

## BICRA On Taiwan Maintained At Group '4'

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OVERVIEW

- We are reviewing our Banking Industry Country Risk Assessment after having published our updated methodology.
- We are maintaining our BICRA on Taiwan at group '4'.
- We are also maintaining our economic risk score at '3', and assigning an industry risk score of '5'.

BICRA ACTION

On Nov. 9, 2011, Standard & Poor's Ratings Services said that it is maintaining its Banking Industry Country Risk Assessment (BICRA) on Taiwan [Taiwan (Republic of China); AA-/Stable/A-1+, cnAAA/cnA-1+] (Unsolicited) at group '4'. It is also maintaining the economic risk score at '3'. At the same time, it has assigned an industry risk score of '5'.

RATIONALE

We have reviewed the Taiwan banking sector under our updated BICRA methodology. Our criteria define the BICRA framework as one "designed to evaluate and compare global banking systems." A BICRA analysis for a country covers rated and unrated financial institutions that take deposits, extend credit, or engage in both activities. A BICRA is scored on a scale from 1 to 10, ranging from the lowest-risk banking systems (group '1') to the highest-risk (group '10'). Other countries in BICRA group '4' are Malaysia, Spain, Brazil, and Mexico.

Our economic risk score of '3' reflects our view that Taiwan has "intermediate risk" in "economic resilience" and "low risk" in terms of "economic imbalances" and "credit risk in the economy," as our criteria define those terms.

We view Taiwan as a middle income economy with moderately stable economic growth supported by a dynamic and entrepreneurial private sector and the Taiwan government's flexible economic policies. These help to mitigate the potential impact of external shocks to the island's export-oriented economy, in our view. Taiwan has averaged 3%-4% annual GDP growth over the past 10 years with moderate economic volatility.

Our view of Taiwan's low risk economic imbalances is based on the moderate rise in house prices in Taiwan and low rise in credit growth during 2007-2010. It also reflects Taiwan's healthy foreign exchange reserves and the island's very strong current account and net external creditor position. We also believe that Taiwan faces low risk of a rapid fall in asset prices.

The very strong household net financial positions in Taiwan could provide good buffers against adverse economic conditions and help offset the potential risks from an intermediate level of private sector indebtedness. Taiwan's low credit risk also reflects the banking sector's adequate lending practices and underwriting standards.

Our industry risk score of '5' for Taiwan is based on our opinion that the country faces "intermediate risk" in its "institutional framework," "very high risk" in its "competitive dynamics," and "very low risk" in "systemwide funding."

Taiwan's regulatory standards are comparable with international standards and the banking system's governance and transparency are adequate, in our view. We also believe that Taiwan's regulator has a moderate track record in managing financial crises and we expect the regulator to continue to conduct timely and effective regulation of the banking system.

Taiwan's banking industry is highly competitive and fragmented with low earning capacity to cushion against potential credit costs. Moreover, the high proportion of state ownership in the sector leads to competitive distortions in the pricing for certain key products. However, we believe the island's banking sector generally has a restrained risk appetite reflected by its somewhat simple business lines, which should alleviate the risk of heightening competitive pressures, in our view.

Systemwide funding for Taiwan's banking sector is a key strength. Banks typically benefit from a high proportion of stable, core customer deposits and good flexibility to access domestic capital markets. In addition, the system's low use of cross-border funding makes it less vulnerable to contagion risks during periods of turbulence in the global capital markets.

We classify the Taiwan government as 'highly supportive' toward domestic banking. We recognize the government's high commitment to maintain system stability and market confidence. It also has proven track record of protecting senior creditors from loss during periods of financial stress and we believe it will continue to provide timely and effective support to the banking sector in times of duress.

RELATED CRITERIA AND RESEARCH

- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Standard & Poor's BICRAs Highlight The Shifting Balance In Global Banking, Nov. 9, 2011
- S&P's BICRAs Measure Banking Risks For 86 Countries, Nov. 9, 2011

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