

ARTICLES

UNLEASHING A TIGER: FINANCIAL DEREGULATION IN TAIWAN

Michael S. Bennett†

I. INTRODUCTION

For a nation of only twenty million people, the accumulation of wealth in the Republic of China (“Taiwan”) is remarkable. At roughly US\$90 billion and rising, its foreign exchange reserves are the largest in the world.¹ Deposits in the official banking system at the beginning of 1992 exceeded US\$300 billion.² Almost another US\$300 billion of liquid savings is believed to exist outside of the official banking system, with a significant amount of such nonbank savings consisting of private gold holdings.³ Even excluding deposits outside the official banking system, the roughly US\$15,000 of official deposits per person in Taiwan is almost half of the amount of per capita deposits in Japan, whose per capita GNP is three times greater than that of Taiwan.⁴

As the statistics recited above suggest, Taiwan has very successfully engaged in the mercantilist enterprise of hoarding capital. The island is bursting with liquidity as a result. However, Taiwan’s financial system has not yet proven capable of unleashing the is-

† Associate, O’Melveny & Myers (New York); J.D., Columbia University School of Law. I gratefully acknowledge the invaluable assistance of Harold B. Dichtes, J.D. expected 1994, Harvard Law School.

1. *Sitting on Its Billions*, *ECONOMIST*, Mar. 14, 1992, at 97. For an interesting discussion of Taiwan’s foreign exchange reserves see Nigel Holloway, *Taiwan Too Reserved*, *FAR E. ECON. REV.*, Jan. 31, 1991, at 48.

2. *Sitting on Its Billions*, *supra* note 1, at 97.

3. *See, e.g.*, Jane K. Winn, *Banking and Finance in Taiwan: The Prospects for Internationalization in the 1990s*, 25 *INT’L LAW* 907 (1991); *A Dangerous Game in Taipei*, *ECONOMIST*, Sept. 9, 1989, at 97. Unofficial depository institutions in Taiwan include underground investment houses, neighborhood loan circles, rotating credit clubs, and companies that take deposits from their employees.

4. *Sitting on Its Billions*, *supra* note 1, at 97. Taiwan’s per capita GNP is approximately US\$8000.

land's prodigious financial resources. Because of extremely conservative government fiscal policies, much of Taiwan's accumulated capital sits idly in the vaults of the Central Bank of China (CBC) rather than being channelled into productive investment.⁵

Financing from the commercial banks,⁶ which hold over half of all banking assets in Taiwan, is generally available only on a short-term basis and on very restrictive terms.⁷ A number of special-purpose banks, such as the Export-Import Bank of China⁸ and the Bank of Communications,⁹ have been established to provide medium- and long-term financing to specific industries or types of businesses, but these institutions have also adopted very conservative lending policies. Medium- and long-term credit is almost always required to be secured by collateral worth at least twice the value of the loan.¹⁰ Financing on the basis of cash-flows alone is extremely rare.¹¹

The postal savings system, the second largest depository institution by assets in Taiwan, is not an alternative source of financing. Postal institutions accept deposits but cannot extend loans. They must redeposit accumulated funds with the CBC or another bank designated by the CBC.¹² Most of the funding for the government-controlled special-purpose banks come from the postal savings

5. See Wallace W.Y. Wang & James T.Y. Yang, *Financial Institutions in Taiwan: An Analysis of the Regulatory Scheme*, 4 J. CHINESE L. 3 (1990); Winn, *supra* note 3.

6. The Banking Law in Taiwan provides that a commercial bank may, among other things, accept checking, demand and time deposits and extend short and medium term loans. Banking Law art. 71 (promulgated Mar. 28, 1931) (Taiwan). All of the twenty-four domestic commercial banks operating in Taiwan prior to the beginning of 1992 were either controlled directly by the government or by overseas Chinese with close ties to the ruling Kuomintang Party. See Jonathan Friedland, *Law for the Jungle*, FAR E. ECON. REV., Jan. 25, 1990, at 52; Winn, *supra* note 3, at 913. In January 1992, this monopoly by government-controlled commercial banks ended when the first two private banks, Grand Commercial Bank and Dah An Commercial Bank, began operating. Since then, thirteen other private banks have opened for business in Taiwan. See *Private Banks Start to Open in Taiwan*, FIN. TIMES, Jan. 28, 1992, at 4; *Bank Reform Leads to Soaring Demand for Funds*, Global Fin. Markets, Apr. 8, 1992, available in Westlaw, BUS-INTL database.

7. See Wang & Yang, *supra* note 5, at 8; see also *Sitting on Its Billions*, *supra* note 1, at 97 (reporting that one reason for the banks' cautious lending policies is that a government bank must answer to the legislature for writing off a loan, regardless of the size of such loan).

8. The Export-Import Bank specializes in trade finance and country risk evaluations. Banking Law arts. 94-95.

9. The Bank of Communications specializes in industrial credit and was designated to provide medium- and long-term financing for development projects. *Id.* arts. 90-91; see Wang & Yang, *supra* note 5, at 10-11.

10. *Sitting on Its Billions*, *supra* note 1; see also Jiann-Chyuan Wang, *Taiwan: Government Policy Regarding the Informal Sector*, Reuter Textline Bus. Taiwan, Jan. 20, 1992.

11. *Sitting on Its Billions*, *supra* note 1.

12. Wang & Yang, *supra* note 5, at 11-12.

system.¹³

In fact, long-term financing alternatives to bank credit are almost nonexistent in Taiwan. The island lacks a well-developed securities market.¹⁴ Although the Taiwan Stock Exchange is one of the world's more active exchanges,¹⁵ it functions more as a casino than as a source of capital for Taiwanese companies.¹⁶ Highly speculative trading, fueled by the excess liquidity in the economy, and insider trading are predominant features of the exchange.¹⁷ Moreover, the private sector in Taiwan is dominated by relatively small closely-held corporations, many of which are wary of opening themselves up to public ownership.¹⁸

An over-the-counter equities market was established in 1990 but had only two listed companies during its first year of existence and has yet to develop a significant place in the economy.¹⁹ The market for long-term corporate bonds is likewise not liquid.²⁰

13. J.W. Wheeler, *Comparative Development Strategies of South Korea and Taiwan as Reflected in Their Respective International Trade Policies*, 11 MICH. J. INT'L L. 472, 484 (1990).

14. The development of a securities market in Taiwan can be traced to a 1950s land reform program in which landowners received government securities as compensation for land that was given to tenant farmers. These securities became the basis for a small over-the-counter market. The Taiwan Stock Exchange was established in 1961. See Lawrence S. Liu, *Financial Developments and Foreign Investment Strategies in Taiwan — a Legal and Policy Perspective*, 25 INT'L LAW. 69, 75 (1991).

15. Shortly before the Taiwan Stock Exchange peaked in early 1990, the volume of trading in one day on Taiwan's exchange exceeded that on the New York and Tokyo stock exchanges combined. See *The Problems of Success, in Asia's Emerging Economies Survey*, ECONOMIST, Nov. 16, 1991, at 14, 15.

16. See Winn, *supra* note 3; *Sitting on Its Billions*, *supra* note 1; *The Sound of Bubbles Bursting*, ECONOMIST, July 21, 1990, at 79.

17. See Winn, *supra* note 3; *Sitting on Its Billions*, *supra* note 1; *The Sound of Bubbles Bursting*, *supra* note 16. The Taiwan Stock Exchange's casino image was recently reinforced by the arrest of two major investors on stock manipulation charges. See Jeremy Mark, *Scandal Brings Hard Times to Stockbrokers in Taiwan*, ASIAN WALL ST. J. WKLY., Nov. 2, 1992, at 29; Jeremy Mark, *Turmoil in Taipei Market Is Blamed on Two Big Hands*, ASIAN WALL ST. J. WKLY., Sept. 21, 1992, at 22; Steven Yong, *Market Mischief Erodes Faith in Taipei's Turbulent Bourse*, NIKKEI WKLY., Oct. 3, 1992, at 21.

18. The majority of private sector business enterprises in Taiwan are small light industrial and trading firms that have fewer than 50 employees and less than US\$1.5 million in annual sales. Winn, *supra* note 3, at 911 n.26. Prior to 1989, many closely held corporations were prohibited from going public by Securities and Exchange Commission and Taiwan Stock Exchange rules which provided that a company could not make an initial public offering if a single corporate shareholder held more than 50% of the company's shares. See Josephine Wang, *How to Reap Investment Rewards in Taiwan*, INT'L FIN. L. REV., Sept. 1990, at 37.

19. See Josephine Wang, *Under the Counter Securities Sales in Taiwan*, INT'L FIN. L. REV., Oct. 1990, at 41. The over-the-counter market is restricted to shares that are not listed on the Taiwan Stock Exchange and are issued by companies that meet certain profitability and shareholder diversification requirements.

20. See Paul S.P. Hsu & Lawrence Liu, *The Transformation of the Securities Mar-*

Therefore, the securities market is not a meaningful provider of either equity or debt financing for Taiwanese companies.

The combination of very cautious commercial bank lending policies and an underdeveloped securities market has produced a large-scale underground financial sector in Taiwan catering to the needs of individuals and small businesses that cannot obtain financing from regulated sources.²¹ The underground sector includes loan sharks, underground investment houses, post-dated check discounters, rotating credit clubs,²² pawn shops, and informal margin lenders for stock purchases.²³ Although Taiwan's financial regulators have partly succeeded in curtailing the underground sector during the past several years,²⁴ a sizeable financial grey market should continue to exist in Taiwan as long as the financing needs of Taiwan's small- and medium-sized businesses are not met by the regulated financial sector.

This financial system, where the official sector only serves the credit needs of the largest blue-chip borrowers and the great majority of businesses are left to compete for financing in the informal sector, may have been adequate during the last three decades of Taiwan's export-oriented economic growth. The small manufacturing companies that fuel Taiwan's export-driven economy and comprise eighty-five percent of the island's industrial sector²⁵ have generally been able to finance themselves or raise capital through family net-

ket in Taiwan, the Republic of China, 27 COLUM. J. TRANSNAT'L L. 169 (1988); *Sitting on Its Billions*, *supra* note 1.

21. See Jonathan Friedland & Lincoln Kaye, *Pennies from Heaven*, FAR E. ECON. REV., Jan. 25, 1990, at 54 (reporting that Taiwan's businesses receive an estimated 40% of their financing from the informal sector).

22. The members of a rotating credit club deposit a fixed amount at regular intervals into a kitty, with each member in turn receiving the entire collected kitty. See Winn, *supra* note 3, at 918.

23. Prior to 1990, government-controlled Fu Hua Securities was the only official source of margin lending for stock purchases. Lincoln Kaye, *Despite the Sobering Experience*, FAR E. ECON. REV., June 28, 1990, at 86. It was estimated, however, that illegal margin lenders financed a third of all stock purchases. *The Sound of Bubbles Bursting*, *supra* note 16, at 79.

24. The amendments to the Banking Law passed in 1989, for example, included a stricter definition of "deposit" and increased the sanctions for illegal deposit-taking. The new article 29-1 of the Banking Law provides:

Using borrowed money, accepting investments, making the depositor a shareholder or using other classifications in order to accept deposits or obtain capital from the general public by agreeing to pay or paying a bonus, interest, share interest or other regard in an excessive amount, shall be deemed the act of accepting deposits.

Banking Law art. 29-1.

See Friedland & Kaye, *supra* note 21, at 56. These changes cut off access to funds for most of the underground investment companies, which, at their peak in the late 1980s, controlled an estimated US\$8 billion from more than one million investors. Winn, *supra* note 3, at 916 n.51.

25. Lincoln Kaye, *Pains of Adolescence*, FAR E. ECON. REV., Jan. 25, 1990, at 51.

works or the informal sector.²⁶ However, with wages steadily rising in Taiwan, the island's small manufacturers are beginning to move their factories offshore to lower-cost areas such as Malaysia,²⁷ Thailand,²⁸ and southern China.²⁹ This movement of light manufacturing overseas is causing significant changes in Taiwan's economy that necessitate reforms in the financial system.

One such change is the shift of Taiwan's industrial sector away from small- and medium-sized, labor intensive enterprises toward high-technology and other high-value-added industries.³⁰ These new companies are generally capital-intensive, with large start-up costs, and often require a high level of outside financing.³¹ Moreover, as Taiwan loses its manufacturing role to lesser-developed East Asian countries, Taiwan's government has ambitions of transforming the island into a major Asian financial center that can compete for capital with Tokyo, Hong Kong, and Singapore.³²

To foster the development of high-technology industries and to position Taiwan as a regional financial center, Taiwan's government has made reform of the island's financial system the focus of its recent economic policies.³³ The government also hopes to produc-

26. See Winn, *supra* note 3, at 911 n.26.

27. See *Triumphant Abroad, in Asia's Emerging Economies Survey, supra* note 15, at 8 (reporting that in 1990, Taiwan replaced Japan as the largest single investor in Malaysia, with its total investments in Malaysia during that year equalling US\$2.3 billion). Taiwan's total assets in Malaysia as of mid-1992 were estimated at US\$5 billion. John Andrews, *Planning Ahead, in Taiwan Survey*, ECONOMIST, Oct. 10, 1992, at 12.

28. Taiwan is Thailand's largest source of foreign investment. Tony Shale, *Taiwan's Regulators Set to Slug It Out*, EUROMONEY, May 1992, at 38. Taiwan's total assets in Thailand as of mid-1992 were estimated at US\$3.4 billion. Andrews, *supra* note 27, at 12.

29. See Jeremy Mark, *Trade Links with China Alter Taiwanese Economy*, ASIAN WALL ST. J. WKLY., Sept. 2, 1991, at 4. Taiwan's total investment in the Chinese mainland is estimated to total US\$3 billion and is rapidly rising. Shale, *supra* note 28, at 45; see also Joseph Battat, *Foreign Investment in China in the 90s: Developing Trends*, E. ASIAN EXECUTIVE REP., Aug. 15, 1991, at 11 (reporting that Taiwan is one of the three largest sources of direct foreign investment in China, along with the United States and Japan).

30. ROBERT WADE, *GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION* 46 (1990).

31. Kaye, *supra* note 25, at 51 (reporting that many of the new high-technology ventures are run by Taiwanese who have worked in "Silicon Valley" in California and are now demanding the same level of financial service at home that they were accustomed to abroad); see also Jeremy Mark, *After Initial Round of Success, Taiwan's Makers of Semiconductors Face Long-Term Challenges*, ASIAN WALL ST. J. WKLY., Nov. 25, 1991, at 18 (reporting that the development of the semiconductor industry in Taiwan has been hampered partly by a shortage of capital).

32. See, e.g., Cynthia Owens, *Official's Dreams of Creating Financial Center Slowed by Regulatory Barriers, Taipei Stigma*, ASIAN WALL ST. J. WKLY., July 15, 1991, at 25.

33. See, e.g., Lawrence S. Liu, *A Roadmap for Taiwan's Financial Reform in the 1990s?*, INT'L FIN. L. REV., Aug. 1991, at 26 (reporting on the 1991 National Financial Conference in Taipei).

tively tap the tremendous amount of capital accumulated on the island by liberalizing and internationalizing the financial system.

This Article discusses the reforms to the securities and banking industries in Taiwan and analyzes the impact of these reforms. The Article focuses on these two areas because the government effort to liberalize Taiwan's financial system has centered around amendments to the banking and securities laws.³⁴ The Article then discusses Taiwan's prospects for becoming a major financial center in Asia in light of the movement toward financial deregulation that is occurring throughout the region.³⁵

II. REFORM OF THE SECURITIES MARKET

A. THE REGULATORY FRAMEWORK OF THE SECURITIES MARKET

The primary law governing the securities market in Taiwan is the Securities and Exchange Law (SEL).³⁶ The SEL provides a comprehensive framework for the public offering³⁷ and issuance of securities.³⁸ The law, modeled after the United States's securities laws, regulates all aspects of the sale of securities, subjects public companies to regular public disclosure requirements,³⁹ and prohibits insider trading and most of the other types of manipulative or deceptive practices that are prohibited in the United States.⁴⁰ The SEL also contains provisions regarding the licensing and supervision of securities firms.⁴¹

Enforcement of the SEL is entrusted primarily to the Securities and Exchange Commission (SEC).⁴² The SEC is under the administration of the Ministry of Finance (MOF), which is one of the eight ministries that make up the Executive Yuan of Taiwan's cen-

34. See Wang & Yang, *supra* note 5, at 16.

35. For a general discussion of the trend toward financial deregulation in Asia, see Steven Levingston, *Thirst for Funds Speeds Asian Financial Reform*, ASIAN WALL ST. J. WKLY., Oct. 28, 1991, at 1.

36. Securities and Exchange Law (promulgated Apr. 30, 1968) (Taiwan) [hereinafter SEL].

37. The SEL defines "public offering" as an offer made to unspecified persons. *Id.* art. 7. Although there are no regulations that specifically address private placements, an offer made to a group of specified persons is not considered to be a public offering regardless of the size of the group of offerees. See Wang, *supra* note 19, at 41.

38. See Liu, *supra* note 14, at 75.

39. The disclosure requirements apply to all listed companies as well as to other companies that have a paid-in capital exceeding a certain set amount. SEL art. 22; see also Company Law art. 156 (promulgated Dec. 26, 1929) (Taiwan).

40. See, e.g., SEL arts. 155 (wash sales and other market manipulations such as spreading rumors or false information in the market), 157 (short-swing trading), 157-1 (insider trading).

41. See *id.* arts. 44-45, 48; Wang & Yang, *supra* note 5, at 19.

42. Wang & Yang, *supra* note 5, at 18.

tral government.⁴³ The SEC's prior approval is required for the subscription and issuance of any securities in Taiwan, with the exception of government bonds and certain other government-approved securities.⁴⁴ The SEC also has extensive rule making powers and has administrative authority over the participants in the securities market with the attendant power to issue warnings and revoke licenses.⁴⁵

Securities trading in Taiwan takes place on the Taiwan Stock Exchange or the very small over-the-counter market. The Taiwan Stock Exchange, the only stock exchange in Taiwan, is a corporation jointly owned by the government and a number of privately-held financial institutions.⁴⁶ The exchange's primary regulatory role is to approve the applications of prospective issuers and jointly review with the SEC all securities traded on the exchange.⁴⁷ As for the over-the-counter market, the principal regulatory entities are the SEC and the Securities Dealers Association, which must approve all securities traded on that market.⁴⁸

The involvement of banks in the securities market is governed primarily by the Banking Law and regulated by the banking authorities.⁴⁹ Under the Banking Law, for example, banks may be permitted to act as underwriters and engage in securities brokerage activities.⁵⁰ Likewise, the securities activities of insurance companies are regulated by the Insurance Law.⁵¹ Securities investment trust enterprises⁵² and other specialized participants in the securities market are also subject to specially tailored regulations.⁵³

The various government entities involved with financial regulation in Taiwan do not always present a monolithic face. In general, the MOF and its constituent agency, the SEC, have pushed for fairly rapid liberalization of Taiwan's financial system, while the

43. Taiwan's central government is composed of five branches: the executive, legislative, judicial, examination, and control/investigation branches. Each of the five branches is called a "Yuan."

44. SEL arts. 16, 22; see Hsu & Liu, *supra* note 20, at 175.

45. See Wang & Yang, *supra* note 5, at 19.

46. *Id.* at 7. The SEL contemplates exchanges that are formed as corporations as well as exchanges that are formed by their members. See SEL arts. 103, 124.

47. Wang & Yang, *supra* note 5, at 20.

48. *Id.*; see Guidelines for the Review of Purchase and Sale of Securities at the Places of Business of Dealers Participating in the Taipei Securities Dealers Association, Ref. No. 76-T'ai-Ts'ai-Chen-8932 (promulgated Feb. 24, 1988) (Taiwan).

49. See Wang & Yang, *supra* note 5, at 17.

50. Banking Law art. 101.

51. Insurance Law (promulgated Dec. 30, 1929) (Taiwan). The Insurance Law, for example, restricts the investments that insurance companies may make in nongovernment securities. *Id.* art. 146.

52. Securities investment trust enterprises are authorized to establish mutual funds to invest in corporate and government securities. See Liu, *supra* note 14, at 76.

53. See Rules for the Administration of Securities Investment Trust Enterprises (promulgated Aug. 10, 1983) (Taiwan).

CBC has taken a much more conservative position.⁵⁴ The CBC is considered to be a bastion of old-guard conservatism where policy-making is dominated by memories of the hyper-inflation and capital flight of the late 1940s that led to the Communist takeover on the mainland.⁵⁵ Regardless of the source of its fears, the CBC has been reluctant to relinquish its control over the currency market, interest rates, and the money supply, and has blocked many of the MOF's reform-minded proposals.⁵⁶

B. INTERNATIONALIZATION OF THE SECURITIES MARKET

In recent years, Taiwan's government has undertaken a program aimed at internationalizing the Taiwan securities market. The government efforts in this regard have generally been extremely slow and cautious.⁵⁷ For example, its program to permit direct foreign investment in the Taiwan Stock Exchange, initially scheduled to begin in 1986, was delayed for four years before it was finally implemented in 1990 with so many restrictions that it is attractive to only a very small number of foreign investors.⁵⁸ Chiefly as a result of the government's caution, the barriers to foreign entry into the securities market remain high.⁵⁹ However, progress toward internationalizing the market has been made in certain areas.

More recently, changes in the foreign exchange law have facilitated an increasing level of foreign participation in the Taiwanese securities market. The principal law regulating foreign exchange in Taiwan is the Statute for the Administration of Foreign Exchange (SAFE) which is administered by the Foreign Exchange Bureau of the CBC.⁶⁰ Prior to a substantial amendment to the law in 1987, SAFE provided that private parties were not allowed to hold foreign currency in Taiwan without the express permission of the CBC and that almost all foreign currency denominated earnings had to be sold to the CBC or another government bank authorized by the CBC to deal in foreign exchange.⁶¹ This strict system of foreign

54. For an interesting discussion of the contrasting philosophies of the MOF and the CBC, see Shale, *supra* note 28.

55. *Id.*; see also Owens, *supra* note 32.

56. The ability of the MOF to continue to push for financial system reforms has been put into doubt by the recent resignation of reform-minded Finance Minister Wang Chien-hsien. See Jeremy Mark, *Popular Taiwanese Minister Submits Resignation Amid Bitter Opposition to Tax-Reform Proposals*, ASIAN WALL ST. J. WKLY., Oct. 12, 1992, at 20.

57. See Owens, *supra* note 32; see also *Sitting on Its Billions*, *supra* note 1.

58. Winn, *supra* note 3, at 942; see also Lawrence Liu, *Securities Market-Opening Measures: An Analysis*, E. ASIAN EXECUTIVE REP., Jan. 15, 1991, at 9.

59. Owens, *supra* note 32.

60. Liu, *supra* note 14, at 70.

61. *Id.*; see also Winn, *supra* note 3, at 931 (noting that the effect of the strict foreign exchange controls was partly reduced by the existence of a large informal market in foreign exchange).

exchange controls was a vestige of the 1950s when Taiwan was chronically short of foreign currency.⁶² By 1987, however, Taiwan had accumulated one of the world's largest foreign exchange reserves and faced substantial domestic and international pressure to liberalize its foreign exchange rules.⁶³

The Legislative Yuan responded to this pressure by passing an amendment to SAFE on June 16, 1987⁶⁴ that authorized the Executive Yuan to discontinue the application of certain core provisions of SAFE in whole or in part upon the occurrence of either (1) a long-term trade surplus, (2) excess foreign exchange reserves, or (3) material changes in the global economy.⁶⁵ Because Taiwan was already at the time of the amendment enjoying both long-term trade surpluses⁶⁶ and excess foreign exchange reserves, the Executive Yuan announced the discontinuance of the core provisions of SAFE within a few days of the amendment's effective date.⁶⁷ The discontinued provisions were quickly replaced, however, by eight new regulations governing foreign exchange that were promulgated by the CBC on July 15, 1987.⁶⁸

Of these eight regulations, two are particularly significant with regard to the internationalization of the Taiwanese securities market: the Regulations for Non-Governmental Inward Remittances⁶⁹ and the Regulations for Non-Governmental Outward Remit-

62. See Winn, *supra* note 3, at 932.

63. See Lawrence Liu, *Taiwan's Deregulation of Foreign Exchange*, E. ASIAN EXECUTIVE REP., July 15, 1987, at 7 (reporting that by the end of 1986, Taiwan's foreign exchange reserves totalled approximately US\$46.7 billion).

64. The amendment was promulgated on June 26, 1987 and became effective three days later, on June 29, 1987. *Id.*

65. See Liu, *supra* note 14, at 70. The amendment passed as Article 26-1 of SAFE. The articles of SAFE that article 26-1 permits the executive branch to discontinue are articles 6-1, 7, 13, and 17. These four articles, which were considered the core provisions of the statute, restricted the possession of foreign currency and required such currency to be exchanged at the CBC or a designated foreign exchange bank. Liu, *supra* note 63, at 7.

66. Taiwan's trade surplus in 1985 was approximately US\$10 billion and in 1986 was approximately US\$16 billion. Liu, *supra* note 63, at 22.

67. The announcement was made on July 9, 1987. *Id.*

68. These eight CBC regulations are: (1) Regulations for the Purchase and Sale of Foreign Exchange by Appointed Banks, (2) Regulations for Non-Governmental Outward Remittances, (3) Regulations for Non-Governmental Inward Remittances, (4) Guidelines for the Operation of Foreign Exchange Businesses by Appointed Banks, (5) Regulations Governing the Collection Business of Foreign Credit Cards, (6) Regulations for Central Bank of China Governance of the Foreign Exchange Operations of Appointed Banks, (7) Regulations for the Establishment and Administration of Foreign Currency Cashiers, and (8) Regulations for the Registration of Balance of Medium-Term or Long-Term Foreign Debts Incurred by Private Enterprises. *Id.* at 20.

69. CBC Regulations for Non-Governmental Inward Remittances, Ref. No. 76-T'ai-Yang-Wai-04472 (promulgated July 13, 1987) (Taiwan).

tances.⁷⁰ These two regulations are the basis of the regulatory scheme governing the movement of foreign investment capital into and out of Taiwan. Under the regulations, an individual or business entity in Taiwan may accept inward remittances up to US\$3 million a year⁷¹ and may make outward remittances up to US\$5 million a year⁷² without prior governmental approval. Remittances above these amounts require the approval of the CBC.⁷³

The regulations increased the opportunities for foreign portfolio investments by Taiwanese nationals.⁷⁴ Although foreign securities may not actually be acquired or sold in Taiwan,⁷⁵ securities that are bought abroad may be delivered to and kept on the island.⁷⁶ Thus, the reforms to the foreign exchange control system have forced the Taiwan Stock Exchange to compete to a limited extent with foreign markets for the funds of local portfolio investors.⁷⁷

However, the new regulations did not significantly open up the Taiwan Stock Exchange to foreign investors. Although these regulations allow for a more liberal flow of foreign exchange than was allowed under the preamendment version of SAFE, direct foreign investment in the exchange continued to be prohibited until December 1990 when a plan to permit limited direct investment by foreign institutional investors was finally approved by the Executive Yuan.⁷⁸

70. CBC Regulations for Non-Governmental Outward Remittances, Ref. No. 76-Tai-Yang-Wai-04466 (promulgated July 13, 1987) (Taiwan).

71. CBC Regulations for Non-Governmental Inward Remittances, *supra* note 69, art. 4. The limit was originally set at US\$50,000 and has since been increased several times. See Liu, *supra* note 14, at 71.

72. CBC Regulations for Non-Governmental Outward Remittances, *supra* note 70, art. 5.

73. For a good discussion of the two regulations, see Hsu & Liu, *supra* note 20, at 170-74.

74. Prior to the 1987 foreign exchange control reforms, Taiwanese companies that wished to make portfolio investments abroad had to apply to have each specific investment approved by the Investment Commission of the Ministry of Economic Affairs under the Regulations Governing the Review of Outward Investment and Outward Technical Cooperation. Foreign portfolio investments by individuals were strictly discouraged. Liu, *supra* note 14, at 72.

75. See Wang, *supra* note 19, at 41. Article 2 of SAFE defines "foreign exchange" to include foreign securities, and article 8 of the statute requires all foreign exchange transactions to be conducted through the CBC or a designated foreign exchange bank.

76. Under the new foreign exchange regulations, the US\$5 million a year that Taiwanese nationals may remit abroad without governmental approval may be used to acquire foreign securities. *Id.*

77. A number of limitations still exist on the ability of Taiwanese nationals to freely invest abroad aside from the US\$5 million dollar annual maximum. For example, before making an investment abroad of between US\$1 million and US\$5 million the prospective investor must file an application with the Investment Commission of the Ministry of Economic Affairs. See Liu, *supra* note 14, at 72. Other regulations seriously restrict the ability of investment companies to recommend foreign securities. See, e.g., Wang, *supra* note 19, at 41.

78. The plan was contained in an amendment to the Regulations Governing Securi-

The plan strictly limits the types of foreign institutional investors who are eligible to invest directly in the securities market as well as the types of instruments in which they may invest.⁷⁹ The foreign institutions that are qualified under the plan are generally banks, insurance companies, and fund management companies, all of which must meet certain minimum size and ranking requirements.⁸⁰ Moreover, the plan provides for maximum quotas for each foreign institution as well as a total aggregate quota for all investments made under the new program,⁸¹ and places burdensome restrictions on both the inward remittance of investment capital and the outward remittance of returns on investment beyond the foreign exchange requirements imposed by SAFE.⁸² Returns on investment, for example, may only be remitted out of Taiwan once a year.

The program also limits the percentage ownership interest that foreign institutional investors can hold in companies listed on the Taiwan Stock Exchange. The total aggregate investment in a listed company by foreign institutions may not exceed ten percent of the company's issued and outstanding shares, and each individual foreign institution may not hold more than five percent of any one company's shares.⁸³

Because of the many restrictions in the plan, foreign institutional investors have not been attracted in large numbers to the Taiwan Stock Exchange.⁸⁴ Moreover, the CBC's often heavy-handed

ties Investment by Overseas Chinese and Foreign Investors and Procedures for Remittance. Liu, *supra* note 58, at 9. Prior to this amendment, foreign investors were only able to invest indirectly in the Taiwan Stock Exchange through foreign funds listed on the New York and London stock exchanges. Liu, *supra* note 14, at 76.

79. The regulations provide for the following qualified investments: (1) listed securities, (2) listed mutual funds, (3) government and corporate bonds, and (4) other securities approved by the SEC. Lawrence S. Liu, *Taiwan: A New Era for Foreign Institutional Investors*, INT'L FIN. L. REV., Mar. 1991, at 36.

80. To qualify, a bank must rank among the 500 largest banks in the free world, as measured by total assets, and must hold securities with an aggregate value of at least US\$300 million. Investment banks are not included. An insurance company must have been in the insurance business at least ten years and hold securities with an aggregate value of at least US\$500 million. A fund management company must have been established for more than five years and must have securities under its management with an aggregate value of at least US\$500 million. The regulations also provide that other types of financial institutions may be approved by the SEC from time to time to directly invest in the Taiwan Stock Exchange. *Id.*

81. These quotas are established jointly by the Ministry of Finance and the CBC. The total aggregate quota for all investment under the plan is set at US\$2.5 billion. *Id.*

82. Inward remittances must be made within three months of the date that a foreign institution's application is approved by the SEC, and the initial remittance must equal at least US\$5 million. Funds remitted into Taiwan for investment may not be taken out of Taiwan for at least three months, and applications for outward remittances require the approval of both the SEC and the CBC, which is given one full month to review such applications. *Id.* at 37.

83. *Id.* at 38.

84. For a discussion of foreign investor criticism of the regulations, see Jeremy

approach to administering the plan has raised concerns about the depth of the Taiwanese government's commitment to internationalize the island's securities market.⁸⁵

During February and March of 1992, for example, the CBC instituted a temporary freeze on the inflow of foreign funds for investment in the Taiwan Stock Exchange out of fear that such funds were causing the Taiwan dollar to appreciate too rapidly.⁸⁶ The CBC was concerned that foreign fund managers were improperly speculating in Taiwan's foreign exchange market, because only seventy percent of the total amount of funds for which they had been granted approval was remitted.⁸⁷ As part of the freeze, the CBC even suspended the approvals that the SEC had previously granted to three foreign institutions to remit investment funds into Taiwan.⁸⁸ Although the CBC rescinded the freeze after only a few weeks, its actions reinforced the Taiwan Stock Exchange's image as an immature market and raised legitimate concern among foreign institutional investors that Taiwan's government places a much higher priority on exchange rate stabilization than on liberalizing the securities market.⁸⁹

Although Taiwan's government professes a desire to internationalize its securities market, it has thus far taken only halting steps toward that goal. Further progress toward internationalization will require, at a minimum, greater liberalization of foreign exchange controls. As the CBC's temporary freeze on the inward remittance of foreign investment funds in early 1992 demonstrates,

Mark & Steven Levingston, *Foreign Fund Managers Criticize Taiwan Move to Attract Investors*, ASIAN WALL ST. J. WKLY., Sept. 24, 1990, at 31; see also *Taiwanese Stockmarket: The Forgotten China Play*, ECONOMIST, Oct. 3, 1992, at 88.

85. See, e.g., Julia Leung, *Foreign Fund Influx Tests Taiwan Dollar, Regulators*, ASIAN WALL ST. J. WKLY., Mar. 2, 1992, at 23.

86. The CBC argues that because the total turnover in the Taiwan foreign exchange market only averages between US\$30 million and US\$100 million a day, lump sum inflows of tens of millions of dollars have a significant effect on the exchange rate. *Id.* Critics of the CBC's move respond that Taiwan's foreign exchange market is unnaturally thin and underused because of the CBC's over-regulation, which encourages many Taiwanese companies to keep their export earnings with offshore subsidiaries. They point out that Taiwanese companies generate more than US\$350 million a day in two-way foreign trade, but that only roughly US\$75 million is turned over in the foreign exchange market. If the foreign exchange market were freed from excessive regulation, the CBC's critics argue, it would become a much deeper market and lump sum remittances of several millions of dollars would have little effect on the exchange rate. See Julian Baum, *Signal Failure*, FAR E. ECON. REV., Feb. 27, 1992, at 60; Shale, *supra* note 28, at 42; Laurence Zuckerman, *Taiwan Central Banker Defends Hoard*, INT'L HERALD TRIB., June 6, 1992, available in LEXIS, Nexis Library, OMNI File.

87. Shale, *supra* note 28, at 42.

88. Those three institutional investors were Banque Indosuez of France (US\$50 million), Morgan Stanley & Co. of the United States (US\$44 million), and John Govett & Co. of the United Kingdom (US\$40 million). *Id.*; see also Luisetta Mudie, *Taiwan's Central Bank Faces Criticism*, FIN. TIMES, Feb. 21, 1992, at 4.

89. See Leung, *supra* note 85, at 23.

currency controls are fundamentally incompatible with an international securities market. The island's securities market will be meaningfully internationalized only when investment capital is allowed to flow freely into and out of Taiwan.

C. OTHER REFORMS OF THE SECURITIES MARKET

The gradual opening of the Taiwan Stock Exchange to foreign participation is just one element of the Taiwanese government's recent program of reforms aimed at creating a more stable securities market on the island. This reform program has two primary goals: (1) the expansion of the total size of the market through internationalization, freer competition within the securities industry, and the introduction of new financial products; and (2) the preservation of the market's integrity through stricter enforcement of the securities rules against those types of manipulative practices that have earned the Taiwan Stock Exchange its casino image.⁹⁰

Thus far, the program has been implemented only to a very limited extent. Taiwanese financial regulators appear to believe that unless they are cautious in introducing reforms, loopholes will be left in the system that will be exploited by enterprising financiers, of which Taiwan seems to have an unusually large number.⁹¹ Regulators are particularly concerned that new financial products, such as currency and interest rate swaps, futures, convertible securities, and other types of derivative and hedging instruments, will simply become fresh objects of highly speculative investing.⁹²

Furthermore, the largest, most powerful firms in the securities industry wield a great deal of political power and have a deeply entrenched interest in preserving much of the regulatory status quo.⁹³ Because these firms have traditionally profited from the high barriers to entry into the securities industry and the generally lax enforcement of securities rules, they have strongly resisted most serious reform proposals.⁹⁴ Certain changes to the regulatory envi-

90. See Jonathan Moore, *The Bull by the Horns*, FAR E. ECON. REV., Jan. 25, 1990, at 56.

91. See Owens, *supra* note 32, at 25. See also Friedland & Kaye, *supra* note 21, at 54 (reporting on the Taiwanese genius for financial entrepreneurship).

92. See Moore, *supra* note 90, at 56. Taiwanese investors appear to have a particular passion for speculation. See Owens, *supra* note 32, at 25, reporting on a scheme known as "betting on air" that was extremely popular in Taiwan from shortly after the Taiwan Stock Exchange's crash in early 1990 until securities regulators cracked down on the scheme in June 1991. "Betting on air" involved betting on the daily movement of the exchange's weighted index or of an individual stock. On some days during the scheme's peak of popularity, it was estimated that four times as much money was "bet on air" as was invested in the stock market.

93. See Michael J. Scown, *Asia's Emerging Equities Markets*, E. ASIAN EXECUTIVE REP., Jan. 15, 1991, at 22 (reporting that as of early 1991, the largest single interest bloc in the Legislative Yuan represented the major brokerage houses).

94. *Id.*

ronment, however, have been made by Taiwan's government.

In early 1988, for example, the Legislative Yuan passed a significant amendment to the SEL.⁹⁵ Prior to the promulgation of this amendment, securities firms were strictly divided into underwriters, brokers, and dealers,⁹⁶ and the number of each type of firm was frozen by the SEC.⁹⁷ The 1988 amendment provided for the creation of integrated securities houses, which could engage in underwriting, dealing, and brokering at the same time,⁹⁸ and also liberalized the rules regarding the granting of securities licenses.⁹⁹ Within six months of the new licensing rules coming into effect, the number of licensed brokerage operations on the island rose from the preamendment number of twenty-eight to over one hundred.¹⁰⁰

The 1988 amendment to the SEL and its implementing regulations also facilitated the entry of foreign securities firms into the Taiwan market. The new rules permit foreign firms to establish branch offices in Taiwan if they meet certain requirements.¹⁰¹ The requirements are intended to ensure that only foreign securities firms with significant assets and international reputations can enter the Taiwanese market. For example, a foreign firm must have ranked among the top ten securities firms in its home country in terms of total assets during the three years prior to its application.¹⁰²

95. The amendment was passed by the Legislative Yuan on January 12, 1988. The amendment affected approximately one-third of the SEL. Hsu & Liu, *supra* note 20, at 181 & n.78.

96. *See id.* at 176. A firm could only engage in one of these lines of business. Brokers can only trade securities for their customers' accounts, whereas dealers can only trade for their own accounts. Trading by dealers has traditionally represented only a very small percentage of the trading activity on the Taiwan Stock Exchange. The only exception to the strict division was that trust companies, as well as the trust or savings departments of commercial banks, could engage in all of these lines of business. *Id.* at 176-77 & n.45.

97. Liu, *supra* note 14, at 75. For the fifteen years prior to the amendment, the numbers of firms had been frozen at twenty-eight brokers, twenty-three underwriters and ten dealers.

98. Establishing an integrated securities house requires prior SEC approval and paid-in capital of one billion New Taiwan dollars. *Id.* at 78.

99. *See* Hsu & Liu, *supra* note 20, at 182. Pursuant to the SEL, as amended, the SEC promulgated the Criteria for the Establishment of Securities Firms and began accepting new applications for securities licenses in May 1988. *Id.* at 183. Under this set of criteria, the minimum paid-in capital for underwriting and dealing licenses is four hundred million New Taiwan dollars and for a brokerage license is two hundred million New Taiwan dollars. *Id.* (citing *Criteria for the Establishment of Securities Firms*, 26 GAZETTE OF THE MINISTRY OF FIN. 23,867 (1988)).

100. *Id.* at 183.

101. SEL art. 28; *see* Hsu & Liu, *supra* note 20, at 184.

102. The criteria for foreign securities firms to establish branches in Taiwan are set forth in the Screening and Approval Criteria for Establishment of Branch Offices of Foreign Securities Firms, which was promulgated by the SEC on June 21, 1989 (an English translation of this piece of implementing regulation appears in E. ASIAN EXECUTIVE REP., July 15, 1989, at 23). In addition to the home country ranking require-

The new rules also allow foreign investors to participate in securities operations in Taiwan through joint ventures with local companies. However, foreign investment in securities joint ventures is subject to two significant limitations: the total aggregate foreign ownership of the joint venture may not exceed forty percent, and the investment by any single foreign investor may not represent more than ten percent of the venture's total paid-in capital.¹⁰³

Another goal of the 1988 amendment was to increase enforcement of the securities rules against manipulative practices to dispel the market's casino image. The amendment clarified the elements of a prohibited practice under the anti-manipulation provision of the SEL,¹⁰⁴ and created civil liability for violations of those provisions.¹⁰⁵ In addition, the amendment substantially increased the SEL's public disclosure requirements,¹⁰⁶ and strengthened the prohibition against insider trading by, among other things, adding a treble civil damages provision.¹⁰⁷

The 1988 amendment to the SEL has been followed by a number of other moves aimed at creating a more stable securities market. For example, Taiwan's government recently established a program to partially privatize a number of state-run enterprises by issuing their shares through the Taiwan Stock Exchange.¹⁰⁸ The privatization program, which is part of the government's effort to expand the size of the exchange and thus reduce its volatility, is intended to involve over twenty state-owned companies and bring the government approximately US\$40 billion by 1996.¹⁰⁹ Critics of

ment, the following criteria, among others, are provided: (1) A foreign firm must not have been subject to any disciplinary actions during the prior three years; (2) its home country must permit reciprocal access for Taiwanese securities firms; (3) it must be a member of the New York, London, and Tokyo stock exchanges; and (4) it must have paid-in capital in excess of US\$2 billion and total assets exceeding US\$20 billion. See C.Y. Huang et al., *Taiwan's Securities Industry Opens to Foreign Brokerages*, E. ASIAN EXECUTIVE REP., July 15, 1989, at 8.

103. SEL arts. 36-37. In addition, a foreign investor may invest in only one securities entity at a time. Liu, *supra* note 14, at 78.

104. SEL art. 155.

105. Hsu & Liu, *supra* note 20, at 185.

106. SEL art. 36. Prior to the amendment, the SEL only required semi-annual reporting. The statute now provides for monthly, quarterly, and extraordinary reports. See Hsu & Liu, *supra* note 20, at 182.

107. Hsu & Liu, *supra* note 20, at 185-86. This provision was highly unusual, both because it was Taiwan's first treble damages clause and because Taiwanese law generally does not allow for punitive damages of any kind. *Id.* at 185 n.116.

108. See William Yang & Osman Tsing, *Taiwan: Government Enterprises to Issue Shares, CBC Defends "Financial Stability"*, Reuter Textline Bus. Taiwan, Feb. 24, 1992, available in LEXIS, World Library, TXTNWS File [hereinafter *CBC Defends Financial Stability*]. The first five state-run enterprises to be listed on the exchange were China Steel, China Petroleum, and three commercial banks, Chang Hwa Commercial Bank, Hua Nan Commercial Bank, and First Commercial Bank. *Taiwan's Privatization Programme Gathers Pace*, FIN. TIMES, Feb. 28, 1992, at 27.

109. *CBC Defends Financial Stability*, *supra* note 108.

the program have argued, however, that the government is undermining the strength of its privatization effort by only issuing shares in poorly performing enterprises and failing to privatize healthy companies.¹¹⁰

The government has also worked to develop a bond market in Taiwan.¹¹¹ A well-functioning bond market has two primary attractions for Taiwan's financial regulators. First, it would provide alternative investment opportunities for Taiwanese investors and thus possibly counteract the Taiwan Stock Exchange's tendency to overheat.¹¹² Bonds would provide a relatively stable investment vehicle for investors who are frightened by the stock market's volatility.¹¹³

Second, Taiwan's government announced in 1991 a massive six-year economic plan to spend more than US\$300 billion on improving the island's infrastructure.¹¹⁴ In order to pay for the plan without tapping into Taiwan's foreign exchange reserves, Taiwanese authorities expect to raise roughly a fourth of the total bill through government bond issues.¹¹⁵ Although a steady stream of very large government bond issues could overwhelm the debt markets and, in the process, eliminate any opportunity for the private sector to raise money through issuing bonds,¹¹⁶ the government hopes that a regular flow of bond issues related to the six-year plan will stimulate the development of a large-scale bond market.¹¹⁷

110. *Taiwan's Privatization Program Gathers Pace*, *supra* note 108, at 27.

111. Until very recently, the bond market in Taiwan was practically nonexistent. As late as July 1991, then Finance Minister Wang Chien-hsien conceded: "The bond market is so small, sometimes we don't know we have a bond market." Owens, *supra* note 32, at 25.

112. See C.Y. Huang & Marc Sterling, *Taiwan's Securities Market: An Analysis of Its Growth and Likely Developments*, E. ASIAN EXECUTIVE REP., Feb. 15, 1990, at 7, 19 (reporting that the underdeveloped bond market contributed to the extraordinary stock price appreciation that led to the Taiwan Stock Exchange's 1990 crash).

113. Jeremy Mark, *Taiwan Plans Revamp of Bond Market to Prepare for Surge in Public Borrowing*, ASIAN WALL ST. J. WKLY., Nov. 4, 1991, at 30 (reporting that the CBC hopes that the development of a bond market will dispel the stereotype that Taiwanese investors are just gamblers).

114. For a description of the plan, see Julian Baum, *Rich in Six Years*, FAR E. ECON. REV., Feb. 14, 1991, at 48.

115. See *id.*; Mark, *supra* note 113, at 30. Taiwan's Council for Economic Planning and Development, which drafted the plan, originally hoped to raise approximately US\$40 billion a year through government bond issues, but that estimate has been scaled down to roughly US\$13 billion a year for each year of the plan. The remainder of the money is expected to come from the privatization of state enterprises and increased tax revenues. See also Josephine Wang-Ho, *Creating the Legal Environment for Taiwan's Six-Year Plan*, E. ASIAN EXECUTIVE REP., Dec. 15, 1991, at 8.

116. Baum, *supra* note 114, at 48.

117. One healthy sign of the growth of a bond market in Taiwan was the Asian Development Bank's issue of US\$200 million in seven-year ADB Dragon Bonds in Taiwan in December 1991. The ADB Dragon Bonds represented Taiwan's first interna-

D. EFFECT OF SECURITIES MARKET REFORMS

Over the past five years, Taiwan's government has made some progress toward creating an open and international securities market on the island: limited foreign investment in the stock market is now permitted; the barriers to enter the financial industry are lower; anti-manipulation rules are more strictly enforced; and the size of the securities market has been cautiously expanded. However, the market remains shallow and ineffective as a capital supplier for the Taiwanese economy.

Despite the government's efforts to encourage well-performing private companies to list substantial blocks of their shares on the Taiwan Stock Exchange,¹¹⁸ demand for new issues continues to outstrip supply, leading to the stock market's legendary instability. Many local companies are hesitant to list shares on the exchange because of the financial disclosure requirements, even though enforcement of the disclosure rules has historically been quite lax.¹¹⁹ Moreover, most of the initial public offerings that are made are intended more to raise money for the owners of the company than for the company itself.¹²⁰

Seeing the necessity of further liberalization of the securities market, the reform-minded MOF continues to push for far-reaching market reforms.¹²¹ The bulk of their proposals, however, have foreign exchange implications requiring at some level the approval of the ultra-conservative CBC.¹²² Thus far, the CBC's reluctance to relax currency controls has frustrated many of the MOF's efforts. The MOF's push to increase the level of foreign investment in the Taiwan Stock Exchange will only be successful if the CBC allows foreign investors to easily remit profits out of Taiwan.¹²³

tional bond issue. Y.D. Deng & Echo Hsu, *Taiwan: ADB Dragon Bond Issue*, INT'L FIN. L. REV., Feb. 1992, at 43.

118. The Taiwan Stock Exchange has a task force that seeks out high-performing private companies and encourages them to list their shares. Hsu & Liu, *supra* note 20, at 189; see also *Finance: Money and Banking*, Country Profile: Taiwan, Aug. 10, 1992, available in Westlaw, BUS-INTL database.

119. Scown, *supra* note 93, at 23.

120. *Sitting on its Billions*, *supra* note 1, at 97.

121. The MOF's protege, the SEC, for example, recently developed a number of proposals to introduce equity derivative products, such as warrants, options, and index future trading, on the Taiwan Stock Exchange. See Shale, *supra* note 28, at 42.

122. See *id.* at 39, quoting the Director-General of the MOF's Bureau of Monetary Affairs, Chen Mu-tsai, as follows:

We want both to promote improvements of a modernized financial-service sector and to provide realistic instruments through which our markets can grow and become more sophisticated. We obviously believe that the regulation of the financial sector should not be the statutory function of the central bank, but it is still unwilling to give up the power that it enjoyed exclusively in Taiwan up until the late 1980s.

123. See *CBC Defends Financial Stability*, *supra* note 108. Some observers have argued that it is easier for foreigners to invest in companies listed on the "experimental"

How long the CBC will be able to block significant liberalization of Taiwan's securities market is unclear.¹²⁴ Pressure from foreign governments and the Taiwanese private sector for a more open market is likely to erode the CBC's power to restrict reforms in the name of monetary stability. Moreover, Taiwan's increasingly evident desire to use its economic strength to influence the mainland should spur the government to push for greater financial development.¹²⁵ As long as the conservatives in the CBC retain the final say over currency matters, however, reform of the securities market is likely to continue at a slow and cautious pace.

III. REFORM OF THE BANKING INDUSTRY

A. THE REGULATORY FRAMEWORK OF THE BANKING INDUSTRY

Taiwan's government exercises control over banks on the island through extensive regulation and, in the case of certain banks, through direct and indirect ownership.¹²⁶ The Banking Law is the primary statute governing banks operating in Taiwan and financial institutions regulated by the Banking Law are under the principal supervision of the MOF.¹²⁷ The MOF is charged with, among other things, establishing capital adequacy requirements, examining the financial records of banks, determining whether a new bank or new branch of an existing bank can be established, and setting penalties for violations of the Banking Law.¹²⁸

The banking industry's other major regulator is the CBC. The principal functions of the CBC are to implement Taiwan's monetary policy and to control the money supply.¹²⁹ The CBC is also responsible for setting minimum reserve against deposit ratios and asset and liability requirements¹³⁰ and approving any banking trans-

Chinese securities exchanges in Shanghai and Shenzhen than it is for foreigners to invest on the Taiwan Stock Exchange. Jeremy Mark, *Interest in Stocks of Taiwan Companies with Investments in China Is Growing*, ASIAN WALL ST. J. WKLY., May 18, 1992, at 19. For a description of the Shanghai and Shenzhen stock exchanges, see Pitman Potter, *Securities Markets Opening to Foreign Participation; Class B Shares in Shanghai and Shenzhen*, E. ASIAN EXECUTIVE REP., Apr. 15, 1992, at 7.

124. See Shale, *supra* note 28, at 45, quoting the General Counsel of the SEC, Chen Chung-tsing, as follows: "There is not one central bank that is capable of stopping global market trends. Not even the Bank of China. For Taiwan, now that we have started the process, there is no going back: total liberalization and internationalization are now inevitable."

125. *Id.*

126. Wang & Yang, *supra* note 5, at 15. For a discussion of government ownership of banks in Taiwan, see *supra* note 6.

127. Wang & Yang, *supra* note 5, at 17; see Banking Law art. 19.

128. Wang & Yang, *supra* note 5, at 17.

129. *Id.* at 41.

130. Banking Law arts. 42-43; Wang & Yang, *supra* note 5, at 17.

action involving foreign currencies.¹³¹ In addition, the CBC serves as the lender of last resort for Taiwan's banking institutions.¹³²

Prior to the changes brought about by the 1989 amendment to the Banking Law, every major commercial bank in Taiwan was owned either by a governmental unit or by the ruling Kuomintang party,¹³³ and the bureaucrats in charge of managing the commercial banks enjoyed a relatively cozy relationship with their regulators.¹³⁴ With the advent of private banks, however, the level of regulatory scrutiny of banking institutions is expected to increase.¹³⁵

B. THE ESTABLISHMENT OF PRIVATE DOMESTIC BANKS

As part of its program to modernize the banking system, the Taiwanese government has committed itself to privatizing the three big government-owned commercial banks¹³⁶ that dominate the Taiwanese banking industry.¹³⁷ While the MOF, a minority owner of the "big three," reduced its holdings in them in 1991, the Provincial Assembly, the banks' majority owner, has thus far refused to privatize its stake.¹³⁸ The Provincial Assembly's continuing refusal to sell its share of the banks stems from its unwillingness to give up the revenue and patronage that it gains from its stake in the "big three." This failure to privatize the three banks has delayed the government's desired pace of reform.¹³⁹

The second element of Taiwan's privatization plan is the creation of new private banks. In 1989, the Taiwanese government amended the Banking Law to allow the formation of new private commercial banks.¹⁴⁰ The amended law authorizes the MOF to promulgate regulations for the licensing of these new banks and sets forth the requirements that such banks will have to meet.¹⁴¹ The MOF subsequently promulgated regulations governing the estab-

131. Banking Law art. 4; Wang & Yang, *supra* note 5, at 17-18.

132. Wang & Yang, *supra* note 5, at 18.

133. Winn, *supra* note 3, at 913; *see also supra* note 6.

134. Kaye, *supra* note 25, at 50-51.

135. The MOF and the CBC may, however, face staffing problems. The establishment of the new, private banks has significantly increased the demand for experienced banking personnel, and government regulators are being actively recruited by the private sector. *See Taiwan to Overhaul Financial System in Next 12-24 Months*, BUS. ASIA, Mar. 11, 1991, at 77, available in Westlaw, BUS-INTL database.

136. The three are Chang Hwa Bank, First Commercial Bank, and Hua Nan Bank. Jonathan Friedland, *Customers Come First*, FAR E. ECON. REV., May 7, 1992, at 72.

137. In 1991, the three combined controlled 80% of Taiwan's national market. *Taiwan Bank Reform Drives Deposit Interest Rates Up, Loan Rates Down*, Global Fin. Markets, July 18, 1991, available in Westlaw, BUS-INTL database.

138. Friedland, *supra* note 135, at 72.

139. *Id.*

140. An English translation of the 1989 Banking Law amendment appears in E. ASIAN EXECUTIVE REP., Oct. 1989, at 25.

141. Banking Law art. 52; *see Winn, supra* note 3, at 935.

lishment of these new banks.¹⁴² The amended law also deregulates interest rates and expands the scope of activities in which banks are permitted to engage.¹⁴³

The amended Banking Law and the Criteria for Establishment of Commercial Banks ("Commercial Bank Criteria") impose strict requirements on private banks. Each bank must have a minimum paid-in capital of NT\$10 billion (US\$367 million)¹⁴⁴ of which eighty percent must be subscribed to by the promoters and twenty percent must be offered to the public.¹⁴⁵ Because such a large amount of paid-in capital is required, all fifteen of the new banks are among the world's top five hundred banks.¹⁴⁶ Furthermore, because of fears of corruption and insider dealing, the Banking Law places strict limits on the extent to which an individual or corporate entity can control any bank.¹⁴⁷ The regulations also require that the new banks be fully automated and that each bank install a minimum number of automated-teller machines ("ATMs").¹⁴⁸ Finally, under the amended Banking Law, banks must retain thirty percent of their earnings as legal reserves and may not pay dividends of more than fifteen percent of earnings until their accumulated reserves equal the total paid-in capital.¹⁴⁹

Current government policy prohibits foreign entities from investing in and promoting the new banks.¹⁵⁰ However, some observers feel that foreign investment in the new banks may be allowed in the future in order to meet the capital needs of the banking system.¹⁵¹ Whether foreign investors would be permitted to establish a

142. Criteria for Establishment of Commercial Banks (promulgated April 10, 1990) (Taiwan); see Winn, *supra* note 3, at 934.

143. For a discussion of these aspects of the Banking Law amendment, see C.Y. Huang & Marc H. Sterling, *New Amendment Liberalizes Taiwan's Banking Sector*, E. ASIAN EXECUTIVE REP., Aug. 1989, at 16.

144. This required initial capital is significantly more than the average capitalization of banks in the United States, Japan, and Europe. Liu, *supra* note 14, at 83. Thus, these new banks should not have any difficulty meeting the capital adequacy standards of the Basle Supervisor's Committee. Winn, *supra* note 3, at 936. In addition, the amended Banking Law requires that the banks maintain a minimum capital of eight percent of their risky assets, thus conforming to the BIS standard. Banking Law art. 44.

145. Winn, *supra* note 3, at 936.

146. Kaye, *supra* note 25, at 50. In fact, five of the fifteen have paid-in capital of more than the minimum NT\$10 billion. These are: Chung Hsing Bank at NT\$13.5 billion, Grand Commercial Bank at NT\$12.6 billion, Wan-Tai and Union Banks at NT\$12 billion each, and Ta Chung Bank at NT\$10.5 billion. Julian Baum, *Bankers Abound*, FAR E. ECON. REV., July 11, 1991, at 36.

147. Article 25 of the Banking Law provides, "[u]nless approved by a central competent authority, a person shall not hold more than 5 percent of the total issued shares of a bank. The total shares held by an interested party shall not exceed 15 percent." Banking Law art. 25.

148. Baum, *supra* note 146, at 36.

149. Banking Law art. 50; see Winn, *supra* note 3, at 935.

150. Huang & Sterling, *supra* note 143, at 17.

151. *Id.*

Taiwanese company which would then be allowed to invest in a bank is unclear.¹⁵²

Following the issuance of the Commercial Bank Criteria, the MOF gave its approval to fifteen of nineteen applicants for a banking license.¹⁵³ The backing for these new banks came principally from the largest and most aggressive industrial groups in Taiwan.¹⁵⁴ Despite the strict regulations which limit the extent to which individuals or companies can control the new private banks, the industrial groups are likely to dominate their affiliated banks.¹⁵⁵ If these groups use their affiliated banks as captive lenders at below-market rates, the ability of the new banks to supply capital to the general market on competitive terms will be impaired.

The opening of fifteen new private banks in 1992 has changed the banking environment of Taiwan. Loan spreads have decreased as price banking has begun to replace relationship banking.¹⁵⁶ Competition from the new banks is also beginning to pressure the previously lethargic state-run banks to provide a better level of service.¹⁵⁷ For example, the requirement that the private banks be fully automated has forced the state-run banks to modernize their own facilities and equipment.¹⁵⁸

In general, the private banks are injecting a degree of en-

152. *Id.*

153. The fifteen banks (and their major investors) which received licenses are Ta-An Bank (Pacific Wire & Cable, USI Far East), Wan-Tai Bank (Prince Motors, San Fu Motors), Far East Bank (Far Eastern Textiles, Asia Cement), Ta Chung Bank (Formosa Plastics), Asia-Pacific Bank (Taichung city businesses, ADI Corp.), Chung Hsing Bank (Hua Eng Copper & Iron), Grand Commercial Bank (President Enterprises), Yu Shan Bank (Taiwan Match, Eagle Food), Union Bank (Union Enterprise Construction), Hua Hsin Bank (Central Investment and Holding, Tuntex), Pao Tao Bank (Yakult), Fu Pang Bank (Foremost, Evergreen Marine Corp.), Chung Hua Bank (China Rebar), Pan Asia Bank (Chang Yi Group), and Tai Hsin Bank (Shing Kong Synthetic Fiber, Weichuan Food Corp., Teco Electric). See Baum, *supra* note 146, at 36.

The MOF's decision to permit the establishment of so many private banks at one time was a surprise to many observers. See Liu, *supra* note 14, at 82; see also Julian Baum, *Banking on Big Business*, FAR E. ECON. REV., Apr. 4, 1991, at 36 (estimating that the MOF would approve as many as half of the fourteen submitted applications). The four applicants which the MOF rejected either breached the rules on capital diversification or had inadequate business plans. Baum, *supra* note 146, at 36.

154. Baum, *supra* note 146, at 35. The Kuomintang is the major shareholder in Hua Hsin Bank through the party's Central Investment Holding Corp. and two other affiliated investment companies. *Id.* at 36.

155. In fact, MOF officials have reportedly admitted that all of the new bank applicants violated the rules aimed at preventing an overconcentration of capital in minor ways. *Id.* at 36.

156. Liu, *supra* note 33, at 26.

157. Friedland, *supra* note 136, at 72; see also Julia Leung, *Taiwan Liberalization Sparks Influx of Banks but Some Analysts Worry About Potential Glut*, ASIAN WALL ST. J. WKLY., Mar. 30, 1992, at 1, 18 (reporting that at least one of the state-run banks has begun offering twice-weekly courtesy classes to its employees).

158. Prior to the establishment of the private banks, more than half of all banking transactions in Taiwan were recorded by hand. Baum, *supra* note 146, at 36.

trepreneurial spirit into a banking industry that was previously known mainly for bureaucratic complacency.¹⁵⁹ Many of the new banks are considered to be extremely ambitious. Grand Commercial Bank, for instance, plans to install ATMs at some of the more than 600 7-Eleven convenience stores on Taiwan owned by one of its major shareholders, President Enterprises.¹⁶⁰ Such a proliferation of ATMs could have a substantial impact on the Taiwanese banking industry since, as of 1991, there were less than 2000 ATMs on the entire island. Moreover, several of the private banks already are planning on establishing international presences.¹⁶¹

In addition to competing directly with the existing commercial banks, the new banks are also competing for business with the underground financial sector¹⁶² which traditionally was the only source of outside financing for small- and medium-sized enterprises. The new banks are likely to displace many of these informal sources of capital as private bank competition and increased government enforcement drive the underground sources out of the market.¹⁶³ Thus, the banking reforms should bring many of the participants in the informal financial sector into the regulated banking industry, resulting in increased financial stability for the entire system as well as profitable opportunities for the new banks.

The emergence of the new private banks is also significant because it gives those sectors of the Taiwanese government which are trying to advance financial reform, mainly the MOF, a new constituency to help pressure the conservative forces in the government to allow further liberalization.¹⁶⁴ Since the major industrial groups in Taiwan now have a large stake in further loosening the restrictions on their affiliated private banks, they are likely to exert their influence on the government and push it to continue along the path of

159. *See id.* at 36.

160. *Id.*

161. The chief operating officer of Bank SinoPac, one of the new banks, says, "Within one year we hope to have assets of \$1.5 billion and we will be applying to set up a foreign department. Our aim is to be first a regional and then a truly international bank operating on a universal banking basis." Shale, *supra* note 28, at 44. Another of the new banks, Kuomintang-controlled Hua Hsin Bank, intends to have offices in Hong Kong, Singapore, Seoul, and Tokyo by the end of the 1990s. Baum, *supra* note 146, at 36.

162. The president of one of the new banks, Alexander Dean of Grand Commercial Bank, has stated that he expects that small- and medium-sized companies, which were mostly unable to tap the official banking sector for funds under the old system, will account for 75% of his bank's business. Baum, *supra* note 146, at 36.

163. In addition to expanding the definition of deposit-taking, *see supra* note 24, the revision of the Banking Law also increased the penalty for accepting deposits without a bank license to up to seven years in prison or a NT\$3 million fine. *Taiwan Revises Banking Law*, Global Fin. Markets, Sept. 19, 1989, available in Westlaw, BUS-INTL database.

164. Shale, *supra* note 28, at 42.

banking reform.¹⁶⁵

Furthermore, the MOF has expressed a willingness to accept more applications for banking licenses.¹⁶⁶ The MOF has also indicated that it is considering lowering the minimum capital requirements for new banks.¹⁶⁷ Both of these measures would increase the number of private commercial banks and strengthen this growing part of the industry. The creation of this new, dynamic sector in the Taiwanese banking market is likely to have the most significant and positive impact on Taiwan's banking reform.

Despite partial liberalization, there are still major obstacles to the creation of a new, modern banking system in Taiwan. The new banks are limited to traditional banking businesses and still cannot engage in foreign exchange trading, one of the most profitable of the core banking businesses.¹⁶⁸ This limitation also prevents the new banks from offering full services to international clients who commonly expect to take care of both their foreign exchange and regular commercial banking needs with one institution.¹⁶⁹

The private banks are also at a competitive disadvantage by having a much higher cost of capital than the state-run banks.¹⁷⁰ Because depositors are wary of putting their money into the new institutions, the private banks have had to offer interest rates on passbook deposits more than one percent higher than the old banks.¹⁷¹ Despite offering higher interest rates, the new banks still had difficulty attracting depositors, and as a result had to rely on their paid-in capital for most of their lending activity.¹⁷²

The new banks also face restrictions on the number of branches they can open, with each bank initially limited to seven.¹⁷³ While the MOF has recently increased the number of branches that banks can open in subsequent years from three to five and has left open the possibility that it will permit banks which show "outstanding busi-

165. Friedland, *supra* note 136, at 73. There is also some evidence that this is already occurring. See Jeremy Mark, *Latest Taiwan Reforms Are Expected to Spur Competition in Banking Sector*, ASIAN WALL ST. J. WKLY., June 8, 1992, at 18 (stating that some analysts believe that the new banks' pressure contributed to the government's decision to liberalize the short-term money market and credit-card industry).

166. *Taiwan: 15 Private Banks Approved*, E. ASIAN EXECUTIVE REP., July 1991, at 6.

167. *Id.*

168. Baum, *supra* note 146, at 36.

169. Osman Tseng, *Taiwan: Banking Regulations Should Be Liberalized*, Reuter Textline Bus. Taiwan, May 4, 1992, available in LEXIS, World Library, TXTNWS File.

170. See *Finance Reform in Taiwan Lowers Borrowing Costs, Expands Credit Lines*, Global Fin. Markets, July 23, 1992, available in Westlaw, BUS-INTL database.

171. *Id.*

172. *Id.*

173. Friedland, *supra* note 136, at 72.

ness performance" to open even more,¹⁷⁴ the new banks will still be at a disadvantage in competing with the big three, which have over 150 branches each.¹⁷⁵ Finally, the MOF does not permit the new banks to join Taiwan's deposit insurance program.¹⁷⁶

The creation of these fifteen new banks has also created a personnel shortage in Taiwan's banking industry. The new banks offer bank executives up to double the compensation of the established banks¹⁷⁷ and more financial security in other ways as well.¹⁷⁸ At least 200 loan officers from the "big three" have departed to work for the new private banks; some observers believe that this brain drain is likely to affect the efficiency of the entire banking system.¹⁷⁹ In the long run, however, the transfer of personnel is likely to have the beneficial effect of concentrating the best and most talented human capital resources in the most dynamic sector of the banking industry.

Following these initial reforms, the Taiwanese financial authorities became very concerned that the new financial institutions were making too many real estate loans and fuelling speculation in the real estate market.¹⁸⁰ In response to this fear, the MOF and the CBC conducted a two-week inspection of local banks in May 1992. The two government agencies believed that the new banks had been making medium- and long-term loans beyond the level permitted.¹⁸¹ The inspectors also maintained that the banks were overex-

174. *Bank Branches to Increase*, Central News Agency, June 2, 1992, available in LEXIS, Nexis Library, INTL File.

175. Friedland, *supra* note 136, at 72.

176. *Id.* at 73; see Deposit Insurance Law (promulgated Jan. 9, 1985) (Taiwan). Nearly all of Taiwan's old banks, with the exception of the "big three," participate in the deposit insurance program. *The Monetary System - National Monetary Institutions, Financing Foreign Operations*, Aug. 1, 1991, available in Westlaw, BUS-INTL database.

177. Friedland, *supra* note 136, at 72; see also Leung, *supra* note 157, at 18 (reporting that the competition for experienced staff generated by the opening of the new banks has raised salary costs by 30% to 40% in the banking industry).

178. In the state-run banks, loan officers have been known to be held personally liable for defaults on loans they had approved. *Sitting on its Billions*, *supra* note 1, at 97.

179. *Financial Reform: Taiwan Moves Forward and Sideways*, BUS. ASIA, July 20, 1992, available in Westlaw, BUS-INTL database.

180. Friedland, *supra* note 136, at 72-73.

181. *Taiwan: Banking Regulations Should Be Liberalized*, *supra* note 169. The controversy arose because the government and the banks had different interpretations of the applicable limits on such term loans. The relevant regulation provides that total outstanding term loans cannot exceed the amount of time deposits the banks have taken. The banks maintain that their initial start-up capital should be included in their total time deposits, while the government contends that the banks may not include their start-up capital. The government's interpretation of these regulations seems ill-conceived since it could substantially reduce the benefits of the banking reforms, in particular the emergence of the new banks as new sources of capital. *Id.*

tending loans for real estate purposes.¹⁸² By subjecting the banks to this excessive regulation, the Taiwanese financial authorities demonstrated an unwillingness to give up control of the financial system and let market forces reign.

The creation of new private banks exhibits the most promise for significant liberalization and reform of Taiwan's banking system. While these banks are still substantially restricted in how they can do business and suffer from certain disadvantages vis-a-vis the state-run banks, they represent a new, modern sector of the banking industry and are attracting its most promising personnel. More importantly, these new banks are backed by powerful economic forces within Taiwan which, coupled with the growing pressures of the world economy and the internationalization of financial markets, will produce a strong dynamic of liberalization and change. However, Taiwan will not be able to realize the full potential of its privatization until it succeeds in prying away the big three from the public sector and allows the new private banks to fully participate in all banking businesses open to the state banks. Fortunately, the trend seems to be toward further liberalization, and the new banks will likely be permitted to engage in a wider range of banking businesses in the near future.¹⁸³

C. FOREIGN BANKS IN TAIWAN

The second major area of the Taiwanese government's banking reforms is the loosening of the constraints imposed on foreign banks in Taiwan. Although a substantial number of foreign banks operate in Taiwan and have a significant presence in the banking market,¹⁸⁴ reform in this area has not yet progressed very far. While a recent

182. The regulations provide that banks cannot extend mortgages which exceed 20% of their outstanding time deposits. *Id.*

183. Many analysts predict that the government will allow the new banks to engage in some foreign exchange business in the near future. Friedland, *supra* note 136, at 73.

184. *Capital Sources*, Investing, Licensing & Trading Conditions Abroad, Sept. 1, 1991, available in Westlaw, BUS-INTL database. U.S. banks which were operating in Taiwan as of the end of 1991 include American Express International Banking Corp., Bank of America, Bank of California, Bank of New York, Bankers Trust Co., Chase Manhattan Bank, Citibank N.A., First Interstate Bank, First National Bank of Boston, Manufacturers Hanover Trust Co. (since merged into Chemical Bank), and Security Pacific Bank (since merged into Bank of America). Other foreign banks operating in Taiwan include: ABN-AMRO Bank, Bangkok Bank, Bank of Nova Scotia, Banque Indosuez, Banque Nationale de Paris, Banque Paribas, Barclay Bank, Credit Lyonnais, Dai-ichi Kangyo, Deutsche Bank, Development Bank of Singapore Ltd., Grindlays Ltd., Hollandsche Bank-Unie NV, Hongkong & Shanghai Banking Corp., International Bank of Singapore Ltd., Lloyds Bank International Ltd., Metropolitan Bank & Trust, National Australia Bank, Royal Bank of Canada, Societe Generale, Standard Bank of South Africa, Standard Chartered Bank, Toronto Dominion Bank, and Westpac Banking Corp. *Foreign Banks with Branches in Taiwan*, Fin. Foreign Operations, Aug. 1, 1991, available in Westlaw, BUS-INTL database.

amendment to the *Guidelines for Screening and Approval of Establishment of Branches and Representative Offices by Foreign Banks (Foreign Bank Guidelines)*¹⁸⁵ has made it somewhat easier for foreign banks to operate in Taiwan, they still face many restrictions.

To be eligible to open a branch in Taiwan, a foreign bank must not have violated any Taiwanese laws during the five years prior to its application and must either (1) have done business worth at least \$1 billion with Taiwanese banks or enterprises in the three years preceding its application, of which sum it must have granted \$180 million as long- or medium-term credits and had business connections with Taiwanese banks for at least ten years,¹⁸⁶ or (2) rank among the world's top five hundred banks in assets or capital and have maintained a representative office in Taiwan for more than one year, during which time it must have transacted with Taiwanese banks and companies business worth at least \$1 billion.¹⁸⁷ The MOF also has the discretion to allow the establishment of a branch office by a bank which has not met either of the two prerequisites in certain narrow situations.¹⁸⁸ Similar but less stringent requirements apply to foreign banks that wish to open a representative office in Taiwan.¹⁸⁹

Under the new *Foreign Bank Guidelines*, foreign banks may open three Taiwanese branches a year.¹⁹⁰ Before the revision of the guidelines, foreign banks were only permitted to operate one branch in Taipei and one in Kaohsiung, and in order to open an additional branch, the bank must have operated its previous branch without violating Taiwanese law for five years. Under the new *Foreign Bank Guidelines*, the MOF can grant licenses to foreign banks to open offices in other cities when market conditions justify such ac-

185. An English translation of the Foreign Bank Guidelines appears in E. ASIAN EXECUTIVE REP., Sept. 1990, at 24 (guidelines promulgated on Apr. 10, 1990).

186. Foreign Bank Guidelines art. 3, ¶ 1.

187. *Id.* art. 3, ¶ 2.

188. *See id.* art. 3, ¶ 2, § 1. The MOF also has the authority to permit foreign banks to open branches to increase the number of foreign countries whose banks are present in Taiwan and to fulfill reciprocity agreements with the central financial authorities of the foreign country. *Id.* art. 3, ¶ 5-6.

189. *Id.* art. 4. In order to qualify to open a representative office, a foreign bank must have had business connections with banks in Taiwan for at least five years and must have transacted business with Taiwanese banks and companies in the amount of US\$300 million or more in the three calendar years prior to its application. *Id.* A foreign bank which either merged with another bank which has a subsidiary in Taiwan or takes over a representative office established by a 100% control bank subsidiary does not have to meet the above requirements. *Id.* As is the case for opening branches, the MOF has the discretion to allow banks which otherwise do not meet the requirements for opening a Taiwanese branch in certain specific situations to open a representative office. Banking Law art. 5-6.

190. Foreign Bank Guidelines art. 7. The previous guidelines permitted foreign banks to open only two branches per year. C.Y. Huang & Jeff Chen, *Taiwan Revises Regulations for Admitting Foreign Banks*, E. ASIAN EXECUTIVE REP., Sept. 1990, at 20.

tion.¹⁹¹ The MOF also has the discretion to allow foreign banks to open additional branches without waiting five years.¹⁹²

The new guidelines also increased the number and scope of businesses in which foreign banks can engage. Foreign banks may now receive savings deposits as well as manage trusts, underwrite securities, and engage in many other aspects of the securities business¹⁹³ subject to the standard SEL requirements.¹⁹⁴ In addition, the new guidelines increase the maximum amount of deposits that a foreign bank can accept from 12.5 to 15 times its inward remitted capital.¹⁹⁵ Foreign banks also may now extend long-term credit, whereas under the old guidelines they were limited to making only short- and medium-term loans.¹⁹⁶ Foreign banks, however, still need the CBC's approval to conduct foreign exchange business.¹⁹⁷

Despite the slight relaxation in the requirements for opening branches, the Taiwanese government still imposes heavy restrictions on the access of foreign banks to the Taiwanese market. The reforms embodied in the *Foreign Bank Guidelines* did little but give the MOF the power to modify the previous, strict guidelines when it sees fit. While the implementation of the *Foreign Bank Guidelines* may contribute to further liberalization of the Taiwanese banking industry, it does not represent a solid commitment to reform. Furthermore, pursuant to the *Foreign Bank Guidelines*, the CBC will continue to have the ability to veto any attempts by foreign banks with branches in Taiwan to increase their inwardly remitted capital above the initial minimum.¹⁹⁸ This will enable either the CBC or the MOF to prevent the expansion of the foreign banks' business.

Recent heavy-handed actions by the CBC suggest that this veto power could represent a significant impediment to the internationalization of the Taiwanese banking market.¹⁹⁹ Observers outside of Taiwan concur in this view. The U.S. Treasury Department, for example, recently accused Taiwan of "outright discrimination"

191. Foreign Bank Guidelines art. 8.

192. *Id.* art. 9.

193. *Id.* art. 12. However, U.S. banks will not be able to take full advantage of this expansion in the scope of permitted securities business since the Glass-Steagall Act prohibits branches of U.S. banks from underwriting securities. See Huang & Chen, *supra* note 190, at 20.

194. Foreign Bank Guidelines art. 13; see, e.g., Y.D. Deng, *Taiwan: Increase in Foreign Bank Capital*, INT'L FIN. L. REV., Jan. 1991, at 45.

195. Foreign Bank Guidelines art. 14; Huang & Chen, *supra* note 190, at 20.

196. Huang & Chen, *supra* note 190, at 20.

197. *Id.*; Foreign Bank Guidelines art. 13.

198. Foreign Bank Guidelines art. 11. Note that under the same article the approval of the MOF is also required in order for a foreign bank to increase its remittance of capital above the minimum level. *Id.*

199. For a discussion of the misapprehension on the part of foreign bankers toward the CBC, see Jeremy Mark, *Taipei's Moves Stir Fear Among Foreign Bankers*, ASIAN WALL ST. J. WKLY., July 29, 1991, at 1.

against foreign banks.²⁰⁰ Unfortunately, this accusation seems justified by the nature and contents of the Taiwanese regulations for foreign banks.

In order for Taiwan to further internationalize its banking market, the government must allow foreign banks freer access to Taiwan's domestic market. The main flaw in the present course of reform is that instead of loosening the existing restrictions on foreign banks, it makes increased access dependent on the goodwill and approval of government agencies which have their own agenda and incentives. While in the short term, some foreign banks may find the reforms profitable,²⁰¹ what the MOF and the CBC give, they can, and have shown themselves willing, to take away.

IV. CONCLUSION: TAIWAN'S ROLE AS A FINANCIAL CENTER

Two primary factors determine the international significance of a financial center. One is its share of international bank-lending, foreign-exchange trading, and fund management. The other is the size and level of internationalization of its domestic securities markets.²⁰² In these terms, Hong Kong is the principal financial center in Southeast Asia and the second most important financial center in all of Asia after Tokyo.²⁰³ Taiwan, on the other hand, remains largely closed off from the international financial system and its markets are relatively insignificant in world terms.

Now, with Hong Kong's future clouded in uncertainty due to the colony's impending return to Chinese sovereignty in 1997, leaders in Taiwan see an opportunity to attract to their island some of Hong Kong's financial business.²⁰⁴ In fact, Taiwan's recent economic reforms were accompanied initially by bold assertions from

200. For a discussion, see *Taiwan Central Banker Defends Hoard*, *supra* note 86; see also Jeremy Mark, *Taiwan Business Bulletin: Central Bank Protests U.S. Treasury Attacks on Policy*, *ASIAN WALL ST. J. WKLY.*, June 8, 1992, at 23.

201. Huang & Chen, *supra* note 190, at 20. Foreign bank operations on Taiwan were mostly unprofitable under the previous guidelines. See Jeremy Mark & Cynthia Owens, *Taiwan's Market Losing Its Appeal for Foreign Banks*, *ASIAN WALL ST. J. WKLY.*, Sept. 10, 1990, at 1; see also Jeremy Mark, *United States Banks Reassess Presence in Taiwan*, *WALL ST. J.*, Sept. 21, 1990, at A7; Cynthia Owens, *Competition Cuts into Profit Margin of Foreign Banks*, *ASIAN WALL ST. J. WKLY.*, July 15, 1991 at 25.

202. John Peet, *Rise and Fall*, in *Financial Centres Survey*, *ECONOMIST*, June 27, 1992, at 4.

203. John Peet, *The Booming Orient*, in *Financial Centres Survey*, *supra* note 202, at 12.

204. See, e.g., Winn, *supra* note 3, at 908; Elizabeth Lu, *Taiwan Aims to Evolve into Financial Center*, *L.A. TIMES*, Oct. 21, 1991, at D3; *Taiwan Strives to Become Regional Financial Center*, *AGENCE FRANCE PRESSE*, May 25, 1992, available in LEXIS, Nexis Library, CURRNT file; Philip Lin, *Taiwan Offers Strong Advantages as Regional Operations Center*, *Reuter Textline Bus. Taiwan*, Dec. 21, 1992, available in LEXIS, World Library, TXTNWS File.

government leaders that the reforms would enable Taiwan to overtake Hong Kong as the principal financial center in the region.²⁰⁵ As the highly cautious nature of the government's economic program has become evident, however, Taiwanese officials have begun to scale down their aspirations. At present, Taiwan's leaders appear to have the more modest ambition of turning the island into a kind of subsidiary Asian financial center rather than into a full-scale replacement for Hong Kong.²⁰⁶

To become any sort of regional financial hub, Taiwan will have to achieve greater progress toward integrating its markets into the world financial system. The reforms discussed above with respect to liberalizing foreign exchange rules, internationalizing the securities market, and permitting foreign banks greater access to the Taiwanese market represent steps in that direction. However, true integration into the international system will only be possible if Taiwan's financial regulators, and in particular the CBC, further relinquish their control over the flow of investment capital into and out of Taiwan.²⁰⁷ International financial entities depend on the freedom to move capital quickly from one market to another in search of optimum returns. If that freedom is not available in Taiwan, the island will never develop an important financial role.

Furthermore, even if the pace of reform in Taiwan were to quicken, the island's best opportunity of attracting a significant volume of financial work from Hong Kong already may have passed. The widespread fear and uncertainty about Hong Kong's future that followed the 1989 Tiananmen Square massacre caused many observers to predict that Hong Kong soon would lose its financial role to a more stable regional competitor.²⁰⁸ Thus far, these predictions have not been proven correct; indeed, the colony's regional financial position has strengthened in the past several years.²⁰⁹

Hong Kong's staying power as the preeminent financial center in Southeast Asia derives from several factors. First, the colony is the finance, trade, and distribution center for the economically booming region of South China.²¹⁰ Most of the foreign investment

205. See, e.g., Kaye, *supra* note 25, at 51; Owens, *supra* note 32, at 25.

206. See Liu, *supra* note 33, at 26.

207. Winn, *supra* note 3, at 941.

208. See Peet, *supra* note 203, at 12.

209. See, e.g., Simon Davies, *Dreams of China Keep Hong Kong in Favour*, FIN. TIMES, May 16, 1992, at 21; Jeremy Grant, *HK Shrugs Off 1997 Fears as China Business Booms*, Reuters Library Rep., Apr. 18, 1992, available in LEXIS, Nexis Library, INTL file; Yasushi Watanabe & Nozomu Kitadai, *Colony Holds Own Despite Singapore's Allure*, NIKKEI WKLY., Mar. 28, 1992, at 32.

210. See *China, Hong Kong Merging as Economic Bloc*, AGENCE FRANCE PRESSE, July 25, 1992, available in LEXIS, Nexis Library, INTL file; Simon Holberton, *Survey of Hong Kong*, FIN. TIMES, May 5, 1992, at 27. The economic output of South China's Guangdong Province has grown at approximately 13% a year since 1979. In Shenzhen,

that fuels South China's expansion either originates from or flows through Hong Kong.²¹¹ Second, in contrast to the overregulation that has hindered Taiwan's financial growth, Hong Kong's present government has demonstrated its commitment to open markets and light-handed regulation.²¹² Third, the colony offers the best combination of geographic location and infrastructure of any city in the region,²¹³ and has in place the critical mass of financial professionals, including bankers, accountants, and lawyers.²¹⁴

These advantages could dissipate after 1997. However, even if the colony's reversion to Chinese rule causes Hong Kong to lose its financial importance in the region, it is unlikely that Taiwan would inherit Hong Kong's mantle. Rather, Singapore appears to be a much more likely successor. Singapore already has successfully challenged Hong Kong's predominance in a few areas²¹⁵ and has launched a highly organized effort to entice financial institutions to relocate there from Hong Kong.²¹⁶ Although Singapore will be hard-pressed to overtake Hong Kong as an all-around financial center because of the republic's extremely small size and chronic labor shortages,²¹⁷ Singapore can be expected to benefit much more

which is the city in Guangdong closest to Hong Kong, output has grown by 47% a year during that period. *Geography and Geometry, in Asia's Emerging Economies Survey, supra* note 15, at 9.

211. Roughly four-fifths of the over US\$20 billion that has been invested in Guangdong in the past twelve years came from Hong Kong companies, which employ over two million workers in the province. *Geography and Geometry, supra* note 210, at 9.

212. See Peet, *supra* note 203, at 17.

213. *Id.*

214. In contrast, Taiwan's government continues to impose onerous restrictions on foreign firms that want to set up operations on the island. In addition to the restrictions on foreign banks discussed in *supra* section III, Taiwan is becoming increasingly inhospitable to foreign law firms. See Samantha Swiss, *Taiwan's About Face on Foreign Lawyers*, INT'L FIN. L. REV., Sept. 1991, at 27. Moreover, in light of Taipei's high levels of pollution, severe traffic problems, and climate that includes prolonged periods of monsoon rains, it is unclear whether the city could ever attract the necessary numbers of foreign financial professionals to be a major financial center. See Owens, *supra* note 32, at 25.

215. In the area of foreign exchange trading, for example, Singapore's futures market, SIMEX, is the most developed in the region and the second largest foreign exchange futures market in all of Asia after Tokyo's market. Peet, *supra* note 203, at 17; see also *SIMEX Gaining Clout as Major Exchange*, NIKKEI WKLY., Aug. 29, 1992, at 20.

216. See, e.g., Angus Foster, *Hong Kong as a Financial Centre; Fear Beneath the Optimism*, FIN. TIMES, Nov. 20, 1991, at 1. As a result of this effort, several large banks, including Chemical Bank and Deutsche Bank, have moved their Southeast Asian regional headquarters from Hong Kong to Singapore. *With Chinese Takeover Looming, Hong Kong Firms Move to Singapore*, L.A. TIMES, June 3, 1991, at D8; see also Watanabe & Kitadai, *supra* note 209, at 32.

217. *Regional Centres Entice Hong Kong Firms to Flee*, AGENCE FRANCE PRESSE, Feb. 23, 1992, available in LEXIS, Nexis Library, INTL File.

than Taiwan if international financial institutions choose to abandon Hong Kong in large numbers.

Moreover, a number of other countries in Southeast Asia are rapidly liberalizing their financial systems in order to attract foreign capital to their markets.²¹⁸ Malaysia, for example, has plans to develop Labuan Island off the coast of Sabah as an offshore tax haven and financial center.²¹⁹ Thailand, likewise, has dramatically reformed its securities laws and has begun to open its financial markets to foreign participation.²²⁰ Although these countries all have infrastructure weaknesses and other problems similar to or greater than those of Taiwan, the wave of financial deregulation that is sweeping the region suggests that Taiwan may have a difficult time making its relatively cautious reforms stand out in a crowded financial marketplace.²²¹

In light of this high level of competition, it is unlikely that Taiwan's recent spate of financial reforms will be sufficient to transform the island into a major regional financial center. The tremendous accumulation of wealth on the island, however, means that Taiwan's financial role should not be entirely dismissed. With its foreign exchange reserves regularly turning over more than US\$1 billion in the morning session alone and its two-way trade generating more than US\$350 million a day,²²² Taiwan's government is sitting on a veritable treasure chest of financial assets. If it can unleash these assets through further and more profound financial deregulation, Taiwan could indeed find itself at the end of the twentieth century as one of the primary financial centers in the Pacific Basin.

218. See Levingston, *supra* note 35, at 1.

219. *Regional Centres Entice Hong Kong Firms to Flee*, *supra* note 217; see also Stephen Duthie, *Labuan's Development as Offshore Center Takes Root, but Its Appeal to US Firms Is Limited*, *ASIAN WALL ST. J. WKLY.*, Sept. 21, 1992, at 18; *Tax Haven Rises Out of Jungle to Help Steer Private Wealth*, *INT'L HERALD TRIB.*, Dec. 10, 1992, available in LEXIS, Nexis Library, OMNI File.

220. See Cynthia Owens, *Securities Reforms May Give Thailand Edge over Region's Emerging Markets*, *ASIAN WALL ST. WKLY.*, Mar. 2, 1992, at 23. The financial reforms in Thailand have included simplifying stock listing procedures and strengthening the rules against market manipulations such as insider trading. *Id.*

221. On the need for Taiwan to continue to undertake financial reforms in light of the changes occurring in other Asian markets, see James H. Fall III, *Taipei Needs to Carry Out Deeper Financial Reforms*, *ASIAN WALL ST. J. WKLY.*, Dec. 21, 1992, at 12.

222. Shale, *supra* note 28, at 38.