Remarks by David Wright at the Taiwan Corporate governance Forum, Taipei, 27 November

I would like to offer a personal perspective on the global regulatory reforms carried out in response to the recent global financial crisis.

The managing director of the International Monetary Fund, Ms. Christine Lagarde, said at her UN speech in September of this year: "*We need 21st century policies for a 21st century global economy, which means thinking more creatively, more cohesively, and more collaboratively than in the past.*"

It is now seventh year after the onset of this grave financial crisis, which has generated an enormous political, economic and social cost to the world. According to some estimates, based on a normal economic growth path trajectory, the world lost 15% of GDP. There is a huge increase in the sovereign debt load and in unemployment, and the market are still suffering stress and difficulties. These costs have to be dealt with, sa such financial chaos is not in the interest of anyone. Therefore the need exists for global financial reform led by the G20 and coordinated by the FSB working with the standard setting boards.

Where we are today? There has been an enormous joint effort globally by G20 and FSB members to do this job. However, the G20 members vary in their perspectives, power, markets and political circumstances. For this crisis, the trouble originated in the developed markets, not from the emerging markets, as in some of the past crises. There is now a huge global effort underway, with a large number of work streams (circa 60-70) and a large number of standard setters involved. Currently, there are 18 international organizations involved in this work and the leaders of the process should define the responsibilities for each to avoid gaps and overlaps. Implementation of these new global standards needs to be taken seriously. However, the challenge is that there are no binding powers to ensure implementation. The risk is that regulators will work in a silo-ed manner.

There is now some important intellectual progress on the key global financial reform issues.

1. *The resolution of systemically important financial institutions (SIFIs)*, the most important issue There is general agreement on the principles of how to do this at the global level, which is in the form of bail-ins. Shareholders and creditors should be the main parties responsible for resolution, not the governments and taxpayers. But the issue remains of cross border or G-Sifis resolution. Who will be responsible for this, the national regulators? BOE Governor and FSB Chair Mark Carney has urged for stronger international cooperation on resolution. Without a strong cross border agreement on cooperation, each national regulator will protect its own interest and risk a failure for the resolution reform.

2. *Bank capital*. Capital requirements, leverage ratio and converging risk weighted assets.

3. *OTC Derivatives*. There is a broad agreement that some progress has been made; OTC derivatives are shifting to regulated exchanges and being cleared. Trade repositories should, in theory, maintain the records. Currently, however, the rules of the EU and US are not harmonized, hindering the reform. A large percentage of the OTC derivatives still cannot move onto the exchanges; only 50% interest rate swaps are being cleared; 22 Trade Repositories have sprouted up, along with IP and access difficulties. There is still a very difficult and long way to go.

4. *Shadow banking*, imperfectly understood, is around 30% of global banking assets. It is growing rapidly and shifting to new market based financing instruments.

Mr Carney has asked for the reforms of these four key issues to be delivered by November next year at the Brisbane G20 Summit.

But there is a fifth key issue, a fifth column, which is *corporate governance*. There is a long list of financial firms that failed during the financial crisis, in part due to failed corporate governance. Their common characteristics were overpowering/out of control CEOs, combined with weak Boards, useless risk management and audit committees that did not challenge the CEOs internally. The cost of this massive incompetence has been huge, as evidenced by the cost of the financial crisis that swept up ordinary people and firms.

Here is an eight -point plan to improve corporate governance:

1. *Regulators should have stronger powers* to test senior managers and board nominees for their competency. It is good to know that the financial regulator in Taiwan has these powers. Failure to pass the rigorous tests should mean exclusion from Board positions or senior managerial positions in significant financial firms.

2. *Auditors have a public function*. They sign-off the audit reports; they are the gatekeepers and should be the whistle-blowers. The IOSCO Board Chair, Mr. Greg Medcraft, is very worried about overall audit quality, and cites a report stating that 50 percent of public company audits are inadequate. Also the current system of audit standard setting that allows auditors to set their own standards is not right, and the right incentives are not in place. Mr. Medcraft wants national audit standard setters of the world to work together to improve the quality of audit standards and to be responsible for them. IOSCO will be establishing a Task Force to work intensively on this next year.

3. *Rating agencies*. They have a lamentable record of subprime/securitization rating as shown by the financial crisis. Reform is needed to correct the model and remove conflicts of interest. We must ensure that the financial system does not rely on the rating agencies instead of on necessary, in- house due diligence work. In short the embededness of ratings has to be reduced in the financial system.

4. *Sanction regimes* in the world are inadequate in most jurisdictions and need to be strengthened. They do not deter. They require strong disincentives to curb misbehavior within the financial system, and far more jail time for convictions for serious offences. There are now massive international inquiries underway on market abuse, manipulation and collusion on benchmarks, currencies, metals trading, etc. What’s next? This widespread corruption and distortion of financial markets has to be stopped.

5. *Rights of shareholders, especially minority shareholders*. It is good the Chairman of Cathay Financial Holdings, Mr. Hong-Tu Tsai, covered this in his remarks earlier today. There is a need to facilitate and incentivize shareholder activism, including minority shareholders. Shareholders are not active enough in participating in the major decisions of the corporations they own.

6. *Accounting standards*. There is currently no single global standard on accounting. IFRS is the standard virtually everyone is using, except the US, with its US GAAP. There is no sign of those standards merging or converging sufficiently. There are fundamental disagreements between the IASB and FASB on impairment of assets. It is very important for investors to have uniform, transparent rules to value and evaluate assets. In the case of European banks during this crisis, it was very damaging when investors did not know or trust the actual quality or value of the bank assets disclosed, given the lack of transparency of the write-offs etc.

7. *Enhanced regulatory intensity of large systemic entities*. There is greater need for enhanced compliance supervision and robust, independent directors to challenge the management of important financial institutions.

8. *Complexity in corporate financial structures*. There are often hundreds of entities in the largest financial institutions. There is a need to decrease the complexity and number of entities, to a much lower level where there could be proper governance and more effective managerial control. Effort is also needed to simplify financial firm structures in order to help with resolution, disclosure and transparency.

In conclusion, we have a global financial repair job at most half done, probably less. There is a need for the leaders of this process to focus and prioritize on building a stronger global financial system. At the moment we do not have binding power to enforce the global rules and standards. This may be just manageable for the world today, where there are only a few markets, even though it is an unfair system with smaller jurisdictions caught between the EU-US juggernauts. However, there will be more sizeable markets in the future, in China, India, Brazil, Indonesia and many other places. Will a much larger number of markets lead to global integration? We will need stronger global institutions. In the EU, there are institutions to make the rules and enforce the rules in the European Court of Justice; at national level every civilized country has laws and courts to enforce them. The same logic should apply to global markets. In short we need to start to build global financial regulatory institutions with real teeth. Not to be open and begin that debate would be a serious global governance problem.