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Why did Taiwan Comply with the Basel Accord?

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Introduction

This paper seeks to explain changes of national bank regulations in Taiwan since 1980s with special regard to the implementation of Basel Accords. It attributes Taiwan's financial public policy outcomes to its underlying political factors. If banking standards set out in the Basel Accords are remedies for series of banking crisis and are efficient methods for stabile profitability as some suggests, why such practices are hard to reach national consensus for global harmonization? Since the choice of national bank regulation is a public policy process, it involves political bargaining among various parties. From the agenda setting stage until the implementation end, politics remains a critical factor that often interferes the due process. The developments from Basel 1 to Basel 3 and their global dissemination cannot be independent from such reality.

In the existing literature, there are, in general, two types of arguments regarding the initiation and implementation of Basel Accords. The first kind of argument emphasized the factor of "global power politics", which consider financially stronger countries have greater power and bigger says in dictating global financial regulations, as well as being more capable of forcing weaker countries to harmonize their financial regulations with the level that satisfy the interests of dominant countries. What happens inside a country or its domestic institutions is less relevant. In other words, domestic situations in all countries are given, or irrelevance to the compliance level. National governments only respond according its power status in the world (Kapstein 1989; Simmons 2001; Drezner 2007; Gadinis 2008; Posner 2009; Tarullo2008). These studies, in a nutshell, attributed the result of global bank regulation and the national level of compliance to the distribution of power. Other factors received less attention. In addition to absolute power politics, a country's level of economic interdependence is possible another source of power. Keohane and Nye (1977) concluded that an asymmetric relationship allows the less dependent actor to generate more effective influence on the other.

The second kind of arguments emphasized the influence of "domestic political system", which considered that national regulations reflects the needs of interest groups

To analyze domestic politics of bank regulation, one should first understand the feature of special interest groups and the public behind such regulatory regime (Peltzman 1976; Becker 1983; Frieden 1991). Admati and Hellwig (2013:193-207) commented that politicians, regulators, and supervisors often align themselves with bankers because politicians need financial resources, which is probably one of the most important factors for elections, from the banks and the banking sector need politician to act against tight bank regulation, which they consider would harm their profitability. In this paper, I look at both international and domestic political factors that shapes Taiwan's bank regulations since 1980s. The next section discusses international and domestic pressures confronted by Taiwan while seeking to implement Basel Accords. The third section traces Taiwan's bank regulations amendments since 1980s. The last section concludes.

International and Domestic Factors in Taiwan

In this section, I provide empirical studies of Taiwan's amendment *the Banking Act* in 1985, 1989, 2000, and 2008. While the latter three times of amendments related more to Basel Accords, the discussion of the first one is necessary because it provides a general picture of Taiwan's financial situation before its compliance with global standards. It was also the first comprehensive amendment of *the Banking Act* since its promulgation in 1931.

International Pressures

A country relies heavily on global financial markets, it might be more vulnerable to globally agreed regulations. In addition, more international trade leads to greater demands on banks' foreign branches to facilitate cross-national businesses. In Taiwan's case, the number of Taiwan's overseas banks in 1995 amounted to 80. Most banks were located in Asia, North America (mainly in the U.S.) and Europe. Among those, 44 were branches, whose parent banks are subject to host countries' financial regulation should it plan to open overseas branches. More overseas branches indicate home countries' greater compliance to the standards set by Basel Accords. The number of domestic banks' overseas presence climbed steadily to 293 in the end of 2013. 110 of those were branches. The distribution of overseas offices, however, becomes more uneven. While the number of overseas bank offices rise rapidly in Asia and fast in North America, more than half of foreign offices were closed in Europe from 1995 to 2013. The rise of overseas banks can be attributed to the surging demands from MNCs' overseas businesses. As table 5.3 shows Taiwan's OFDI around the world, including investments

in Mainland China, increased about 8-fold from 1995 to 2013 with a peak of US\$20.9 billion in 2012. Total exports also increased albeit in a more stable pace. Confronting with Taiwan's climbing demands of banks internationalization for financially supporting global businesses. Banks and governments were facing greater pressures to adjust themselves for higher standards if domestic banks wished to pass host countries' standards for the entry of overseas branches. As for the external debt position, Taiwan has been continuously purchased foreign assets due to its positions as a net creditor around the world. As a consequence, Taiwan does not receive international pressure coming from major western creditors like Indonesia.

Table 5.1 Taiwan's domestic banks' statistics

Year	NUM	BR	ASIA	NA	EU	OFDI	EX	RES
1995	80	44	31	24	20	2.4	217.4	-3.9
1996	95	51	45	24	20	3.4	220.5	1.1
1997	117	60	63	27	20	7.2	239.1	-7.3
1998	137	66	77	31	20	5.3	217.8	4.8
1999	150	70	77	45	19	4.5	234.9	18.6
2000	160	74	85	47	18	7.7	292.7	2.5
2001	172	74	78	67	17	7.2	234.3	17.4
2002	178	78	86	69	13	10.1	248.6	33.7
2003	184	80	93	69	12	11.7	278.6	37.1
2004	191	80	99	70	11	10.3	351.1	26.6
2005	203	79	109	74	11	8.5	381.0	20.1
2006	222	82	128	77	10	12.0	426.7	6.1
2007	236	82	136	83	10	16.4	465.9	-4.0
2008	242	84	141	84	10	15.2	496.1	23.3
2009	249	88	151	82	10	10.1	378.0	54.1
2010	258	93	171	72	10	17.4	525.8	40.2
2011	263	100	177	73	8	18.1	589.7	6.2
2012	268	106	184	71	8	20.9	571.7	15.5
2013	293	110	207	73	8	14.4	575.3	11.3

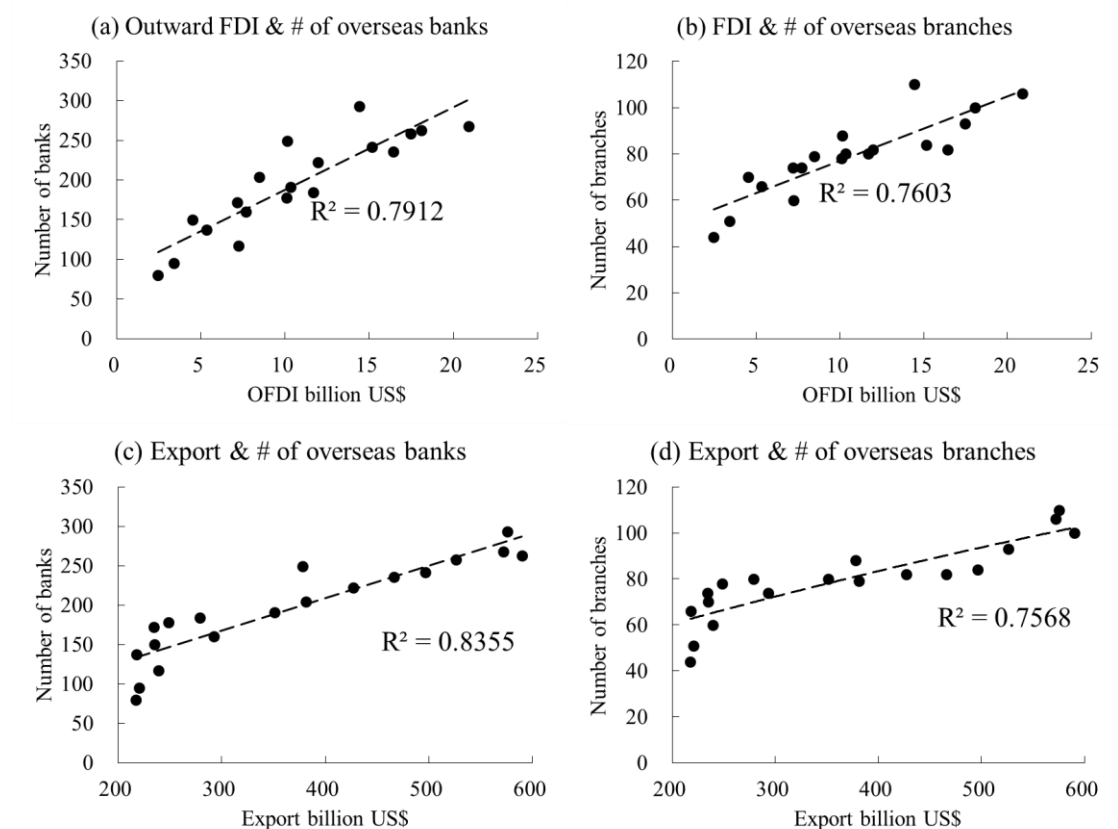
Note:

1. NUM, BR, ASIA, NA, EU, OFDI, EX, and RES respectively represent the number of Taiwan's overseas banks (including offices and subsidiaries) of domestic banks, the number of overseas branches the number of overseas branches in Asia, the number of overseas branches in North America, the number of overseas branches in Europe, Taiwan's outward foreign direct investment in billion US\$, Taiwan's export volume in billion US\$, and Taiwan's purchases of foreign reserve assets in its balance of payments.
2. Data comes from the Ministry of Finance's and Financial Supervisory Commission's Basic Financial Data (1995-2013) and data from Ministry of Economic Affairs and Central Bank.

Figure 5.1 demonstrate the correlations between the number of overseas banks and

branches and the degree of exposure to global market. As is shown, the number of overseas banks and branches were strongly correlated both with the volume of Taiwan's OFDI around the world and total export volumes. The Pearson product-moment correlation coefficient (Pearson's r) for OFDI and the number of overseas banks equals 0.889 ($R^2=0.7912$); Pearson's r for OFDI and the number of overseas branches equals 0.872 ($R^2=0.7603$); Pearson's r for exports and the number of overseas banks equals 0.914 ($R^2=0.8355$); Pearson's r for exports and the number of overseas branches equals 0.870 ($R^2=0.7568$). If one would like to make a causal relationship out of these four strong correlations, it would be more plausible to attribute the surge of overseas banks to OFDI and exports. If Taiwan hardly invest overseas or trade with foreign countries, there is no need for the foreign presence of domestic banks.

Figure 5.1 Number of Taiwan's overseas banks and exposure to global market



Source: Data comes from the Ministry of Finance's and Financial Supervisory Commission's Basic Financial Data (1995-2013) and Statistics from Ministry of Economic Affairs and Taiwan's Central Bank.

The U.S. hosted the largest number of Taiwanese overseas bank branches. They amounted to 22 in 1995 and 63 in 2013. The first foreign branch was opened in New York in June 1946 by The International Commercial Bank of China in Taiwan, which was later merged together with Chiao Tung Bank into the new Mega International

Commercial Bank in 2006. After 53 years Chang Hwa Bank was the second Taiwanese bank opening a branch in New York. In 1992 The International Commercial Bank of China had the largest number of foreign branches in the U.S. Los Angeles is another city that hosts many Taiwanese overseas banks (Li et al. 1992). Both cities maintained close economic ties with Taiwan through overseas Taiwanese who businesses abroad needed financial services operated by overseas branches to connect themselves back home. Most foreign branches had limited connection to local native people and businesses. That's one of the main reasons why most overseas banks choose foreign locations that have large volume of trades and foreign investments by Taiwanese.

Due to the ever-increasing international trades between Taiwan and the U.S. and the large number of overseas Chinese residing there, it is no coincidence that the U.S. hosts the largest number of Taiwanese overseas representative offices, branches, or subsidiaries. Since U.S. was the most influential creator for the Basel Accords, it set up more stringent regulations for the entry of foreign banks' offices. U.S.'s *The Foreign Bank Supervision Enhancement Act* of 1991 clearly prescribed that countries failing to implement the Basel Accord, it banks will confront additional funds requirement while applying for branch licenses (Misback 1993). For countries that are more interdependent than the U.S. in a specific dyadic relationship, the U.S. has the upper hand for exerting international pressures for the harmonization of domestic bank regulations into the Basel Accords in the more interdependent country. Like that Tokyo was threatened by Washington by the ban on the entry of Japanese banks to expand its offices in the U.S. (Kapstein 1989), Taiwanese banks would confront the same challenges in their applications for entering financial markets in the U.S. As Taiwan trades more, invests more overseas and becomes a highly dependent on global economic markets, it requires the internationalization of domestic banks to catch up with its global businesses expansion. Such urgent requirement inevitably would put pressures on domestic bank regulatory regime. If Taiwan's bank regulations and banks' performance cannot meet global standards, the opening of foreign branches are likely to be blocked by the host country, which I will discuss in greater detail below. Therefore Taiwanese government, together with domestic banks, had to deal with such pressure in order to be financially and structurally competent to sustain Taiwan's overseas economic adventure. International pressures for greater compliance of Basel Accords can be great for those who rely highly on the global market, especially those controlled by BCBS members.

Domestic Pressures

Domestic politics can play a role in domestic bank regulations and banks' subsequent performances. Higher compliance happens more when the ruling political party also controls the legislative body. Beside, in terms of the government-bank cooperation, a banking system dominated by GOBs is more willing to accept and follow public policies because most banks are owned by the government that decides their budgets and appoints top-level positions. Such perspective is further supports in several interviews. Discussing the government's banking policies, a former chairman of a GOB expressed that the bank it used to serve would cooperate fully with governmental policies.¹ On the contrary, a vice president of a POB considered that official interventions are too many and unnecessary but since banks in Taiwan were tightly controlled they had to obey requests from the government.² Combining both factors, a government that is more unified and controls a majority of banks can more effectively implement international standards, such as the Basel Accord. The lowest level of implementation will occur in a divided government and a POB-dominated financial system.

In Taiwan's case, the core domestic bank regulation is *The Banking Act of The Republic of China* (銀行法). To internalize Basel Accords, it requires the amendment of the banking act by the Legislative Yuan of Republic of China, which is the main legislative body to check executive body. If the legislative body is more in line with the executive body, it would be more easily to initiate and pass the amendment. Taiwan became a democratic country that held public election for the position of president in 1996. From 1992 to 1995 the then president Lee Teng-hui was elected by the National Assembly. He was also the chairman of the ruling political party, Kuomintang (KMT) that also controlled the Legislative Yuan. As shown in 1992 to 2000, Taiwan was ruled under KMT that controlled both the executive and legislative bodies.

According to the model's prediction, the amendment of the *Banking Act* would be more likely to succeed. Opposition parties under such political structure can do little to block public policy initiated by the ruling government. Entering 2000, however, Taiwan experienced a divided government, with the executive body was controlled by the president-elect Chen Shui-bian and his Democratic Progressive Party (DPP) while the legislature was controlled by neither of KMT or DPP. During the time, the Legislative Yuan was easily paralyzed by legislative obstruction or fist fights between the two parties. It thus lowers the chance of amending domestic bank regulations. In 2008, KMT regained the ruling position, together with the control of the Legislative Yuan, which

¹ Author's interview in Taipei with the former Chairman of a government-owned bank on August 1, 2014

² Author's interview in Taipei with a vice-president of a Taiwanese private bank on September 1, 2014.

allowed more room for the changes of the *Banking Act*.

Table 5.2 Taiwan's governmental and financial structure, 1992-2014

Period	RULE	BLUE	GREEN	GOVT	BANK
1992-1995	KMT	63.4	31.0	Unified	GOB
1995-1998	KMT	64.6	32.9	Unified	GOB
1998-2000	KMT	59.6	31.1	Unified	GOB → POB
2000-2001	DPP	59.6	31.1	Divided	GOB → POB
2001-2004	DPP	51.1	44.4	Divided	GOB → POB
2004-2008	DPP	50.7	44.9	Divided	POB
2008-2012	KMT	72.6	23.9	Unified	POB
2012-2014	KMT	59.3	38.1	Unified	POB

Note: RULE, KMT, DPP, and GOVT each represent the ruling party, KMT's share of legislators in the Legislative Yuan, DPP's share of legislators in the Legislative Yuan, and the structure of the government

In addition to the political system, the type of bank ownership can be related to government's sensitiveness to domestic politics. Government-owned banks (GOBs) are more sensitive to the creation of aggregate social welfare, which can be more cooperative to the initiation of public policy (Sapienza 2004). Before the amendment of *the Banking Act* in 1989, there are only three private-owned banks, which were chartered banks that enjoyed special privileges. Two of them, Bank of Overseas Chinese and United World Chinese Commercial Bank, were chartered for public polices' purpose. All of the rest were GOB. During the post-war period, financial resources were scarce and therefore the government had to control banks to control price inflation and direct money for economic plans (Yu and Wang 2005:207). While banks were owned by the government, the influence of domestic politics was minor. The performance of GOBs was low due to the public monopoly. They cannot compete with foreign banks that were more autonomous, sizable, ambitious, efficient, flexible, and transparent while Taiwan's fast economic growth required more competent banks to manage abundant wealth (Yu and Wang 2005:213-16). The call for privatization became more urgent during the 1980s. In 1989, the amendment of Article 52 of the *Banking Act* opened a window for the entry of private-owned banks (POB). According to Article 52, the Ministry of Finance, which was one of the main bank regulators back then, enacted the *Standards Governing the Establishment of Commercial Banks* (商業銀行設立標準) in 1990 and POB started to flourish. Table 5.5 shows the change of distribution of GOB and POB from late 1980s to 2001 (Lee 2002). In 1986, 87.5% banks were GOB and the proportion dropped to 9.4% only after 15 years. After 1990 POB dominated Taiwan's financial markets. As the model predicts, bankers from POB would become

more influential since they held more financial resources to constitute stronger political lobby for lax regulations.

Table 5.3 Number of Taiwan's banks and their average performance

Year	NUM	GOB	POB	CAR	NPL	ROE	ROA
1986	24	21	3	-	-	-	-
1991	25	13	12	-	0.97	-	-
1992	40	13	27	-	0.81	-	-
1993	41	13	28	18.1	1.14	10.4	1.1
1994	42	13	29	14.5	1.82	11.5	1
1995	42	13	29	13.6	2.85	9	0.7
1996	42	13	29	12.9	3.68	9.7	0.7
1997	47	13	34	11.4	3.82	9.6	0.8
1998	48	9	39	10.4	4.36	7.99	0.59
1999	52	5	47	11.17	4.88	5.87	0.49
2000	53	5	48	10.75	5.34	4.9	0.39
2001	53	5	48	10.4	11.26	5.5	0.4
2002	52	5	47	10.63	8.85	-5.11	-0.49
2003	50	5	45	10.07	6.08	6.52	0.47
2004	49	5	44	10.67	3.8	8.81	0.58
2005	45	5	40	10.34	2.24	4.41	0.34
2006	42	4	38	10.11	2.13	-7.34	-0.41
2007	39	3	36	10.57	1.84	2.6	0.07
2008	37	3	34	10.78	1.54	-0.67	-0.09
2009	37	3	34	11.64	1.15	4.33	0.25
2010	37	3	34	12.02	0.61	8.58	0.54
2011	37	3	34	12.13	0.43	8.27	0.54
2012	38	3	35	12.54	0.4	9.58	0.62
2013	39	3	36	11.78	0.38	10.22	0.66

Note: NUM, GOB,³ POB, CAR, NPL, ROE, and ROA each represent total number of Taiwan's domestic banks, number of GOB, number of POB, average of capital adequacy ratio, average non-performing loan ratio, and average return on equity ratio and return on assets ratio of all banks in Taiwan

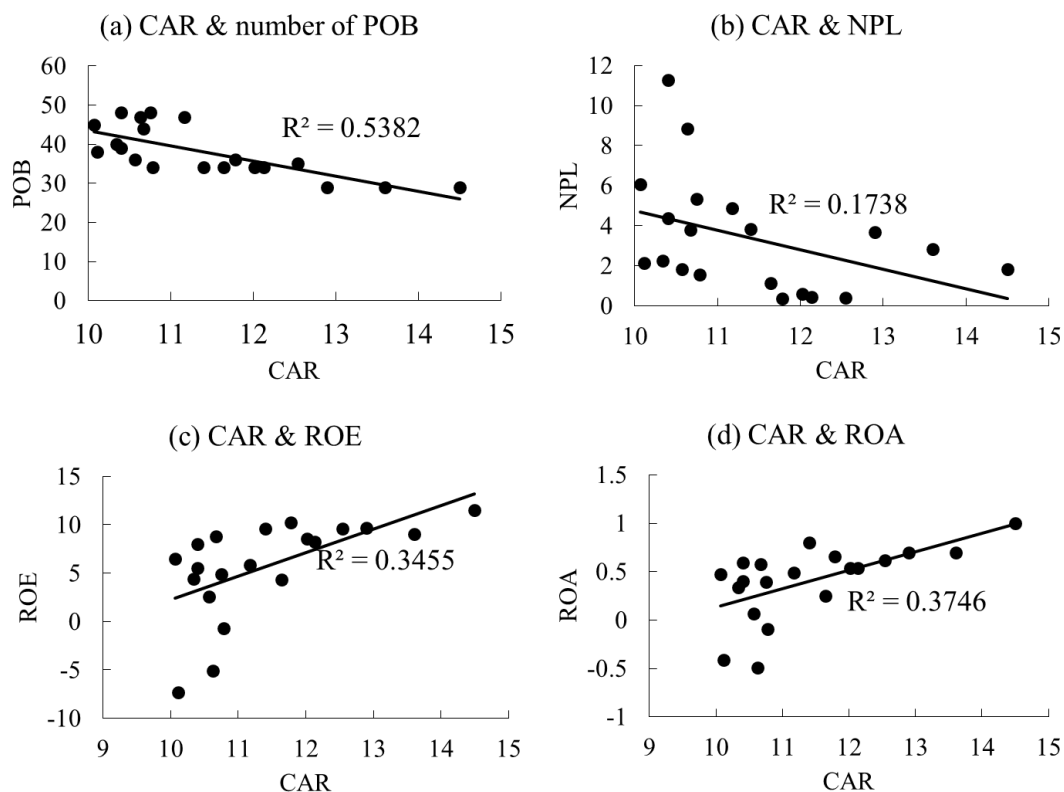
Source: Statistics from the Ministry of Finance, Financial Supervisory Commission, Lee (2002), and Lee and Tang (2007).

Shen and Lin (2012:189) found that POBs perform better than GOBs that can be further classified by political and non-political GOBs. The latter performs better than the former. Testing Taiwan's case seems to contradict their arguments. In figure 5.2(b)

³ GOB here refers to banks that are controlled by the government holding more than 20% shares.

there is strong negative correlation (Pearson's $r = -0.417$) between NPL and CAR. There are also stronger positive correlations between CAR and ROE (Pearson's $r = 0.588$) and ROA (Pearson's $r = 0.612$), as demonstrated in figure 5.2(c) and (d). All these initial statistical results lead to a tentative conclusion that a higher CAR is strongly correlated to banks' performances. In addition, according to figure 5.2(a), it seems that the number of POB share a strong negative correlation with CAR (Pearson's $r = -0.734$). The more the number of POB or privatized GOB is, the laxer the bank regulatory results would be. As POB started to flourish in early 1990s, Taiwan's CAR declined from 18.1% in 1993 to 10.4 in 2001. The NPL ratio climbed from 0.97% in 1991 to 11.26% in 2001. Return on equity decreased from 10.4% in 1993 to -5.11% in 2002. All these coincided with a wave of entry of POB and GOB privatization. It was also the time when Taiwan experienced a divided government and the ruling political party confronted severe obstruction from the legislative body, which had already been much more sensitive to POB's political lobby. In sum, the theoretical framework would predict a strong influence of domestic politics in Taiwan starting from early 1990s and reached its peak during the Chen Shui-bian administration. Before and after that period, the political circumstances were more favorable for internalizing Basel Accords that put stringent regulatory standards on Taiwanese banks.

Figure 5.2 Number of POBs, bank performance and CAR



Source: Statistics from the Ministry of Finance, Financial Supervisory Commission, Lee (2002), and Lee and Tang (2007).

Changes of Taiwan's Bank Regulations

In this section I discuss how Taiwan's bank regulations were changed by international pressures, domestic pressures and exogenous shocks during the four major *Banking Act* amendments in 1985, 1989, 2000, and 2008. They related more closely to the spirit and contents of Basel Accords.

Amendment of the Banking Act in 1985

Capital requirement is the core of a bank's properness and health (Barth, Caprio and Levine 2006:110-31). It demonstrates how high a bank exposes to and how competent can it ward off to potential credit risk, market risk, and operational risk. A proper standard would lead the banks to raise its capital and reduce risky investments. It can be manifest in a bank's minimum capital entry requirement and capital adequacy ratio. By setting a minimum of capital entry requirement before issuing license, the authority can better ensure a bank's initial quality. This can force new banks to maintain an acceptable financial quality at their initial stage. After entering the market, the capital requirement of a bank becomes an important indicator for a bank's health. The measurement and calculation for the requirement varies. A more internationally agreed capital standard first appeared as Basel 1, which was embodied in the 1988 *International Convergence of Capital Measurement and Capital Standards* published by BIS in July 1988.⁴ It set a standard of 8% for capital to weighted risk assets. The standard was expected to be enforced in BCBS member countries by the end of 1992. Such standard was later upgraded in the Basel 2, which treated capital requirement as one of the three pillars of a country's regulatory regime. It was official released in June, 2004 and the final version, which is titled *Basel 2: International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, came out in June, 2006.⁵ After series of financial crises damaging the U.S. and Europe, Basel 3, another upgrade of Basel Accords, was agreed by members of BCBS during 2010 to 2011 and expected observance around the world by 2015. Since Basel 3 is currently underway, this section will deal mainly to changes of Taiwan's bank regulations from 1980s to 2010. I will discuss the amendments of Taiwan's *Banking Act* in 1985, 1989, and 2008.

As mentioned in the previous section, Taiwan had experienced four local financial crises in early 1980s. They resulted in subsequent bank runs on Asia Trust and

⁴ The document can be retrieved in BIS's website at <http://www.bis.org/publ/bcbs04a.pdf>.

⁵ The document can be retrieved in BIS's website at <http://www.bis.org/publ/bcbs128.htm>.

Investment Corporation in 1982, Tenth Credit Cooperative Association of Taipei City in 1985, Cathay Trust and Investment Corporation (CTIC) in 1985, and Overseas Chinese Trust & Investment Corporation (OCTIC) in 1985. The main cause came from financial frauds and poor corporate governance that led to a large number of low-quality assets and non-performing loans (Lee 1994:58-94, Wu 2008a, Yu and Wang 2005:267-71). Most of bad loans were approved by bank lenders' *guanxi*, or personal relationship, with the borrowers. For example, The Tsai Family from the Lin Yuan (霖園) Group used its OCTIC to purchase their personal real estate assets with prices above market values. They also concentrated their mortgage loans to family members and their close friends who involved heavily in land and real estate speculations. OCTIC was put under great risk once the real estate market collapses. That actually happened as Formosa Incident, or Kaohsiung Incident, and the subsequent political unrests erupted in early 1980s and the real estate market was greatly hit (Lee 1994:58-94). A series of bank runs forced the government to restrain financial institutions from loans based on *guanxi* regardless of borrowers' debt-paying ability and the appropriate market value of the collaterals. While working for a private family bank, a now top level banker recalled that when a big loan was applied, an internal committee consisted of about ten people from the core departments of the bank will be formed to review the application. But when the loan was applied by someone or companies related to the family business, a smaller committee that included only family member was formed. Those loans were hardly rejected. Unlike nowadays that financial professionalism precedes, the banking environment back then was dominated by personal relationship.⁶ Therefore, the first major attempt to amend *the Banking Act* in 1985 targeted exactly such problems. Although it did not closely relate to the capital requirement but the underlying motivations was similar. Both are devised to control risks coming from banks' loans and investments.

Before 1985 Basel 1 had not released and promoted globally; therefore the government had not yet confronted with high international pressures for complying Basel 1. The influence on bank regulations mainly came from domestic politics. Before the amendment in 1985, articles 32 and 33 of *the Banking Act* regulated who shouldn't be loaned by the banks. Article 32 proscribed that "No unsecured credit and bank guarantee shall be extended by a Bank to its own responsible person, to its staff members"; article 33 proscribed that "For any secured credit extended by a Bank to its own responsible person, to its staff members, or loans extended to any interested companies or individuals of its own responsible person or of a staff member, the terms of such extended credit shall not be more favorable than other borrowers." Invited by

⁶ An interview with a banker in Taipei on September 1, 2014.

the Legislative Yuan to explain the amendment of *the Banking Act* during the 73th Session in March 12, 1984, the then Minister of Finance Hsu Li-teh (徐立德) stated that “the amendment should include the prohibition of unsecured credit extended to any interested party of its own responsible person or of a staff member.” As for the terms of extended credits and loans, Hsu stated that article 33 should be amended that “the terms shall not be more favorable than other same category customers.” Hsu also added that “an augmented article 33-1 is needed to clearly define the meaning of ‘interested party’.” To correct speculation on short-term investment, such as real estates by trust companies, which are agents of public’s saving for longer and more stable investments, Hsu proposed the need to amended article 101, which prescribed what trust companied can invest and what they can’t. The government wanted to prevent trust companies from dealing with real estates, direct investments in manufacturing businesses, and securities investment trust. (Legislative Yuan (Taiwan) 1984a:68-70) Such amendment was targeted to solve the mismanagement of credits extended, loans and investments emerged in the early 1980s. Confronting with financial crisis, in fact, the KMT government strived to regulate Taiwan’s financial market in a more stringent way, especially for trust corporations that attracted abundant wealth resulting from Taiwan fast economic growth better than inefficient GOB. The exogenous shock provided a stronger motivation for the authority to direct banks pursuing less-risky assets with higher quality.

Although international pressures were less obvious, domestic politics seemed to play some role during the bargaining occurring in the Legislative Yuan, even though in 1985 Taiwan was still in the middle of its democratization under a more unified government controlled by KMT’s centralized rule. Confronting the reform plan envisaged by the Ministry of Finance, several legislators strongly opposed it. In a closer look, those legislators were agents for the financial industry. During the meeting on May 2nd, 1984 of the 73th Session, at least five legislators close to major bankers stated different reasons to oppose official proposals. They were Liu Sung-pan (劉松藩), Wang Jin-pyng (王金平), Kuo Jung-tsung (郭榮宗), Li Tsung-jen (李宗仁), and Hung Yu-chin (洪玉欽), who were allegedly belonged to the “thirteen brothers in the Legislative Yuan (立法院十三兄弟)” led by Tsai Chern-chou (蔡辰洲), a legislator from Lin Yuan Group owned by the Tsai Family. They represented the interests of financial sectors, especially trust corporations when POB’s license was not opened for application. More than half of the members were in the board of directors of in local financial institutions (Lee 2003:115). According to many press reports, those thirteen brothers’ campaign contributions relied heavily from trust companies. In an interview with the United Daily News in 1984 when the rumors spread out before the amendment, Tsia said that

“according to his indirect understanding, local credit cooperatives had their local bases and they helped legislative candidates. After successfully elected, it is normal for them to reflect their (credit cooperatives) interests” (Chen 1984). One anonymous officials in finance ministry described trust and investment companies as the “national biggest group in influence peddling” (Huang and Kou 1984).

For example, when Wang was in personal financial crisis in the 1970s, he used a barren land in the countryside of Tainan as collateral to receive credits way beyond the market value from CTIC of Tsai’s family. Liu was seen as the most important figure among the thirteen brothers. He was considered a middleman between the Tsai family and KMT’s big shots, such as the Minister of Finance Hsu Li-teh (Yang 2002). According to investigation conducted by the Control Yuan of the ROC, CTIC’s illegal loans surged to NT\$3.8 billion during Hsu’s term as the Finance Minister, which was more than 3-fold compared to Hsu’s predecessor. He later resigned and was held responsible for the lack of bank supervision on CTIC (United Daily News 1985).⁷ While amendment of article 32 and 33 and the augmented article 33-1 strived to prevented risky and inappropriate loans and credits, Hung Yu-chin first argued against the amendment, saying that the scope and definition of ‘ the interested party’ was too extensive. He used Hong Kong and Singapore as examples to counter stringent regulations. Following Hung’s reasoning, Li Tsung-jen added that Taiwan had criminal law to punish misbehavior done by bank staffs and there is no need to further regulate. He stated that “a bank is a financial institution for profits, any kinds of loans should be allowed.” Wang Jin-pyng further oppose by connect more restricted regulations to potential economic downturn, which was not allowed while Taiwan started to rise (Legislative Yuan (Taiwan) 1984c:83-93). Kuo Jung-tsung seconded the view of Hung by adding Japan’s and Germany’s experience in regulating banks that are less stringent than the proposed amendments. Liu Sung-pan simply opposed by questioning the correlation between local financial crises and bad loans, credit extended, and investment (Legislative Yuan (Taiwan) 1984b:25-34).

Article 101 was another main battleground during the amendment of *the Banking Act* in 1985. The main point is whether trust corporations should be treated as banks and should be allowed to engage in short-term businesses, such as, issuing cheques, trading stocks or investing in real estate market and manufacturing businesses. Although several legislators supported the Ministry of Finance’s view that forbid short-term operation on those items, the thirteen brothers strongly opposed and urged others

⁷ During an interview with the author on August 22, 2014, a central bank official recalled that Hsu’s crony capitalism and the subsequent weak regulation were the major cause for CTIC’s liquidity crisis.

to treat trust corporations as banks and allow the existence of short-term financial businesses. For example, Tsai Chern-chou used statistics to argue that the assets controlled by trust companies were too small to influence the market and the incident of Asia Trust and Investment Corporation in 1982 was not the result of management of short-term assets. His view was immediately seconded by Wang Jin-pyng, who stated that the high real estate prices were nothing to do with speculation by trust companies, which should be allowed to function as commercial banks. Li Tsung-jen jumped in right after Wang by providing a legal perspective to support that trust corporation should be allowed to issue cheques. He further said that it would be dangerous for customers to carry cash while the public security was poor (Legislative Yuan (Taiwan) 1984d:151-55).

Although confronted with oppositions, articles 32, 33, and 101 were successfully amended and article 33-1 augmented according to the Ministry of Finance's initial proposal. Its success came from the pressures coming directly from the ruling party. The relationship between political party and state was coined as a state ruled by a Leninist party, which controlled administrative system in every level and scope. Kuomintang was also adept at mobilizing the society for national policies (Cheng 1989, Chou and Nathan 1987). It needed to, at least, tackle problems resented by the most public and used a centralized decision-making all the way to the administrative apparatus to solve them. As conflicts in amending the *Banking Act* became intensive, Kuomintang invited its prime minister, legislator with opposing views, and several involving ministers, for a meeting. This time the party sided with the Ministry of Finance and refused to answer to the interests of trust and investment corporations by asking the amendment be passed with the most stringent standard. The party threatened to punish legislators who would not obey according to the party line. It was also evident that the then president Chiang Ching-kuo (蔣經國) was very disappointed with the crony capitalism phenomenon. He expressed his insistence that the government should follow the principle of anti-monopoly, anti-privilege, and anti-speculation during a conference. In fact, president Chiang despised close government-business relationship. Right after the Tenth Credit Cooperative Association of Taipei City's liquidity crisis in February 1985, the bank was taken over, Tsai Chern-chou was indicted, and the group of thirteen brothers was automatically dismissed and lost their power (Lee 2003:115-19, Su 1992:37-46). According to the summary for the amendment initiated by the Ministry of Finance in 1983, series of local bank crises caused by trust and investment corporations' risky and corruptive investments was the main reasons for the reform. Using the model in chapter 3, exogenous crisis changed the preference of domestic politics, which caused greater domestic pressures given the level of bank regulations.

With Kuomintang and the administration's push, the *Banking Act* became more stringent.

Amendment of the Banking Act in 1989

From the above analysis, the amendment of the *Banking Act* in 1985 was mainly influenced by financial crises that changed the ruling party's and administration's preferences and tolerance on bank regulations. After 1988 when Basel 1 was published by BIS, Taiwan was subject to different combination of factors that affected its bank regulations. The core of Basel 1 was to set an 8% CAR using its method to calculate the total of risk-weighted assets. In Taiwan, article 44, which prescribed the risk bearing capacity of banks, stated that the authority should set a maximum level for a bank's ratio of liability to equity. For the bank that exceeded the prescribed ratio, the authority can restrict the bank from distributing its profits. The *Banking Act* in 1988 obviously did not fit in Basel 1. On January 17, 1989, the Executive Yuan sent a comprehensive proposal of the amendment of the *Banking Act* to the Legislative Yuan for deliberation and approval. The package included article 44, which prescribed the risk bearing capacity of banks. The proposed revision stated that "To strengthen banks' financial basis, unless approved by the Competent Authority, banks' equity capital to its risk assets shall not be less than 8%. If a bank's actual ratio is less than the prescribed standard, the Competent Authority shall restrict the bank from distributing its profits." It also give the power of prescribing the method of calculating equity capital and risk assets to the Competent Authority, which was the Ministry of Finance in 1989. Regardless of actual performance of banks, Taiwan's regulatory compliance was swift. According to the theoretical framework, the change came from sensitiveness to international or domestic pressures and the preference of foreign or domestic sectors.

First, the international pressure was high from 1988 to 1992, which is the expected time for global harmonization of the Basel Accord. As discussed above, Taiwan's international pressures mainly came from its tie interdependent relationship with the world, especially the U.S., which was the main initiator and promoter of it. Many banks that sought the establishment of foreign branches in the U.S. and other major western advanced industrial countries worried that the failure of attaining 8% CAR will lower their chances of the approval of application of branches. As mentioned above, Taiwan's global economic adventure required home country bank's foreign apparatus to facilitate financial service because the costs of credits are lower with Taiwanese banks because they have already built businesses connections at home and are more familiar with the

overall situation of that Taiwanese overseas companies.⁸ One former central bank official, who later also serve in a GOB, recalled that Taiwanese bank was then required to observe both U.S.'s federal and state laws that asked for more stringent and complex capital requirement. Taiwanese banks, in turn, were forced to adjust capital structure in order to enter financial markets in America.⁹ Should the Taiwanese bank's CAR could not exceed the 8% limit, it is very likely that the new application will be turned down. Chang Hsiu-lien (張秀蓮), the deputy director-general of the Bureau of Monetary Affairs, the Ministry of Finance, once commented that if Taiwan's banks cannot reach BIS's 8% CAR standard by the BCBS members' deadline (the end of 1992), they will face difficulties for establishing foreign branches in the future. Her comments came out when the bureau was urgently deliberating for formulating the scope and methods of calculation of capital and risk-weighted assets in order to assist banks to reach the target (Li 1991). Such international pressures not only put pressures on the governments but also major banks in Taiwan. Such pressure also push the Ministry of Finance to ask the Bankers Association of The Republic of China for drafting a reviewing standard for approving the establishment of foreign branches by Taiwanese home banks. The association recommended the ministry to include Basel Accord's CAR in the application requirement (Chien 1991). Indeed, Taiwanese banks had suffered setbacks while applying for foreign branches.

In 1992, Taiwan Business Bank, while applying for a foreign branch in the U.S., received U.S. authority's notification, asking to explain the failure of reaching 8% CAR. A senior staff responsible for external affairs in Hua Nan Bank indicated that Hong Kong, which complied the Basel Accord in 1990, required foreign banks to sell assets if the 8% CAR was not met (Yeh and Lai 1992). Farmers Bank of China's first application for setting up a branch in Los Angeles was rejected by the U.S. federal government, for not meeting 8% CAR. Only when it increased equity to improve its CAR to 10.6% in 1995, its reapplication was approved (Chiang 1995). Belgium's Banking and Finance Commission, when reviewing the application of the establishment of United Taiwan Bank in Brussels that was formed by Taiwan Cooperative Bank, Bank of Taiwan, Land Bank of Taiwan, and Taiwan Business Bank, would approve the application only when it increased equity of US\$10 million dollars because Taiwan Cooperative Bank and Taiwan Business Bank failed to reach 8% CAR (Chiang 1992). The vice president of the Central Bank, Yu Cheng (俞政), ironically commented that

⁸ Although the majority of customers of banks' foreign branches were overseas Taiwanese, which incurs less risks, in the long-run, banks also expect to do businesses with foreign individuals and companies. This view was shared by a vice-president of Taiwanese POB in Taiwan, during an interview on September 1, 2014.

⁹ Author's interview in Taipei on August 1, 2014.

domestic banks should go abroad as soon as possible before the end of 1992 when they still can because foreign countries would have more flexibility on the Taiwanese banks' structures (Yu 1992). As can be seen, Taiwanese government and society seemed to be very sensitive to international pressures resulting from its high interdependence with western countries.

Domestically, the then finance minister, Kuo Wan-jung (郭婉容) estimated that, using Basel Accord's method, the average CAR of Taiwan's bank in 1988 was about 6.6% while some legislator estimated that the actual rate was merely about 1.5%-2%.¹⁰ Despite of disagreement on the actual CAR, it seemed to be plausible that most banks in the late 1980s did not meet the standard. According to the three commercial banks' own calculation based on the Basel Accord,¹¹ their CARs were merely 3-4% in 1988. They suffered from pressures of increasing their equity in order to apply the license in host countries for their foreign branches (Economic Daily News 1988). The department of finance of the Taiwan Provincial Government estimated that in 1990 only Bank of Taiwan's 12.77% and Land Bank of Taiwan's 8.52% exceed Basel's 8% CAR out of all seven banks under its control. But only Bank of Taiwan was capable of sustaining the standard in 1992. The worst was Taiwan Cooperative Bank's 2.64% (Yen 1991). For most banks during the time needed to increase their equity or change the structure of their assets for improving their CAR, those banks had to sacrifice their ability to create credits or invest. Such concerns were shared by many bankers. For example, the president of Taiwan Cooperative Bank, Lo Chi-tang (羅際棠) worried that improving CAR at the expense of credit-making ability will influence Taiwan's economy in a negative way (Lai 1992). Despite of concerns from bankers, it did not constitute a great domestic pressures to counter the revision of article 44 of the *Banking Act* in 1989 since 87.5% banks controlling for more than 60% of assets were government owned (Lee and Tang 2007), which shall receive and follow direction from the authority. To increase their equity, they relied on government budgetary approved by the Legislative Yuan, rather than their own pockets. In addition, private banks were only allowed for license application in 1990 when the Ministry of Finance promulgated *Standards Governing the Establishment of Commercial Banks*, which provided regulations for new banks' application. Potential private banks had no time arguing against the revision of article 44 initiated by the governments but strove for the authority's approval. It is clear that the unequal ownership distribution that tilted heavily toward the government did not lead to a favorable condition for forming a strong lobbying force against Basel Accord.

¹⁰ Official records were published by the Legislative Yuan. Please contact the author for copies.

¹¹ The three commercial banks, or *san shang yin* in Chinese, referred to First Bank, Hua Nan Bank, and Chang Hwa Bank that were under the provincial government's control.

During the deliberation of article 44 in Legislative Yuan, the content of revision did not face strong oppositions. Most comments from the legislators were too minor to stop the legal compliance with 8% CAR. Probably the most strong opposition came from KMT legislator Chou Wen-yung (周文勇) who contended that the 8% should be applicable to all banks. Not until existing banks reach the target should we ask new banks to comply. Legislator Chang Pen-Tsao (張平沼) seconded this view stating that it would be unfair to force new banks to comply while allowing existing banks several years to adjust.¹² Beyond such criticism, there was no objection to the 8% level itself. Members from the finance committee of Legislative Yuan, which was responsible for detailed reviews during the second reading, seemed to reach a consensus to pass the 8% CAR and allowing the authority, the Ministry of Finance, to initiate an administrative order to regulate the calculation of capitals and risk-weighted assets, as well as the way to restrain banks from distributing bonuses should they fail to reach 8% CAR. The compliance to Basel 1 did not confront severe domestic pressures as the amendment of the *Banking Act* in 1985. The pressures mainly came indirectly from foreign countries. According to my model, due to the introduction of Basel 1, Taiwanese governments' preference of international pressure changed upward given the level of bank regulation. At a given lower level of regulation, governments would face more expected political cost because if the bank regulation does not elevate to the Basel 1, Taiwanese banks' establishing foreign branches would be obstructed by host countries, which created economic costs to overseas businessmen and negatively harm Taiwan's economy. As a consequence, the compliance to a more stringent Basel 1 can be reached in 1989.

Amendment of the Banking Act in 2000 and 2008

In June 1999, BCBS published a document called *A New Capital Adequacy Framework*, which aimed at replacing Basel 1. The motivation came from the incompetence of Basel 1 of 1988 to prevent Asian Financial Crisis in 1997. It first presented the three pillars of bank regulations, which are minimum capital requirements, supervisory review process, and effective use of market discipline. This new regulatory framework had been discussed, reviewed, and tested actively and the first draft was published in 2004; the final version, which is coined as Basel 2, was released in 2006. During the period from 1989 to 2000, not only did Taiwan harmonize its bank regulation to Basel 1, the actual performance of most banks maintained a CAR above 8% (see table 5.6). Banks considered complying Basel 1 as important for their performance. For example, many banks hesitated to a syndicated loan for the building of Taiwan High Speed Rail, which was operated in the form of government-supported

¹² See footnote 7.

build–operate–transfer (BOT), because the project was not guaranteed by the government. In this case the risk weight under Basel 1 was 100%. The approval of such loans would harm involving banks' CARs. With the guarantee from the government, however, the risk weight will lower to 20% (Chiu 1998).

For the Taiwanese government, as early as 1996 when BIS revealed the intention to revise Basel 1 by adding market risk to the calculation of CAR, the authority had revealed that it was ready to change the law (Chan 1996). It was evident that Taiwan's regulatory regime for banks were very sensitive to the updates of Basel Accords. For example, although Taiwan was not a member of BIS and had no influence in standard setting, the central bank sent staffs to BIS's meeting every year in order to bring back latest information and knowledge that contribute to internal policies discussion in the government. Continuous participation was due to the necessity for the globally-connected Taiwan to observe international standards as soon as possible.¹³ Since most banks can easily meet Basel's capital requirement, no significant objection to the compliance with Basel Accords came from the banking sectors.

Table 5.4 Number of banks with CAR below 8%

	1993	1994	1995	1996	1997	1998	1999	2000
Avg. CAR	18.1	14.5	13.6	12.9	11.4	10.4	11.2	10.8
# < 8%	3	1	2	1	1	2	4	5
# of banks	41	42	42	42	47	48	52	53
%	7.3	2.4	4.8	2.4	2.1	4.2	7.7	9.4

Note: Data comes from "main financial and managerial ratios" in the Quarterly Report on Domestic Bank Performance (本國銀行營運績效季報) published by the Central Bank of the ROC

To allow greater flexibility to adjust Taiwan's bank regulatory regime to the fast-changing Basel Accords, the amendment of article 44 of the *Banking Act* stated that "a bank's equity capital to its risk assets shall not be less than 8%. The Competent Authority shall raise the ratio if necessary." It also added that "the Competent Authority shall impose restrictions on risk assets when necessary." The original contents that allowed the authority to issue administrative order for prescribing the calculation of CAR and restraining banks with CAR below 8% from distributing bonuses remained. The Executive Yuan's explained that the amendment of article 44 was for more flexibly and timely observing with standards set by BIS¹⁴. While the CAR of 8% did not change but its calculation underwent several revisions made by BCBS. All these changes were

¹³ This view is shared by interviews with a former and a present central bank officials in Taipei on August 1 and August 22, 2014.

¹⁴ See footnote 7.

immediately reflected by in the administrative order of *Regulations Governing the Capital Adequacy and Capital Category of Banks*, which can be adjusted by the Ministry of Finance according to BCBS's updated methods. Since 2000 it was amended eight times for compliance with Basel Accords.

According to the official explanations by the Ministry of Finance and Financial Supervisory Commission, which took over the banking supervision power from the Ministry of Finance and the Central Bank in July 1, 2004, the amendment were made to align Taiwan's bank regulation of CAR with Basel Accords. The amendments in 2002 and 2003, and 2007 were devised to comply with the updated Basel 1 published in 1988, and the Basel 2 that was first published in 2004.¹⁵ In 2008 article 44 of the *Banking Act* was amended again, it changed the 8% CAR to "a certain ratio" that reflected the difference of calculation of CARs among difference countries and the change of thoughts on CAR by BCBS. However, it referred to the article 38 of *U.S. Federal Deposit Insurance Act* to categorize CAR into four types: adequate capital, inadequate capital, significantly inadequate capital, and seriously inadequate capital. It defined seriously inadequate capital as CAR or equity to asset ratio less than 2%. The purpose of categorization was to prescribe necessary official actions for banks in different situations. Articles 44-1 and 44.2 were augmented for this purpose. They related to the second pillar of Basel 2, which will be discussed in the following paragraph.

From 2000 to 2008, Taiwan's CAR regime was changed several times mainly for fitting in the changes of Basel Accords. There is no clear evidence demonstrating the obstructions from banking sectors and legislators. In fact, according to interviews with top- and mid-level managers from GOBs and POBs, most major Taiwanese banks after mid-2000 became professional enough to meet Basel's capital requirement. When planning their regular credit plan, the capital required by the Basel standard will be allocated in the beginning to ensure the observance. In addition, Taiwan high saving rate allow enough capitals for banks to easily achieve the target. From banks' point of view, there is no need to reject a standard that banks had already met.¹⁶

On the contrary, international pressures seemed to play more roles for the immediate compliance. According to the Taiwan's financial stability report in 2007 written and published by the Central Bank of the ROC, FSA will require banks to

¹⁵ See footnote 7.

¹⁶ Author's interviews with mangers from a mid-level manager from Citibank, a senior manager from Yuanta Bank and a top-level manager from Fuban Financial on July 28, August 8 and September 1 respectively in 2014.

comply with Basel 2's capital requirement after the first season in 2007; to report their assessment results to FSA according to Basel 2's second pillar after the fourth season of 2008; to disclose relevant information prescribed in Basel 3's third pillar in the banks' websites after the fourth season of 2008 (Central Bank of the Republic of China (Taiwan) 2008:31-32). International pressure from Washington is especially high. A banker provided a vivid example regarding U.S.'s *Foreign Account Tax Compliance Act* that asks banks around the world to submit information to Washington regarding U.S. citizen's skeptical foreign assets. Although serious complaints arise among Taiwanese banks due to the increases of costs, such as hiring people for matching records or purchasing and synchronizing information systems, banks has to cooperate with the U.S. on the observance of the federal law. That is because Taiwan's banks are too weak to resist the request from a government that controls one of the biggest financial market in the world.¹⁷

For the second pillar of Basel 2 that focused on supervisory review process, the *Banking Act* was amended that encouraged banks to initiate an operation procedure that reviews their overall CAR. In the amendment of 2000, article 45-1 was augmented to prescribe that "a bank shall establish an internal control system and audit system. In addition, "a bank shall establish an internal processing system and procedures with respect to the evaluation of asset quality, the creation of loan loss provision, the clearing of and writing off of non-performing and non-accrual loans." The law gave the right to establish related regulations to the competent authority. In 2005 article 45-1 was amended to make it more specific. This part reflected Basel 2's requiring banks to develop its own trustworthy methods for calculation risk assets. When this article was reviewed in the Legislative Yuan, no one challenges it. It was passed as its original form.

Another focus in Basel 2 expected that the official supervisors shall devise a strategy to assess, control and supervise each bank's CAR. For banks does not satisfy the standards of official assessment, supervisors should adopted necessary means. The supervisors shall possess power and means that incentivize banks to pass the minimum level of CAR. In addition, bank supervisors should intervene in insolvent banks as soon as possible and assist them to correct the problems. To make the authority effective, Taiwan had to deal with the originally scattered regulatory regimes, which were controlled by the Central Bank and the Ministry of Finance. On July 1st, 2004, Financial Supervisory Commission (FSC) was established to strengthen supervisory agency's level and power that lead to greater performance on financial supervision (Wu 2008a:61-63). For specific legal contents for FSC to deal with troubled banks, two

¹⁷ Author's interview with a vice-president of POB based in Taipei on September 1, 2014.

articles, 44-1 and 44-2, were augmented during the amendment of the *Banking Act* in 2008. Both article prescribes specifically what the authority should do to banks with inadequate, significantly inadequate, and seriously inadequate capital. For example, if a bank has seriously inadequate capital problem, it shall not make payments to their responsible persons other than remunerations.

In addition, that bank shall be taken over by the authority that has the power to the bank's operation and management and disposal of the bank's properties. Both articles provide the legal basis and means for official supervisors to engage in troubled banks as soon as possible. The amendment for these articles did not confront opposition from legislators. During the legislative inquiry on the amendment of the *Banking Act* on November 24, 2008, the only legislator mentioning those articles was Liao Cheng-ching (廖正井) who was once the president of Taipei Bank and bank supervisor in the Central Bank and the Ministry of Finance. In fact, he considered an 8% percent CAR as pointless by giving an example that even though Citibank Taiwan maintained a CRD of 10.4%, it was still in the trouble. As a consequence, Liao asked for more ambitious and stringent regulatory regime for bank supervision (Legislative Yuan (Taiwan) 2008:227-30). The amendments were easily passed as its original form proposed by FSC.

Although the legal amendment did not suffer from domestic lobbies, the FSA's management of insolvent banks confronted enormous lobbies from concerned groups. In article 17-6, the *Financial Institutions Merger Act* promulgated in 2000 states the "the losses from sale of non-performing loans by a Financial Institution due to merger may be carried forward over 15 years". As a consequence two insolvent banks, after merging, would become one healthy bank, which yearly NPLs on the book becomes 1/15 of the original amounts. Due to this law, FSC had received strong lobbies from the legislators and related parties that sought interests out of the bank restructuring plan.¹⁸

For the third pillar of Basel 2, market discipline, which aimed at developing an information disclosure procedure that give market participants access to information for assessing a bank's capital adequacy. The regulatory authority should have power to require banks under its jurisdiction to disclose audited financial information on a regular basis. In 2000, article 49, which originally prescribed that after the end of a calendar year a bank shall provide related financial information to the authority for future reference, was amended. The new version proposed by the Ministry of Finance prescribed that a bank shall published annual reports documenting related financial

¹⁸ Author's interview with a former top-level official from FSA on August 8, 2014.

information within 15 days after being recognized during the shareholders' meeting. In addition, all disclosed information should be audited.¹⁹ The amendment was passed in its original form without confronting legislative obstruction. To accommodate article 49 with specific procedure, the Ministry of Finance issued the administrative order *Regulations Governing Information to be Published in Annual Reports of Banks* in 2001. The regulation comprehensively required banks to disclose trustworthy financial information. Since its promulgation, it has been amended 7 times in order to comply with Basel Accords' changing calculation CAR, strengthen corporate governance of banks, and follow to the international standard for publishing financial report.²⁰ Such information disclosure regulations were further extended to bills finance companies.

Since 2000 the *Banking Act* and several administrative orders were issues to accommodate the three pillars of BCBS's best practices and 2008 was a year for Taiwan to leap a big step forward for complying with Basel 2, as discussed above. It was also a year that saw a series of financial crises breaking out in Europe and North America. The exogenous shock frightened Taiwanese people and changed their perception of financial institutions. In a poll conducted by TVBS in October 2008, 67% of respondents expressed concerns to global financial crises; 37% people distrust private-owned banks; 60% considered it possible for the occurrence of financial crisis in Taiwan; 43% distrusted their financial consultants.²¹ The society was haunted by the possible upcoming financial crisis, especially when several domestic and foreign financial institutions in Taiwan were also hit by U.S. subprime mortgage crisis. People's confidence to financial system dropped faster than the actual damages (Kuo 2009:65-70). Under such situation, governments' sensitiveness to banking sectors decreased while politicians were incentivized to take actions that answer general public's concerns.

Aside from a crisis with a global scope, even a local crisis can change domestic situation. In an interview with a former FSA top-level official, he recalled that right after DDP took the power in 2000 the government had tried hard to revise regulations that require banks to disclose their clients' information when necessary, especially those possesses enormous bad debts resulting from crony capitalism. Back then, however, DPP confronted a divided government while the banking reform had led the balance to a POBs-dominated system. The domestic political and economic situation was very sensitive to political pressures. KMT legislators always use article 48 of the Banking Act, which prescribed that banks should not disclose clients' information only when

¹⁹ See footnote 7.

²⁰ Official explanations for each revisions can be accessed at <http://goo.gl/D9p3ih>, accessed on September 5, 2014.

²¹ The report can be accessed at <http://goo.gl/bP1T6P>, accessed on September 5, 2014.

necessary. But how necessary is necessary was not stated. As a consequence, the DPP government was unable to control enough information. On January 6, 2007 when the bank run on the Chinese Bank (中華銀行) occurred, things started to change. The bank was controlled by China Rebar (力霸集團), which was owned by Wang You-theng (王又曾). In late 2006, Rebar announced that two of major holding companies were in serious debts, people started to withdraw their deposits in the Chinese Bank. Wang himself had already got NT\$800 million credits and flee Taiwan. This scandal shocked Taiwanese society, which realized the importance of information disclosure. After then, the official said, reform became easily and confronted less obstruction from KMT that became less legitimate to block while confronted greater public pressures for banking reforms. Under such friendlier environment, the article 48 was finally revised and passes in the Legislative Yuan, which requires banks to disclose the names of their clients if their bad debts exceed a certain level. Now in every Taiwanese bank's websites people have direct access to this information.²²

Before the financial crisis, as discussed above, the second and third pillars of the Basel 2 faced with greater domestic lobbies more than the first pillar that is easier for Taiwan's banks to comply. After the financial crisis, however, the preference of domestic political factor had changed, which lowered the sensitiveness to the banking sector that asked for less stringent bank regulations. Since several key members in BCSB, especially the U.S., were suffered from financial crises, it would be less legitimate to exert pressures for global harmonization regarding bank regulations that failed to bail them out of crises. Therefore another revision in Basel 3 was called upon and would cost each country more for compliance in the short-term. Therefore international pressure appeared again. Together, the changes of both preference of international and domestic pressures raise the compliance level of Basel Accord in Taiwan.

Conclusion

From the above analysis, Taiwan's compliance with the Basel Accords can be illustrated by looking at the international and domestic factors mentioned above. The *Banking Act* amendment in 1985 was a result of serires of local bank runs that change the domestic preference in favor more prudential bank regulations while international pressures remained vague. In 1989, international pressures came with the introduction of Basel 1 and its implementation in countries important to Taiwan's overseas markets. Since domestic preference did not change much, pressures from abroad further push up

²² Author's interview with a former top-level official from FSA on August 8, 2014.

the level of Taiwan's bank regulations, which results in the implementation of 8% CAR and subsequent administration fiat for related regulations in detail. Later in 2000, Taiwan was alarmed by 1997 AFC, the emergence of several large insolvent publicly listed companies and global financial crises in the 2000s while, at the same time, the number and influences of POBs rised. The crises influenced international and domestic pressures for greater prudential bank reform and the rise of POBs reduce such pressures. As a total, domestic preference was cancel out, which allowed the effect of international pressures for higher level of Basel Accord. To sum up, it was the combination of international pressure, domestic pressure, and financial crises as exogenous shock that determine the results of Taiwan's bank regulations. One should not discuss them separately.

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