The Evolution of Taiwan's Corporate Governance Reforms after the Repeal of Martial Law—Observation from the Changes of Political Environment

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Table of Contents

I. Introduction

Corporate Governance has been heatedly discussed for quite a long time and will continuously maintain its important position in the corporate law and securities law field if we simply focus on investor protection.[1] It may also affect the government policies in other fields, such as investment, trade, tax and corporate social responsibilities policies, because good corporate governance would also positively influence the national economic development, and social welfare. To be sure, there are many other reasons and evidences showing that corporate governance will and shall continue to be the main theme in the corporate law particularly targeting the publicly held corporations. Taiwan, as a member of the international society, having been actively participating in the global commercial and financial market activities, has quickly responded to the occurrences of domestic and foreign corporate scandals and has adopted measures to reinforce the corporate governance system.

One may be curious to know whether Taiwan's corporate governance regime mainly follows the U.S. model, the German model or has its own unique content. It is also interesting to know whether Taiwan implements the corporate governance policy via hard law or soft law, mandatory rules or self-regulation. To fully understand Taiwan's corporate governance regime, one may need to go further to examine the contemporary problems and the recent regulatory reforms of the corporate governance regime in Taiwan.

It may be hard to imagine the connection between the democratization and the corporate governance. It is also unimaginable to see a corporate law scholar talking about the Martial Law and corporate governance in the same time.[2] However, it will be interesting to see in the corporate law field whether the adoption of Martial Law and its abolition have to some extent affected the policy-making of corporate law or corporate governance. One of the purposes of this article is to discuss whether we can observe any noticeable changes in the corporate governance policy-making in the process of democratization or whether there is only slight, minimum or barely any influences from the Martial Law.

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[1] *See generally*, Jason M. Loring & C. Keith Taylor, Empirical Study: *Shareholder Activism: Directorial Responses to Investors' Attempts to Change the Corporate Governance Landscape*, 41 WAKE FOREST L. REV. 321 (Spring 2006); Roberta Romano, *Less Is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174 (Summer 2001); James A. Fanto, *Investor Education, Securities Disclosure, and the Creation and Enforcement of Corporate Governance and Firm Norms*, 48 CATH. U. L. REV. 15 (Fall 1998).

[2] The Martial Law was enacted on November 29, 1934, amended on January 14, 1947. After the Kuomintang government retreated from China to Taiwan and the occurrence of the "228 Incident," the government declared the martial law effective on May 20, 1948. The martial law remained effective until July 15, 1987 when the President announced the abolition of the martial law.

Section II of this article begins with the introduction of the evolution of Taiwan's corporate governance regime. In addition to what the major contents of the corporate governance are, the regulatory philosophy of the competent authority, including the use of self-regulation or mandatory rules, will also be discussed. Section III introduces the major amendments of the corporate and securities laws, particularly regarding the corporate governance issues. The discussion is divided into two periods, one covering the amendments prior to the abolition of the martial law and the other stage covering the amendments after the repeal of the martial law. By looking at the frequency and contents of the amendments prior and after the repeal of martial law, the purpose for such division is to observe whether democratization has great influence on the field of corporate law. In Section IV, we focus on the process of democratization and regulatory agency reforms on the evolution of corporate governance regime. We examine how two regulatory agencies—the competent authorities of the Companies Act and the Securities and Exchange Act—interact with each other on corporate governance policies. After the repeal of martial law, there is a regulatory agency reform, unifying three major regulatory agencies, i.e., banking, insurance, and securities and futures regulators, into a single regulator, i.e., the Financial Supervisory Commission (FSC). Whether this is the product of democratization? Section Five goes further to explore whether we can observe any implications and influences from the abolition of the martial law on the corporate governance regime. We will identify the factors affecting the corporate regulatory reform by examining whether the process of democratization has improved the administrative efficiency, whether corporations are free to invest in China and whether Chinese capital are free to flow into Taiwan, and whether the corporate governance policies are formulated by the competent authorities mainly based on the need of the industry and economic factors or could also be affected by the mentality of the high ranking officers and reasons other than the economic factors. Section VI provides the conclusion of this article.

II. The Evolution of Taiwan's Corporate Governance Regime —Self-Regulations v. Mandatory Rules

Corporate governance was not a well-known term and was not heatedly discussed in Taiwan until the beginning of the 21st Century. This is evidenced by the literatures published prior to the Year of 2000 that very few with topics relevant to corporate governance. It is further evidenced with the establishment of the Corporate Governance Association in Taiwan in 2002[3], the introduction of independent directors

[3] The Corporate Governance Association (TCGA) was established on March 13, 2002. The TCGA was sponsored by the Securities and Futures Commission, the Bureau of Monetary Affairs of the Ministry

by the Taiwan Stock Exchange in 2002, and the promulgation of the Code of Corporate Governance for Listed Companies.[4] The following will discuss the evolution of Taiwan's Corporate Governance Regime that began with the self-regulation and moved toward the codification of the corporate governance policies. However, it is necessary to note that self-regulation still plays an important role.

A. Introducing Independent Directors and Other Corporate Governance Policies via Self-Regulation

Corporate governance reform was initiated by the Securities and Futures Commission, the predecessor of the Financial Supervisory Commission, and co-sponsored by the Taiwan Stock Exchange, the GreTai Securities Market (GTSM), the Securities and Futures Institute, and the Corporate Governance Association. Since paying attention to the corporate governance of publicly held corporations, how to enhance the monitoring function to watch the board of directors and management, at least to prevent self-dealing and fraudulent misconducts, has been the focus of the corporate governance reform in Taiwan.

At the initial stage (beginning from early 2002), with regard to the monitoring mechanism, corporate governance reform includes three major strategies. First of all, listed companies are required to appoint at least five directors.[5] Among them, at least two directors must be independent directors, and at least one independent director must be specialized in finance or accounting. Second, listed companies must have at minimum three supervisors.[6] Among them, at least one must be independent supervisor and specialized in finance or accounting. Third, publicly held corporations are required to set up internal audit system, which is arranged by the board of directors and management to ensure that the company has complied with the law, has

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of Finance (MOF), the GreTai Securities Market (GTSM or OTC), Taiwan Securities Central Depository, Taiwan Futures Exchange, Securities and Futures Institute, four CPA Associations, etc. Information obtained from the website of the TCGA, available at http://www.cga.org.tw/index.php?content=english. (Last visited on Oct. 1, 2007).

[4] According to the instruction of the Securities and Futures Commission (SFC Reference No. Taiwan-Finance-Securities-(I)-0910004984 (Sept. 26, 2002)), the Taiwan Stock Exchange and the GreTai Securities Market jointly promulgated the Code of Corporate Governance for Listed Companies on October 4, 2002. Taiwan Stock Exchange Reference No. Taiwan-Securities-91-Listing-025298 (Oct. 4, 2002).

[5] Beginning from February 2002, the listing requirements of both TSE and GreTai Securities Market require that companies applying for listing on the TSE or GTSM must have at least 5 directors and at least 2 of them must be independent directors. Non-listed companies need appoint only three directors as required by the Company Law. Cf. Company Law, §192, para. 1.

[6] Currently, publicly held companies must have two or more supervisors as required by the Company Law. Company Law, §216, para. 2.

fully, timely, and adequately made financial disclosures, and has taken necessary measures to maximize the interests to shareholders and other stakeholders.[7]

B. Codification of Corporate Governance Regime

In order to enhance the effectiveness of corporate governance and to justify the requirements that require publicly held corporations to appoint independent directors, in 2004, the securities regulator initiated the codification of the corporate governance measures, particularly the introduction of independent directors and audit committee, and the enhancement of the board of directors' functions by proposing a TSEA Amendment Bill.[8] The 2004 Proposed Reform requiring publicly held corporations to appoint independent directors and set up audit committees did not go through the legislative process and was aborted. In April 2005, a new TSEA amendment bill (2005 Proposed Reform) was sent by the Executive Yuan and was sent to the Legislative Yuan in July 2005. With some revisions to the 2005 Proposed Reform, the Legislative Yuan complete three-reading process on December 20, 2005 and took effect on January 11, 2006 by the Presidential Order. The provisions regarding corporate governance did not become effective until January 1, 2007.[9]

Beginning from January 2007, there will be three major models of corporate structure for publicly held corporation in Taiwan. Generally speaking, a publicly held corporation has the option to decide the model of its internal corporate structure. However, the Financial Supervisory Commission (FSC) may order certain types of corporation to appoint independent directors (Model Two) or establish an audit committee (Model Three).

(a) Model One—Two-Tier System

The first model is the traditional and current corporate structure as required by the Company Law since its enaction in 1929. Under Model One, a company has a shareholders' meeting, a board of directors and supervisors. Shareholders elect both directors and supervisors. The board is composed of executives and some outside directors. Supervisors serve as the monitoring organ to monitor the performance of the board of directors and the management. Under this old fashioned two-tier

[7] Regulations Governing Establishment of Internal Control Systems by Public Companies, promulgated on Nov. 18, 2002 (as amended). To implement, the Taiwan Stock Exchange issued "Taiwan Stock Exchange Corporation Direction for Auditing Internal Control Systems of Listed Companies" in April, 2003; the GreTai Securities Market also issued similar Direction applicable on OTC companies.

[8] In July 2004, a TSEA Amendment Bill (2004 Proposed Reform), proposed by the TSFB of the FSC, was adopted by the Executive Yuan and was sent to the Legislative Yuan.

[9] Taiwan Securities and Exchange Act, arts. 181-2 & 183.

corporate structure, supervisors are criticized for not being able to exercise the monitoring role because of the passivity and the close relationship with the controlling shareholders and directors.

After the amendment of the TSEA 2006, non-publicly held corporations will maintain this two-tier corporate structure. As for publicly held corporations, if not designated by the FSC to appoint independent directors or to establish an audit committee, it may maintain the traditional two-tier board corporate structure.

(b) Model Two—Two-Tier System with Independent Directors

As discussed in the earlier section, the FSC may order certain corporations to appoint independent directors into the board of directors but still maintain supervisors as the official monitoring organ. Under Model Two, supervisors serve as the monitoring organ. Although independent directors play some monitoring function, under this model, they are directors and do not have comparable supervisory powers held by supervisors according to the Company Law. Articles 14-2 to 14-3 and Independent Director Regulation promulgated by the FSC govern the appointment, qualifications, missions, and powers of the independent directors.[10] The major function of the independent directors is to participate the board meeting and provide their professional and independent opinions regarding material corporate affairs as listed in Article 14-3 of the TSEA. It requires that the dissenting and reserved opinion of the independent directors be recorded in the minutes of the board meeting and published on the Market Observation Post System.[11] According to the FSC order, beginning from January 2007, financial institutions and listed companies with more than NT$50 billion of paid-in capital will be required to appoint independent directors.[12]

(c) Model Three—One-Tier System and Audit Committee

The FSC may require certain publicly held corporation establish an audit committee. The TSEA does not clearly point out whether audit committee is a subcommittee of the board. However, if a company establishes an audit committee, it has to abolish supervisors. Therefore, audit committee is established to replace

[10] Regulations Governing the Appointment and Required Compliance Matters of the Independent Directors of the Publicly Held Corporations, promulgated by the Financial Supervisory Commission of the Executive Yuan (Mar. 28, 2006) [hereinafter the Independent Director Regulation].

[11] TSEA, §14-3; Regulations Governing the Board of Directors of Publicly Held Corporations, §17, para. 2, promulgated by the FSC per Order No. Finance-Supervisory-Securities-(1)-0950001615 of the Financial Supervisory Commission, Executive Yuan (Mar. 28, 2006) [hereinafter the BOD Regulation]. The Market Observation Post System can be accessed via http://w3.tse.com.tw/docs/eng_home.htm.

[12] Order No. Finance-Supervisory-Securities-(1)-0950001616 of the Financial Supervisory Commission, Executive Yuan (Mar. 28, 2006).

supervisors and serves as the supervisory organ. The TSEA explicitly delegate supervisory powers of supervisors to both the audit committee and its members.[13] Therefore, unlike the independent directors of Model Two, independent directors under Model Three serve not only as a director but also enjoy the supervisory powers.

In addition to the supervisory powers set forth under Article 14-4, important corporate affairs, as listed under Article 14-5, must obtain approval from the audit committee before it goes to the board meeting. However, the audit committee does not have the veto power. Although the audit committee disapproves the proposal, the board meeting still can approve it by approval of more than two thirds of all board members.[14] It is necessary to note that the board is not required to be composed of majority independent directors. However, under such circumstances, the TSEA requires the minutes of the board meeting to record the disapproval of the audit committee and publish on the Market Observation Post System.[15]

III. Observation from Major Amendments of Securities and Corporate Laws

The following introduces the major amendments of the corporate and securities laws regarding the corporate governance issues.[16] The discussion is divided into two periods, one covering the amendments prior to the abolition of the martial law and the other stage covering the amendments after the repeal of the martial law. By looking at the frequency and contents of the amendments prior and after the repeal of martial law, the purpose for such division is to observe whether democratization has material influence on the field of corporate law.

A. Corporate and Securities Law Amendments Prior to July 1987

Prior to the repeal of the Martial Law, the Companies Act has five amendments after the enaction of the Companies Act in 1966. (See Table 1) The total amended and newly added provisions in these five amendments are 275. Among them, 29

[13] TSEA, §14-4, paras. 3 & 4.

[14] TSEA, §14-5, para. 2.

[15] TSEA, §14-5, para. 2; BOD Regulation, §17, para. 2.

[16] As mentioned, the term "corporate governance" was not popular in Taiwan prior until the last decade of the 20th Century. Although corporate governance is not used prior to the repeal of the martial law and even in the first couple of years after its repeal, the discussion in this section collect major corporate and securities laws amendments focusing on the provisions having relevance to the definition of corporate governance, such as provisions regarding maximizing shareholders' interest, increasing the transparency and reliability of corporate financial information, and protecting the interest of stakeholders. For definition of corporate governance, *see* Florence Shu-Acquaye, *Corporate Governance Issues: United States and the European Union*, 29 HOUS. J. INT'L L. 583, 583 n.1 (Spring 2007).

provisions involve the changes of shareholders' right or other corporate governance matters. In terms of the TSEA, because the TSEA has shorter life than the Companies Act, there are only twice amendments during this period. In these two amendments, 10 provisions were amended or added and 6 of them are related to corporate governance. (See Table 2)

B. Corporate and Securities Law Amendments After July 1987

After the repeal of the Martial Law, there have been six amendments on the Companies Act until October 2007. (See Table 1) The total amended and newly added provisions in these six amendments are 368. Among them, 78 provisions involve the changes of shareholders' right, directors or other corporate governance matters. In terms of the TSEA, there have been ten amendments during this period. In these ten amendments, 170 provisions were amended or added and 57 of them are related to insider trading, market manipulation, disclosure, criminal and civil liabilities, and other corporate governance matters. (See Table 2)

TABLE 1

The Amendments of the Companies Act

The Companies Act has been amended for 13 times since it was enacted on December 26, 1929. (Total Provisions: 233)		
Date of Amendment	Total Number of Amended and/or Newly Added Provisions	Number of Amended or Newly Added Provisions Related to Corporate Governance
1946.04.12	Newly Enacted (Total Provisions: 361)	
1966.07.19	Newly Enacted (Total Provisions: 449)	The current Companies Act is based on the Companies Act of 1966.
1968.03.25	2	0
1969.09.11	4	0
1970.09.04	53	2
1980.05.09	119	13
1983.12.07	97	16
1990.11.10	**18**	**6**
1997.06.25	**98**	**25**
2000.11.15	**2**	**0**
2001.11.12	**229**	**37**
2005.06.22	**15**	**10**
2006.02.03	**6**	**0**

TABLE 2

Amendments of the Securities and Exchange Act

The Securities and Exchange Act has been amended for twelve times since it was enacted on April 30, 1968. (Total Provisions: 183)		
Date of Amendment	Total Number of Amended or Newly Added Provisions	Number of Amended or Newly Added Provisions Related to Corporate Governance
1981.11.13	5	3
1983.05.11	5	3
1988.01.29	**55**	**17**
1997.05.07	**4**	**0**
2000.07.19	**35**	**7**
2001.11.14	**6**	**2**
2002.02.06	**18**	**11**
2002.06.12	**5**	**4**
2004.04.28	**4**	**0**
2005.05.18	**3**	**0**
2006.01.11	**38**	**16**
2006.05.30	**2**	**0**

From the frequency of the corporate and securities law amendments, it is perceived that more amendments are made frequently after the repeal of the Martial Law. However, the amendments could also be initiated because of responding to the corporate scandals or regulatory reforms of foreign jurisdiction. For example, the TSEA was amended in 1988 to add a provision to regulate insider trading in responding to the U.S. Federal insider trading legislation made in the same year. The amendments of the Companies Act in 2001 and the TSEA in 2006 were to follow the recent regulatory reforms in Europe, Japan, and the United States and to prevent corporate scandals. Therefore, from the figures of the Tables 1 & 2 can only partially prove that the government has done more after 1987. However, it might not have any relevance with the repeal of the Martial Law. It would be interesting to see the evolution of the corporate and securities laws in the neighboring countries.

IV. Democratization and Regulatory Agency Reform

A. Dual Regulatory Agencies on Corporate Governance Policies

Currently, there are two major governmental agencies whose policies have direct influence on a company's corporate governance. One is the Ministry of Economic

Affairs (MOEA) and the other is the Financial Supervisory Commission (FSC).

The MOEA is the competent authority of the Companies Act. All companies must register with the MOEA to establish and begin to run businesses. Important corporate information, such as the articles of incorporation[17], must be filed with the MOEA. From time to time, the MOEA, with the authorization of the Companies Act, makes rules, orders, and releases to enforce and interpret the Companies Act. The MOEA usually initiates and proposes bills to amend the Companies Act. As said, the Companies Act sets forth provisions governing the rights, duties, and powers of shareholders, the shareholders' meeting, directors and the board of directors. The revision of the Companies Act in this regard, such as enlarge or limit the power in making a business judgment, will materially affect a company's corporate governance.

The FSC is the competent authority of the Securities and Exchange Act (TSEA).[18] With regard to the governance of a corporation, the FSC has a broad range of powers delegated by the TSEA to supervise and regulate publicly held corporations primarily by requiring registration and disclosure of corporate information periodically and in the instance of issuing securities. Corporate insiders of a publicly held corporation, including directors, supervisors, managers, and 10 percent shareholders, must report their shareholding as well as the changes of their

[17] The following information required to be stated in the articles of incorporation: (Company Law, §129)

(1) Name of the company;

(2) Business to be engaged;

(3) Total number of authorized shares and par value;

(4) Location of the head office;

(5) Number of directors and supervisors and their tenure of office; and

(6) The date of execution of the articles of incorporation.

The following information must be included in the articles of incorporation if applicable: (Company Law, §130)

(1) Establishment of branch office;

(2) If authorized shares are to be issued by installment, the number of shares fixed and issued at the time of incorporation;

(3) Causes for dissolution of the company;

(4) Types of preferred shares and their rights and obligations;

(5) Special benefits to be accorded to promoters and the names of beneficiaries.

[18] The competent authority for the TSEA was the Securities and Exchange Commission (SEC) of the MOEA when the TSEA was enacted in 1968. In fact, the SEC was established on September 1, 1960. On July 1, 1981, the SEC was moved from the MOEA to the Ministry of Finance (MOF). The SEC was renamed the Securities and Futures Commission in 1996 to reflect the expansion of its regulatory power to cover futures market. In order to create a more efficient regulatory structure, the Financial Supervisory Commission was created in July 2004 to consolidate three major regulators of financial market, i.e. the banking, insurance and securities regulators. For more discussion of the establishment of the FSC, *see infra* Section IV. B., at 12.

shareholding. Corporate insiders must also report to the FSC prior to the sales of their shares of the corporation.[19] With the authorization of the TSEA, the FSC makes rules to enforce the TSEA, which significantly influences the corporate governance of publicly held corporations in many aspects.[20]

The scope of powers of the MOEA and the FSC in regulating the corporations are mainly distinguished and determined by the Companies Act and the Securities and TSEA. However, because there is an overlap on the scope of powers, sometimes it is difficult to determine whether the MOEA or the FSC is in charge of the subject matter.[21] From the past experiences, there were several cases brought up the issues on who should take charge of the subject matter. For example, in April 2003, the securities regulator issued a definition of "manager" to include president, vice-president, assistant manager, and head of accounting and finance department.[22] The purpose for issuing this definition is to ascertain that those persons are treated as managers under the TSEA and must comply with the disclosure requirements and other requirements applicable to managers. From its appearance, it is within the scope of the securities regulator's authority. However, it is argued that whether a person can be treated as a manager must comply with Article 29 of the Companies Act that such person is appointed as a manager with the approval of the board of directors. In practice, for the convenience to deal with customers or the business representatives of other companies, it is quite common for the employee of a corporation to hold the title of assistant manager or other managerial position without the approval of the board. Such definition made by the securities regulator was criticized for not only exceeding the authorization of the TSEA but also inappropriately expanding the scope of regulation.

B. Regulatory Agency Reform

In order to exam whether democratization has any impact on corporate governance regime, another aspect is to discuss the government's efforts to engage in regulatory agency reform. Prior to the repeal of the martial law, although there were

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[19] Taiwan Securities and Exchange Act, art. 22-2.

[20] For example, "Rules Governing Shareholders Matters of Publicly Issuing Companies" provides procedural and practical rules for handling shareholders' matters. Kung-K'ai Fa-Hsing Ku-P'iao Kung-Szu Ku-Wu Ch'u-Li Chuen-Tse (Rules Governing Shareholders Matters of Publicly Issuing Companies), approved by the SFC, Order (77)-T'ai-Tsai-Cheng-(II) No. 000053 (promulgated on Nov. 24, 1988, as amended).

[21] The powers of the FSC and MOEA are overlapped in the following two categories: (1) public offerings of securities; (2) regulating the publicly held corporations. If a subject matter belongs to one of the two categories, normally the FSC is in charge if the TSEA has provisions governing that subject matter.

[22] Securities and Futures Commission Order No. Taiwan-Finance-Securities-(III)-0920001301, in Ministry of Finance Gazette, Vol. 41, No. 2057, at 3116 (March 27, 2003).

voices to increase the administrative efficiency in the public sector, very slow movement or reform was observed.[23] One of the explanations is that there was no effective monitoring mechanism to oversee the performance of government and there is no sanction for poor performance. This does not indicate that financial regulators performed poorly prior to the repeal of the martial law. However, there still is room for improvement. After the repeal of the martial law, the formation of real opposition political party and liberalization in regulating the media that gradually enable the media to discuss and criticize on the performance of the government officers and the government agencies have changed the situation. This phenomenon forces the government to take necessary steps to reform.

In order to steadily develop the financial market and increase the efficiency of monitoring the financial industry, the MOF initiated a proposal that to create an integrated financial regulator to oversee the various businesses of the financial industry is viable and necessary to cure the problem that multiple financial regulators cannot efficiently supervise the financial industry.[24] In August 1995, the Fourth Credit Cooperative of Chang-Hua became insolvent.[25] It exposed the problem whether the Cooperative Bank that was responsible for financial supervision of credit cooperatives had conducted on-site examinations regularly and found the problem before the Credit Cooperative of Chang-Hua became insolvent.[26] After reviewing the proposal of the MOF, in February 1997, the Executive Yuan instructed the relevant departments to study the possibility to create a unitary financial supervision system. After a long process, the Executive Yuan sent the Bill of the Organic Act Governing the Establishment of the Financial Supervisory Commission, Executive Yuan (FSC Organic Act) to the Legislative Yuan on March 28, 2001, and the FSC Organic Act was enacted on July 23, 2003. Accordingly, the FSC was established on July 1,

[23] Prior to the establishment of the FSC, the securities and futures industry, banking industry and insurance industry were regulated by three different regulators, i.e. the Securities and Futures Commission, the Bureau of Finance of the MOF, and the Department of Insurance of the MOF. In the banking industry, the Central Bank, the Central Depository Insurance Corporation, the Ministry of Finance and the Cooperative Bank were responsible for the supervision of financial institutions. The former three regulators carried out the regular on-site examinations until the FSC was established. Cooperative Bank ceased to carry out financial examinations after July 1996. You-Tsai Tsai, *A Review of the Unitary Financial Supervision System and the Draft of the Organic Act of the Financial Supervisory Commission*, ICBC MONTHLY (July 2003).

[24] Sean C. Chen, *Financial Supervision: the Source of Regulation and the Reform Direction*, TAIWAN LAW JOURNAL, vol. 62, at 138-144 (September 2004).

[25] J.Y. Interpretation No. 489, Appendix (July 30, 1999).

[26] Syue-ming Yu, *Legal Aspects of Bank Failure: The Change Hwa 4th Credit Cooperative Case—Lessions from the Bankruptcy Model of American Banks*, NTU L. J., Vol. 29, No. 4, at 59-83 (July 2000).

2004.[27] The FSC consolidates three major financial regulators, including the Securities and Futures Commission, the Bureau of Finance of the Ministry of Finance (MOF), and the Department of Insurance of the MOF. It is interesting to note that during the process of establishing the FSC, in addition to certain critique from the academia, the most fierce obstacles arising from the government internally because by creating a new regulator would curtail the power of the then existing three regulators. Otherwise, the opinions of the ruling party and opposition party, though with slight difference in how to structure the unitary financial supervision system, both support the regulatory agency reform.[28]

According to the FSC Organic Act, the Commission shall be composed of nine full-time commissioners.[29] Currently, there are only six commissioners appointed.[30] Under the FSC, there are four major bureaus responsible for the supervision of different financial sectors.[31] The FSC makes decisions by the resolution of the commissioners. Normally, the Securities and Futures Bureau, the Banking Bureau, or the Insurance Bureau prepares policy proposals and the commissioners make the final decision that becomes the policy of the FSC. To be sure, the FSC may propose a policy initiated by the commissioners or instruct one of the Bureaus to engage in further studies. It is necessary to note that although the integrated financial supervisory system has been created, because the Companies Act and the TSEA both regulate corporations, the MOEA and the FSC must work together and prevent conflicts in formulating the corporate governance policies.[32]

V. Implications and Influences from Abolition of Martial Law on Corporate Governance Regime—Factors

[27] The establishment of the FSC was following the global trend to consolidate the financial regulators into a single one to have a more efficient regulatory framework. For example, the United Kingdom, South Korea, Japan, …all have had a unified financial regulator before Taiwan established the FSC.

[28] In addition to the action taken by the government, the Taiwan Thinktank and the National Policy Foundation (sponsored by the KMT), two major think tanks of the country, expressed their support of the regulatory agency reform. Ching-Yu Chiu, *Financial Reform and Unitary Financial Supervision*, NPF COMMENTARY, Finance (Comment) No. 090-011 (Jan. 13, 2001).

[29] The Organic Act of the Financial Supervisory Commission, Executive Yuan [hereinafter the FSC Organic Act], art. 8. The tenure of the commissioner is 4 years. Id.

[30] The commissioners of the FSC are nominated by the Premier and appointed by the President.

[31] Four major bureaus include the Securities and Futures Bureau (SFB), the Banking Bureau, the Insurance Bureau, and the Examination Bureau. The SFB is the former Securities and Futures Commission; the Banking Bureau is the former the Bureau of Finance of the MOF; and the Insurance Bureau is the former Department of Insurance of the MOF. The Establishment of the FSC integrates the former financial regulators under the umbrella of the FSC.

[32] The U.S. federal securities regulators and state regulators have encountered similar problems. *See generally*, Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625 (Spring 2004).

affecting the Development of Corporate Regulatory Reforms

In this section, this article examines the implications and influences from the abolition of the martial law on the corporate governance regime. It will point out the factors affecting the corporate regulatory reform. Especially, it examines whether the process of democratization has improved the administrative efficiency, whether corporations' foreign investment, particularly the investment in China, are affected, whether Chinese capital are free to flow into Taiwan, and whether the corporate governance policies are formulated by the competent authorities based on the need of the industry and economic factors or affected by the mentality of the high ranking officers, political parties and reasons other than the economic factors.

A. Improvement on Administrative Efficiency

After the repeal of the martial law, at least two factors are important and have significantly pushed the movement of democratization. One is that the political parties, particularly the opposition parties, were able to legally establish. The other one is liberalization in the media industry. Although there are a lot of criticisms that the liberalization of media industry after 1987 is not truly helpful to the sound development of democratization because of the strong attachment of the media to the political party, it does play the role to monitor the government by disclosing the information to the public.[33] In terms of the monitoring function, though there is still much room for improvement, both the opposition party and the media have played an important role to watch the performance of the government. Moreover, with regard to the corporate policies, the business and financial industries have increased their influence on the formulation of policies. For example, the current version of the TSEA provisions regarding the independent directors and audit committees is greatly different from the original version proposed by the securities regulator in 2004 partly because of strong objection from the industry.[34] These factors to some extent have become an impetus to improve the administrative efficiency of the government.

However, though there is a general improvement of the administrative efficiency, to be critical, it can also be argued that in the corporate law field that some reforms

[33] Chien-san Feng, *Eighty Years of Mass Media in Taiwan 1921-2002*, TWENTY FIRST CENTURY, vol. 74, at 119-126 (December 2002).

[34] For example, in the 2004 proposed TSEA Amendment Bill, important corporate decisions, such as making private placement or appointing CPA, must obtain majority votes from independent directors or members of the audit committee. However, under the current TSEA, both independent directors and audit committee will not have the veto power on major corporate resolutions as listed on Articles 14-3 and 14-5 of the TSEA.

could have done much earlier. For example, while the corporate law textbooks and the Companies inform the reader that supervisors are appointed to monitor the performance of the board of directors and the management, it has long been criticized that supervisors cannot effectively monitor the corporate management. Because the nomination and election of directors and supervisors are dominated or heavily influenced by the management and the controlling shareholders, in most cases, supervisors and directors are on the same side and cannot perform the supervisory function. Additionally, Taiwan's Companies Act allows a legal person and the government, and its representatives to be elected and appointed as the directors and supervisors in the same time. This aggravates the problem that supervisors cannot effectively monitor the corporate management. No active actions were taken until the amendment of the TSEA in 2006. Although the TSEA has prohibited a legal person and its representatives from being elected as directors and supervisors in the same time, the Companies Act still maintains the questionable provision.[35]

B. Political Competition—Racing to the Top or Bottom?

The corporate scandals happened in the last decades have incurred huge losses to investors and the society. The competent authority has responded quickly to enhance corporate governance policies. The political competition among major political parties has brought good news to investors. As of the end of August 2007, there were 13,522,635 accumulated book-entry accounts opened by investors with the Taiwan Depository & Clearing Corporation.[36] Individual investors have been still actively participating in the stock market. Although the average trading value of domestic individual investors for the Taiwan Stock Exchange has dropped from 90.7 percent in 1997 to 68.5 for the first 8 months in 2007, it still exceeds 2/3 of the market trading value.[37]

After the repeal of martial law, the establishment of new political parties and political competition became possible. Democratization has created political competition that is good for the citizens for the long run. During the Presidential and legislators' elections, investors have been the group of people that every political

[35] In January 2006, the TSEA added a new provision prohibiting the representatives of the government or legal person from serving as directors and supervisors of a publicly held corporation in the same time. TSEA, art. 26, para. 2. When the Companies Act was amended in November 2001, it was proposed to make the same prohibition but the proposed provision was removed during the three-reading procedure in the Legislative Yuan, partly because strong objection from the business industry and legislators who own publicly held corporations or having strong tie with enterprises.

[36] Taiwan Depository & Clearing Corporation, Statistics of Book-entry Accounts, *available at* http://www.tdcc.com.tw/english/etc_05sat.htm (last visited on October 5, 2007).

[37] FSC, Securities Market Major Indicators, 2007 August Catalog, Table 16: Investors Structure in Terms of Trading Value on TSEC Market, at 28 (September 2007), *available at* http://www.sfb.gov.tw/statistics/point/9608/t16.xls.

party would like to sweeten. Investor protection has become one of the important propaganda for the political campaign by all political parties, including the ruling party, opposition party, the government officers, and all legislators.

This article also takes the position that for healthy development of the securities market and national economy, it is important to enhance corporate governance and investor protection. For example, it did not encounter a lot of objections in Legislative Yuan when the Securities and Futures Investors Protection Act was enacted in July 2002.[38] For this type of legislation, very seldom would legislators express opposition. However, if the regulatory policies or legislation for investor protection are formulated or done in a hasty manner, experiences have shown negative effects to investors. There has been literature warning the politics may have corrupting corporate governance.[39] This article takes similar view that politicians should be more careful in helping investors and not to ruin the corporate governance regime.

Another observation is to look at the background of the head of securities regulator and see whether the political parties affect the appointment. Prior to the establishment of the FSC, there were eleven persons serving as the chairman of the SEC or the SFC from March 1971 to June 2004.[40] Among them, 6 persons' places of origin are in different provinces of China and 5 are in Taiwan. Prior to the repeal of the Martial Law, those chairmen's places of origin are all in different provinces of China. The first Chairman Chang immediately after the repeal of the Martial Law was born in Taiwan. After 1987, if we calculate the chairmen of the SEC, SFC and the FSC, there were 10 Chairmen. Among them, eight out of ten chairmen's places of origin are in Taiwan. There is no direct evidence showing that political parties heavily influence the appointment of the chairmen of the SEC and SFC or the Director-General of the Securities and Exchange Bureau of the FSC. However, if looking at the expertise or education background of those chairmen, all of them obtain either law, business, finance or administration degrees. Most of them have experiences in the corporate, securities, banking, and finance industry or promoted from the SEC, SFC or other relevant government agencies. Therefore, this article considers that expertise and other qualifications of a person are the most important

[38] Interestingly, although the Securities and Futures Investors Protection Act (SFIPA) did not encounter objections from the ruling parties and opposition party, the Judicial Yuan raised serious concerns over certain provisions of the SFIPA, such as the exemption of the court costs for the portion of the monetary damages exceeding NT$100 million if the Securities and Futures Investors Protection Center (SFIPC) brings securities class action to recover damages for investors. *See e.g.* SFIPA, arts. 28 & 35. The position of the Judicial Yuan to object those exemptions bases on the equality of litigants to pay court costs.

[39] Steven A. Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313, 319 (Summer 2007).

[40] Information obtained from the Securities and Futures Bureau of the FSC (on file of the Personnel Office).

determinants rather than political factors because in the corporate and securities field the candidate needs expertise and professional knowledge in the relevant fields to qualify.

C. Internationalization and Open Market Policy

In terms of the development of securities market, following the trend of internationalization and globalization, cross-border listing and investment have become a very common phenomena. International cooperation on setting standard in regulating the securities market and financial market and emphasis of corporate governance are two of the major themes following this trend. Taiwan's securities regulator joined the International Organization of Securities Commissions (IOSCO) in 1985 as an Ordinary Member; the Taiwan Stock Exchange (TSE) and the Taiwan Futures Exchange are Associate Members of the IOSCO.[41] Prior to 2007, Taiwan's securities regulator signed around 20 bilateral Memoranda of Understanding (MOUs) with foreign securities regulators.[42] In 2002, the IOSCO adopted a new Multilateral Memorandum of Understanding (MMOU) intending to increase international cooperation on securities regulation, particularly to defeat securities crimes by creating a cooperative network and procedure for helping foreign regulators to obtain information and evidences, and to investigate securities crimes.[43] After several years' studies and efforts, the FSC became a signatory of the IOSCO MMOU in April 2007.[44]

Not only the securities regulator has devoted on international cooperation but also self-regulatory organizations and the Taiwan Corporate Governance Association (TCGA) have actively participated in international organizations or associations hoping to internationalize Taiwan's securities market and improve the corporate governance regime. As mentioned above, the TSE and the Futures Exchange have joined the IOSCO as the Associate Members. The TSE is also a member of the World

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[41] TAIWAN YEARBOOK 2005. The International Organization of Securities Commissions (IOSCO) was established in 1983, expanded from its ancestor Inter-American Regional Association formed in 1974. As of October 2007, IOSCO has 109 Ordinary Members, 11 Associate Members, and 69 Affiliate Members. *See* http://www.iosco.org/about/index.cfm?section=history & http://www.iosco.org/lists, visited on October 10, 2007.

[42] For bilateral MOUs signed by Taiwan's securities regulators and other IOSCO members, please *see* http://www.iosco.org/library/_display_mou.cfm?jurid=65.

[43] The Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU) was adopted by the IOSCO in May 2002, *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf.

[44] Taiwan's FSC filed application to become the signatory of the IOSCO MMOU with the IOSCO in August 2005. *See* Financial Supervisory Commission, *Important Resolutions and Policies*, SECURITIES & FUTURES MONTHLY, Vol. 25, No. 5, at 81 (May 16, 2007).

Federation of Exchanges (WFE).[45] The TCGA has actively communicated with the Asian Corporate Governance Association and other international associations hoping to enhance Taiwan's corporate governance standards.

To improve the corporate governance has been an international issue instead of purely domestic issue. How to improve the corporate monitoring mechanism has also one of the focuses in corporate governance regime. The term "independent director" has also become a common language shared among international securities regulators. Taiwan introduced independent director and audit committee for at least three reasons. First, to improve the internal monitoring mechanism of publicly held corporations. Second, to increase the integrity of the stock market and attract investment particularly foreign investors to invest in Taiwan's stock market. Because the survey and evaluation made by corporate governance associations on the performance of the corporate governance of Taiwan's publicly held corporations, particularly listed companies, affect the investment decisions of both domestic and foreign investors to invest in Taiwan's market, the securities regulator has paid attention to those survey and evaluation made by international corporate associations in formulating the policies regarding corporate governance regime. Third, using international language to communicate with foreign regulators. Taiwan officially introduced independent director and audit committee in the TSEA. Though criticized by scholars, these topics have become common language for the FSC and public companies to have dialogue with foreign investors and foreign regulators. Therefore, the internationalization and open market policy play more important role in affecting the policies on corporate governance than the democratization.

D. Mainland Affairs

Among all factors influencing the formulating of corporate governance policies, only in one aspect can we find more political influence, i.e., the investment of the companies in China. Even after the repeal of the Martial Law, the government, including the KMT and DPP as the ruling party, is still very cautious in liberalizing Mainland investment policy.[46] For quite a long time, Taiwan's companies could not make direct investment in China, including establishing a subsidiary or join-stock

[45] The International Federation of Stock Exchanges (*Federation Internationale des Bourses de Valeurs* or FIBV) was formed in 1961 aiming to increase international cooperation among stock exchanges. The FIBV was renamed as the World Federation of Exchanges in 2001. *See* http://www.world-exchanges.org/WFE/home.asp?action=organization.

[46] In addition to the MOEA, FSC and the Central Bank, the Mainland Affairs Council of the Executive Yuan and the National Security Bureau of the Republic of China also have influences on whether to liberalize the policy of corporate investment to China.

corporations.[47] However, many companies have already had businesses in China by establishing a subsidiary or investment company in the "tax heaven' countries and then invest in China.

Because of the special relationship between Taiwan and China, the policy regarding the corporate investment in China does involve the corporate governance issues. First, it creates more disputes regarding whether a company has complied with relevant laws, including the Mainland investment policy. For example, the investment of the UMC, one of the leading semiconductor foundries in Taiwan, in a Soochow corporation was probed for violation of the Mainland investment policy and failed to make necessary disclosure to shareholders.[48] It also involves whether this is an illegal investment by the UMC or it's an "invented strategic alliance."[49]

Second, if the Mainland investment policy is liberalized, one of the major issues is regarding the supervision of the company's operation in China, including the accounting issue. Unlike the international cooperation MOUs proposed by the IOSCO, because there is no official cooperation arrangement between Taiwan and China, Taiwan's regulators cannot engage on-site examination. The reliability of the business and financial information regarding the Mainland investment remains questionable. Unless there are breaking through arrangement between Taiwan's FSC and Chinese Securities Regulatory Commission, the investors will have potential risk because the information regarding the operation in China is not transparent.

VI. Conclusion

Taiwan's corporate governance policies are mainly set forth by the FSC, the MOEA, and the self-regulatory organizations of the securities market, particularly the Taiwan Stock Exchange and the GreTai Securities Market. In formulating the policies, the competent authorities and self-regulators have devoted great efforts to do research and consult with experts prior to proposing corporate law and securities law amendments and promulgating new policies. Other factors affecting the corporate governance policies include academic literatures on the relevant issues, the opinions and suggestions from the industry, such as listed companies, National Federation of Industry or the General Chamber of Commerce, Taiwan Corporate Governance

[47] In addition to the Companies Act and the TSEA, the Act Governing Relations Between the Peoples of the Taiwan Area and the Mainland Area [hereinafter the Mainland Relation Act] is affecting the corporate investment in China.

[48] The UMC was fined by the MOEA for violation of articles 35 & 86 of the Mainland Relation Act that require companies to obtain prior approval from the competent authority before any investment in China. MOEA Real-time News (Feb. 15, 2006, 5:55 p.m.), *available at* http://w2kdmz1.moea.gov.tw/user/news/detail-1.asp?kind=&id=10741.

[49] The UMC claimed that the relationship between UMC and the Soochow corporation is an "invented strategic alliance." (http://www.umc.com/chinese/news/20050804.asp).

Association, CPA Association, and Securities and Futures Investors Protection Center, and other practitioners. Some policies are formulated in response to the corporate scandals or other contemporary issues. Moreover, as a member of the international society, Taiwan's policy makers also take into consideration the interests, opinions or recommendations of foreign institutional investors, international corporate governance associations, such as Asian Corporate Governance Association, and international organizations, such as IOSCO.

Democratization definitely helps the formulation of government policies. For example, according article 7 of the Central Regulation Standard Act and Chapter Four of the Administrative Procedure Act, the regulations promulgated by the government agencies must comply with certain procedure, including holding public hearing, public announcement and filing with the Legislative Yuan. However, with regard to the corporate governance policies, democratization plays only limited role.

The following concludes the relationship of Democratization and the formulation of corporate governance policies from our observations:

First, political competition makes it easier to promote the investor protection and corporate governance policies. However, the potential risk is that policies may be in the form of over protection to investor and would possibly harm the business industry and investors as a result. For the long run, it should be more cautious in formulating the policy. Second, in the corporate governance regime, the most of the policies are formulated because of the regulatory purpose, to protect investors, to ensure the sound development of the securities market, and affected by the economic factors. Democratization and other political factors have relatively light impact on this field.