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## V. International financial reform proposals and their policy implications for Taiwan

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The impact of the recent global financial crisis on Taiwan's financial system was moderate in comparison with what happened in the US and European countries. This was because Taiwan did not suffer from such investment banking problems: its asset securitization was not as developed, and its regulatory system was comparatively sound in general. Nevertheless, a succession of international financial reforms that will influence the future development of global financial regulation were proposed. Taiwan's financial authorities should closely monitor their progress and take this opportunity to review the differences between Taiwan's current regulatory framework and the international proposals, as well as contemplate further improvements in Taiwan's future financial reform, so as to strengthen financial regulation.

### 5.1 International financial reform

From the beginning of 2009, advanced countries (e.g. the US and the UK) and international organizations successively proposed a number of plans or recommendations on financial reform in hopes of preventing future financial crises. These include: (1) *The Turner Review* and the white paper on *reforming financial markets* in the UK; (2) A comprehensive plan for financial regulatory reform and related draft legislation proposed by the US; (3) Initiatives or resolutions relating to financial regulatory reform made by the G20 and the European Union (EU) summit members; (4) A series of proposals to enhance the Basel II framework and strengthen the liquidity risk monitoring framework announced by the BCBS; and (5) Policy recommendations issued by the IMF, etc.

Table 5.1 summarizes the key recommendations on the above-mentioned financial regulatory reform issues, focusing not only on prevention of systemic risks and macro-prudential supervision, but also on the management of capital adequacy and liquidity risk.

On 21 October 2009, the Senior Supervisors Group (SSG), a forum composed of senior supervisors from seven advanced countries, released a report entitled *Risk Management Lessons from the Global Banking Crisis of 2008*. The report not only conveyed their assessment of current weaknesses of the risk management practices in financial institutions, but also identified ten critical areas in need of improvement that require on-going progress by financial institutions to address issues in governance, remuneration, risk management, and market infrastructure.

**Table 5.1 The key international recommendations for financial reform**

Items	Issues	Recommendations
1	Coverage of regulation	<ol style="list-style-type: none"> <li>1. All financial activities that might trigger systemic risk should be monitored appropriately.</li> <li>2. Strengthening regulation on systemically important financial institutions (SIFIs) and financial instruments.</li> </ol>
2	Macroprudential analysis	<ol style="list-style-type: none"> <li>1. Enhancing macroprudential analysis and policy responses.</li> <li>2. Developing regulatory tools that are indispensable for monitoring and measuring systemic risk.</li> <li>3. Taking system-wide considerations on credit expansion, liquidity, asset prices and leverage.</li> <li>4. Focusing on interconnections among SIFIs and systemic risks.</li> </ol>
3	Capital adequacy and accounting	<ol style="list-style-type: none"> <li>1. Increasing the quality and level of capital.</li> <li>2. Mitigating the pro-cyclical effects of Basel II.</li> <li>3. Creating counter-cyclical capital buffers.</li> <li>4. Establishing lower limits on leverage ratios (i.e. capital/assets), as part of supplementary tools in the Basel II framework.</li> <li>5. Strengthening stress testing practices in financial institutions.</li> </ol>
4	Risk management of financial institutions	<ol style="list-style-type: none"> <li>1. Requiring financial institutions to implement firm-wide risk management systems; improving the independence of risk management functions and the effectiveness of independent directors' oversight.</li> <li>2. Improving liquidity management in financial institutions; capital surcharges should be imposed on financial institutions taking higher liquidity risks.</li> </ol>
5	Remuneration	<ol style="list-style-type: none"> <li>1. Remuneration policies should be designed to avoid incentives for taking undue risk.</li> <li>2. Variable remuneration could take the form of deferred payment or with recourse.</li> <li>3. Remuneration policies and structures should be transparent.</li> <li>4. Assuring remuneration committees operate independently.</li> <li>5. Supervisory authorities should have powers to amend the remuneration structures of financial institutions that perform poorly or require government intervention.</li> </ol>
6	Supervision and infrastructure of securitization and over-the-counter (OTC) derivatives	<ol style="list-style-type: none"> <li>1. Requiring originators and issuers of asset securitization to partly take risks arising from the securitized products.</li> <li>2. Introducing counterparty margin system for OTC derivatives.</li> <li>3. Developing clearing and central counterparties system for standardized OTC derivatives, in particular for credit default swaps (CDS).</li> <li>4. Imposing higher capital requirements on non-central-clearing derivative products.</li> </ol>
7	Credit rating agencies	<ol style="list-style-type: none"> <li>1. Credit rating agencies should be subject to registration and supervision.</li> <li>2. Enhancing transparency in the methodologies of credit rating.</li> <li>3. Differentiating credit ratings of structured financial products.</li> <li>4. Reducing reliance on credit ratings for prudential supervision.</li> <li>5. Clearly communicating with investors regarding the appropriate use of credit ratings.</li> </ol>

8	Deposit insurance and resolution of impaired financial institutions	<ol style="list-style-type: none"> <li>1. Making sure that the vast majority of retail depositors are protected.</li> <li>2. Establishing a regime for the orderly resolution of impaired financial institutions.</li> </ol>
9	Global cross-border financial institutions	<ol style="list-style-type: none"> <li>1. A crisis coordination mechanism and contingency plans should be in place for domestic regulators, the central bank and the Treasury.</li> <li>2. Establishing a college of supervisors for large and complex financial institutions.</li> <li>3. Organizing a task force for crisis management of cross-border financial institutions so as to improve information sharing during emergent times.</li> </ol>
10	Consumer protection and anti-money laundering	<ol style="list-style-type: none"> <li>1. Establishing an independent agency for consumer protection and education.</li> <li>2. Implementing prudential measures to deal with financial transactions relating to tax havens, money laundering, corruption and terrorists.</li> </ol>

Sources: IMF, BCBS, SSG, G-20 Summits, and official government websites in the UK, the US and the EU.

## 5.2 Implications for financial reform in Taiwan

In view of the above-mentioned international proposals for financial reform, current financial regulation in Taiwan has, in some areas, made significant progress, such as:

- All systemically important financial institutions are covered by current financial regulation;
- A well-established deposit insurance scheme and resolution mechanisms for impaired financial institutions have been put in place;
- Regulators have actively engaged in the improvement of consumer financial education and protection; an exclusive chapter for coping with consumer disputes involving financial services is included in a draft of the Financial Services Act; and
- Significant progress has already been made in facilitating anti-money laundering work. For example, anti-terrorism is governed by the Money Laundering Control Act, which was amended in 2009; the required amount of large cash transactions that should be reported by financial institutions has been lowered to NT\$500,000 from NT\$1,000,000.

In terms of international cooperation of financial supervision, considering that internationalization with respect to either financial institutions or financial markets in Taiwan is not as developed as that of the US or European countries, the authorities can actively seek opportunities for participation in international cooperation of cross-border supervision.

With regard to other key issues and recommendations listed in Table 5.1, the relevant authorities may make reference to them and make appropriate adjustments. In this fashion, the CBC and the FSC have deliberated on some of the recommendations and are considering the feasibility and alternatives of implementing them in Taiwan. These include:

- Enhancing macro-prudential supervision;
- Increasing the quality and level of capital requirements for financial institutions;
- Strengthening risk management in financial institutions;
- Reforming financial institutions' remuneration systems;
- Enhancing supervision and infrastructure for securitization and OTC derivatives; and
- Improving the surveillance and transparency of credit rating agencies.