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TAIWAN ACADEMY OF BANKING AND FINANCE

Research on Financial Industry Development Strategy Action Plan of Taiwan in 2018

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December 2018

Abstract

Vice President of the Executive Yuan at the time Shih Jun-ji and Chairman of the Taiwan Financial Services Roundtable (TFSR) Ren Nei proposed a strategy for development of the financial industry based on three core values: growth, employment, and distribution of benefits. Each year since 2011, TFSR has entrusted TABF to compile a Financial Recommendations White Paper, which has earned wide recognition from industry, government, and academia, helping implement the Taiwan Action Plan for Financial Industry Development. In 2018, TABF's research focused on three issues: fintech, compliance, and project financing. With research experience in areas including financial regulation, it will help advise the Financial Securities Commission (FSC). These efforts to improve the competitiveness of the financial industry, develop financial services, activate the real economy, and promote public welfare are in line with its founding purposes and public role.

Findings

1. Action Plan for Financial Industry Development

This case mainly involves the 11 financial regulation and strategic financial development tasks proposed by the FSC in 2018. It complements TABF's 2018 research focus in three main areas: fintech, compliance, and project financing. It examines issues related to Taiwan's financial environment and draws relevant policy conclusions. Furthermore, with reference to the strategic financial industry development framework proposed by Vice President of the Executive Yuan Shih Jun-ji and TFSR Chairman Ren Nei, it takes growth, employment, and allocation as its three core values. These core values are accompanied by three major development strategies: finance-driven industry growth, finance-driven wage increases, and financial inclusion. Four main policy directions are further introduced: a more competitive financial industry, a new order in the financial market, corporate social responsibility (CSR), and fairness and justice for consumers.

Reference is made to the US, Hong Kong, and Singapore financial industry development blueprints. For example, in order to consolidate Singapore's status as a financial hub, its Financial Services Transformation Blueprint proposed a development vision to "build up Singapore as an Asian financial center linking global markets, supporting Asian development, and supporting the Singapore economy." This paper has defined four major strategies for the domestic financial industry to implement the three major directions (commercial strategy, technological innovation, and employment): international, financing, society, and consumers. In accordance with the priorities of financial regulators, it develops detailed strategies, targets, and specific action plans to improve the competitiveness of the industry. Subsequently, it describes the impact of important issues on the overall industry, and proposes TABF's responses or solutions to regulators, and finally summarizes and gives views on future strategic development.

2. Sources for the Financial Industry Vision

This study summarizes the financial development plans in Singapore, US, and Hong Kong and creates four strategic strategies to in accordance to the core targets, strategies, and directions: national/international finance, domestic finance for finance, finance for society, and finance for consumers. The sources of the vision for each strategy are as follows. A. National/international finance: (1) Internationalizing the market; (2) Digitizing financial services; (3) Developing an Asian wealth management center; and (4)

Developing capital markets. B. Domestic finance for finance: (1) Diversifying financial business opportunities; and (2) Improving compliance. C. Finance for society: (1) More infrastructure participation; (2) Environmental protection through green financing; and (3) Employee welfare and cultivation. D. Finance for consumers: (1) Better consumer protection; and (2) Innovative open banking cooperation.

The Financial Development White Paper of the FSC and the Finance Development Action Plan of the Executive Yuan are also considered. The former is the FSC's views on the finance industry (including banks, securities, and insurance) for government consideration, implemented in specific policies. Most of its recommendations are measures for the government to relax controls. The vision of the latter is cooperation with industry, combination with technological innovation, entering international markets, financial inclusion, and specific targets and strategies for banks, securities, futures, insurance, and fintech.

In accordance with the above strategies, this study is divided into four strategies: a more competitive financial industry, a new order in the financial market, CSR, and fairness and justice for consumers. The four accompanying policy directions are national/international finance, domestic finance for finance, finance for society, and finance for consumers. In accordance with the priorities of the administration, detailed strategies, targets, and action plans are developed to improve the competitiveness of the financial industry. No divisions are made by industry subsector; rather the targets, strategies, and tactics are planned on a comprehensive basis based on the priorities of regulators.

Results

1. A More Competitive Financial Industry

(A) Expanding business in international financial markets, and adding overseas bases

Due to their high growth rate, increasing middle class incomes, demographic dividend of over 50% working-age population, and youth consumption, emerging Asian countries (including ASEAN and India) have recently become investment focus points for the whole world, including Taiwan. These countries hold great opportunities, and are key areas for Taiwan's New Southbound Policy. Future sustainable focus points will include infrastructure investment, high net worth customers, personal finance for the middle class, corporate transformation investment financing, consulting for listing in Taiwan, and fintech. It is however important to understand the associated country and financial risks.

Taiwan's financial industry may measure the synergistic effect of its overseas deployment from the perspective of financial holding companies taking advantage of diverse opportunities in Asian countries. Taiwanese banks and financial intuitions will not become regional Asian financial institutions overnight. Each one must carefully consider its strategic orientation and learning objectives based on its current conditions and strengths. To become regional banks, they cannot rely solely upon their own power. Authorities also need to appropriate support and assist the industry in order to create an environment suitable for regional financial institutions so that banks can find niche overseas customers and services.

Recommendations:

- The FSC should sign Memoranda of Financial Supervision Cooperation with regulators in other countries to strengthen bilateral relations by sharing financial information and cooperating on regulation, and should further strengthen bilateral relations through informal official meetings like the Asian Supervisors' Annual Meeting and the annual meeting of the Asian-Pacific Association of Banking Institutes (APABI), helping financial companies from both sides expand their investment opportunities.
- Most Southeast Asian countries have financial access policies allowing foreign banks to introduce new technology or capital to help local financial markets. Therefore, banks should strengthen their project financing for solar power, offshore wind, and other renewable energies to help smoothen their entry into foreign markets.

(B) Diversifying Financial Products

The FSC aims to turn Taiwan into a regional Asian wealth management center. The first step to do so is to manage the needs to domestic savers. A total of NT$ 4.28 trillion is currently managed by domestic trusts, which the FSC hopes to increase to NT$ 5 trillion, so that they at least grow faster than overseas funds. It hopes to use various supporting facilities to help domestic trust companies strengthen their product development and trading skills. Even if they still must invest in overseas funds, the funds can still be planned domestically before going to overseas asset management companies. At the very least, they must train domestic staff more in investment, fund product design, and risk control, and should raise salaries and retain staff after becoming profitable. As of the end of August, 2018, Taiwan overall banking sector had NT$ 39.9 trillion in deposits and NT$ 29.9 in loans, with NT$ 10 trillion in idle funds.

Hong Kong and Singapore are both international financial centers. Aside from serving as financial intermediaries, providing loans, and supporting the economy and industrial development, the asset management by their banks play a key role in their national development. Taiwan is less internationalized than these places. Apart from its insufficient linkage with international capital and business, there is also room to strengthen financial product diversification and asset management skills. Taiwan has several advantages to develop regional wealth management centers in Asia, including abundant excess savings, good public education, large demand for pensions in an aging society, and rising public awareness of wealth management. It should develop products linked to international securities, diversify products geographically, and encourage fintech to increase willingness to invest.

Recommendations:

- The FSC should call together relevant departments and companies to deliberate on financial product development in major international financial centers. It should plan to introduce a range of products covering financial and wealth management, equities, bonds, insurance, foreign exchange, and financial derivatives.
- Further complete internationalization of spot commodities to provide a wide range of amplification, hedging, arbitrage, spread, and rate differential strategies, encouraging the development of different ETF types so that investors can diversify through a single investment.

(C) Establishing suitable listing standards for specific key industries and developing niche capital markets

Competition between major stock exchanges is an inevitable part of globalization. Hong Kong has also reduced profitability requirements and provided exemptions for its biotech listings. Institutions must consistently respond to new industry developments, fields, and characteristics. Although Taiwan's biotech companies are small, they have deep R&D capability. The government also incentivizes biotech companies to enter Taiwan's capital markets by exempting them from profitability requirements; furthermore, Taiwan's over-the-counter listing system is rigorous, and it has many years of experience promoting capital market entry by biotechs. The sector has made full use of this market, reflecting Taiwan's advantages in capital markets over Hong Kong.

Moreover, in the case of the over-the-counter market, a task force has been set up for the biotech industry to improve the efficiency of reviews, assist in fundraising, and improve corporate governance. The market has now cancelled the pre-review process for new listings, and rejected applications are mainly due to major doubts about the stability of a company's finances, overly frequent transactions with related parties, financial independence, trademark infringement risks in major sales regions, and the reasonableness of related party transactions. In the future, further review may be implemented with reference to the development needs of the capital market.

Recommendations:

- Establish regulations and systems that are in line with international standards, so that when a company meets the requirements, it is internationally competitive, and can still list even if still unprofitable.
- The FSC can gather regulators for certain activities to discuss key industries, review and determine whether products and technologies are successful and market-oriented using a review committee, and conduct special-purpose audits on projects to establish suitable listing standards.

2. Establish a New Order in the Financial Market

(A) Build bridges between finance and the 5+2 industries

The government is promoting innovation in the "Asian Silicon Valley," "Smart Machinery," "Green Energy," "Biotech," "Defense," "New Agriculture," and "Circular Economy" as the core force driving Taiwan's next-generation industry growth. It can consider how to turn the 5+2 industries into important niches, using the abundant funds in the country's financial system to establish a bridge for communication and dialog between these industries and financial institutions. The resulting blueprint can achieve the important objective of financial industry development.

In order to encourage banks to form long-term partnerships with these key industries, the Banking Bureau of the FSC is assisting new companies to obtain working capital, and has formulated the Program to Reward Lending by Domestic Banks to New Enterprises in Key Industries. Codes were set up for these key industries to calculate lending amounts. As of the end of November 2018, domestic banks had lent NT$ 5.09 trillion to these industries, but many of the recipients may have originally been large corporations that had been in contact with the banks for a long time. SMEs and startups, however, which face urgent fund needs and have potential for development, still face difficulties.

Recommendations:

- The Executive Yuan should create 5+2-related promotion departments to guide the development of each industry and select model companies with good development potential from among them to create bridges for communication and dialogue with financial institutions, thereby supporting both sides to cooperatively explore outstanding new ventures.
- With reference to policies in countries like Germany and Japan for financial institutions to support industry, targeted financing solutions should be proposed for the 5+2 industries to strengthen tracking of actual fund use, flows, and benefits, to make sure that recipients are using the funds for their designated purposes.

(B) Set differentiated development targets for financial institutions

Looking at the overall situation of financial institutions regulated as banks, the classification mainly reflects the type of bank (domestic, foreign, or policy), credit cooperative, or coupon. For grading, regulators look at how different institutions such as banks (holding companies and domestic and foreign banks), credit cooperatives, and coupon companies based on certain conditions. These conditions may be based on financial or risk metrics such asset, capital, non-performing asset ratio, or bad debt coverage. Modern banking has become quite diversified. In addition to working capital for trade, it has also expanded into businesses such as real estate financing, financial transactions, and commodity consulting. Banks need space to grow, but the impact of this development on the sector's risk level is not uniform. Therefore, the past consistent regulatory approach for all banks must be adjusted, so banks should set appropriate development objectives according to their category and level.

Recommendations:

- Regulators should explore the business development priorities of different bank types and levels. Specialized banks should be encouraged to develop niches, and banks should be encouraged to plan appropriate global and domestic business development priorities based on their size.
- The FSC's current grading method seems to prefer financial and risk-based indicators. It can try exploring which what other indicators are suitable for inclusion based on international experience.

(C) Pay attention to internal and external whistleblower protection mechanisms

In recent years, the rights of the public have been threatened in important industries such as manufacturing, food safety, and finance. Related cases have included excessive discharge of wastewater, improper food production or ingredients, and related-party transactions, which infringed shareholders' rights. Whistleblower systems must urgently coordinate with other systems to provide early warning for such incidents and prevent further harm to the public. The main international whistleblower protection laws are the US Whistleblower Protection Act of 1989, after whose passage various countries such as the UK, Australia, Japan, Canada, India, South Africa, Ireland, and New Zealand began to enact laws to provide whistleblowers with channels to disclose illegal or inappropriate activities by their organizations.

Recommendations:

- In order to implement the objectives of the Whistleblower Protection Act, aside from administrative and judicial relief mechanisms and identity protection measures, a certain percentage of the resulting award can be set aside as an award to be used as reference for regulators so that whistleblowers are not subject to exclusion or unreasonable treatment.

3. CSR in the Financial Industry

(A) Increase financial incentives for investment in long-term care

In December 2017, the FSC revised and released the Regulations Governing the Use of Insurer's funds in Special Projects, Public Utilities and Social Welfare Enterprises, adding long-term care service institutions to the list of project application and public and social welfare investment targets. The revisions to these Regulations are in response to the Regulations on Long-term Care Institutions, which came into effect in January 2018. In these revisions, in response to the long-term care agency nonprofit regulations, formulated in January 2018, insurers investing less than 45% of the investee's paid-in capital and whose risk-based capital (RBC) meets certain conditions can in principle apply for approval from the FSC to invest in nonprofits. Although the amendment to the Insurance Law eliminates the past difficulties for the supervisor role, Articles 33 and 36 of the Regulations on Long-term Care Institutions prohibit the chairman from being appointed to the board of directors and limit distribution of earnings, which may affect insurers' willingness to invest.

It should be noted that from the perspective of minimum rate of return, the insurance industry's returns for real estate investments must not be lower than China Post's two-year savings fund small deposit rate plus 1.5% (currently 2.345%). However, the long-term care business involves public social welfare. If the operator needs to rent real estate, it can expect limited rent payment capacity, making it difficult for it to reach the minimum profit rate limit at the early stage. This situation is the same as encouraging insurance industry investment in public construction, promoting development of the private economy and reducing financial pressure from the government. Therefore, in order to provide a reasonable premium for private institutions bearing investment risks, it is necessary to establish corresponding incentive mechanisms to rationalize project revenue and increase willingness to invest.

Recommendations:

- The FSC should amend the reasonable rate of return in the Criteria and Treatment Principles for Insurance Industry Investments in Utilized and Income-Earning Real Estate, dividing real estate investment into two categories: social public welfare (including public construction) and non-social public welfare (general real estate). The minimum yield requirement of the former should be less.

(B) Develop new green energy financing instruments and insurance products

Financing problems for the green energy industry include a lack of capital and difficulties in credit collateral valuation and risk control. Observing the main international financing and investment channels for renewable energy, including government funds, project financing, green bonds, capital market instruments, and insurance. The recent development of green bonds has not only been widely discussed in the international financial market, but as an important bridge between the capita market and the green economy, they are also growing rapidly in issuance scale. After referring to the GBP and CBS international green bonds standards, in April 2017, Taiwan issued the Green Bond Principles to establish a domestic Green Bond Qualification System. As of July 2018, domestic banks, branches of foreign banks in Taiwan, and state-owned businesses had issued a total of 18 green bonds, used for expenditures and lending by green projects.

In addition, green liability insurance is used for companies that may pollute the environment. It includes assisting companies and agriculture to manage climate change, incorporating trip mileage into vehicle premiums, environmentally-friendly materials for reconstruction or restoration, renewable energy, and insurance related to carbon trading. Although Taiwan has developed green insurance, it is mostly limited to the green nature of the insured object. Properly controlling risks and fully understanding the characteristics of the renewable energy industry will help the financial industry grow past its previous focus on resources to support the green industry and help the green energy industry grow. Promoting a sound green financial system, including green bonds, insurance, securitized commodities, and relevant human resources, is therefore recommended.

Recommendations:

- The FSC should encourage the securities industry to raise and issue domestic green index funds (including ETFs), and to work with the Environmental Protection Administration's overall greenhouse gas emission plan to develop derivatives such as carbon futures and options.
- The FSC should encourage the property insurance industry to develop renewable energy (wind or solar) or insurance products related to environmental technologies and climate change.

(C) Increase the salary structure flexibility of workers and plan to retain talent

In October 2017, the FSC reported to the Finance Committee of the Executive Yuan that it would promote a development strategy of five financial industries. One of its items is to incorporate CSR into the industry, and it encourages listed financial institutions to increase their salaries or to use some dividends to increase salaries. Recently, the Ministry of Finance agreed to decouple the salary structures and increase mechanisms of its subsidiary financial institutions, including Bank of Taiwan, Land Bank of Taiwan, and Export-Import Bank from those of public servants to improve flexibility. The draft amendment to the Company Law passed the third reading recently by the Legislative Yuan gives profitable companies flexibility in mechanisms to retain talent. The foreign practice is to allow companies to stipulate employee treasury shares and equity in the articles of association, extending the scope of equity holdings for employees of holding or subordinate companies who meet certain conditions. It even adds a provision stipulating that non-public issuers may issue new shares specifically for employees.

In terms of responsibilities towards employees, in addition to regularly assessing market salary standards to strengthen remuneration strategies, the FSC also aims to strengthen the salary structure disclosure by financial institutions. Therefore, the in July 2018, the FSC announced that by the end of June 2019, listed companies would fully disclose their salary expenditures and average salaries of full-time non-management staff. Starting in 2020, they would also add median employee information. In fact, by strengthening disclosure of internal information, corporations are encouraged to reasonably adjust their salaries and establish internal salary adjustment mechanisms. The amendments to the Company Law also expanded the objects of employee remuneration and improved the use of employee remuneration mechanisms, which not only helps companies retain top talent and improve their competitiveness, but also fulfills their CSR responsibilities.

Recommendations:

- Financial institutions (including banks, securities companies, and insurers) should set long-term incentives. In addition to the current compensation in cash, they can also study stock compensation for ordinary employees, and use the employee stock ownership system match share purchases up to a certain amount, uniting employees' efforts to cultivate human resources.

4. Fairer Compensation

(A) Build a third-party fintech consumer information consulting platform

The Financial Ombudsman Institution announced the case types in the third quarter of 2018, dominated by "disputes over violation of financial product conditions or risk statements" for banks, and "margin calls" for securities. The insurance industry is divided into life and property insurance segments. Life insurance cases are mainly "surgical identification," while non-claims cases are "business solicitation disputes"; property insurance is mainly "claim amount determination," while non-claims cases are "not following service specifications." The FSC will launch an assessment mechanism and, its internal Consumer Protection Steering Committee Report has passed the "Fair Treatment Principles Rating Mechanism for Financial Institutions." It is expected to submit the report for finalization following communication with financial institutions at the end of December 2018.

Furthermore, the Financial Consumer Appraisal Center established through the Financial Consumer Protection Law (FCPL) acts as an impartial third party to help effectively resolve financial disputes and protect consumer rights. As financial technology changes by the day, however, financial products and services will be updated in ways that may be unfamiliar to consumers, therefore the FCPL must be amended in response to fintech development. Regulators should consider the balance between business development and supervision, and periodically assess whether the financial industry is protecting consumers. A third-party fintech consumer information advice platform should be able to enhance consumer protection.

Recommendations:

- The FSC should lead establishment of a corporation to serve as a third-party fintech consumer information advice platform. Implementation of the Fair Treatment Principles Rating Mechanism for Financial Institutions and inclusion of fintech projects will reduce the occurrence of financial disputes and implement consumer protection systems to promote the sound development of financial markets.

(B) Build an API to Link Third Parties with Banks

In order to promote cross-border competition and financial innovation, in 2016, the EU passed the Payment Service Directive 2 (PSD2), requiring banks, starting January 13, 2018, with user permission, to use Application Programming Interfaces (API) to allow third parties to access consumer data systems, retrieve account information, and pay individuals and merchants. APIs also allow each bank account of a consumer to be securely integrated. Advanced countries including the US, UK, Australia, Singapore, Japan, and Korea are now working on developing APIs and planning their own financial data sharing plans (i.e. open banking).

The Monetary Authority of Singapore (MAS) has established a Financial Industry API Register to promote data sharing between financial institutions. The center has 134 APIs in 6 categories. Citibank, OCBC, and Standard Chartered are three of its main data sharing banks. This platform has helped change the relationship between fintech startups and banks from competition to cooperation, which together constitute a symbiotic financial ecosystem, bringing more innovation, and creating good partnerships and ecosystems. On July 18, 2018, the Hong Kong Monetary Authority (HKMA) announced the Open API Framework, and on July 23 the first batch of 50 APIs were launched on its website, including data such as exchange and interest rates, banking systems, data on foreign exchange funds, press releases, and cash register schedules.

Recommendations:

- Several domestic banks have tried using open APIs to accelerate innovation and increase competitiveness, so there are apparently sufficient market incentives. Consider emulating MAS to encourage financial institutions to use APIs to strengthen relations between institutions, in areas including information on finances (such as account details, credit card limits, and loans), credit (such as vehicle loans and mortgages), loyalty and rewards (such as reward points management), non-financial information (such as consumer profiles and account overviews and integration), transactions (such as credit card authentication, instant refunds and clearing, and remittance certification), location (such as proximity services), and products (such as terms of use).

- Open financial data is closely tied into consumer interest and privacy risks. We can refer to Hong Kong's approach, promoting open banking and open APIs in stages, and clarifying regulatory compliance requirements for information security, consumer privacy, transaction security, and how banks should manage cooperation with third parties, promoting cross-industry cooperation and promoting innovative energy, bringing consumers more convenient and friendly services and experiences, and gradually building a fintech ecosystem, and even gradually promoting open data to other, non-financial areas.