

## TAIWAN

### SECURITIES

#### *SUMMARY*

Securities in Taiwan are traded on a stock exchange or an over-the-counter (OTC) market. At the stock exchange, over 99 percent of trading is in equity shares. There are relatively few listed companies, but Taipei's very high turnover rate gives it the third largest annual trading volume in the world, second only to the stock exchanges in New York and London. Ninety-five percent of trading on the OTC market is in bonds, mostly issued by the public sector. Also traded on the OTC market are a few bonds issued by corporations or regional financial institutions, such as the Asian Development Bank (ADB). A futures exchange was established on July 21, 1998.

Over the past several years, many restrictions on foreign securities and futures firms seeking to operate in Taiwan have been lifted. Foreign firms may establish either branches or subsidiaries whose foreign ownership may reach 100 percent. However, U.S. securities firms have a limited presence, including two branches, five representative offices, and one subsidiary. One of Taiwan's 25 securities investment trust companies is 100 percent owned by a U.S. firm. Three of ten branches set up by foreign futures brokers come from the United States. Foreign investors' share of securities trading is very small, less than 2 percent.

Both U.S. (and other foreign) individual and institutional investors may engage in securities trading. Most restrictions on capital flows have been removed. However, foreign investors still face investment amount limits and foreign ownership limits.

#### *DESCRIPTION OF THE MARKET*

Taiwan has a stock exchange and an OTC market. The Taiwan Stock Exchange (TAIEX) is organized as a corporation, with 39 percent of the ownership held by state-run financial institutions and enterprises. The TAIEX is a venue for centralized securities trading. Equity shares of listed companies account for over 99 percent of total trading at the TAIEX. Beneficiary certificates of mutual funds, warrants, Taiwan Depositary Receipts (TDRs), and corporate bonds are also traded on the TAIEX. Government bonds are listed at the TAIEX, but no trading has been reported in the last three years.

Unlike the TAIEX, bonds account for 95 percent of trading on the OTC market. The OTC market is organized as a nonprofit institution, most of whose capital comes from the TAIEX, the Taiwan Securities Deposit Corporation, the Taipei Securities Firms Association, and the Kaohsiung Securities Firms Association. The four fund-contributors assign half of the trustees, while the

government appoints the other half. Equity shares registered with the OTC market occupy the remaining 5 percent share. Repurchase agreements account for over 90 percent of the bond trading.

At the end of 1997, a total of 404 companies were listed on the TAIEX. The market value of their equity shares was US\$297 billion. Despite the small number of listed companies (less than a quarter of that in Tokyo), trading volume, at US\$1.3 trillion in 1997, ranked the third largest in the world, second only to the markets in New York and London, and 46 percent higher than the US\$894 billion reported by the Tokyo Stock Exchange. The TAIEX's large trading volume is due to a very high turnover rate. On average, an equity share traded 368 times in 1997, compared with 66 times in New York, 44 times in London, and 33 times in Tokyo.

Also listed on the TAIEX at the end of 1997 were 7.5 billion beneficiary certificates belonging to 21 mutual funds and 164 million warrants belonging to seven issues.

Not many companies are listed on the OTC market. However, the number has increased tenfold in the past four years, from 11 at the beginning of 1994 to 114 at the end of 1997. The market value of registered equity shares increased 105 times, to US\$31.5 billion. Trading volume on the OTC market in 1997 totaled US\$1.5 trillion, nearly 50 percent greater than in 1996.

Outstanding bonds listed on the TAIEX and the OTC market at the end of 1997 included NT\$1,034 billion (US\$31.7 billion) of government bonds, NT\$211.5 billion (US\$6.5 billion) of corporate bonds, US\$600 million of ADB bonds, ¥3 billion of ADB bonds, and NT\$29.4 billion in NT dollar denominated bonds issued by the ADB, Central American Bank for Economic Integration, European Bank for Reconstruction and Development, Inter-American Development Bank, and Nordic Investment Bank.

Foreign companies listed on securities markets of 15 nations are permitted to list their equity shares and issue TDRs or corporate bonds on the TAIEX or the OTC market. However, as of January 1998, only one foreign company had issued TDRs on the TAIEX. No foreign company has ever listed equity shares or issued corporate bonds in Taiwan.

Taiwan companies are permitted to list their equity shares and issue Global Depositary Receipts (GDRs) or corporate bonds in any foreign securities market. As of the end of 1997, a total of 21 Taiwan companies had listed GDRs on major stock markets all over the world, including the New York Stock Exchange. Forty-five domestic firms have issued corporate bonds overseas, mostly in Europe. No Taiwan company has ever listed equity shares offshore.

Despite the Asian financial crisis, the TAIEX performed well in 1997 and 1998. The stock price index rose 18 percent in 1997 and another 11 percent in the first quarter of 1998. Trading volume in 1997 amounted to US\$1,157 billion, nearly three times the level of the previous year. In the first

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quarter of 1998, trading volume rose by another 23 percent over the same period of 1997, to reach US\$294 billion.

There were two million trading accounts on the TAIEX and 2.8 million accounts for trading on the OTC market at the end of 1997. Each investor may open more than one account. For instance, 160 foreign institutional investors have opened over seven thousand accounts for trading on the OTC market.

Individual investors dominate trading on both the TAIEX and the OTC market. In 1997, they accounted for 90.7 percent of trading at the TAIEX. The shares were only 7.6 percent for domestic institutional investors and 1.7 percent for qualified foreign institutional investors (QFIIs). Taiwan began to permit foreign individual persons and non-QFII foreign companies to trade in securities on the TAIEX and the OTC market in March 1996. The volume of trading by these non-QFII investors has been very small, although it has been increasing steadily.

On the OTC market, domestic institutional investors accounted for 22 percent of trading in registered equity shares in 1997. The share for foreign institutional investors was 2.4 percent. While smaller than on the TAIEX, the share of individual persons was still very high, at over 75 percent.

Taiwan investors are permitted to trade in securities listed on all stock exchanges of foreign nations, except the People's Republic of China (PRC). Trading may go through either of two channels, including a nondiscretionary foreign exchange trust program. Under this program, securities investment consultant companies may provide a client with consulting services. The client then enters into a "nondiscretionary trust agreement" with a bank that will convert the local currency into foreign currency for investment in designated foreign securities through a foreign broker. Trading in securities listed on foreign stock exchanges may also be done through domestic securities firms and branches of foreign securities companies which have membership at those foreign markets.

Taiwan first permitted offshore futures trading in 1993. By the end of 1997, a total of 184 futures products listed on 40 futures exchanges in 17 nations could be traded through 22 domestic brokers, who were required to submit trading bids to branches of ten foreign futures brokers for transmission to foreign futures markets. In August 1997, Taiwan permitted domestic investors to trade in offshore Taiwan stock price index futures; the main vehicle for this trading was a contract introduced by the Singapore International Monetary Exchange (SIMEX).

The Taiwan International Mercantile Exchange started operation on July 21, 1998. Initially, only stock price index futures were available for trading. Foreign investors are permitted to trade, though a foreign investor's trading volume may not exceed 30 percent of total inward remitted capital.

## **Institutional Investors**

Insurance companies, banks, retirement funds, securities investment trust companies, and investment firms are major institutional investors. State-owned banks, the Postal Savings System, and such state-controlled funds as the Civil Service Retirement Program and the Labor Retirement Program have also been influential market players, and were organized into a stock market stabilization force by the authorities during the period of cross-strait tensions and PRC missile tests in early 1996. Trading by officially-controlled entities successfully stabilized the stock market during this period.

Taiwan's securities markets were opened to QFIIs in December 1990. QFII requirements have been relaxed many times since then. As of May 1998, a QFII must obtain approval from the Taiwan Securities and Futures Exchange Commission (TSFC), and must be (1) one of the top 1,000 non-communist banks, or (2) an insurance company with US\$300 million or more in assets, or (3) a fund manager with at least US\$200 million in assets, or (4) a securities company with net worth of US\$100 million or more, or previous experience with Taiwan securities. As of the end of the 1997, a total of 346 foreign institutional investors had been approved to trade securities in Taiwan. Net of outward remittances, they had brought in investment funds totaling US\$8.7 billion, of which 84 percent was kept in the form of equity shares, with the remaining 16 percent mainly in bank deposits and commercial paper.

In March of 1996, foreign individual investors and foreign companies other than QFIIs were permitted to trade in securities on the TAIEX and the OTC market. However, the maximum allowed portfolio investment is less for foreign individual investors and non-QFII foreign companies than for QFIIs. Investments by foreign persons are subject to limits on annual remittances, as well as various restrictions on the types and amounts of instruments in which they may invest. A total of 327 investors under this category were trading in equity shares by the end of 1997. Their inward remittances, net of outward remittances, totaled US\$1 billion.

## **Regulation**

The TSFC is the official regulatory agency under the jurisdiction of the Ministry of Finance. The TSFC chairman ranks just below a Vice Minister. The TSFC has eight divisions that oversee securities issuance, securities firms regulation, securities trading, futures trading, market regulation, inspection, and auditing.

The TAIEX and the Over-The-Counter Trading Center (OTCTC) are both self-regulating entities. The TAIEX is responsible for preliminary review of all listing applications, clearing and settlement, and examining operations and financial conditions of securities brokers and dealers.

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Before floating equity shares or corporate bonds on the OTC market, companies are required to register with the OTCTC. Public bonds and bonds issued by ADB and other regional financial institutions are automatically listed on the TAIEX and the OTC market upon issuance.

### ***U.S. PRESENCE IN THE MARKET***

The U.S. presence in Taiwan's securities market is small. Of the 14 foreign securities companies operating branches in Taiwan, two come from the United States. One of them engages only in securities trading on the U.S. stock exchange on behalf of local clients. The other engages in brokerage, dealer, and underwriter services in addition to securities trading on the New York Stock Exchange. Five of the 14 representative offices of foreign securities companies are U.S. firms. These representative offices seek business for their offices outside Taiwan, chiefly underwriting the issuance of corporate bonds and GDRs by Taiwan companies. In addition, one U.S. firm operates a subsidiary on the island. Among Taiwan's 25 securities investment trust companies, one is 100 percent owned by a U.S. firm, while others have some U.S. ownership. U.S. firms have also established securities investment counseling firms to promote the sale of offshore funds in Taiwan.

U.S. firms also have a presence in the offshore futures brokerage business. Ten foreign firms have set up branches for futures brokerage: three of these are from the United States. No U.S. firms held ownership in the 21 local futures brokerage firms by the end of May of 1998. However, one U.S. firm is organizing a subsidiary whose ownership will be over 90 percent held by the U.S. company. According to TSFC, many of about 500 overseas mutual funds approved by TSFC for local investors to trade through non-discretionary foreign exchange trusts for investment in foreign securities are U.S. mutual funds.

Foreign institutional investors' share of securities trading was only 1.7 percent in 1997. TSFC cannot identify trading by U.S. institutional investors. Only a handful of Taiwan's 115 securities investment consultant companies have U.S. investment.

### ***TREATMENT OF U.S. FINANCIAL INSTITUTIONS***

There has been significant liberalization of the securities sector in the past four years. The one-year waiting period to upgrade a representative office to a branch was dropped. Almost all foreign ownership restrictions have been abolished; U.S. firms may now create 100 percent owned subsidiaries, and they may now engage freely in joint ventures. Foreigners are allowed to establish 100 percent foreign-owned securities investment and trust companies (SITCs). However, if a foreign firm or individual invests in an SITC, that investment must be more than nominal. In March of 1996, TSFC set a minimum foreign ownership limit of 20 percent for foreign banks, insurance

companies, and fund managers in an SITC. The purpose of this minimum ownership limit is to encourage foreign participation in the local market.

The limits on foreign ownership in futures brokerage firms were lifted in late 1996.

Foreign and domestic firms face the same capital requirements and, after establishment, may provide essentially the same services (including brokerage, dealing, underwriting, and securities financing). Both local and U.S. securities firms may provide brokerage services in foreign securities for local investors. The foreign securities markets on which both domestic and foreign securities firms may broker securities trading have expanded to include any stock exchange in the world, other than those in the PRC.

Most restrictions on repatriation of capital and earnings by foreign institutional investors have been removed.

U.S. securities firms continue to face discriminatory treatment in several areas, however. U.S. (and other foreign) qualified institutional investors are subject to a US\$600 million investment limit per investor, which was raised from US\$400 million in December 1996. The US\$7.5 billion limit on aggregate foreign investment in the TAIEX was replaced by the foreign ownership limits in listed firms in 1995. Limits on foreign ownership in a listed company remain, although these ceilings have been raised several times over the past four years. As of October 1, 1998, these limits were 15 percent for an individual foreign investor and 30 percent for all foreign investors combined. Taiwan authorities have committed in their offer on financial services for their WTO accession to removing these ceilings by 2000.

Foreign individuals and foreign companies other than QFIIs now may trade in and hold equity and debt instruments listed on the TAIEX and the OTC market. However, they are subject to outstanding investment fund limits of US\$5 million for each foreign individual and US\$50 million for each non-QFII foreign company, which correspond to remaining capital flow restrictions.

In June 1997, Taiwan allowed domestic companies to list their stocks on any foreign stock markets. Meanwhile, Taiwan permitted foreign companies listed on stock markets of 15 nations (including the United States) to list their equity shares, TDRs, and corporate bonds on the TAIEX or the OTC market. It also permitted foreign companies not listed on the 15 designated markets to issue corporate bonds in Taiwan if they have a minimum credit rating of A (by Standard and Poor's or Moody's). In January 1998, the first TDR was issued by a foreign company. However, no corporate bonds have as yet been issued by foreign companies.

Despite the many positive measures undertaken by the Taiwan authorities, the overall environment for securities firms operating in Taiwan remains restrictive. Capital and exchange controls still in effect for large sums impede the range of operations, as do limitations on foreign institutional

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investors. Issues of securities by foreign issuers remain scarce due to stringent listing requirements. Marketing and sale of foreign mutual funds is heavily regulated and restricted. Although foreign firms may invest in or own securities firms in Taiwan, Taiwan law still forbids foreign individuals from being licensed as dealers, traders, brokers or underwriters.

In the past four years, Taiwan has fulfilled most of its commitments included in the GATS schedule negotiated as part of its accession to the WTO. These commitments have been designed principally to open markets to foreign investors. To some extent, Taiwan has gone beyond its GATS commitments. Foreign ownership limits on SITCs, securities investment consultant companies, and others have been lifted. Taiwanese securities authorities have allowed more foreign institutional investors to enter the market. Securities firms are not restricted to brokering, dealing, and underwriting. They may offer securities financing and other services. For underwriting of foreign listings by Taiwanese companies, foreign securities firms are no longer required to enter into an underwriting cooperation contract with a local underwriter. At present, Taiwan still maintains two limits on foreign ownership of a listed company, i.e., 15 percent for a single foreign investor and 30 percent for all foreign investors. Nevertheless, Taiwan is committed to removing these two limits by the year 2000. Taiwan currently bans foreign individuals from being licensed as dealers, traders, brokers or underwriters. Both foreign individual investors and foreign institutional investors are subject to investment fund limits which have been raised from time to time. As of yet, however, Taiwanese authorities have no timetable to abolish them.

Foreign institutional investors are no longer subject to capital flow restrictions. Non-deliverable forward (NDF) contracts have been opened to foreign institutional investors to hedge their foreign exchange risk but since the onset of the Asian financial crisis, the Central Bank of China has applied administrative controls to reduce the NDF positions of banks. Except for the restriction on NDF contracts, the Asian crisis has not led to any new barrier to market openness.

<b>Trading Volume in Taiwan's Securities Market</b>		
(NT\$ billions)		
	1996	1997
Taiwan Stock Exchange	13,142.1	37,763.4
<i>Equities</i>	12,907.6	37,241.2
<i>Beneficiary Certificates</i>	224.5	500.5
<i>Warrants</i>	0.0	2.0
<i>Convertible Corporate Bonds</i>	10.0	19.8
OTC Market	28,741.0	42,682.9
<i>Equities</i>	453.5	1,310.7
<i>Government Bonds</i>	28,287.5	40,372.2
TOTAL	41,883.1	80,446.3
US\$ (billions)	1,525.2	2,805.4

Notes: Exchange rates against the U.S. dollar are NT\$27.46 in 1996 and NT\$28.67 in 1997.