainland China, including their overseas branches, as well as overseas branches of foreign banks on Mainland China.