

Overcoming Crisis and the Role of Deposit Insurance

Chin-Tsair Tsay October 24 ,2003

Distinguished Guests, Ladies and Gentlemen:

I consider it a great honor to have this opportunity to speak on the role played by the Central Deposit Insurance Corporation (CDIC) in handling financial crises in Taiwan. My report today is divided into four parts. I shall first introduce Taiwan's economic and financial situation. Next, I will discuss the financial problems that Taiwan is currently facing. Then I will speak on how Taiwan is handling systemic financial crises. Finally, I shall share with you what the CDIC has learned from its experiences of handling financial crises.

1. Taiwan's Economic and Financial Conditions

Before I introduce Taiwan's economic and financial conditions, I shall first use a slide to help you gain a basic understanding of Taiwan. Taiwan is an island located in the East Asian region in the Western Pacific. Its neighbors include the Philippines (to the south), China (to the west), and Okinawa, Japan, and Korea (to the north). It has strong economic ties with all of them. Taiwan's population is currently around 23 million and it covers a land area of some 36,000 square kilometers.

During the past few decades, the Taiwan government has placed a strong emphasis on the development of international trade.

Because of its hard-working people, Taiwan has become famous for its achievements in creating an “economic miracle.” It not only sustained a very high economic growth rate over a long period of time, but also consistently registered surpluses on its external trade and current accounts. For a time, it also had the highest foreign exchange reserves in the world. At present, its foreign exchange reserves amount to 190 billion US dollars, the third highest in the world. Taiwan’s average GDP growth rate over the last ten years has been 6.3 percent, and its unemployment rate 2.8 percent. Prices have remained stable, and the consumer price index has on average increased by about 1.8 percent each year. Taiwan’s overall economic fundamentals have remained remarkably stable.

As for Taiwan’s financial situation, before 1990, the banking system consisted mostly of government-owned banks. There were only a few private-sector banks that had been set up a long time previously. Because the government maintained very strict financial supervision, financial institutions adopted very conservative lending policies. As a result, there were very few instances of bad debts. When financial institutions failed, the government usually encouraged the large government-owned banks to take them over or else manage them until they got back on track.

Because of Taiwan’s persistent trade surpluses, the Central

Bank's foreign exchange reserves rapidly accumulated. Over the five-year period from 1984 to 1989, for instance, Taiwan's foreign exchange reserves drastically increased from a little over US\$10 billion to US\$80 billion. This resulted in the financial system being awash with funds. In order to upgrade quality of financial services and encourage financial innovation, calls for financial liberalization and internationalization as well as increase of market opening became louder every day. For this reason, in 1990, the government allowed 16 new private banks to commence operations at a time, even before it could ensure the soundness of financial supervision, strengthen financial discipline and privatize its government-owned banks. However, because the size of the market did not increase, and there was little financial innovation and relatively few new financial products, competition within the banking sector became increasingly fierce. It was in these circumstances that the seeds of financial instability were sown. The financial institutions most seriously affected were the community financial institutions, and so now I would like to turn my attention toward these.

2. The Financial Problems Facing Taiwan

(1) The Operating Crises of Community Financial Institutions

Taiwan's community financial institutions, namely, the credit cooperative associations and credit departments of farmers' and

fishermen's associations, have small scales of operations, their financial structures are fragile, and they lack sufficient specialized personnel. Confronted with fierce competition from the new private banks, they started to face operating crises in 1995. In addition, following the devastating September 21, 1999 earthquake in Taiwan and tumbling real estate prices, community financial institutions later suffered even greater losses from their operations. Furthermore, there was no suitable mechanism to help problem community financial institutions to be absorbed by healthy banks and withdraw from the market. The government's failure to resolve such a problem could well have led to a major financial crisis.

(2) As Non-performing Loans have Increased, Profits have Declined

As Taiwan promoted financial liberalization and internationalization, too many financial institutions entered the market. Competition among them thus became increasingly fierce. In 1997, both enterprises and banks were affected by the spreading Asian financial crisis, and losses from both overseas lending and investments increased. Then, dropping of real estate prices caused by the September 21, 1999 earthquake as well as the recent global economic recession have made many enterprises in the construction and related industries experienced financial difficulties. Consequently, the non-performing loans of financial

institutions have significantly increased. How to deal with financial crises has become an important issue facing the Taiwan government.

3. Steps Taken to Resolve Taiwan's Systemic Financial Crisis

(1) Establishing a Mechanism to Enable Problem Financial Institutions to Withdraw from the Market

1. By revising the *Deposit Insurance Act*, participation in deposit insurance that was previously voluntary has since 1999 been converted into the mandatory system. Therefore, all financial institutions in Taiwan are now part of the deposit insurance system. It is hoped that, by means of the deposit insurance mechanism, problem financial institutions will be able to withdraw from the market.
2. Relevant laws and regulations have been revised to strengthen financial supervision as well as the powers and functions related to the handling of problem financial institutions. This is providing the banking industry with a legal basis for facilitating mergers involving the credit departments of farmers' and fishermen's associations and other such community financial institutions.
3. The National Assembly passed a budget of about 4 billion US dollars to set up the Financial Restructuring Fund on

July 9, 2001. A temporary blanket guarantee has been provided for a period of three years, and the CDIC has been given responsibility for dealing with problem financial institutions.

(2) Handling the Financial Crisis

1. In order to safeguard the rights and interests of depositors and maintain an unbroken flow of financial services, a total of 36 credit departments of farmers' and fishermen's associations and 8 credit cooperative associations have by means of purchase and assumption (P&A) transactions withdrawn from the market without incident since July 2001. The total cost is about 3 billion US dollars.
2. By providing a blanket guarantee, a regional financial crisis has been avoided, and the government has in stabilizing financial order promoted comprehensive financial reform.
3. The government is currently waiting for the National Assembly to approve more funds for resolving the NPL and over-banking problems.

4. Experiences and Lessons

I have just explained the main points regarding how the CDIC has assisted the government in handling financial crisis situations.

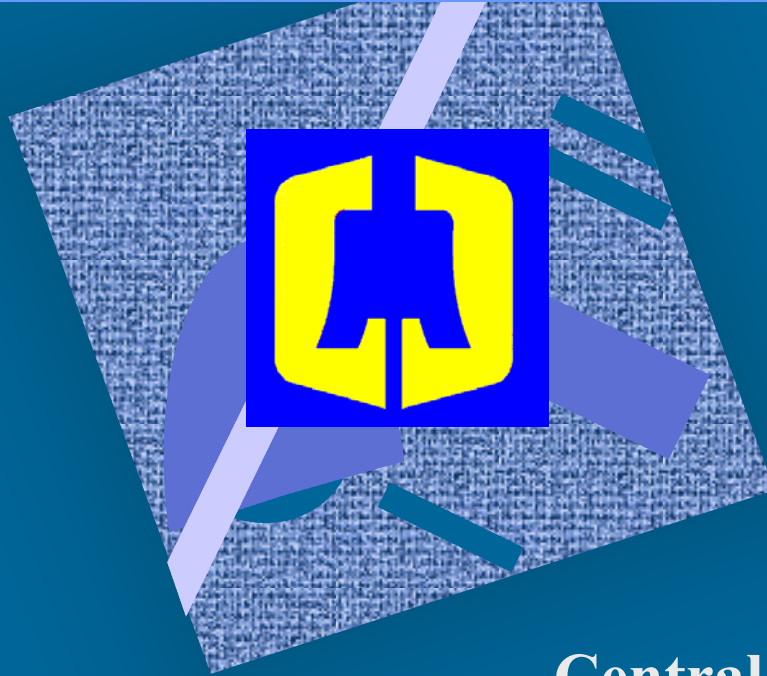
As I bring my remarks to a close, I would like to take this opportunity to share with all of you Taiwan's experiences in dealing with problem financial institutions and the lessons it has learned. The main findings are as follows:

- (1) The credit departments of farmers' and fishermen's associations are weak financial institutions that are in need of special assistance from the government. If they form an independent financial subsystem, the spreading of the financial crisis to the rest of the financial system can be avoided.
- (2) Before opening up the market to new financial institutions, the function of financial supervision should be strengthened and the current operational efficiency of financial institutions should be enhanced. Only then could the financial market be developed soundly.
- (3) The deposit insurance system is one part of the financial supervisory system that allows problem financial institutions to withdraw from the market without incident. Making participation in deposit insurance mandatory can help resolve the problems these financial institutions face.
- (4) At times when it is not possible for an economy to recover from a financial crisis based on the normal market mechanism, the government needs to step in. The earlier it

- deals with the situation, the lower will be the costs incurred.
- (5) A financial crisis arises because of an unsound operating environment. When implementing structural reforms, it is necessary to simultaneously promote corporate restructuring if the financial reforms are to be successful.

Ladies and Gentlemen, I would like to bring my remarks to a close here. Thank you very much for your attention.

Overcoming Crisis and the Role of Deposit Insurance



Presented by
Chin-Tsair Tsay
Chairman

Central Deposit Insurance Corporation
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Overcoming Crisis and the Role of Deposit Insurance

- Overview of Taiwan's Economic Profile (1990-2002)
- The Financial Problems Facing Taiwan
- Steps Taken to Resolve Systemic Financial Crisis
- Experiences and Lessons



Taiwan's Geographic Location





Overview of Taiwan's Economic Profile (1990-2002)

1. Int'l Trade Surplus & Huge Foreign Exchange Reserves

(Average Int'l Trade Surplus: USD 10,705 Million;
Current Reserves: USD 186 Billion, 3rd Place in the World)

2. High GDP Growth Rate (Average: 6.3%)

3. Low Unemployment Rate (Average: 2.8%)

4. Low Consumer Price Index (Average Growth Rate: 1.8%)



Development of Financial Industry

- **Until 1990 :**

Composed Mainly of Gov't-Owned Banks with Conservative Lending Policies & Low NPL Ratios

- **Since 1990 :**

Opened up the Market to Allow the Establishment of Private Commercial Banks



The Financial Problems Facing Taiwan

Operational Crisis of Community Financial Institutions



**Speedy Financial Liberalization Resulted
in Over-Banking & Fierce Competition**

**Lack of Withdrawal Mechanism
for Unsound Community Financial Institutions**



The Financial Problems Facing Taiwan

**NPLs Have Increased,
So Profits Have Declined**

Stock & Real Estate Market Bubbles

Global Economic Recession

Corporate Sector Crisis



Steps Taken to Resolve the Systemic Financial Crisis

Establishing a Withdrawal Mechanism



Implemented Mandatory Deposit Insurance

Improved Legal Framework to Strengthen Financial Supervision and Facilitate Mergers

Passed a US\$ 4 billion Financial Restructuring Fund and Provided Blanket Guarantee



Steps Taken to Resolve the Systemic Financial Crisis

Handling the Financial Crisis



Disposed of 44 Community Financial Institutions Via P&A

Further Budgets to Be Appropriated to Resolve NPL & Over-banking Problems



Experiences and Lessons

**Forming an Independent Financial Subsystem for
Farmers' and Fishermen's Associations
May Segregate the Financial Crisis**

**Financial Supervision and Efficiency
Should Be Enhanced before Financial Liberalization**

**A Mandatory Deposit Insurance System
Can Help Resolve Problem Financial Institutions**

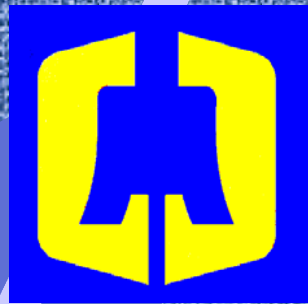


Experiences and Lessons

**The Government's Early Intervention is Important
to Resolve the Systemic Financial Crisis**

**Corporate Restructuring & Financial Reform
Should Be Promoted Simultaneously**

Thank You.



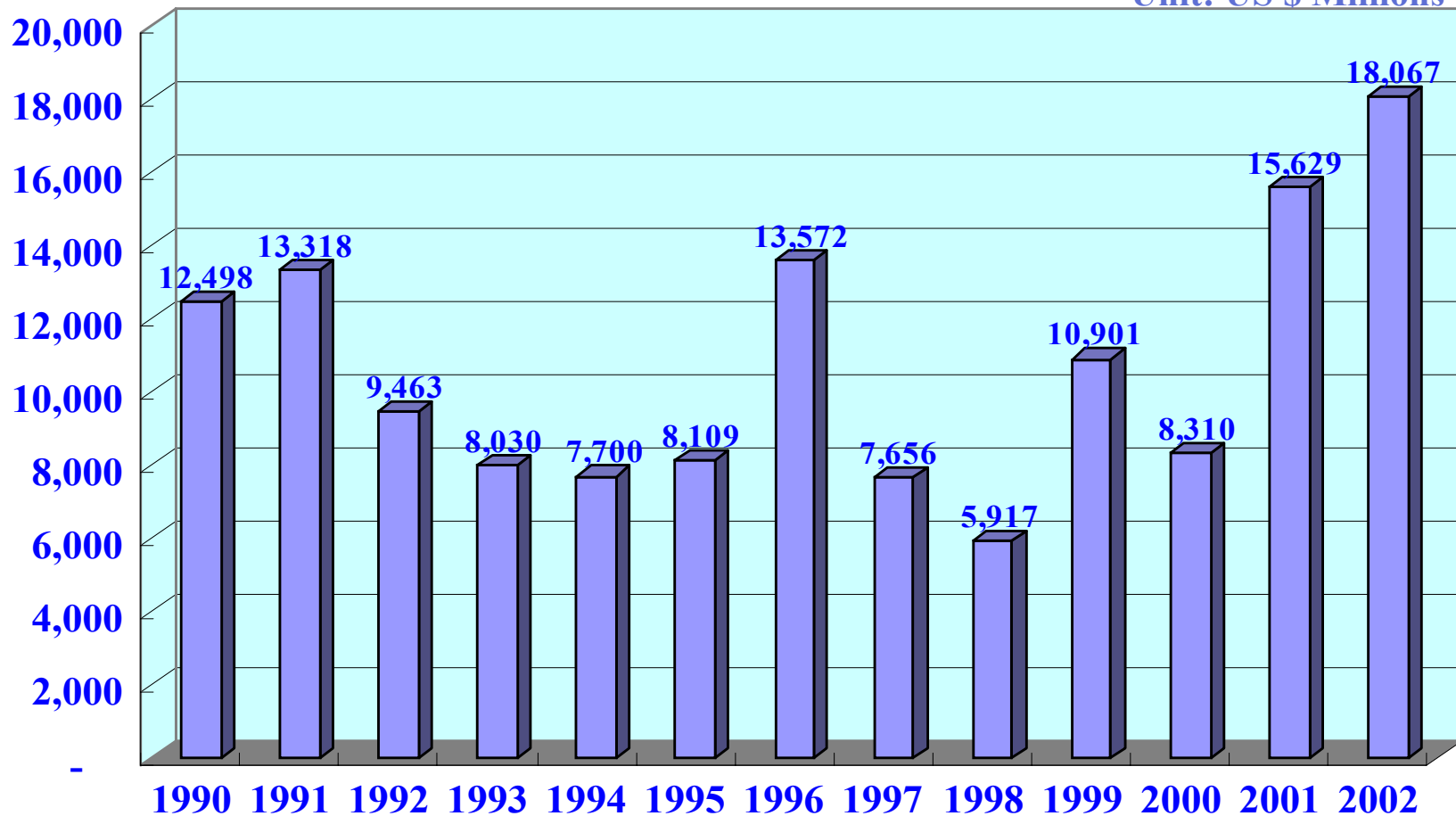
**For more information,
please go to**

www.cdic.gov.tw

1. Export Surpluses



Unit: US \$ Millions

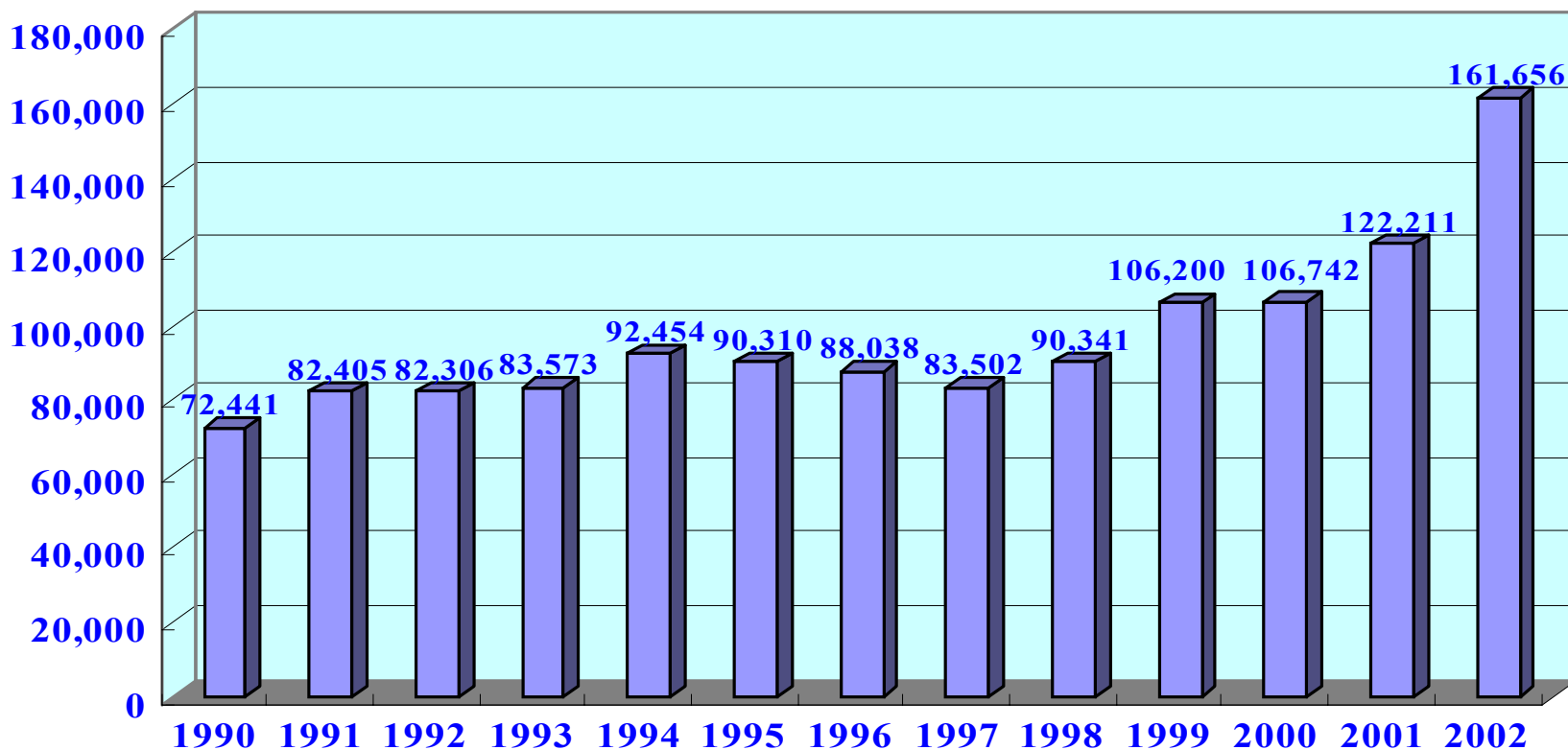




Overview of Economic Profile :

2. Foreign Exchange Reserves

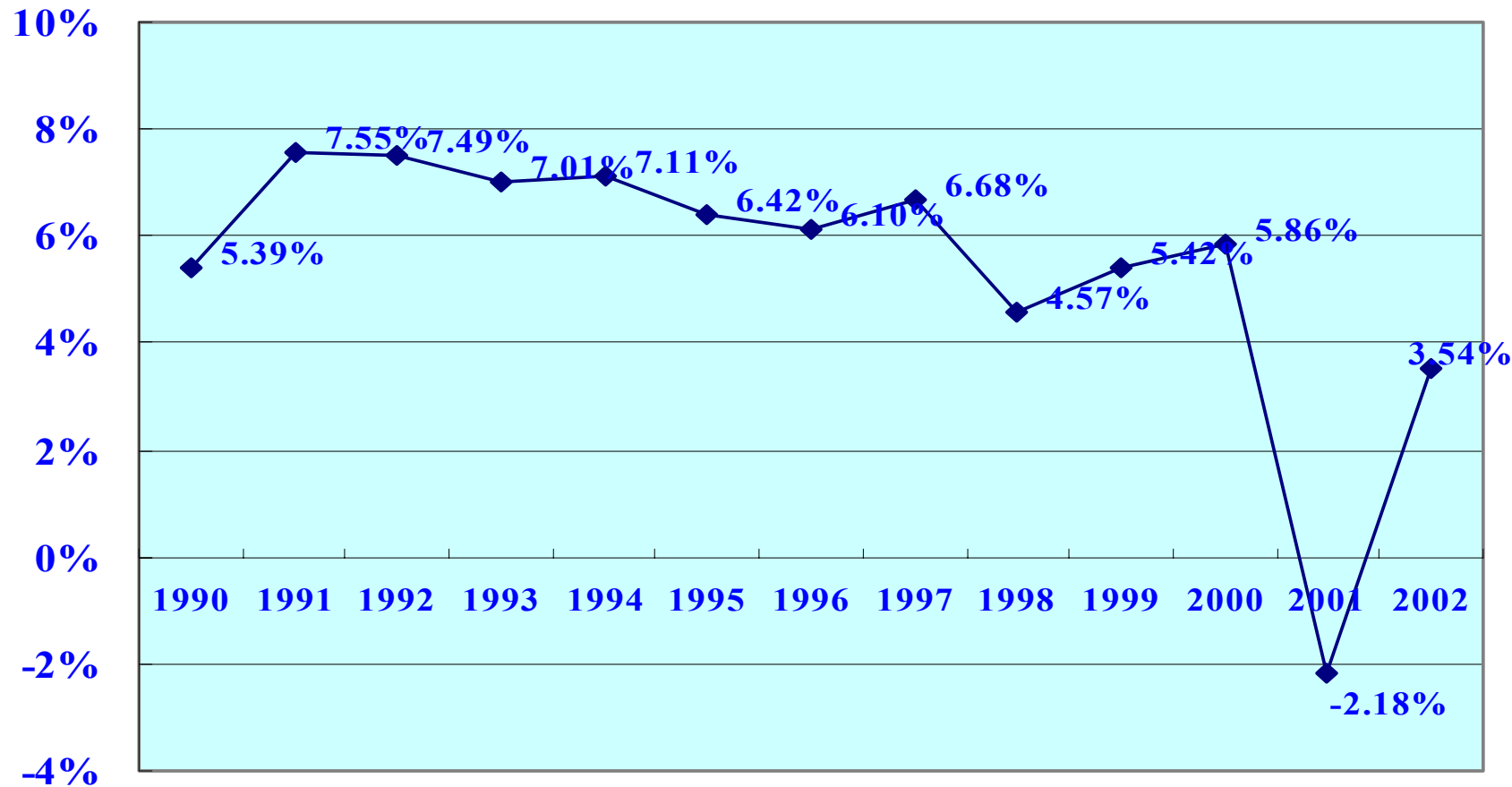
Unit: US \$ Millions





Overview of Economic Profile :

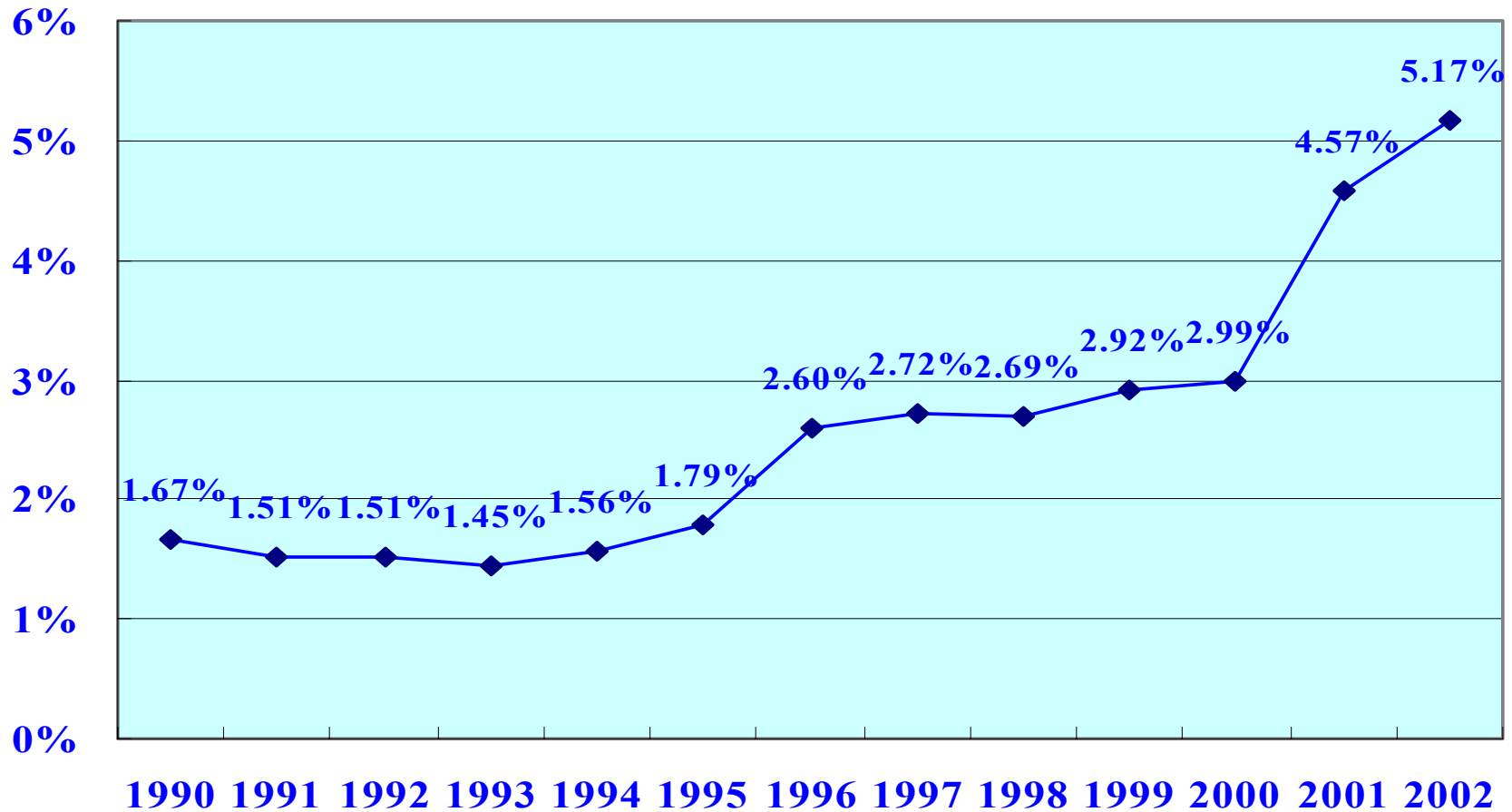
3. Economic Growth Rate





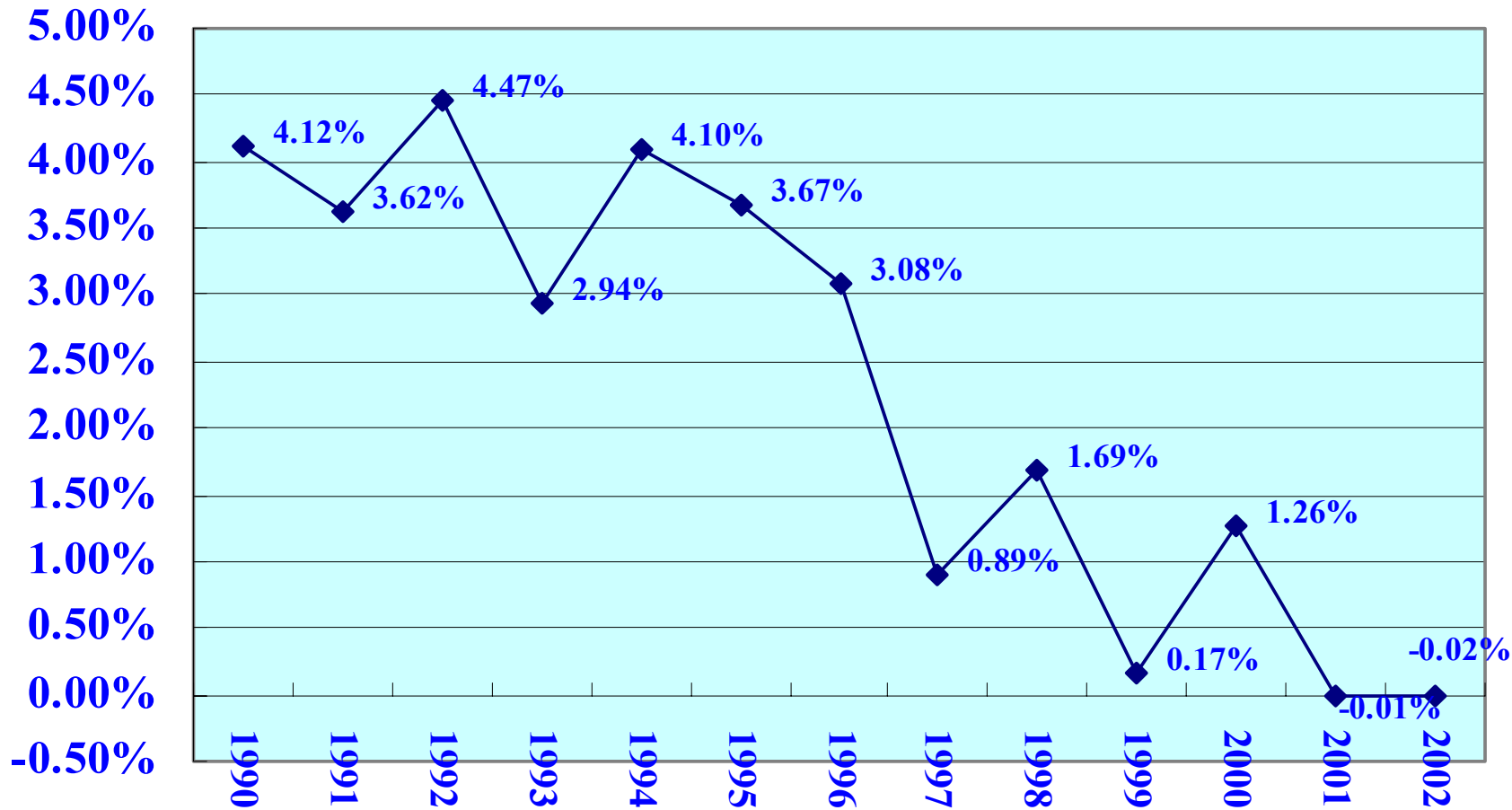
Overview of Economic Profile :

4. Unemployment Rate



Overview of Economic Profile :

5. CPI Growth Rate





Financial Institutions in Taiwan

Numbers of Financial Institutions

	Commercial Banks	Bills Finance Companies	Branches of Foreign Banks	Credit Cooperatives	Farmers' & Fishermen's Associations	Trust Investment Companies	Securities Companies	Insurance Companies
1990	24	3	35	74	308	6	381	38
1991	24	3	37	74	311	6	353	42
1992	40	3	36	74	312	7	294	43
1993	41	3	37	74	312	7	272	53
1994	42	3	37	74	312	6	262	54
1995	42	10	38	73	312	5	247	56
1996	42	12	41	73	312	5	229	61
1997	47	14	46	64	314	5	221	58
1998	48	16	46	54	314	4	215	61
1999	52	16	41	50	314	3	212	63
2000	53	16	39	48	314	3	190	62
2001	53	15	38	39	285	3	183	58
2002	52	14	36	37	278	3	163	57