19th Annual Conference on Pacific Basin Finance, Economics, Accounting, and Management

**The Trend of Global Financial Reform and Prospects for Taiwan's Financial Industry in the Wake of the Financial Tsunami**

Dr. Jih-Chu Lee

Vice Chairperson of Financial Supervisory Commission

Date: July 8, 2011

**Ⅰ. Introduction**

I am much honored to take part in the 19th Annual Conference on PBFEAM. This conference is ranked as one of the three most important financial gatherings in the Asia-Pacific region, and all of you here are experts in the fields of finance, economics, and accounting, so I am looking forward to a very productive conference.

Most of the economies around the world could not escape from the big hit of the recent financial tsunami. This is especially true in countries with advanced financial sectors, such as the UK and the US. Fortunately, most of us have survived the storm. The major international financial bodies and financially advanced countries have been studying the causes of this financial tsunami, and are actively pushing forward with a number of financial reform policies and measures in response. Many factors contributed to the recent financial crisis, such as human greed, excess global money supply, pay and compensation structures inconsistent with various firms’ long term goals and prudent risk takings; lack of transparency for over packaged financial products, and failure of credit rating agencies to preserve their independence and serve their intended functions independently. However, while all of these were surely contributing factors, in my personal opinion the biggest problem lay elsewhere, it is the lack of appropriate financial supervisory systems. For in the final analysis, government oversight is the last line of defense in the battle to maintain financial stability.

**Ⅱ. Trend of global financial reform**

The lack of appropriate financial supervision in advanced Western nations stemmed primarily from over reliance on market mechanisms. They believed that markets could function just fine on their own, and that market mechanisms would quickly correct market irregularities. But they appear to have overlooked a key presumption of economics—"the market" only works properly when there are transparency and symmetry of information, and where there are no economic externalities. In the real economy, however, economic externalities do exist in the financial industry. Take the "too big to fail" issue as an example. Since the failure of a systemically important financial institution (SIFI) may spread its disastrous impact onto other sectors of the economy, the government will make every effort to not let it fail. Another example is the asymmetric information in the sophisticated financial derivatives market. In such a situation, we know that relying on market mechanisms and industry self-discipline to keep the financial system running properly offers little chance of success. In the latest round of global financial reforms, this issue has not gone unnoticed and measures have been put forward accordingly. These include requirements for better information disclosure, and strengthening prudential supervision at both the micro and macro levels. In addition, supervisory authorities have set out higher requirements for SIFIs. For example, they require SIFIs maintain a higher capital adequacy ratio than ordinary financial institutions in hopes that the externalities they generate will be internalized as much as possible. In other words, while taking measures to ensure a well functioned market mechanism at one hand, authorities are working simultaneously to strengthen prudential supervision at both the micro and macro levels.

Financial reforms rolled out around the world can be broadly categorized as follows:

 (1) Strengthening information disclosure, market self-discipline, and prudential supervision at the micro and macro levels;

 (2) Enhancing capital adequacy and risk management capabilities of financial institutions;

 (3) Better safeguard for the interests of financial consumers;

 (4) Ensuring sound pay and compensation structures;

 (5) Promoting supervisory reforms of credit rating agencies;

 (6) Strengthening derivatives trading mechanisms and supervision.

 (7) Improving accounting standards systems.

Every financial system has its own uniqueness in terms of market sophistication, consumers’ understanding of financial products, self-discipline within the industry, and regulatory framework. Therefore, the Financial Supervisory Commission (FSC) has continuously adopted flexible and adaptable supervisory reform measures both in tandem with the international trends and local market needs.

**Ⅲ. Financial reform measures in Taiwan**

Taiwan was able to weather the recent financial crisis relatively well thanks to our government's adoption of a blanket deposit guarantee and various other well-chosen response measures. Even so, the FSC has still been working actively to reform its supervisory system and bring it in line with other systems around the world. Key reforms adopted here in Taiwan include the following:

 (1) We have officially announced the implementation of Basel III ahead of schedule in order to strengthen the capital adequacy and liquidity of financial institutions.

 (2) We have achieved passage of the Financial Consumer Protection Act by the Legislature, which provides a legal basis for the establishment of a financial consumer dispute resolution mechanism.

 (3) We have issued Rules Governing the Establishment of Remuneration Committees by Listed Companies so as to enhance the soundness of their compensation structures.

 (4) We have amended the Regulations Governing the Administration of Credit Rating Enterprises. The amendments are designed to strengthen supervision of credit rating agencies and improve the quality of credit ratings issued in Taiwan.

 (5) We will implement the IFRS standards on schedule.

**Ⅳ. Opportunities for Taiwan's financial industry**

The financial tsunami didn't just affect the global financial industry. It also knocked the momentum of global economic development off its axis. Many emerging economies, and especially those in Asia, have bounced back much more strongly than Western economies have. The most notable case in this regard is mainland China. Taiwan's economy is currently linked very tightly to the mainland's, and the people on the two sides of the Taiwan Strait share the natural advantage of a common culture and language. The FSC, in addition to actively seeking to build up a more sound financial system, has also been working hard to help financial services firms identify better development opportunities on the mainland. Over the past two years, therefore, our government has entered into the ECFA and three MOUs for financial supervisory cooperation with the mainland's financial authorities. By entering into these agreements, we seek to ensure that our financial services providers have access to the mainland market under conditions that are more advantageous than those offered to firms from other countries. This will help our financial services firms develop more successfully in the mainland. Favorable market access for our banks will also help many Taiwan-invested enterprises operating in the mainland. In addition to the MOUs and the ECFA, the FSC and the China Banking Regulatory Commission have officially established a cross-strait financial supervisory cooperation platform. Within the framework of this platform, the two sides can arrange regular and ad hoc meetings among chairpersons, vice chairpersons, and officials at the working level. In the meantime, mainland China has sought actively in recent years to promote partial internationalization of the RMB, so we are taking steps to seize the attendant opportunities. In addition to allowing the Hong Kong branches of Taiwan banks to handle RMB business, we are making plans to allow offshore banking units (OBUs) and overseas branches of domestic banks to apply for permission to handle RMB business. In particular, Taiwan's financial industry is now in healthier shape than at any other period in the past 10 years. As of March 2011, our banks have an average capital adequacy ratio of 12.1%, an average NPL ratio of 0.55%, and an average coverage ratio of 172.35%. With our financial institutions in such good shape, with the opportunities they now have to enter the mainland market and develop their international markets, and with more sound financial supervisory mechanisms in place, it seems to me that Taiwan's financial industry have outstanding development potential.

**Ⅴ. Conclusion**

In closing, I have very high hopes that the experts and professionals we have here will engage in scintillating discussions, and in the process will put forward very valuable suggestions on financial supervision and financial industry development. Once again, I look forward to a very successful conference, and wish you all the best of health. Thank you!