TAIWAN

BANKING

SUMMARY

As of 1997, 45 foreign banks were operating 71 branch offices in Taiwan. Although liberalization led to the establishment of 16 new banks in the 1990s, 13 state-owned banks still dominate Taiwan's banking sector. They account for more than 60 percent of assets and deposits of all deposit-taking institutions. Over the past four years, Taiwan has lifted most restrictions on entry as branches or as subsidiaries. Most restrictions on foreign banks' operations have also been removed although both domestic and foreign banks are subject to strict prudential requirements.

The deposit-taking sector is regulated by a number of agencies on a job-division basis. In principle, Taiwan's Central Bank of China (CBC) supervises bills finance companies, investment and trust companies, banks set up prior to 1990, and, with a few exceptions, foreign banks. The Ministry of Finance's (MOF) Bureau of Monetary Affairs (BMA) inspects banks established after 1990. The Central Deposit Insurance Corporation oversees all community financial institutions enrolled in the deposit insurance system.

At the end of 1997, 14 U.S. banks had 25 branches in Taiwan. They are allowed access to the market on the island either as subsidiaries or branches. However, none have entered as subsidiaries. These U.S. banks, generally focusing on wholesale banking, account for around 2 percent of deposits and loans. They are very active in the foreign exchange and credit card markets: one of them ranks among the top five in the bank-to-customer foreign exchange market and has a 14 percent share of the credit card market.

The financial crisis in East Asia has led to a drop in Taiwan's exports, resulting in a slowdown in the economy, a cash flow problem for some firms, and a consequent increase in the bank nonperforming loan ratio to about 4 percent. Nevertheless, both domestic and foreign banks have reported relatively good results. Before tax profits in the first quarter of 1998 more than doubled (over the same period in 1997) to NT$63 billion for domestic banks, and those for foreign banks shot up more than 50 percent to NT$3.89 billion. While domestic banks are expanding their operations, the picture for foreign banks is mixed; there is continued interest in expansion of retail banking but some foreign banks are reducing treasury operations as foreign exchange trading has become more restrictive.

DESCRIPTION OF THE MARKET

Structure of the Market

Taiwan has a relatively large financial sector. As of the end of 1997, a total of 471 financial institutions operated 5,696 deposit-taking offices throughout the island. On average, each office served 3,800 persons on the island. These financial institutions included 92 banks, 64 credit cooperative associations, 314 credit departments of farmers' and fishermen's associations, and one postal savings system.

There were also 23 non-deposit taking financial institutions operating 97 branches all over the island, including five investment and trust companies, four securities finance companies, and 14 bills finance companies.

Banks

The banking community is composed of 92 banks. There were 47 domestic banks at the end of 1997, slightly more than the 45 foreign banks. However, domestic banks operated 2,176 branches, far more than the 26 branches of foreign banks. Domestic banks accounted for 66 percent of total deposits and 84 percent of loans for the entire deposit-taking community, including community financial institutions. Foreign banks' share was only 2.4 percent of deposits, and 3.2 percent of loans.

Foreign bank presence in Taiwan has taken the form of either branch and representative offices. Foreign banks have not established subsidiary or joint venture banks, although Taiwan does not forbid such options. The number of foreign bank offices (branches and representative offices) in Taiwan increased from 82 at the end of 1994 to 101 at the end of March 1998. During this period, the number of foreign banks having branches in Taiwan rose from 37 to 46. The number of branches (i.e., head offices plus additional branches) of these foreign banks grew from 57 to 74. The number of representative offices climbed from 25 to 27.

Only banks are authorized to operate the full range of foreign exchange businesses, which is a strong point for foreign banks. Foreign banks also specialize in trade related financing. They occupy a market share of 28 percent in foreign exchange deposits, 30 percent in foreign exchange trading volume, and 43 percent in export Letters of Credit (L/C) notification.

The banking community is dominated by the public sector. At the end of 1997, only 13 of Taiwan's 47 domestic banks were owned or effectively controlled by government agencies. However, these 13 government-affiliated banks accounted for 61 percent of bank assets, 60 percent of bank deposits, and 63 percent of bank credit. The Bank of Taiwan (BOT), owned by the Taiwan Provincial Government (TPG), is the largest bank on the island. The BOT accounts for 11 percent of total deposits accepted by all domestic and foreign banks. It accounts for 10.9 percent of total loans extended by all domestic and foreign banks. No law or regulation grants preferential treatment. In addition to commercial banking services, CBC contracts with BOT to issue NT dollar notes.

A number of the banks owned by the authorities have been assigned special policy duties. The Cooperative Bank of Taiwan (CBT), also owned by the TPG, is the *de facto* central bank for community financial institutions. The CBT, Land Bank of Taiwan (LBT), owned by the TPG, and Farmers Bank of China (FBC), owned by MOF, provide services to the community financial institutions.

Export-Import Bank (EIB), like its counterparts in the United States and other developed nations, offers credits to promote trade. Trade credits offered by the EIB include medium and long-term loans and credit guarantees to finance exports of turnkey plants, capital goods, and technical services. It also offers overseas investment credit and export insurance. Unlike other banks, the EIB does not take deposits from its customers.

The Central Trust of China (CTC) is not only a bank but the largest insurance agency in Taiwan. It operates a civil service employee insurance program covering several hundreds of thousands of civil service employees. In addition, it is the major public sector foreign procurement agent.

Overseas Banking Network

Taiwan banks have been very aggressive in building overseas banking networks. Since 1994, the number of their overseas offices has expanded by 70 percent, from 69 units to 117 units by the end of 1997, including 21 subsidiaries, 60 branches, and 36 representative offices. This expansion has been most significant in Southeast Asia; Taiwan bank offices in ASEAN (the Association of Southeast Asian Nations) increased nearly fivefold, to 34 units at the end of 1997, compared with only seven units four years earlier. During the same period, Taiwan banks' offices in the United States rose from 21 to 25 units.

Community Financial Institutions

Taiwan has a very large number of small community financial institutions. At the end of 1997, they numbered 378. One out of every three deposit-taking offices (head and branch offices) is a community financial institution. However, they accounted for only 12 percent of total assets and 17 percent of deposits, and 12 percent of loans of the entire deposit-taking sector. Community financial institutions fall into two categories: credit cooperative associations and the credit departments of farmers' and fishermen's associations. In principle, they may take deposits from and extend loans to their members only. They are required to place mandatory deposit reserves with the Cooperative Bank of Taiwan (CBT). When they are in need of accommodations, they must go to the CBT, Farmers Bank, or Land Bank of Taiwan. They may not go to the other banks directly. No foreign membership is allowed in community banking institutions.

Postal Savings System (PSS)

The PSS is affiliated with the Directorate General of Posts, and operates the largest number of deposit-taking offices. Its 1,527 branches throughout Taiwan accept nearly 15 percent of deposits taken by all deposit-taking institutions. In principle, PSS only takes deposits, and may not offer any loans to its depositors. It is required to place its deposits with domestic and foreign banks.

Merger and Transformation

In 1988, Taiwan lifted a ban on establishment of new banks. As a result, 15 new banks were established in 1990 and 1991. The Taiwan authorities have also adopted a policy to encourage investment and trust companies, and credit cooperative associations (CCAs) to merge or transform into banks. A series of bank runs at community financial institutions in 1995 accelerated this process of merger and transformation. Over the past six years, two out of eight investment and trust companies have been reorganized into commercial banks, while another has merged with an existing bank. The remaining five trust and investment companies are planning to reorganize into commercial banks. Since January 1997, five CCAs have been reformed into commercial banks and another five merged with commercial banks. As a result, the number of CCAs has fallen from 74 in 1994 to 64 in 1997.

Prudential Requirements

Taiwan's authorities have established prudential requirements for banks. Ownership may exceed neither 5 percent for each shareholder nor 15 percent per shareholder plus relatives and corporate entities under their control. Banks are forbidden from offering unsecured loans to shareholders controlling more than 3 percent ownership or bank executives. In addition to other prudential requirements, banks must meet the Bank for International Settlements (BIS) capital adequacy requirement that capital must exceed 8 percent of risk-weighted assets.

ATMs and Credit Cards

Automatic teller machine (ATM) services are common in Taiwan. From 1994 to 1997, the number of ATMs increased 74 percent, to 11,606 units. ATM cards in circulation doubled to 32.6 million, close to one and a half ATM cards for every person on the island. During this four-year period, transactions via ATM cards more than doubled, reaching US$148 billion.

Credit card business also expanded substantially between 1994 and 1997. There were 7.8 million credit cards in circulation at the end of 1997, a nearly threefold rise over four years ago. In the four-year period, expenditure with credit cards also increased almost threefold, to US$11.5 billion. Domestic and foreign banks can set up and operate their own ATMs and ATM networks. There are no restrictions on the number of ATMs set up by either a domestic or foreign bank. Credit card issuing institutions may process credit card bills by themselves. They may join the bill processing systems of the National Credit Card Center or the Financial Information Center. Credit cards issued by U.S. banks account for 17.5 percent of total credit cards in circulation. Most large U.S. banks in Taiwan have set up their own processing centers.

Foreign Exchange Trading

Taiwan has a relatively free foreign exchange market. Banks both domestic and foreign are all authorized to do foreign exchange business. They set their own buying and selling exchange rates. They may offer and trade in most financial derivatives, including forwards, swaps and options. Banks are required to obtain prior approval from the CBC before introducing new financial products to the market. Banks which intend to introduce products already present in the market need not obtain prior approval, but they must report them to the CBC for purpose of records. The size of the foreign exchange market has expanded substantially, and the trading volume totaled US$4.9 billion in December 1997, doubling its level of four years earlier. This total includes US$2.1 billion traded in the bank-customer market and US$2.8 billion at the interbank market.

Both foreign and domestic banks are subject to overbought and oversold positions which are set by the banks themselves and which must be reported to the CBC for the record. Trading in NT dollar-related derivatives may not exceed one-third of the position. Domestic and foreign banks may introduce new financial derivatives after prior approval is obtained from the CBC. Both domestic and foreign banks may introduce financial derivatives which already been approved by the CBC, although these banks must report the products introduction for the record.

To stabilize the foreign exchange market, due to the financial crisis in East Asia, the CBC partially closed the non-deliverable forward (NDF) market to domestic corporate entities in May of 1998. While the NDF market is still open to foreign institutional investors, the volume of trading has fallen dramatically. The CBC also has prohibited domestic and foreign banks from introducing new financial derivatives syndicated from two or more NT dollar related products. In addition, the CBC has stepped up monitoring over foreign exchange (FX) transactions and since July has required banks to instantly report by phone to the CBC any FX transaction exceeding US$5 million. Then, in mid-August, the CBC required an instant phone report for any FX transaction exceeding NT$1 million.

Offshore Banking Units (OBU)

A total of 72 OBUs were operating in Taiwan at the end of 1997, including 38 set up by domestic banks and 34 established by foreign banks. Their assets totaled US$39 billion at the end of 1997, up 46 percent from four years ago level.

The present requirement for foreign banks to set up an OBU is that they be among the top 500 worldwide in terms of assets. The CBC is considering further lowering the ranking criterion because no foreign bank without a commercial presence in Taiwan has ever set up an OBU. Treatment for foreign banks' OBUs is identical to that for domestic banks' OBUs. No restrictions are imposed on cross border activities of foreign and domestic banks' OBUs.

Regulatory Structure

In addition to internal controls, financial institutions are subject to regular and irregular examination. Authorities charged with banking examination include the Bank Examination Department (BED) under the CBC, the BMA under MOF, and the Central Deposit Insurance Corporation (CDIC). Supervisory responsibilities are shared among the three agencies as follows: BED supervises domestic banks (except the Changhwa Commercial Bank (CCB) and 16 new banks established after 1990, non-Asian foreign banks, bills finance companies (a company authorized to underwrite and issue commercial paper) and investment and trust companies (except Taiwan Development and Trust Corp. (TDTC) and China Development Corp. (CDC)) and business banks which do not participate in the deposit insurance program (except the Business Bank of Taiwan (BBT)). BMA oversees CCB, TDTC, CDC, BBT, the 16 post-1990 banks, and foreign banks from Asia. CDIC monitors credit cooperative associations, credit departments of farmers' and fishermen's associations, investment and trust companies, and business banks participating in the deposit insurance program. Taiwan sets no foreign ownership limit on bills finance companies. No foreign banks have ownership in such companies because banks are already permitted to do bills finance business, including issuing guarantees for commercial paper.

There are no restrictions on interest rates that banks can charge. A voluntary deposit insurance system covers 64 percent of foreign banks, 83 percent of domestic banks, and 88 percent of community financial institutions. The system guarantees up to NT$1 million per depositor.

Taiwan enacted the Money Laundering Prevention Law in April of 1997. The Ministry of Finance requires all financial institutions (including banks, trust and investment companies, postal savings system, insurance firms and jewelry stores) to report transactions (including deposits and withdrawals) of a person exceeding NT$1.5 million in a day to the Money Laundering Prevention Center. Banks and required institutions will be penalized for failure to record and report transactions suspected of money laundering.

U.S. PRESENCE IN THE MARKET

Fourteen U.S. banks operate 25 branch offices in Taiwan, an increase from 11 banks and 19 branches in 1994. They account for only 2.3 percent of bank deposits and 2 percent of bank loans. Most of them concentrate on wholesale banking. Although they account for only 3 percent of export letter of credit (L/C) loans and open only 6 percent of import L/Cs, these U.S. banks handle nearly one-fourth of the export L/C notification market. Since 1994, the number of U.S. representative offices declined from seven to three.

U.S. banks have been very active in the credit card business and foreign exchange trading, especially in the interbank market. Although it only operates nine offices around the island, Citibank is the largest foreign bank in Taiwan, and ranks among the top five in the bank-to-customer foreign exchange market; the other four are local banks. In addition, Citibank accounts for 14 percent of the credit card market here. It is one of a few foreign banks to achieve success in retail banking in Taiwan.

TREATMENT OF U.S. FINANCIAL INSTITUTIONS

Taiwan has substantially liberalized the banking sector in the past four years. It has lifted a ban on foreign investment in local banks. Both domestic and foreign investors are subject to identical ownership limits, i.e., 5 percent per shareholder and 15 percent for all related groups. Establishment of Taiwan branches is no longer limited to the 500 largest banks in the world, if the bank's business transactions with Taiwan banks and enterprises have been large. A two-year waiting period requirement before establishment of additional branches has been dropped, as has a geographical restriction (under which foreign bank branches were limited to Taipei and Kaohsiung) and an annual quota for new branches (under which only three branches of foreign banks could be established a year). Also, the rule that foreigners may not exceed 10 percent of the entire staff of a bank office has been abolished.

The limit of 15 times local capital on a foreign bank's NT dollar deposits has been removed. Taiwan's authorities no longer forbid domestic and foreign banks from offering NT dollar credits secured by foreign exchange deposits as collateral. The authorities do not require all bank credits to be secured by collateral. Banks may, based on their best judgement, offer unsecured credit. Foreign currency credit is no longer limited to finance trade-related transactions. A restriction that commercial paper guaranteed by a foreign bank branch could not exceed ten times the bank's net worth has been lifted. These guarantees may be offered for commercial paper issued by individual persons. In addition, both domestic and foreign banks are permitted to underwrite and certify issuance of commercial paper.

In order to engage in certain transactions (e.g., perfecting a mortgage), Taiwan requires that a bank provide proof that the same privilege is available on a reciprocal basis to Taiwan institutions in the home jurisdiction of the foreign bank.

Taiwan's Ministry of the Interior (MOI) requires a foreign bank to produce a "certificate of reciprocity" issued by the government of its home country (or state in the United States) for its mortgage registration. Without such a certificate or statement, foreign banks are not permitted to process mortgage registrations at the land administration office. According to MOI, the requirement is based on the "Land Law" and the "Regulations Governing Acquisition of Land Rights by Foreigners." According to the MOI, 13 states have reciprocity arrangements with Taiwan, as follows: Ohio, Alaska, Tennessee, Florida, Massachusetts, New Jersey, Connecticut, Missouri, Delaware, California, Hawaii, Texas, Michigan and New York. For some U.S. banks with state charters, it has been difficult to obtain acceptable documentation of reciprocity.

In foreign exchange trading, the CBC has authorized banks to set their own overbought and oversold positions for internal control; the positions must be reported to CBC for record. CBC has replaced the foreign liability limit for a domestic and foreign bank with the foreign liability reserve requirement which CBC has not yet set. Capital funds borrowed from foreign sources are foreign liability, just like deposits which are a kind of on-shore liability. According to the CBC, a domestic and foreign bank must keep a required reserve for foreign liability, just like the required reserve that a bank must keep for deposits taken from customers. A domestic or foreign bank may introduce financial derivatives which have already been approved by CBC, although the bank must report the products' introduction to the CBC for record. The coverage of forward foreign exchange contracts has been expanded from a limited category of transactions to include all kinds of transactions which could be supported by documents.

Different standards are used to calculate the limits on lending to a single customer for domestic and foreign banks, but they generally favor foreign banks. For a foreign bank, total NT dollar loans for a single customer (a natural person or a corporate entity) may not exceed 10 percent of the bank's total lending portfolio or NT$1 billion, whichever is higher. For foreign banks, total foreign currency loans to a single customer may not exceed 25 percent of the net worth of the foreign bank's consolidated operations in Taiwan. So far, the lending of U.S. banks has not reached the ceiling, but the limits may become a constraint in the future as the scale of business of U.S. firms expands. For domestic banks, the limit on NT dollar loans is 3 percent of net worth for individuals and 15 percent of net worth for juridical persons (i.e., corporate entities). Loans with a term of over one year may not exceed the total fixed-term deposits of a bank, and residential construction loan exposure may not exceed 20 percent of savings deposits.

Foreign banks face difficulties in matching NT dollar loan and deposit maturities, due to the relatively underdeveloped interbank market, and the lack of longer-term debt instruments in the market. As Taiwan presses ahead with major infrastructure projects, such as independent power plants or the high speed rail project, which are have been or will be financed by medium and long term funds administered by the Council for Economic Planning and Development (CEPD), foreign banks have been effectively prevented from acting as arranger for loan facilities for these projects. CBC and CEPD insist that any arranger for these project loans using CEPD funds must meet onshore minimum net worth and total asset amount requirements (NT$20 billion and NT$100 billion, respectively), irrespective of the institution's global net worth or total assets. Although in principle exceptions to these criteria can be granted after special review by CEPD, the policy has imposed constraints on U.S. banks' ability to actively participate in the project financing market in Taiwan.

Taiwan's Financial System
December 31, 1997

Institution	Number of Firms	Domestic Branches	Assets (US$ millions)	Percent of Deposits
Domestic Banks	47	2,176	514,622	66.1
Foreign Banks	45	26	37,274	2.4
of which U.S. Banks	*14*	*10*	*15,288*	*1.4*
Credit Cooperatives	64	505	40,886	8
Credit Departments of Framers' & Fishermen's Associations	314	991	45,572	8.7
Postal Savings System	1	1,527	78,403	14.9
Investment & Trust Companies	5	61	14,434	n/a
Securities Finance Companies	4	2	7,781	n/a
Bills Finance Companies	14	34	50,967	n/a