

CAPITAL MARKETS

The Committee recognizes the regulators' continuing efforts to enhance Taiwan's capital markets. We note with appreciation their responsiveness to our suggestions in facilitating market liberalization and development, such as extending the scope of securities eligible for securities borrowing and lending and day-trading activities, extending T+2 delivery practice to Emerging Market stocks, etc.

We also applaud the initiatives raised by the government to boost the securities market in Taiwan. As global capital markets are highly connected and compete with one another in growth and development, Taiwan's capital markets need to continue to align with international market practices and strengthen international competitiveness, and to attract and retain capital investment and talent, particularly at a time when the government is looking to promote its financial import substitution project and revitalize the securities market. In this regard, we continue to present suggestions on supporting the growth of the capital market for the benefit of both local and international participants. As always, the Committee stands ready to assist the Taiwan government in its endeavors to create a fair, open, and competitive financial-services environment and to contribute to boosting Taiwan's financial industry development.

Suggestion 1: Support the growth of the Offshore Securities Unit (OSU) market.

1.1 Relax the establishment qualification for OSUs. A

new set of rules governing the establishment of OSUs, announced by the Financial Supervisory Commission (FSC) in February 2014, allows foreign investors to access offshore products through an OSU set up in Taiwan. As of February 2016, 17 local securities firms were engaged in the OSU business, but there was a lack of participation by international securities firms due to the high net worth requirement for OSU applications (either above NT\$4 billion or NT\$10 billion, depending on the type). The situation has impacted market growth and talent retention within Taiwan.

By way of comparison, a January 2016 Central Bank report states that 25 out of the total 62 Offshore Banking Units (OBUs) are operated by foreign banks, accounting for US\$24.7 billion or 14% of total OBU assets. The lack of net-worth requirements has enabled the OBU market to boom, contributing to the excellent performance of the banking industry over the past few years. As it has been two years since establishment of the OSU regulation, the Committee urges the regulators to ease the OSU qualification by either 1) lowering the net worth requirement, or 2) allowing foreign securities firms to apply the net worth of their headquarters or parent companies, or else provide an irrevocable guarantee issued by the headquarters or parent company.

Relaxing the net-worth criteria would increase the volume of OSU transactions and profits due to the diversified product platforms offered by foreign securities firms. Furthermore, the revised policy would help retain talent onshore as the broader financial market would

offer more career opportunities. It would be very much in line with the regulators' stated principle of Financial Import Substitution, serving to boost Taiwan's capital market overall.

- 1.2 Revise the current regulation permitting only non-residents to purchase unregistered funds through the OSU platform.** According to FSC rulings, for their domestic customers (who are limited to certain classes of professional investors), OSUs can only offer funds or financial products registered or approved by the competent authority. In other words, the OSUs' domestic customers should have sufficient financial resources and professional knowledge, enabling them to adequately assess the risks associated with trading unregistered funds. The Committee therefore suggests that the FSC expand the scope of services and products that OSUs can provide to these domestic professional investors. This step would make the Taiwan market more competitive with Singapore and Hong Kong, and further the retention in Taiwan of investment funds from domestic professional investors.

Suggestion 2: Relax securities investment rules, allowing wider participation to foster market growth.

2.1 Ease restrictions on the securities borrowing and

lending market. Securities borrowing and lending (SBL) is a common trading practice internationally. Financial regulators generally consider that covered short-selling after stock borrowing actually helps improve the price discovery mechanism and adds liquidity to the market. The Committee expresses its appreciation to the FSC and the Taiwan Stock Exchange for extending the scope of eligible securities and the tenor for SBL trades. We further suggest that the following SBL rules be relaxed to help resolve some of the issues specific to the Taiwan market and to align with international market standards.

- a. Daily short-selling cap. The current rule limiting the daily short-selling volume of a borrowed stock to a maximum of 20% of the average trading volume of the stock in the previous 30 trading days is the most stringent among Asian markets. The rule has created trading/hedging risks as investors are sometimes unable to sell their borrowed stocks. The Committee proposes removing or relaxing the daily limit on the short selling of borrowed stocks to support market liquidity and volume. Regulators could still introduce a stricter short-selling limit during a crisis, while maintaining a more relaxed daily limit during normal market conditions. This policy would be in line with the government's goal of accelerating the internationalization of the Taiwan securities market, and will benefit the entire industry, including lenders,

borrowers, and brokers.

- b. Repatriation of sales proceeds from borrowed stocks. Under the current rules, a foreign institutional investor (FINI) can repatriate sales proceeds from borrowed shares as “capital repatriation” but not as “earnings repatriation.” However, many FINIs have made investments in the market for years and have repatriated most of the capital amount, while retaining a large amount of earnings for continued investments in Taiwan. Other FINIs have maintained a large amount of collateral in Taiwan. The Committee suggests that regulators relax the rule that the sales proceeds from borrowed securities can only be repatriated as “capital.”

2.2 Exempt exchange-listed convertible bonds from the 30% limit of total net-remitted-in-capital. Effective April 22, 2015, the FSC began including corporate bonds and bank debentures within the 30% limit for total net-remitted-in-capital, in addition to government bonds, money market instruments, and premiums paid and net settlement amounts for certain derivatives. The Committee understands that the purpose of the policy is to encourage FINIs to invest more in the stock market rather than in the fixed-income market in Taiwan. The ruling also helps to reduce the possibility of Taiwan Dollar currency speculation. However, convertible bonds, which can be converted into equity, also come within the scope of the 30% limit, as they are considered as a type of corporate bond. Convertible bonds in Taiwan are exchange-listed and are traded and settled in the same way as stocks. They generally carry much lower interest rates and the price movements are more closely correlated to those of the equity than fixed-income market. The Committee therefore suggests exempting exchange-listed convertible bonds from the 30% limit so as to benefit the liquidity of the Taiwan market.

2.3 Enable the establishment of unsponsored ADR programs representing Taiwanese listed equity issuers.

It has been over a year since the regulator’s announcement in late 2014 allowing Taiwanese listed companies to establish non-capital-raising depository receipt programs on the over-the-counter markets (also known as Level 1 ADRs) in the United States. However, there have been no Taiwanese listed corporate or financial-institution issuers that have proceeded with establishing an inaugural Level 1 ADR program. The reasons are that 1) the 97 companies that were eligible and originally approved for such a program had a FINI holding ratio of 40-70%, and 2) the eligible candidates are concerned about potential negative local regulatory impact that cannot be fully foreseen, as well as about perceived responsibility given that the program is Sponsored. We therefore urge the regulator to revise the regulatory approval to enable

the establishment of Unsponsored ADR programs, and secondly to broaden the permitted issuers to include small and mid-cap names that are not necessarily part of an index component.

As of year-end 2015, there were 835 Unsponsored ADR programs across the Asia-Pacific, comprising over 50% of the 1,628 distinct global issuers with Unsponsored ADR programs. Japan (28.5% of outstanding Asian Unsponsored ADR programs), China (16.3%), and Hong Kong (15%) have dominated the Unsponsored ADR programs in the region, while Korea and India are currently liberalizing their rules to enable issuers to participate in Unsponsored ADR programs to fill U.S. demand. This product is also accepted and trusted in markets such as Singapore, the Philippines, Thailand, and Indonesia. Taiwan is a market that would greatly benefit from more exposure to an offshore investor pool that currently has no means to access the Taiwanese equity market.

Another potential benefit of introducing the Unsponsored ADR product in Taiwan would be that locally listed issuers would experience initial trading and investor interaction via the OTC platform in the United States, eventually giving them enough comfort to upgrade to a Sponsored Level 1 ADR program. It provides a way to help close the experience gap. Both program types could flourish and grow as a result, providing mutual benefit to each other and creating more liquidity for Taiwanese corporate issuers.

Suggestion 3: Support the enhancement of cross-strait capital market activities.

3.1 Relax the qualification of Formosa Bond issuers to include more PRC companies.

The Committee appreciates the continuing progress in relaxing the qualifications for Formosa Bond issuers. Yet with very few exceptions, most PRC-incorporated companies still cannot issue Formosa Bonds. Currently, Formosa Bonds issued by PRC companies are only offered to professional investors. In addition, a renminbi (RMB) 45 billion upper limit has been imposed on the total amount of outstanding Formosa Bonds that may be issued by PRC corporations. The limit is quite low compared to the current outstanding balance of RMB deposits in Taiwan, which has exceeded RMB 310 billion. Thus, the risk exposure is minimal.

Besides, professional investors can already invest in RMB bonds issued by PRC companies in other jurisdictions through sub-brokerage. Further relaxation of the issuer qualification would lessen the tendency for Taiwan investors to go offshore to invest in suitable RMB products, strengthen the competitiveness of Taiwan as an offshore RMB center, and provide alternative channels

for utilization of RMB aside from deposits in the Taipei branch of the Bank of China.

The Committee understands Taiwan regulators' concerns regarding PRC enterprises' financial statement transparency and solvency. Thus the Committee suggests initially limiting the qualified PRC enterprises to companies that are listed on either the Shanghai or Shenzhen Stock Exchange and are among the top 50 listed corporations in market capitalization in their respective stock market.

3.2 Relax the PRC shareholding percentage restriction for F-shares, and enact clear standards for determining "PRC persons."

3.2.1 Lower the threshold of PRC shareholding for foreign issuers applying for listing on a Taiwan stock exchange. Currently, PRC companies applying for listing in Taiwan must incorporate a holding listing vehicle in a non-PRC jurisdiction, and when PRC persons hold more than 30% of the total shares of the listing vehicle, a special approval is required with the preconditions that Taiwanese shareholders have higher shareholding than PRC shareholders and that they have "control" of the listing vehicle.

The market projects that China's capital market will experience substantial growth in the mid-term and long-term. In addition, capital markets in Asia and America continue to open up to PRC enterprises so as to increase their market capitalization. Thus, the further opening of Taiwan's capital market to conform to the international trend and catch up with other jurisdictions is worth considering. Otherwise, Taiwan's capital market may soon be marginalized due its relatively low growth.

Given that the common definition of "control" of a company is a majority shareholding, the Committee suggests increasing the shareholding threshold to 50% for special approval of entities incorporated in a non-PRC jurisdiction to be listed in Taiwan.

3.2.2 Review the definition of a "PRC person" and adopt a predictable and consistent standard. Under current rules, whether an issuer with PRC persons among its shareholders qualifies for listing shall be reviewed based on both the issuer's legal form and its economic substance. In practice, however, no clear standard exists for "economic substance."

In addition, companies owned by overseas Chinese constitute the largest source of foreign companies applying for primary listing on Taiwan's stock exchanges. Many of their shareholders are ethnic Chinese who originally come from the PRC, but have long renounced their PRC citizenship. But they hesitate to explore the opportunity to list in

Taiwan, given the uncertainty surrounding regulators' determination of "PRC persons."

Further, the Act Governing Relations between the People of the Taiwan Area and the Mainland Area (Cross-Strait Relations Act) and other relevant rulings have specified that a former PRC citizen who has resided overseas for at least four years and has obtained citizenship in the resident country will not be considered a PRC person. The Investment Commission of the Ministry of Economic Affairs adopts the same standard when reviewing PRC investment applications. Thus, the Committee requests that the FSC to adopt the same definition of "PRC person" as the Mainland Affairs Council and the Investment Commission.

3.3 Relax restrictions on Chinese QDIIs' investment in Taiwan. China's regulations on Qualified Foreign Institutional Investor (QFII) investments into China were largely relaxed in March this year. In particular, the maximum basic quota has been extended from US\$1 billion to US\$5 billion, and the investment funds can be repatriated out and remitted in again as long as the remitted-in fund does not exceed the approved quota. However, the regulations in Taiwan still impose strict restrictions on investments into Taiwan by Chinese Qualified Domestic Institutional Investors (QDIIs). For instance, the investment quota for a single QDII is limited to US\$100 million, while the aggregated quota for all QDIIs is only US\$500 million. In addition, a QDII must complete the fund injection for all approved quota within a month of approval, and the investment funds repatriated must be remitted back within six months or the quota will expire.

The QDIIs are highly regulated by China's financial regulators (SAFE, CSRC, CBRC and CIRC) and the portfolios are managed by professional fund managers. Moreover, there are already caps, which apply to QDIIs, on the percentage of holdings in certain restricted industries. Therefore, the Committee suggests relaxation of the aggregated investment quota and removal of the quota timelines. The benefits will include attracting investment by established institutions to the local securities market, enhancing interaction and business development in cross-strait financial markets, and increasing RMB-related FX/hedging products in the local financial market.

Suggestion 4: Enhance market efficiencies and competitiveness.

4.1 Allow brokers to appoint Account Operators. To attract and retain international broker-dealers and related professional talent, a number of Asian markets have introduced new clearing and settlement options, including

Third Party Clearing (TPC) and/or Account Operators (AO) to provide more flexibility to their member firms. The Committee understands that it may be difficult under the current regulations and infrastructure in Taiwan to introduce TPC. In the shorter-run, we suggest that regulators allow brokers to outsource various operations, including securities and cash settlement processing, safekeeping, asset servicing, reconciliation, reporting, statement generation, etc. to an AO. The benefits to the market would include the following:

- Flexible cost structure, replacing fixed cost with variable cost. Brokers will be able to reduce their fixed cost whenever revenue line declines cause brokers to face either smaller margins or loss. With variable cost under the AO model, brokers will be able to maintain operating margin as the model only requires them to incur costs when there are transactions. Broker-dealers are able to free up capital and focus on their areas of expertise in research, dealing, brokerage, and execution, which in turn will attract more investors and talent to the market.
- Enhanced liquidity/funding. Brokers could benefit from intraday funding provided by the agent. Should their FINI customers fail to make cash payments to them on the settlement day, brokers will still be able to make payment to the exchange on the settlement day through the credit line funding. This credit facility will allow brokers to obtain funding sources for the next three days while they sort out the failed payment issues with the FINI customers. As a result, they may feel less need to check the availability of cash in the customer's account on T/T+1.
- Enhanced market efficiency. Brokers' trades will be supported by a few large service providers, allowing higher processing and market settlement efficiencies. The service providers, generally large banks and brokers, have global service centers and local infrastructure to support volume hikes and long-term growth.
- Greater choice. The AO model will be additional option for brokers to choose from in addition to the traditional market offering, giving them more flexibility over their business model so as to find the best fit for their business. It will enable Taiwan to maintain competitiveness in its rules and infrastructure against other markets.

4.2 Develop electronic tax statements on FINI income. The Committee appreciates that the government is exploring the development of electronic tax statements on FINIs' income, with access to FINIs' e-tax statements by the appointed custodians and/or the registered tax agents. Currently the tax statements on FINIs' income are still paper-based, requiring an extremely high volume of

paper usage and excessive time and effort by the local tax agents and custodians for reconciliation, filing, and audit, as well as delaying the FINIs' ability to repatriate earnings. The Committee urges the government to expedite this development, as it will enhance the competitiveness of the market by shortening the processing and auditing time by the local tax guarantors and agents, reducing the costs for issuers and company registrars in handling tax statements, and protecting the environment by heavily reducing paper usage.

4.3 Forgo Saturday trading to align with international practice and reduce settlement risk. In order to allow for three-day weekends at times of certain national holidays, the government declares other Saturdays as make-up working days. The securities and futures markets have followed the same practice. But Saturday trading causes additional operational risks and costs for all stakeholders engaged in the capital market for equities investment by foreign investors. Market executions on the Thursday and Friday prior to the working Saturday require special handling to facilitate clearing and settlement. Meanwhile, client communications on trade affirmation, funding arrangements, foreign-currency conversion, etc. are hard to perform, and the risk of client default or delay in settlement increases because of the closure of international monetary and FX markets on Saturdays. According to our informal survey, no other global financial markets open on a weekend. Although China has a similar practice that takes Saturday or Sunday as a working day in certain cases, the securities and futures markets remain closed on those occasions. The historical record shows that trading volume on Saturdays is relatively slim. At a time when the government is trying to boost Taiwan's markets and align with international best practices, Saturday trading is an example of the kind of unusual practice that presents a barrier for international investors. The Committee proposes the cancellation of working Saturdays on the Taiwan securities and futures markets to reduce settlement risks, align with international practice, and thus create a friendlier environment for capital market investment.