

2. Developments of the Offshore Banking Business in Taiwan

Introduction

The offshore banking business of local banks situated in Taiwan was first set up in 1983. Relaxation of financial regulations and growing overseas investment by local firms in recent years have increased the demand for offshore financial services. Over the years, the offshore banking units (OBUs) of banks have developed into one of the major financial channels for overseas subsidiaries of Taiwanese enterprises. This annex will provide a brief review of the developments of offshore banking business in Taiwan.

Origin of Offshore Banking Units

The Offshore Banking Act was promulgated in December 1983 to promote the integration of local banks into international financial markets. It authorized banks to set up offshore banking branches within Taiwan. The first OBU was set up in June 1984.

OBUs are permitted to undertake foreign currency denominated transactions only, offering services mainly to non-residents. OBUs are exempt from reserve requirements, business income tax, business tax, and stamp duties; the interest paid to non-residents is also exempt from withholding tax. Originally, OBUs were limited to accept deposits and extend credit in foreign currencies as well as conducting other foreign exchange transactions with overseas financial markets.

The early operation of Taiwan's OBUs was very limited due to the lack of competitiveness of domestic banks in international financial markets. Usually, OBUs obtained their loans from foreign financial institutions to extend credit to domestic financial institutions. They also took part in syndication loans, but predominantly those which were extended to large domestic companies in Taiwan or the latter's overseas subsidiaries. In short, both their size and operating profits were limited and they failed to play their expected role in international financial markets.

The Role of Offshore Banking Units in the Cross-Strait Business

With the emergence of China's economy and the increasing overseas investment activities by Taiwan's enterprises, the demand for funding overseas business and related financial services from domestic firms in Taiwan continued to grow. The majority of domestic firms set up their

offshore subsidiaries in a third country to facilitate their cross-strait business operations. In light of this, the government authorized OBUs to engage in trade-related banking business and offer services in financial derivative products to non-residents in May 1992. Since then, OBUs have served as a major channel enabling domestic companies to conduct cross-strait business operations through their offshore subsidiaries, facilitating the overseas operations of local firms.

For the past few years the government has made further efforts in expanding the lines of business of OBUs to encourage domestic firms to shift their funds overseas back to Taiwan and use the OBUs as their funding management centers. This has not only balanced the flows of funds across the Taiwan Strait but also strengthened the competitiveness of the domestic banking industry.

Recent Deregulation in Offshore Banking Business

One of the major deregulation efforts was to increase the access to offshore banking services. In the beginning, the offshore banking operations of domestic banks in Taiwan were conducted through independent branches. This is different from the international practice of maintaining separate accounting records rather than setting up branch offices. As there was only one OBU branch per bank and they were mostly located in Taipei, it was inconvenient for firms to access such services.

From the year 2000, the domestic branches of banks were allowed to act as agents on behalf of their OBUs to meet the offshore financial needs of local firms. The offshore businesses that domestic banking units (DBUs) may conduct on behalf of their OBUs have been gradually expanded to include import and export financing, deposits and loans in foreign currencies, and inward and outward remittances. There were around 70 OBUs as of year-end 2004 and more than 1,100 domestic branches of banks that may act as agents on behalf of their offshore units.

Initially, OBUs had to conduct trade financing and remittances through foreign financial institutions via a third country. But from June 2001, Taiwan's OBUs were allowed to engage in business directly with financial institutions in China. This significantly reduced the amount of time and fees involved. In November 2001, the Central Bank of China allowed offshore subsidiaries of local firms to make inward remittances for the usage of the parent company without being subject to the US\$50 million ceiling. This made it possible for parent companies to utilize the funds deposited at OBUs by their offshore subsidiaries. It also encouraged firms to transfer funding back to Taiwan through OBUs and establish Taiwan as the funding management

center for local enterprises.

Other measures adopted include allowing banks to provide credit and factoring services to Taiwanese enterprises operating in China from August 2002. In November 2004, OBUs were also permitted to extend credit in foreign currencies to the offshore subsidiaries of domestic firms to be used in China. In January 2005, offshore firms were allowed to obtain credit from OBUs by sharing their domestic parent firms' DBU credit lines secured by onshore assets. These measures greatly improved the availability of funding for firms.

In addition, OBUs also provided non-delivery forwards and options (NDFs and NDOs) businesses of US dollars against Chinese renminbi from August 2003 to offer firms with the financial products to hedge their foreign exchange exposure.

Current State of Offshore Banking Units

As a result of the above measures, OBU operations have grown steadily in recent years. As of the end of 2004, 70 banks in Taiwan were engaged in OBU operations. These include 42 domestic banks and 28 foreign banks. Total assets of all OBUs amounted to US\$69.2 billion at the end of 2004, triple those of 1991, and increasing 11 percent compared to the previous year.

Outstanding deposits and loans made by non-financial institutions also grew substantially. Deposits made by non-financial institutions at year-end 2004 amounted to NT\$18.8 billion, a 15-fold increase compared to that in 1991, and a growth of 15 percent compared to the previous year. Loans to non-financial institutions and non-residents reached NT\$15.3 billion, growing 18 percent compared to the previous year, or a 7-fold increase over 1991.

Total cross-strait remittances made through all OBUs reached NT\$8 billion in December 2004, a 22-fold increase compared to the NT\$0.35 billion in June 2001, when direct remittances were first authorized. The pre-tax earnings from the OBUs of domestic banks account for 10.3 percent of their total earnings in 2004.

Conclusion

The recent developments of the offshore banking business in Taiwan show that not only have OBUs become an important source of income for domestic banks, they have also developed into funding centers for Taiwanese enterprises in managing their overseas operations.

Looking forward, OBU operations will continue to provide firms with the services they require in setting up Taiwan as their global operating center. They will also provide vital sources of income for banks and facilitate their involvement in international financial markets.