

## **Financial Resilience of Taiwan's Banking Sector**

Taiwan adopts financial supervisory measures in step with international practices and those measures have been effective in strengthening the financial resilience of our banking sector and supporting real economic growth.

After the 2008 financial crisis, the Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB) and other international bodies have proposed series of reforms to improve banking sector's ability to absorb shocks from economic and financial impact, strengthen its financial resilience and promote stability in the financial markets. In line with the international standards, the FSC has also adopted some important measures since the crisis as presented below:

1. Capital adequacy:

(1) To make sure domestic banks measure up to Basel III capital requirements in both quality and quantity, the FSC has been raising the minimum requirements for capital adequacy ratios every year since 2013. Starting from 2019, the minimum requirements for common equity tier 1 ratio, tier 1 capital ratio and total capital adequacy ratio will be 7%, 8.5% and 10.5% respectively.

(2) To improve the loss-absorbing capacity of systemically important banks, the FSC request domestic systemically important banks to meet 2% additional regulatory capital requirements and 2% additional internal capital requirements with Common Equity Tier 1 Capital only. These additional capital requirements must be achieved before the end of each of the four years equally starting from the next year after the designated date.

2. Leverage ratio: To improve inconsistency in the application of risk weights for calculating capital charge and to supplement the aforementioned risk-based capital requirements, the FSC, in reference to BCBS recommendations, requires that starting 2018, the leverage ratio (tier 1 capital/total exposures) of banks shall not be less than 3%.
3. Liquidity coverage ratio (LCR): To enhance the ability of banks to restore short-term liquidity, the FSC and the Central Bank have implemented liquidity coverage ratio since 2015 and require that the LCR (high-quality liquid assets / total net cash outflows over the next 30 calendar days) of banks shall not be less than 100% starting 2019.
4. Net stable funding ratio (NSFR): To make sure banks hold sufficient long-term stable funds to support their business development, the FSC, in consultation with the Central Bank, had promulgated the requirement for NSFR (available stable

funding/required stable funding) in reference to the BCBS recommendation, and implemented the ratio in 2018 in line with the international practice.

As of end of Q1 2023, the average common equity tier 1 ratio, tier 1 capital ratio and total capital adequacy ratio of domestic banks have reached 11.55%, 12.88% and 15.08% respectively, all higher than the minimum requirements. In addition, the 2021 stress test results show that the average capital adequacy ratios and leverage ratio of domestic banks under stress scenarios are higher than the minimum requirements set for 2021, indicating Taiwan's banking sector has developed considerable financial resilience.

To strengthen the risk bearing capacity and international competitiveness of domestic banks, the FSC will continue to watch the international trends in financial supervision reforms and changes in global economic and financial situations, and adopt relevant measures in reference to the international practices:

1. Continue to conduct stress tests: The FSC will, in line with changes in domestic and international economic and financial situations, establish stress scenarios for specific risks or total position and conduct stress tests in a timely manner to grasp the risk bearing capacity of banks under adverse conditions.
2. Implement countercyclical capital buffer (CCyB) when necessary: The FSC has established regulations authorizing the implementation of CCyB, but has not implemented the requirements in consideration that the measures adopted in recent years for increase in provision for bad debts have produced the similar effect of capital increase during credit growth. However the FSC will consider adopting CCyB measures in the future in reference to international practices.

Below is a table comparing the financial resilience measures recommended by international organizations and adoption of those measures in Taiwan.

**Financial resilience measures recommended by international organizations and adoption of those measures in Taiwan**

| <b>Financial resilience measures recommended by international organizations</b> |   | <b>Adoption in Taiwan</b>   |
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| Capital adequacy  | BCBS released Basel III in December 2010, which calls for increase in minimum capital adequacy requirements every year and implementation of Basel III in phases starting 2013.   | The FSC has amended the Regulations Governing the Capital Adequacy and Capital Category of Banks in November 2012 and implemented the amended regulations in step with international practices.   |
|   | Bail-in mechanism: BCBS issued another document in January 2011 requiring banks to convert tier 1 and tier 2 capital instruments other than common stocks issued by the bank to common stocks or write off the debts when certain trigger conditions are met to address the issue of loss absorbency. | The aforementioned Regulations has set forth the manner by which banks are required to use capital instruments other than common stocks to absorb loss by stipulating that “The priority order for the distribution of the earnings and assets of the holder of additional Tier 1 or Tier 2 capital is the same as that of a common stock holder when the competent authority assigned officials to take receivership over the bank, order such a bank to suspend and wind up business, or liquidate the bank”, which already has the “bail-in” effect. |
| Leverage ratio  | BCBS issued the leverage ratio framework and disclosure requirements in January 2014, which revised the method for calculating leverage ratio and disclosure requirements and will be implemented   | The FSC has amended relevant regulations in December 2014 and implemented the amended regulations in step with international practices.   |

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|                                       | in 2018.  |  |
| Quantitative liquidity indicators     | Liquidity coverage ratio (LCR): BCBS issued the LCR requirements in January 2013, which finalize the methodology for LCR calculation and are implemented in 2015.             | The FSC and the Central Bank jointly promulgated the Standards Implementing the Liquidity Coverage Ratio of Banks in December 2014, which is implemented in step with international practices.   |
|                                       | Net stable funding ratio (NSFR): BSBC released the NSFR document in October 2014, which finalizes the methodology for NSFR calculation and will be implemented in 2018.       | The FSC and the Central bank jointly promulgated the Standards Implementing the Net stable funding ratio of Banks in December 2016, which is implemented in step with international practices.   |
| The third pillar                      | BCBS released the Revised Pillar 3 Disclosure Requirements in March 2017 and set the date of implementation at the end of 2017 and 2018 to step up banks' disclosure on RWA . | The FSC has amended the Regulations Governing the Disclosure of the Relevant Information Concerning the Capital Adequacy and Risk Management in January 2018 and implemented the amended regulations in line with international practices.   |
| Countercyclical capital buffer (CCyB) | BCBS released the CCyB guidance for the reference of regulators in setting their CCyB level in December 2010.   | <p>The Regulations Governing the Capital Adequacy and Capital Category of Banks contain provisions authorizing the implementation of CCyB. However CCyB has not been implemented in consideration of the following reasons:</p> <p>Taiwan has been increasing the amount of provision for bad debts by banks. For instance, the provision ratio for exposures in</p> |

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|  |   | <p>Mainland China and for real estate loan assets has been raised to 1.5%, which has the countercyclical buffer effect. Also it is questionable whether increased CCyB can be smoothly released to absorb loss when the credit cycle is reversed. Thus the FSC will evaluate the matter further and continue to watch the development in other countries at the present time.</p>   |
| Global systemically important banks (G-SIBs) | <ol style="list-style-type: none"> <li>1. FSB issued in November 2015 the total loss absorbing capacity (TLAC) standard for globally systemically important banks (G-SIBs) to measure whether those banks have sufficient capital buffer to absorb loss, thereby reducing the impact on financial stability. The standard will be implemented in 2019.</li> <li>2. BCBS released the TLAC holdings standard in October 2016, which will be implemented in 2019.</li> <li>3. Besides, BCBS released the framework for dealing with domestic systemically important banks in October 2012.</li> </ol> | <ol style="list-style-type: none"> <li>1. Taiwan has not have G-SIBs and hence needs not adopt the FSB rules. As for the finalized documents BCBS had released, the FSC will look into related matters and implement new requirements in step with international practices.</li> <li>2. The FSC has completed the framework to designate the D-SIBs in Taiwan, and its supervisory measures that has been stipulated in the “Regulation Governing the Capital Adequacy and Capital Category of Bank”. The FSC also designated CTBC bank, Cathay United Bank, Taipei Fubon Bank, Mega International Commercial Bank, and Taiwan Cooperative Bank on 2019.12.27 and First commercial bank on</li> </ol> |

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|   |   | 2020.12.31 as the D-SIBs in Taiwan.  |
| International Financial Reporting Standards (IFRSs) | The statements and interpretations issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC), collectively referred to as IFRSs, include IFRSs and IFRICs issued by IASB and IASs and SICs issued by IASC. | The FSC has amended the Regulations Governing the Preparation of Financial Reports by Public Banks in August 2011 and all public banks have been preparing their financial statements based on IFRSs since fiscal year 2013. |
|   | IASB issued IFRS9 Financial Instruments in July 2014, which took effect on 2018.1.1.  | The FSC has issued a press release in December 2016, which announced financial holding companies and banks should implement IFRS9 in 2018.   |
|   | IASB issued IFRS16 Leases in January 2016, which took effect on 2019.1.1.   | In line with the adoption of IFRS 16 in 2019, the FSC announced amendments to the Regulations Governing the Preparation of Financial Reports, which also took effect on 2019.1.1.  |